

**Property Taxation in Indonesia:
Challenges from Decentralization**

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Abstract

In 1986, Indonesia embarked on a major property tax reform, generally recognized as perhaps the most successful property tax reform in the developing world. The reform simplified basic tax policy, introduced innovative administrative reforms and generated substantial revenue increases. Since 1999, the property tax has again come under scrutiny for possible reform—this time to enable the property tax system to more effectively support the ongoing decentralization reforms.

This paper examines these two reforms—the initial property tax reform of 1986 and the potential property tax reform to further support decentralization. The first section reviews the specific policy and administrative reforms from 1986-2001, which laid a solid foundation for effective property taxation in Indonesia. The paper shows that the property tax in Indonesia has made substantial progress but continues to under perform by international standards. It is estimated that Indonesia could generate at least a 43 percent increase in property tax revenues.

The second section of this paper explores options to enable the property tax to better support the decentralization reforms. The fundamental change would be to grant tax rate discretion to local governments in order to promote autonomy and accountability, allowing a more efficient link between local revenue and expenditure decisions. The second change would be to allocate the property tax revenues entirely to local governments, providing more direct local government ownership of the property tax. The third change would be to adjust the relative administrative responsibilities between central and local governments while maintaining the current “co-administration” approach. These three changes could be implemented immediately within the current legal and institutional structure.

About the Author

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Property Taxation in Indonesia: Challenges from Decentralization

1. Introduction

Indonesia is in the midst of an exciting decentralization reform. The reform began in 1999 with the passage of Law No 22/1999 on Regional Government (UU PD) and Law No. 25/1999 on the Fiscal Balance between Central Government and the Regions (UU PKPD), both of which were brought into effect in January 2001. These laws have introduced rapid, major changes to the intergovernmental division of expenditure and revenue responsibilities, prompting the reform's characterization as a "Big Bang" reform initiative (World Bank, 2001).

Law No. 22/1999 brought major fundamental changes in expenditure responsibilities across levels of government, making local governments responsible for virtually all public services with the exception of defence and security, foreign policy, monetary and fiscal policy, the judiciary and religious affairs. In 2001, over 16,000 public service facilities and over 2.2 million civil servants were transferred from the central to the local government level (Hoffman and Kaiser, 2002).

To complement these expenditure shifts, Law No. 25/1999 introduced changes to the revenue side of intergovernmental finance. The intergovernmental transfer system was radically changed—replacing the previous salary grant for civil servants and the basic block grants known as the INPRES programs with a new grant known as the Basic Allocation Grant (*Dana Alokasi Umum (DAU)*) (Lewis, 2001; Brodjonegoro and Martinez-Vazquez, 2002). Tax revenue sharing was expanded to provide provincial and local governments with a portion of the national personal income tax (20%), forestry (80%), mining (80%), fisheries (80%), oil (15%) and gas taxes (30%), in addition to the existing tax share from the property tax (91%) and the property transfer tax (80%). Provincial and local government own-source revenue options, however, remained unchanged.

On aggregate, the decentralized revenues under Law No. 25/1999 appear sufficient to fund the newly devolved expenditure responsibilities under Law No. 22/1999 (Saad, 2001, Hoffman and Kaiser, 2002). However, the new intergovernmental fiscal structure continues to perpetuate local government dependency on central government transfers and shared taxes. Local own source revenues (*Pendapatan Asli Daerah* or PAD) are quite small—making up only between 5-15 percent of total local fiscal resources (Sidik and Katjamiko, 2002). To realize the potential efficiency and accountability gains from decentralization, local governments need expanded own source revenues and enhanced discretion over the use of central level transfers and shared taxes (Ahmad and Krelove, 1999; World Bank, 2002b).

This need for increased local own source revenues and discretion has introduced renewed pressure for change in the property tax in Indonesia. Although the property tax system was dramatically improved during the 1986 reform, it remained structured as a shared tax, not enacted as a new local tax. Revenues accrue to the local governments, but local governments have no direct control over the level of revenues collected, no discretion over the tax rate and no legal responsibility for tax administration. This has led to a debate on if, how and when the property tax should be changed to further promote local autonomy, and control and responsibility of revenue decisions.

This paper will focus on these two reforms—the 1986 reform which initially transformed the property tax into a viable government revenue instrument and the nascent reform which is exploring how to restructure the property tax to further support decentralization. Section 2 will focus on the 1986 reform experience, reviewing the fundamental policy and administrative reforms up to 1994 and those subsequently introduced from 1994-2001. Section 3 will then examine options which can enable the property tax to better support the ongoing decentralization reforms. The paper will close with summary comments.

2. The Property Tax Reform Experience from 1986-2001¹

Prior to discussing the reform that began in 1986, it is helpful to understand the historical context of the property tax in Indonesia. The property tax represents the oldest and most widely collected tax in Indonesia, dating back to before the 1600s. Even prior to the Dutch colonial period, peasants traditionally paid a tribute or “contribution in kind” to the landed aristocracy. Immediately following Dutch colonization in the early 1600s, the property tax system was systematized and became the dominant source of revenue for the colonial government. The original *landrente* regulations were issued in 1611, requiring all farmers to pay 20 to 50 percent of their crop to the Dutch colonial government. In 1816 this *landrente* was standardized at 20 percent of agricultural production. In 1923 and 1928, the first individual property taxes (*verponding*) were introduced, designed primarily for the urban areas.

During the Japanese occupation in the 1940s, the property tax system shifted from being a land rent to being a land tax based on agricultural output. Immediately after Independence, the Government of Indonesia initially eliminated the property tax, replacing it with a “land income tax.” This land income tax ultimately failed, leading to the reintroduction of a Land Output Tax (*Pajak Hasil Bumi*, Law No. 11, 1959), which was assessed at a rate of 5 percent on the net value of land, earmarked to local governments for rural development projects.

¹ This section draws heavily on Booth, 1974 and Kelly (1989, 1992, 1993, 1996).

In 1965, the various property-related taxes were consolidated into the Ipeda (*Iuran Pendapatan Daerah*) system, which translated means “Contribution for Regional Development.” This change was an attempt to distance the property tax from its colonial past, turning it into a central government shared tax, with revenues assigned to provincial and local governments for financing local and regional development. This Ipeda system combined the rural output tax with the individual property taxes on improved and unimproved land. At the same time, the government was administering several other property-related taxes such as a separate household tax and a net wealth tax.

These various property-related taxes each had slightly different bases, with varying tax rates and were administered by different agencies and levels of government. Property tax collection was less than 60 percent, with large variation by property type and location. Most property tax information was out of date, having been compiled largely during the Dutch colonial period and subsequently maintained on an ad hoc basis, creating major discrepancies in data quality. Property valuations were considerably lower than true market value and inconsistent among properties—one study estimated that appraised values were about a quarter of market value, while effective tax rates ranged from 0.01 to 0.4 percent of market value (Lerche, 1979). The low revenue collection rates, the incomplete data in the fiscal cadastre and the inconsistent valuations generated major equity, efficiency and administrative problems, and low revenue yield.

Faced with these realities, the Government included the property tax as an integral component of the 1984 central government tax reform, a reform which ultimately revised the income tax in January 1984, introduced the value added tax in April 1995 and led to the Land and Building Tax in January 1986 (Gillis, 1984). The newly enacted Land and Building Tax (Law No. 12/1985 *Pajak Bumi dan Bangunan {PBB}*) significantly rationalized the property tax policy framework, broadened the tax base, reduced exemptions, simplified the rate structure, and introduced a framework for improved administration.

The new PBB law simplified the property tax system by eliminating seven different property-related taxes and introducing a single flat tax rate of 0.5 percent assessed on the capital value of land and improvements. The Land and Building Tax eliminated the previous 50 percent concession to residential property and progressive rates for rural land. An assessment ratio ranging from 20 to 100 percent was introduced to provide flexibility in adapting property tax implementation to economic, political and social

conditions.² This ratio was originally set uniformly at 20 percent in 1986, yielding an effective statutory tax rate of 0.1 percent for all properties.

The tax liability was defined broadly to fall upon either the owner and/or beneficiary of the land and/or building to better facilitate tax administration in light of unclear or incomplete legal cadastre and property titles. Under the law, all identified beneficiaries and/or owners are jointly and severally liable for the property tax. The new law broadened the tax base by reducing tax base exemptions and by switching the tax base from rental value to capital value.³ The previous power of the Director of the tax department to grant special exemptions was eliminated.

Several provisions were incorporated into the PBB law to improve equity. A valuation deduction for buildings was introduced for all properties which exempted most rural housing and low value urban structures, making the property tax a land tax in rural and low value urban areas. The valuation deduction, which is deducted from the building value to determine the taxable property value, is set at a unit amount which introduces an element of progressivity to the property tax system. In addition, the legal structure was simplified to facilitate implementation in order to reduce inappropriate administration.

The PBB law stipulated strict deadlines and penalties to ensure timely and accurate property registration and tax payment. Taxpayers and third party institutions dealing with property (e.g., notaries, planning and land departments) were required to provide property information. Failure to provide the information could result in the imposition of penalties. Taxpayers were given 6 months to pay their tax liabilities. A 2 percent per month penalty (up to a maximum of 24 months) was applied on late payments. Seizure and auction of movable and/or immovable property was permitted in cases of non-compliance.

The PBB law stipulated several fundamental changes in the administration of property information, valuation, revenue collection and enforcement. The major change in the revenue collection procedures was the designation of the banking sector as responsible for the receiving and accounting components of tax collection. The law allows the

² Under the PBB law, the tax rate is fixed at 0.5 percent of property value but allows for an assessment ratio from 0.2 to 1.0 that can be set by Presidential Decree. To change the tax rate requires a change in the law through parliament while the assessment ratio can be changed more easily overtime. The assessment ratio was originally set at a uniform 20 percent in 1986 but was changed in 1994 to a differential rate depending on the value and type of property.

³ Tax exemptions are narrowly defined—limited to non-profit organizations engaged in non-profit religious, educational, cultural and social activities, graveyards, protected forests, national parks, social common land (*adat*), diplomatic offices, and international organizations. The Minister for Finance is given the option to grant special exemption for unique, exceptional cases, as required.

Minister of Finance to delegate various revenue collection activities to the provincial and local governments; thus, regional governments are involved in rural and urban collections, while the central government is responsible for the estate, forestry and mining sectors. The construction and updating of the fiscal cadastre—including the basic property tax information and the valuation—is the legal responsibility of the central government tax department but in practice is implemented with some participation of the regional governments. Property valuation continued through a simple mass valuation process based on similar land value zones for land and the replacement cost for buildings.⁴

The PBB law also stipulated a new division of the revenues between levels of government. The distribution of tax revenue was 64.2 percent to the local governments, 16.2 percent to the provincial governments, 10 percent to the central government, and 9 percent to cover administration costs. The property tax revenues are now considered as discretionary revenue to the local governments, available for the local routine or development budget.

⁴ The property tax is assessed on the sales value for each property, as determined by the tax department. Property valuations are to be carried out every three years, except in those areas of rapid development where the exercise can be carried out on an annual basis. The tax department is given flexibility in choosing the valuation technique. With the exception of unique, high value properties, all rural and urban properties are valued through a simple mass appraisal system which uses a similar land value zone approach for land, and a building classification system based on the replacement cost approach for buildings. The estate, forestry and mining sectors are valued through a different system.

The mass appraisal process for urban and rural land is based on a “similar land value zone” approach where land is divided up into various zones, each with an average sales price per square meter as determined by the tax department. These similar land value zones are identified and published into land value books that are used in the valuation process. The tax department, in close consultation with the regional governments, issues these land value books. All land parcels located within one zone are valued by multiplying the land area times the average per unit price. The buildings are valued based on a cost approach using cost tables determined by the tax department. The total property value is the summation of the land and building values.

Although the tax department is responsible for property valuation, the tax department works closely with the local government officials in determining the land value books. All land value books are discussed with the local governments, signed off by the regional head, prior to being authorized for property tax valuation purposes. This review process ensures a degree of quality control, ownership and transparency in the land values used for taxation.

These fundamental policy changes in the PBB law established an enabling framework for the government to embark on a major administrative reform that introduced several innovative improvements to property tax administrative systems and procedures.

The first step in the administrative reform was the reorganization of the property tax offices along functional lines in 1989. The number of regional field offices was doubled to 106 and these were renamed as “Property Tax Service Offices” instead of “Property Tax Inspection Offices,” the name change reflecting the government’s change in emphasis to taxpayer service. These 106 regional offices are currently staffed by 6,700 central government employees, administering the property tax for about 50 million taxpayers and 78 million properties. In Jakarta alone, the property tax involves about 1.2 million taxpayers and 1.6 million properties.

Immediately following this administrative reorganization, the government shifted its property tax reform implementation strategy from one narrowly focused on improving property valuations in high value urban properties to a comprehensive approach that was led by property revenue collections (Kelly, 1993).⁵ This “collection-led” strategy began with the introduction of the payment point collection system (*Sistem Tempat Pembayaran* or SISTEP) which was first field tested in 1989 and subsequently replicated throughout Indonesia by 1992. This SISTEP system simplified the collection function, reduced compliance and administration costs and provided a delinquency list for enforcement purposes.

The SISTEP system established the banking sector to be responsible for the receiving and accounting of tax revenues. Specific banks were designated within a predetermined geographic zone to serve as “payment points” for the property tax. Preprinted receipts were deposited at each payment point to reduce the administrative and compliance costs. Receipts remaining at the payment point after the payment due date provided the basis for the creation of the delinquency list for enforcement purposes.

Under the SISTEP system, collection efficiency immediately improved from an average of 65 percent to 79 percent in its first year of implementation. This new collection system enabled more effective accounting for the receipts and for enforcement against non-

⁵ The initial phase of administrative reform (1988-1991) was funded with assistance from the World Bank. The project was originally designed to place priority on valuing the top 50,000 properties in the largest cities. Immediately after project commencement, however, the Government quickly recognized that improved valuations, in the absence of an effectively functioning comprehensive tax administrative system, would not generate the equity, efficiency and revenue goals. The government therefore shifted to a “collection-led” reform strategy (Kelly, 1992, 1993).

compliance, leading to the first seizure of property for property tax delinquency in 1991—the first property seizure for delinquency since independence in 1945.

Complementing these revenue collection and enforcement activities, the Government established a comprehensive, computer-based property tax administration management system (*Sistem Manajemen Informasi Obyek Pajak* or SISMIOP) to manage all aspects of the fiscal cadastre, valuation, billing, collection, enforcement, and taxpayer service (Kelly, 1996). This SISMIOP system integrated information processing with the administrative procedures necessary to comprehensively manage all aspects of the property tax. By 1994, the SISMIOP system was introduced throughout Indonesia and currently manages over 78 million properties.

Thus, this first phase of the reform, from 1986–1994, laid the basic policy and administrative framework to transform the property tax system into a viable revenue generating fiscal instrument. The reform simplified the basic tax policy while introducing major innovative administrative reforms and generating substantial revenue increases. It is generally recognized as perhaps the most successful property tax reform in the developing world (Rosengard, 1998, Youngman and Malme, 1994).

Keys to Success

The success of the reform's first phase from 1986-1994 can be attributed to several significant factors:

First, the government mobilized strong political, management and operational support by linking the property tax reform component to the momentum of the comprehensive tax reform of 1984. The strong political leadership behind the broader tax reform enabled the enactment of the new law and provided the support to undertake and sustain the administrative reforms necessary for its successful implementation.

Second, the property tax reform was built on an established tax culture in Indonesia. The property tax has a long history in Indonesia. Thus, there was a well-established property tax tradition both among the citizen-taxpayers and the tax administration. The reform built upon this tradition, while simplifying the policy framework, effectively linking policy with administration, and implementing a comprehensive set of administrative reforms within a “collection-led” implementation strategy.

Third, the reform did not focus solely on tax policy changes but introduced major administration changes to improve taxpayer service, reduce compliance and administrative costs, improve equity and enhance revenue mobilization. Starting with the payment point system (SISTEP) rationalization, the reform moved to integrate and improve all tax administration functions through the computer-assisted property tax administrative management system (SISMIOP). The SISMIOP system introduced the use of computerization, which required a rationalization of procedures, including the

establishment of a unique parcel identification numbering system, systems development and support, and capacity training on new standard operating procedures and computer use. Improved institutionalized systems and procedures provided the framework for reform sustainability.

Fourth, these innovative administrative changes were developed and introduced on a pilot basis which allowed the government to field test procedures, economize on scarce managerial and field staff and gauge possible reactions to the new procedures. Once proven successful, the SISTEP and SISMIOP system and procedures were gradually adapted and replicated nationwide. These administrative reforms were first introduced in 1989 and replicated throughout Indonesia by 1994, providing the framework for minor policy adjustments and improved technological embellishments.

Fifth, all administrative procedures, systems and technology applications were developed cognizant of the available institutional capacity to facilitate implementation. Although capacity development programs were instituted, all procedures were designed initially to match the existing administrative capacity, with the intent that the systems could evolve in line with capacity development. The key was to ensure that all new systems and procedures could be readily implemented and sustained with existing capacity.

Further Policy and Administrative Changes (1994-2001)

Following the initial policy and administrative reform from 1986-1994, the government introduced several policy and administrative changes. The major change came in 1994 when the Government amended the Land and Building Tax law.⁶

First, the government changed the revenue allocation, shifting the 10 percent, which was originally allocated to the central government, to the local governments.⁷ Thirty-five

⁶ In addition to the revisions to the Land and Building Tax law (Law No.12/98), the Government in 1997 enacted a Land and Building Acquisition Tax (Law No.21/97) which is a tax of 5 percent applied to the “acquisition value” of the property minus a valuation deduction of up to Rp 60 million, a threshold that is determined by the regional government. The Land and Building Acquisition Tax is a central level shared tax where the central government retains 20% of the revenues while distributing 16% to the provinces and 64% to the local governments. In FY 2001, this acquisition tax was expected to collect about Rp. 1.1 trillion.

percent of this was allocated equally to all local governments as an “equalization” component, while the remaining 65 percent was allocated as incentive revenue to local governments reaching the government mandated property tax revenue targets.

Second, the assessment ratio was changed from one uniform percentage applied to all properties to one differentiated by property value and sector. Under the changes, high value urban properties over Rp. 1 billion began using an assessment ratio of 40 percent, which raised their statutory tax rate from 0.15 percent to 0.2 percent. Subsequently in 2000, the assessment ratio of 40 percent was extended to all rural and urban high value properties over Rp 1 billion and to all estate and forestry properties.⁸

Third, the valuation deduction was increased from Rp. 7 million to Rp. 8 million and changed from a deduction based only on the building value to one based on the total land and building valuation. This essentially took away the advantages of differential rate taxation of land and buildings.⁹ The valuation deduction was also modified from being based on each property to one being based on each property owner. Thus, a single property owner could only receive one land and building deduction, requiring the tax administration to clearly identify properties belonging to the same owner. In 2001, this

⁷ The allocation of the property tax revenues had been a point of contention immediately since the enactment of the Land and Building Tax in 1986. At the time, it was argued that the revenues should be allocated solely to local governments. However, policymakers decided to allocate ten percent to the central government largely to replace the central government revenues that were lost through the abolishment of the National Wealth Tax (*Pajak Kekayaan Negera*). The inclusion of the ten percent to the central government was heavily criticized at the time as a “centralization” of the property tax, since the central government had previously not received any revenue from the property tax under the IPEDA system.

⁸ Currently, only mining and urban and rural properties under the Rp 1 billion threshold use the 20 percent assessment ratio. This differentiated assessment ratio introduces a somewhat progressive rate structure based on individual property values.

⁹ The original valuation deduction was only on buildings because the policymakers in 1985 felt that everyone who owned land should “participate in development” by paying at least a token amount through the property tax. Given the uncertainty in land titles, citizens preferred to pay the property tax in order to have a property tax receipt that provided evidence of “indicative ownership”, especially for low value property under customary ownership (*Hak Girik*). The policy change in 1994 for the first time exempted low value land from the property tax.

valuation deduction was increased up to a maximum of Rp. 12 million, but discretion was given to each regional government to set the valuation deduction threshold.¹⁰

In addition to these three policy changes, the Government has introduced some embellishments on the use of technology from 1994-2001. The government has renamed the basic SISMIOP system as i-SISMIOP to signify the change towards a more internet-friendly and automated taxpayer service environment. In addition, the government is gradually incorporating mapping and other GIS components into the SISMIOP system.

In Jakarta and Surabaya, the tax department also introduced a Payment On Line System (POS) at each property tax payment point within the banking system in 1999. This POS, implemented through joint cooperation between the PBB tax department, the local governments and the banking system, was designed to further simplify the collection system—providing on-line information on collections to enable more effective cash flow management, compliance enhancement activities and taxpayer service. This POS system is capable of being expanded to cover all major local level revenues. The tax department also instituted a Telephone Information System in 37 of the regional offices to improve taxpayer service and the dissemination of PBB-related tax information based on the property identification number.

Since the enactment of the Land and Building Tax, with its various associated policy and administrative changes, property tax revenues have grown from 154 billion in 1985-86 to over Rp. 5.2 trillion in 2001, representing an average annual increase of over 24 percent from 1985/86. As Table 1 indicates, the revenue increase comes from the mining and urban sector.

¹⁰ The valuation deduction which was originally set at Rp. 2 million in 1986 was increased to Rp. 3.5 million in 1990, to Rp. 7 million in 1992, to Rp. 8 million in 1994 and to Rp. 12 million in 2001. In 2001, local governments were given the discretion in setting this deduction up to a maximum of Rp. 12 million. Granting discretion to the local government was an attempt to accommodate the pressure from the decentralization reform, this discretionary power being the only discretionary policy variable available to local governments to affect the level of property tax revenues—since the tax base and tax rate decisions continue to be determined by the central government. In 2001, 210 (61%) local authorities continued to use Rp 8 million, 17 increased the deduction, while 114 (33%) decreased the deduction.

**Table 1: Property Tax Revenue Collection by Sector 1992-2001
(in Rp billion)**

Year	Rural	Urban	Estate	Forestry	Mining	Total
1969/70	5.9	0.8	0.7	0.0	0.5	7.9
1972/73	10.5	1.9	1.0	0.1	1.6	15.1
1975/76	22.7	5.9	3.7	1.6	2.0	35.8
1978/79	30.7	9.9	6.6	9.1	7.7	64.0
1981/82	36.2	20.6	11.2	12.5	15.1	95.6
1984/85	49.6	45.6	15.5	19.1	36.8	166.6
1987/88	76.8	95.1	32.3	7.0	104.8	316.0
1990/01	116.3	169.6	47	59.2	378.9	771.0
1993/94	154	382	55	129	767	1,486
1996/97	227	768	87	207	1,148	2,438
1999/00	267	1,040	201	175	1,584	3,267
2000**	267	1,084	199	132	1,879	3,562
2001	322	1,712	245	170	2,838	5,287

Source: Government of Indonesia, Directorate of Property Taxation, 2001.

** In 2000, the GOI changed the fiscal year to the calendar year. Thus, FY 2000 only includes 9 months, and the 12-month equivalent revenue collection would be Rp. 4,677 billion.

As a shared tax being allocated to local governments, the property tax plays an important role in local government finance. As Table 2 indicates, the property tax provided about 11 percent of total local revenue, 50 percent of non-grant revenue and two-thirds of all local government tax revenues (67 percent) in 1999/2000. The relative contribution of the property tax to the local governments remained constant from 1987 through 1999. At the provincial level, it provides 11 percent of total revenues, 22 percent of non-grant revenue and 26 percent of tax revenue. For the provincial governments, due to the relative decline in grant funds, the property tax has increased in relative importance from 2.1 percent of total revenue in 1987/88 to 10.8 percent in 1999/2000.

Table 2: Regional Government Revenue Structure, 1987/88 and 1999/00

	1987/88		1999/00	
	Rp billion	%	Rp billion	%
Provincial Government	2,791	100.0	11,871	100
Central Grants	2,112	75.7	6,041	50.9
Property Tax	58	2.1	1,277	10.8
Level I Taxes	459	16.4	3,632	30.6
User Charges	58	2.1	268	2.3
Government Enterprises	19	0.7	102	0.9
Other Revenues	75	2.7	336	2.8
Loans	11	0.4	215	1.8
Property Tax as % of total revenues		2.1		10.8
Property Tax as % of non-grant revenues		8.5		21.9
Property Tax as % of total tax revenues		11.2		26.0

	Rp billion	%	Rp billion	%
Local Government	1,414	100.0	26,935	100.0
Central Grants	911	64.4	21,176	78.6
Property Tax	146	10.3	2,893	10.7
Level II Taxes	74	5.2	1,416	5.3
User Charges	152	10.8	971	3.6
Government Enterprises	7	0.5	75	0.3
Other Revenues	71	5.0	301	1.1
Loans	54	3.8	103	0.4
Property Tax as % of total revenues		10.3		10.7
Property Tax as % of non-grant revenues		28.9		50.2
Property Tax as % of total tax revenues		66.3		67.1

Source: National and Regional Government Budget Database, 2001.

Although overall property tax revenues grew substantially since the 1986 reform, there remains significant room for further improvement. As a percent of GDP, the urban property taxes more than doubled from 0.05 to 0.12 percent from 1984 through 1993, while the mining sector revenues increased substantially from 0.04 to 0.23 percent during the same period. In contrast, rural property taxes declined slightly from 0.06 to 0.05 percent while estates and forestry property tax revenue remained virtually unchanged during the same period. The dramatic increase in the mining sector revenues is largely attributed to the way in which the government allocates its national oil-related revenues, while the change in urban revenues can be largely attributed to the improvements in policy and administration introduced by the 1986 reform. From 1993-2000, property tax revenues as a percentage of GDP have remained relatively stagnate, linked to the overall fiscal crisis in Indonesia during that period.

By international standards, the absolute level of property tax revenues remains quite low. In 2001, the property taxes represented only 0.35 percent of GDP, about 2.9 percent of total government tax revenues and roughly 11 percent of local government revenues. Although comparative data is scarce, property taxes throughout the world account for about 0.5-3.0 percent of GDP, 2-4 percent of total government taxes and between 40-80 percent of local government finance. In contrast to developed countries, developing countries tend to generate significantly less property tax revenue—typically generating a maximum of 40 percent of local government revenue, 2 percent of total government revenue and about 0.5 percent of GDP (Youngman and Malme, 1994, Kelly, 1995, IMF, 1996, OECD, 1997).

These aggregate statistics suggests that property tax revenues in Indonesia could be increased substantially. For example, if Indonesia were to collect property taxes equal to 0.5 percent of GDP, property tax revenues would increase by about 43 percent—thus, potentially generating an additional Rp. 2.7 trillion per year for a total of about Rp 7.5 trillion annually.¹¹ These potential revenues could come from a combination of increased effective tax rates and administrative improvements in expanding the tax base coverage, improving the valuation level and enhancing collection efficiency.

Using a simple tax revenue model (Kelly, 2000, 2002), it is possible to estimate the potential impact from administrative improvements alone. The model is as follows:

¹¹ In addition, there is a one-time possibility of increasing the collection of current tax arrears stood at Rp. 2.1 trillion in January 2001.

$$\text{Tax Revenue} = \underbrace{[\text{Tax Base} * \text{TR}]}_{\text{(Policy variables)}} * \underbrace{[\text{CVR} * \text{VR} * \text{CLR}]}_{\text{(Administrative Variables)}}$$

Definitions used in this tax revenue model are as follows:

Tax Base Tax Base is defined according to the government policy in terms of what is and is not taxed. In the case of Indonesia, it is the value of the land and buildings and the value of the mining, estate and forestry property.

TR Tax Rate is defined as the statutory tax rate. In the case of Indonesia, it is the tax rate of 0.5 percent multiplied by the assessment ratio. Currently the assessment ratio is differentiated by property value and sector, 20 percent for low value properties and 40 percent for higher value properties. The statutory tax rate thus ranges from 0.15 to 0.2 percent.

CVR Coverage Ratio is defined as the amount of taxable property captured in the fiscal cadastre, divided by the total taxable property in a jurisdiction, measuring the accuracy and completeness of the valuation roll information.

VR Valuation Ratio is defined as the value on the valuation rolls divided by the real market value of properties on the valuation roll. This measures the accuracy of the property valuation level.¹²

CLR Collection Ratio is defined as the tax revenue collected over the total tax liability billed for that year, measuring the collection efficiency. The CLR is affected by the collection of both current liability and tax arrears.¹³

As this formula indicates, tax revenues are equal to the tax base multiplied by the tax rate whilst being further affected by three administrative variables of coverage, valuation and

¹² The Valuation Ratio measures the accuracy of the overall valuation level (i.e., what percentage of market value is being captured through the valuation process). In contrast, the relative accuracy of the valuations is measured by the coefficient of dispersion (i.e., the dispersion around the median). In tax policy, it must be remembered that property valuation is only to determine the relative tax burdens of properties, not the absolute tax burden per property. That absolute burden is determined through the tax rate—not the valuation ratio. However, in a country like Indonesia, where the tax rate is fixed in law, the accuracy of the valuation ratio does impact the total revenue level. However, if the property rate discretion is given to the local governments, the importance of the valuation ratio will diminish, except for the importance in determining the relative equity in the allocation of the tax burdens.

¹³ The Collection Ratio measures the efficiency of the revenue collection. It is possible to break the Collection Ratio into two components, Collection Ratio on current liability and Collection Ratio on outstanding liability. The Collection Ratio on outstanding liability could be referred to as the Enforcement Ratio.

collection. The tax base is a policy variable determined by the government as to what is and is not included in the tax base. The tax rate is also a policy variable determined by government decision. Once basic policy decisions are made, the potential tax revenue is a function of three administrative variables, namely the accuracy and level of the coverage ratio, the valuation ratio and the collection ratio. These three administrative ratios ultimately determine the effective tax rate and tax burden for each property, affecting the revenue yield, economic efficiency and overall equity. Unlike the tax base and tax rate, which are politically determined, the coverage ratio, valuation ratio and collection ratios are affected by administrative capacity and political will continuously throughout the year.

Using this model, it is possible to estimate the potential revenue yield from improved administration in Indonesia. Indonesia is currently estimated to have, on average, a coverage ratio of about 80 percent, a valuation ratio of about 60 percent, and a collection ratio of about 80 percent. If the government could improve each ratio by 10 percentage points, that is up to about 90 percent coverage ratio, 70 percent valuation ratio, and 90 percent collection ratio, it would be possible to improve revenues 24 percent overall, without any commensurate change to the tax rate itself.¹⁴

There are thus three variables affecting the level of property tax revenues in Indonesia—the level of the property tax base, the statutory tax rate and the quality of tax administration. The level of the property tax base is a function of the property market dynamics of supply and demand for property, factors outside the direct control of either the central or local governments. However, the remaining two variables (the determination of the tax rate and the quality of administration) fall under the direct responsibility of the central government. The statutory tax rate is the policy variable, the rate being fixed in law by parliament and the assessment ratio being fixed by presidential decree, with no discretion, responsibility or control by the local governments. The administrative variables are also the responsibility of the central government but in practice are “co-administered” between the central and local governments. There is thus some, but quite limited, influence by the local governments on the quality of tax administration.

¹⁴ This improvement estimate is calculated as the change between the existing administrative efficiency of the coverage ratio (0.8) * valuation ratio (0.6) * collection ratio (0.80) = 0.38 and the improved administrative ratios of 0.9 * 0.7 * 0.9 = 0.57). The percentage change from 0.38 to 0.57 is 48 percent. However, the improvement estimate should only apply to the rural, urban, estate and forestry sectors, those sectors that directly rely on Directorate of Property Taxation administration. The mining sector revenues are administered outside the tax department, thus the tax department cannot directly influence the coverage, valuation, or collection ratios. Excluding the mining sector revenues, which account for about 50 percent of the total revenues, the possible administrative improvements would be equal to 24 percent.

As shown, international experience would suggest that Indonesia could collect property tax revenues at least equal to 0.5 percent of GDP or about Rp. 7.5 trillion. This implies a possible 43 percent increase in property tax revenues. The simple revenue model suggests that Indonesia could improve property tax revenues by 24 percent by improving tax administration, namely the coverage, valuation and collection ratios. This means that the difference of 19 percent could come from changes to the effective tax rate.¹⁵ If the effective tax could be gradually increased up to full statutory tax rate of 0.5 percent, along with these administrative improvements, property tax could generate about Rp. 9.3 trillion, or about 0.62 percent of GDP.

As a central government shared tax, the property tax already provides the major proportion of the revenues to the provincial and local governments. The two remaining variables (the tax rate and administrative improvements) influencing the level of these property tax revenues fall under central government control, limiting the ability of local governments to rely more heavily on property tax revenues. In light of the ongoing decentralization reforms, there is now increasing consideration to shift the control of these two remaining variables to the local governments. In this way, the local government could be given direct tax rate discretion and more direct influence on improvements to the tax base coverage, the level of property valuation and collection ratios. These various options will be explored in the following section.

3. Reforming the Property Tax to further Support Decentralization

The Indonesian decentralization reform has radically changed the basic structure and financing of the public sector. Major expenditure responsibilities have been shifted to the local level, while revenues have been increased through a new grant system and expanded shared tax revenues.

One area that remains largely untouched, however, has been the development of local own revenues—those revenues directly under the responsibility and discretion of the

¹⁵ Under a fixed tax rate regime, the level of the valuation ratio significantly affects the overall level of revenue mobilization. However, if tax rate discretion is given to the local governments, administrative improvements to the level of overall valuation are not the critical administrative variable. The critical tax administrative consideration would be the quality of the relative valuations for equity purposes not the absolute level of the valuations for revenue purposes. Thus, under a tax rate discretion regime, the contribution to increased revenues from administrative improvements could be closer to 13 percent since the major administrative improvements would be due to increases in the tax base coverage and in collection efficiency. Tax rate discretion could then change revenues by up to 30 percentage points in order to reach the 0.5 percent of GDP (see also footnote 16).

local governments. As earlier indicated, overall local own revenues make up only about 15 percent of total regional fiscal resources. Although provincial governments mobilize up to 44 percent of their own revenues, local governments do not fare as well. Jakarta, for example, collects only 30 percent of their own revenues while the average urban area collects 15 percent and the average rural local government collects as little as 5 percent of their own revenues.

Although aggregate revenues have been initially provided to meet the new local expenditure responsibilities, local own source revenues remain too low to support and sustain the move toward greater decentralization. Local governments must be given access to sufficient revenue instruments over which they can exercise discretion to mobilize additional revenues at the margin in order to be more autonomous, responsible and accountable to their citizens and to match their local expenditures and revenues in an efficient manner.

Immediately prior to the decentralization reforms in 1999, the Government had enacted Law No 18/1997 to rationalize the regional level revenue structure. This law provided a closed list of taxes available to provincial and local governments in order to stop the practice of local governments issuing a plethora of local taxes, most of which generate little revenue but impose high administrative, compliance and efficiency costs on the economy. This law successfully reduced regional taxes from 42 to 9 and regional levies from 192 to 30 (APEC, 2001). Any proposed new tax was forced to be approved by the Ministry of Finance.

As part of the decentralization reform, the Government replaced Law 18/1997 with Law No. 34/2000 which allowed local governments to introduce new local tax regulations based on broad principles, such as revenue adequacy, efficiency, equity and administrative feasibility. Oversight responsibility was shifted from the Ministry of Finance to the Ministry of Home Affairs to review these local revenue regulations. Local governments are now reintroducing revenue instruments previously eliminated under Law No. 18/97 as well as developing new ones (Saad, 2001).

Experience to date indicates that the Ministry of Home Affairs appears reluctant to intervene in questioning the new local government levies. This is beginning to lead to a number of new local taxes that potentially are detrimental to overall economic development and violate the basic taxation principles of revenue adequacy, efficiency, equity and administrative feasibility (Ray, 2001; Sidik and Katjamiko, 2002, Hoffman and Kaiser, 2002).

To avoid this emerging proliferation of inappropriate local revenue instruments, government reformers are reconsidering the original revenue assignment decisions, trying to identify a different possible mix of grants, shared revenues and own source revenues. There is now serious debate as to whether to reassign more buoyant tax bases to supplement those few already under direct local government control. Based on public

finance theory and international practice, the major candidate under consideration is the Land and Building Tax.

It is generally accepted that the property tax is an excellent local level tax for the following reasons:

- Property taxes can generate adequate revenues with proper administration.
- Property taxes are an efficient tax since property is not easily exported, which allows a link between those who derive benefits from tax-funded services with those who bear the tax burden.
- Property taxes can be quite equitable, especially in developing countries where land is the major repository of wealth.
- Property taxes are relatively easy to administer. Property can be easily identified and impossible to hide. Property is also an asset that can serve as security against payment—subject to seizure and ultimately sale in case of noncompliance, thus further simplifying administration.

With perhaps the exception of Sweden, where the property tax is entirely a central government tax (i.e., policy, administration and revenues are all assigned to the central government), virtually all countries allocate the property tax to the local governments. Property taxes account for about 40-80 percent of local government revenues, except in developing countries where the property tax may generate a maximum of 40 percent of local government revenues.

In every country, the central government sets the broad tax policy and administrative framework and plays at least an oversight role to ensure the uniform application of the property tax law. There is great similarity in tax policy structure. Most governments tend to tax land and buildings on a capital basis, while providing tax relief to government, diplomatic, religious and educational properties.¹⁶ Property valuations tend to be carried out through very simple mass valuation systems rather than relying on single parcel valuations. Tax rate structures do vary; some apply uniform rates while others apply multiple rates differentiated by use, value and/or location of property. With the exception of Indonesia, virtually all countries allow some local government discretion in setting the tax rates. Collection and enforcement systems tend to be largely similar, with slight variations depending on a country's legal and administrative framework.

¹⁶ Although most countries tax both land and improvements (eg, North America, Asia, and Europe), some countries tax only land (eg, Jamaica, Kenya, Bermuda, and parts of Australia and South Africa) while a few countries tax only buildings (eg, Ghana and Tanzania).

In only a few countries (e.g., Chile and Indonesia), the property tax is structured and administered as a central level shared tax, where central government controls the tax policy and administration with only the revenues assigned to local governments. Although quite similar, the property tax systems in Chile and Indonesia have a few differences. In Chile, all administrative costs are borne by the central government budget, thus no portion of the property tax is deducted for tax administration. Sixty percent of the revenues are returned to local governments based on property location, while 40 percent is allocated to all local governments on a formula basis to achieve a certain level of equalization. Chile also provides limited tax rate discretion to the local governments. In Indonesia, by contrast, nine percent of the property tax is retained for administrative costs in addition to the central government budget allocation to the tax department. Eighty-one percent of the revenues are assigned to local governments based on property location, while only 6.5 percent is allocated among all local governments to achieve a certain level of equalization and 3.5 percent is allocated based on the achievement of property tax collection targets.¹⁷ Indonesia provides no rate discretion to the local governments.

In virtually all other countries, the property tax is assigned to the local government as a local revenue instrument under broad general guidelines and oversight from the central or higher level of government. The central government usually defines the tax base definitions, although local governments are sometimes given limited options to offer special exemptions or relief. At the same time local governments are given discretion over the tax rate, often within limits or oversight by the central government.

International experience shows that virtually any level of government can effectively administer the property tax (Munro-Faure, 2000). Chile and Indonesia are two examples where the tax department administers the property tax centrally—although as explained earlier, Indonesia tends to jointly administer its property tax to some extent with the local government. At the other extreme, the property tax in North America, Australia and Japan is largely administered by the local governments, but with general oversight by either the central or state level governments to ensure uniform application of the law.

Responsibility for property tax administration varies among countries. Typically the administration is under direct local government control, although there are many countries that co-administer the property tax between the central and local governments. Collection responsibility is vested with the local government which receives the revenues, while the maintenance of the fiscal cadastre and property valuation are often centralized for reasons of quality control, economies of scale and equity. For example, the property tax systems in New Zealand, Jamaica, Denmark, Malaysia, Uganda and

¹⁷ In 2001, Indonesia introduced the DAU grant that contains an equalization element that overshadows the 6.5 percent of the property tax allocated for equalization purposes. This property tax equalization component can now be eliminated, allowing the tax revenues to be allocated to local governments based on property location.

Thailand centralize the property valuation for taxation purposes. In the United Kingdom, the responsibility is split with the central government being responsible for administering all aspects of the commercial property tax (known as the Uniform Business Rate), while the local governments are responsible for collecting the residential property tax (known as the council tax) based on tax roll information which is maintained by the central government's Valuation Office located within the Inland Revenue Department. These countries essentially co-administered their property tax between the central and local governments; with the tax roll and valuation functions administered at the central level while collection and enforcement are administered at the local level.

The main arguments for central government involvement in the fiscal cadastre and valuation functions are the need for central government access to property information for other taxation and policy purposes, economies of scale in administration, and the need to provide effective oversight to ensure the uniform and equitable application of tax laws. On the other hand, it can be argued that technological advances have considerably weakened the economies of scale argument and that local level knowledge is essential to improve the fiscal cadastre and valuation quality. In practice throughout the world, the property tax seems best implemented in an efficient and equitable manner by drawing on the comparative advantages offered by both the central and local government administrative capacities.

Differences in tax policy and administration structure between countries largely depend on historical legacy but can also be shaped by such factors as the level of institutional capacity, government accountability, local autonomy and trust, as well as varying economies of scale of different administrative functions. The key issue necessary to support sustained decentralization goals is to ensure that local governments have access to the property tax revenues and that they have some discretion over the rate to affect the amount of revenue collected at the margin. Allowing tax rate discretion by local governments is the critical policy decision needed to increase the accountability, autonomy and responsibility of local governments under increased decentralization. Local government must have some discretion over the tax rate in order to determine and affect the amount of collected revenue.

On the administrative side, there are strong arguments for both active central and local government involvement—the common pattern is for increased local government responsibility with central government oversight and possible central level involvement in the fiscal cadastre maintenance and property valuation.

How Does Theory and International Experience Apply to the Current Indonesian Property Tax Situation?

First, it is important to remember that the Indonesian property tax reform of 1986-1994 made a tremendous impact by turning the property tax into a viable and credible revenue source. The government's "collection-led" strategy was successful in shifting the focus

from one looking narrowly at property valuation to one focused comprehensively on improving all aspects of property tax administration, namely: collection and enforcement, taxpayer service, property identification and information management and property valuations.

The successful implementation of the payment point system (SISTEP) was followed by the development and implementation of the comprehensive property tax administration system (SISMIOP). These basic administration reforms are now fully integrated into the property tax system in Indonesia. The key to further reform will be to strengthen these administrative systems while introducing the incremental policy changes needed to make the property tax better able to support the decentralization objectives.

As theory and international experience confirm, there are two minimum requirements for a tax instrument to be able to support further decentralization.

First, the revenues must accrue to local governments with sufficient discretion on the use of those funds so that these revenues can be used for the needs identified by the local citizens, creating a clear correspondence between local revenues and local expenditures. The property tax revenues in Indonesia should be reallocated entirely to the local governments, eliminating the portion currently allocated to the provincial level. The loss in provincial revenues could be compensated through increasing the tax rate on the provincial motor vehicle and fuel taxes.

In addition, the property tax revenues currently retained for administrative costs should be reduced after careful evaluation of the administrative cost structure for the central and local governments. Although the original nine percent established in 1986 may have generated an appropriate amount to cover administrative costs, property tax revenues have since increased 20 fold without a commensurate increase in administrative costs. Reducing the amount retained by the central government for administration would increase the property tax revenues received by local governments.

Second, local governments must be given some discretion over the effective tax rate to influence the level of revenues collected at the margin. As shown in the tax revenue model specification, the tax rate is the one critical policy variable that can directly affect the level of property tax mobilization outside the definition of the tax base. Currently local governments have no tax rate discretion; this is set in national law at 0.5 percent, in combination with an assessment rate determined through Presidential Decree. Giving rate discretion to local governments would grant the ability, responsibility and accountability to the local government to raise additional revenues in line with local citizen preferences.

Local governments could be given immediate discretion over effective tax rates by being given the freedom to set the assessment ratio. A new Presidential Decree could be issued giving local governments discretion to increase the assessment ratio on rural and urban properties uniformly up to 100 percent. The central tax office then would assess the tax liability based on this assessment ratio as determined by the local government. In this

way, local governments would be responsible and accountable for the increased effective tax rate. As the tax revenue model indicated, allowing local government discretion to choose up to a 0.5 percent tax rate could generate over Rp. 9 trillion in property tax revenues, an increase of close to 70 percent.

These two changes, increasing the portion of property tax revenues going to local governments and granting local discretion on setting the effective tax rate, would immediately enable the property tax to further support the decentralization reform. There is little debate that these two changes are essential. Within the current Indonesian legal and institutional framework, these changes can immediately be implemented through either a presidential and ministerial decree, thereby avoiding the need to open up the property tax legislation to parliamentary debate. The property tax, at least in the short term, could remain a central government shared tax, administered by the central government but with an increasing amount of revenue and rate discretion given to the local governments. This has been the approach followed successfully by Chile, which is the only other major country administering the property tax as a shared tax.

There is strong theoretical reasons and international experience to support the continuation of Indonesia's property tax "co-administration". The only real debate is on the proper balance in the division of administrative responsibilities between the central and local governments. Central level policy and administrative oversight is imperative to ensure uniform implementation of the law. Central level involvement is also important to ensure cost effectiveness, consistency and standardization in fiscal cadastre maintenance and property valuation, although with increased local government involvement. Revenue collection should remain the responsibility of the local government, at least for the rural and urban properties, while enforcement responsibility should be expanded to include a more direct involvement by the local government. The key to success is to maintain the correct balance between central and local involvement in administration—not to make administration either a purely central or local government responsibility.

Thus, in the short to medium term, it would be advisable to maintain the property tax as a shared tax under central government administration. At the same time, it will be important to begin adjusting the division in relative administrative responsibilities between the central and local levels. In general, local governments need to be incorporated more into the various tax administrative components that affect the coverage, valuation and collection ratios. However, in light of the extreme diversity in local level leadership, management, and operational capacity across Indonesia, it will be important to adjust the relative responsibilities appropriately. Some local governments will need to depend primarily on central government administration, while others will be able to play a more expanded role in administration. The 9 percent allocated to cover administration costs should then be reduced and adjusted in a transparent and accountable manner to ensure that each level of administration is adequately motivated compensated for the actual costs of implementation.

Of critical importance is maintaining the major administrative improvements introduced during the initial period of the 1986 property tax reforms. The basic collection system (SISTEP) and the property tax administration management system (SISMIOP) are now effectively functioning through the 106 regional PBB offices, the local governments and the banking sector. The systems are standardized throughout the country, thus maintaining a uniform and equitable system. It will be important in the decentralization process to maintain the advantages of a standardized and uniform administrative process throughout Indonesia. Allowing the proliferation of 300 different property tax administrative systems, standards and procedures would be a terrible step in the wrong direction.

4. Closing Comments

Indonesia is currently in the midst of an exciting decentralization reform. Substantial progress has been made in rationalizing the expenditure and revenue assignments and introducing an effective intergovernmental fiscal transfer system. To promote greater local autonomy, accountability and efficiency, the government is now reviewing the need to increase the level of local own source revenues. The key concern is that local governments must have sufficient revenues over which they can exercise discretion in order to efficiently link local revenue and expenditure decisions.

In the initial fiscal decentralization reforms, changes were introduced to modify the intergovernmental transfer system and shared taxes to provide sufficient funds for local governments to meet their newly assigned expenditure responsibilities. However, local own source revenues remain very limited, producing only between 5 to 15 percent of total local revenues, perpetuating continued dependency on the central government. To address this issue, the government is now exploring options to strengthen local own source revenues. The primary option under serious consideration is how to restructure the property tax to better support the decentralization reform.

In the early 1980s, the Government was faced with the challenge of how best to restructure the entire property tax system into a viable revenue instrument. Through a process of policy simplification and innovative administrative reform, the government established a firm foundation for sustainable, efficient and equitable property tax revenue mobilization. The SISTEP payment point system introduced in 1989 continues to facilitate tax collection, while the property tax administrative management system (SISMIOP) introduced in 1991 continues to successfully integrate data collection, data management, valuation, assessment, billing and collection, enforcement and taxpayer service. The Government's constant challenge has been to ensure that the coverage, valuation and collection ratios are consistently being improved while gradually moving the effective statutory rate to 0.5 percent.

Since 1999, however, the property tax system in Indonesia has been facing another challenge, the challenge of transforming itself into a revenue instrument better able to

support the country's decentralization goals. The key to meeting this challenge will be the granting of tax rate discretion to local governments to enhance their autonomy, responsibility and accountability to their citizens. As argued in this paper, this fundamental change can easily be implemented within the context of the current legal and institutional tax sharing structure. Similarly, international experience would suggest that the total tax proceeds should accrue to the local government, rather than being allocated to both provincial and local governments. This change also can be easily implemented within the current legal structure.

Transferring tax administration completely to local government is more questionable. This paper argues that the basic "co-administration" approach should be maintained in Indonesia. The key is to review the exact responsibility mix between the central and local governments to ensure that the comparative advantages and institutional incentives are tailored appropriately. Over time, local governments may need to assume a larger role in the maintenance of the fiscal cadastre information and in enforcement against noncompliance, while the central government may need to shift its primary focus to providing policy and administrative guidance, technical support, property valuation, monitoring and oversight to ensure that the property tax is uniformly administered throughout Indonesia in a cost effective and equitable manner. Blindly transferring administrative responsibility from the central to the local government could prove disastrous.

Property taxation has historically played a critical role in the financing of Indonesia since the early 1600s. Although the relative role has shifted through time, the property tax continues to offer local governments an important potential revenue source for discretionary funds. In 1986, Indonesia dramatically transformed the property tax into a viable revenue instrument. Since 1999, the property tax is once again under scrutiny for possible reform—this time introducing changes to enable the property tax to better support the decentralization objectives. The major challenge for Indonesia will be systematically introduce appropriate changes to allow the property tax to more effectively support the country's decentralization goals, without forfeiting the major progress that has been achieved to date in the property tax administrative system.

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