The OECD Review of Regulatory Reform in Indonesia is one of a series of country reports carried out under the Regulatory Reform Programme of the OECD, in response to the 1997 mandate by OECD Ministers.

Under this programme, the OECD has assessed the regulatory management policies of 24 member countries, as well as Brazil, China and Russia. The reviews aim at assisting governments to improve regulatory quality – that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. The review methodology has developed over two decades of peer learning. It draws on and is grounded in a number of OECD instruments including: the 1995 Recommendation of the Council of the OECD on Improving the Quality of Government Regulation; the 2005 Guiding Principles for Regulatory Quality and Performance; the 2009 OECD Recommendation on Competition Assessment; the 2012 OECD Recommendation of the Council on Regulatory Policy and Governance; and the 2012 OECD Recommendation for Public Governance of Public-Private Partnerships. This is the first review in this series to be undertaken under the auspices of the OECD Regulatory Policy Committee, which was formed in 2009.

The country reviews follow a multi-disciplinary approach and focus on the government’s capacity to manage regulatory reform, competition policy and enforcement, market openness, and on the regulatory framework of specific sectors against the backdrop of the medium-term macroeconomic situation. Taken as a whole, the reviews demonstrate that a well-structured and implemented programme of regulatory reform can make a significant contribution to better economic performance and enhanced social welfare. Economic growth, job creation, innovation, investment and new industries are boosted by effective regulatory reform, which also helps to bring lower prices and more choices for consumers. Comprehensive regulatory reforms produce results more quickly than piece-meal approaches, and they help countries to adjust more quickly and easily to changing circumstances and external shocks. At the same time, a balanced reform programme must take social concerns into account. Experience shows that the costs of reform can be reduced if reform is comprehensive and accompanied by appropriate support measures.

While reducing and reforming regulations are key elements of a broad programme of regulatory reform, experience also shows that in more competitive and efficient markets, new institutions and regulations may be necessary to ensure compatibility of public and private objectives. Sustained and consistent political leadership is another essential element of successful reform, and a transparent and informed public dialogue on the benefits and costs of reform is necessary for building and maintaining broad public support.

The policy options presented in the reviews pose challenges for each country. However, the reviews are in-depth and every effort is made to consult with and engage a wide range of stakeholders to ensure that the policy options presented are relevant and attainable within the specific context and policy priorities of the country.
To support this review the Indonesian Minister for Finance, the Hon. Agus D W Martowardojo, established a Task Force of Indonesian officials drawn from a number of ministries across the government including, the Ministry of Finance, the Ministry of Trade, the Commission for the Supervision of Business Competition (KPPU), the National Development Planning Agency (Bappenas) and the Co-ordinating Ministry for Economic Affairs. Through the course of this review the OECD held working group meetings with this task force in Jakarta, Indonesia and officials participated in peer discussion with the relevant OECD Committees in Paris.

This review consists of six chapters. The first chapter sets out the social and economic context for the Review of Regulatory Reform in Indonesia. It describes the significant political and economic challenges that have led to the transformation of Indonesia over the past decade. The following chapters each summarise the detailed and comprehensive background reports which were peer reviewed by an OECD committee in Paris with the participation of officials of the government of Indonesia and conclude with policy options for consideration by the government of Indonesia. Market Openness in Indonesia was reviewed by the Working Party of the Trade Committee of the OECD on 22 March 2012. Governance of Public Private Partnerships was reviewed by the OECD Network of Senior Public, Private Partnership Officials on 26 March 2012. Government Capacity to Assure High Quality Regulation in Indonesia, and Regulatory Settings for Ports, Rail and Shipping in Indonesia were reviewed by the Regulatory Policy Committee on 12 April 2012. Competition Law and Policy in Indonesia was reviewed by the Competition Committee on 13 June 2012.

The full background reports are available at www.oecd.org/regreform/backgroundreports.

The OECD Regulatory Policy Committee

The mandate of the Regulatory Policy Committee is to assist members and non-members in building and strengthening capacity for regulatory quality and regulatory reform. The Regulatory Policy Committee is supported by staff within the Regulatory Policy Division of the Public Governance and Territorial Development Directorate.

The OECD Public Governance and Territorial Development Directorate’s unique emphasis on institutional design and policy implementation supports mutual learning and diffusion of best practice in different societal and market conditions. The goal is to help countries build better government systems and implement policies at both national and regional level that lead to sustainable economic and social development.

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Executive summary

Indonesia has overcome substantial challenges to establish the governance institutions of a democratic market-based state

Regulatory reform can be viewed strategically, in both developed as well as developing countries, as one of the core instruments at the disposal of governments for managing the economy, influencing business behavior and implementing social policy. In the current global economic climate – challenged by continuing instability in financial markets on the one hand and the growing fiscal burden for providing key public services such as health, education and social insurance schemes on the other – the modern State will have to utilise its regulatory power wisely if it expects to be smarter if not smaller. In the case of Indonesia, regulatory reform is also part of the country’s ambitious attempt to consolidate democratic policy making, to sharply increase its economic growth to rival other large economies in the region as well as to deliver on key social welfare objectives.

Indonesia is the largest archipelagic state in the world with more than 17 000 islands, around 6 000 inhabited, covering nearly 2 million square kilometers. It has a diverse ethnic and religious population of approximately 241 million. In 2011, Indonesia’s per capita gross domestic product (GDP) at purchasing power parity was USD 4 809.

Following the beginning of the Reformasi era in 1999, Indonesia has made remarkable progress in establishing the central components of a modern democracy from open elections to a free media. Furthermore, “big bang” decentralisation has transformed the government into one of the most decentralised polities in the world. It has also been successful in effecting a robust economic recovery following the deepest output fall in its entire post-independence history in 1998-99. Such systemic transition has also been accompanied by a decline of social violence and separatist disturbances.

Yet the advent of democracy and “big bang” decentralisation has not been sufficient to deliver a competitive market and trade-friendly regulatory regime. The extensive institutional transformation within the Indonesian administration over the past decade is also resulting in a complex if not disorderly policy-making process. Likewise, rapid decentralisation results in much regulatory overlap and inconsistencies across the national economy. Potentially more worrying, decentralisation may also create more opportunities for corruption by increasing the number of decision makers across the Indonesian archipelago with the power to exploit the policy-making process for personal gain.

A commitment to regulatory reform in Indonesia is necessary now to support continuing economic development

The formulation and implementation of the ambitious and comprehensive Master Plan for Economic Development (MP3EI) is one of the government’s responses to these political and economic pressures. It is a response rooted in open markets and private investment especially in the form of public-private partnerships (PPPs). The Master Plan intends to create new growth centers based on regional economic potential as well as increased connectivity between six Indonesian economic corridors. Total investment of the plan is USD 445 billion (with roughly half accounting for new infrastructure) by 2025.
While the scale and ambitions of the Master Plan have been rightly applauded, a measure of scepticism surrounds its tight implementation schedules and the enormous private sector funding it requires – let alone government capacity to effectively oversee the delivery of the plan. Likewise, the Master Plan necessitates a major effort at producing a transparent and comprehensive regulatory framework for a number of infrastructure sectors and the streamlining of the policy-making process across a range of government ministries/agencies (hereinafter “agencies”).

The emergence of the Association of Southeast Asian Nations (ASEAN) Economic Community is also putting pressure on Indonesia to accelerate the bureaucratic, administrative and regulatory reforms needed to ensure its competitiveness both in Southeast Asia and globally. Being the largest ASEAN economy and its most populous country, Indonesia has much to gain from being at the centre of the ASEAN Economic Community. There have been a number of signals indicating Indonesia’s seriousness to meet the ASEAN free trade objectives. Yet the work that remains to be done to harmonise Indonesia’s regulatory regime is also a matter of great importance in the context of accelerated ASEAN economic integration by 2015.

Regulatory reform is also a key element of Indonesia’s regional commitment to the Asia-Pacific Economic Cooperation (APEC). The Honolulu Declaration signed by APEC leaders in 2011 commits Indonesia to adopt a whole-of-government approach to regulatory management, assess the impact of regulation, and promote public consultation practices. Indonesia is required to report on the implementation of these practices in 2013, when it will chair APEC.

The policy findings in this review are aimed at assisting the government of Indonesia to achieve its reform objectives

This report follows a multidisciplinary review of regulatory reform in Indonesia drawing on engagement with officials within the government of Indonesia and the combined experience of OECD committees. Through this Regulatory Reform Review of Indonesia, high level officials from the government of Indonesia have joined OECD committees to participate in a peer review process with counterparts from OECD countries to examine and propose reform opportunities to assist the government to achieve its economic and social policy goals. This was supported by working group meetings within Indonesia, with a task force of government agencies established by the Minister for Finance. In this process, the government of Indonesia and the OECD also involved Indonesia’s multilateral and bilateral development partnerships and consulted with non-government actors. The process of this review provides a basis for further engagement and dialogue with the OECD to support the government of Indonesia in the implementation of the findings and recommendations where it is considered most useful.

The government of Indonesia faces considerable challenges in establishing governance arrangements to manage the consequences of decentralisation and the goal of connecting the archipelago. This report identifies a number of steps that the government of Indonesia should take to realise economic opportunities through improvements to regulatory management, the effective application of competition policy, consistent policies on market openness and getting the regulatory settings right for the facilitation of private investment in infrastructure. Each chapter covers one of these significant policy areas, and identifies relevant policy findings for consideration by the government of Indonesia.

Taken together, regulatory reform is set to be the next major domain of institutional development, and not just the province of technical experts and lawyers. Regulatory reform should now become central to the economic and institutional reform agenda. This will allow Indonesia to realise the economic dividend from political democracy, to rationalise the regulatory complexities from decentralisation and to support the investment climate that is needed to achieve the goals of the Master Plan and to take full advantage of ASEAN economic integration. How well and how quickly this is done may well provide the key motivational force for Indonesian democratic consolidation and sustained economic growth in the coming decades.
Regulatory reform will underpin the implementation of the Master Plan for Acceleration and Expansion of Indonesia’s Economic Development, 2011-2025

The ambition of the government of Indonesia stated in the Master Plan is to “create an independent, well-developed equitable and prosperous society.” Its strategy is to use the Master Plan to capitalise on the huge economic potential associated with its geographical location within East Asia to maintain real year on year economic growth above 7%, and to transform Indonesia into a developed country by 2025. Indonesia’s considerable assets include its position as the fourth most populous country in the world, abundant natural resources and proximity to the world’s fastest growing markets. “Indonesia aims to position itself as one of the world’s main food suppliers, as a processing centre for agricultural, fishery and natural resources as well as a center for global logistics by 2025 or earlier” (Republic of Indonesia, 2010).

The challenges to this ambition are considerable. Chief among these is the provision of new infrastructure including telecommunications, airports, seaports, railways and roads, to reduce transportation and logistics costs, connect regions and underpin economic development. The strategy for delivery of this infrastructure firmly depends on regulatory reform to attract greater private sector investment. The Master Plan states:

Regulations must be clear, and without possibilities for misinterpretation, in order to encourage trust and maximum participation from investors to build much needed industries and infrastructure. In order to achieve the above objectives, all existing regulatory frameworks must be evaluated, and strategic steps must be taken to revise and change regulations. (…) co-operation between the government and the private sector under the public-private partnerships (PPP) scheme is expected to bring in much needed investments (Republic of Indonesia, 2010, p. 22).

In addition to regulatory reform, the Master Plan depends on the development of a more effective bureaucracy supported by strong institutions. This reflects an acknowledgement that the conditions for economic development will not follow automatically from a central planning model, but depend on institutional transformation within the bureaucracy to facilitate economic and market opportunities. It calls for a change in the mindset of officials and leadership within the administration. The state has a core role to play in facilitating the success of the public-private partnership model, eliminating regulatory and administrative barriers to the formulation of new industries and to facilitate the participation of existing small businesses in the formal economy.

Regional integration in ASEAN and APEC both require and underpin liberalisation of domestic markets

In the past economic liberalisation and tariff reductions have been driven by competitive pressures for regional economic integration and enhanced regional trade. The past decade has seen a gradual strengthening of ASEAN intra-regional integration. Total ASEAN trade reached USD 1.5 trillion in 2009 accounting for 25% of total trade, up from 22% in 2000 and interregional inflows of foreign direct investment (FDI) have increased dramatically from 3% of the total in 2000 to 20% by 2008. There is an acknowledgement that integrating the regulatory environment among ASEAN member countries will reinforce economic integration. In 2006, ASEAN countries developed a region-wide blueprint to realise single market integration of the ASEAN Economic Community by 2015. More immediately the government of Indonesia aims to reach ASEAN logistic integration by 2013. Despite some achievements in rule harmonisation, Indonesia still lags behind some of its neighbours, including Malaysia, Singapore, Thailand and Vietnam in the implementation of rule harmonisation in priority sectors.
The government should build on existing systems to improve the co-ordination of regulatory management practices...

The government of Indonesia has made a commitment to enhance the business and investment climate and promote exports. Key measures have included the Investment Climate Policy Package (Presidential Instruction 3/2006) and the Policy to Accelerate the Development of the Real Sector and Empowerment of Micro, Small and Medium Enterprises (Presidential Instruction 6/2007). Moreover, in 2004 it introduced a common approach to the formulation of laws and regulations and in 2009 and 2011 consolidated this framework, focusing specifically on sub-national regulations that have the potential to affect the investment climate. Law 12/2011 guides the formulation of laws and regulations, including requirements for forward planning of new regulation, mandatory **ex ante** analysis for bills and draft sub-national regulations and provision for the involvement of external experts in regulatory consultations. Law 28/2009 on Sub-national Taxes and Charges also gives the national government strengthened powers to review and repeal sub-national regulations that contradict higher order regulation.

However, overall the system is weakened by being fragmented and uncoordinated. Following decentralisation there was a proliferation of illegal sub-national government taxes and charges adversely affecting the local investment climate and hindering internal market openness. Moreover, sub-national governments often did not share information on regulations that imposed taxes and charges, with the consequence that the national government could not effectively oversee regulatory decision making. The Minister of Finance has examined approximately 13 200 sub-national regulations and recommended to the Minister of Home Affairs that approximately 4 900 (37%) be invalidated. However, only 1 800 (36%) of those recommended to be invalidated have been revoked.

Tracking regulations is made more difficult due the absence of a single comprehensive and integrated electronic database of government laws and regulations accessible within a user-friendly portal. This is necessary to support efforts by the government of Indonesia to cap the proliferation of sub-national laws and regulations, and to ensure their coherence with higher order regulation. It would also facilitate more effective dissemination and compliance with laws and regulations.

... and establish clear policy frameworks and institutional responsibilities for regulatory reform

To become more effective the overall framework for the formulation of laws and regulations requires an explicit whole-of-government approach for regulatory policy, including: responsibility for co-ordination and oversight of regulatory policy; a commitment to assess the cost-benefit of new regulatory proposals and existing regulations, and; the effective implementation of the principles of transparency and public consultation in regulatory decision making.

An explicit regulatory policy would define the process by which the government of Indonesia decides whether to use regulation to address a policy problem through evidence-based decision making. The basis for a whole-of-government policy can be found in Law 12/2011 on the Formulation of Laws and Regulations as well as the National Medium-term Development Plan (RPJMN) and Master Plan. These plans, however, focus on sectoral regulation rather than the regulatory management system more generally.

Adopting a “whole-of-government” policy would enable the government to take into account the dynamic interplay between the different institutions involved in the regulatory process and overcome obstacles from the operation of functions in silos. A policy based on international best practice and the [2012 OECD Recommendation of the Council on Regulatory Policy and Governance](http://www.oecd.org/reg jsonString)

It should be articulated through a political commitment to direct public sector entities – including at sub-national levels – to control regulation. It should build upon the framework for the formulation of laws and regulations in Law 12/2011 which provides flexibility to the executive to enhance regulatory management systems at both national and sub-national levels through the use of presidential and government regulations.
While Law 12/2011 imposes an obligation on the executive branch to conduct public consultation on bills and draft sub-national regulations there are no formal guidelines for consultation with affected parties in the regulatory decision-making process. Establishing such guidelines would improve opportunities for the public to contribute to the formulation of regulatory proposals and enhance trust in government by increasing standardisation of citizens’ experiences participating in different public consultation processes. The law also requires the preparation of academic studies, but these do not explicitly require a quantitative assessment of the economic impact of regulations and are not well integrated in discussions within the executive, in public consultations or deliberations within the legislature. Reforms to the use of the academic study could provide the basis for better regulatory impact analysis and public consultation.

The key obstacle to effective co-ordination appears to be that there is no single entity in the government of Indonesia that is accountable for ensuring that laws and regulations serve whole-of-government policy objectives. Establishing a single public sector entity charged with regulatory oversight close to the centre of government that is tasked with promoting evidence-based decision making and co-ordinating with the other entities in government is key to ensuring that regulation serves a whole-of-government policy. This function could most practically be taken up by the Co ordinating Ministry for Economic Affairs which currently plays a leading role in co-ordinating regulatory reform from a sectoral perspective.

**A stronger application of competition law and policy will provide further economic opportunities for Indonesia**

Prior to democratic reforms Indonesia allowed excessive market concentration and dominance to emerge in multiple markets. The creation of the Commission for the Supervision of Business Competition (KPPU), and the Indonesian competition law responded to demands for democracy, more equal economic opportunity and improved economic performance. Competition law and policy have played a substantial role in underpinning Indonesia's economic achievements since 1999. However, a number of problems with the original legislative framework now require legislative amendments and competition law and policy is not being leveraged as effectively as possible, suggesting that it has become less of a priority of government. For example, the government has been accepting a smaller proportion of the KPPU recommendations which minimise anti competitive impacts in proposed legislation.

Indonesia's legacy means that programmes of legislative reform to remove anti competitive provisions are of particular importance to the country’s economy. A review by the United Nations Conference on Trade and Development (UNCTAD) found that “most competition problems in Indonesia stem from government actions”. More systematic involvement of the KPPU in the legislative process is necessary to ensure timely identification of all legislative proposals with potentially significant competitive impacts. If the Co ordinating Ministry for Economic Affairs were to notify the KPPU of all new legislative proposals when an academic study is commenced, the KPPU could advise on the design of proposed legislation that affects business and/or consumers. In addition, the government should endorse clear principles to identify when licensing is appropriate and when other forms of regulation are sufficient. Particular priority should be given to reviewing and reforming existing legislation to remove unnecessary regulatory impediments to competition, with a specific focus on business licences.

**Effective co-ordination of competition assessment will avoid future problems arising, particularly in the development of new infrastructure facilities and business licensing**

It is especially important to ensure that laws promote competition in the priority area of major infrastructure investment. To consider whether any agreements might breach the competition law, the KPPU should be involved in its capacity as a competition advocate whenever significant new economic investment opportunities are offered by any relevant government agency, in order to exercise its jurisdiction.
The incumbent operators in the Indonesian ports and rail industries are substantial government-owned businesses that in many cases hold dominant positions in their respective markets. Indonesia requires considerable investment in new transport infrastructure and any tenders, licences, land releases or other opportunities to develop new facilities need to be allocated with a view to fostering new competition. A particular case in point is that initiatives to introduce a “hub port” policy in Indonesia should not create statutory monopolies. In addition, in its law enforcement role, the KPPU should give particular attention to the domestic shipping sector to ensure that cartels do not emerge on domestic routes, particularly on any routes where foreign competitors have been required to exit.

**Clarification of the powers the KPPU and stability in its leadership will improve its effectiveness**

The Competition Law (Law 5/1999) should explicitly define the investigative powers of the KPPU to provide for dawn raid powers, powers to demand documents and information and the ability to require a witness to answer questions. The Competition Law would also be improved by the addition of a general prohibition on anti-competitive conduct. The current time limits for decisions, of 30 or 60 days in most cases, are shorter than those found in most OECD countries, particularly for abuse of dominance cases, where a detailed investigation in a complex case may take a year to complete. Indonesia should maintain its existing deadlines only for merger matters where investigations need to be completed reasonably quickly to enable the transaction to proceed. For other matters it should consider extending the deadlines for preliminary and final KPPU examination, particularly in complex abuse of dominance cases, to up to 12–18 months. “Stop the clock” mechanisms, or triggers for fixed extensions of time in certain circumstances would also provide the KPPU with greater flexibility. Providing extra time for investigations will become more important if the KPPU’s investigatory powers are extended.

The appointment rules for the KPPU undermine continuity and stability and make it difficult to address long-term, strategic issues. All the members of the KPPU are appointed for the same fixed five-year term, renewable only once. A new chairperson and vice chairperson are elected by the members of the Commission every year. To overcome problems associated with the leadership leaving office at the same time, the appointments of the chairperson and vice chairperson should be for longer than one year, and the term of members should be staggered.

**The Indonesian economy has benefited from trade liberalisation measures**

FDI in Indonesia has been robust. Inward stocks as a share of GDP reached a 7 year high in 2009 at 20% of GDP, in the worst year of the global economic crisis. In 2010, however Indonesia’s FDI performance lagged most of the other ASEAN economies, (including Thailand 40% of GDP and Vietnam 62% of GDP) suggesting that there is significant scope to further boost investment. Furthermore, FDI is not spread equally across the archipelago. GDP growth rates and Indonesia’s share of world trade remain below pre-1997 levels, and Indonesia has experienced a steady deterioration in its terms of trade.

Indonesia has lost competitiveness in some traditional export sectors, such as textiles and wood, but is increasing its competitiveness on world markets in other sectors, such as motor vehicles. Services trade is less developed and concentrated in a few sectors but business services are also increasingly important. Trade patterns for both goods and services have shifted markedly toward Asian and developing countries, in part due to the rise of production networks and ASEAN regional integration.

The commitment to build the ASEAN Economic Community by 2015 is pushing the reform effort forward in Indonesia and other countries in the region. As a result, tariff liberalisation has been deep and successful, with falling rates of effective protection. Liberalisation in services is less advanced however, and recent regulatory changes are causing concern among some foreign providers of services, especially in the logistics and telecommunications sectors. Reform of the regulation of services provides potential opportunities to boost domestic productivity and improve trade performance.
However, renewed emphasis on promoting market openness is needed to reverse deteriorating terms of trade

The establishment of the 2007 Investment Law (Law 25/2007) and its implementing regulations represented a significant step toward improving the investment environment in Indonesia, but important ambiguities remain regarding the application of the law. The use of non-tariff measures (NTMs) appears to be becoming more prevalent which is a worrying development given that these measures are less transparent and more easily influenced by special interests. Not all NTMs have a clear policy objective that is in Indonesia’s overall economic interest. An increase in NTMs undermines Indonesia's overarching intent to be more open, and creates less predictability. It also reduces the domestic economy's access to imported inputs, which play a critical role in connecting global value chains and driving export performance.

The authority to use non-tariff measures is spread across a wide range of ministries and government agencies, which makes a whole-of-government approach to policy making in this area challenging. More than 13 government agencies have authority over some type of NTM in Indonesia. The Ministry of Trade has the authority over the largest number (58.4%), followed by the quarantine agencies (18.5%), the National Food and Drug Control Agency (BPOM) (15.1%) and the Ministry of Health (3.8%). Other agencies issue NTMs related to product standards, public safety and environmental protection (Preparation Team INSW, 2009). The absence of a process to ensure co-ordination among agencies creates ample scope for contradictory and overlapping measures that can negatively impact the economy.

Other restrictions include local content requirements, limitations concerning state-owned enterprises, pre-shipment inspection and port limitations for imports of certain products. Local content requirements in government procurement and restrictions on ports of entry appear to have particularly increased in the past few years. The government has issued three presidential decrees on Indonesia’s Investment Negative List. Although it held consultations with the private sector during the drafting of the main body of the regulations, problems with the implementing language remain and cause uncertainties for investors. This reflects the fact that the drafting of economic regulations for policies that restrict market behaviour can be extremely difficult. There may also be a problem with the regulatory process itself since the final drafts of the implementing regulations, such as Presidential Regulation 36/2010, were never submitted for broad public comment.

Better co-ordination is necessary to ensure that regulatory measures are not trade restrictive

To conduct proper evaluations of regulations, stronger co-ordination among line ministries is critical. In recent years, there have been several prominent examples of new regulations that contradict higher order laws and regulations, thus creating regulatory uncertainty. Such co-ordination is particularly important in the context of the decentralisation of authority and the increasing influence of the Peoples’ House of Representatives (DPR) in regulatory policy. As a result of these changes, line ministries now seem to have more control over the policies within their sectors and sectoral interests have greater political sway. This leads to potential protectionist tendencies that can only be offset by independent evaluations that take an economy-wide approach to policy making.

Independent and objective evaluations of policies from an economy-wide perspective are not currently institutionalised in Indonesia. The development of well-defined criteria to guide the evaluation of significant regulations is necessary to overcome the fragmentation in the policy-making process which allows special interests to exert influence. This illustrates the need for an institution within the existing regulatory framework to conduct these types of evaluations, with a view to significantly enhance inter-ministerial co-ordination and improve regulatory outcomes. Furthermore, systematic public consultation involving a broad base of stakeholders would enhance transparency and avoid unintended trade restrictions.
Better co-ordination between the central government and the regions is also critical to ensuring the overall national interest. While significant steps have been taken to create one stop shops for the many licences needed to start and operate a business in Indonesia, more effort is needed to streamline the licences themselves. In particular, an objective review of local laws and regulations is needed to ensure that sub-national licences have clear policy objectives and are not contradictory or duplicative.

The right regulatory settings are needed for efficient competition in the delivery of services in the ports, rail and shipping sectors

An efficient and competitive logistics sector is necessary to support economic development and integration across the archipelago. Indonesia’s overall performance on the World Bank’s Logistics Performance Index is in line with the average for countries at its level of development. However, the quality of trade and transport related infrastructure, particularly relating to the operational performance of and the level of investment in Indonesia’s port sector, is deficient. Many of Indonesia’s main ports are already running at maximum capacity and anticipated high growth rates will result in serious congestion unless urgent action is taken.

The government of Indonesia has made significant advances in developing and implementing improved regulatory frameworks for competition and efficiency in logistics. Recent changes to the 2008 Law on Shipping and the 2007 Law on Railways have the potential to radically transform Indonesia’s rail and maritime industries. The broad framework established by these laws reflects the lessons that have been learned throughout the world over the last few decades, introducing concepts such as the separation of regulatory and operational functions, seeking to foster increased competition and encourage private sector participation.

These regulatory frameworks are fundamentally sound. However, in some cases there is a contradiction between the specific provisions of the laws or the supporting regulations and the broad strategic direction. A more detailed articulation of the strategic directions is required to provide an effective platform for improved governance and increased efficiency.

The 2008 Law on Shipping has separated the functions of the port operator and the port authority with responsibility for regulation. This removed the legislated monopoly of Indonesia’s port corporations on commercial ports and opened up the sector to other operators from the private sector. This is based on the standard Northern European and Australian landlord model which separates the port authority from the operators of the port functions. However the government must establish new port authorities with adequate resources and expertise to manage ports effectively. It should clarify and integrate planning responsibilities for the ports sector among various levels of government. The legal responsibilities of the new port authorities must be made clear and measures put in place to ensure that the incumbent port operators do not abuse their monopoly power. Shipper choice should be maintained by continuing to permit the direct export and import of international cargoes through a large number of ports across Indonesia.

The 2008 Law on Shipping reversed previous liberalisation measures, reintroducing cabotage requirements and formally requiring that all foreign flag vessels operating in Indonesian domestic trades be replaced by or reregistered as Indonesian flag vessel and use Indonesia crews. It will be important that the application of this law does not undermine Indonesia’s commitment to work towards the development of a single integrated ASEAN shipping market.

The greatest opportunities for expanding the share of the freight market handled by rail are in the development of lines servicing commodity exports, particularly those linking coal mines to ports. The 2007 Law on Railways abolished the state-owned monopoly, opening it for private and local government investment. However, implementation of the vertical separation of the rail infrastructure management and above rail operations has been slow. Guidelines covering safety, technical standards and interconnection are also required to facilitate sub-national government or private sector investment.
Good governance of public-private partnerships is essential to secure private investment in infrastructure

Infrastructure investment as a percentage of government expenditure in Indonesia decreased sharply following the Asian crisis from just below 10% to about 4%. Indonesia has a serious infrastructure deficit and the government acknowledges that a considerable investment in infrastructure facilities will be required to address the backlog and secure the country's future economic development. The Master Plan focuses on increasing connectivity in Indonesia through more use of private investment through PPPs in toll roads, rail and power generation. Accordingly, getting the conditions right to facilitate the procurement of PPPs is a necessary threshold issue for addressing infrastructure investment.

Before the reform process started in the early 2000s, most infrastructure projects not undertaken by the central, provincial or local government were awarded through direct appointment to either SOEs or private firms. The government of Indonesia has now addressed a number of complex issues with the procurement of PPPs, including defining the policy and legal framework, identifying a pipeline of projects, and establishing dedicated units with specialist expertise and frameworks to guide the selection of projects. The process and principles of procurement through competitive bidding were established in Presidential Regulations 67/2005, and improved by Presidential Regulations 13/2010 and 56/2011. Potential projects were notified through a series of infrastructure summits, and in 2011 the National Development Planning Agency (Bappenas) “PPP Book” covered an extensive list of potential and priority projects, including thirteen that were deemed ready for offer.

However, the system continues to be hampered by administrative delays, and problems with the co-ordination of responsibility for the identification and procurement of PPP projects. Development of the necessary expertise remains a key issue for the government. By 2011 the contract for the Central Java power plant was the only project to have met the Presidential regulations and passed through the PPP procurement cycle. Access to land is also an obstacle, though a new law was passed in 2011 to facilitate the expropriation of land for public works. Indonesia's experiences are not unique. Countries using PPPs have found it necessary to progressively refine their systems based on lessons learned. This report suggests a number of policy findings, based on the principles in the 2012 OECD Recommendation for Public Governance of PPPs, which Indonesia should pursue to support its ambitions to deliver infrastructure through a reliance on PPPs.

This involves political leadership, administrative co-ordination and a focus on securing value for money

To overcome bureaucratic inertia and prioritise projects the government should establish a Presidential Committee for Infrastructure Projects. This would ensure that Bappenas, the Ministry of Finance, the Co-ordinating Ministry for Economic Affairs and relevant line ministries, align their infrastructure decisions with the government’s overall strategy and objectives. The Presidential Committee could develop a shortlist of relatively straight-forward PPP projects in order to get the PPP programme moving.

The Ministry of Finance should play a key role at all gateway stages of PPP projects. It should act as a gate-keeper providing scrutiny and approval of all significant infrastructure investment decisions be these PPP or non-PPP projects. The Ministry of Finance should also take a key role in strengthening capacity within the procuring agencies to better plan the preparation of feasibility studies and tenders.

PPPs should only be chosen if they represent more value for money than other forms of infrastructure delivery. The government should establish clear “value for money” criteria as the basis on which to select projects, involving a whole-of-life approach that considers the present value of future costs and benefits. It should use a public sector comparator or equivalent benchmark/reference model against which it compares bids received. The role of state-owned enterprises with regards to PPPs (whether the SOE the public or private party) should be carefully assessed in order to avoid a conflict of interest and a level playing field. Unsolicited bids should be avoided or at least subjected to a higher level of scrutiny and donor funded projects should also comply with the gateway and budgetary process.
Government has a key role in co-ordinating policy to connect Indonesia to markets

Regulatory reform must be high on the political agenda of Indonesia to ensure that it achieves the goals of building responsive and open regulatory systems and is able to create competitive domestic markets. Indonesia is a large and geographically diverse country that relies heavily on the export of natural resource-based products. Geographical constraints and infrastructure bottlenecks impose high logistics costs which fragment the domestic market and hamper economic growth. To achieve the rates of growth needed to create new jobs and allow Indonesia to reach its growth potential, it needs to better integrate its domestic markets. This would allow greater returns to scale and scope, improve efficiency, and create more competitive markets so that Indonesia can move into higher value added products that encourage more innovation among domestic firms. Linking Indonesia to world markets will spur trade, which in turn will help boost domestic production, with positive knock-on effects for employment and domestic consumption.

Indonesia should support this goal of integration by ensuring that regulatory frameworks support the efficient operation of markets. This will require strong leadership and co-ordination and will need clear allocation of responsibilities among senior officials in the administration based on a clear statement of policy. A stronger focus on policy co-ordination within government to ensure that regulation facilitates competitive access to Indonesian markets will support the continued creation of economic opportunities and help Indonesia realise its high growth potential.

The OECD policy findings should be tested and further developed in conjunction with the government of Indonesia

Through this review, delegates to the OECD committees have learned more about the challenges that Indonesia faces and the government’s efforts to meet them. It has built a basis for further engagement and dialogue with the OECD to support the Indonesian government in the implementation of the findings and recommendations where it is considered most useful. It would also be prudent to review the progress of the implementation of the findings of the review after three to four years.

The process of review has also identified a number of notable policy areas that have not been examined, or have only been touched upon, where further policy evaluation is necessary. Potential areas for further examination include: drawing on the expertise of the Network of Senior PPP officials to apply the 2012 OECD Recommendation for the Governance of Public-Private Partnerships to an evaluation of PPP performance in specific sectors, and the role of state-owned enterprises; applying the OECD Principles for Enhancing Integrity in Public Procurement to assess the challenges facing traditional government infrastructure procurement; assessing the role and performance of independent regulators in infrastructure sectors against OECD best practice and the 2012 OECD Recommendation of the Council on Regulatory Policy and Governance; and a diagnostic assessment of the public governance frameworks of the public administration in Indonesia to look more closely at areas such as policy development, human resource management, e-government, as well as strategic planning and the link to budget management.