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INDONESIA

STRENGTHENING CO-ORDINATION AND CONNECTING MARKETS



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OECD Reviews of Regulatory Reform: Indonesia 2012

STRENGTHENING CO-ORDINATION AND CONNECTING MARKETS



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Foreword

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.*

Acknowledgements

The Regulatory Reform Review of Indonesia reflects significant contributions from a number of participants in the government of Indonesia, with special acknowledgments to the leadership of the Ministry of Finance, and the participation in the Indonesian Task Force of the Ministry of Trade, the National Development Planning Agency (Bappenas), the Commission for the Supervision of Business Competition (KPPU), the Co-ordinating Ministry for Economic Affairs, and the Ministry of Law and Human Rights. As an input to the review, the Indonesian Ministry of Finance and the OECD organised three working group meetings with this task force in Jakarta in February 2011, October 2011 and February 2012. Valuable contributions were also received from the delegates to the OECD Regulatory Policy Committee, the Competition Committee, the Working Party of the Trade Committee, and the OECD Network of Senior Public-Private Partnership Officials.

The Regulatory Reform Review of Indonesia was made possible with the financial support of the Australian Government, through the Australian Agency for International Development (AusAID), the Government of the United Kingdom through the Prosperity Fund – Indonesia Programme, and from the Ministry of Economic Affairs, Agriculture and Innovation in the Government of the Netherlands.

The project was managed by Gregory Bounds, Deputy Head of the Regulatory Policy Division under the supervision of Nick Malyshev. Dr Satish Mishra, consultant provided the political and economic overview. James Sheppard, OECD Policy Analyst, prepared the chapter on regulatory governance. The competition chapter was prepared by a team from the OECD Competition Policy Division including, Nicholas Taylor, Principal Administrator, Jung-Won Song, Senior Project Manager and Hilary Jennings, Head of Global Relations for Competition, together with Rex Deighton-Smith, consultant. The Market Openness chapter was prepared by Molly Lesher, OECD Trade Policy Analyst, with input from Stephen L. Magiera, consultant. The chapter on the Regulation of Ports, Rail and Shipping, was prepared by Steve Meyrick, consultant. The chapter on the governance of public-private partnerships; policy process and structure, was prepared by Ian Hawkesworth, co-ordinator of the OECD Network of Senior PPP Officials and Philippe Burger, Professor of Economics at the University of the Free State, South Africa. The document was prepared for publication by Jennifer Stein.

The country reviews on regulatory reform are co-ordinated by the Regulatory Policy Division, headed by Nick Malyshev, in the Directorate for Public Governance and Territorial Development, under the responsibility of Rolf Alter, Director. The horizontal programme on regulatory reform is led by the OECD Regulatory Policy Committee.

Table of contents

Acronyms and abbreviations 11

Executive summary 15

Résumé 27

Chapter 1. **Setting priorities for reform and development in Indonesia** 41

Introduction 42
1.1. The government of Indonesia 2000-2010 reform agenda 42
1.2. Economic recovery and current regulatory priorities 50
1.3. Conclusion 65
Bibliography 68

Chapter 2. **Government capacity to assure high quality regulation** 71

Introduction 72
2.1. Developing a whole-of-government approach to regulatory policy 72
2.2. Regulatory decision-making procedures and the use of *ex ante* impact assessment 84
2.3. Openness of regulatory decision making 94
2.4. Policy options for consideration 99
Bibliography 104

Chapter 3. **Competition law and policy** 107

Introduction 108
3.1. Competition advocacy: Competition reviews of new and existing legislation 109
3.2. The transport sector: Competition's contribution to connectivity 114
3.3. Competition law 116
3.4. Institutional arrangements for the KPPU 123
3.5. Policy options for consideration 125
Bibliography 129

Chapter 4. **Market openness** 131

Introduction 132
4.1. The current trade and economic environment in Indonesia 132
4.2. Recent developments in trade and investment policy 135
4.3. The trade and investment policy-making process in Indonesia 141
4.4. Integrating Indonesia's domestic market and linking it to world markets 145
4.5. Policy options for consideration 149
Bibliography 155

Chapter 5. **Regulatory and competition issues in ports, rail and shipping** 157

Introduction 158
5.1. Ports 158
5.2. Shipping 167
5.3. Rail 170
5.4. Policy options for consideration 176
Bibliography 178

Chapter 6. **Public-private partnership governance: Policy, process and structure** 183

Introduction 184
6.1. Defining PPPs and the challenges around it 184
6.2. The changing scene for PPPs in Indonesia 189
6.3. The PPP contract award cycle and the role of the different institutions in Indonesia 192
6.4. Establish a clear, predictable and effective institutional framework supported by competent and well-resourced authorities 195
6.5. Ground the selection of PPPs in value for money 198
6.6. Use the budgetary process transparently and ensure the integrity of the procurement process 206
6.7. Policy options for consideration 209
Bibliography 211

Tables

1.1. Economic projections 50
1.2. Internet usage in Indonesia 63
2.1. The government of Indonesia's hierarchy of laws and regulations 74
2.2. Extracts from Indonesia's 2010-14 National Medium-term Development Plan relating to regulatory reform and its annual monitoring report 76
2.3. Indonesia's Secretariat of State standards for the formulation of laws and regulations 80
2.4. Indonesian Co-ordinating Ministry's portfolios 81
2.5. Responsibilities and powers of Indonesia's national public sector entities involved in ensuring regulatory quality 86
2.6. Selected government of Indonesia national databases on laws and regulations 98
4.1. Selected indicators, Indonesia and Southeast Asia, 2010 133
4.2. Key licences and permits for starting a manufacturing business in Indonesia 147
5.1. Indonesia: Port corporations 160
6.1. What percentage of public sector infrastructure investment takes place through PPPs (2010)? 189
6.2. Do the following make PPPs more attractive in comparison to traditional infrastructure procurement? 191
6.3. Do the following make traditional infrastructure procurement more attractive in comparison to PPPs? 191

Figures

1.1. Indonesia's annual growth, percentage of GDP 45
1.2. Real GDP growth and per capita GDP growth in Indonesia, 1960-2010 51
1.3. Contributions to GDP growth in Indonesia, 2006-10 51
1.4. FDI inflows in Indonesia 52
1.5. The development planning hierarchy 54
1.6. The MP3EI plans for Indonesia's gross domestic product 59
1.7. Indication of infrastructure investment for the MP3EI 59
2.1. Government of Indonesia procedures for harmonising bills, draft government and draft presidential regulations 92
4.1. Evolution of GDP per capita and trade as a share of GDP in Indonesia 134
4.2. Inward stock of FDI as a share of GDP 135
5.1. Revised governance arrangements for the strategic ports of Indonesia 160
6.1. An institutional setup for PPPs in Indonesia 200

Acronyms and abbreviations

ADB	Asian Development Bank
AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
APEC	Asia-Pacific Economic Co-operation
API	Automatic import licences
ASEAN	Association of Southeast Asian Nations
Bappedas	Sub-national Development Planning Agencies (*Badan Perencanaan Pembangunan Daerah*)
Bappenas	National Development Planning Agency (*Badan Perencanaan Pembangunan Nasional*)
BCC	Business cost calculator
BKPM	Investment Co-ordinating Board (*Badan Kerjasama dan Penanaman Modal*)
BPKP	Finance and Development Supervisory Board (*Badan Pengawasan Keuangan dan Pembangunan*)
BPOM	National Agency for Food and Drug Control (*Badan Pengawa Obat dan Makanan*)
BRICS	Brazil, Russia Federation, India and People's Republic of China
CEPT	Common Effective Preferential Tariff
DGST	Director General of Sea Transport
DPR	Finance and Development Supervisory Board (*Badan Pengawasan Keuangan dan Pembangunan*)
FDI	Foreign Direct Investment
GCA	Government contracting agency
GDP	Gross domestic product
IBRD	International Bank for Reconstruction and Development
IDR	Indonesian Rupiah
IIGF	Indonesian Investment Guarantee Fund
IMF	International Monetary Fund
IMO	Infrastructure maintenance and operation
INSW	Indonesian National Single Window
INTR	Indonesian National Trade Repository
IP	Producer Importer Licence

IPC	Indonesian Port Corporations
IT	Registered Importer Licence
KADI	Indonesian Anti-dumping Committee (*Komite Anti Dumping Indonesia*)
KADIN	Indonesian Chamber of Commerce (*Kamar Dagang dan Industri*)
KAN	National Accreditation Committee (*Komite Akreditasi Nasional)*
KKPPI	National Committee for the Acceleration of Infrastructure Provision (*Komite Kebijakan Percepatan Penyediaan Infrastruktur*)
KNT	Team for Non-Tariff Measures (*Komite Non Tarif*)
KPK	Indonesian Corruption Eradication Commission (*Komisi Pemberantasan Korupsi*)
KPPOD	Committee for the Monitoring of Regional Autonomy Implementation / "Regional Autonomy Watch" (*Komite Pemantauan Pelaksanaan Otonomi Daerah*)
KPPU	Commission for the Supervision of Business Competition (*Komisi Pengawas Persaingan Usaha*)
LARF	Land Acquisition Revolving Fund
LPR	Limited public railway
MoF	Ministry of Finance (*Kementerian Keuangan*)
MoHA	Ministry of Home Affairs (*Kementerian Dalam Negeri*)
MP3EI	Master Plan for Acceleration and Expansion of Indonesia's Economic Development, 2011-2025 (Master Plan *Percepatan dan Perluasan Pembangunan Ekonomi* Indonesia)
NGO	Non-governmental organisation
NPIK	Specific Importer Identification Code Number (*Nomor Pengenal Importir Khusus*)
NPMP	National Port Master Plan
NTM	Non-tariff measures
P3CU	Public-Private Partnership Central Unit, housed in Bappenas
PDAM	Sub-national government Water SOE (*Perusahaan Daerah Air Minum*)
PDF	Project Development Fund
Pelindo	Port corporation (*Pelubahan Indonesia*)
Pelni	Indonesian National Shipping Line (*Pelayaran Nasional Indonesia*)
PJKA	Perusahaan Jawatan Kereta Api
PMU	Project management unit
Prolegda	Sub-national governments programmes (*Program Legislati Daerah*)
Prolegnas	National Legislative Programme (*Program Legislati Nasional*)
PSC	Public sector comparator

PSO	Public service obligation
PT	Limited liability company (*Perusahan Terbatas*)
PT IIFF	Infrastructure Financing Facility
PT SMI	Sarana Multi Infrastruktur, a conduit to channel funds into the PT IIFF
Renstra	(Medium-term) Strategic plan (*Recana strategis*)
RIA	Regulatory impact assessment
RIS	Regulatory Impact Statement
RMU	Risk Management Unit, housed in the Ministry of Finance
RPJMN	National Medium-term Development Plan (*Rencana Pembangunan Jangka Menengah Nasional*)
RRC	Reducing Regulation Committee
PLN	National Electricity Company (*Perusahan Listrik Negara*)
SOE for toll roads	PT. Jasa Marga
SPB	Goods Registration Letter (*Surat Pendaftaran Barang*)
SPI	Import Approval Document (*Surat Persetujuan Import*)
SPPT-SNI	Certified Commodities – Indonesia National Standard (*Sertfikat Produk Penggunaan Tanda – Standar Nasional Indonesia*)
SPS	Sanitary and phytosanitary measures
STE	State trading enterprise
TAC	Track access charges
TBT	Technical barriers to trade
Timnas PEPI	National Team for the Enhancement of Exports and Investment (*Tim Nasional Peningkatan Ekspor dan Peningkatan Investasi*)
UKP4	President's Delivery Unit on Development Monitoring and Oversight (*Unit Kerja Presiden bidang Pengawasan dan Pengendalian Pembangunan*)
UNCTAD	United Nations Conference on Trade and Development
USAID	United States Agency for International Development
USD	United States dollars

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 policies 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*. 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 Private-Public 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.

Résumé

L'Indonésie a surmonté de sérieux défis pour se doter des institutions de gouvernance d'un État démocratique fondé sur le marché

La réforme de la réglementation peut être considérée, de façon stratégique, dans les pays développés comme dans les pays en développement, comme l'un des instruments essentiels à la disposition des gouvernements pour gérer l'économie, influer sur le comportement des entreprises et mettre en œuvre la politique sociale. Dans le climat économique mondial actuel – marqué par la persistance de l'instabilité sur les marchés financiers, d'une part, et des contraintes budgétaires croissantes pour assurer les services publics clés tels que la santé, l'éducation et la protection sociale, d'autre part – l'État moderne devra utiliser son pouvoir réglementaire de façon judicieuse s'il entend être plus intelligent sinon plus petit. S'agissant de l'Indonésie, la réforme de la réglementation est aussi un aspect de l'effort ambitieux engagé par le pays pour consolider un processus décisionnel démocratique, stimuler vivement sa croissance économique de façon à rivaliser avec les autres grandes économies de la région et réaliser des objectifs majeurs sur le plan de la protection sociale.

L'Indonésie est le plus grand État archipel au monde, comptant plus de 17 000 îles dont environ 6 000 sont habitées, et couvrant près de 2 millions de kilomètres carrés. La population, diverse du point de vue ethnique et religieux, est d'environ 241 millions d'habitants. En 2011, le produit intérieur brut (PIB) par habitant, en parités de pouvoir d'achat, s'élevait à 4 809 USD.

Suite à l'avènement de l'ère des réformes, en 1999, l'Indonésie a réalisé des progrès remarquables en mettant en place les dispositifs centraux d'une démocratie moderne, ce qui signifie des élections libres aussi bien que des médias libres. En outre, le vaste mouvement de décentralisation fait que le pays a aujourd'hui une des formes de gouvernement les plus décentralisées au monde. Il a aussi réussi à opérer un solide redressement de son économie après la baisse la plus profonde de sa production, en 1998-99, depuis l'indépendance. Cette transition systémique s'est aussi accompagnée d'un recul des violences sociales et des troubles séparatistes.

Cependant, l'avènement de la démocratie et le vaste mouvement de décentralisation n'ont pas suffi pour instaurer un marché concurrentiel et un régime réglementaire favorable aux échanges. Les mutations institutionnelles d'ampleur opérées au sein de l'administration indonésienne au cours de la dernière décennie se traduisent aussi par un processus décisionnel complexe si ce n'est confus. De même, le mouvement rapide de décentralisation entraîne de nombreux chevauchements dans la réglementation et des incohérences au niveau de l'économie nationale. Ce qui est peut-être plus préoccupant encore c'est que la décentralisation peut aussi induire un risque accru de corruption en augmentant à travers tout l'archipel le nombre de personnes investies d'un pouvoir de décision qui peuvent exploiter le processus décisionnel dans leur propre intérêt.

Un engagement en faveur de la réforme de la réglementation en Indonésie s'impose aujourd'hui pour étayer la poursuite du développement économique

Le plan, ambitieux et exhaustif, de développement économique (Master Plan for Economic Development ou MP3EI), élaboré et mis en œuvre par les autorités, est l'une des réponses du gouvernement indonésien à ces contraintes politiques et économiques. Ce plan est fondé sur des marchés ouverts et sur l'investissement privé, en particulier sous la forme de partenariats public-privé (PPP). Le Master Plan vise à créer de nouveaux centres de croissance en fonction du potentiel économique de chaque région, ainsi qu'à renforcer les liens entre six corridors économiques. Le plan représente un investissement total de 445 milliards USD (dont la moitié environ pour de nouvelles infrastructures) à l'horizon 2025. Si le plan est à juste titre salué pour son ampleur et son ambition, le calendrier serré de mise en œuvre et l'énorme effort financier qu'il exige de la part du secteur privé – sans parler de la capacité de l'administration d'en superviser véritablement la réalisation -- suscitent un certain scepticisme. De même, le plan nécessite un gros effort pour produire un cadre réglementaire transparent et compréhensible dans un certain nombre de secteurs d'infrastructure et suppose de rationnaliser le processus décisionnel au sein de divers ministères et organismes gouvernementaux.

L'émergence de la Communauté économique de l'Association des nations de l'Asie du Sud-est (ASEAN) pousse aussi l'Indonésie à accélérer les réformes bureaucratiques, administratives et réglementaires nécessaires pour garantir sa compétitivité, à la fois en Asie du Sud-est et au niveau mondial. Étant la première économie et le pays le plus peuplé de l'ASEAN, l'Indonésie a beaucoup à gagner à être au centre de la Communauté économique de l'ASEAN. Il y a un certain nombre de signes qui indiquent que l'Indonésie est désireuse de réaliser les objectifs de libre-échange de l'Association. Cependant, le travail qu'il reste à accomplir pour harmoniser le régime réglementaire de l'Indonésie revêt aussi une grande importance dans le contexte du processus accéléré d'intégration économique de l'ASEAN à l'horizon 2015.

La réforme de la réglementation est aussi un élément clé de l'engagement de l'Indonésie, au niveau régional, dans le cadre de la coopération économique Asie-Pacifique (APEC). Par la Déclaration d'Honolulu signée par les dirigeants de l'APEC en 2011, l'Indonésie s'engage à adopter une approche inter-administrations de la gestion de la réglementation, à évaluer l'impact de la réglementation et à promouvoir des pratiques de consultations publiques. L'Indonésie doit faire rapport sur la mise en œuvre de ces pratiques en 2013, lorsqu'elle assurera la présidence de l'APEC. Le présent rapport pourra concourir à la réalisation des obligations de reporting du gouvernement indonésien vis-à-vis de l'APEC.

Les conclusions formulées dans cet examen visent à aider le gouvernement indonésien à réaliser ses objectifs de réforme

Ce rapport fait suite à un examen pluridisciplinaire de la réforme de la réglementation en Indonésie, exploitant l'implication des agents au sein du gouvernement indonésien et l'expérience collective des comités de l'OCDE. Dans le cadre de cet examen de la réforme de la réglementation en Indonésie, des fonctionnaires de haut rang du gouvernement indonésien sont venus dans des comités de l'OCDE pour participer à un processus d'examen entre pairs avec leurs homologues des pays de l'OCDE, en vue d'examiner et de proposer les pistes de réforme possibles pour aider le gouvernement à atteindre ses objectifs de politique économique et sociale. Cela s'est accompagné de réunions en groupes de travail en Indonésie, avec la mise en place par le Ministère des

finances d'un groupe de réflexion réunissant divers organismes gouvernementaux. Le gouvernement indonésien et l'OCDE ont aussi associé à ce processus les partenariats multilatéraux et bilatéraux de l'Indonésie pour le développement, et ont consulté les acteurs non gouvernementaux. Ce processus d'examen constitue une base pour la poursuite de l'engagement et du dialogue avec l'OCDE, pour soutenir le gouvernement indonésien dans la mise en œuvre des conclusions et recommandations jugées les plus utiles.

Le gouvernement indonésien se trouve face à de formidables enjeux pour mettre en place les mécanismes de gouvernance qui permettront de gérer les conséquences de la décentralisation et d'atteindre l'objectif recherché de mieux lier entre elles les différentes régions de l'archipel. Ce rapport identifie un certain nombre de mesures que le gouvernement devrait prendre pour réaliser son potentiel économique, à savoir améliorer la gestion de la réglementation, assurer une application effective de la politique de la concurrence, assurer la cohérence des politiques visant l'ouverture des marchés et instaurer le cadre réglementaire adéquat pour faciliter les investissements privés dans les infrastructures. Chaque chapitre couvre un de ces aspects et identifie les conclusions pertinentes auxquelles le gouvernement indonésien devrait réfléchir.

De façon générale, la réforme de la réglementation doit être le prochain grand domaine d'action du développement institutionnel, et ne doit pas être l'apanage des techniciens et des juristes. La réforme de la réglementation doit devenir un élément central du programme des réformes économiques et institutionnelles. Cela permettra à l'Indonésie de percevoir les dividendes économiques de la démocratie politique, d'introduire de la rationalité dans les complexités réglementaires issues de la décentralisation et de renforcer le climat de l'investissement nécessaire pour atteindre les objectifs du Master Plan et tirer pleinement avantage de l'intégration économique de l'ASEAN. Savoir dans quelle mesure et à quel rythme cela se fera pourrait être le facteur de motivation clé de l'effort de consolidation de la démocratie en Indonésie et d'une croissance économique soutenue dans les décennies à venir.

La réforme de la réglementation sera un point d'appui pour la mise en œuvre du Plan d'accélération et d'expansion du développement économique de l'Indonésie 2011-25

L'ambition du gouvernement indonésien, telle qu'énoncée dans le Master Plan, est de « créer une société indépendante, bien développée, équitable et prospère ». Sa stratégie est d'utiliser le plan pour exploiter pleinement le vaste potentiel économique que représente le positionnement géographique du pays au sein de l'Asie de l'Est, pour maintenir une croissance économique réelle supérieure à 7 % en glissement annuel et transformer l'Indonésie en un pays développé à l'horizon 2025. Les atouts de l'Indonésie tiennent à sa situation de quatrième pays le plus peuplé au monde, à l'abondance de ses ressources naturelles et à sa proximité par rapport aux marchés qui connaissent la croissance la plus rapide au monde. « L'Indonésie a pour ambition de devenir l'un des premiers fournisseurs de produits alimentaires dans le monde, d'être un centre majeur de transformation des produits de l'agriculture et de la pêche et des ressources naturelles, ainsi qu'un centre de la logistique au niveau mondial, à l'horizon 2025 au plus tard » (République d'Indonésie, 2010).

Les défis à relever sont considérables. Il faut, en particulier, mettre en place de nouvelles infrastructures, en matière de télécommunications, d'aéroports, d'infrastructures portuaires, de réseaux ferroviaires et routiers, pour réduire les coûts de transport et de logistique, mieux relier les régions et soutenir le développement

économique. La stratégie pour réaliser ces infrastructures dépend dans une large mesure des réformes de la réglementation qui permettront d'attirer les investissements du secteur privé. Le plan stipule à cet égard :

> Les réglementations doivent être claires et ne pas risquer de prêter à des interprétations erronées pour encourager la confiance et la participation maximum des investisseurs à l'édification des industries et des infrastructures dont le pays a grand besoin. Pour atteindre cet objectif, il faudra évaluer tous les dispositifs réglementaires en place et prendre des mesures à visée stratégique pour revoir et modifier la réglementation. (…) les coopérations entre le gouvernement et le secteur privé, dans le cadre des partenariats public-privé (PPP), devraient jouer un rôle déterminant dans la réalisation des investissements nécessaires (République d'Indonésie, 2010).

En plus de la réforme de la réglementation, la réalisation du Master Plan suppose une bureaucratie plus efficace soutenue par des mécanismes institutionnels forts. Il est admis que les conditions du développement économique ne découleront pas automatiquement d'un modèle de planification centrale mais qu'il faudra que s'opèrent des mutations institutionnelles au sein de la bureaucratie pour faciliter l'émergence des opportunités économiques et de marché. Il faut que s'opère un changement dans l'attitude des fonctionnaires et au niveau de l'encadrement dans les administrations. L'État a un rôle essentiel à jouer pour ce qui est de faciliter la réussite du modèle des partenariats public-privé, éliminer les obstacles réglementaires et administratifs à l'émergence de nouvelles activités et faciliter la participation des petites entreprises existantes à l'économie déclarée.

L'intégration régionale au sein de l'ASEAN et de l'APEC à la fois nécessite et soutient la libéralisation des marchés intérieurs

Dans le passé, la libéralisation économique et la réduction des droits de douane étaient liées aux pressions concurrentielles en faveur de l'intégration économique régionale et du développement des échanges au niveau régional. L'intégration régionale au sein de l'ASEAN s'est peu à peu renforcée au cours de la dernière décennie. Les échanges totaux au sein de l'ASEAN ont représenté 1 500 milliards USD en 2009, soit 25 % du total des échanges contre 22 % en 2000, et les flux d'investissements directs étrangers (IDE) au sein de la région ont augmenté de façon spectaculaire, passant de 3 % du total en 2000 à 20 % en 2008. Il est admis que l'intégration de l'environnement réglementaire des pays membres de l'ASEAN renforcera l'intégration économique. En 2006, les pays de l'ASEAN ont élaboré un schéma au niveau régional pour réaliser l'intégration de la communauté économique de l'ASEAN au sein d'un marché unique à l'horizon 2015. Dans un avenir plus immédiat, le gouvernement indonésien vise à réaliser l'intégration logistique de l'ASEAN d'ici 2013. Malgré des progrès dans l'harmonisation des règles, l'Indonésie est encore en retard par rapport à certains de ses voisins comme la Malaisie, Singapour, la Thaïlande et le Viet Nam, pour ce qui est du déploiement de l'harmonisation des règles dans les secteurs prioritaires.

Le gouvernement devrait s'appuyer sur les systèmes existants pour améliorer la coordination des pratiques de gestion de la réglementation ...

Le gouvernement indonésien s'est engagé à améliorer le climat pour l'activité des entreprises et l'investissement et à promouvoir les exportations. Parmi les mesures clés qui ont été prises, on signalera le paquet de mesures visant le climat de l'investissement (Instruction présidentielle 3/2006) et la politique destinée à accélérer le développement du

secteur réel et l'habilitation des micro, petites et moyennes entreprises (Instruction présidentielle 6/2007). En outre, en 2004, le gouvernement a défini une approche commune pour la formulation des lois et réglementations et, en 2009 et 2011, il a consolidé ce cadre, se focalisant, en particulier, sur les réglementations à l'échelon infranational susceptibles d'affecter le climat de l'investissement. La Loi 12/2011 encadre la formulation des lois et réglementations, avec notamment l'obligation d'une planification prospective des nouvelles réglementations, une évaluation préalable obligatoire des projets de loi et projets de réglementation à l'échelon infranational et l'implication d'experts extérieurs dans les consultations. Par ailleurs, la Loi 28/2009 relative à la fiscalité à l'échelon infranational confère des pouvoirs accrus au gouvernement national pour examiner et abroger les réglementations infranationales qui enfreindraient une réglementation de niveau supérieur.

Cependant, dans l'ensemble, le système souffre d'être fragmenté et non coordonné. A la suite de la décentralisation on a assisté à une multiplication des taxes et prélèvements instaurés par les autorités infranationales qui ont eu un impact négatif sur le climat de l'investissement au niveau local et ont nui à l'ouverture du marché interne. En outre, souvent, les autorités infranationales n'ont pas partagé l'information concernant les réglementations instaurant taxes et prélèvements, de sorte que le gouvernement national ne pouvait pas véritablement superviser le processus décisionnel. Le Ministère des finances a examiné environ 13 200 réglementations de niveau infranational et a recommandé au Ministère des affaires intérieures d'en abroger environ 4 900 (37 %). Cependant, seulement 1 800 (36 %) des réglementations qu'il était recommandé d'abroger l'ont été effectivement.

Le suivi des réglementations est rendu plus difficile par l'absence de base de données électronique intégrée, unique et exhaustive, qui ouvrirait l'accès à l'ensemble des lois et réglementations au travers d'un portail facile à utiliser. C'est indispensable pour étayer les efforts déployés par le gouvernement indonésien pour endiguer la prolifération des lois et réglementations à l'échelon infranational et en assurer la cohérence avec les dispositifs à l'échelon supérieur. Cela contribuerait aussi à la diffusion et au respect effectif des lois et réglementations.

...et définir des cadres d'action et des responsabilités institutionnelles claires en matière de réforme de la réglementation

Pour être plus efficace, le cadre général de la formulation des lois et réglementations nécessite une approche inter-administrations explicite, ce qui recouvre plusieurs aspects : responsabilité de la coordination et de la supervision de la politique réglementaire ; engagement à évaluer le rapport coûts-avantages des nouvelles propositions de réglementation et des réglementations existantes ; et, mise en œuvre effective des principes de transparence et de consultation du public dans le processus décisionnel en matière réglementaire.

Une politique réglementaire expressément formulée définirait le processus selon lequel le gouvernement déciderait s'il y a lieu de recourir à la réglementation pour traiter un problème en s'appuyant sur un processus décisionnel étayé par les faits. Le fondement d'une approche inter-administrations peut se trouver dans la Loi 12/2011 relative à la formulation des lois et réglementations, ainsi que dans le Plan de développement national à moyen terme et dans le Master Plan. Cependant, ces plans sont davantage axés sur les réglementations sectorielles plutôt que sur le système de gestion de la réglementation de façon plus générale.

Le fait d'adopter une approche inter-administrations permettrait au gouvernement d'exploiter les interactions dynamiques entre les différentes institutions parties au processus réglementaire et permettrait de surmonter les obstacles liés à un fonctionnement en silo. Une politique fondée sur les meilleures pratiques au niveau international devrait s'articuler avec l'engagement politique d'amener les entités du secteur public – y compris à l'échelon infranational – à contrôler la réglementation. Il faudrait s'appuyer sur le cadre défini par la Loi 12/2011, qui donne une certaine flexibilité à l'exécutif pour la gestion de la réglementation, tant au niveau national qu'au niveau infranational, en prévoyant le recours à des réglementations émanant de la présidence et du gouvernement.

Bien que la Loi 12/2011 fasse obligation à l'exécutif de mener des consultations publiques sur les projets de loi et projets de réglementation à l'échelon infranational, il n'y a pas obligation formelle de consulter les parties concernées durant le processus décisionnel. En fixant la ligne de conduite à tenir à cet effet on améliorerait la possibilité pour le public de contribuer à la formulation des propositions de réglementation et on renforcerait la confiance dans le gouvernement en introduisant plus d'uniformité dans les différents processus de consultation du public. La Loi prévoit aussi que doivent être réalisées des études théoriques mais ne fait pas expressément obligation de procéder à une évaluation quantitative de l'impact économiques de la réglementation, et les études ne sont pas bien intégrées dans les discussions au sein de l'exécutif ni dans les consultations publiques ou dans les délibérations au sein de la législature. Des réformes quant à l'utilisation des études théoriques pourraient servir de base à une amélioration de l'analyse d'impact de la réglementation et des consultations publiques.

Le principal obstacle à une coordination efficace semble tenir à ce qu'il n'y a pas d'entité unique, au niveau du gouvernement, qui soit chargée de veiller à ce que les lois et réglementations servent des objectifs intéressant l'ensemble des administrations. Une entité unique de supervision de la réglementation, proche du centre de gouvernement, qui serait chargée de promouvoir une prise de décision fondée sur des données d'observation et d'une fonction de coordination avec les autres entités gouvernementales est un élément clé pour garantir que la réglementation sert la politique de l'ensemble du gouvernement. Le plus aisé, d'un point de vue pratique, serait de confier cette tâche au ministère chargé de la coordination pour les affaires économiques, qui joue actuellement un rôle déterminant dans la coordination de la réforme de la réglementation dans une perspective sectorielle.

Une application plus déterminée du droit et de la politique de la concurrence ouvrira de plus larges opportunités économiques à l'Indonésie

Avant que n'interviennent les réformes démocratiques, l'Indonésie autorisait des phénomènes excessifs de concentration et de dominance sur de multiples marchés. La création de la Commission de surveillance de la concurrence (la KPPU) et la loi sur la concurrence visent à répondre aux demandes de démocratie, de plus d'égalité dans les opportunités économiques et d'amélioration des performances économiques. Le droit et la politique de la concurrence ont beaucoup contribué à la réussite économique de l'Indonésie depuis 1999. Cependant, les déficiences du cadre législatif initial appellent aujourd'hui des amendements et le droit et la politique de la concurrence ne sont pas utilisés avec autant d'efficacité que cela pourrait être le cas, ce qui donnerait à penser que c'est devenu une moindre priorité pour les autorités. On constate, par exemple, une

diminution de la proportion de recommandations émanant de la KPPU visant à minimiser l'impact anticoncurrentiel des législations proposées qui sont acceptées par le gouvernement.

L'histoire montre que les programmes de réforme visant à supprimer les dispositions anticoncurrentielles revêtent une importance particulière pour l'économie indonésienne. Un examen réalisé par la Conférence des Nations Unies sur le commerce et le développement (CNUCED) conclut ainsi : « En Indonésie, les pouvoirs publics sont à la source de la plupart des problèmes de concurrence ». Une implication plus systématique de la KPPU dans le processus législatif s'impose pour garantir que soient repérées sans délai toutes les propositions législatives qui risquent d'avoir un impact notable sur la concurrence. C'est ainsi que le Ministère de la coordination pour les affaires économiques pourrait être chargé d'informer la KPPU de toutes les nouvelles propositions législatives lorsqu'une analyse théorique s'engage, de façon à permettre à la Commission de formuler un avis sur la conception de la législation proposée pour autant qu'elle affecte les entreprises et/ou les consommateurs. En outre, le gouvernement devrait définir des principes clairs pour déterminer quand une autorisation est nécessaire et quand d'autres formes de réglementation sont suffisantes. Il conviendrait, en priorité, de réexaminer et de réformer les législations existantes pour en retirer les éléments qui font inutilement obstacle à la concurrence en se focalisant, en particulier, sur le système des licences pour les entreprises.

Une coordination efficace de l'évaluation de la concurrence permettra d'éviter un certain nombre de problèmes à l'avenir, en particulier dans le développement des nouveaux équipements d'infrastructure et pour l'octroi de licences aux entreprises

Il importe, en particulier, de veiller à ce que les lois encouragent la concurrence dans le secteur prioritaire de l'investissement dans les infrastructures. La KPPU devrait être associée au processus en sa qualité de promoteur de la concurrence chaque fois que d'importantes opportunités de réaliser de nouveaux investissements sont offertes par une agence gouvernementale, afin d'exercer son pouvoir de dire si d'éventuels accords pourraient enfreindre le droit de la concurrence.

Les opérateurs historiques dans les secteurs portuaire et ferroviaire, en Indonésie, sont de grandes entreprises publiques qui, dans bien des cas, sont en position dominante sur leur marché. Les investissements à réaliser, en Indonésie, dans les infrastructures de transport sont considérables, et toutes les procédures d'appel d'offres, d'octroi de licences, de cession de terrains ou autres opportunités pour la mise en place de nouveaux équipements devraient se dérouler avec le souci de faire émerger une nouvelle concurrence. Il faudrait notamment veiller à ce que les initiatives liées à une politique de plateformes portuaires, en Indonésie, n'aboutissent pas à la création de monopoles officiels. En outre, étant chargée de veiller à l'application de la loi, la KPPU devrait, en particulier, dans le secteur du transport maritime, veiller à ce que des cartels n'apparaissent pas sur les voies maritimes intérieures, en particulier sur les voies maritimes dont les concurrents étrangers ont été contraints de se retirer.

La KPPU sera plus efficace si ses pouvoirs sont mieux définis et sa direction stable

Il faudrait aussi que la loi sur la concurrence décrive explicitement les pouvoirs d'investigation de la KPPU, qui devrait être dotée en particulier de pouvoirs de perquisition impromptue, du pouvoir de demander des documents et des renseignements et de la capacité d'exiger d'un témoin qu'il réponde à des questions. La loi sur la concurrence (loi 5/1999) pourrait aussi être améliorée par l'interdiction générale de tout

comportement anticoncurrentiel. Les délais actuels de décision, de 30 ou 60 jours dans la plupart des cas, sont beaucoup plus courts que dans la plupart des pays de l'OCDE, en particulier dans les cas d'abus de position dominante, dans lesquels l'enquête peut durer un an si l'affaire est complexe. L'Indonésie ne devrait maintenir les délais en vigueur que dans les affaires de fusion qui exigent des enquêtes relativement rapides pour que l'opération puisse être menée à bien. Elle devrait dans les autres affaires envisager de porter le délai fixé pour l'examen préliminaire et final de la KPPU, en particulier dans les affaires complexes d'abus de position dominante, à une durée comprise entre 12 et 18 mois. Des mécanismes permettant d'« arrêter les pendules » ou de déclencher des délais supplémentaires dans des situations particulières assoupliraient le fonctionnement de la KPPU. Il faudra prévoir plus de temps pour les enquêtes si les pouvoirs d'investigation de la KPPU sont élargis, de façon qu'elle puisse les exercer correctement.

Les règles de recrutement de la KPPU nuisent à la stabilité et à la continuité de ses activités, ainsi qu'à la prise en compte des questions stratégiques présentant des implications à long terme. Tous les membres de la KPPU sont nommés pour une durée déterminée de cinq ans, renouvelable une fois seulement, avec des mandats qui viennent à expiration à la même date. Le président et le vice-président sont élus chaque année par les membres de la Commission pour un an. Pour remédier au problème que pose le départ simultané des dirigeants, il faudrait que les mandats du président et du vice-président soient plus longs, et que les ceux des membres soient décalés.

L'économie indonésienne a tiré parti des mesures de libéralisation des échanges

L'IDE est dynamique en Indonésie, et la part des stocks en provenance de l'étranger dans le PIB a atteint son point le plus élevé des sept dernières années en 2009, à 20 % du PIB, l'année la plus noire de la crise économique mondiale. En 2010, cependant, les niveaux d'IDE sont restés inférieurs à ceux de la plupart des autres économies de l'ASEAN (40 % du PIB en Thaïlande et 62 % du PIB au Viet Nam), ce qui semble indiquer que l'Indonésie dispose d'une grande marge de manœuvre pour développer l'investissement. En outre, l'IDE ne se répartit pas de façon uniforme dans l'archipel. Les taux de croissance du PIB et la part de l'Indonésie dans le commerce mondial sont restés en deçà des niveaux enregistrés avant 1997, et les termes de l'échange ont enregistré une détérioration régulière.

L'Indonésie a perdu la compétitivité dont elle bénéficiait dans certains secteurs traditionnels d'exportation, comme les textiles et le bois, mais elle devient plus compétitive sur les marchés mondiaux dans d'autres secteurs comme l'automobile. Les échanges de services, moins développés, se concentrent dans quelques secteurs, mais les services aux entreprises prennent de l'importance. Les courants d'échanges de biens comme de services se sont nettement réorientés vers l'Asie et les pays en développement, notamment du fait de l'expansion des réseaux de production et de l'intégration régionale dans le cadre de l'ASEAN.

La volonté de créer la communauté économique de l'ASEAN en 2015 accélère les efforts de réforme en Indonésie et dans d'autres pays de la région. Elle a conduit en particulier à une libéralisation tarifaire complète et couronnée de succès qui a fait reculer les taux de protection effective. En revanche, la libéralisation des services est moins avancée et les évolutions réglementaires récentes suscitent l'inquiétude de certains prestataires de services étrangers, en particulier dans les secteurs de la logistique et des télécommunications. La réforme de la réglementation des services offre des possibilités de renforcement de la productivité intérieure et d'amélioration des performances commerciales.

Il faut cependant promouvoir l'ouverture du marché avec plus de détermination pour mettre fin à la détérioration des termes de l'échange

L'adoption en 2007 de la loi sur l'investissement (loi 25/2007) et de ses règlements d'application a marqué une étape importante de l'amélioration des conditions de l'investissement en Indonésie, mais d'importantes ambiguïtés dans l'application de la loi doivent encore être levées. On observe avec inquiétude une recrudescence de l'utilisation des mesures non tarifaires (MNT), moins transparentes et plus facilement influencées par des intérêts particuliers. Les MNT ne répondent pas toutes à un objectif clair coïncidant avec l'intérêt économique général de l'Indonésie. Leur accroissement va à l'encontre de la volonté générale d'ouverture du pays et nuit à la prévisibilité. En outre, il réduit l'accès de l'économie nationale aux intrants importés, qui contribuent de façon décisive à relier les chaînes de valeur mondiales et à renforcer les performances à l'exportation.

De nombreux ministères et organismes gouvernementaux ont le pouvoir d'utiliser des mesures non tarifaires, de sorte qu'il est difficile d'adopter dans ce domaine une approche interministérielle de la prise de décision. Au moins 13 organismes gouvernementaux exercent des compétences sur un type de MNT ou un autre. C'est du ministère du Commerce que relève le plus grand nombre de MNT (58.4 %) ; il est suivi des organismes de contrôle sanitaire (18.5 %), de l'agence nationale de contrôle des produits alimentaires et des médicaments (BPOM) (15.1 %) et du ministère de la Santé (3.8 %). D'autres organismes adoptent des MNT en rapport avec les normes de produits, la sécurité du public et la protection de l'environnement (Preparation Team INSW (2009), "Import and Export Licensing: Provisions of Prohibited and Restricted Goods for Import and Export"). L'absence de procédure de coordination entre les organismes publics crée de nombreuses possibilités de mesures contradictoires et se recoupant en partie qui risquent d'avoir des répercussions négatives sur l'économie.

D'autres restrictions s'appliquent, telles que les dispositions sur le contenu local, les limitations concernant les entreprises d'État, l'inspection avant expédition et les restrictions touchant les importations de certains produits, possibles seulement dans quelques ports. Les dispositions sur le contenu local dans les marchés publics et les restrictions relatives aux ports d'entrée ont particulièrement augmenté ces dernières années. Le gouvernement a publié trois décrets présidentiels sur la liste négative applicable aux investissements en Indonésie. Malgré les consultations organisées avec le secteur privé pendant l'établissement des réglementations, la formulation des directives d'application continue de poser des problèmes qui sont source d'incertitudes pour les investisseurs. La rédaction des réglementations économiques en rapport avec les politiques de restriction des comportements sur le marché peut présenter de grandes difficultés. La procédure réglementaire elle-même peut être problématique, comme en témoigne le fait que les dernières versions des règlements d'application, par exemple du règlement présidentiel 36/2010, n'ont jamais été soumises à la population pour qu'elle fasse part de ses observations.

Il faut renforcer la coordination pour s'assurer que les mesures réglementaires ne font pas obstacle aux échanges

Pour procéder à ces évaluations, il est essentiel d'instaurer une plus grande coordination entre les ministères opérationnels. Ces dernières années ont été marquées par plusieurs exemples notables de réglementations nouvelles qui contredisent des lois ou réglementations de rang plus élevé, créant ainsi une incertitude réglementaire. La coordination est particulièrement importante dans le contexte de la décentralisation des pouvoirs et de l'influence croissante de la Chambre des représentants (DPR) dans les

politiques réglementaires. Par suite de ces évolutions, les ministères opérationnels semblent avoir maintenant plus de contrôle sur les politiques qui relèvent de leurs compétences, et les intérêts sectoriels exercent une influence politique plus forte. Les tendances protectionnistes qui risquent d'en résulter ne peuvent être compensées que par des évaluations indépendantes qui abordent la prise de décision au niveau de l'ensemble de l'économie.

Pour l'instant, l'Indonésie n'a pas institutionnalisé les évaluations indépendantes et objectives des politiques dans l'ensemble de l'économie. Elle doit définir des critères précis pour guider l'évaluation des réglementations importantes, de façon à remédier à la fragmentation du processus de prise de décision qui laisse à des intérêts particuliers la possibilité d'exercer leur influence. C'est pourquoi le dispositif réglementaire en place doit comporter une institution qui conduise ce type d'évaluations, de façon à renforcer nettement la coordination entre les ministères et à améliorer les effets des réglementations. Il est important également de veiller à organiser systématiquement des consultations publiques s'adressant à un vaste échantillon de parties prenantes, de façon à renforcer la transparence et à éviter toute restriction involontaire des échanges.

L'amélioration de la coordination entre le gouvernement central et les régions est aussi un élément essentiel de l'intérêt national général. D'importantes mesures ont déjà été prises pour grouper dans des guichets uniques les nombreuses autorisations nécessaires pour créer et exploiter une entreprise, mais des efforts s'imposent encore pour simplifier les autorisations elles-mêmes. En particulier, il faut procéder à un examen objectif des lois et réglementations locales pour s'assurer que les autorisations placées sous leur juridiction répondent à des objectifs clairs, ne se contredisent pas et ne font pas double emploi.

Pour que les services soient soumis à une concurrence efficace dans les secteurs portuaire, ferroviaire et maritime, il faut un environnement réglementaire approprié

Le développement et l'intégration économiques de l'archipel doivent s'appuyer sur un secteur logistique efficace et compétitif. La performance générale de l'Indonésie au regard de l'indice de performance logistique de la Banque mondiale correspond à la moyenne des pays qui se situent au même niveau de développement, mais la qualité des infrastructures d'échanges et de transports, en particulier les performances opérationnelles et le niveau d'investissement dans le secteur portuaire sont insuffisants. La capacité de nombreux grands ports indonésiens est déjà mise à l'épreuve, et les forts taux de croissance prévus aboutiront à de graves problèmes de congestion si des mesures ne sont pas prises rapidement.

Le gouvernement indonésien a bien progressé dans l'établissement et la mise en œuvre de dispositifs réglementaires améliorés favorisant la concurrence et l'efficacité. Les modifications apportées récemment à la loi de 2008 sur le transport maritime et à la loi de 2007 sur les chemins de fer sont en mesure de transformer radicalement les industries des transports maritimes et ferroviaires. Le cadre général mis en place par ces lois tient compte de l'expérience acquise à l'échelle mondiale ces dernières décennies, et se sert de concepts nouveaux comme la séparation des fonctions de réglementation et d'exploitation, en cherchant à renforcer la concurrence et à encourager la participation du secteur privé.

Ces dispositifs réglementaires sont fondamentalement sains. Il arrive cependant que des dispositions spécifiques des lois ou des textes d'accompagnement n'aillent pas dans le sens de la stratégie générale ou qu'une formulation plus précise des orientations stratégiques soit nécessaire pour créer un cadre propice à une amélioration de la gouvernance et à une plus grande efficacité.

La loi de 2008 sur le transport maritime a séparé les fonctions de l'opérateur portuaire et de l'autorité portuaire responsable de l'application de la réglementation. Elle a ainsi mis fin au monopole légal exercé dans les ports commerciaux indonésiens par les corporations portuaires et ouvert le secteur à d'autres opérateurs du secteur privé. Elle s'appuie sur le modèle du « port propriétaire » tel qu'il a cours en Europe du Nord et en Australie, qui sépare les fonctions de l'autorité portuaire et celles des opérateurs. Le gouvernement doit cependant établir de nouvelles autorités portuaires dotées de ressources et de compétences adéquates pour une gestion efficace des ports et définir plus clairement, en les intégrant, les responsabilités des différents niveaux de gouvernement en matière de planification. Les responsabilités des nouvelles autorités portuaires prévues par la loi doivent être expliquées clairement et des mesures doivent être mises en place pour que les opérateurs portuaires n'abusent pas de leur pouvoir de monopole dans les ports où ils sont en activité. Il faut maintenir la possibilité de choisir l'expéditeur en continuant d'autoriser l'exportation et l'importation directes de cargaisons internationales dans de nombreux ports d'Indonésie.

La loi de 2008 sur le transport maritime est revenue sur les mesures antérieures de libéralisation en rétablissant des dispositions sur le cabotage et en exigeant officiellement que tous les navires battant pavillon étranger exploités dans les eaux territoriales indonésiennes soient remplacés ou ré-immatriculés sous pavillon indonésien et qu'ils emploient des équipages indonésiens. Il importe cependant que l'application de cette loi ne compromette pas l'engagement de l'Indonésie à s'associer à la mise en place d'un marché unique du transport maritime dans l'ASEAN.

Pour accroître la part du transport ferroviaire sur le marché du fret, les solutions les plus intéressantes concernent la création de lignes destinées à l'exportation de marchandises, en particulier pour assurer la liaison entre les mines de charbon et les ports. La loi de 2007 sur les chemins de fer a aboli le monopole d'État et ouvert le secteur ferroviaire aux investissements des opérateurs privés et des collectivités locales. Cependant, la séparation verticale entre la gestion des infrastructures ferroviaires et les opérations de transport s'est accomplie lentement. Il faudrait aussi des directives sur la sécurité, les normes techniques et l'interconnexion pour faciliter les investissements des gouvernements infranationaux ou du secteur privé.

La mobilisation d'investissements privés dans les infrastructures doit s'appuyer sur une bonne gouvernance des partenariats public/privé

La part des investissements en infrastructures dans les dépenses publiques de l'Indonésie a nettement baissé à la suite de la crise asiatique, passant de 10 % à 4 % environ. Le déficit d'infrastructures est grave et le gouvernement reconnaît qu'il faudra des investissements considérables pour rattraper le retard accumulé et assurer le développement économique futur du pays. Le Master Plan vise surtout à améliorer les connexions en renforçant de façon significative l'investissement privé, à travers des PPP, en faveur des routes à péage, du secteur ferroviaire et de la production d'électricité. En conséquence, il faut d'abord que le gouvernement crée les conditions adéquates pour faciliter les achats des PPP avant d'aborder la question de l'investissement dans les infrastructures.

Avant le lancement des réformes dans les années 2000, la plupart des projets d'infrastructure qui ne relevaient pas des autorités centrales, provinciales ou locales étaient attribués à des entreprises publiques ou privées désignées directement. Le gouvernement indonésien a maintenant résolu plusieurs problèmes complexes en rapport avec les achats des PPP, notamment en définissant les politiques et le dispositif législatif qui les encadrent, en préparant une liste de projets et en créant des unités spéciales composées d'experts et des dispositifs destinés à guider le choix des projets. Les procédures et principes de l'attribution des marchés par appel d'offres ont été établis dans les règlements présidentiels 13/2010 et 56/2011. Les projets potentiels ont été signalés dans le cadre d'une série de conférences sur les infrastructures, et l'organisme national de planification du développement (Bappenas) a publié en 2011 le « livre des PPP », où figure une liste des projets potentiels et prioritaires, dont 13 étaient jugés prêts pour adjudication.

Les délais administratifs et les problèmes posés par la coordination des responsabilités pour le choix des projets des PPP et l'attribution des marchés continuent cependant de faire obstacle au bon fonctionnement du système. La mise en place des compétences nécessaires reste aussi un enjeu de taille pour le gouvernement indonésien. En 2011, le marché relatif à la centrale électrique du centre de Java était le seul projet qui ait franchi avec succès toutes les étapes du cycle d'attribution des marchés des PPP prévues dans les règlements présidentiels. L'accès aux terres constitue également un obstacle, malgré une nouvelle loi adoptée en 2011 pour faciliter l'expropriation des terres en faveur des projets de travaux publics. Ces difficultés ne sont propres à l'Indonésie. Les pays qui font appel à des PPP ont dû progressivement affiner leurs dispositifs en s'appuyant sur l'expérience acquise. Ce rapport présente différentes conclusions, sur la base de la *Recommandation de l'OCDE de 2012 sur les principes applicables à la gouvernance publique des PPP*, que l'Indonésie devrait faire siennes pour atteindre ses objectifs de développement des infrastructures en s'appuyant sur les PPP.

Direction politique, coordination administrative et souci d'optimisation des dépenses sont les conditions du succès des PPP

Pour surmonter l'inertie bureaucratique et donner la priorité aux projets, le gouvernement devrait créer un comité présidentiel chargé des projets d'infrastructure, afin que le Bappenas, le ministère des Finances, le ministère chargé de la coordination des affaires économiques et les ministères opérationnels concernés alignent leurs décisions en matière d'infrastructures avec la stratégie et les objectifs généraux du gouvernement. Le comité présidentiel pourrait dresser une liste de quelques projets de PPP relativement simples pour faire avancer le programme de PPP.

Le ministère des Finances devrait jouer un rôle clé à toutes les étapes décisives des projets de PPP. Il devrait assurer une fonction de contrôle en analysant en détail et en approuvant toutes les décisions importantes d'investissement d'infrastructures, qu'il s'agisse de projets de PPP ou non. Le ministère des Finances devrait aussi contribuer de façon déterminante au renforcement des capacités des organismes acheteurs, en mettant l'accent sur l'amélioration de la planification, la préparation des études de faisabilité et des offres.

Les PPP ne devraient être retenus que s'ils offrent la meilleure rentabilité par rapport à d'autres formes de réalisation des infrastructures. Le gouvernement doit définir des critères précis de rentabilité sur lesquels se fondera la sélection des projets, en adoptant une approche qui couvre tout le cycle de vie et envisage la valeur actuelle des coûts et des avantages à venir. Il devrait utiliser un comparateur du secteur public ou un modèle

d'étalonnage/référentiel équivalent pour comparer les offres reçues. Il faudrait évaluer avec attention le rôle des entreprises publiques dans les PPP pour empêcher tout conflit d'intérêt et assurer des conditions de pleine concurrence. Les offres non sollicitées devraient être évitées ou au moins soumises à un examen plus minutieux et les projets financés par des donneurs devraient être conformes aux procédures budgétaires et d'accompagnement.

Le gouvernement joue un rôle essentiel en coordonnant les politiques pour assurer la liaison de l'Indonésie aux marchés

L'Indonésie doit placer la réforme des réglementations au premier rang de ses priorités politiques si elle veut atteindre ses objectifs, en se dotant de systèmes réglementaires réactifs et ouverts et de marchés intérieurs compétitifs. C'est un grand pays très divers sur le plan géographique qui dépend beaucoup de l'exportation de produits provenant des ressources naturelles. Les contraintes géographiques et les goulets d'étranglement au niveau des infrastructures entraînent des coûts logistiques élevés qui fragmentent le marché intérieur et entravent la croissance économique. Si elle veut atteindre les taux de croissance nécessaires pour absorber de nouveaux entrants et tirer parti de son potentiel de croissance, l'Indonésie doit améliorer l'intégration de ses marchés intérieurs. De meilleurs rendements d'échelle et d'envergure, une amélioration de l'efficience et la création de marchés plus compétitifs en résulteront et l'Indonésie pourra se tourner vers des produits à valeur ajoutée plus élevée tandis que les entreprises seront incitées à plus d'innovation. Les liaisons établies entre l'Indonésie et les marchés mondiaux stimuleront les échanges qui contribueront à leur tour à renforcer la production intérieure, avec des répercussions positives sur l'emploi et la consommation intérieure.

L'Indonésie doit appuyer cet objectif d'intégration en veillant à ce que les cadres réglementaires favorisent le bon fonctionnement des marchés. Il faudra pour cela une direction forte et une bonne coordination, ainsi qu'une répartition claire des compétences parmi les hauts responsables de l'administration, fondée sur une déclaration d'orientation précise. Une coordination plus poussée entre les administrations, qui s'assureront ainsi que la réglementation facilite un accès concurrentiel aux marchés indonésiens, contribuera à la création permanente de nouvelles opportunités économiques et aidera l'Indonésie à exploiter son fort potentiel de croissance.

Les conclusions de l'OCDE devraient être mises à l'épreuve et enrichies en collaboration avec le gouvernement indonésien

Cet examen a apporté aux délégués des comités de l'OCDE des informations nouvelles sur les efforts du gouvernement indonésien et les difficultés auxquelles le pays doit faire face. Il fournit les bases d'une collaboration et d'un dialogue plus poussés avec l'OCDE qui permettront d'aider le gouvernement dans la mise en œuvre des conclusions et des recommandations formulées dans les secteurs où elles seront jugées les plus utiles. Il serait aussi prudent de dresser le bilan de cette mise en œuvre après trois ou quatre ans.

L'examen a permis de constater que plusieurs domaines notables de l'action publique avaient échappé à l'analyse, ou à peine été abordés, et qu'une évaluation complémentaire était nécessaire. Des travaux pourraient notamment être envisagés sur les aspects suivants : exploitation des compétences du réseaux des hauts responsables des PPP pour l'application de la *Recommandation de l'OCDE sur la gouvernance publique des PPP* à l'évaluation des performances des PPP dans des secteurs précis et du rôle des entreprises d'État ; application des *Principes de l'OCDE pour renforcer l'intégrité dans les marchés publics* à l'évaluation des difficultés rencontrées dans les marchés publics traditionnels

d'infrastructures ; évaluation du rôle et des performances des régulateurs indépendants dans les secteurs d'infrastructures au regard des bonnes pratiques de l'OCDE et de la *Recommandation du Conseil de l'OCDE concernant la politique et la gouvernance réglementaires* ; et évaluation des cadres de gouvernance publique de l'administration indonésienne axée plus particulièrement sur l'élaboration des politiques, la gestion des ressources humaines, l'administration électronique, la planification stratégique et ses liens avec la gestion budgétaire, par exemple.

Chapter 1

Setting priorities for reform and development in Indonesia

This chapter sets out the social and economic context for the Review of Regulatory Reform in Indonesia*. It describes the significant political and economic challenges faced by Indonesia over the past 15 years, including the impact of the Asian financial crisis, widespread growth in democracy and "big bang" decentralisation. It identifies that significant progress has been made but argues that Indonesia has to continue to commit to a path of institutional transformation to improve the performance of the public administration, consolidate the gains so far and address the regulatory complexities and overlaps resulting from a process of rapid transformation. Regulatory reform must be high on Indonesia's political agenda to ensure that it achieves the objective of building responsive and open regulatory systems that will support its economic and development goals to create competitive domestic markets and be competitive in the ASEAN region.*

Introduction

Achieving successful regulatory reform now constitutes one of the most critical issues facing the government of Indonesia and it will become even more important in the context of the recently adopted Master Plan for the Acceleration and Expansion of Indonesia Economic Development 2011-2025 (MP3EI) which aims to foster economic development along six economic corridors designated according to differences in broad competitive advantage. In the 13 years since the collapse of the pre-Reformasi government in 1999 and the country's first democratic elections, Indonesia has adopted a multiparty democracy, rebuilt its financial structure, decentralised its decision-making processes and given free rein to a vibrant media and civil society.

Arguably, the scale and the speed of the change in political and economic institutions during Indonesia's first reform decade (2000-10) allowed little space for the overall reform of the regulatory framework. In the context of Indonesia's "systemic transition" regulatory reform has not been the priority, seen as subordinate perhaps to the more central task of setting in place an architecture of democratic and market regulatory institutions. In the overall sequencing of systemic reform, it is necessary to first establish the architecture of governing institutions and electoral processes. However, having established the governing and administrative structures which have the authority to change an inherited structure of regulations it is now necessary to focus on the challenges of reducing regulatory complexity and overlap and to ensure that Indonesian regulatory frameworks promote market competition and openness.

The advent of democracy and its governing institutions and processes is of course not sufficient to deliver a market-competitive and trade-friendly regulatory regime. However, in the future Indonesia will face increasing pressures for regulatory reform in order to realise the economic dividend from political democracy. Regulatory reform should now become central to the economic and institutional reform agenda for Indonesia to rationalise the considerable regulatory complexities arising from the first decade of big bang decentralisation, and to support the investment climate that is needed to achieve the goals of the MP3EI.

1.1. The government of Indonesia 2000-2010 reform agenda

During its first reform decade, the focus of Indonesia was concerned with institutional reform to deal with the implications of economic and social shocks arising from the economic collapse resulting from the Asian financial crisis, and the political implosion which followed. Fears of national disintegration following the demise of the Suharto government led to the adoption of a big-bang decentralisation programme which severely challenged Indonesia's already weakened planning, budgeting and policy-making processes and capabilities.

The first reform decade in Indonesia was characterised by an enormous reform agenda covering everything from banks to sub-national government, from electoral reform to anti-corruption, from civilian control of the Indonesian National Armed Forces to the reorganisation of the Indonesian National Police. However, while dealing with these urgent policy concerns, regulatory reform was not given the attention it required.

Towards the end of the first reform decade as a result of Indonesia's success in delivering near total reform of its governance and many of its economic and financial institutions attention to regulatory reform is a more prominent concern as the government tries to address the need to sustain economic growth, improve social welfare, employment and the efficiency of natural resource use and management.

Box 1.1. What is regulation and regulatory reform?

In the OECD work, regulation refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers. Regulations fall into three categories:

- Economic regulations intervene directly in market decisions such as pricing, competition, market entry, or exit. Reform aims to increase economic efficiency by reducing barriers to competition and innovation, often through deregulation and use of efficiency-promoting regulation, and by improving regulatory frameworks for market functioning and prudential oversight.

- Social regulations protect public interests such as health, safety, the environment, and social cohesion. The economic effects of social regulations may be secondary concerns or even unexpected, but can be substantial. Reform aims to verify that regulation is needed, and to design regulatory and other instruments, such as market incentives and goal-based approaches, that are more flexible, simpler, and more effective at lower cost.

- Administrative regulations are paperwork and administrative formalities through which governments collect information and intervene in individual economic decisions. They can have substantial impacts on private sector performance. Reform aims at eliminating those no longer needed, streamlining and simplifying those that are needed, and improving the transparency of application.

Regulatory reform is used in the OECD work to refer to changes that improve regulatory quality, that is, enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform. Deregulation is a subset of regulatory reform and refers to complete or partial elimination of regulation in a sector to improve economic performance.

Source: OECD (1997), *OECD Report on Regulatory Reform*, OECD Publishing, Paris.

Initial political and economic developments

The 1945 Constitution established the system of Presidential Rule and the core concept of the Unitary State. The 1945 Constitution survived despite the demise of Indonesia's first attempt at Constitutional Democracy in the mid 1950s which gave way first to Soekarno's Guided Democracy (1957-1965) and then to the New Order (1966-1998). The New Order was in essence an authoritarian, centralised government with close ties to the military. The President was confirmed in office by a handpicked People's Consultative Assembly (Maj*elis Permusyawaratan Rakyat* or MPR) meeting every five years for the purpose. The military had a dual function (*Dwi Fungsi*) to play an active role in national development as well as in the provision of security. It maintained a system of parallel government down to the village level, alongside civilian layers of government.

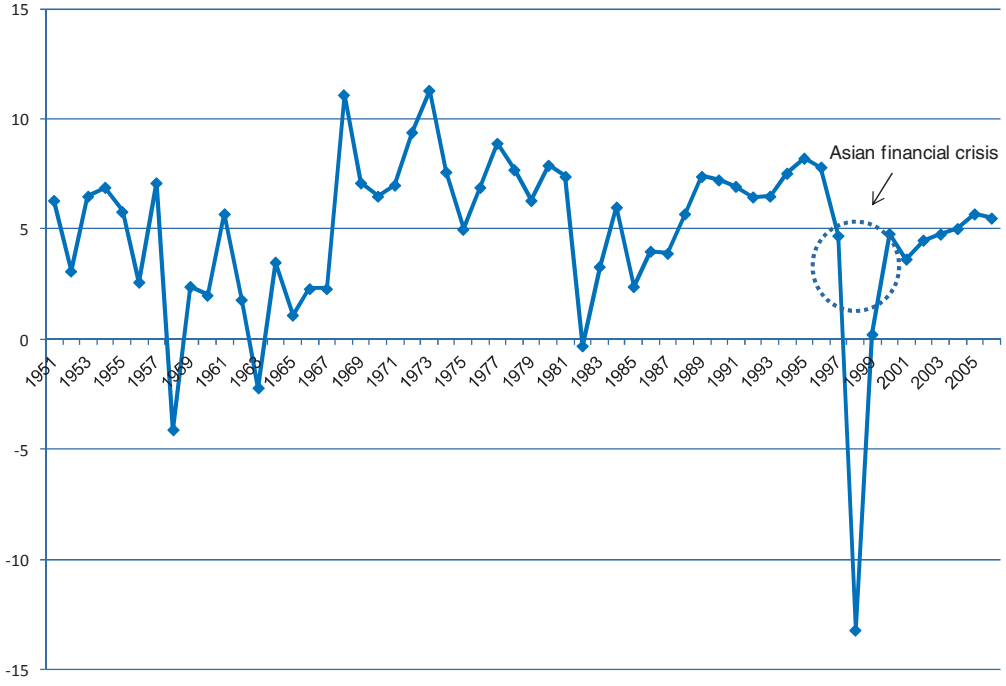
Under this highly integrated and centralised system of government Indonesia experienced record economic growth over three decades, beginning with the early 1970s. At the same time, it also created a system of crony capitalism under which government contracts were awarded by relationship and clientelism rather than through transparent government processes. The New Order government remained in operation for nearly 30 years until the challenges of the Asian financial crisis.

The impact of the Asian financial crisis on Indonesia

The Asian financial crisis proved to be an economic and political cataclysm for Indonesia. The contagion of the Asian financial crisis spread quickly throughout the Southeast Asia region. The economy-wide shock triggered partly by weak financial markets and the absence of a arms-length and independent regulatory institutions, was the most severe in Indonesia's post independent history. The decline in GDP growth in 1998-99 the sharpest over a forty year period, (Figure 1.1) was considerably greater than anything experienced in the economic protectionism of Soekarno's Guided Democracy or in the dislocation and political strife of the 1965-66 years which had been marked by social violence, hyperinflation and economic breakdown which led to the New Order.

The social cost of the crisis contributed to the dissolution of the New Order Government. The National Bureau of Statistics estimated that the incidence of poverty, on a head count ratio, which had declined from around 60% below the national poverty line in 1970 to just over 11% in 1995, more than doubled to 23% within the first two years of the Asian financial crisis. These numbers were to fall in the following three years largely due to fall in the international rice price, the increase in the minimum wage and later as a result of Indonesia's social safety net programmes. The rise in the incidence of overall poverty, which indicated that even in 2002 some 38 million Indonesians lived below the national poverty line of 2 100 calories per day, was only a small part of the story. Income distribution among the poor also worsened as seen by the sharp increase in the poverty severity index which stood at 0.41 in 1996 only to rise sharply to 1.23 in 1999 (UNDP, 2004, p. 15).

Figure 1.1. Indonesia's annual growth, percentage of GDP



Note: 1960-65 from 1960 weights, 1966-77 from 1973 weights, 1978-93 from 1983 weights, 1994-99 from 1993 weights, and 2000-06 from 2000 weights.

Source: Woo, Glassburner and Nasution (1994), CNS, Mishra (2001), and IMF in Strategic Asia (2008), "Setting the Stage for Japan-Indonesia Business Co-operation: Implications of Indonesia's 2009 Elections", prepared for Japan Bank for International Cooperation by Strategic Asia Indonesia.

Decentralisation and the policy agenda of Indonesia's first democratic decade

Indonesia's transition to democracy was as sudden as it was unexpected. Multiparty democracy was advocated by a mixture of political, religious and civil society groups. The ensuing amendment of the 1945 Constitution while retaining a unitary state governed by a directly elected President, laid the foundations for a separation of powers and a multiparty democracy. Despite the scale of the political transformation, the new era of *Reformasi* was the outcome of a spontaneous and public pressure for a retreat from an authoritarian and centralised form of government. Hence, major constitutional and institutional initiatives such as the establishment of a new electoral system and political decentralisation were done remarkably quickly.

The first half of the last decade until the 2004 presidential and parliamentary elections was occupied with the reform of the financial sector and the restructuring of Indonesian banks on the one hand and the enormous task of establishing Indonesia's decentralised government structure on the other. It was also characterised by efforts to contain the sharp rise in social violence following the economic collapse of 1998 and the political dislocation that followed.

In the context of the crowded economic and political policy agenda of the first decade of Indonesian multiparty democracy the government was not focussed on developing a national policy on the revision of the regulatory framework. However, the urgency of reforming the regulatory framework became more apparent towards the end of the last decade in the context of the need to sustain increases in investment to GDP ratios and

resolve the regulatory complexity and inefficiencies which followed Indonesia's "big bang" decentralisation. The announcement of the MP3EI in 2011, which projects an ambitious growth plan between 2012-2025 demonstrates an awareness of the importance of having a transparent and legally certain regulatory framework on which long-term investment plans can be based.

Multiparty elections and the establishment of a political system founded on the principle of separation of powers are the core features of any democratic political system. This is also the case with Indonesia. However, the Indonesian transition is characterised by a number of major achievements that have deepened its political legitimacy within a single decade. In addition, the new political system has also been able to effect rapid economic recovery and lay the foundations for a second round of reforms covering decentralisation, anti-corruption and the rationalisation of its regulatory and decision making structures.

Besides the amendment of the 1945 Constitution and the establishment of free multiparty parliamentary and presidential elections (including similar elections for sub-national government) two major political gains of the Indonesian transition deserve mention. The first was the establishment of political decentralisation. The second was the reduction of social violence, which for the first time in recent history provided the political space and the opportunity to focus attention on other much needed policies ranging from the reduction of poverty to the promotion of economic growth and the improvement of the investment climate.

The end of the New Order gave rise to widespread demands for democracy and empowerment from regions outside Java who wanted more control over their own internal affairs. At the inception of the *Reformasi* era in 1999, the government began an ambitious decentralisation programme. Following the enactment in May 1999 of Law 22/1999 on Sub-national government and its implementation in January 2001, "apart from foreign affairs, defence, security and monetary affairs, basically all government affairs were transferred or shared with directly elected sub-national governments." In 2004 the law was revised (Law 32/2004), and Indonesian sub-national governments achieved increased autonomy. Sub-national governments became responsible for public administration, health, education, social services, economic development, social security and preserving the environment (Sutmuller *et al.*, 2011).

On the one hand, decentralisation has increased the legislative role of sub-national governments thereby bringing policy-making closer to citizens. On the other hand, decentralisation has transferred many governance responsibilities to sub-national authorities that have limited capacity to formulate, implement, and enforce regulations.[1] Problems with excessive red tape have increased since Indonesia implemented its ambitious decentralisation programme. Twelve thousand sub-national regulations were enacted as the move to decentralise was made, with many later found to be in conflict with national regulations (Mangkusubroto *et al.*, 2012).

Problems have arisen from inconsistencies between sub-national regulations and national laws as a result of policy making and implementation at multiple levels. Power was redistributed to sub-national governments without clear arrangements being made for co-ordination with the central authority. This has caused regulatory requirements to accumulate and has complicated interpretation, especially when contradictory stipulations are found. Decentralisation has also complicated the application process for land titles for foreign investors as the decentralisation law permits sub-national governments to impose additional requirements (OECD, 2010, p. 67).

Box 1.2. The evolution of the regulatory process in the light of decentralisation

The issue of sub-national regulations was greatly complicated in the late 1990s by Indonesia's efforts to decentralise its political and economic decision-making processes. In 1999, the DPR passed two laws on decentralisation.[1] These laws granted sub-national governments greater authority over their domestic economies, but in the process made the Indonesian legal system more complex. To begin with, the number of lawmaking bodies increased from approximately 292 districts/cities in 1998 to 33 provinces and 484 districts/cities in 2009, with even more bodies and individuals having lawmaking powers (Butt, 2010). The pressure to raise revenue to support sub-national policy priorities led to a proliferation of new sub-national regulations (*peraturan daerah*). By 2006, at least 12 000 regulations had been registered with the central government, but the actual number is probably much higher because of underreporting (Butt, 2010).

Under the laws on decentralisation, taxes and user charges all require review by the central government. The review process is set forth in Ministerial Regulation 53/2007 and depends on where the sub-national regulation originates. Provincial legislation and governor regulations are reviewed by the Ministry of Home Affairs (MoHA); district and city regulations and other lower-level regulations are assessed by a team established by the governor of the province in which the district or city is located (Butt, 2010).[2] Failure to meet the proper procedure may result in invalidation in certain circumstances.

Nearly 10 000 sub-national regulations have been reviewed under these processes. Between 2001 and 2009, 13 387 sub-national regulations were received by the national government; 9 772 were evaluated; and 3 513 were recommended to be revoked (Radaksi, 2009). In addition, about 500 sub-national regulations have also been invalidated during the pre-approval process (Butt, 2010).

In an analysis of 500 decisions on the MoHA website, Butt (2010) concludes that the most common reason for invalidating sub-national regulations is that they imposed illegal taxes or user charges, and thus contradicted national laws on sub-national taxes and user charges.[3] Only a very small number of sub-national regulations appear to have been invalidated for other reasons. These sub-national regulations involved the establishment of co-operatives, business permits, and rickshaw (becak) licences. Even though most sub-national regulations likely pertain to taxes and user charges, one would have expected more sub-national regulations to have been invalidated for other reasons as well (Butt, 2010).

In addition to focusing on taxes and user charges, Butt (2010) argues that the review process may not work effectively for other reasons as well. First, the reviews are conducted by relatively small teams from MoHA and governors' offices. These teams may decide not to review many sub-national regulations simply because they lack the human and other resources needed for a review. Second, many regional governments may not send their sub-national regulations to the national government for review, and even fewer for pre-approval, as required by the 2004 Law on Sub-national Government. This may change now as a result of the sanctions that were introduced under the Law 28/2009 on Taxes and User Charges. Finally, sub-natioanl governments also rarely use regulatory impact assessments to consider the likely effects of proposed regulations. Very few sub-national governments seem to maintain formal consultative processes with the private sector and citizens, and only interact with the private sector and citizens to "socialise" regulations after they have been enacted.

1. Law 22/1999 on Sub-national Government; Law 25/1999 on Inter-governmental Fiscal Relations.
2. Regional lawmakers must send their regulations to the central government within seven days of enactment. The central government has 60 days in which to conduct the review. Sub-national regulations not reviewed within this time period enter into force by default.
3. Law 18/1997 on Sub-National Taxes and User Charges and its amendment (Law 34/2000).

The Government has made the issue a priority area in its Medium-Term Development Plan (2010-2014), led by the National Development Planning Agency (Bappenas), as well as in the MP3EI. In order to address the issue of inconsistent regulation and to reduce the large inventory of laws/regulations which have accumulated, the government intends to systematically inventory, review and simplify laws and regulations at both national and local government levels.

The OECD Indonesia Investment Review 2010 notes that, "The Ministry of Home Affairs (MoHA) has evaluated sub-government regulations and draft regulations and recommended the revocation of 1 123 sub-national regulations (with 1999 others targeted for revocation) because of inconsistency with higher-level laws/regulations and estimated harm to the sub-national investment climate."[2] While the Committee for the Monitoring of Regional Autonomy Implementation (KPPOD) is responsible for monitoring and evaluating all sub-national government regulations, and can make recommendations to the Ministry of Home Affairs on amendments and revocations that are required. However, in a January 2012 article for the Strategic Review it is stated that four thousand conflicting sub-national regulations still remain to be settled, with these being the more complicated to straighten out and therefore more demanding of time, attention and regulatory capacity (Mangkusubroto *et al*., 2012).

The jurisdictions of sub-national governments themselves have been relatively indistinct as regional divisions were continually changing shape until a recent moratorium on the creation of new districts. Prior to this moratorium districts were mutating into new, smaller entities at will; the number of regional authorities (districts and sub-districts) increased from 440 in 2004 to 497 in 2009.[3] This process created more and more entities producing regulations and managing implementation, thereby increasing the scope for divergence from the centre, while further straining accountability by blurring the line between policy and implementation and its authority. Furthermore, with regional autonomy has come the right, indeed the requirement, for provincial, city and regency governments to manage sub-national finances (Sutmuller *et al*., 2011). This has led to locally imposed taxes and levies being used as a source of income rather than legitimate user charges, while taxation is not formulated with incentives for development in mind.

Decentralisation has also created more opportunities for corruption by increasing the number of decision makers across the Indonesian Archipelago with the power to exploit policy-making processes for personal gain. A lack of transparency and clarity of regulations, combined with the various lengthy stages of bureaucratic processes, have further enabled corruption to persist introducing another unaccountable influence on an already entangled policy-making process.

Anti-corruption efforts in Indonesia

Institutionalised corruption is a challenge that the government has acknowledged and continues to tackle. The World Bank estimates that corruption may increase the cost of doing business in Indonesia by as much as 20% (Business Monitor International, 2011). The problem of corruption has not only been encountered in the political system during the process of business start up, but also in the judicial system during dispute settlement. The customs and tax services are other areas vulnerable to corruption as regards import duties and taxes. A lack of transparency and clarity of regulations, combined with the various lengthy stages of bureaucratic processes, have further enabled corruption to persist. Decentralisation has also created more opportunities for corruption increasing the number of decision makers across the Indonesian archipelago. Although this issue is

endemic – in 2010 Indonesia ranked 110 out of 178 countries on Transparency International's Corruption Perceptions Index[4] – the government of Indonesia is trying to break a long tradition of corruption by implementing transparent and accountable governance.

While the first anti-corruption measure introduced in Indonesia was enacted following the general election of 1955, the fight against corruption has only gained significant momentum over the past decade. The Clean Government Law[5], was the first comprehensive act to clarify the definition of corruption in order that it could be identified in its various forms and perpetrators charged on the basis of clear breaches of the law. To further enable judicial action to be taken against corruption in public life, this law outlined the charges and procedures for prosecution. Over the years, several additional laws have been issued to establish institutions to identify corruption and pass judgment on perpetrators: a Corruption Court, a Judicial Commission and a National Ombudsman Commission.

The government has also attempted reform of the judiciary to accelerate its drive against corruption and promote legal certainty. This is a critical element in the anti-corruption agenda since Indonesia's judicial system enjoyed little independence from the executive in pre-Reformasi days, and there had been virtually no high level prosecutions for corruption. Over the second half of the last decade however, several reform initiatives have been introduced, such as the introduction of regular rotations and merit-based assessments of judges and, significantly, the publication of court decisions; decisions were previously confidential and therefore avoided public and legal expert scrutiny.

The Indonesian Corruption Eradication Commission (*Komisi Pemberantasan Korupsi* (KPK)) has successfully prosecuted several politicians, legislators, former ministers, police officers, civil servants, justice officials and other government officials. Increasing institutionalisation of anti-corruption measures – such as scrutiny of bank accounts and transparency of public tenders, procedures for investigation and prosecution and active agencies with the power to undertake such procedures – will make corruption less possible as well as increasing risks for perpetrators. As it becomes increasingly clear that corruption is detectable by the agencies empowered to discover it, and that no-one is immune from investigation and prosecution no matter how high their professional standing, corruption will become a less attractive prospect to those with the opportunity to engage in it.

What is also significant is that details of suspected acts of corruption and the suspected perpetrators have been published in the media. Coverage of the issue by the Indonesian press has been relentless. This level of transparency (made possible by the Freedom of Information Act,[6]another reform measure introduced in the post-Suharto period) will make it harder for corruption to be covered up by those in power with a vested interest in doing so.

So far then, legislation against corruption, the creation of procedures and institutional arrangements to deal with it, and increased transparency magnified by a free press all represent the considerable progress of anti-corruption reforms.

1.2. Economic recovery and current regulatory priorities

Indonesia's rapid, relatively non-violent and large-scale institutional and social transformation laid the foundations for a robust economic recovery within five years of the onset of the Asian financial and economic shock. Macroeconomic stability, an ambitious social safety net, a sharp rise in foreign loans and grants and a sharp recovery in consumer confidence all played a part in the recovery. However, much of this would not have been possible in a combative and politically charged political atmosphere that often prevails during such system wide transformations. The absence of polarised ideological positions across different political parties and the willingness of Indonesian political leaders to coalesce in national coalition governments helped Indonesia to focus on putting in place the key elements of its democratic political architecture, including the separation of powers, open and free multiparty elections and the establishment of a Constitution Court within a short space of its first democratic election in 1999 and its presidential elections of 2004. Indonesian democracy was thus able to preside over a remarkably rapid economic recovery founded first on rising consumer confidence and then on a sharp rise in foreign investment. It was also able to preside over a comprehensive restructuring of its financial institutions, especially its banks and capital markets, such as to largely escape the contagion from the 2008 global financial shock.

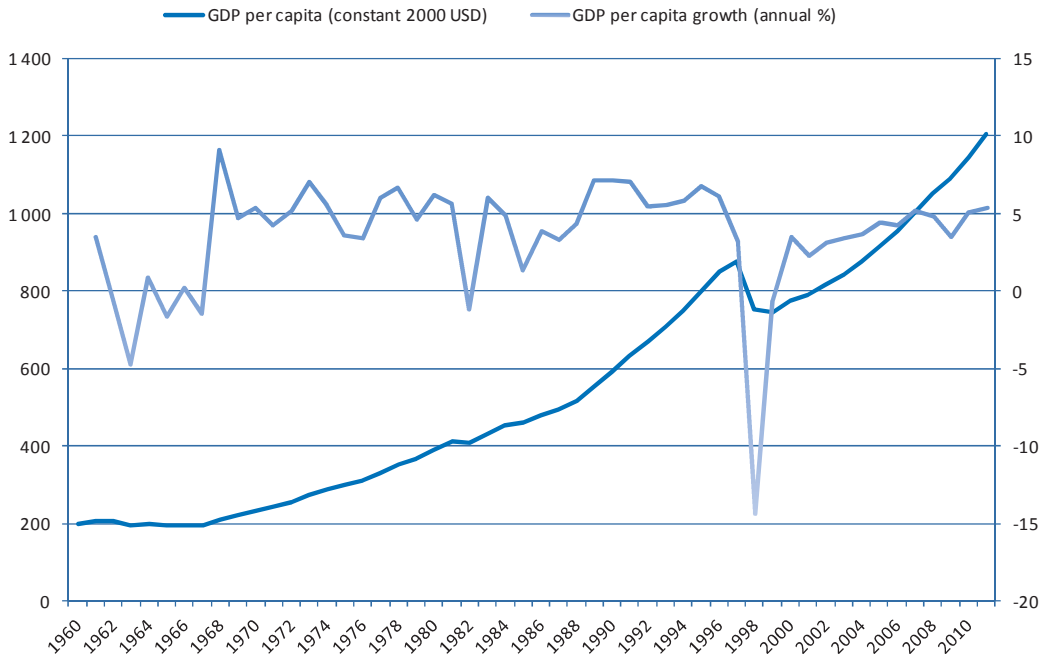
Table 1.1. Economic projections

	2010	2011	2012	2013
OECD secretariat projections (July 2012)				
Real GDP (per cent)	6.2	6.5	6.0	6.2
Inflation (end-year, per cent)	7.0	3.8	4.0	4.5
Current account (per cent of GDP)	0.7	0.2	-0.8	-1.4
Public balance (per cent of GDP)	-0.7	-2.0	-2.1	-1.9
Government of Indonesia projections				
Real GDP (per cent)	6.2	6.5	6.5	6.8 to 7.2
Inflation (end-year, per cent)	7.0	3.8	6.8	4.5 to 5.5
Current account (per cent of GDP)	0.7	0.2	0.4	0.6
Public balance (per cent of GDP)	-0.7	-2.0	-2.2	-1.3 to -1.9

Source: OECD and Ministry of Finance.

Indonesia emerged relatively unscathed from the 2008 financial crisis. Economic growth in recent years has finally started to reach pre-crisis levels despite the rapid structural and decentralisation reforms that occurred post the fall of Soeharto. From the longer-term perspective except for the Asian financial crisis Indonesia has experienced stable rates of growth, though not in recent years as impressive as the growth rates for China and India.

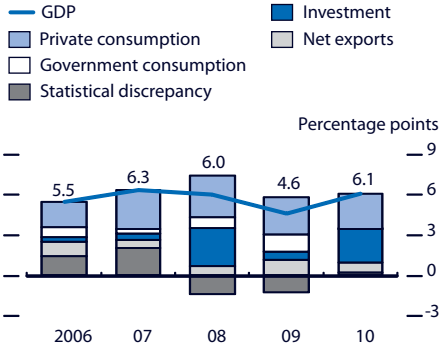
Figure 1.2. Real GDP growth and per capita GDP growth in Indonesia, 1960-2010



Source: Strategic Asia with data from the World Bank Database, *http://data.worldbank.org/country/indonesia*, accessed in June 2012.

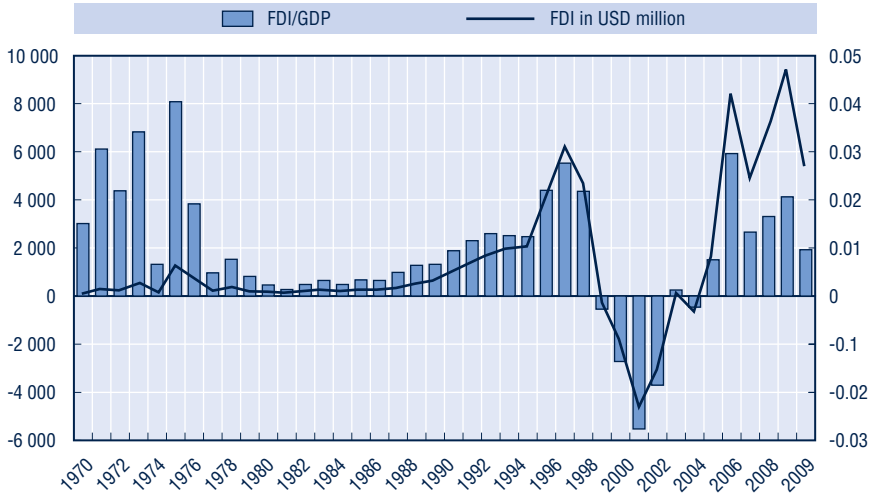
While the initial years of recovery post the Asian financial crisis were driven by consumption driven growth accompanied by a series of major reforms in the banking sector, current growth is now being propelled by a significant increase in Foreign Direct Investment especially focused on the manufacturing sector.

Figure 1.3. Contributions to GDP growth in Indonesia, 2006-10



Source: ADB (2011), *Asian Development Outlook 2011*, April.

Figure 1.4. FDI inflows in Indonesia



Source: OECD Statistical Database, Bank Indonesia.

To support future economic growth and stability, the government of Indonesia has recently introduced several regulations to improve the investment climate including the 2007 Investment Law and the Land Acquisition Bill.

Although the effectiveness and scope of these laws is under considerable debate, the first decade of Indonesia's systemic transition has been characterised by some major successes including the establishment of a politically credible multiparty democracy, decentralised decision making, reduction in social conflict, a high profile anti-corruption drive and a convincing economic recovery. Within this ambitious reform agenda during the last decade, the emphasis was on maintaining national unity, in avoiding social disintegration and political polarisation and in recovering from its deepest economic crisis since independence. Towards the end of the last decade, growing confidence in the new political system and the speed of the economic recovery has opened the door to a much more ambitious economic agenda as outlined in the MP3EI. Reform of the regulatory framework is an inherent part of implementing this plan. The political and institutional transformations of the first decade of Indonesian democracy provide the enabling conditions for the determined efforts at regulatory reform that have been missing during the last decade.

Present-day priorities

Looking forward, the very successes of Indonesia's democracy and the remarkable speed with which this has taken place have created second generation problems that concern policy makers today. Boundary changes and unpredictable decisions of sub-national governments on business licences have increased business risks, laws and regulations exhibit internal inconsistency as well as poor sequencing, inflexible procurement policies have resulted in an under-expenditure of government budgets, the policy-making process is mired in confusion and overlapping authority. Moreover, the success of Indonesia's elections and open media has raised economic expectations of both business but more importantly citizens. While economic inequality is not central to the government's policy agenda today, the experience of India and China with respect to

sharp increased inter-household or inter-regional inequality is not lost on Indonesian policy makers. The newly announced MP3EI which intends to accelerate Indonesian economic growth sharply has the reduction of inter-regional inequality as an important goal.

To consolidate democracy, to control the excesses and confusions of rapid decentralisation, to provide incentives to the private sector and to conclude public-private partnerships in infrastructure requires a transparent, predictable and easily understood set of "rules of the game". The very success of Indonesia's systemic transition has lent urgency to addressing a host of second generation institutional problems. This cannot be done without addressing Indonesia's regulatory framework and designing a programme of regulatory reform in a wide range of areas from transport and decentralisation to governance and the policy-making process. This in turn requires an appreciation of Indonesia's legal and regulatory framework.

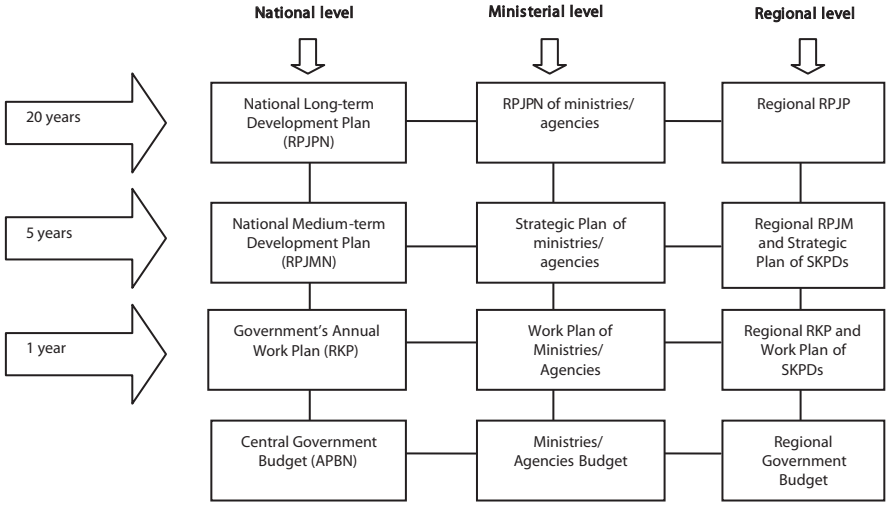
Institutional transformation and the complexities of the regulatory framework

Rapid institutional transformations during Indonesia's democratic transition in over the past decade have resulted in disorderly decision-making procedures. The policy-making process was further complicated by the active role played by the DPR and a multitude of actors are now able to exert their influence to delay, amend or block legislation during the course of its passage. The number of agents required to coalesce in agreement on each piece of legislation requires a bill to be shaped according to multiple interests, delays it indefinitely through conflict or lack of interest or necessitates a high level authority to back a bill's passage using his/her influence to elicit assent. The necessity to involve highly placed agents to co-ordinate decision making creates a bottleneck, while the increased plurality of the policy-making process exposes decisions to multiple avenues of dissent and obstruction. In addition, the growth of institutions responsible for regulation and implementation has resulted in overlapping jurisdictions, inefficient use of resources and competing political interests with institutions inevitably colliding with one another (Mangkusubroto *et al.* 2012). This issue of multiple units of decision making increased with the transfer of regulatory power to sub-national governments during the process of decentralisation, a central element of the institutional transformation.

The Indonesian legislative hierarchy

There appear to be two major policy-making processes in Indonesia, with the first one looking at regular development planning and budgeting and the second one focusing on the development of more *ad hoc* laws and regulations. The development plans are, to all intents and purposes, binding. They are drawn up in combination with the annual budget, they determine budget allocations to the line ministries and they set the agenda for the line ministries own five-year term strategic plans (Renstra). What is more, they have the express intent of the President behind them; such high level commitment is an important factor in policy plans being realised through parliamentary approval and co-operative implementation, as will be expanded upon further in this report.

Figure 1.5. The development planning hierarchy



Source: STIE YKPN (n.d.), "Perencanaandan Penyusunan Anggaran [Planning and Budgeting]", Reprinted in *The political economy of policy-making in Indonesia: Opportunities for improving the demand for and use of knowledge*, Ajoy Datta *et al*. (2011), The Overseas Development Institute.

Implementation guidelines

Once a bill has been approved as law, it is by no means the end of the policy-making process. Laws provide statements of general principle, so often laws which entail high level principles require sensitive implementing regulations to be issued in the form of government or presidential regulations or decrees. This may delay implementation where the necessary guidelines must address politically sensitive and technically complicated issues. For example, Law 40/2004 on universal provision of Social Protection and Social Insurance is yet to be enacted as it is dependent on the issuance of government regulations for implementation. The Social Security Organising Body (BPJS) Bill was passed in October 2011 regarding the institutional structure of a single social security organisation, which will require three existing state social protection agencies to be merged. Even this bill is yet to accomplish the task which will require extensive financial auditing of the existing bodies as they make the transition to not-for-profit status.

Box 1.3. Indonesia's legislative hierarchy

Since 2004, there have been a number of reforms to clarify the legal hierarchy into a number of specific instruments At the national level, its hierarchy of laws and regulations involve six levels.[1]



After the Constitution, laws occupy the highest level of the legislative system. The DPR and the President collaborate in the preparation of laws, but the President has no power to veto laws passed by the DPR. The next level in the hierarchy includes government regulations in lieu of law. This type of legislative tool is issued by the President only in the event of an emergency, or a situation in which a law is immediately needed and there are no other options for legislating the issue.

Government regulations are issued by the President and are used to set out the implementing regulations needed to realise a particular law. Government regulations may only be prepared if provisions for their existence are made in a law. Presidential regulations are situated at the next level in the legislative hierarchy, and are issued by the President. Like government regulations, presidential regulations are used to provide implementing regulations related to a given law and the execution of executive power. Unlike government regulations, a presidential regulation can be made even if it does not mention explicitly the law to which it relates. Provincial regulations, which are developed by the provincial House of Representatives in collaboration with the governor, follow. Finally, regency and city regulations represent the lowest level of the hierarchy, and are formulated by the regency/city House of Representatives in collaboration with the regent/mayor.

In general, there are no specific requirements stipulating the timeframe in which implementing regulations should be passed, although there appears to be a goal of enacting these regulations within one year of the passage of a law. In practice, however, this does not appear to happen systematically. For example, the Mineral and Coal Mining Law was passed in 2009, but implementing regulations are still being promulgated.

Instructions issued by the President (*Instruksi Presiden*) and Ministers (*Instruksi Menteri*); regulations issued by Ministers (*Peraturan Menteri*) and Director Generals (*Peraturan Direktur Jenderal*); decrees issued by the President (*Keputusan Presiden*), Ministers (*Keputusan Menteri*) and Director Generals (*Keputusan Direktur Jenderal*); and joint ministerial letters (*Surat Kebersamaan Menteri*), are not a part of the legislative framework.

Presidential Instructions have no legal standing, but are an important statement of political commitment or intent. They are used to highlight important issues that need to be addressed, direct bodies to co-operate and co-ordinate actions, and provide instructions on a range of measures that should be taken. They cannot include legislative amendments or contradict laws. The President can use them to call upon the People's House of Representatives and ministries to draw up appropriate legislation. In the case of decrees, they are only binding on their respective sectors as an administrative decision.

Once legislation is enacted, it is published in the State Gazette of the Republic of Indonesia (*Lembaran Negara Republik Indonesia*). In addition, laws and government regulations are accompanied by an elucidation (*penjelasan*), or official explanatory document. This explanatory document is then published in the Supplement to the State Gazette (*Tambahan Lembaran Negara*) and is meant to represent the authoritative document for purposes of interpretation. The State Report (*Berita Negara*) represents another publication in which the government publishes other government documents and public notices.

1. Law 12/2011.

Source: OECD (2012), "Government Capacity to Assure High Quality Regulation in Indonesia", available at *www.oecd.org/regreform/backgroundreports*.

Plurality of decision making

The increased role of the National People's House of Representatives (DPR) in the legislative process since the fall of Suharto, has increased the plurality of the policy-making process. The number of agents now active in formulating, scrutinising and assenting to legislation has increased the scope for legislation to be amended, delayed or blocked, facilitating a slowdown in the legislative process. For example, the Land Clearance bill, originally scheduled for completion in July to September at the latest, was finally passed in December 2011 (Yulisman, 2011). DPR commissions exert considerable influence over the passage of legislation. For example, the Datta *et al*., (2011) state: "during the budget process, individual commissions whose concerns have not been addressed have been known to hold back budgetary disbursements until they have, even when the budget has been formally approved. As a result budget disbursements on occasion have not been authorised until several months into the next fiscal year. In 2007, for example, about 45% of all expenditures were delayed". Once introduced to the DPR by the executive a bill will be assigned to a DPR commission for discussion. It is not until consensus, which must take the form of unanimous agreement, has been reached in a DPR commission that legislation can pass to the plenary session stage. A problem inventory list, known as a DIM, will form the basis for negotiations. This list could contain hundreds of items all of which must be resolved before the bill can be finalised (Datta *et al.*, 2011).

Membership of DPR commissions is proportionate to party representation in the DPR. Commission members are dependent on their party nomination for their membership and so must be seen to perform adequately by the party nucleus. As such, party representatives may seek to exert their party's influence in the form of adversarial debate on the basis of party loyalty, even when a political party does not have a clear agenda for how a particular piece of legislation should be shaped. The practice of unanimous agreement gives each member of parliament the power to block the legislation until it has been altered to accommodate their position. This means that legislation might only secure passage through the legislature after it has become diluted, ambiguous or even contradictory to accommodate the views of all members of the DPR commission assigned to discuss it. Although there is an electoral threshold which must be reached for

a political party to gain representation in the DPR, the minority parties that do make it are represented in the commissions and therefore must agree to the legislation for it to continue through the legislative process. This means that a piece of legislation might be blocked or altered in accordance with the will of a minority party even when the majority has already assented (Datta *et al.*, 2011).

Within the Indonesian decision making system various units operate independently, working in silos even where their responsibilities overlap and therefore need to be co-ordinated. Since democratisation there has been considerable growth in the number of institutions operating within the political system. Institutions have been created as emergency measures, in response to new priorities, or to check the work of other pre-existing institutions. A number of commissions and taskforces have been established under the Office of the President in order to alter the working procedures of existing bodies to make them more effective. The President's Delivery Unit on Development Monitoring and Oversight (UKP4) was set up at the beginning of President Yudhoyono's second term to ensure his policy agenda was being met by various ministries required – but failing – to co-ordinate their activities with one another.

This evolving institutional landscape has meant that the distinct jurisdictions of each Ministry, agency, unit and other policy or implementation body has become more complicated, sometimes resulting in a duplication of outcomes where functions overlap. An example of this is the MP3EI which runs parallel to the medium and long-term plans developed by Bappenas. Furthermore, siloisation results in this type of inefficiency which is characterised by both a lack of co-ordination as well as competing agendas (Mangkusubroto *et al.*, 2012).

Regulatory reform in Indonesia's future development agenda

A number of political and economic considerations are driving the government of Indonesia towards greater concern with the reform of its regulatory institutions and the quality of its regulations. The urgency of regulatory reform in the current context stems from the dynamic issues described in the introduction to this section; the need for regulation to establish a competitive global market; the need for developing Asian countries to increase sustainable growth while reversing inequality; the limited fiscal space of such governments given the need to shore up development by accumulating foreign reserves and limiting government spending; the resultant need to attract private participation in public infrastructure projects through public-private partnerships. At the same time, competition for markets, investment and the acquisition of new technologies and supply networks will be established in the ASEAN region through increased integration of this particular economic community. In consequence of this move towards integration, Indonesia is under increasing pressure to harmonise its regulations with ASEAN standards by 2015.

Indonesia will seek to make its production competitive with its ASEAN peers through the MP3EI, geared towards increased specialisation and the exploitation of comparative advantage through growth poles in selected regions within an improved infrastructure framework. The distribution of these growth poles across the archipelago will bring lagging regions closer to the development levels of the leading cities, thereby reducing regional inequality. Regulatory reform to harmonise, simplify and improve the market friendliness of existing regulations will be necessary to attract investors.

Acceleration of economic growth through infrastructure connectivity (MP3EI)

Regulatory reform in Indonesia is key for the success of the MP3EI. The MP3EI outlines a long term picture and vision of Indonesia's development plan for 2011-2025 and it serves as the foundation for transforming Indonesia into one of the 10 major economies in the world by 2025.

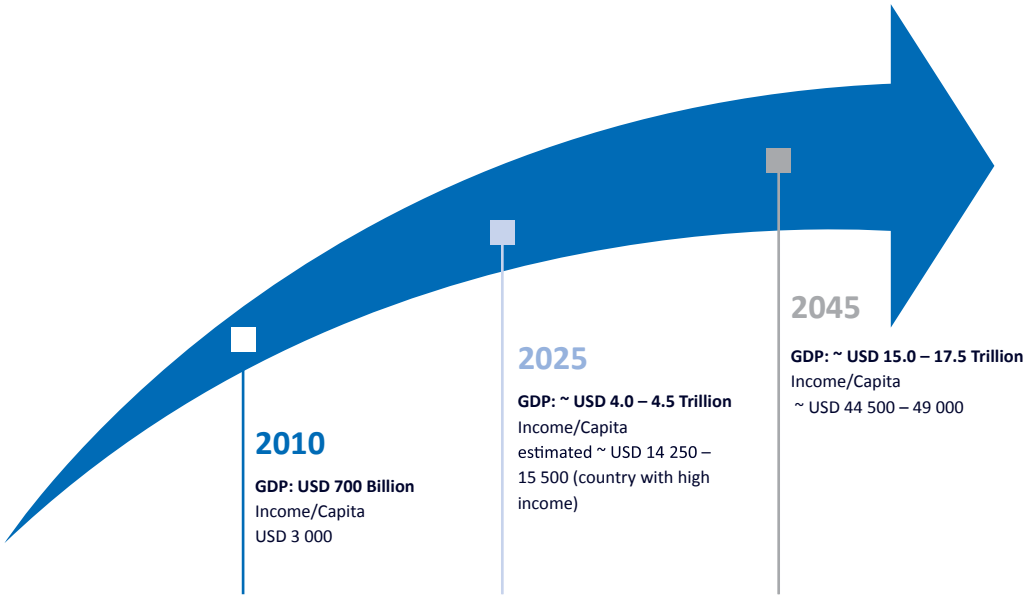
MP3EI intends to create new growth centres based on regional economic potential as well as increased connectivity between the six Indonesian Economic Corridors in Sumatra, Java, Kalimantan, Sulawesi, Bali-Nusa Tenggara and Papua-Kepulauan Maluku. The rationale behind developing new growth centres is to utilise regional advantages, explore regional strengths, and reduce the existing spatial imbalance of economic development throughout the nation. The MP3EI draws a long term economic map for Indonesia's future which includes:

- Acceleration of real GDP growth to 7.5% per year by 2014 and for the remainder of the MP3EI period till 2025.
- A sharp increase in the per capita GDP of around USD 3 000 in 2010 to close to USD 14 250 by 2025; growth should further result in a per capita GDP of 44 500-49 000 by 2045.
- Emphasis on 8 main development programmes and 22 economic activities.
- Total investment targets of IDR 4 012 trillion (USD 445 billion) by 2025 of which the government will provide 10%, SOEs 18%, PPPs 21% and the private sector 51%.
- Infrastructure investment of IDR 1 786 trillion (approximately USD 198 billion), accounting for 44.5% of the total investment estimates. Out of this total the largest share will be go on power and energy infrastructure amounting to IDR 681 trillion (approximately USD 75.6 billion), 38% of the total infrastructure budget, 17% of the total estimated investment needed for the MP3EI (Republic of Indonesia, 2010).

Despite all this, there is much scepticism surrounding the fulfillment of the MP3EI. The reasons for this scepticism include: tight implementation schedules, the enormous private sector funding sought and the limited capacity within the government to conclude the needed PPP agreements for infrastructure investment in the coming decade, as well as the need to swiftly upgrade Indonesia's human capital to meet the manpower needs across each economic corridors and quickly overcome structural constraints through regulatory reform.

Looking at the bigger picture, the MP3EI is critical for many reasons. First, it contains the imprint of virtually all the key policy making institutions in the country supported by a host of international expertise. Work on it was directly overseen by the President and the Vice President while a large number of working groups were convened in the process, including one for each projected economic corridor.[7] The process of MP3EI formulation has promoted inclusiveness, high political commitment, expert consultation and public announcement. No other policy initiative has received either such a high profile or so much attention in the entire period following the collapse of the New Order.

Figure 1.6. The MP3EI plans for Indonesia's gross domestic product

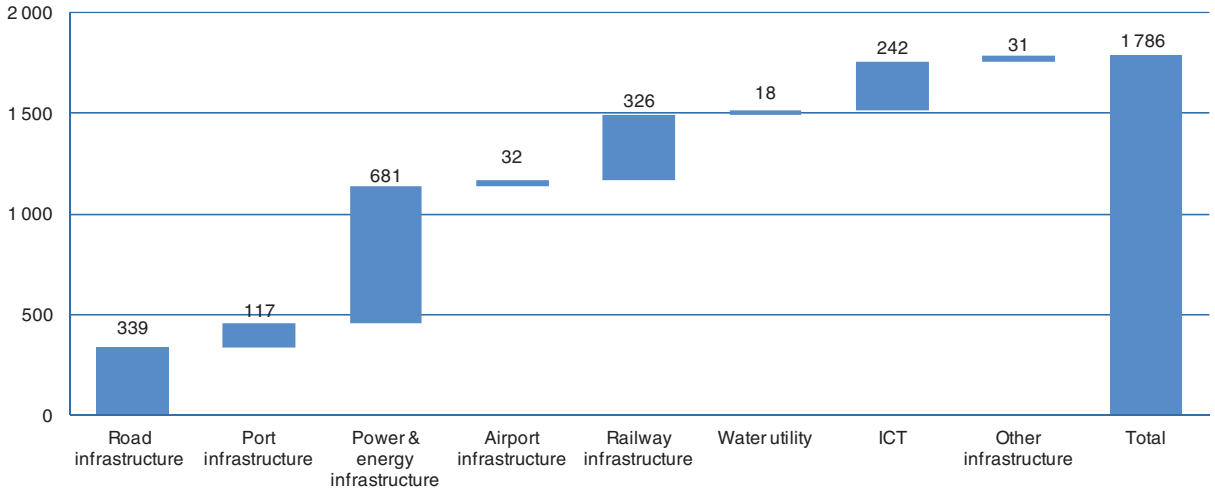


Source: Republic of Indonesia (2010), *Master Plan Percepatan dan Perluasan Pembangunan Ekonomi Indonesia* (Master Plan for the Acceleration and Expansion of Indonesian Economic Growth), Co-ordinating Ministry for Economic Affairs, *Jakarta.*

The private sector has an important role to play in economic development, particularly in generating investments and creating employment opportunities, that is why the Government is providing special incentives to support the development of these corridors. The aim of providing such incentives is to encourage businesses to build long term prospects in the development of the new economic growth centres.

Figure 1.7. Indication of infrastructure investment for the MP3EI

Values in trillion IDR



Source: Republic of Indonesia (2010), *Master Plan Percepatan dan Perluasan Pembangunan Ekonomi Indonesia*, (Master Plan for the Acceleration and Expansion of Indonesian Economic Growth), Co-ordinating Ministry for Economic Affairs, *Jakarta.*

The total value of the infrastructure investment projects, connectivity and other economic sectors and sub sectors will reach USD 450 billion. Financing from the government will cover 12% of the cost. The remaining balance should be provided by the private sector (49%), state-owned enterprises for 18% and public-private partnerships (PPPs) 21%. But for this to occur, there are a number of regulations that need to be removed, aligned or reviewed. Regulatory reform is a critical component of the first phase (2011-15) of the MP3EI which identifies regulatory bottlenecks in at least nine national laws, six government regulations, five presidential regulations, presidential decrees, presidential instructions, nine ministerial regulations and a number of sub-national regulations and permits (APEC, 2011). The first phase of the MP3EI aims to:

- at the national level: review cross sector regulations and streamline permit applications related to spatial management, labour, taxation and the ease of capital investments; and

- at the sub-national level: revise regulations and permits concerning the mineral and coal, forestry and transport sectors as well as basic infrastructure (APEC, 2011).

Relying on large private sector investments will mean that the government of Indonesia will need to create a favourable environment that can win the trust of the private sector through clearer regulations, therefore reducing opportunities for misinterpretation, increasing trust and participation from investors in this process (Republic of Indonesia, 2010). All this puts considerable pressure on the government to accelerate the process of regulatory reform in order to reach growth targets.

The overall direction of the MP3EI contains a series of very general policy suggestions seeking private investment through PPPs in infrastructure and overall investment increases including FDI for manufacturing and other sectors. This shows a willingness to address the regulatory framework, contract security and land rights issues. Also, one of the results of the drive for economic diversification in the MP3EI is the focus on raising sub-national value added, but given that the MP3EI is still an evolving document and there is much room for clarification and industry or firm specific presentations, the regulatory mechanisms and targets are still being worked out. Currently every line ministry is in the process of defining its Renstra in light of the broad directions set out in the MP3EI.

International regulatory co-operation – rule harmonisation in ASEAN Economic Community 2015

Internal pressure for advancing reforms in Indonesia are evident on one side, but on the other side the emergence of the ASEAN Economic Community is also putting pressure on Indonesia to accelerate the bureaucratic, administrative and regulatory reform needed to ensure its competitiveness regionally and globally. The ASEAN Economic Community includes the commitment by ASEAN member countries to establish a single market and production base, with free flow of goods, services, investment, capital and skilled labour by 2015. The ASEAN Economic community includes integration schemes on: trade, investment and services. Trade and investment integration has been progressed through a series of related Free Trade Agreements (ASEAN Secretariat, 2011).

Regional integration into ASEAN has become an important policy priority for Indonesia. The "ASEAN Vision 2020", aiming to integrate Southeast Asian economies through equitable economic development and reduced socio economic disparities, is now becoming a reality. Closer integration of Indonesia into ASEAN – the member with the largest economy and population – will result in several future opportunities, ranging from regional stability and economic prosperity. The process of regional integration, however, will require considerable efforts from the government of Indonesia to align its policies within ASEAN frameworks.

There have already been a number of signals indicating Indonesia's seriousness to meet the ASEAN free trade objectives in the form of the inclusion of some ASEAN Economic Community commitments in formal government policy (e.g. Presidential Instruction 5/2008). Presidential instructions have outlined many detailed plans for domestic policy to remove tariff and non-tariff barriers, and simplify the AFTA common Effective Preferential Tariff (CEPT) Rule of Origins. The Government of Indonesia also initiated the National Logistics Blueprint 2008, aiming to improve the Indonesian logistics sector. The Blueprint is consistent with the Agenda of the ASEAN Economic Community in its plan to improve the services of the Indonesian logistics services provider industries (Narjoko *et al*., 2010).

To prepare Indonesia to become part of the ASEAN Economic Community and to improve its competitiveness, the Ministry of Trade is also accelerating industrial readiness within the integration framework. According to a research report by the Ministry of Trade in 2009 the ASEAN Economic Community requires standard harmonisation which implies that all industrial products must be regionally standardised under the Mutual Recognition Agreement scheme (Narjoko *et al*., 2010). This process will require the integration of 11 priority sectors including: wood based products, automotives, rubber based products, textiles and apparel, agro based products, fisheries, electric and electronic equipment, health care, air travel and logistics services. The successful standardisation of the 11 priority integration sectors is critical for the realisation of the ASEAN economic Community yet special efforts are required to finalise the roadmap for Indonesian integration through the assessment of each priority sector in terms of its legal aspects, financial requirements and technical issues.

Despite some advances in rule harmonisation, Indonesia still lags behind some of its neighbours, including Malaysia, Singapore, Thailand and Vietnam, in its achievements in the mutual recognition scheme. For instance, in the case of electronic equipment market liberalisation, the standards for 199 products still need to be harmonised. By 2009, Indonesia had only registered 19 products, which is considerably low when compared to Malaysia, registering 156 products, Thailand 56 or Singapore 34. Often the registration of a product could indicate the good's competitiveness in the ASEAN single market.

Another example may be drawn from the food sector, where ASEAN members should register approximately 80 products to be standardised. Indonesia however will need considerable efforts to register all products given that 21 out of 80 of the food categories have no mandatory national standards, which need to be implemented prior to ASEAN products registration. The lack of accredited labs might be one of the barriers in the implementation and evaluation of the mandatory national standard.

Indonesia's commitment to create an Economic community recognises the importance of continued expansion in trade and investments for ASEAN overall economic growth, and Indonesia has already benefitted from rapid growth in exports and foreign investments. The past decade has seen a gradual strengthening of ASEAN intra

regional integration. Total ASEAN trade has reached USD 1.5 trillion in 2009, with intra-ASEAN trade accounting for 25%, up from 22% in 2000. Meanwhile intra regional FDI inflows have increased dramatically since 2000, up from 3% of FDI inflows to 20% by 2008. The economic community is designed to transform ASEAN countries as a magnet for export-oriented investment (World Bank, 2011b).

ASEAN leaders addressed the issues of regulatory reforms for the first time at 20th Meeting of the High Level Task Force on Economic Integration (HLTF-EI) summit in August 2011, as countries prepare themselves for full economic integration by 2015. The HLTF-EI is the advisory body of the Economic Ministers of ASEAN, with the task to ensure that economic integration by 2015 is on track. One of the most important steps forward was the institutionalisation of the Annual Regulatory Reform Dialogue, an annual forum for discussions on regulatory reform particularly focusing on trade, transport facilitation, trade in services and investment facilitation. The efforts shown by all ASEAN members is a proactive step towards looking at ways to deal with impediments to trade, investment facilitation, as ASEAN advances its economic integration. There is an acknowledgement that strengthening the regulatory environment among ASEAN member countries will reinforce economic integration (Jakarta Post, 2011).

In view of increased economic integration, Indonesia's inability to compete with other countries would result in them overtaking its position in the global market. A breakthrough action is needed to deal with the discussed challenges, or the opportunities of future integration in ASEAN might not be fully taken advantage of.

Indonesia and APEC

Regulatory reform is also a key element of Indonesia's regional commitments to the Asia-Pacific Economic Cooperation (APEC). In 2011, the leaders of APEC issued "The Honolulu Declaration" committing all APEC countries to adopt a whole-of-government approach to regulatory management, assess the impact of regulation and promote public consultation in regulatory decision making. This declaration also committed leaders to report on their actions to implement good regulatory practices in November 2013, when Indonesia will chair APEC.[8]

Box 1.4. 2011 APEC Leaders Honolulu Declaration and the APEC-OECD Integrated Checklist

Building high quality regulatory environments is a key component of APEC work to promote free and open trade and investment in the Asia-Pacific. Since its inception, APEC has promoted the use of good regulatory practices and worked to reduce the negative impact of regulatory divergences on trade and investment. APEC work in this area seeks to embed the concepts of non-discrimination, transparency and accountability into the regulatory cultures of APEC economies, which will help create jobs and promote economic growth.

Therefore, APEC Leaders agreed to undertake the following actions by November 2013 to strengthen the implementation of Good Regulatory Practices:

1. Develop, use or strengthen processes, mechanisms or bodies to enable a whole-of-government approach in the development of regulations, including co-ordination across regulatory, standards and trade agencies.
2. Develop, use or strengthen mechanisms for assessing the impact of regulations, which involves effective and consistent use of the tools and best practices for developing new regulations and reviewing existing regulations.

3. Implement the principles related to public consultation of the 2005 APEC-OECD Integrated Checklist on Regulatory Reform section on regulatory policy and the 2004 Leaders' Statement to Implement the APEC Transparency Standards.

Member economies of APEC and the OECD recognised that regulatory reform is a central element in the promotion of open and competitive markets, and a key driver of economic efficiency and consumer welfare. As a result, agreement for an APEC-OECD Co-operative Initiative on Regulatory Reform was reached in June 2000 and was endorsed at the APEC Ministerial Meeting on 12-13 November 2000 in Brunei Darussalam, in order to promote the implementation of the APEC and the OECD principles by building domestic capacities for quality regulation. In 2005, the Executive Bodies of the APEC and the OECD approved the APEC-OECD Checklist, a voluntary tool that member economies may use to evaluate their respective regulatory reform efforts.

Source: 2011 Leaders' Declaration, "The Honolulu Declaration – Toward a Seamless Regional Economy, Annex D: Strengthening Implementation of Good Regulatory Practices" The 19th APEC Economic Leaders' Meeting, 12-13 November 2011, *www.apec.org/Meeting-Papers/Leaders-Declarations/2011/2011_aelm/2011_aelm_annexD.aspx.*

Open media and public awareness of red tape and over regulation

The technological advances of the past few years have transformed the way people communicate and exchange information. The strongest movement impacting people's lives has been the rise of citizen engagement through the use of social media and mobile phone devices, whereby people around the world want to be more actively involved in government-citizen engagement through public information and interaction.[9]

The government-citizen engagement we are witnessing today around the world starts from the premise that effective communication is necessary to uphold the pillars of good governance – accountability and transparency – and should be a central mechanism of democratic societies. In Indonesia this mechanism has come into existence following the growth in media outlets, increased diversity of ownership and a reduction in restrictions on media freedom since the end of the New Order regime.[10] Less than 300 print media existed in early 1999, a figure which has risen to over 1 000 today. Increased Internet usage has caused access to media to diffuse and increase and new institutions have been established to oversee the media, such as the Press Council and the Indonesian Broadcasting Commission (USAID, 2009).

Table 1.2. Internet usage in Indonesia

Year	Number of subscribers	Number of users
1998	134 000	512 000
1999	256 000	1 000 000
2000	400 000	1 900 000
2001	581 000	4 200 000
2002	667 002	4 500 000
2003	865 706	8 080 534
2004	1 087 428	11 226 143
2005	1 500 000	16 000 000
2006	1 700 000	20 000 000
2007	2 000 000	25 000 000

Source: *Don't Shoot the Messenger: Policy Challenges Facing the Indonesian Media*, Tessa Piper, November 2009, USAID.

An important milestone for Indonesia's open media has been the Public Information Act, which now means people have the legal rights to access information held by public institutions. This introduction of positive rights is part of a shift in the government's approach to media regulation which has changed from an attitude of control and censorship to one of guaranteeing international principles of freedom of information, although a Freedom of Information Act is yet to be passed. This change has been exemplified by reform of the Ministry of Information and Communication, which was once Soeharto's media censor. Although criticisms are still made, and are in fact increasing, of government regulation of the media, this itself depicts the increased freedom for scrutiny and censure of government actions since the fall of the Soeharto regime. Remaining criticisms are warranted but the move towards increased media freedom has so far been considerable.

The government of Indonesia must therefore be prepared to meet the expectations and demands for higher standards of accountability and transparency that independent media outlets will make on it on behalf of their consumers. This means simplifying and formalising the regulatory framework so the actors directly influencing the drawing up of legislation can be observed and held to account, and ensuring the provisions of regulations can be clearly understood so that those outside the government can observe whether or not they are being enforced. One initiative which demonstrates the government's commitment to effective public information comes from the Ministry of Forestry; the Ministry is currently sharing maps of forests and peat land covered under the moratorium on new concessions in accordance with Presidential instruction 10/2011 so that observance and enforcement of the moratorium can be monitored. Increased media activity and public demand for information will also require the government to improve its policy performance as its weaknesses will be closely observed by the general public. One means by which it can achieve improved performance is by de-clogging the legislative process which is currently impeding the realisation of policy objectives.

Simultaneously the media itself will push for regulatory reform in policy areas relevant to its own operating environment. A lively NGO community has joined the lobby for increased media freedom and effectiveness. Such organisations include Sains, Estetika and Teknologi (SET) Foundation, a non-profit organisation which works on advocacy for freedom of expression; the Jakarta-based Institute for the Studies on Free Flow of Information (ISAI); and the lobby, Coalition for the Freedom of Information, an alliance of 54 NGOs in Indonesia which advocates the ratification of the Freedom of Information Act. Concerns have been raised by experts and information practitioners, such as multiple interpretations of some of the articles in the Public Information Law, including articles that could affect press freedom. Other concerns are with the low level of readiness of public institutions to implement the Law, and a lack of understanding and even ignorance from media organisations and journalists regarding the relevance and importance of the Law to their profession. In fact many institutions in Indonesia are still not ready to carry out the obligations mandated by the Public Information Act law. With only 12 public institutions considered ready to implement the Law, including: the Constitutional Court, the Ministry of Health, the police, and the Indonesia Financial Transaction Reports and Analysis Centre. The media apparatus, supported by an NGO community committed to the values of media freedom and independence, will push for reform in these areas in order to strengthen its own operating environment thereby increasing its effectiveness as a watchdog and advocator for future reform.[11]

1.3. Conclusion

Regulatory reform is an essential part of the armoury of modernising both the State as well as government in both developed as well as developing countries. Challenged by increasing instability in global financial and commodity markets on the one hand and the growing fiscal burden of provision of key public services such as health, education and social insurance schemes on the other, the modern State is expected to be smarter if not smaller. In the case of Indonesia however, Regulatory Reform is also part of the country's ambitious attempt to consolidate a multiparty democracy as well as to sharply increase its rate of GDP growth to rival other large economies in the region.

Following its decision to begin a transition to multiparty democracy in 1999, Indonesia has made remarkable progress in establishing the central components of a modern democracy from open elections to an open media. It has also transformed a centralised form of 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, remarkably, by a decline of social violence and separatist disturbances. This has raised investor confidence in long term infrastructure investment.

The growing importance of a reform of Indonesia's regulatory framework is to a large extent the result of Indonesia's successful systemic transition. Rapid decentralisation has resulted in much regulatory overlap and inconsistency. Transactional politics in the central and regional legislatures have contributed to a very slow legislative process. A growing middle class is demanding a greater share in national income through more employment opportunities and higher social insurance and wages. Inter-regional inequality remains a key political concern.

The formulation of the MP3EI is one response 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. The public expectations and civil service generated by the MP3EI however require a major effort at producing a transparent and comprehensible regulatory framework. It also requires a streamlining of the policy-making process which has occupied the attention of policy makers since the mid-2000s.

Indonesia's regulatory regime is also a matter of great importance in the context of accelerated ASEAN economic integration by 2015. Being the largest ASEAN economy and its most populous country, Indonesia has much to gain from being at the centre of a regional economic community. Indonesia membership in APEC can also deliver important dividends on regulatory reform.

All the above taken together mean that regulatory reform, often seen to be the domain of technical experts and lawyers, is set to be the next major domain of institutional development. How well and how quickly this is done may well provide the motive force for Indonesian democratic consolidation and sustained economic growth in the coming decade or more.

Notes

1. Evidence for this can be traced in Chapter 4 of the Law 4/2009, "authority for the management of minerals and coal", largely delegated to the provincial and local levels of government. The deficiency of local government to manage the increasingly onerous process of co-ordinating licences, has already translated in the field to unrestrained mining practices. It is likely that such problems will further escalate the number of unqualified investors currently seeking mining licences, which continues to increase. The ability of regional government to led and determine policies and generate new streams of revenue has been brought about by the wave of regional autonomy. Since more than 8 000 mining licences were issued over the 12 months of December 2010, it is conceivable that regional governments will continue to pursue a strategy of rampant exploitation of mineral resources, justified in terms of raising more regional incomes or speeding up the pace of development. Combining the limited capacity of local government to enforce mining regulations, the entry of unqualified investors that lack technological, technical and financial competence appears likely to result in rapid depletion of Indonesia's mineral resources, extensive damage to the environment and minimum generation of revenues from the state. (Source: A dream denied? Mining legislation and the constitution in Indonesia, KosimGandaturuna, Kristy Haymon, *Bulletin of Indonesian Economic Studies*, Vol. 47, No. 2, August 2011).
2. Taken from the Masterplan Acceleration and Expansion of Indonesia Economy Development 2011-2025, Chapter 4, p. 179.
3. "When it comes to regional autonomy in Indonesia, breaking up should be harder to do", Yosua Situmorang, *Jakarta Globe*, May 25, 2010.
4. Business Monitor International, Indonesia Business Forecast Report Q1 2011, p. 10.
5. Law 28/1999, "State Organizer who is Free and Clean from Corruption, Collusion and Nepotism", available at *www.assetrecovery.org/kc/resources/org.apache.wicket.Application/repo?nid=b2963642-a342-11dc-bf1b-335d0754ba85.*
6 Freedom Information Act, Law 40/1999 stipulates the press has the freedom to search, obtain, and spread the information.
7. Which reported their findings and key suggestions to a special two day meeting between the government and the SOEs plus local governments in Bogor chaired by the President between 21 and 22 February, 2011. A series of follow up meetings took place between government and business leaders between 18 and 19 April, 2011.
8. Presidential Decree 29/2010 regarding the Establishment of the National Committee for the Implementation of High Level APEC Meeting and Bali as the Location of APEC 2013.
9. For an in depth discussion of state-society relations in Indonesia see Buehler (2011), pp. 65-87.

10. "The reality today is that all sectors of media – print, television, radio and online – are vibrant, ownership is diverse, and content covers everything from celebrity gossip through to serious debates about the country's political and economic future, with the workings of both local and national government frequently analysed in the media" (Piper, 2009).

11. This is not to suggest that media freedom, independence and effectiveness has reached optimum levels in Indonesia. See Piper (2009) for a discussion of the pressures on media freedom, particularly conglomerate ownership, editorial interference and the influence of vested interests.

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Chapter 2

Government capacity to assure high quality regulation

This chapter is a summary of the background report Government Capacity to Assure High Quality Regulation in Indonesia, available at www.oecd.org/regreform/backgroundreports. *It finds that the government of Indonesia should implement measures to adopt a whole-of-government approach in the development of regulations, including allocating clear responsibility for co-ordination and oversight of regulatory policy; assess the impact of new regulatory proposals and existing regulations; and apply the principles of transparency and public consultation in regulatory decision making.*

Introduction

This chapter examines the capacity of Indonesia's national government and to support the appropriate use of regulation in order to achieve the government's economic, social and environmental goals. The OECD considers "regulation" to include not only laws but all types of subordinate regulations, including informal or administrative regulations, where these are important. The assessment and recommendations contained in this chapter have been informed by the *2012 Recommendation of the OECD Council on Regulatory Policy and Governance*. This Recommendation emphasises the benefits for countries to adopt a "whole-of-government" approach to regulatory reform, to effectively consult, co-ordinate and communicate in regulatory decision making process when addressing the challenges posed by the inter-connectedness of sectors and economies.

Although the government of Indonesia has taken a number of steps to enhance regulatory quality during the past 15 years attention needs to focus on developing a well functioning regulatory framework. The government's awareness and understanding of the role of regulatory reform in facilitating economic development has been reflected in a new framework for the formulation of laws and regulations and various national development plans. Missing from the framework for the formulation of laws and regulations is *i)* an explicit whole-of-government approach for regulatory policy, including responsibility for co-ordination and oversight of regulatory policy; *ii)* a commitment to assess the cost-benefit of new regulatory proposals and existing regulations; and *iii)* the effective implementation of the principles of transparency and public consultation in regulatory decision making.

The chapter is structured into three parts closely corresponding with the terms of the commitment that the government of Indonesia made in the 2011 APEC (Leaders') Honolulu Declaration to strengthen implementation of good regulatory practices. All APEC member economies – including Indonesia – have committed to report in 2013 on actions taken to: *i)* adopt a whole-of-government approach in the development of regulations, including responsibility for co-ordination and oversight of regulatory policy; *ii)* assess the impact of new regulations and existing regulations; and *iii)* effectively implement transparency and public consultation in the regulatory decision making process. This chapter focus is primarily the national (i.e. central) executive; it does not focus on the capacity within the national legislature and within sub-national governments, or look at the performance of regulators.

2.1. Developing a whole-of-government approach to regulatory policy

Indonesia has reformed its framework for regulatory decision making during the past 15 years in response to the needs of democratisation (1998-99) and decentralisation (post 2000). In 2004 the national government introduced a law to provide a common approach to the formulation of laws and regulation. Action has since been taken by the government to further consolidate this framework in 2009 and 2011 – focusing specifically on sub-national regulations that have the potential to affect the investment climate and market openness. Regulatory reform is also referenced in various national development

plans but is focused on demonstrating quantitative reductions in the number of regulations rather than the qualitative outcomes of actions. Indonesia does not, however, have an explicit whole-of-government policy to ensure quality in regulation and regulatory management. Nor does it have a clear institutional responsibility for ensuring regulation serves whole-of-government policy.

A sound basis for a regulatory policy: regulatory hierarchy, principles and management tools

In 2004, the government of Indonesia promulgated Law 10/2004 to provide a clear hierarchy and common framework for regulatory decision making at both the national and sub-national level. Law 10/2004 on the Formulation of Laws and Regulations revoked a plethora of laws and regulations related to the formulation of government regulation spanning back to Indonesian independence in 1945. Law 10/2004 sought to respond to regulatory uncertainty following the country's "big bang" political and administrative decentralisation established in Laws 22/1999 on Sub-national Government and 25/1999 on Inter-Governmental Fiscal Relations. These two laws – which became effective in 2001 – bestowed provinces and districts/cities with broad and wide-ranging regulatory authority through directly-elected legislatures and sub-national executives. Law 10/2004 established sub-national regulations below government regulations but above ministry regulations (Table 2.1).

Although Presidential Instructions are positioned outside of the regulatory hierarchy outlined in Law 10/2004, it warrants attention here as an important statement of the Executive's commitment. Presidential instructions are used to highlight important issues that need to be addressed, to direct bodies to co-operate and co-ordinate actions and to provide instructions on a range of measures that should be taken. They cannot include legislative amendments or contradict laws. Moreover, the President can use such instructions to call upon the People's House of Representatives and ministries to draw up appropriate legislation and take specific actions. Recent examples of presidential instructions include 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).

Law 10/2004 established, for the first time, principles and identified a number of tools to support regulatory decision making – and marks the beginning of the government's focus on improving regulatory quality. The principles are:

- Clarity of purpose (of regulatory instruments);
- Appropriate authority (for regulatory decision making);
- Appropriate (regulatory) instrument (for purpose);
- Implementable;
- Outcome-oriented;
- Clear wording (of regulatory instruments); and
- Openness (of regulatory decision making).

Table 2.1. The government of Indonesia's hierarchy of laws and regulations

English	Description
Law	Laws are formulated by the House of Representatives with agreement of the President of the Republic. The contents of laws include: i) regulation about the specific matters contained in the 1945 Constitution, ii) matters defined by other laws to be regulated by law; iii) ratification of international agreements; iv) implementation of decision of the Constitutional Court; and/or v) fulfilling the legal norms in the general public. Laws can include penal sanctions up to 6 months in prison or fines to a maximum of IDR 50 million in accordance with other laws. The President of the Republic has no power of veto: under the Constitution if the President does not sign a bill passed by the House of Representatives, it will self-enact and automatically become Law after 30 days.
Government regulation in lieu of law	Government regulations in lieu of law are issued by the President of the Republic and come into immediate effect in relation to emergency, the need is immediate, and cannot be legislated or regulated in any other way. Matters that can be regulated by government regulations in lieu of law are the same as ordinary laws. A government regulation in lieu of law once enacted is only applicable for a definite period of time; namely, it must be ratified by the House of Representatives in the first session after its enactment. Should the House of Representatives ratify a government regulation in lieu of law then it will be re-enacted as a Law; otherwise it will be revoked.
Government regulation	Government regulations are issued by the President of the Republic to implement a specific law. They are to support the implementation of laws, specifically the requirements of specific laws and may not diverge from the content of the law which they support to implement. Government regulations may only contain sanctioning provisions if the law to which it relates also contains those same sanctions.
Presidential regulation	Presidential regulations are issued by the President of the Republic to implement laws and government regulations and to support the authority of the executive branch of government. A presidential regulation can be made even if it does not mention explicitly the law to which it relates.
Provincial regulation	Provincial regulations are formulated by the provincial House of Representatives with the agreement of the Governor. The content of provincial regulations is to support the implementation of regional autonomy and "assisting tasks" as well as that related to specific needs of sub-national government and support implementation of laws and regulations of higher levels of government. Provincial regulations can include penal sanctions up to 6 months in prison or fines to a maximum of IDR 50 million in accordance with other laws and regulations.
Regency/city regulation	Regency/city regulations are formulated by the regency/city legislature with the agreement of the regent/mayor. The content of regency/city regulations is to support the implementation of regional autonomy and "assisting tasks" as well as that related to specific needs of sub-national government and support implementation of laws and regulations of higher levels of government. Regency/city regulations can include penal sanctions up to 6 months in prison or fines to a maximum of IDR 50 million in accordance with other laws and regulations.

Source: Adapted from Law 12/2011 on the Formulation of Laws and Regulations.

Moreover, Law 10/2004 introduced the requirement for forward planning and public consultation of regulatory decision making and *ex ante* assessment of regulatory proposals. These are discussed in more detail in subsequent sections of this chapter. This framework has subsequently been consolidated in 2009 and 2011 following the passage of Law 28/2009 on Sub-national Taxes and Charges and Law 12/2011 amending Law 10/2004.

Consolidation of the government of Indonesia's regulatory framework in 2009 and 2011

Two main changes have been made to the framework outlined in Law 10/2004 in 2009 and 2011. Law 28/2009 on Sub-national Taxes and Charges introduced a "closed list" of taxes and charges that may be regulated by sub-national governments and a deadline for its implementation. Law 28/2009 also strengthened the authority of the national government to conduct an *ex ante* review of sub-national regulations imposing taxes and charges. The national government may withhold inter-governmental transfers from sub-national governments that do not share draft regulations and that continue to implement regulations inconsistent with higher-order regulation. Law 28/2009 responded

to two main challenges. Following decentralisation there was a proliferation of illegal sub-national government's taxes and charges adversely affecting the sub-national investment climate and hindering internal market openness. Moreover, sub-national government's 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.

Law 12/2011 on the Formulation of Laws and Regulations replaced Law 10/2004 on the same subject, introducing three main changes. It expanded the obligation for the forward planning of new regulation beyond laws and sub-national regulations to include government and presidential regulations. It made mandatory previously voluntary *ex ante* assessment of regulatory proposals for bills and draft sub-national regulations. It also included an explicit provision for the involvement of external (i.e. non-governmental) experts in the formulation of the bills and draft sub-national government regulations. Law 12/2011 did not, however, respond to the challenges of the position of ministerial regulations in the legal hierarchy.

The commitment to regulatory reform in national plans focuses on a number of laws, not their impacts

The government of Indonesia has made a commitment to regulatory reform as part of the national development plans to enhance business and investment climate as well as promote exports. These plans include the national medium-term development plan (both 2004-09 and 2010-14) and the Master Plan for the Acceleration and Expansion of Indonesian Economic Growth 2010-2025 (MP3EI). National medium-term development plan is intended as an elaboration of the President's platform and shapes the strategic plans of national public sector entities and development plans of sub-national governments. The current national medium-term development plan sets targets to review the stock of sub-national regulations and reduce licensing burdens (Table 2.2). In 2010, the government of Indonesia launched the MP3EI as an integral element of the national development planning system, in parallel with the medium-term development plan. The MP3EI emphasises accelerating the formulation of implementation regulations for key sectors and efforts to expedite the issuance of licences and permits. The implementation of these plans is overseen by the government's co-ordinating ministries and state secretariat.

While efforts have been made to measure progress in implementing these plans, reporting is limited in scope. For example, the report on the first year implementation of the 2010-14 national medium-term development plan only included one of the two indicators for ensuring consistency of regulation across levels of government (Republic of Indonesia, 2011, 2012) (Table 2.2). In relation to the MP3EI, the government reports that 22 laws and regulations have been amended to support the implementation of the MP3EI; 18 laws and regulations currently being amended; and 33 laws and regulations in the pipeline to be amended. Monitoring indicators focus entirely on quantitative indicators of the number of laws and do not include qualitative assessment measures, emphasising the achievement of output targets rather than outcomes. Moreover, the plans focus on the actions by individual sub-national governments rather than collective (horizontal) action across multiple sub-national governments.

Table 2.2. Extract from Indonesia's 2010-14 National Medium-term Development Plan relating to regulatory reform and its annual monitoring report

A. Targets of Priority 1: administrative and governance reform

Priority activity	Objective	Indicator	Target					Estimated cost (in IDR billion)	Responsible organisation
			2010	2011	2012	2013	2014		
4. Regulation. Acceleration of harmonisation & synchronisation of laws & regulations between the national & sub-national governments, including concluding a review of 12 000 sub-national regulations by 2011.									
Structuring of ministry & non-ministry body legislation & legislative assistance	Acceleration of harmonisation & synchronisation of laws & regulations between the national & sub-national governments	Number of sub-national regulations reviewed	3 000	9 000	3 000	2 500	2 500	12.5	Ministry of Home Affairs
Facilitating the formulation of sub-national regulations	Increasing provincial, regency/city regulation that is mapped & published in sub-national government information systems	Percentage of sub-national government	20%	40%	60%	80%	100%	9.0	Ministry of Law & Human Rights

B. Progress in achieving targets of Priority 1: administrative and governance reform

Priority activity	Objective	Indicator	Target					Actual cost (in IDR billion)	Responsible organisation
			2010	2011	2012	2013	2014		
4. Regulation. Acceleration of harmonisation & synchronisation of laws & regulations between the national & sub-national governments, including concluding a review of 12 000 sub-national regulations by 2011.									
Structuring of ministry & non-ministry body legislation & legislative assistance	Acceleration of harmonisation & synchronisation of laws & regulations between the national & sub-national governments	Number of sub-national regulations reviewed	3 000	9 000	n.a.	n.a.	n.a.	Not reported	Not reported
Facilitating the formulation of sub-national regulations	Increasing provincial, regency/city regulation that is mapped & published in sub-national government information systems	Percentage of sub-national government	Not reported	Not reported	n.a.	n.a.	n.a.	Not reported	Not reported

n.a. = not available

Source: Republic of Indonesia (2010), *Lampiran Peraturan Presiden Republic Indonesia Nomor 5 Tahun 2010 tentang Rencana Pembangunan Jangka Menengah Nasional (RPJMN) Tahun 2010-2014, Buku II: Matriks Rencana Tindak Perkementerian/Lembaga*, (Annex to Regulation of the President of the Republic of Indonesia 5/2010 on the National Medium-Term Development Plan, 2010-2014, Book II: Action Plan Matrix for Ministries and Agencies), Kementerian Perencanaan Pembangunan Nasional/Badan Perencanaan Pembangunan Nasional (Bappenas), Jakarta *www.bappenas.go.id/node/0/2518/buku-rpjmn-2010-2014/;* Republic of Indonesia (2011), *Evaluasi Satu Tahun Pelaksanaan RPJMN 2010-2014* (Evaluation of the First Year Implementation of the 2010-2014 Medium-Term Development Plan), Bappenas, Jakarta; Republic of Indonesia (2012), *Evaluasi Dua Tahun Pelaksanaan RPJMN 2010-2014* [Evaluation of the Second Year Implementation of the 2010-2014 Medium-Term Development Plan], Bappenas, Jakarta.

Moving towards an explicit "whole-of-government" regulatory policy building on Law 12/2011

Indonesia does not have an explicit "whole-of-government" policy to ensure quality in regulation and regulatory management. An explicit regulatory policy defines the process by which government, when identifying a policy objective, decides whether to use regulation as a policy instrument, and proceeds to draft and adopt a regulation through evidence-based decision making. Adopting a whole-of-government policy enables the government to take into account the dynamic interplay between the different institutions involved in the regulatory process and to overcome obstacles created by a traditional compartmentalisation of functions.

In establishing an explicit whole-of-government policy for regulatory management, the government of Indonesia could formally:

- Recognise that ensuring coherence in regulation and administrative simplification are elements of, but do not substitute for, a comprehensive regulatory reform programme;
- Adopt an integrated approach, which considers policies, institutions and tools as a whole, at all levels of government and across sectors;
- Ensure that, if regulation is used, the economic, social and environmental benefits justify the cost, distributional effects are considered and net benefits are maximised;
- Maintain a regulatory management system, including both *ex ante* impact assessment and *ex post* evaluation as key parts of evidence-based decision making;
- Review systematically the stock of regulations periodically to eliminate or replace those which are obsolete, insufficient or inefficient;
- Develop and maintain a capacity to ensure that regulatory policy remains relevant and effective and can adjust and respond to emerging challenges;
- Implement and evaluate a communications strategy to secure on-going support for the goals of regulatory quality; and
- Establish mechanisms for monitoring and reporting on the performance of the regulatory management system against the intended outcomes.

In the Indonesian context, an explicit whole-of-government policy could be articulated through a presidential instruction. As noted above, this instrument is used to articulate statement of political commitment and to direct public sector entities – including at sub-national levels – to co-ordinate actions and to define a range of measures that should be taken. Moreover, it is critical that the President of the Republic periodically update the instruction to drawing upon lessons learnt as well as international good practice.

Box 2.1. An explicit "whole-of-government" regulatory policy: The example of the United Kingdom

In 2010, the United Kingdom published a new policy, by way on a coalition agreement, outlining the government's commitments and approach for regulatory reform. There are four elements to the policy

- Considering alternatives to the use of regulation;
- New decision-making structures for regulatory proposals;
- Tougher scrutiny of existing regulations; and
- Streamlining and improving the system of enforcement, departing from "tick-box" systems of inspection and audit.

Considering the appropriate alternatives to the use of regulation

At the core of the policy is a focus on helping policy makers identify the most effective approach to achieving a desired policy outcome by ensuring alternative approaches to regulation are thoroughly explored, and that traditional "command and control" regulation is seen as the last, not first, resort.

Examples of alternatives to "command and control" regulation include self-regulation (unilaterial codes of conduct, charters, etc.), co-regulation (accreditation and standards, approved codes, etc.), information and education (rating systems, labeling, etc.), economic instruments (taxes, permits, auctions, etc.) and no new intervention (clarifying existing regulation, improved enforcement, etc.)

New decision-making structure for regulatory proposals

The creation of the Reducing Regulation Committee (RRC), a Cabinet sub-Committee, has been established to take strategic oversight of the delivery of the government's regulatory framework. It has broad terms of reference to consider issues relating to regulation. These include scrutinising, challenging and approving all new regulatory proposals.

A One-in, One-out rule that no new primary or secondary legislation which imposes costs on business or civil society organisations can be brought in without identifying existing regulations with an equivalent value that can be removed. The objective of this rule is to reduce regulatory costs; remove redundant regulation; support a culture change of the government's approach to regulation; and to deliver a positive outcome for business and civil society organisations.

An independent body, the Regulatory Policy Committee, will provide external scrutiny of the impact assessments of all new regulatory proposals – and the associated proposed removal of existing regulation under the One-in, One-out rule – proposed by public sector entities.

Domestic legislation that imposes a regulatory burden on businesses or civil society organisations and which comes into force on or after April 2011 is required to include a sunset clause. The inclusion of a (seven year) sunset clause means that regulation will expire automatically on a certain date unless positive action is taken to renew it. Where a sunset clause is not used, a "duty to review" clause should be used in order to ensure the regulation is regularly reviewed.

Tougher scrutiny of existing regulations

The new policy commits the government to improving the quality of evaluation of regulatory decision making. Plans for evaluation should be considered at an early stage and should be set out in the impact assessment accompanying the consultation on the proposed policy. Monitoring should be used to collect the information that will be needed to carry out a post-implementation review. Monitoring allows for early action where regulations are proving costly, difficult or ineffective.

Post-implementation review refers to the review of regulatory policy that complements the ex-ante appraisal contained in the impact assessment. Departments will be required to undertake reviews of their existing "stock" of regulation to identify opportunities to remove or revise regulations. This process will be critical to the successful implementation of the One-in, One-out rule.

The Your Freedom website, launched on 1 July 2010, provides a new way for citizens to suggest regulation that they think should be removed or changed. These suggestions have been put forward to the relevant departments for consideration and could prove a useful source of ideas for departments that need to identify "OUTs" under the One-In, One-Out rule.

Streamlining and improving the system of enforcement

One of the more challenging aspects of implementing truly risk-based enforcement of regulation is to give appropriate recognition to a business's own efforts to comply with regulation.

Source: HM Government (2010), "Reducing Regulation Made Simple: Less Regulation, Better Regulation and Regulation as a Law Resort", *www.bis.gov.uk/assets/biscore/better-regulation/docs/r/10-1155-reducing-regulation-made-simple.pdf*

An explicit whole-of-government policy should build upon the foundation created by Law 12/2011. This law provides the national executive with much flexibility to develop a regulatory management system spanning both the national and sub-national level using a combination of presidential and government regulations. The law provide for a presidential regulation establishing guidelines and techniques – including those that may help to better align the government of Indonesia's practices within international good practice – for the formulation of laws and regulations. There is also substantial scope within Law 12/2011 to issue government regulations related on public consultation and dissemination. Given the legislative hierarchy established within Law 12/2011, with government and presidential regulations having a higher legal standing than sub-national regulations, any such proposals have the potential to achieve a consistent whole-of-government approach to regulation management – all without any amendments to Law 12/2011.

Identifying clear institution responsibility for ensuring regulation serves a whole-of-government policy

Although various national public sector entities exist with responsibility for overseeing regulatory decision making there is no single entity accountable for ensuring that laws/regulation serve a whole-of-government policy. The state and cabinet secretariats support the formulation of laws and national regulations, and have authority to return regulatory proposals if deemed unsatisfactory. The three co-ordinating ministries oversee implementation of national development plans, with the Co-ordinating Ministry for Economic Affairs playing a leading role in regulatory reform from a sectoral perspective. The Ministry of Law and Human Rights co-ordinates the formulation of proposals from a legal drafting perspective. The Ministries Home Affairs and Finance focus on coherence of sub-national regulations with the public interest and higher-order regulation (Table 2.3).

Co-ordination and oversight of the regulatory system is considered key to ensuring that regulation serves whole-of-government policy. To be successful, reform will have to be co-ordinated across a number of areas, with clear roles and accountability framework is necessary. Co-ordination across levels of government should be accompanied by efforts to develop regulatory management capacity at a sub-national level. National governments have a role to play in supporting the development of sub-national capacities for regulatory management, through appropriate governance and fiscal arrangements and incentives, as well as providing advice and training to officials.

The state and cabinet secretariats support the formulation of laws and national regulations, and have authority to return regulatory proposals if deemed unsatisfactory

The State Secretariat provides analysis as well as administrative and technical support to the President and Vice President of the Republic. It is involved in the formulation of bills, draft government regulation in lieu of law and draft government regulations, either directly in the formulation or to provide a technical or legal opinion. In addition, the State Secretariat supports relations with national and sub-national government institutions, political, non-governmental and civil society organisations.[1] The legislative function within the State Secretariat is supported by a Deputy for Legislation and advisors on economic, politics, law and security, defence and as well as social welfare.[2]

The Cabinet Secretariat also provides analysis as well as administrative and technical support to the President and Vice President of the Republic. Its responsibilities include *i)* analysing government policy and programmes; *ii)* drafting presidential regulations, decrees and instructions, as well as preparing a legal opinion for the President of the Republic; *iii)* evaluating analysis on the implementation of government policies and programmes; and *iv)* preparing cabinet meetings chaired by the President and Vice President, co-ordinating follow up and reporting on meetings. The responsibilities related to regulation are shared between three deputies, paralleling the portfolios of the co-ordinating ministries, discussed below.[3]

Table 2.3. Indonesia's Secretariat of State standards for the formulation of laws and regulations

Economic matters	Politics, law and security	Social welfare
Analysis and agreement on initiatives to formulate bills		
Analysis and agreement on bills initiated by the executive		
Analysis and agreement on bills initiated by the House of Representatives		
Analysis and agreement on draft regulations in lieu of law		
Analysis and agreement on draft government regulations		
Preparing legal opinion on disagreements of substance related to bills, draft regulations in lieu of law and draft government regulations		
Monitoring and reporting on the formulation of bills, draft regulations in lieu of law and draft government regulations		
Preparing considerations by the State Secretary on draft presidential regulations		
Authentification of laws, government regulations in lieu of law and government regulations		
Evaluation and formulation of legal opinions on the implementation of laws, government regulations in lieu of law and government regulations		

Source: 2011 Service Standards of Secretariat of State Work Units (Standar Pelayanan, Unit Kerja Di Lingkungan Kementerian Sekretariat Negara, Republik Indonesia, Tahun 2011), *www.setneg.go.id.*

In 2009, the State Secretariat issued service standards for its activities as part of a drive for professionalisation.[4] The standards cover the Deputy of Legislation and its involvement in the formulation of laws and regulations. There are eight common standards for all legislative policy areas and an additional two standards for economic matters (Table 2.3). The standards apply only to the State Secretariat and not the Cabinet Secretariat. Information was not available on the implementation of these service standards.

The co-ordinating ministries oversee implementation of national development plans, with the Co-ordinating Ministry for Economic Affairs playing a leading role in regulatory reform

Indonesia's co-ordinating ministries are responsible for increasing co-ordination in the formulation of public policy and synchronising of policy implementation[5] – including that related to the national medium-term development plan. The Co-ordinating Ministry for Economic Affairs is responsible for matters related to the business and investment climate and infrastructure contained in the medium-term development plan. The Co-ordinating Ministry for Politics, Law and Security is responsible for governance and bureaucratic reform.[6] The activities of the co-ordinating ministries to implement the national medium-term development plan are monitored by the Presidential Delivery Unit on Development Control and Oversight located within the State Secretariat.[7] The Head of the Presidential Delivery Unit reports once every two months on the implementation of the plan to the President of the Republic.

Table 2.4. Indonesian Co-ordinating Ministry's portfolios

Co-ordinating Ministry for Economic Affairs	Co-ordinating Ministry for Politics, Law and Security	Co-ordinating Ministry for Social Welfare
Ministry of Agriculture	Ministry of Home Affairs	Ministry of Health
Ministry of Co-operatives and Small and Medium Enterprises	Ministry of Law and Human Rights	Ministry of National Education
Ministry of Development for Remote Areas	Ministry of Foreign Affairs	Ministry of Social Affairs
Ministry of Energy and Natural Resources	Ministry of Defence	Ministry of Religion
Ministry of Finance	Ministry of Communication and Information	Ministry of Culture and Tourism
Ministry of Forestry	Ministry of State Administrative Reform	Ministry of the Environment
Ministry of Industry	National Police Headquarters	Ministry of Women's Empowerment and Child Protection
Ministry of Manpower and Transmigration	National Armed Forces Headquarters	Ministry of Public Housing
Ministry of Maritime Affairs and Fisheries	Attorney General	Ministry of Youth Affairs and Sports
Ministry of Public Works	National Intelligence Agency	
Ministry of Research and Technology	National Signals Agency	
Ministry of State-Owned Enterprises	Republic of Indonesia Maritime Security Co-ordination Agency	
Ministry of Tourism and Creative Economy		
Ministry of Trade		
Ministry of Transport		
Capital Investment Co-ordination Board		
National Development Planning Agency (Bappenas)		
National Land Agency		

In addition to its role in overseeing the implementation of the national medium-term development plan, the Co-ordinating Ministry for Economic Affairs currently heads the regulation working group for the implementation of the MP3EI.[8] This working group is responsible for *i)*accelerating the completion of implementation regulations; *ii)* eliminating overlap between existing regulations between national and sub-national levels as well as between sectors and institutions; *iii)* amending and establishing new regulations to support implementation of the MP3EI.

More generally, the Co-ordinating Ministry for Economic Affairs has sought to promote co-ordination across all of its portfolio areas. This co-ordination includes on issues related to its policy portfolio, between the national and sub-national governments and between sub-national governments.[9] The Co-ordinating Ministry for Economic Affairs' portfolio includes *i)* special economic zones; *ii)* national spatial planning; *iii)* accelerating infrastructure development; *iv)* water and irrigation management; *v)* fiscal decentralisation; *vi)* natural resource management; *vii)* micro, small and medium enterprise development; *viii)* increasing investment and the promotion of exports; *ix)* international economic co-operation; and *x)* enhancing public participation in economic policy.

The Ministry of Law and Human Rights is responsible for policies related to the formulation of laws and regulations, with a strong focus on legal quality

The Ministry of Law and Human Rights co-ordinated the development of Law 12/2011, and its predecessor Law 10/2004, on the Formulation of Laws and Regulations. Within the framework of Law 12/2011, the Ministry of Law and Human Rights co-ordinates the input of the federal executive into the preparation of the five-year National Legislative Programme (Prolegnas) and its annual priorities. The Ministry also supports sub-national governments to formulate their respective Sub-national Legislative Programmes (Prolegda). Finally, in relation to openness in regulatory formulation and decision making, it maintains one of the main government databases on laws and regulations.

The Ministry of Law and Human Rights has two Echelon-I units that share responsibility for these functions: *i)* the Directorate General of Law and Regulation; and *ii)* the National Law Development Agency. The Directorate General of Law and Regulation develops policies, provides technical guidance and externally evaluates the formulation of laws and regulations. It is structured into five directorates: *i)* the Directorate for Formulation (of Regulation); *ii)* the Directorate for Facilitating the Formulation of Sub-national Regulations; *iii)* the Directorate for Publication (of Regulations); *iv)* the Directorate for Harmonisation; and *v)* the Directorate for Regulation Litigation. Details on the specific responsibilities of these directorates and resourcing were not available at the time of drafting this working paper.

The National Law Development Agency is responsible for formulating technical policies for the formulation and evaluation of the Prolegnas. It is structured into four centers: *i)* the Centre for National Legal Research and Development; *ii)* the Centre for National Legal Development Planning; *iii)* the Centre for National Legal Information Network and Documentation; and *iv)* the Centre for Legal Outreach. Details on the specific responsibilities and resourcing of these centers were not available at the time of drafting this working paper.

The activities of the Ministry of Law and Human Rights are supported by the Ministries Home Affairs and Finance, but are focussed narrowly on regulations imposing taxes and charges

The Ministry of Home Affairs establishes procedures for the review of regulations issued by both the sub-national House of Representatives and sub-national executives. All reviews are co-ordinated by the Regulatory Assessment and Evaluation Section of the Ministry of Home Affairs' Legal Bureau. The Ministry of Home Affairs' Legal Bureau is supported by the Ministry of Finance Directorate General of Sub-national Financing in the case of sub-national regulations on taxes and user charges. It also delegates to governors the responsibility for review of regency/city regulations. The Ministry of Home Affairs' Regulatory Assessment and Evaluation Section is organised into three divisions covering: *i)* Sumatera and Kalimantan; *ii)* Java and Bali; and *iii)* Sulawesi, Nusa Tenggara, Maluku and Papua.

The Ministry of Finance Directorate General of Sub-national Financing has a specific Directorate for Sub-national Taxes and Charges. It is organised into four sub-directorates covering: *i)* Sumatera, *ii)* Java, Bali and Nusa Tenggara, *iii)* Kalimantan and Sulawesi; and *iv)* Maluku and Papua. Details on the specific responsibilities and resourcing of these sub-directorates were not available at the time of drafting this working paper.

Bappenas has taken an initiative for developing **ex ante** *and* **ex post** *regulatory impact assessment tools, but the extent to which these tools are effectively integrated in decision making is unclear*

The National Development Planning Agency (Bappenas) is responsible for formulating medium-term national development policies and plans. Its Directorate for the Analysis of Laws and Regulation, established in October 2007, has a mandate to: *i)* inventorise draft and existing laws and regulations; *ii)* review and evaluate draft and existing laws and regulations; *iii)* co-ordinate and harmonise draft and existing laws and regulations at national and sub-national levels; *iv)* formulate policy recommendations on draft and existing laws and regulations; and *v)* make available information on the results of analysis of draft and existing laws and regulations. It is organised into three units, responsible for laws and national regulations, sub-national regulations and information management, respectively. The Directorate is staffed by 7 planning staff.

The Directorate for the Analysis of Laws and Regulation has developed the Regulation Framework Analysis Model (*Model Analisa Kerangka Regulasi* or Makara) for proposed bills and sub-national regulations and the Law and Regulation Analysis Model (*Model Analisa Peraturan Perundang-undangan* or Mapp) for reviewing and simplifying existing laws and regulations. These activities include identifying and analysing problematic laws and regulations as well as preparing an action plan of regulatory reform in co-ordination with sectoral ministries (OECD, 2011).

However, there is no institution formally responsible for co-ordination and oversight to ensure that regulation serves whole-of-government policy

Establishing a single public sector entity charged with regulatory oversight close to the centre of government is considered key to ensuring that regulation serves a whole-of-government policy. This public sector entity should be tasked with a variety of functions or tasks in order to promote high quality evidence-based decision making. These functions include:

- Responsibility to formulate regulatory policy goals, strategies and benefits, including developing and implementing a communications strategy to secure ongoing support for regulatory quality;

- Examining the potential for regulation to be more effective including promoting the consideration of regulatory measures in areas of policy where regulation is likely to be necessary;

- Co-ordinating *ex post* evaluation for policy revision and for refinement of *ex ante* methods;

- Quality control through the review of the quality of impact assessments and returning proposed rules for which impact assessments are inadequate;

- Providing training and guidance on impact assessment and strategies for improving regulatory performance; and

- Responsibility for monitoring and periodic reporting on regulatory management system performance.

In giving consideration to establishing an institution formally responsible for regulatory co-ordination and oversight, the government of Indonesia would benefit from consideration of a number of factors. The specific location should be established close to the centre of government, to ensure that regulation serves whole-of-government policy. The authority of a regulatory oversight body should be set forth in mandate with adequate organisational, functional and financial independence from political influence. Regulatory oversight should be based on expertise, in the form of a trained professional staff capable of undertaking evaluation of regulatory proposals and options, as well as their impacts on business and the general public. Technical knowledge can reveal and make transparent the significant impacts, tradeoffs and alternatives of regulatory choices – informing politicians and policy makers as well as the public of both the promise and pitfalls of regulation.

2.2. Regulatory decision-making procedures and the use of *ex ante* impact assessment

Law 12/2011 establishes procedures for internal government co-ordination, and *ex ante* assessment of proposed new laws and sub-national government regulations. Legislative programmes support planning and resourcing of regulatory decision making. Academic studies serve as a pre-requisite to initiate bills and draft sub-national regulations. Procedures exist to support alignment and balancing of regulatory decision making between national public sector entities. The national government has authority to review sub-national regulation for consistency. There is, however, no formal policy to periodically review the stock of existing laws and national government regulations.

Legislative programmes support planning and resourcing of regulatory decision making

Law 12/2011 (and its predecessor, Law 10/2004) establishes the obligation for national and sub-national governments to publish a forward looking plan of laws and sub-national regulations, respectively. The national government is required to publish a National Legislative Programme (Prolegnas) spanning five-year with explicit annual priorities. The time span of the Prolegnas corresponds with the administration's term. Sub-national governments programmes (Prolegda) span only one year. In order to be included in these plans, a bill or draft sub-national regulation must be accompanied by information on its proposed objective, scope and outcomes. This information is to be sourced from a mandatory academic study, (discussed in the following section). The Prolegnas and Prolegda are prepared jointly by the legislature and executive. The Prolegnas annual priorities and the Prolegda are voted by the plenary of their respective legislature before a vote on the annual budget. This timing is intended to ensure that proposals in the Prolegnas/Prolegda are included in the annual work plans and budgets of national public sector entities.

The Prolegnas, its annual priorities and Prolegda reflects input of both the executive and legislature. Within the legislature, the drafting units co-ordinates input from political factions, committees and members within their respective house of representatives as well as the general public. Within the executive, the Ministry of Law and Human Rights and sub-national legal departments co-ordinate input from their ministries/sections at their respective level of government. The Ministry of Law and Human Rights supports sub-national governments in the formulation of their Prolegda, as noted above. However, there is no specific mechanism for co-ordinating regulatory planning between levels of government and across the same levels of government. Moreover, at the time of drafting this chapter, information was not available on the number of sub-national governments that have formulated a Prolegda or established guidelines for doing so.

From 2012, the national government is obliged to prepare and publish annual plans for government and presidential regulations. Law 12/2011 notes that these plans are to include information on the title and subject of these proposed regulations. Information on the proposed objective, scope and outcomes as is required for bills is not required for government and presidential regulations. Nor is it required that an academic study be completed before draft regulation is included within the programme. Ministries and non-ministerial public organisatons are responsible for initiating government and presidential regulations in accordance with their powers, and the plans co-ordinated by the Ministry of Law and Human Rights. At the time of drafting this working paper, guidelines for the formulation of programmes for government and president regulations had yet to be established. Nor was information available on plans by the government to introduce annual programmes for government and president regulations.

Table 2.5. Responsibilities and powers of Indonesia's national public sector entities involved in ensuring regulatory quality

Level of government, Institution	A. Responsibilities						B. Powers		
	Formulating regulatory policy goals, strategies and benefits	Developing and implementing communications strategy for regulatory quality	Identifying opportunities for whole-of-government improvements in regulatory policy	Developing programmes for reducing administrative and compliance cost of regulation	Developing guidelines & tools for public organisations to support regulatory quality	Responsibility for monitoring and periodic reporting on performance of regulatory management	Examining economic cost-benefit of regulation (e.g. competition, trade)	Examine legality of regulation (e.g. drafting, public consultation, due process)	Authority to return regulatory proposals if deemed unsatisfactory
National regulation									
State Secretariat	o	o	o	o	o	o	n.a.	n.a.	● Laws, government regulations
Cabinet Secretariat	o	o	o	o	o	o	n.a.	n.a.	● Presidential regulations
Co-ordinating Ministry for Economic Affairs	o	o	o	o	o	● Administrative simplification in RPJMN	o	o	● Regulation identified in MP3EI
Co-ordinating Ministry for Politics, Law & Security	o	o	o	o	o	● Harmonisation in RPJMN	o	o	o
National Development Planning Agency	o	o	o	● Formulating RPJMN	● RIA, stock of regulations	o	●	o	o
Ministry of Law & Human Rights	o	o	o	o	●	o	o	●	● Legal dimensions
Sub-national regulation									
Ministry of Home Affairs	o	o	o	o	o	o	o	● Sub-national regulations	● Sub-national regulations
Ministry of Finance	o	o	o	o	o	o	●	● Sub-national taxes & charges	o

● = yes, o = no; n.a. = not available; RPJMN = National Medium-term Development Plan; MP3EI = Master Plan for the Acceleration and Expansion of Indonesian Economic Growth; RIA = regulatory impact assessment.

Box 2.2. Effective co-ordination within the executive branch: The example of the cabinet process in Australia

The Federal Cabinet plays a vital role in maintaining and co-ordinating the quality of regulatory policy in the Australian Government. The central purpose of Cabinet is to ensure consistency in public policy formulation, support ministers in meeting their individual and collective responsibilities, facilitate co-ordinated and strategic policy development and enable informed decision making on all issues requiring collective determination (Australian Government, 2004). The Cabinet process is the product of convention and practice, its principles and procedures are formalised in the Cabinet Handbook, not in legislation. However, given the Westminster culture, it is worth noting that the procedures have a binding effect, and that conventions play a powerful role to ensure that due process is respected. As a result, the arrangements in place are often stricter than in other countries, even if they are not supported by legislation. The Cabinet is supported by a dedicated secretariat located in the Department of the Prime Minister and Cabinet that manages the business flow to Cabinet and ensures that Cabinet processes and rules are followed. Specialised work of the Cabinet is delegated to various standing and *ad hoc* committees.

The deliberations of the Federal Cabinet are one of the key mechanisms for the consideration of policies that have a regulatory impact and its processes reinforce the broader regulatory quality control measures of the Regulatory Impact Statement (RIS) process. The Cabinet processes require that a submission brought to Cabinet or its committees by a Minister must include a clear recommendation and accompanying justification for the recommendation. This must include an assessment of the regulatory impacts, including a summary of the regulatory impact statement, and/or the results of the Business Cost calculator (BCC) or its equivalent. Where the impacts are considered highly significant the RIS should include a quantified cost benefit analysis. Further details must also be provided about the proposed implementation of the regulatory policy, its financial implications, and impacts on small business, regional Australia and families.

Cabinet submissions on significant regulatory proposals are circulated for their formal co-ordination comments and the submission must identify whether there is agreement among relevant departments and agencies for the proposal. The Cabinet Handbook specifies certain consultation timelines within government including a minimum five day consideration period for Cabinet submissions, unless designated by the Prime Minister or the Cabinet Secretary for immediate consideration. All submissions to Cabinet must be assessed by the Department of Prime Minister and Cabinet, the Treasury and the Department of Finance and Deregulation for financial impacts. The Attorney-General's Department has responsibility for assessing if submissions have legal or constitutional issues. Where the requirements for the preparation of a RIS have not been met, the Cabinet Secretariat has a gate keeping role of ensuring that regulatory proposals do not proceed for deliberation by Cabinet. Similarly, the Cabinet Secretariat may reject a submission where it has not undertaken appropriate consultation, or addressed strong criticism by other departments.

Source: OECD (2009), *OECD Reviews of Regulatory Reform: Australia – Towards a Seamless National Economy*, OECD Publishing, Paris, p. 31.

Academic studies serve as a pre-requisite to initiate bills and draft sub-national regulations

Law 12/2011 on the Formulation on Laws and Regulations requires that bills and draft sub-national government regulations be based on a standardised academic study (Box 2.3). Presidential Regulation 68/2005 subsequently notes that the formulation of the academic paper is to be done by the initiator of the proposed bill together with Ministry of Law and Human Rights' Department General of Laws and Regulations. It allows for

the preparation of an academic study to be done by universities or another specialised third party. Although one of the main changes introduced by Law 12/2011, in replacing Law 10/2004, was the inclusion of an annex outlining the format of an academic study, the concept and format for the academic paper had existed for some time previously. In parallel, the National Development Planning Agency (Bappenas) has development tools to support *ex ante* and *ex post* regulatory impact assessments – though at the time of writing this chapter the Bappenas tools had not been piloted and their position *vis-a-vis* the academic study was not clear (Box 2.3). Bappenas is reported to have invited relevant stakeholders from national and sun-national government to introduce these tools and encourage their voluntary application. Mandatory use of these tools, however, requires the support of the Ministry of Law and Human Rights and Ministry of Home Affairs.

The academic study is intended to justify the government's intervention and choice of instrument prior to discussions of a bill and draft sub-national government regulation and shares similarities with regulatory impact assessment good practice. For example, both aim to improve the design of regulation by assisting policy makers to identify the specific policy need and objective of the regulation. Both are intended to be integrated early into the policy-making process, as is a prerequisite for initiating formal discussions on laws and sub-national regulations. Both are intended to be prepared by the institution that is initiating the bill or draft sub-national regulation.

Box 2.3. Government of Indonesia's template for an academic study underpinning bills and draft sub-national regulations

Law 12/2011 on the Formulation of Laws and Regulations outlines a standardised structure for academic studies. These studies are to be structured as follows:

- Introduction
  - Outlining the reasons why an in-depth and comprehensive theoretical study needs to be prepared as a reference document to the formulation of proposed bill/draft sub-national regulation;
  - Identifying the challenge(s) faced by the state and society; the reason(s) why the government has a role in resolving the challenge(s); why the challenge(s) should be resolved by law/sub-national regulation;
  - Defining the philosophical, sociological and juridical basis to formulate the proposed bill/draft sub-national regulation; and the proposed goal(s), scope and direction of the proposed bill/draft sub-national regulation; and
  - Describing the methodology for the formulation of academic study, i.e. normative (examination data, interviews, discussions, public hearings) and empirical (surveys, etc.).
- Theoretical and empirical study
  - Examining the theoretical and principles, practical implementation, as well as social, political and economic implications, including the impact on public finances, of the proposed bill and sub-national regulation.
- Evaluation and analysis of related laws and regulations
  - Reviewing existing laws and regulations, possible linkages between the proposed law or sub-national government regulation with existing laws and regulations, including those revoked and/or amended, as a basis for discussing vertical and horizontal harmonisation of any new regulations.
- Philosophical, sociological and juridical basis

  - The philosophical basis is to give consideration of and reasons illustrating that the proposed bill/draft regulation gives consideration to livelihood, consciousness and legal ideals, including the Indonesian state philosophy of Pancasila and the Preamble to the 1945 Constitution;
  - The sociological basis is to give consideration of and reasons illustrating that the proposed bill/draft regulation meets the needs of the general public, based on empirical evidence concerning real challenges and needs of the general public and state; and
  - The juridical bases is to give consideration of and reasons illustrating that the proposed bill/draft regulation to address the challenge, or fill a legal void, gives legal certainty and provide social justice. It also relates to the need to issue new laws/regulations where existing laws/regulations are outdated, inconsistent or overlapping.
- Scope of possible law and sub-national regulation
  - Defining related terminology and concepts, materials that should be regulated, possible sanctions to be included within the proposed law or sub-national regulation; and transition clause based on the results of the previous chapters.
- Conclusions
  - Including recommendations related to a need to include the subject of the academic study in a law or sub-national regulation, or secondary legislation; the priority of the proposed law or sub-national regulation in the Prolegnas/Prolegda; and other remarks to support the improvement of future academic studies

Source: Adapted from Law 12/2011 on the Formulation on Laws and Regulations.

Box 2.4. The National Development Planning Agency (Bappenas): Future Regulation Analysis and Law and Regulation Analysis Tools

The National Development Planning Agency (Bappenas) has taken the initiative to develop tools to support the review of new and existing laws and regulations. Two tools have been formulated to date: the Regulation Framework Analysis Model (*Model Analisa Kerangka Regulasi*) and the Law and Regulation Analysis Model (*Model Analisa Peraturan Perundang-undangan*).

The Regulation Framework Analysis Model is a tool to perform analysis of the proposed bill listed in the annual priorities of the Prolegnas that has an academic study and in the Annual Government Work plan – or in the Prolegda and in the Annual Sub-National Government Workplan.

The Law and Regulation Analysis Model is an analytical tool to map, assess and provide recommendations on laws and regulations that could or do hamper national development. Both the Regulation Framework Analysis and Law and Regulation Analysis Models are based on the following principles:

- *Simple*: easily understood and operational for all public organisations (national and sub-national), stakeholders (i.e. entrepreneurs, businesses, non-governmental organisations) and affected citizens;
- *User-friendly*: easily applied by public organisations at both the national and sub-national level that will apply the model, based on the criteria for the application of the model; and
- *Accountable*: even though the model is simple and user-friendly, both in terms of effectiveness and procedure from a practical and academic perspective.

The Regulation Framework Analysis is based on the following criteria:

- *Legal basis*: whether bills or draft sub-national regulations have a sound legal basis related to the substance or materials to be regulated;

- *Needs*: whether bills or draft sub-national regulations are in accordance with development planning documents (i.e. National Medium-Term Development Plan for bills and sub-national medium-term development plans for draft sub-national regulations) and development priorities; and whether bills or draft sub-national regulations are based on clear objectives and in accordance with societal needs; and
- *Potential burden on public finances and benefit for the general public*: whether bills or draft sub-national regulations negatively impacts on public finances created by the establishment of new public organisations, new infrastructure, formulation of new implementing regulations, increasing government expenditures and the possibility to have a positive economic and social impact.

The Law and Regulation Analysis Model contains three criteria:

- *Legal basis:* whether the regulation is potentially problematic (i.e. inconsistent, duplicative, or not operational);
- *Needs:* whether the regulation has a clear objective and needed by the general public and development as well as an answer to the problem that is trying to solve; and
- *Friendly:* whether the regulation is going to create an excessive burden (i.e. cost, time or process) on directly affected parties (i.e. those targeted by the regulation).

Source: Website of Directorate for the Analysis of Laws and Regulation, *http://dapp.bappenas.go.id/*, accessed 1 December, 2012.

However, academic studies share significant differences with regulatory impact assessment good practice. Academic studies are required only for bills and draft sub-national regulations but not their implementing regulations. The expected content of the academic studies is not proportionate to the expected economic, social and environmental significance of the regulation. Academic studies do not, in practice, explicitly require an assessment of the quantitative impact, including direct and indirect cost borne by business, citizens or government. Law 12/2011 requires that an academic study should assess the cost of regulatory decisions, however the empirical dimensions are often underdeveloped. This reflects, in part, the approach to preparing the academic studies which is compliance oriented. Academic studies are not well integrated in, and updated based on, discussions within the executive, in public consultations or deliberations within the legislature. Moreover, there is evidence to suggest that academic studies are prepared only after the bill is formulated. Finally, academic studies are not systematically made publicly available with only a select few available on the National Law Development Agency website.

Adapting the current concept of the academic study as a real tool of regulatory impact assessment

In integrating an *ex ante* assessment to ensure that regulations and regulatory frameworks serve the public interest, the government of Indonesia could undertake actions to:

- Ensure *ex ante* assessment are proportional to the significance of the expected economic, social and environmental significance of the regulatory proposal;
- Use *ex ante* assessment to quantify the benefits and costs – both direct (administrative, financial and capital costs) and indirect (opportunity costs) – of significant regulatory proposals;

- Include within *ex ante* assessments, where relevant, qualitative descriptions of impacts that are difficult or impossible to quantify, such as equity, fairness and distributional effects;
- Make publicly available the results of *ex ante* assessments, together with regulatory proposals, in a suitable format and with adequate time to support deliberation of regulatory proposals;
- Develop clear policies, training programmes, guidance and quality control mechanisms for data collection and use of data in *ex ante* assessments; and
- Establish responsibility within government for identifying good practice in the use of *ex ante* assessments as a basis to support training and capacity building within government.

Harmonisation supports alignment and balancing of regulatory decision making

Harmonisation is considered a key stage of regulatory decision making, leveraging the knowledge of other public sector entities as a means of aligning, adjusting and enhancing the quality of laws and regulations. Law 12/2011 establishes the obligation for the harmonisation of bills and draft government, presidential and sub-national regulations. Within the national executive harmonisation is supported by an *ad hoc* inter-ministerial committee composed of relevant ministers or heads of non-ministerial bodies. These committees within the national executive are to be established following the approval of the Prolegnas by the national legislature or following a proposal by the national executive to establish a government or presidential regulation. Inter-ministerial committees are chaired by the minister or the head of non-ministerial body that initiated the bill, draft government or draft presidential regulation. The activities of these committees are overseen by the Ministry of Law and Human Rights.

Ministers and heads of non-ministerial bodies are invited to participate in an inter-ministerial committee by the minister initiating the bill or draft regulation. Upon being invited, ministers and heads of non-ministerial bodies are obliged to formally delegate an official to the committee and must be a legal expert and/or have technical knowledge of the issues to be regulated. Every committee must also include a representative of the Ministry of Law and Human Rights and the head of the initiating minister's legal bureau. The head of the legal bureau is to serve as the secretariat of the committee. Under Law 12/2011, initiating ministers may also invite experts from universities, social, political, professional or civil society organisations as considered necessary to participate in the inter-ministerial committee discussions. Similarly, the initiating minister may circulate the bill, draft government or draft presidential regulation to the general public for comment and as further input for the committee's discussions.

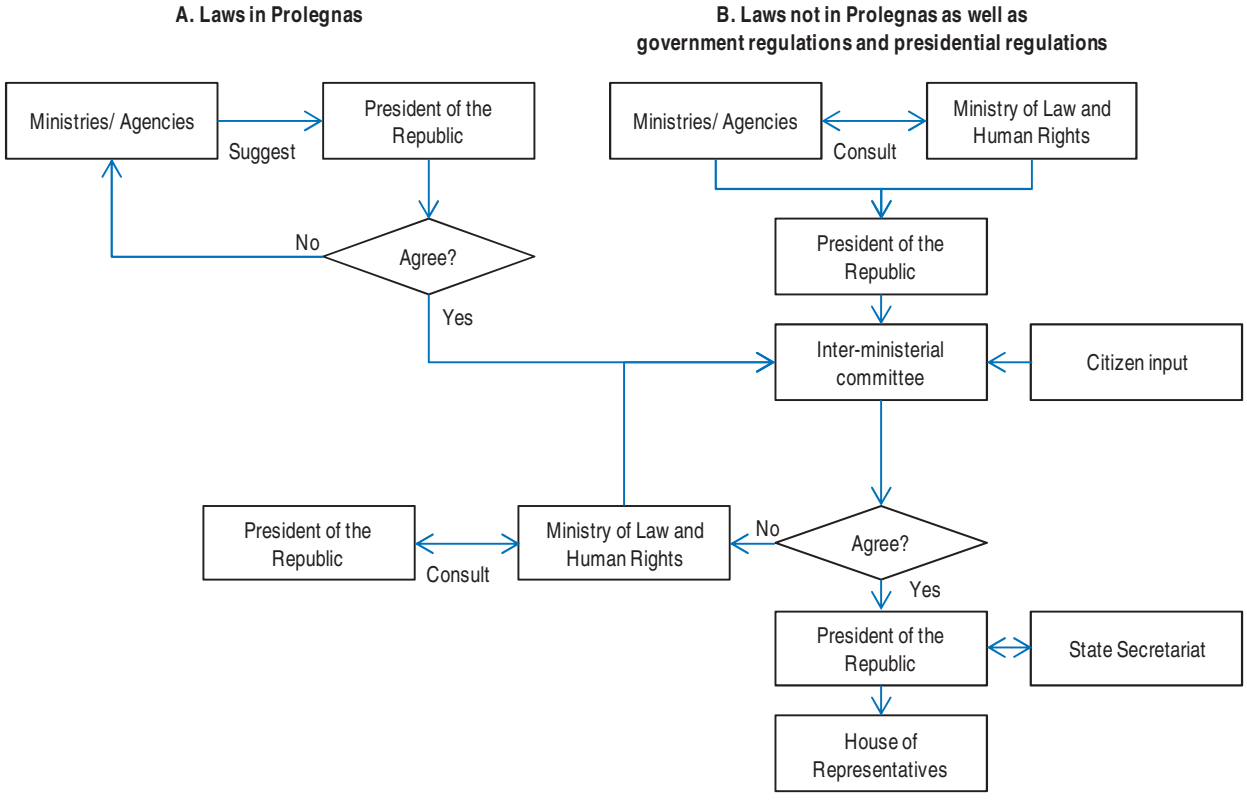
If any concerns cannot be resolved through the inter-ministerial committee, the matter is communicated in writing to the President of the Republic for a decision. The President also has the prerogative to approval of a bill initiated by the executive, draft government or draft presidential regulation.

The national government reviews sub-national regulation to support a whole-of-government approach

The national government has authority to review sub-national regulations, with separate processes existing for regulations that do not impose taxes and user changes and those that do. Sub-national governments must transmit regulations that do not impose taxes and user charges to the Minister of Home Affairs within seven days after being enacted, under Law 32/2004 on Sub-national Government. The Minister of Home Affairs is to guarantee that sub-national regulations are reviewed against two criteria: public interest; and coherence with laws and/or higher-order regulation. The Minister of Home Affairs has 60 days to invalidate, by presidential regulation, any sub-national regulation that breaches either one of these criteria. The position of the Minister of Home Affairs must be accompanied by a written explanation of the reason for invalidation. It is subsequently the responsibility of the head of the sub-national executive to stop the implementation of an invalidated regulation within seven days. The sub-national executive is also responsible for working with the respective legislature to revoke the regulation. A sub-national government may also appeal a national government decision to invalidate a regulation to the Supreme Court.

Figure 2.1. Government of Indonesia procedures for harmonising bills, draft government and draft presidential regulations

As of August, 2011



Source: Adapted from website of the Ministry of Law and Human Rights – based on Presidential Regulation 68/2005 regarding the Formulation of Bills, Draft Presidential Regulations in Lieu of Law, Draft Government Regulations, Draft Presidential Regulations, *http://ditjenpp.kemenkumham.go.id/proses-penyiapan-ruu.html.*

In comparison with the process described above, the national government reviews sub-national regulations that impose taxes and user charges before their enactment, under Law 28/2009. Any such regulations that impose taxes and user changes must be submitted to the Ministers of Home Affairs and Finance within three days after being approved by the sub-national government, but before it is enacted. The Minister of Home Affairs, in co-ordination with the Minister of Finance, is to determine within 15 days whether the sub-national regulation may be enacted. If the position of the Ministers of Home Affairs and Finance is to block the draft regulation the reasons must be explained in writing. The sub-national government must re-submit the regulation to the Ministers of Home Affairs and Finance within seven days of its enactment. If an enacted sub-national regulation that imposes taxes and user charges conflicts with the public interest and/or higher order regulations, the Minister of Finance can recommend to the President of the Republic, through the Minister of Home Affairs, to revoke the regulation. The Minister of Finance must, however, issue its recommendation within 20 days of receiving the enacted regulation. The Minister of Finance can also withhold or reduce inter-government transfers if a sub-national government does not comply.

The Minister of Home Affairs is tasked with overseeing the implementation of the results of clarification and evaluation of sub-national regulations and provincial governor's oversight of regency/city regulations. Governors are obliged to oversee the implementation of the results of clarification and evaluation of regency/city regulations. Moreover, governors must submit a written report every three months, and as requested, on the results of oversight of regency/city regulations to the Minister of Home Affairs.

Despite the existence of a formal review mechanisms, challenges remain with sub-national regulation

Since the beginning of decentralisation (2001) until the end of 2010, approximately 13 600 sub-national government regulations have been sent to the national government for review. The Minister of Finance has examined approximately 13 200 of these 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 had been revoked. Periodic surveys by non-government organisation have found number issues with sub-national regulations. For example, a 2011 survey that approximately 80% of approximately 1 500 sub-national regulations from approximately 240 regencies/cities did not make reference to appropriate higher-order regulation. The same survey found the content of sub-national regulations inadequate in approximately 40% of cases, including a lack of clarity of the procedures, processing time and cost of licensing. Finally, the underlying principle of regulation was considered problematic in approximately 23% of regulations, including for reasons of a negative economic impact or lack of sub-national government authority to issue such a regulation (KPPOD/The Asia Foundation, 2011).

There are a number of common explanations for these challenges. Sub-national governments are not always aware of changes to higher-order regulation owing to ineffective communication channels between the national and sub-national tiers of government. The national government is unable to review all sub-national regulations within the statutory deadlines because of the sheer number of sub-national regulations received. Not all sub-national regulations are sent to the national government for review: it has been estimated that only 30-40% of sub-national regulations were sent to the national government during the first years of decentralisation. The national government's review process has not timely with a lag of 2–6 years between enactment and invalidation of regulations. Sub-national governments do not always rescind regulations that have

been invalidated by the national government. Moreover, prior to 2009, there were no sanctions for sub-national governments that did not revoke regulations that were invalidated by the national government (Lewis, 2003; Butt, 2010).

Besides the current ex post *review of sub-national regulations, there is no review of the stock of regulation*

The government of Indonesia has not developed programmes to review the stock of significant regulation against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations remain up to date, cost-justified, cost-effective and consistent and delivers its intended policy objectives. The 2010-14 medium-term national development plan establishes quantitative targets for the review of sub-national government regulations. It sets out to target 12 500 sub-national regulations: 3 000 in 2010, 9 000 in 2011, 3 000 in 2012, 2 500 in 2013 and 2 500 in 2014. While the national government met this target in 2010 and 2011, there is no indication that the review has targeted significant regulation rather than simply the backlog of sub-national regulations that must be reviewed.

The evaluation of existing policies through *ex post* impact analysis is necessary to ensure that regulations are effective and efficient. In some circumstances, the formal processes of *ex post* impact analysis may be more effective than *ex ante* analysis at informing ongoing policy debate. This is likely to be the case for example, if regulations have been developed under pressure to implement a rapid response. Consideration should be given early in the policy cycle to the performance criteria for *ex post* evaluation, including whether the objectives of the regulation are clear, what data will be used to measure performance as well as the allocation of institutional resources. It can be difficult to direct scarce policy resources to review existing regulation; accordingly, it is necessary to systematically programme the review of regulation to ensure that *ex post* evaluation is undertaken. Practical methods include embedding the use of sunset clauses or requirements for mandatory periodic evaluation in rules, scheduled review programmes and standing mechanisms by which the public can make recommendations to modify existing regulation.

2.3. Openness of regulatory decision making

Openness is a key principle of Indonesia's regulatory framework under Law 12/2011, and its predecessor Law 10/2004. However, its practice is not well documented. Nevertheless, there have been some *ad hoc* donor-led studies on the use of public consultation that have demonstrated its use. The commitment to public consultation in regulatory decision making within Law 12/2011 could be supplement with practical guidelines. Such guidelines could also provide a basis for evaluating public consultation by individual public sector entities and by a central institution responsible for ensuring regulation serves a whole-of-government policy. All regulations must be disseminated electronically but no comprehensive electronic database exists. The government of Indonesia could formulate guidelines for public consultation on regulatory decision making and establish a common database on laws and regulations.

Public consultation is a key element of regulatory decision making but its practice is not well documented

Law 12/2011 introduced the obligation for the executive branch to conduct public consultation on bills and draft sub-national regulations. Previously, Law 10/2004 only required public consultation to be conducted by the legislature, i.e. limited to laws. Law

12/2011 provides a basis for the general public to provide input, either orally or in writing, into the formulation of laws and regulations. The general public is broadly defined in this law as including individuals and professional, civil society and sub-national cultural groups that may be affected by or that have an interest in the matter being regulated. The general public's participation is to be achieved through public hearings, workshops and discussions among other fora. Law 12/2011 also provides for the involvement of experts in the formulation of laws and sub-national regulations. There is, however, no reference to public consultation for government and presidential regulations in Law 12/2011. Although public consultation is not formally required for other regulatory instruments under Law 12/2011, the executive had introduced the requirement for public consultation on regulatory proposals, through Presidential Regulation 68/2005.

A difficulty exists to assess the quality of public consultation in regulatory decision making in Indonesia as ministries and sub-national governments do not maintain easily accessible records regarding the process and outcome. Interviews for the preparation of this chapter found that public officials are not able to offer any reports or data on the quantity or quality of public consultation. A 2009 study found various types of consultation were being used by national and sub-national governments in Indonesia. This study identified common forms of consultation as including: *i)* group meetings with experts and stakeholders, including from universities, business associations and non-government organisations; *ii)* posting the draft laws and regulation on the ministry's website together with an invitation for public comment; *iii)* public hearings, meetings and workshops to which public is invited; *iv)* focus group discussion with affected parties; and *v)* random surveys of the general public (USAID, 2009). The situation within the executive contrasts with that in the legislature where transcripts of public hearings – one form of public consultation – are produced and bound together with documents submitted by the public for later reference.

No guidelines exist for conducting and evaluating public consultation in regulatory decision making

The government of Indonesia could establish a clear policy identifying how to conduct open and balanced public consultation in order to review existing and develop new laws and regulations. In the absence of formal guidelines for public consultation on regulatory decision making, considerable flexibility and heterogeneity can be expected to arise across different public sector entities and sectors. The absence of a common approach also raises the risk that officials responsible for organising public consultation on draft regulatory proposals will opt for a smaller scale process of consultation rather than all of the relevant stakeholders and the general public that would want to participate.

In developing formal guidelines for public consultation, the government of Indonesia could consider introducing requirements to:

- Consult on all aspects of *ex ante* assessment and explicitly use these assessments as part of the consultation process for the formulation of laws and regulations;
- Structure *ex post* evaluations of existing laws and regulations around the needs of affected parties, engaging views on the design and implementation of reviews, including prioritisation;

- Establish specific consultation plans with a clear statement of the purpose and objectives of consultation when assessing new and evaluating existing the regulation;
- Make available to the public, as far as possible, all relevant material from regulatory dossiers including the supporting analyses, reasons for regulatory decisions and all relevant data;
- Utilise a wide spectrum of consultation formats to engage a broad diversity of stakeholders within the population and keep the burden of consultation to a minimum;
- Highlight specific tools to assist the consultation process, such as consultation planning templates, checklists, good practices notes, etc;
- Allow sufficient periods of time to allow stakeholders the opportunity to consider proposed regulations and to participate in the regulation making process;
- Document the process and input received from the consultation to inform the regulation making process and as a basis for evaluation; and
- Develop appropriate capability (skills, guidance and training) within government to effectively manage consultation of affected parties.

Box 2.5. Ensuring effective transparency and citizen engagement in regulatory decision making: The example of Canada

In Canada, the appropriateness of the consultations conducted by departments with stakeholders prior to seeking Cabinet's consideration of a regulatory proposal, together with the outcome of the consultations, such as stakeholder support, play a role in determining whether Cabinet will approve the pre-publication of the proposal for comments by the public in general.

In 2009, the government of Canada issued a *Guide for Effective Regulatory Consultation*. The guidelines provide information on the components of effective regulatory consultation together with checklists on

- Ongoing, constructive, and professional relationship with stakeholders
- Consultation plan
  - Statement of purpose and objectives
  - Public environment analysis
  - Developing realistic timelines
  - Internal and interdepartmental co-ordination
  - Selecting consultation tools
  - Selecting participants
  - Effective budgeting
  - Ongoing evaluation, end-of-process evaluation, and documentation
  - Feedback/follow-up
- Conducting the consultations
  - Communicating neutral, relevant, and timely information
  - Ensuring that officials have the necessary skills

Source: Treasury Board Secretariat (Canada) (2009), "Guidelines for Effective Regulatory Consultations," *www.tbs-sct.gc.ca/ri-qr/documents/gl-ld/erc-cer/erc-cerpr-eng.asp?format=print.*

Although all laws and regulations must be electronically disseminated, no comprehensive database exists

Laws and sub-national regulations included under Law 12/2011 must be published in the Official Gazette of the Republic of Indonesia. Although Law 12/2011 only formally establishes this obligation for laws and sub-national regulations, President Regulation 1/2007 on the Approval, Promulgation and Distribution of Laws and Regulations establishes the obligation for government regulations in lieu of law, government and presidential regulations. Dissemination is intended to ensure that public institutions, ministries and non-department organisations, sub-national government and other stakeholders understand and comprehend the contents of the laws and regulations as a pre-requisite for successful implementation. Responsibility for publishing laws and sub-national government regulations in the Official Gazette is the responsibility of the Minister of Law and Human Rights, under Law 12/2011. Previously, publication was the responsibility of the respective minister. If a law or regulation is required to be translated into other languages (e.g. English), responsibility for its translation is the responsibility of the Ministry of Law and Human Rights.

The dissemination of laws and regulations must also be made through electronic media, though no comprehensive database exists (Table 2.6). The State and Cabinet Secretariats distribute an authorised copy of laws to the government institutions, ministries, non-department organisations, sub-national governments and other stakeholders. Ministers are also required to provide a copy of laws and regulation to the general public. Other stakeholders may request a copy of the law/regulation to the State Secretariat, Cabinet Secretariat or the secretariat of the related ministry/institution or sub-national secretariat. The State Secretariat, Cabinet Secretariat, secretariats of public institutions and sub-national secretariats are required to maintain an Internet portal containing the relevant laws and regulations. State and Cabinet Secretariats are required to publish laws and regulations that are approved or issued by the President of the Republic. Secretariats of public institutions, ministries and sub-national governments are required to provide information on regulations issued by the head of their organisation, minister, sub-national head of government, respectively. Other public institutions may operate and maintain their own information system.

Table 2.6. Selected government of Indonesia national databases on laws and regulations

Institution (responsible unit)	Content												Coverage	Search by:				Additional materials (e.g. RIA)	Support information requests
	1945 Constitution	Laws	Regulations in lieu of Law	Government Regulations	Presidential Regulation	Presidential Decree	Presidential Instruction	Own regulations	Own decrees	Other entities regulations	Other entities decrees	Sub-national regulations		Themes, sector	Legal instrument	Year issued	Multiple criteria		
State Secretariat	●	●	●	●	●	●	●	●	●	o	o	o	1999 - onwards	o	●	●	●	o	o
Ministry of Trade	●	●	●	●	●	●	●	●	●	●	o	o	1985-	●	●	●	●	o	●
Ministry of Finance	●	●	●	●	●	●	●	●	●	o	o	o	1968 onwards	●	●	●	o	o	o
Ministry of Law and Human Rights	●	●	●	●	●	●	●	o	o	Some	Some	Some	1945-	o	●	●	o	o	o

● = yes, o = no

Source: Adapated from Bappenas (2010), "Koordinasi Strategis Pengembangan Studi Kelaakan Database Peraturan Perundang-undangan Tahun 2010" [Strategic Co-ordination for the Development of Feasibility Study for a Database of Laws and Regulations, Final Report," Direktorat Analisa Peraturan Perundang-undangan, Kementerian Perencanaan Pembangunan Nasional/Badan Perencanaan Pembangunan Nasional, *www.bappenas.go.id.*

2.4. Policy options for consideration

The government of Indonesia should focus on developing a well functioning regulatory framework in the coming years to support its goals established in its development plans. The government of Indonesia's attention could focus on establishing an explicit policy for regulatory reform emphasising the need to ensure that economic, social and environmental benefits justify the cost of regulation. In embedding this focus into the existing framework, the government of Indonesia could also take action to assure the principles of co-ordination, impact assessment and public consultation are effectively implemented.

- ***Formulate an explicit whole-of-government policy to ensure economic, social and environmental benefits of regulation justify the cost, that distributional effects are considered and net benefits are maximised.***

Regulatory policy defines the process by which government, when identifying a policy objective, decides whether to use regulation as a policy instrument, and proceeds to draft and adopt a regulation through evidence-based decision making. Adopting a "whole-of-government" policy enables the government to take into account the dynamic interplay between the different institutions involved in the regulatory process and to overcome obstacles created by a traditional compartmentalisation of functions.

The government of Indonesia does not have an explicit whole-of-government policy for ensuring a well-functioning regulatory management system. Elements of a policy can be found in Law 12/2011 on the Formulation of Laws and Regulations as well as the National Medium-term Development Plan and MP3EI. These plans, however, focus on sectoral regulation rather than the regulatory management systems more generally.

In the Indonesian context, an explicit whole-of-government policy could be articulated through a presidential instruction. This instrument is used to articulate statements of political commitment and to direct public sector entities – including at sub-national levels – to co-ordinate actions and to define a range of measures that should be taken. Moreover, it is critical that the President of the Republic periodically update the instruction drawing upon lessons learnt as well as international good practice.

Furthermore, an explicit strategy should aim to build upon Law 12/2011 which provides a framework for the formulation of laws and regulations. This law provides much flexibility to the executive to enhance regulatory management systems at both national and sub-national levels through the use of presidential and government regulations.

- ***Develop formal guidelines for public consultation in regulatory decision making to support consistent practices, quality control of processes and capacity building of involved public officials.***

Public consultation is a key element of open government – a principle that Indonesia has committed to pursue as one of eight founding member of the Open Government Partnership, together with Brazil, Mexico, Norway, the Philippines, South Africa, the United Kingdom and the United States.

There are no formal guidelines for consultation with affected parties in the regulatory decision-making process. Establishing such guidelines can enhance opportunities for the public to contribute to the formulation of regulatory proposals and to the quality of the supporting analysis underlying regulation. It can also enhance trust in government by increasing standardisation of citizen's experiences participating in different public consultation processes.

In the Indonesian context, guidelines for public consultation could be included in the proposed revision of Presidential Regulation 68/2005 on the Procedure for Preparing Bills, Draft Government Regulations in Lieu of Law, Draft Government Regulations and Draft Presidential Regulations. This regulation guides procedures at both national and sub-national levels of government.

It would also be considered beneficial to include the results of public consultation in the regulatory dossiers together with analyses from *ex ante* impact assessment, *ex post* evaluations, reasons for regulatory decisions and all other relevant information and data. This information could be to supplement and support quality control in regulatory decision making. Moreover, the same information could support training and capacity building in regulatory decision making.

In addition, regulations guiding legislative programmes at national and sub-national levels could be amended to enhance information disclosure and support more effective public consultation. Regulatory programmes support transparency, forward planning and resourcing of regulatory decision making. Bills and draft regulations included in the legislative programmes include the proposed title of the law or regulation as well as responsible institution. This could be complemented with critical information such as the proposed timetable for discussion and contact details necessary for public consultation.

- ***Utilise new technologies to support codification, regulatory decision making processes and dissemination of new and existing regulations at all levels of government.***

There is no single comprehensive and integrated electronic database of government laws and regulations. All laws and regulations are required to be disseminated using both electronic and print media. Electronic databases are maintained by a number of public institutions, including the Peoples' House of Representatives, the State and Cabinet Secretariats, the Ministry of Law and Human Rights, the Ministry of Trade, the Ministry of Finance, among others. Moreover, current regulations allow any public institution to operate and maintain their own law and regulation database.

New technologies offer the possibility of integrating existing law and regulation databases into a comprehensive and user-friendly portal. Such a portal could support the codification – the systematic inventorisation and rationalisation – of laws and regulations as a basis for *ex post* evaluation of existing regulations on a sectoral basis. It could also 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. New technologies could also support more effective dissemination and compliance with laws and regulations.

- ***Integrate* ex ante *assessment into the formulation of new regulatory proposals to effectively consider the quantitative and qualitative benefits and costs borne by business, citizens and government.***

Indonesia's concept of an academic study shares a number of similarities, but also important differences, with regulatory impact assessment (RIA) good practices. Academic studies are intended to define the specific policy need and objective of bills and draft sub-national regulations. The preparation of a study is integrated early into the decision process, as a prerequisite for initiating any discussions on a regulatory proposal. Preparation of the study also resides with the institution initiating the regulatory proposal.

However, academic studies also share a number of significant differences with RIA good practice. The analysis to be contained in academic studies is uniform to all bills and draft sub-national regulations; it is not required for implementing regulations. Academic studies do not explicitly require a quantitative assessment of the direct (administrative and financial) and indirect (opportunity) cost of regulation. Nor are the studies integrated into the discussions of regulatory proposals.

In parallel, Bappenas and a number of government organisations have been developing RIA tools to support *ex ante* assessment of bills and regulations. However, it is unclear the extent to which these tools have been piloted and actions have been taken to ensure adequate training, guidance and quality control.

In the Indonesian context, Law 12/2011 allows for President Regulations to introduce changes to techniques for formulating laws and regulations. Moreover, presidential regulations may be revised with relative ease within the executive and can be used to influence both national and sub-national government practices.

- ***Conduct systematic programme reviews of the stock of significant regulation against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations remain up to date, cost-effective and consistent and delivers the intended policy objectives.***

There is no formal policy goal and process to review the stock of existing laws and regulations within Indonesia's national government. The concept of *ex post* reviews of regulations is most clearly identified in Indonesia with the actions of the Ministry of Home Affairs to review approved sub-national regulations that do not impose taxes and charges in order to ensure consistency with higher order legislation. Such reviews are applied to all sub-national regulations rather than those that are considered significant.

In parallel, Bappenas has standardised tools to support *ex post* evaluation of existing laws and regulations. However, it is unclear what is the legal basis for these tools and the extent to which the tools have been piloted and actions have been taken to ensure adequate training, guidance and quality control.

In the Indonesian context, Law 12/2011 allows for the government other matters not included within the current framework for the formulation of laws and regulations. This provides scope for the executive to introduce specific guidelines and procedures for the *ex post* evaluation of the stock of significant laws and regulations. Moreover, government regulations may be revised with relative ease within the executive and can be used to influence both national and sub-national government practices.

- ***Establish an independent institution to actively provide oversight of a whole-of-government regulatory policy and goals, support the implementation of the policy and foster regulatory quality.***

There is no institution that has formal responsibility for providing a whole-of-government perspective on the implementation of regulatory policy. Rather, a number of public institutions exist to provide with seemingly overlapping responsibilities over regulatory decision making – including the development of tools to support regulatory management and the formal review of regulatory proposals.

Indonesia should establish an independent institution to co-ordinate and provide oversight of regulatory quality, including impact assessments. Such an authority should be close to the centre of government and could be housed within the existing institutional framework, such as the Co-ordinating Ministry for Economic Affairs. This institution already oversees 18 national government entities, including the Ministries of Agriculture, Industry, Trade and Transport as well as the Capital Investment Co-ordination Board. Moreover, the Co-ordinating Ministry for Economic Affairs responsibilities have traditionally focused on explicit co-ordination and reporting for decision making and accountability purposes.

Notes

1. President Regulation 58/2010 on the State Secretariat, as amended by President Regulation 80/2010, Arts. 4, 62-67. See also State Secretariat Ministry Regulation 2/2011 on the Organisation and Work Procedures of the State Secretariat.
2. President Regulation 58/2010 on the State Secretariat, as amended by President Regulation 80/2010, Arts. 2, 3. See also State Secretariat Ministry Regulation 2/2011 on the Organisation and Work Procedures of the State Secretariat.
3. President Regulation 82/2010 on the Cabinet Secretariat, Arts. 2, 3, 4. See also Cabinet Secretariat Regulation 1/2011 on the Organisation and Responsibilities of the Cabinet Secretariat.
4. State Secretariat Regulation 8/2007 on Guidelines for the Development of Service Standards within the State Secretariat of the Republic of Indonesia.
5. Presidential Regulation 47/2009 on the Establishment and Organisation of Ministries. See also Kementerian Koordinator Bidang Perekonomian (2011), *Profil 2011: Kementerian Koordinator Bidang Perekonomian* (Co-ordinating Ministry for Economic Affairs Profile 2011).
6. Presidential Instruction 1/2010 on the 2010 National Development Priorities.
7. Presidential Regulation 54/2009 on the Presidential Work Unit on Development Control and Oversight amended Presidential Decree 17/2006 on the President Programme Delivery and Reform Unit, as amended by Presidential Regulation 21/2008. The organisation and work procedures of the Presidential Work Unit on Development Control and Oversight is established by State Secretariat Minister Regulation 3/2010.

8. There are nine work groups in total involved in the implementation of the 2010-2025 Master Plan on the Acceleration and Expansion of *Indonesian* Economic Growth. Six focus on individual growth corridors, three focus on cross sectoral issues including regulation, connectivity and human resource and research and technology, and one serves as the General Secretariat for the Master Plan. See Co-ordinating Ministry for Economic Affairs Decrees 35/2011 and 36/2011.

9. The Co-ordinating Ministry for Economic Affairs was established in 1966 with the name of Co-ordinating Ministry for Economics, Finance and Industry, which it used in 1966-1983 and again in 1998-2000. Its name was changed to the Co-ordinating Ministry for Economics, Finance and Development Oversight between 1988 and 1998. Its name was changed to the Co-ordinating Ministry for Economic Affairs in 2000.

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Chapter 3

Competition law and policy

This chapter is a summary of the background report Competition Law and Policy in Indonesia, available at www.oecd.org/regreform/backgroundreports. *It notes that Indonesia has made significant progress implementing the framework for competition policy and law enforcement over the past decade in the face of major challenges. However, it finds that the effectiveness of the Competition Agency is hampered by a number of residual problems with the legislative framework and that competition law and policy must be restored to a high priority on the government's regulatory policy agenda. Better integration of the Competition Agency in the policy process and the application of competition assessment to the development of new regulatory proposals and existing legislation will realize economic gains through improved market performance right across the economy.*

Introduction

Competitive, accessible and efficient markets are centrally important for all free market economies and, in particular, for economies undergoing rapid development. In general, the OECD and its member governments have found that the most effective approach to maximising growth and consumer welfare is that the government should step back and permit markets to determine where and how resources are used and to self-correct when circumstances change. However, one of the government's important roles is to establish a system of laws, policies and institutions that identify and address impediments to competitive markets. To be effective, competition policy must contain two key elements:

- Incorporation of competition principles into all government decisions that can affect markets; and
- an effectively enforced competition law setting legal standards of behaviour for all commercial entities, whether they are privately owned businesses or state-owned enterprises.

Indonesia's competition law, and the extensive enforcement and advocacy efforts of the Commission for the Supervision of Business Competition (KPPU), have been in place for more than a decade. The Indonesian competition law was a response to both popular demands for democracy and more equal economic opportunity and to the need to improve the performance of the economy. Like almost all other competition laws around the world, an important purpose of Indonesia's competition law is to enhance economic efficiency. A particular concern was to counter the excessive market concentration that had emerged in multiple markets over time, providing some businesses with too much conglomerate strength and aggregate economic power.

Indonesia has made substantial progress in implementing its competition policy in the face of major challenges, including the lack of expert economic and legal resources, faced by most developing countries and frequent changes in both micro-economic policy and the architecture of government. Competition law and policy have played a substantial role in underpinning Indonesia's economic achievements since 1999. Nevertheless, accumulated experience has revealed a number of significant problems with the original legislative package, which should be addressed in a second generation of reform. While some problems have already been addressed, often following advocacy by KPPU, others remain, despite apparent consensus on the desirability of reform in several areas. The contribution of competition law and the KPPU to economic development has therefore been less than might otherwise have been the case.

Moreover, it seems that competition law and policy have slipped in priority, both within the executive and the legislature, since the initial passing of the law. For example, the proportion of KPPU recommendations for changes to proposed legislation to minimise anti-competitive impacts that have been accepted by the government has declined in recent years. Given the substantial competition issues that remain to be addressed in the Indonesian economy, it is essential that competition law and policy are restored to their former high levels of priority within the legislature and executive.

The following seeks to assist Indonesia by building on the analyses of competition law and policy undertaken by UNCTAD and the OECD previously, updating the state of play since those reports were written and by delving more deeply into certain problems. In addition to an update since the previous reviews, the report focuses on key issues of competition advocacy and competition's contribution to connectivity and institutional arrangements.

3.1. Competition advocacy: Competition reviews of new and existing legislation

Government legislation has long constituted one of the most important sources of restrictions on competition in most countries. Indonesia has a substantial legacy of anti-competitive legislation, much of which remains in place despite the considerable efforts made since 1999. Removing or reforming legislative restrictions on competition can substantially improve economic efficiency, lower prices and improve consumer welfare. For these reasons, review of legislative restrictions on competition has been a core element of the horizontal programme of country reviews of regulatory reform conducted by the OECD since 1998.

Reforming existing legislation and scrutinising new legislative proposals to promote competition can help governments enhance economic growth and the wellbeing of their citizens. This remains a challenge even in OECD countries that have a long history of significant reform programmes. Reflecting this, the OECD Council adopted a *Recommendation on Competition Assessment* in 2009. The recommendation calls on governments to adopt processes to identify existing or proposed public policies that unduly restrict competition, to revise these policies by adopting less anti-competitive alternatives, to ensure that these review processes occur at an early stage in the policy process and to ensure that competition authorities are involved in the processes of competition assessment.

The relatively recent adoption of the competition law and the substantial legacy of anti-competitive legislation mean that programmes of legislative reform to remove anti-competitive provisions are of particular importance in the Indonesian context. The recent UNCTAD review found that "most competition problems in Indonesia stem from government actions". Legislative restrictions on competition have, in most cases, been adopted in pursuit of some particular social or economic objective. However, as the *OECD Competition Assessment Toolkit* highlights, there are usually several means of achieving these objectives. Governments should choose those that do not restrict competition or, at a minimum, minimise anti-competitive effects.

Competition authorities can have a highly influential role in advocating for the reform or repeal of existing anti-competitive legislation, as well as contributing to the development of new legislation. However, if they are to exercise these roles effectively, they must have adequate powers and resources and must be located within an institutional structure that allows them to operate in an effective and timely manner. The following considers the role of the KPPU and the institutional and procedural arrangements under which it operates.

Current KPPU practice

The KPPU is involved in competition reviews of proposed and existing legislation at the national and sub-national level. Its role in this regard is one of competition advocacy: identifying aspects of proposed legislation that may restrict competition and arguing for the removal or modification of such provisions. KPPU may become involved in advising on proposed legislation by being invited to comment on a proposal by either the ministry proposing the legislation or by the Co-ordinating Ministry for Economic Affairs, or it may seek involvement in the process on its own initiative. Indeed, Article 35 of the Competition Law obliges KPPU to provide advice and opinions on government policies identified as potentially harming competition, indicating that it has a clear legal authority in this regard. In addition, KPPU is also invited by the DPR to submit comments and recommendations on draft legislation in some cases. Moreover the KPPU at times provide its comments on a legislative proposal directly to the President. This ability to engage directly at the highest political level indicates a high level of access to the decision-making process.

KPPU exercises its policy recommendation function across a wide range of government policy concerns, with a particular focus on transport (25% of recommendations), telecommunications and trade policy. Moreover, the level of KPPU involvement in the legislative process has generally demonstrated an increasing trend over time: it has reviewed around twice as many proposed laws in the period since 2007 as in the previous five years. Conversely, KPPU data does not demonstrate any increase over time in the proportion of its policy recommendations that are *adopted* by government. Indeed, to the extent that a trend can be discerned, it appears to be a negative one. Moreover, in the majority of cases in which government has determined not to amend proposed laws in response to KPPU recommendations, no written response to the recommendation has been received.

The KPPU processes for making competition assessments and policy recommendations are robust and well-designed. They are informed in part by economic studies undertaken in relation to the most important sectors of the economy. In addition, KPPU has concluded memoranda of understanding with academic and research institutions to establish collaborative relationships in collecting data and publishing research on competition issues. Competition Impact Assessments of legislative proposals typically include qualitative benefit/cost analysis and are conducted in accordance with internal guidelines which have been developed to ensure consistency and quality. Initial screening of regulations focuses on the key tests established in the OECD Competition Assessment Toolkit with problems identified via this screening being subject to further analysis. KPPU policy recommendations are accompanied by Position Papers, which contain quantitative and qualitative analysis supporting its positions.

KPPU involvement is, in most cases, initially sought at a relatively early stage in the legislative process – often at the time of the preparation of the first technical draft – and subsequent comments may also be sought at later stages. However, in a number of cases KPPU involvement has not commenced until a late stage in the legislative process and has, accordingly, had little or no influence on the outcome. In others, including major reforms such as the adoption of the "hub ports" policy, it has not been consulted at all. This may be a reflection of the fact that the current arrangements for KPPU to advise on new legislative proposals appear to be largely *ad hoc* in nature. As noted above, there are several possible means by which KPPU may become involved in providing advice on proposed legislation. However, there is no single, formal process for making a

determination as to whether KPPU should be invited to review it and provide comment and it appears KPPU may not become aware of some proposals with major anti-competitive implications until a late stage.

A system for integrating competition analysis into national law making

A more systematic process governing the involvement of the KPPU in the *legislative process* could significantly improve outcomes by ensuring timely notification of the competition authority of all legislative proposals with potentially significant competitive impacts. One option would involve the Co-ordinating Ministry for Economic Affairs notifying KPPU of all new legislative proposals, ideally when the academic draft is commenced, thus allowing KPPU input to influence the early shaping of the proposed legislation. A variant of this approach would see the notification requirement limited to proposed legislation that affects business and/or consumers. This would reduce the resource implications of the proposal both for the Co-ordinating Ministry for Economic Affairs and for KPPU and prevent unnecessary and time-consuming procedural steps being added for non-economic legislation.

An alternative approach would see the Co-ordinating Ministry for Economic Affairs, or some other co-ordinating agency, undertaking its own initial assessment of legislative proposals to determine whether consultation with KPPU is required. Such an initial assessment could be conducted using the OECD Competition Assessment Toolkit, which assists non-specialists in making such assessments by posing specific questions designed to identify potential competition issues. Under this option, where the application of the toolkit questions suggests a possible competition issue exists (i.e. there is a positive answer to one or more of the questions), KPPU would be asked to conduct an initial assessment.

The OECD considers that in Indonesia's circumstances, the first option is likely to be superior because, at this stage, competition expertise is largely centralised within the KPPU. *We therefore recommend that the KPPU be notified of all new legislative proposals.* However, if neither of the above options is adopted, a more limited initiative should be undertaken to enhance KPPU ability to contribute to more competition-friendly laws in the priority area of *infrastructure*. All legislative proposals relating to major infrastructure investments should be analysed by the KPPU, with the Co-ordinating Ministry for Economic Affairs being given responsibility for ensuring that this consultation occurs in all cases.

Lower level rules (i.e. regulations and decrees) frequently impose restrictions on competition and, therefore, also need scrutiny. This is often absent under current arrangements, particularly if there is significant delay between the adoption of the Act and the relevant subordinate instruments, as frequently occurs. A systematic process is needed to ensure KPPU scrutiny of proposed lower level rules, and should be adopted in parallel to that proposed above for primary legislation.

The timing of KPPU advice is also important. Currently, the agency is typically asked for comment at the technical draft stage of the process, and will frequently also be asked for further input prior to the Bill being submitted to the DPR. This early and repeated consultation supports KPPU ability of this input to influence the ultimate legislative outcome. However, further potential improvements to the timing and extent of KPPU role could be considered. First, commencing KPPU involvement at the academic draft stage would encourage consideration of fundamentally different approaches, where major

competition concerns are identified: it is a general principle of regulatory impact assessment that it is likely to be more influential if commenced at the earliest possible stage of the process.

Second, KPPU should, in some cases, stay engaged with the sponsoring agency throughout the development of the legislative proposal. Questions of detailed legislative design may be highly important in determining the size and nature of the competition impacts contained in the law finally adopted, so enabling KPPU able to provide feedback and assistance at several stages in the process is likely to lead to improved outcomes.

Finally, in order to ensure a high level of compliance, KPPU comments on the final draft bill, should be made available to members of the DPR.

A further consideration is how to *ensure that the KPPU analysis and recommendations have the greatest chance of being implemented:* The low rate of adoption of KPPU recommendations in recent years (e.g. 33% between 2008 and 2011) suggests that this issue requires urgent attention. Adoption of the reforms proposed above would, in itself, be expected to increase the take up of these recommendations, however, an additional step could be to ensure that KPPU recommendations are made available to ministers as part of the cabinet process, as well as to the DPR at the time that Bills are debated. This would ensure that all legislative decision-makers were aware of any competition issues highlighted at the time of their deliberations on the proposed legislation.

KPPU input into sub-national law making

The relatively high degree of legislative authority exercised by regional/local government since Indonesia's decentralisation reforms were implemented raises the issue of ensuring that sub-national laws are consistent with national legislation. The Government of Indonesia has prioritised the need to ensure the consistency of national and sub-national laws, particularly by ensuring scrutiny of sub-national laws by the Ministry of Law and Human Rights and obtaining advice from the non-governmental organisation, Committee for the Monitoring of Regional Autonomy Implementation (KPPOD), on inconsistencies between sub-national regulations and national laws. However, the impact of sub-national regulations specifically on competition is also a major area of concern, which was highlighted in the UNCTAD review. The relatively low level of awareness of competition policy issues in most local governments risks seeing the national government's pro-competitive reforms being undermined by sub-national regulation.

KPPU has recently begun to adopt a proactive policy in this regard, providing advice in respect of sub-national regulation and advocating competition policy principles at the sub-national level, including by establishing a small number of regional offices. This shift in priorities is in line with the findings of the UNCTAD review. However, given the very large number of sub-national governments requiring scrutiny, substantial practical limits on KPPU ability to operate at these sub-national levels remain. Another potential issue is that of sensitivity among sub-national governments to national government intervention in the exercise of their legislative powers.

A systematic mechanism should be put in place to ensure either that the KPPU itself is involved in the most important regional and local business law proposals or, as occurs in some other countries, agencies at the sub-national level are established, appropriately resourced and given responsibility for this task.

Review of existing legislation

The relatively recent adoption of competition policy in Indonesia and substantial legacy of anti-competitive legislation mean that the success of programmes of review of existing legislation is crucial to the overall performance of the competition policy. KPPU states that it has the power to review and make recommendations to reform any existing legislation that is considered to have anti-competitive impacts. However, a combination of limited resources and significant competing priorities mean that its ability to address major anti-competitive impacts of existing legislation is limited in practice. In addition to the concurrent need to scrutinise new legislative proposals, KPPU role in fighting bid rigging cases has generated an enormous work-load. The introduction of a new merger notification regime will add to the KPPU resource constraints. Competing priorities mean that, while KPPU resources have been substantially increased in recent years, only a very small proportion of its staff is devoted to the assessment of existing legislation.

The task of ensuring that legislation does not unnecessarily restrict competition must involve a balance between addressing the competitive implications of new legislative proposals and action to identify and address anti-competitive elements of the stock of existing legislation. In the Indonesian context, with a substantial legacy of anti-competitive legislation, *substantial priority should be accorded to the task of reviewing and reforming existing legislation to remove unnecessary regulatory impediments to competition. Given that it is the predominant body in terms of competition policy expertise, the KPPU should have a central role in this work.*

Reforming business licensing

Business licensing is pervasive in many countries and raises particular competition policy issues. Several studies, including the OECD 2010 review, have concluded that business licensing constitutes an area of particular concern in Indonesia, with the number of licences required being unusually large and the processes for obtaining these licences slow and costly. While initiatives have been undertaken to reduce the costs of business licensing in recent years, the most recent assessment by the IBRD accords Indonesia a low comparative ranking on its ease of starting a business criterion. Moreover, it appears that the IBRD assessment of Indonesian business licensing is based on conditions in Jakarta, while the position is significantly worse in some regional areas, where sub-national governments have increasingly used their powers to create additional licence requirements since the 2001 decentralisation programme, but often demonstrate limited capacity in implementation,

From a competition viewpoint licensing unavoidably has certain disadvantages compared with other forms of regulation. It creates a barrier to entry to markets (including geographical expansion of existing businesses) and is also likely to impede innovation and flexibility. Requiring parties to apply for licences can enable incumbent operators to be forewarned of their competitors' confidential plans to enter a market if the evaluation process includes public consultation. The barrier to entry that a licence constitutes is even higher in countries that face a significant corruption problem because

corruption either adds to the money costs of obtaining a licence (if the applicant does make an illegal corrupt payment) or to the difficulties in obtaining a licence (if the applicant refuses to make an illegal corrupt payment).

Reform of licensing should be an important part of programmes to review and reform legislative restrictions on competition. The OECD Competition Assessment Toolkit discusses a range of alternative approaches to achieving the objectives that typically underpin business licensing and provides a starting point for consideration of reform opportunities.

Improving competition policy awareness throughout government

KPPU has a substantial education and outreach effort designed to broaden understanding of competition principles and the competition law throughout the government and society. These activities are important given the relatively recent adoption of competition law and policy and the lack of experience with open markets in Indonesia. Understanding of key competition issues is likely to be limited in many key institutions.

Despite the KPPU efforts to spread the awareness of how important competition is to all aspects of government business decision making, competition policy appears to have slipped from the priorities of the DPR and the executive. In fact finding for this report, the OECD team was struck by a "compartmentalised" policy-making culture in relation to competition. Central agencies tended to acknowledge that competition might be an issue in relation to policy decisions but to regard competition as an issue that could be addressed as an after-thought. They also felt this was an issue that was in the exclusive and narrow domain of the KPPU. Given the generally low level of understanding of these issues within many government ministries with major regulatory responsibilities affecting competition, consideration should be given to expanding KPPU education and awareness programme and focusing effort specifically on major regulators, both at senior levels and during induction training for policy recruits.

Training staff is likely to be among the most effective means of changing the culture of central agencies and, ultimately, of the administration as a whole in relation to competition issues. Given resource limitations within KPPU itself, consideration could be given to working with academic and research organisations, particularly those with which KPPU already has Memoranda of Understanding in place, to enable much of this training activity to be carried out by these external bodies.

3.2. The transport sector: Competition's contribution to connectivity

In large countries, the efficient operation of transport markets is an important determinant of economic performance. Competition can improve the performance of this important sector itself and also facilitate greater competition between suppliers located in different parts of the country.

Conversely, transport bottlenecks can be a means for operators to engage in anticompetitive conduct and extract monopoly rents either in the transport markets themselves or through limiting the transport of people or goods between markets. Therefore, there is an important role for the competition law and policy in the transport sector. This has not always been properly recognised in Indonesia.

The KPPU has been very active in the transport sector both as a law enforcement agency and through its advocacy activities. However, it appears that other agencies are not always aware of the important role that the KPPU can and should play. A key area of concern in this regard relates to the recently developed "hub port" policy.

As discussed more fully elsewhere in this report, any initiatives to introduce a "hub port" policy in Indonesia should be implemented through government policies that, while facilitating the establishment of efficient hub ports that are attractive to users, avoid requiring users to use the hub-ports or preventing users from choosing to by-pass hub ports. In other words, there should be no statutory monopolies created for hub-ports. Laws that prevent foreign ships from undertaking shipping between two domestic Indonesian ports for domestic cargo are likely to lessen competition by reducing the actual number of competitors, by removing competitive disciplines created simply by the *possibility* of foreign entry and by consequently increasing the risk of cartel behaviours arising among a limited number of incumbents.

The apparent lack of consultation with KPPU in the course of development of the current policy may have meant that these concerns received inadequate scrutiny during the policy development process. It is important that KPPU is consulted on any further key decisions to ensure that similar competition issues are given adequate consideration. 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.

The incumbent operators in the ports and rail industries are substantial government owned businesses that in many cases hold dominant positions in their respective markets. Much new transport infrastructure will be needed in the forthcoming period and any tenders, licences, land releases or other opportunities to develop these new facilities should be allocated with a view to fostering new competition where possible.

The KPPU should be involved in its capacity as a competition advocate whenever significant new opportunities are offered by any relevant government agency; and should exercise its jurisdiction under the competition law to consider whether any agreements might breach the competition law.

Under previous reforms to the railway industry the existing, state owned railway business was to be separated into a business that was responsible for the maintenance and expansion of the track and selling usage rights to train operators and a separate business to operate the existing trains and train services. This reform is a fundamental first step before any competition can emerge in the areas covered by the existing railway infrastructure. The delay to implementing the separation or even an interim track access arrangement has prevented competition from commencing in any substantial way.

The reforms were also designed to facilitate the construction of private railways, but none have emerged. In a number of respects, the way in which the reforms have been implemented into law (for example the requirement for the private railway to be owned and operated by a single freight user) significantly reduces the potential for such projects to be attractive and, again, competition to provide new infrastructure has been hampered.

These issues, in turn, push cargoes back onto roads that are over-crowded and the delays prevent the suppliers of goods located in one part of Indonesia from effectively competing with suppliers located in other locations. In its advocacy role, the KPPU should monitor and be consulted on key aspects of the implementation of these reforms to ensure that effective competition can emerge in the rail sector as soon as possible.

3.3. Competition law

As previous reports have found, the Indonesian competition law rests upon a sound conceptual framework. The guiding principles underpinning a fully effective competition law should be centred, as in Indonesia, on economic efficiency and the aggregate economic welfare of the people. Particularly at this point in Indonesia's history, the other purposes identified by the competition law concerning equality of economic opportunity and economic democracy are consistent with the central concept of economic welfare maximisation and should help in making competition a core value for business and the society as a whole.

An effective competition law should generally comprise at least three core elements: the prohibition of anticompetitive horizontal contracts – with particular attention directed towards "hard core cartels" such as price fixing, market allocation and bid rigging; the prohibition of monopolisation or abuse of dominance and a mechanism to safeguard against anticompetitive mergers. While Indonesia's law does contain these core elements, there are certain problems and anomalies with its design and implementation, which are discussed below.

The prohibition of anticompetitive agreements

With respect to anticompetitive agreements, the key problem is that there is no overall prohibition of horizontal agreements that restrict, impede, hinder or substantially lessen competition. Thus, some anticompetitive agreements may not come within the ambit of the law's specific prohibitions. Moreover, because these specific prohibitions refer to particular forms of conduct, specific market structures and specific circumstances, the risk arises that business actors will not fully understand their rights and obligations. Unproductive litigation to determine whether the detailed specifics of the provision are met may also be encouraged, rather than there being a focus on the simple, central question of whether there has been an agreement with an anticompetitive outcome. *Indonesia should consider adopting a general prohibition on anti-competitive conduct in its competition law* while also consolidating and simplifying existing horizontal prohibitions. This should be done either by subsuming them into the general prohibition or by developing a more structured statement of all the circumstances in which "*per se*" illegality applies or, at a minimum, by repealing the words "potentially resulting in monopolistic practices and or unfair business competition" from its market allocation and cartel provisions.

The prohibition of abuse of dominance

With respect to monopolisation and abuse of dominance, too, problems highlighted in previous reviews remain. A key issue is that the current Article 25 defines dominance in terms of certain market share thresholds. Dominance should, rather, be held to exist only when a firm has the ability to distort market outcomes: for example by raising prices on an enduring basis without significant constraint from its competitors, customers and consumers. Provisions that can lead to a finding of dominance when market power does not exist can create disincentives for firms to grow and may mis-classify certain conduct that may be pro-competitive as being economically damaging. Similarly, the reliance on a simple market share threshold may lead to failure to recognise and address the exercise of market power by a firm with a lower market share than the threshold level.

A second concern is that the types of conduct that are included as a breach of Article 25 are too specific. For example, under paragraph c. of Article 25 it appears that a dominant firm's conduct is caught if it prevents the entry of a potential new competitor but not if a company has always been present in the market in a small way but now proposes to expand and become a fully fledged competitor. Although other Articles in the law catch other specific conduct there are commonly recognised forms of abusive conduct that are not unequivocally caught.

Other provisions of the Act seem to be primarily addressing concerns that would arise in abuse of dominance cases, and therefore appear to overlap with Article 25. These include Article 4 (oligopoly agreements where oligopoly is deemed or suspected from market shares); Articles 7 and 20 (predatory pricing); Article 19 (restricting the activities of competitors or discrimination); and Article 20 (deviations from cost based pricing). Each of these provisions, as well as those mentioned above, takes a significantly different approach to the identification of monopolisation or abuse of dominance and this makes the Indonesian competition law very complex indeed. This complexity creates uncertainty with different interpretations of multiple provisions that could cover similar situations, and may discourage some forms of pro-competitive conduct.

Senior KPPU officials have a good understanding of all the above matters and, following an UNCTAD recommendation, have published guidelines setting out how it interprets the various provisions, thus enhancing predictability as to its approach to enforcement of the law. However, while these guidelines demonstrate a high degree of consistency with established principles of economic analysis in abuse of dominance cases, the document sits uncomfortably with the description of the legal position. This gap between the description of enforcement policy in the guidelines and the provisions in the law creates legal uncertainty. *Indonesia should consider whether a single, clear, principled abuse of dominance provision would be preferable.*

Preventing anticompetitive mergers

The first two paragraphs of Article 28 provide clearly expressed prohibitions, one against anticompetitive mergers and the other against anticompetitive acquisitions of shares, while the required Government regulations to set forth further provisions on merger review have now been enacted. Thus, Indonesia now has a fully functioning merger control regime.

An important role of a merger control regime is to provide a mechanism by which the competition authority can become aware of, and take action against, an anticompetitive merger *before* the merger is consummated, given the likely difficulty of unwinding mergers *ex post*. Widely adopted mechanisms include mandatory pre-merger notification for mergers that cross a certain threshold (e.g. the European Commission, the US and China), voluntary formal pre-merger notification (e.g. Singapore, New Zealand and the United Kingdom) and voluntary informal pre-merger notification (e.g. Australia). Indonesia has adopted a unique combination of a voluntary pre-merger notification (consultation), which existed before the regulations, and a compulsory post-merger notification, which was introduced in the regulations.

When considering the merits of these different mechanisms, the trade-off for the competition authority is between the higher likelihood of detection of anti-competitive mergers under a mandatory pre-merger notification system versus a voluntary system that reduces the detection rate but saves on scarce agency resources which would have otherwise been devoted to reviewing notified transactions under a mandatory system. On

the parties' side, the trade-off is between higher legal certainty under a mandatory pre-notification system versus cost-savings on filing mergers under a voluntary system. In weighing this trade-off, the difficulty of unwinding many completed mergers must be considered alongside the fact that most mergers do not raise competition problems.

At a conceptual level, the unique Indonesian combination of a voluntary pre-merger notification (consultation) option and a compulsory post-merger notification requirement may provide a good system that could achieve a good balance between detection and minimising the burdens for legitimate mergers. The compulsory post-merger notification system could provide a means to detect whether the parties who have chosen not to make a pre-merger notification (consultation) made that choice responsibly and the voluntary pre-notification (consultation) system could enable time sensitive non-problematic mergers to be consummated without delay. On the other hand, if not carefully administered this unique Indonesian system could result in the worst of all worlds – anticompetitive mergers being consummated without being first notified to the KPPU and, if the post-merger notification system is onerous or duplicative, the merger parties and KPPU bearing significant post implementation costs for all mergers be they pro-competitive or anti-competitive and in some cases, after irreversible damage to the market has already been done. *The performance of Indonesia's unique merger notification system should therefore be monitored and, if necessary, adjusted once the system has been in use for some years.*

Other competition law prohibitions

As well as the three main prohibitions, it may be appropriate for a competition law to include additional prohibitions, where they are not inconsistent with the above prohibitions and they promote long run competitive outcomes. Indonesia has included a number of additional prohibitions in its law.

The Indonesian law contains a number of vertical prohibitions of a "*per se*" nature: these are Article 6 (price discrimination), Article 8 (resale price maintenance) and Article 15 (limited exclusive dealing). There is a theoretical case for retaining *per se* illegality for resale price maintenance, but in the other two prohibitions should be made subject to a competition analysis. Prohibiting price discrimination can have anti-competitive impacts in some circumstances, leading many countries to repeal or create extensive exceptions to their specific laws concerning price discrimination. Instead, economically harmful price discrimination conduct is identified and prevented under the abuse of dominance prohibition.

A particular purpose of the Indonesian competition law is to curb excess levels of concentration that accumulated prior to the law taking effect. In pursuit of this goal, the Indonesian competition law contains specific prohibitions against certain ownership structures, including trusts (Article 12), cross-directorships (Article 26) and majority cross-shareholdings (Article 27). Given the specific problem of excess concentration that Indonesia faces, these prohibitions appear to be appropriate at this time. However, the effect of these provisions should be monitored in the future with a particular focus on whether the prohibitions continue to be needed and/or whether there are circumstances in which these prohibitions may prevent business from adopting efficient structures.

Investigatory powers

For a competition law enforcement system to be fully effective, the enforcement agency requires certain investigatory powers including the ability to obtain evidence and other information from businesses and third parties even if those parties do not wish to provide that information. On its face, the Indonesian competition law gives the KPPU a range of formal powers to obtain information including the power to require businesses to produce evidence and for witnesses to be examined. Nevertheless, the legal position appears to be problematic in key respects. The fact that KPPU Secretariat is not yet part of the Civil Service has prevented it undertaking some formal investigation functions and forced it to rely on the development of co-operative arrangements with the police and civil service investigators to conduct search, interception, arrest and seizure activities. As well, there have been legal challenges to the exercise of certain investigatory powers by KPPU.

The powers in the competition law to demand information, enter onto private property, search and take or copy material are all significant intrusions upon property rights and the right to privacy. In the absence of express, detailed provisions, many justice systems will construe the provisions providing such powers narrowly. Consequently, in most countries the equivalent powers are considerably more detailed than is the case in Indonesia's competition law, with extensive provisions concerning who makes the decision to use compulsory powers and how, what the document advising the target of the decision should contain and what is the jurisdiction of the court to enforce the decision against a non-co-operative target. Neither the KPPU nor the Police unequivocally assert that the three short sentences in Article 41 of the Law give them the ability to conduct a "dawn raid" at the premises of a business where the business does not consent. No mandatory dawn raids appear to have been conducted and many cartel cases show that even the less intrusive statutory powers to demand information or documents have not been used either.

The current uncertainty presumably results in fewer cases being proved than otherwise would be the case, with those cases that do proceed tending to be based solely or largely on indirect evidence. That tends to be less reliable than direct evidence that could be obtained if the KPPU had effective compulsory powers and used them. *These problems should be addressed through a review and reform of the law to provide explicitly for these powers*, including providing for explicit investigatory powers and detailing who may exercise them and in what manner.

Leniency and immunity policies

Many competition authorities have found that cartel detection is greatly enhanced by an immunity policy, where the first cartelist to disclose their role and fully co-operate with the authority is immune from penalty and/or a leniency policy, where a reduced penalty is imposed. For a considerable period, the KPPU itself and external commentators on the Indonesian system have recognised that an immunity and/or leniency policy would be a very helpful addition to the suite of investigatory tools. While there has been some uncertainty, the OECD understands that expert opinion currently suggests that an amendment to the existing competition law would be required to achieve this outcome. *We therefore recommend considering legislative change to introduce a system of immunity or leniency for cartel offences.*

Experience suggests that immunity/leniency policies typically require some refinements to be made after initial experience with their implementation is accumulated. Consequently, it is generally better not to exhaustively specify the full details of the policy in the primary legislation. Instead, it is preferable (if possible in the legal context of the country) to enact a general power for the agency to grant immunity or leniency that is supplemented by a power to make regulations or establish guidelines to establish the details of the practical operation of these policies. These forms of legislative provision enable the agency to make adjustments to the policy in light of implementation experience without needing further Parliamentary law changes.

Decision-making processes and appeals

Deadlines

Once the investigation process is completed, the decision making stage of the process occurs. Clearly, a delay in reaching a conclusion to correct a competition law breach could result in lasting damage to the market and, equally, taking too long to exculpate an accused could cause significant damage to that company's business. A particular consideration in merger matters is that investigations need to be completed reasonably quickly to enable the transaction to proceed. Tight deadlines for decision making can therefore be valuable, particularly for mergers.

In other countries, deadlines are more common in merger matters than non-merger matters and it is rare that authorities do not have an ability to extend the decision deadline if the parties are being slow to provide information. Requiring decisions to be taken in too hasty a time frame poses the significant risk of inadequate fact finding, inadequate analysis and decisional errors. The current Indonesian time limits, 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 abuse of dominance case can easily take a year to complete.

Indonesia should maintain its existing deadlines for merger matters only. 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 to 18 months. Alternatively, it should adopt measures that provide KPPU with greater flexibility on timing, such as "stop the clock" mechanisms, or triggers for fixed extensions of time in certain circumstances such as where a dawn raid has been undertaken or where quantitative economic analysis is to be undertaken. Providing more time for investigations would be even more important if the reforms suggested above concerning enhancing the KPPU investigatory powers were adopted, to ensure that the KPPU has adequate time to use those powers properly.

Appeals

Consistent with international practice, Indonesia provides for the review of the KPPU decisions through the court system. Article 45 of the law provides for appeals to the District Court to be made within 14 days and for the court to decide these appeals within 30 days of commencement of the hearing. Similar deadlines exist in relation to appeals from decisions of the District Court to the Supreme Court.

The key questions in competition law cases often involve consideration of detailed factual matter, and are sometimes conceptually complex. These factors mean that the current deadlines will often be unrealistic, with insufficient time for the court to give

adequate consideration to the issues before them. The timing issue is exacerbated by the fact that appeals are heard by generalist courts in Indonesia, rather than the specialist competition tribunals that some countries have created. Most OECD countries do not provide for statutory court deadlines for appeals of competition agency decisions, while observation of actual practice suggests that the average time taken to decide such appeals is much longer than the limits established in the current Indonesian law in almost all cases. *Indonesia should consider amending current time limits to enable sufficient time for the court to consider the substance of each case.*

Remedies

The most important remedies for competition laws are penalties to deter businesses from contravening the law, forward-looking orders requiring or prohibiting particular behaviour, divestitures in anticompetitive merger cases; disqualification of employees from holding executive positions in companies and revocation of a company's business licence (where applicable); and compensation for victims.

The Indonesian law provides for all of the above remedies, including both civil financial penalties and criminal financial and imprisonment penalties. Moreover, they are frequently levied, with KPPU reporting that over IDR 949 billion (USD 125 million) in administrative penalties and a similar amount in compensation payments have been levied over a ten year period. However, the collection of fines is in the hands of the courts and data provided to the OECD suggest that many penalties currently go uncollected. KPPU has recognised the need to more rigorously enforce the payment of penalties in its 2010 annual report. Action to enhance collection rates is essential, since low levels of enforcement of penalties are associated with reduced compliance with competition law.

Criminal penalties

The Indonesian law currently allows for criminal sanctions in a wider range of cases than most countries. To date, criminal sanctions for competition infringements have not yet been applied in Indonesia and there is an on-going debate on whether the KPPU should have criminal powers.

Individual criminal sanctions for competition infringements, including imprisonment, exist in a number of OECD countries. However, criminal sanctions are often limited to certain kinds of hard core conduct, e.g. cartels and big rigging conspiracies.

While, pursuing individual criminal sanctions is increasingly considered an effective way to deter and punish hard core cartel activity by holding culpable individuals accountable through seeking jail sentences, the trend towards criminalisation is not yet matched by a comparable criminal enforcement record. Outside the United States, very few jurisdictions have actually prosecuted cartels under their criminal provisions, but continue to prosecute cartels under their civil/administrative powers. The high standard of proof required in most criminal cases may account for the lack of successful criminal prosecutions to date. Moreover many developing and emerging economies have not criminalised cartel conduct. In addition, many of these countries do not yet have a fully functional civil/administrative cartel programme in place.

Indonesia should reconsider its approach to applying criminal sanctions to competition law contraventions, in the following respects:

- There should be a clear signal to the business community as to when their executives risk criminal sanctions. This could be achieved through narrowing the scope of criminal liability in the law itself or through a clearly articulated enforcement policy.
- In high priority areas such as cartels, the law should provide a clear basis for applying criminal sanctions to the individual employees involved in the contraventions as opposed to the business entities that employ them.

Redress for parties who have suffered loss from contraventions of the competition law

Most countries consider that parties who have suffered losses through breaches of competition law should have an avenue of redress. The Indonesian law attempts to provide strong rights for parties who have suffered losses, but there appear to be impediments which are undermining the adoption of this principle in practice.

In Indonesia, the competition law enables parties who have suffered a loss as a result of non-compliance with the law to make a complaint to KPPU, which is required to investigate it. However, there is also a general legal provision enabling parties who have suffered loss from a breach of a publicly enforceable law to take court action to recover such losses. On its face, this would enable claimants to take action in competition law cases. However, the competition law does not explicitly set out how its provisions would interact with the general provisions in the Civil Code and it has been left up to the Courts to resolve this question. So far these provisions have been considered in only a small number of District Court cases and the approach appears to be that the courts may enable parties to take "follow-on" actions where the KPPU has decided that the competition law has been breached but that victims cannot seek redress directly in the court.

The operation of the complaint and compensation provisions within the competition law, and the provision in the civil code for private claims, appear in practice to be flawed in at least two respects. First, the two possible avenues for redress (a KPPU award of compensation and a follow-on action in the courts) are both unpredictable. Second, the KPPU states that the obligation to investigate all validly lodged complaints constitutes a significant call on its resources. The current approach by the courts of only permitting parties to sue for damages if there has first been a finding by the KPPU that the law has been breached, encourages victims to lodge complaints with the KPPU. KPPU has indicated that the fact that it is required to investigate all validly filed complaints reduces the agency's flexibility to allocate resources to the allegations that are the best substantiated or towards the cases that are likely to cause the greatest economic damage to the economy as a whole. Requiring private litigants to first pursue a KPPU complaint process appears to compound the burdens on the KPPU resources.

To address these problems Indonesia could consider better delineating a separate private enforcement channel from the public enforcement channel and identifying an optimal interaction between the two. In the short run, the KPPU could improve predictability by issuing guidelines on how it exercises its discretion to award compensation.

Continuing the theme of reforms to the legal framework, the next section addresses institutional arrangements issues for the KPPU to administer the competition law and policy effectively. These issues include the system of appointment of Commission members and their tenures, employing more KPPU staff and financial resources.

3.4. Institutional arrangements for the KPPU

The KPPU has been established as an independent agency[1] rather than an agency within a ministry. Independence in this context means that the executive government does not have the power to instruct the Commissioners and staff of the KPPU whether or how to pursue investigations or affect decisions. This approach is consistent with international best practice. However, although this formally established independence is important to the integrity of the KPPU, there are a number of aspects of the particular way in which independence has been implemented within Indonesia that appear to be significantly hampering the KPPU effectiveness.

The appointment of the Chairperson, Vice Chairperson and Members of the Commission

The first problem concerns the tenure of Members, Chairperson and Vice Chairperson. The Members of the Commission are appointed for a fixed five year term and are eligible for reappointment for only one subsequent term. While these arrangements are common, the current practice in which there is a "spill" of all the Member positions at the same time, rather than having individual Commissioners appointed for over-lapping terms, is not. The contemporaneous change in the whole leadership of the Commission works against continuity and stability and makes it difficult to address long-term, strategic issues. The practice of having the Chairperson and Vice Chairperson elected by the Members of the Commission each year for a one year period of office also works against stability and continuity and is, to the OECD knowledge, a unique arrangement.

Options to address these problems while still maintaining the concept of fixed term tenure and rejuvenation of the membership include staggering appointments so that one or two Members are appointed each year for a period of five years and either appointing a Chairperson and Vice Chairperson for a five year term or continuing the election process but for a longer term than just one year.

Employing KPPU staff

Although KPPU staff are employed by the State, most are not "public servants" in the strict Indonesian sense. This arrangement appears to have been adopted initially both with a view to strengthening KPPU independence and enhancing its ability to recruit and retain expert staff by providing flexibility in employment conditions. However, in the current context, this non-public servant status puts the relevant staff in an uncertain position with respect to their terms and conditions of employment and their future remuneration prospects. This, in turn, poses a challenge for the KPPU in competing with both the private sector and the public service in recruiting and retaining highly qualified staff. In addition, as discussed above, it has created difficulties in the exercise of investigatory powers.

One option employed in other countries is to make the staff of the competition authority "public servants" but specify that they report only to agency commissioners, and not to the executive government. This could be difficult to implement in the Indonesian context of centralised decision making on public service numbers and employment arrangements. An alternative would be to specify in legislation that key

1. See Article 30.

aspects of the terms and conditions of employment and the powers of the KPPU staff are to the same as those applicable from time to time to public servants. In order to ensure that the KPPU has access to quality staff who see their long term career prospects as being within the broader public service, Indonesia could also consider enabling retirement benefits to be transferable by staff between the public service and their KPPU employment.

KPPU resourcing

Indonesia has invested substantial resources in competition law and policy, particularly in recent years. Reflecting this, KPPU staffing has grown from around 100 in 2006 to its current level of 426 Members and staff. However, despite this rapid growth, the KPPU remains constrained by insufficient resources, particularly in relation to professional staff. The requirement to investigate all complaints imposes a heavy requirement on the organisation's resources. Together with the prioritisation of enforcement, especially fighting bid-rigging in public procurement, this leaves little available for advocacy or other non-enforcement work. Furthermore, implementing the suggestions in this report to increase the scope of work undertaken (for example in relation to competition assessments on new and existing legislation) and the depth of work (for example using dawn raid powers in competition law investigations) would require more staff resources.

As discussed above Indonesia has an acknowledged problem of corruption and much of the enforcement burden for this work falls upon the KPPU. Fighting cartel cases that involve corruption has generated an enormous work-load for the KPPU on investigating allegations of bid rigging in government tenders. Although this work is important, it appears that the level of resources required to carry this work out does not leave the KPPU with enough resources to undertake other important activities that have the potential to generate substantial additional economic benefits, such as:

- a systematic programme of preventative work in relation to bid rigging which, as the statistics on bid rigging cases demonstrate, should be a priority for Indonesia;
- significant advocacy efforts in relation to new laws, which is particularly important given the lack of awareness of the importance of competition policy among the Ministries;
- market studies to address the substantial back-log of anticompetitive regulations; and
- fighting abuse of dominance cases and controlling mergers.

We therefore recommend that Indonesia further increase the staff and financial resources available to the KPPU, in the light of the recommendations in this chapter, and particularly to ensure that the advocacy function can be effectively delivered, with no loss of focus on enforcement of the law. While there are numerous calls on government resources, a sound competition law and policy that is vigorously implemented in practice contributes substantially to increasing national income by boosting growth, innovation and international competitiveness, and benefiting consumers in particular. This will ultimately mean higher expenditures by government on the competition agency will often be offset via increases in tax revenue over time.

3.5. Policy options for consideration

Competition advocacy

- ***Establish a formal system under which the Co-ordinating Ministry for Economic Affairs notifies KPPU of all new legislative proposals around the time the academic draft is commenced, to enable KPPU to influence the early shaping of proposed legislation.***
  - Optionally, for procedural simplicity, this system could exclude legislation related only to social policy, or to national security.
  - As an immediate priority ensure that KPPU is consulted on all legislative proposals relating to major infrastructure investments, perhaps through a Presidential decree or instruction.
  - KPPU should remain involved with the sponsoring agency or ministry throughout the development of the legislative proposal.
  - Make KPPU comments on the Bill available to Ministers as part of the cabinet process and to Members of the DPR at the time the Bill is debated.
- ***Ensure KPPU is more systematically involved in reviewing lower-level rules, through commenting on those parts of new Acts that authorise the making of lower-level rules. Where such a potential effect is identified, this could trigger a requirement for KPPU to be consulted prior to the power to make the lower level rule being exercised.***
- ***Either KPPU should be involved in the most important regional and local business law proposals, or agencies at the sub-national level should be appropriately educated, resourced and given responsibility for this task.***
- ***KPPU and the government of Indonesia should give priority to reviewing and reforming existing legislation to remove unnecessary regulatory impediments to competition.***
- ***Reform the business licensing system:***
  - Set out principles to identify when licensing is appropriate and when other forms of regulation are sufficient.
  - Otherwise, regulatory requirements should apply as rules applying to anyone participating in an industry, not as licensing requirements.
  - Existing licensing schemes should be evaluated to determine whether their removal or a shift to regulations instead of licences might lower barriers to entry.
  - Where licences are to remain, the conditions under which they are awarded and any conditions imposed on the operations of licence holders should be scrutinised to ensure they do not unnecessarily restrict competition.
- ***Train staff in Government in competition awareness, perhaps using academic and research organisations with whom KPPU has MOUs.***

The transport sector

- *There should be no statutory monopolies created for hub-ports.*
- *Laws that prevent foreign ships from undertaking shipping between two domestic Indonesian ports for domestic cargo are likely to lessen competition, so KPPU should be consulted on any further key decisions.*
- *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.*
- *Any tenders, licences, land releases or other opportunities to develop new port facilities should be allocated with a view to fostering new competition where possible.*
- *The KPPU should exercise its jurisdiction under the competition law to consider whether any agreements in the ports activity might breach the competition law. This includes agreements between the incumbent operators and any new operators, or between the government and an incumbent operator by which that operator is chosen to undertake a new opportunity.*
- *KPPU should monitor and be consulted on key aspects of the implementation of reforms to the rail sector to ensure that effective competition can emerge as soon as possible.*

Competition law

- *Regarding anti-competitive Agreements, Indonesia should consider: introducing a general prohibition that covers all agreements which have an anticompetitive object or effect. At a minimum Indonesia should consider repealing the words "potentially resulting in monopolistic practices and or unfair business competition" from its market allocation and cartel provisions.*
- *The second paragraph of Article 25 which deems firms to be dominant if 50% or 75% market share thresholds are exceeded, should either be removed or amended so that the law provides that market shares are only presumptions, not determinative of dominance.*
- *Articles 17 and 18 should be repealed because they would only be independently applicable (i.e. applicable when Article 25 was not breached) in a way that would likely hamper competition.*
- *Indonesia should consider whether a single, clear, principled abuse of dominance provision would be preferable to Articles 4, 7, 19 and 20 outlawing specific practices.*
- *The performance of Indonesia's unique merger notification system should be reviewed once the system has been in use for some years.*
- *Indonesian competition law should be made consistent with current international best practices as follows:*

  - In the short term the KPPU should continue to adopt a selective, "principles-based" approach to enforcement and, where possible, publish more explanatory papers and guidelines to explain its approach;
  - In the medium term, however, it would be preferable to amend the law to:
    - organise the prohibitions on anti-competitive behaviours in a clear and logical thematic structure;
    - eliminate duplication, overlap and inconsistency;
    - standardise language within and between the provisions;
    - better match the language of each prohibition to the harm it seeks to address; and
    - where appropriate, repeal existing prohibitions or establish significant exceptions to them, in order permit pro-competitive conduct in relevant circumstances.

- ***Resolve uncertainty about KPPU staff's powers to conduct dawn raids by reforming the law to:***
  - Provide explicitly for each of dawn raid powers: powers to demand documents and information, and the ability to require a witness to answer questions;
  - Determine what powers and roles are assigned to each of the police and the KPPU staff;
  - Clarify or ensure that KPPU employees have the ability to undertake a dawn raid, even if they are not civil servants;
  - Provide sufficiently detailed provisions to ensure that it is clear which decision making steps and documentation are required for the exercise of the powers; and
  - Explicitly vest at least one court with jurisdiction to adjudicate questions about the exercise of the powers by the law enforcement agencies, as well as about non-compliance by target firms, and provide that court with sufficient remedy powers.
- ***Legislate to introduce a system of immunity or leniency for cartel offences.***
- ***Maintain the existing deadlines only for merger matters but for other matters consider:***
  - Extending the deadlines for preliminary and final KPPU examination, particularly in complex abuse of dominance cases, to be up to 12 to 18 months; or
  - Adopting measures that provide the KPPU with some timing flexibility, such as an ability to "stop the clock".
- ***Consider amending the court time frames to enable sufficient time to consider the substance of each case.***

- ***The KPPU should prioritise enforcement of its penalty orders, as the level of recovery of fines is very low.***
- ***Reconsider the approach to applying criminal sanctions to competition law contraventions:***
  - Provide a clear signal to the business community as to when executives risk criminal sanctions to ensure that potentially pro-competitive behaviour is not discouraged. This could be achieved through narrowing the scope of criminal liability in the law itself or through a clearly articulated enforcement policy.
  - In high priority areas such as cartels, the law should provide a clear basis for applying criminal sanctions to the individual employees involved in the contraventions.
- ***Enhance redress for parties who have suffered losses by delineating a separate private enforcement channel from the public enforcement channel. In the short run, the KPPU could improve predictability by issuing guidelines on how it exercises its discretion to award compensation.***

Institutional arrangements

- ***Avoid problems associated with all members and chairperson leaving office at the same time by:***
  - Staggering appointments so that one or two Members are appointed each year for a period of five years; and
  - Either appointing a Chairperson and Vice Chairperson for a five year term or continuing the election process but for a longer term than just one year.
- ***Clarify the status of KPPU employees.***
- ***Ensure KPPU has adequate resourcing, especially staff, to allow it to implement the recommendations in this chapter, and particularly to engage in effective advocacy work to Government, without diverting resources from enforcement work.***

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Chapter 4

Market openness

This chapter is a summary of the background report Market Openness in Indonesia, available at www.oecd.org/regreform/backgroundreports. *It identifies how enhancing Indonesia's performance in trade and investment will be the key to achieving its goals for real economic growth and improvements to health, education and poverty reduction. It assesses the recent developments in trade and investment policy in Indonesia and recommends further measures that Indonesia should take to improve the regulatory process and link its internal domestic market, and its economy as a whole, to world markets. These focus on applying an economy-wide evaluation of policies and regulation, implementing systematic public consultation, streamlining licensing, and improving co-ordination of the regulatory powers of the central government and the regions.*

Introduction

This chapter represents a condensed version of a larger study on the market openness aspects of regulatory reform in Indonesia (see Lesher, 2012). The overall aim is to demonstrate the ways in which regulatory reform can help Indonesia achieve its own economic objectives, namely to transform Indonesia into one of the 10 major economies in the world by 2025 (Republic of Indonesia, 2010). To achieve this, real economic growth must reach 7-9% per year, and improvements are envisaged in education and health outcomes, employment, and poverty reduction. To achieve these goals, policy reforms will be needed to increase competitiveness, improve the business climate, and establish an efficient distribution network.

Regulatory reform is one tool that can help governments enhance market openness through the improvement of existing laws and regulations. It can also ensure that the creation of new laws and regulations are non-discriminatory and efficient. Regulatory reform can help reduce the regulatory burdens faced by firms including in their trading activities, and thus facilitate trade and investment. With the help of advanced regulatory reform tools and approaches – such as regulatory impact analysis (RIA), administrative simplification, and consultations – governments can create regulations and regulatory procedures that efficiently meet their policy objectives and at the same time support market access.

This chapter addresses five principal issues. Section 1 provides an overview of the current trade and economic environment in Indonesia. Section 2 surveys the trade and investment policy-making process currently in place and is followed in Section 3 by an outline of recent developments in trade and investment policy in Indonesia. Section 4 addresses steps that have been taken, or that could be useful, to better link Indonesia's internal domestic market, as well as the Indonesian economy as a whole, to world markets. Section 5 offers five key recommendations aimed at improving the regulatory process.

4.1. The current trade and economic environment in Indonesia

Any analysis of Indonesia must be viewed through the lens of its experience during the 1997-98 Asian financial crisis, which inflicted significant damage on the domestic economy. Exchange rate pressures led to a steep devaluation of the Indonesian rupiah (IDR), which stood at 15% of its USD value in the last 6 months of 1997 (Blalock and Roy, 2007). In 1998, investment declined by 45%, GDP contracted by 13%, and poverty rose sharply. Economic hardship led to unrest, and President Suharto resigned after three decades as President, ending the New Order regime and paving the way for democracy to take hold.

As part of the transition to democracy, decentralisation was rolled out. This process resulted in a significant transfer of power from national to provincial and district/city governments. While decentralisation is widely viewed as a necessary condition for keeping the archipelago together during the democratisation process, it has also created unique challenges. In the trade and investment context, issues have become particularly manifest as sub-national governments now have the ability to impose investment and trade taxes that may create internal barriers to trade in the domestic market. This section assesses various indicators of Indonesia's economic performance with the aim of understanding better how government regulations and processes can be made more efficient and conducive to trade and growth.

Trade has contributed to Indonesia's impressive growth, but trade and growth remain below potential

Indonesia weathered the 2008-09 economic crisis well, in part due to significant and successful structural reforms implemented in the aftermath of the Asian financial crisis. Since peaking in 2005, Indonesia's unemployment rate has been falling and stood at 8.4% in 2010 (Table 4.1). Concerns about inflation have also diminished, with inflation running at 4.4% year-on-year in October 2011 (ADB, 2011b). Indonesia is running a modest current account surplus as a share of GDP, and growth and investment have been strong.

Table 4.1. Selected indicators, Indonesia and Southeast Asia, 2010

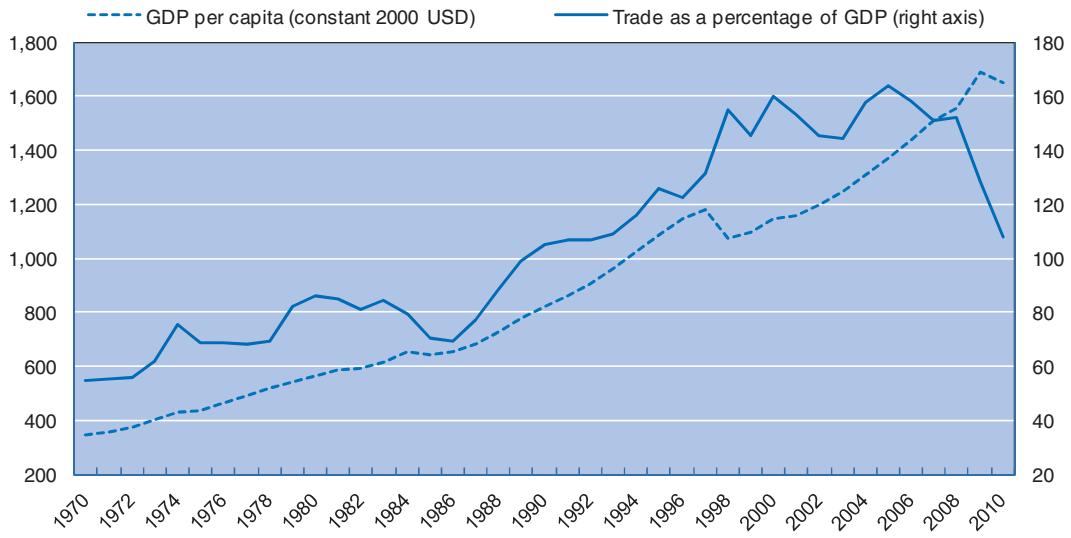
	Indonesia	Southeast Asia
GDP growth (% per year)	6.1	7.9
Inflation (% per year)	5.1	4.0
Unemployment rate (%)	8.4	n/a
Current account balance (share of GDP)	0.9	6.3

Source: ADB Outlook Update 2011.

In the first half 2011, GDP growth averaged 6.5% due to robust investment, a pick-up in private consumption and strong export performance (ADB, 2011a). Looking ahead, short-term projections suggest growth rates of around 6% for 2011 and 2012 (OECD, 2010b). However, Indonesia has yet to fully recover to growth rates pre-Asian financial crisis, and its 2010 growth rate was a full two percentage points below the ASEAN average, suggesting that scope remains to further enhance growth. Moreover, growth is not evenly spread across regions, with Java contributing almost 60% of Indonesia's total growth in 2010 (BPS Statistics).

Indonesia's GDP per capita has risen almost five-fold in the past forty years (Figure 4.1). Trade has played an important role in this remarkable achievement. In the past 25 years, trade as a share of GDP increased significantly in Indonesia, in part due to the country's outward-oriented development strategy. And while the deep global trade contraction in 2009 is apparent, more recent data suggest that trade has increased to levels closer to trend.

Figure 4.1. Evolution of GDP per capita and trade as a share of GDP in Indonesia



Source: World Bank's World Development Indicators, *http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2*, accessed 5 March 2012.

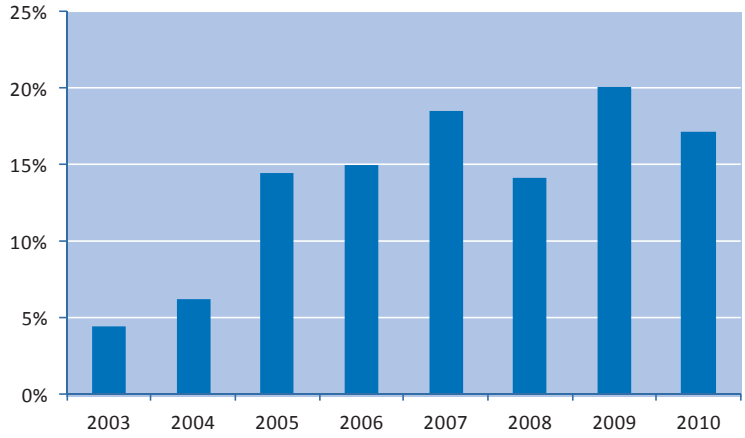
Openness has been an important driver of structural change. The rise of intra-industry trade in Asia coupled with deep and successful reforms aimed at improving economic performance has contributed to changes in trade patterns as well as underlying structural adjustments (Plummer and Chia, 2009). Imports – particularly of services – play an important role in boosting domestic productivity via technology spillovers, lower costs and access to a greater variety of inputs (Lesher and Nordås, 2006).

This development has emerged despite the fact that Indonesia's share in world trade in both goods and services has not recovered to levels prior to the Asian financial crisis, underscoring the severity of the crisis on the Indonesian economy. The difference between the peak and current levels is particularly marked in the services sector, and investment demand dropped precipitously. This is in part because Indonesia's average annual rate of growth of trade has been below that of other Asian economies, such as China, India, Singapore and Vietnam. It also partly explained by the relatively high regulatory burdens faced by service providers in Indonesia. Thus, there remains much potential in the Indonesian economy to boost trade, and thus growth, going forward.

FDI has benefited Indonesia, but it is not widely spread across the archipelago

Inward stocks of foreign direct investment (FDI) in Indonesia have been increasing steadily since 2003 and stood at 17% of GDP in 2010 (Figure 4.2). This upward trend persisted in spite of the global economic crisis of 2008-09; in fact, inward FDI stocks as a share of GDP reached their highest point (20%) in the last seven years in 2009, the worst year of the global economic crisis. This reflects Indonesia's attractiveness as an investment destination both in terms of its large domestic market as well as its location as a production platform to serve other Asian markets. However, Indonesia's FDI performance lags most of the other ASEAN economies, suggesting that there is significant scope to further boost investment.

Figure 4.2. Inward stock of FDI as a share of GDP



Source: World Bank's World Development Indicators, *http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2*, accessed 5 March 2012 and UnctadStat, *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx*, accessed 5 March 2012.

Data from Indonesia's Investment Co-ordinating Board (BKPM) suggest that foreign investment is concentrated in Java (60%) and Sumatra (21%), particularly in the Jakarta metropolitan area, Batam, Bintan and Karimun (OECD, 2010a). Since 2004, FDI concentration has shifted from manufacturing toward the mining and quarrying and certain services sectors (OECD, 2010a). Foreign investors tend to come from other Asian countries, with Japan, Korea, Malaysia and Singapore as important investors (OECD, 2010a). However, other countries, such as the United States (particularly in the mining sector) and the United Kingdom are also important sources of FDI in Indonesia.

4.2. Recent developments in trade and investment policy

Tariff liberalisation has been deep and successful in Indonesia, and today it represents a relatively low-tariff country by developing-country standards. The effective rate of protection has also fallen over the past decade, although effective rates remain above nominal rates of protection. And as tariffs have fallen, non-tariff measures, which are less transparent and more easily manipulated, appear to have risen in number and scope. A new trade law is also currently being formulated.

Tariffs have fallen sharply in recent years

Indonesia's MFN applied tariffs have fallen by two-thirds since the early 1990s to about 6.7% in 2010, a relatively low figure by developing country standards. Overall, MFN tariffs are higher for finished goods than they are for intermediate inputs, implying a cascading tariff structure. As a result, the impact of tariffs on production depends not only on the tariff applied on final goods in a particular sector, but also on the tariffs applied on the intermediate inputs used in production. This is particularly important given the shift toward production networks.

The inherent distortions in this cascading tariff structure are evident in an analysis of nominal and effective rates of protection (Lesher, 2012). In almost all sectors analysed, effective rates of protection are higher than nominal rates in 2005, the most recent year data is available. Effective rates are notable in the textiles and wood sectors, two sectors in which Indonesia has been losing competitiveness. The food, beverages and tobacco as well as the rubber products sectors also have higher effective rates of protection than other sectors. Given that effective rates are generally higher than nominal rates of protection, the reduction in tariff dispersion over time has been very important, even though more can still be done.

Regional economic integration has played a pivotal role in driving economic liberalism in general and tariff reductions in particular in Indonesia (Plummer and Chia, 2009; Feridhanusetyawan and Pangestu, 2003). While ASEAN initial foundations were based more on political rather than economic union, the ASEAN Common Effective Preferential Tariff (CEPT) scheme in 1992 started the momentum toward freer trade within the ASEAN region. The CEPT served as the framework for the ASEAN Free Trade Area (AFTA), which began implementation in 1993.

In 1997, ASEAN leaders adopted Vision 2020, which aspires to create a region characterised by stability and prosperity; where there is free flow of goods, services, and investment; the freer flow of capital; and less poverty and income inequality. To realise this goal, in 2003 ASEAN leaders pledged to create the ASEAN Economic Community (AEC) by 2020, noting that the AEC is the ultimate goal of regional integration (Bali Concord II). In 2006, ASEAN countries decided to develop a region-wide blueprint to realise the AEC and adopt a more ambitious target date of 2015 for its completion. In 2007, ASEAN leaders signed the Cebu Declaration on the Acceleration of the Establishment of an ASEAN Community by 2015; the AEC Blueprint was formally adopted later that year.

Services reform would boost trade, investment and growth

While further reducing border barriers to agriculture and manufactures, particularly in the relatively small product categories in which tariff peaks exist, can be useful in reducing distortions in the domestic economy, it is in the services sectors that the most significant reforms are needed. Services play an important role in the production of goods and facilitate trade of both primary products and manufactures (e.g. logistics, communications and transport services). It also employs about 40% of the workforce.

Trade via commercial presence (Mode 3 trade in services) is important for Indonesia.[1] This type of investment is a critical component of the government's growth strategy; as such, Indonesian policy makers have been putting significant effort into trying to improve the investment environment.

Indonesia has been actively trying to improve the investment policy environment, but challenges persist

In March 2007, the DPR passed a new Law on Investment (Law 25/2007).[2] This law opens all business sectors to foreign investment unless specified in a presidential regulation containing Indonesia's Investment Negative List. The first two of these regulations were issued in 2007. The presidential regulations implementing the Investment Law consist of two sections. The first is the set of clauses that guide implementation of the investment restrictions in the Investment Negative List. The second is the actual list of investment restrictions.

The Investment Law narrows the disparities between domestic and foreign investors by providing national treatment and increases in the length of work permits available to foreigners. The new law is a major piece of legislation with several important features, but the law and its implementing regulations also promulgate distinctions between domestic and foreign investors. For instance, foreign investment must take the form of a limited liability company, foreigners cannot invest in sectors limited to small and medium-sized enterprises, and several restrictions in the amended Negative Investment List apply only to foreigners. Divesture requirements are also not mentioned in the new law.[3]

A presidential regulation with Indonesia's new Investment Negative List was issued in 2007 soon after the after passage of the Investment Law.[4] The new list was compiled by an inter-departmental team responsible for gathering all regulations impacting investment, including those in lower-order government decrees and any unofficial regulations that may have existed. Although the 2007 list covers far more sectors and thus appears more restrictive than previously, it is not clear whether the inter-departmental team added to the list of restrictions, or whether the new list simply includes restrictions that already existed in sectoral regulations

In 2010, a new Negative Investment List was issued under Presidential Regulation 36/2010. According to BKPM, 40 sub-sectors, largely in the construction services sector, have been liberalised for investment, while 10 sub-sectors have become more closed.[5] Although the sub-sector count makes it appear as though the new list is more open, this is difficult to determine because the sub-sectors vary in size and importance. For example, investment in telecommunication towers is now entirely closed to foreign investors and represents a large sector from an investment perspective, and foreign ownership was reduced in several capital- and technological-intensive sectors (e.g., transport, pharmaceutical manufacturing and distribution).

In addition, despite some important revisions to the Investment Negative List, restrictions on foreign investment in key sectors such as pharmaceuticals, distribution, telecommunications and transport services remain. Moreover, although meant to address many of implementation issues identified by the government and other stakeholders, the new regulation left a number of ambiguities that require further clarification (Magiera, 2011a). The regulatory environment for FDI is important given that economies with more liberal FDI regimes tend to attract more investment (Kalinova *et al*., 2010).

Non-tariff measures touch upon many segments of the economy

Indonesia maintains a number of different types of non-tariff measures (NTMs) at its borders. The measures are listed in Indonesia's NTM database, LARTAS (*Larangan Terbatas*). This database is used by Customs for the clearance of goods and will be publicly available on the portal of Indonesia's National Single Window (INSW). The portal will be further developed and in the future will house Indonesia's National Trade Repository (INTR).[6]

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 Agency for Food and Drug Control (15.1%) and the Ministry of Health (3.8%). The remaining agencies issue NTMs related to product standards, public safety and environmental protection, and have less than 1% of the total each (Preparation Team INSW, 2009). The large number of government agencies that have the ability to impose NTMs poses challenges to the

regulatory process. 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.

Indonesia's NTMs are of four general types: *i)* licences, *ii)* sanitary and phytosanitary requirements (SPS) and technical barriers to trade, *iii)* export restrictions, and *iv)* other restrictions (e.g. local content requirements).

Licences

The Ministry of Trade and Indonesia's National Agency for Food and Drug Control (BPOM) both require certain licences and registration requirements. Many product categories are subject to two or more licensing requirements, and the licensing system has also been used to restrict imports of certain commodities, such as salt, rice, refined sugar and meats. The types of licences are discussed below.

- *Automatic import licences (API).* All importers must reside in Indonesia and register with the Ministry of Trade.[7]

- *Producer Importer Licence (IP).* IP licences are granted to companies that import goods for use in their own production, and not for sale on the domestic market. Products subject to IP include: rice, sugar, textile and textile products, salt, iron and steel, certain petrochemical and chemical products, non-dangerous waste, pharmaceutical precursors, lubricants and most recently, horticultural products (fruit, vegetables, and ornamental plants). The stated government purpose of the IP for many of these products, such as rice, sugar and salt, is to protect domestic producers.

- *Registered Importer Licence (IT).* Importers of certain products must register with the Ministry of Trade. IT licences are required for imports of the following products: alcoholic beverages, iron and steel, salt, dibromide, explosive materials, compact discs, rough diamonds, multifunction colour printing machines, hand tools, perfume, cyclamate, saccharine, pharmaceutical precursors and most recently horticultural products (fruit, vegetables, and ornamental plants).

- *Specific Importer Identification Code Number* (*NPIK).* Since 2002, imports of certain types of products require a NPIK from the Ministry of Trade. This permit can only be granted to companies that hold either a Producer Importer (IP) or a Registered Importer Licence (IT). NPIK permits apply to corn, rice, soybeans, sugar, textile and related products, shoes, electronics, and toys. Without the permit, goods can be detained at the port. The NPIK was introduced to stop smuggling and represent about 21% of all NTMs in Indonesia (WTO, 2007).

- *Import Approval Document (SPI).* In addition to Producer Importer Licence (IP), Registered Importer Licence (IT) and Specific Importer Identification Code Number (NPIK), each shipment of some commodities requires an Import Approval Document from the responsible government agency. The SPI is used to protect public health, intellectual property rights, and for managing trade in the case of salt, sugar, cloves, rice, and hand tools.

Sanitary and phytosanitary measures (SPS) and technical barriers to trade

Indonesia's three quarantine agencies – animal, fish, and plant – apply select sanitary and phytosanitary requirements; the principal types are outlined below. Certification requirements and technical standards are sometimes mandated by Indonesia's National Standard (SNI) agency, as well as other agencies such as the Ministry of Communication and Information Technology.

- *Sanitary and phytosanitary measures.* Indonesia maintains SPS measures for animal, fish and plant products. Products falling under the measures must obtain an approval of disembarkation from ships for testing and a certificate of release by the relevant quarantine agency after testing.

- *Import Notification Document (Surat Keterangan Impor).* Imports of food supplements, processed foods, traditional medicines, drugs, and materials for the production of cosmetics must be approved by BPOM before entering Indonesia. These products must meet Indonesian quality standards and can only be distributed in Indonesia by companies approved by BPOM.

- *Technical barriers to trade (TBT).* Indonesia's TBTs include mandatory standards, certification and commodity registration requirements issued by a number of agencies.[8] The most important are those under Indonesia's national standard certification (SNI). Certified commodities (SPPT-SNI) must be registered (SPB) with the related Ministries. The mandated standards apply to both imported and domestically produced goods. Certification is made by the National Accreditation Committee (KAN). Some goods may be subject to more than one certification.[9]

Export restrictions

Governments may impose export restrictions for a variety of reasons, such as to stabilise domestic prices of a particular good (e.g. rice), as a means to promote downstream industries or as retaliation for trade or other policy stances taken by foreign governments. But export restrictions represent another type of NTM, as they limit the quantity domestic producers are permitted to export.

- *Mining.* The Mineral and Coal Mining Law 4/2009 requires that minerals and coal be processed before exporting. Implementing regulations were published in 2010 and 2012, but the export restriction on raw materials remains in place.

- *Palm oil.* In 2007, Indonesia introduced an export tax on palm oil with tax rates linked to the world market price. The objective is to secure domestic supplies, boost the local refining industry, and reduce price volatility for cooking oil. Recently, the Ministry of Finance issued a decree that raises the minimum price used to set the tax rate on crude palm oil from 700 USD per ton to 750 USD per ton, and lowers the maximum tax rate for crude oil from 25% to 22.5% whenever the price of crude palm oil exceeds 1 250 USD per metric ton on Malaysia's futures market. The export tax for downstream products (e.g. refined bleached deodorised palm oil) was also reduced from a maximum of 25% to a maximum of 10% (Christie, 2011).

- *Rattan.* In November of 2011, the Minister of Trade signed a decree banning the export of raw rattan as of 1 January 2012.[10] According to the government, the decree is part of a series of measures aimed at reviving industries that use rattan as an input (e.g., furniture). The Minister of Forestry is expected to issue regulations limiting rattan harvesting to maintain sustainability. Other regulations involve the inter-island distribution of rattan and a warehouse receipt system for the storage of excess rattan that cannot be absorbed by local processors.

Other types of non-tariff measures

Other restrictions, such as local content requirements, limitations concerning state-owned enterprises, pre-shipment inspection and port limitations for imports of certain products, are also applied. Local content requirements in government procurement and restrictions on ports of entry appear to have particularly increased in the past few years. Examples are noted below.

- *Local content requirements.* In 2009, the Ministry of Communication and Information Technology issued regulations requiring that all telecommunication companies spend 35% of their capital expenditure on local equipment. In addition, at least 40% of inputs must be sourced locally, rising to 50% in five years. Companies must regularly report their use of local components to the Ministry and can lose their operators' permits for non-compliance (Rosender, 2009). Since 2009, Indonesia has also required bidders for energy service contracts to fulfill a 35% local content requirement. Other local content requirements implemented recently involve the maritime and shipping sector, electric power generation, oil and gas sector, mining industry and sugar producers.

- *Bulog and State Agencies.* According to the WTO, Bulog is Indonesia's only state trading enterprise (STE). As an STE, Bulog has responsibility for managing Indonesia's rice stabilisation programme and maintaining rice stocks for distribution to the military and to low-income families (WTO, 2007).

- *Pre-shipment Inspection (PSI).* Many commodities that are subject to the Producer Importer Licence (IP), Registered Importer Licence (IT), Specific Importer Identification Code Number (NPIK), and Import Approval Document (SPI) must also undergo pre-shipment inspection in the exporting country. The commodities requiring PSI include cereals, sugar, foods, rubber, wood, textiles, footwear, mineral products such as salt, plastics, stone and glass, metals, pharmaceutical precursor, and machinery. The inspection is undertaken by PT Surveyor, a state-owned inspection company.

- *Limitations on port of entry.* The Ministry of Trade limits the port of entry for certain commodities. Many of the commodities[11] covered by PSI can only be imported through five Indonesian seaports (Belawan in Medan, Tanjung Priok in Jakarta, Tanjung Emus in Semarang, Tanguy Perak in Surabaya, Soekarno-Hatta in Makassar, Dumai in Dumai) and all international airports. In February 2012, the Minister of Agriculture also announced that he would limit the entry point for horticulture imports to just four entry points, excluding the main seaport of Tanjung Priok in Jakarta.

4.3. The trade and investment policy-making process in Indonesia

One aspect of this decentralised approach is evident in the use of high-level teams formed by the President to advance major policy initiatives in Indonesia. Indeed, these teams tend to dominate the trade, and to a lesser extent investment, policy-making process.

Team tariff

Team Tariff is a high-level, inter-ministerial body responsible for advising and designing tariff policy in Indonesia, and is one of Indonesia's longest standing policy institutions. All of Indonesia's major trade tariff reforms since the late 1980s were led by Team Tariff, supported by technical staff from various line ministries. In its early years, Team Tariff also took responsibility for customs issues and the administration of Indonesia's trade policy, in addition to anti-dumping duties and safeguards prior to the establishment of Indonesian Anti-dumping Committee (KADI) within the Ministry of Trade.

Team Tariff is composed of five ministries: the Ministry of Finance, the Ministry of Industry, the Ministry of Trade, the Ministry of Agriculture, and the Co-ordinating Ministry for Economic Affairs. The Ministers are supported by a Secretariat and supporting team (Technical Team Tariff) which is responsible for policy analysis and recommendations to the Ministers. The Team Tariff Secretariat is managed by a Chairman and Vice-Chairman with a small administrative staff. There is no other full-time staff assigned to the Team. Rather, officials are assigned to work for Team Tariff by their respective ministries.

The Secretariat meets regularly to discuss policy issues and formulate recommendations. Officials from other ministries are invited to participate and become part of the technical team if a policy question involves sectors under those ministries, e.g. the Ministry of Marine Affairs and Fisheries in the case of fishery products or the Ministry of Forestry in the case of forest products. The private sector is invited occasionally to provide input at Team Tariff meetings. Team Tariff recommendations are typically set out in policy memos that are sent to Ministers. Formal decisions on tariffs are contained in decrees from the Minister of Finance.

Although Team Tariff has been in existence for over twenty years, there are no overarching regulations determining its operational procedures. These seem to have been driven by the Chairman of the Secretariat and the Minister of Finance, who determine the overall work programme of the Secretariat. For example, meetings with the private sector and other stakeholders are *ad hoc* and not part of a formal consultative process. Since Indonesian regulations do not provide guidance on the decision making process or overall objectives of trade policy, tariff policy can be subject to considerable political pressure and may not always reflect Indonesia's overarching economic interest.

Under Indonesian Law, the Minister of Finance has the final authority to make changes in tariffs, export taxes, and other duties that are applied at Indonesia's borders. Since the mandate of Team Tariff is limited to tax issues that are under the authority of the Minister of Finance, it has no authority over other trade policy issues, such as non-tax issues involving NTMs. To fill this void, a new Team on Non-Tariff Measures was established in 2011.

The Team for Non-Tariff Measures (KNT)

In September 2011, the Minister of Trade issued a decree establishing a Team for Non-Tariff Measures (KNT).[12] The primary task of the KNT is to formulate policies on NTMs implemented by Indonesia. In so doing, the Team should conduct impact analysis of proposed measures, ensure their compliance with Indonesia's international obligations such as under the WTO, and monitor and evaluate measures already in place. The impact analysis should include surveys and consultations with stakeholders.

Although the Team is to co-ordinate with other government agencies when considering non-tariff measures, its scope of activities appears to be limited to those measures that are under the authority of the Ministry of Trade. Unlike Team Tariff, the Non-Tariff Measures Team is not inter-ministerial; its members consist only of staff from the Ministry of Trade. As a result, the Team would seem to have no authority over, for example, sanitary and phytosanitary (SPS) measures introduced by the Ministry of Health or the Ministry of Agriculture. Standard operating procedures for the Team, including the establishment of a Secretariat as well as mechanisms for consultations and impact assessment procedures, are now being developed by the Ministry of Trade with an expected operational date in 2012.

The National Team for the Enhancement of Exports and Investment (Timnas PEPI)

The National Team for the Enhancement of Exports and Investment (*Tim Nasional Peningkatan Ekspor dan Peningkatan Investasi* or Timnas PEPI) is a high-level policy-making body led by the President and chaired by the Co-ordinating Minister for Economic Affairs.[13] Timnas PEPI consists of more than 20 Ministers and heads of institutions. The Chief Executive is the Co-ordinating Minister for Economic Affairs, who is also responsible for the Secretariat that supports Timnas PEPI in implementing its duties.

The main goal of Timnas PEPI is to accelerate national economic development through increases in exports and investment. Its duties include the development of policies to increase exports and investment, facilitation of policy implementation, resolution of problems hindering exports and investment, and economic deregulation and de-bureaucratisation. Initially, Timnas PEPI consisted of four working groups. In 2011, the Co-ordinating Minister for Economic Affairs reconfigured Timnas PEPI into just two working groups: one covering trade and one covering investment.

As was previously the case, there is a Secretariat financed by the Co-ordinating Ministry for Economic Affairs. The Working Groups are financed by the agencies of their respective Chairperson, namely the Ministry of Trade and BKPM. Currently, there is four senior staff in the Secretariat who cover trade, investment, public policy and law. The main goals and duties of the new Timnas PEPI appear similar to those previously under the old configuration. However, this body is currently inactive due to the absence of a Chair and it is unclear whether the government will revive this body in the future.

The 2007 Investment Law and the role of Timnas PEPI

Timnas PEPI played a key role in the formulation of the 2007 Investment Law, an important step in improving the investment environment in Indonesia. One goal of the 2007 Investment Law is to increase investment by providing greater certainty to investors. The substance of the law is discussed in Section II.

While the Investment Law represents an important step in improving the investment environment, some issues remain. The 2007 Investment Law allows line ministries to issue "technical" regulations, and some line ministries have used this power to limit foreign investment even though this is in contradiction to the spirit of the Investment Law itself.[14] As a result, the implementing regulations have created considerable uncertainty for foreign investors. The government also did not systematically involve the private sector and other non-governmental actors in the development of the implementing regulations of the Investment Law, and this has created some concerns.

Due in part to concerns expressed by foreign investors, Timnas PEPI launched a review of the implementing regulations for Indonesia's Investment Law using several case studies in 2008-09. In so doing, it conducted numerous interviews with government officials, the private sector, and business associations. It determined that uncertainties regarding the implementing regulations were a major concern of foreign investors, and that this uncertainty could be just as detrimental to investment as the limits placed on investment in the Investment Negative List.[15] On this basis, Timnas PEPI developed early drafts of revised implementing regulations for the Investment Law.

During the latter part of the decade, Timnas PEPI also served as an "independent" analytical unit on investment issues. The Secretariat, in collaboration with BKPM, conducted inter-departmental meetings on proposals by line ministries to revise the Investment Negative List, and co-ordinated cost/benefit analyses of ministry requests. By requiring such an analysis, it is likely that the Secretariat successfully limited the number of new restrictions added to the Investment Negative List (Mageira, 2011a).[16]

Finally, the Secretariat of Timnas PEPI served as a repository for information on investment policy, and facilitated the transparency and ease with which investors were able to obtain information and legal interpretations of the Investment Law. It provided technical support to other Ministers for meetings with the private sector and international investors on the Investment Law, and sometimes met directly with the private sector and associations to resolve problems related to the interpretation of the Investment Law and its implementing regulations.

During the run-up to the 2009 Presidential elections and for most of 2010, Timnas PEPI ceased to function while awaiting a new ministerial decree on its operations and for the appointment of a new Chair. This perhaps illustrates the drawback of not having permanent independent bodies devoted to trade and investment policy. During this time, investment policy fell under the authority of BKPM which then took on all responsibilities for the issuance of a new Investment Negative List – Presidential Regulation 36/2010.

Perpres 36/2010 and the role of BKPM

Presidential Regulation 36/2010 revokes the previous implementing regulations for the Investment Law and contains revised implementing language and several changes to Indonesia's Investment Negative List. This regulation was meant to resolve many of the uncertainties of the past, and also includes several improvements that make the Investment Negative List more comprehensive and transparent. In particular, the decree codifies a number of Indonesia's commitments in ASEAN and therefore improves the Investment Negative List as a single source of information on investment (Magiera, 2011b).

Despite these improvements, ambiguities persisted (see Section II). As a result, BKPM began the process of reviewing Perpres 36/2010 in 2011. BKPM organised consultations with the investment community on each of the major implementation issues, and also requested input from international investors through Indonesia's Chamber of Commerce (KADIN). Based on these consultations, BKPM prepared a position paper on changes to the implementing language of the presidential decree. The position paper has been presented to the Co-ordinating Ministry for Economic Affairs for submission to the Timnas PEPI Working Group for the Expansion of Investment.

The Government has now 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 Perpres 36/2010, were never submitted for broad public comment.

… but ministries also play an important role in the policy process

The Ministry of Trade is responsible for supporting Indonesia in international trade negotiations. Within the Ministry, there are directorates for handling WTO and regional issues, as well as substantive issues such as services. The Ministry of Trade has also formed an inter-governmental working group on trade matters, with the aim of assisting trade negotiations. The Secretariat for Indonesia's antidumping committee (KADI) is also located in the Ministry of Trade.

The Ministry of Trade does not have primary responsibility for policy reforms except in those areas in which it is the principal sectoral ministry, such as wholesale and retail trade, commission agent services and franchising. The overall responsibility for other services, such as telecommunications, falls under their respective sectoral ministries.

Responsibility for NTMs lies across various ministries with the Ministry of Trade having final authority over about half as measured by the percentage of HS codes covered. The Ministry of Trade has formed a Non-Tariff Team and is developing standard operating procedures for the evaluation of proposed NTMs under its control.

The Ministry of Finance is responsible for tariffs, and is assisted by Team Tariff, of which the Ministry of Trade is a member. The Ministry of Finance is also involved in regulating certain professional services[17] and is the primary sectoral ministry (together with Bank Indonesia in certain sub-sectors) for regulations concerning financial services.

Investment policy had been handled primarily by Timnas PEPI, and more recently shifted to BKPM. BKPM administers domestic and foreign investment applications and promotes investment. Its Chairman reports directly to the President, which has enabled it to exert strong influence over government policy. Indeed, since 2009 the Chairman's position has the same level as a Minister (OECD, 2010a). The 2007 Investment Law enshrined BKPM role as the key governmental actor on investment policy.

The Co-ordinating Ministry for Economic Affairs plays an important role in co-ordinating various ministries and government agencies that deal with cross-cutting economic policy issues. For example, the Co-ordinating Ministry for Economic Affairs was responsible for drafting the government Master Plan for the Acceleration of Economic Development 2011-2025, and has a specific role *vis-à-vis* regulatory reform in

the most recent five-year development plan. In the government's structure, the Co-ordinating Ministry for Economic Affairs sits above line ministries and should play a pivotal role in ensuring the coherence of economic policy across the government, including in the formulation of regulations.

The National Development Planning Agency (Bappenas) holds responsibility for formulating national (annual, five-years, and long-term) development plans. Bappenas has developed several regulatory reform tools, including a well-developed framework to perform RIAs. However, it appears that in practice these tools are not always applied systematically. As a result, sub-optimal regulatory outcomes can occur that are not in Indonesia's best economic interest. Thus, it appears that scope exists for expanding Bappenas' role in the regulatory review process.

Overall, the trade and investment policy-making process in Indonesia is fragmented across many ministries and government agencies. There is no formal, independent body to evaluate trade and investment policies from an economy-wide perspective, or to ensure public consultations involving a broad base of stakeholders. Various high-level teams have sometimes been engaged to conduct regulatory reviews and hold consultations with stakeholders, but this occurs on an *ad hoc* basis and is the result of strong, effective leadership rather than an inherent requirement embedded in the regulatory process.

4.4. Integrating Indonesia's domestic market and linking it to world markets

Indonesia is a large and geographically diverse country that relies heavily on natural resource-based products for its exports. It suffers from high logistics costs and infrastructure bottlenecks that can fragment the domestic market. To achieve the kind of growth needed to absorb new entrants into the labour market and allow Indonesia to reach its growth potential, Indonesia needs to better integrate its domestic market. 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, and lead to more innovation among domestic firms.

Moreover, better 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. Access to a wider variety of imported inputs will also decrease costs for consumers and producers, as well as encourage productivity gains via technology transfer.

Connecting Indonesia's domestic market more effectively

Although inadequate infrastructure and the terrain of the country are major causes of high costs, government barriers to interregional trade can raise these costs even further and lead to the artificial division of domestic markets. Sub-national governments in Indonesia have a long history of restricting domestic trade. Such barriers are one of the factors behind Indonesia's 'high cost economy' and are also detrimental to rural poverty alleviation since they lower rural incomes.

Domestic measures affecting the sub-national business climate

The general perception in Indonesia is that decentralisation has led to a tremendous increase in the use of taxes, user charges, and other regulations with negative impacts on the business community (Lewis, 2006). With the advent of Law 34/2000, sub-national governments often use sub-national taxes and user charges as sources of revenue.

Although Indonesia's regulations state that user charges should be based on the value of the service provided to business, there often is no service other than the issuance of a licence. An overview of some of the more questionable measures related to business licensing, taxes and user charges, and third party contributions are discussed below.

Business licensing

Complex licensing procedures have been identified as an important factor underlying Indonesia's business climate. They can also be particularly detrimental to micro-, small- and medium-sized enterprises. Before regional autonomy, licences were issued by the sub-national offices of government ministries. After regional autonomy, these sub-national offices were converted to sub-national departments (*dinas*) and retained their authority to issue licences. With licensing now under sub-national control, there appears to have been a proliferation of new licensing requirements (KPPOD and the Asia Foundation, 2008).

Six of the most important types of licences and permits are described below. Each of these permits is administered by district or city governments.

- *The construction permit (IMB)* is one of the most complicated licences since it combines building function, land use, road access, and safety.

- *Business registration (TDP)* provides information on the business to the government. Businesses can register only after all other physical and sectoral licences are obtained.

- *The industrial registration (TDI)* is the major technical licence for industrial activities of small- and medium-sized enterprises.

- *The trading licence (SIUP)* is the main technical licence for trading activities, but is also required by any manufacturer who buys or sells on the domestic market.

- *The nuisance permit (HO)* requires approval by neighbours of the business after assessing the disturbance caused by business activities, such as traffic or noise.

- *The operating licence (IUT)* represents the primary operating licence needed for a manufacturing firm. For service providers, the operating licence is usually issued by the line ministry responsible for the service sector.

To provide some sense of the complexity of the licensing process, Table 4.2 provides a list of the licences and permits needed to start a manufacturing business in Indonesia.

The process of forming a manufacturing firm begins with the investment approval. This is required of all foreign companies and foreign and domestic firms that seek special tax facilities. This is followed by obtaining various permits, the technical licences authorising the business, and the registration process. Several of the steps needed to obtain licences and permits must be done sequentially. Moreover, many approvals are now under the authority of sub-national governments because of decentralisation.[18]

Table 4.2. Key licences and permits for starting a manufacturing business in Indonesia

Stage in the licensing process	Name of licence/permit	Name of institution in charge
Company formation	Personal Identification (KTP)	Sub District Office
	Deed of Establishment	Notary
	Domicile Letter (Surat Domisilii)	Kelurahan (sub District Office)
	Tax ID (NPWP)	Directorate General of Tax, Ministry of Finance (Central Government
	Approval of Deed of Establishment (SK Pendirian PT)	Ministry of Law and Human Right (Central Government)
Initial approvals	Approval Letter (SP)	Investment Co-ordinating Board (Central Government)
	Principal Permit	Dinas Perindustrian dan Perdagangan (Local Office of Industry and Trade)
Land and building licence	Land Usage Permit (SIPPT)	Dinas Tata Kota (city Planning Office)
	Environmental (ANDAL/UKL/UPL/SPPL)	Badan Pengelola Lingkungan Hidup Dearah (Local Environmental Body)
	Building Construction Permit (IMB)	Dinas Penataan dan Pengawasan Bangunan (Local Office for Building Permit and Control)
	Nuisance Permit (UUG)	Dinas Keamanan dan Ketertiban (Local Office for Civil Security)
Final operating licence	Permanent Operating Licence (IUT)	Investment Co-ordinating Board (Central Government, BPMPKUD)
	Industrial Permit (TDI or IUI)	Dinas/Sudin Perindustrian dan Perdagangan (Local Office of Industry and Trade)
	Trade Licence (SIUP)	Dinas/Sudin Perindustrian dan Perdagangan (Local Office of Industry and Trade)
Business Registration	Business Registration (TDP)	Suku Dinas Perindustrian dan Perdagangan (Local Office of Industry and Trade)

Source: Nurridzki, N. (2010), "Pilot Study: Mapping and Streamlining Business Licenses at the National Level," *A Report for the Multi Donor Facility for Trade and Investment Climate*, World Bank, August.

Often, it is not the cost but the complexity of the licensing process which is the problem. Many licences and permits must be obtained sequentially. For example, all manufacturing companies must obtain a registration (TDP) from the Ministry of Trade. This can only be done after all other permits have been obtained, yet the information needs are similar if not identical to those of other permits (Nurridzki, 2010). In one major improvement, the government has simplified the application process by allowing applicants to obtain the trading licence and business registration at the same time.

The 2007 Investment Law mandates the establishment of one-stop shop investment services (*Pelayanan Terpadu Satu Pintu* or PTSP) for investment licences and permits. In 2009, a Presidential Regulation was issued which sets out implementation guidelines for the PTSP. These guidelines call for the development of an electronic online system (SPIPISE) for investment licences by BKPM within three years. The system aims at providing a national single window for licensing applications and approvals, and involves BKPM, provincial governments, and district level one-stop shops.[19] Currently, the licensing processes for five sectors are included in the system – trade, industry, tourism, agriculture and health – although line ministries have not devolved authority to BKPM to administer a majority of these licences. For the system to become fully operational, a number of technical issues must be worked out (e.g. a data model needs to be developed with common formats for all data elements needed for each licence).

The on-line system will also provide access to the business processes for the licences issued by Indonesia's technical ministries to provide a single source of information for investors. With that in mind, BKPM has requested each line ministry to provide manuals and business processes for their licences. It would also like to issue an updated *Petunjuk Teknis* (Technical Manual) on investment regulations in Indonesia.

Most recommendations to improve the licensing process in Indonesia have focused on streamlining the process, rather than on reforming the licences themselves. Since many licences have been devolved to the sub-national level, improvements have been sought through the development of one–stop shops in the regions.[20] But according to the KPPOD and the Asia Foundation (2008), only 7% of all businesses used these shops. Most obtained licences directly from the line ministries, often using agents. This could change as one-stop shops continue to be developed throughout the country.

Other taxes, charges and third-party contributions

In using their powers to make regulations, regional governments have at times appeared more concerned with achieving the short-term goal of increasing sub-national revenue by collecting regional taxes and charges. Most of these taxes and charges fall disproportionately on the business community. They include illegal user charges, taxes and security payments, and are collected in a number of ways, including road user charges and at district border crossings, and by different government departments based on the type of commodity.[21]

Third-party contributions (SPK) are also very common in Indonesia and consist of "voluntary" payment to governments.[22] Although operating like a tax, the contribution is not recorded as such on government accounts and is classified instead as "other sources of income." As a result, the contributions do not technically fall under Indonesia's laws or regulations restricting the types of taxes that may be imposed by sub-national governments. Sometimes the user charges are paid by businesses that bid on construction projects or for the supply of goods and services to sub-national governments (Bachtiar, 2009). There are also several examples of SPK being paid on traded commodities, such as cattle.

Linking Indonesia to world markets

Enhancing Indonesia's connectivity to world markets will improve trade performance and enhance growth. Stronger export growth will help spur domestic production, with positive knock-on effects for employment and domestic consumption. Import growth helps decrease costs for consumers and producers, in addition to the productivity-related spillovers derived from technology transfer.

Indonesia's National Single Window (INSW) for trade

Indonesia's National Single Window (INSW) represents a major government effort at facilitating trade. The goal is to expedite the clearance of goods across Indonesia's borders by simplifying and streamlining customs clearance and cargo release procedures. When fully established, traders and government agencies will be able to process all official export/import documents through a single point of contact.

The development of the INSW was driven by Indonesia's commitments to ASEAN under the Agreement to Establish and Implement the ASEAN Single Window. This agreement was signed by Economic Ministers in 2005, and was followed by the *ASEAN*

Protocol for single windows, which was signed by Finance Ministers in 2006. These agreements require the establishment of national single windows (NSWs) by each ASEAN Member State. The ASEAN Single Window will then provide the regional architecture that connects and integrates the NSWs so that information can be exchanged electronically among countries.

Development of the INSW is proceeding in stages. In 2010, the INSW became formally operational and is now mandatory in five Indonesian ports with 18 participating government agencies (out of 39 agencies involved in export and import activities). These ports handle about 90% of all Indonesian trade. Electronic linkages have been created between the participating government agencies and Customs so that Customs is notified electronically when an import licence or permit is issued. Some government agencies have also implemented electronic "track and trace" so that importers can quickly identify problems.

The INSW portal serves as the gateway to the system for users with a password/ID. When fully developed, exporters and importers will be able to submit clearance and licensing requests, monitor the clearance process and obtain clearance/licences online. In addition, the portal provides open access to trade policy information concerning tariffs and the various permits required for import and export. Users can also obtain the service-level agreements and standard operating procedures for the processing of trade documents by 18 government agencies.

In 2010, the Secretariat of the INSW issued guidelines on a new consultative process involving government agencies and the private sector. The objective is to ensure the most efficient implementation of the INSW in a way in which all stakeholders benefit. In particular, the forum provides the private sector with a vehicle for voicing concerns regarding the operation of the NSW and to actively participate in its development. It also allows the government to "socialise" the single window with the private sector and participating government agencies.

Although much progress has been made, the INSW has not yet reached its goals of single sign-on, submission and synchronous processing of trade documents. The INSW involves the co-ordination and transformation of the operating procedures of a large number of agencies. The IT systems of these agencies may need updating, back office systems for the issuance of permits need to be modernised, and legal and IT issues pertaining to the transfer of information between the private sector and government agencies, and among government agencies, need to be addressed. There are also legal issues related to the transmission, security, and confidentiality of data, and with the translation of decrees in a way that will allow electronic decision making.

4.5. Policy options for consideration

Five key recommendations aimed at improving the regulatory process are outlined below.

- ***Institutionalise independent and objective evaluations of policies from an economy-wide perspective***

Independent and objective evaluations of policies from an economy-wide perspective are not currently institutionalised in Indonesia. Various high-level teams have sometimes been engaged to conduct regulatory reviews, but this occurs on an *ad hoc* basis and is the result of strong, effective leadership rather than an inherent requirement embedded in the regulatory process.

To conduct such evaluations, 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 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.

An institution within the existing regulatory framework can be given the authority to conduct these types of evaluations. For example, Bappenas, the Co-ordinating Ministry for Economic Affairs or the Vice President's Office could be empowered to perform this function. Stronger powers, particularly vis-à-vis the institution's ability to act as a broker and clearing house for conflicting regulations, would be useful in this regard. Regardless of location, the priority is that some institution is empowered to undertake objective and independent evaluations of policies from an economy-wide perspective, this institution has the capacity to ensure proper evaluations take place, and inter-ministerial co-ordination is enhanced.

- ***Institute a process in which broad public consultations are systematically required***

Although the government has held consultations with the private sector and non-governmental actors, this is also the result of *ad hoc* processes, usually driven by the leader of a high-level team, rather than embedded in the regulatory process itself. A mechanism is needed to ensure public consultations involving a broad base of stakeholders are held systematically to enhance transparency and avoid unintended trade restrictions.

As one part of the process, a position paper distributed to all stakeholders as a consultative document with a formal "request for comment" could be useful. The process might also include a review of the final language by stakeholders before a draft regulation is sent to the DPR. Although this review might not lead to language that is acceptable to all parties, it would at least ensure that the regulations reflect the government's intent. It would also provide additional opportunities to discuss regulatory alternatives and best practices.

Rules or guidelines that ensure contact and consultations with experts in the relevant policy evaluation teams and interested parties would also be useful. Public hearings could then be designed to formally involve "interested parties" in the policy process while providing information that will facilitate the government in forming decisions more transparently. An on-line mechanism would ensure the broadest possible reach and facilitate interactions with stakeholders, including other governments. More comprehensive public consultations would also serve to lessen the implementation burden for both domestic and foreign firms once regulations have been enacted. Systematic notification of new trade-related laws and regulations would also greatly improve predictability and transparency, for example via the WTO and other relevant international bodies to which Indonesia is a signatory.

- ***Streamline the licensing process***

While significant steps have been taken to successfully group the many licences needed to start and operate a business in Indonesia into one-stop shops, more effort is needed to streamline the licences themselves. This paper highlighted some of the duplicative licences that currently exist, as well as others that appear to have budgetary support or rent-seeking rather than clear policy objectives. In particular, efforts to ensure that sub-national licences have clear policy objectives and are not contradictory or duplicative are important.

To further this aim, a first step could be to empower BKPM to undertake a review of all national licences with a view to streamlining the licences themselves. Duplicative licences should be eliminated, as should licences without a clear policy objective. Alternative compensation mechanisms could then be employed to create the necessary incentives for ministries to devolve their licensing power to BKPM, thus improving one-stop shop servicing. A second step could then involve an assessment at the sub-national level, thus reconciling national and regional licensing regimes. It would be important to grandfather existing licences to avoid the need to re-license.

As part of the streamlining process, the government could also develop an inventory of all business licences and permits at the national level. The inventory could document the objectives of each licence/permit, the issuing authority, and examine whether the licence/permit represents a barrier to entry that should be included on the Investment Negative List. Requirements for licences/permits, as well as other regulations impacting investment at the sector level, could be compiled and included in an updated version of BKPM's Technical Bulletin, as well as be made available on Indonesia's National Single Window for Investment. This review process would represent a preliminary step in considering whether Indonesia would benefit from a guillotine approach to regulatory reform.

- ***Ensure that new laws and regulations benefit Indonesia as a whole***

The fragmentation of the policy-making process has led to an increase in opportunities for special interests to exert influence over government policy. As a result, the government may wish to consider embedding RIAs systematically into the policy process for any new law or regulation that meets a pre-determined "threshold test." Threshold tests vary from country to country, and may combine both quantitative (i.e., likely costs will exceed USD 100 million) and qualitative (i.e., more than 100 million people will be affected) targets. RIAs are one of the most important tools governments have for making informed decisions on the *ex ante* impact of new laws and regulations. While there are already instruments in place for this (practical guidelines issued by both Bappenas and MoHA), they are not applied systematically. As a result, sub-optimal regulatory outcomes can occur.

One way to facilitate the process is to develop well-defined regulatory impact assessment requirements as a guide to the evaluation of policy measures. This would advocate an assessment of the national interest taking account of the economic welfare of the majority of Indonesian citizens, but might also give specific priority to other policy goals. These principles would need to be transparently enshrined in a national law so as to supersede district/city or provincial regulations. It would also need to be carefully crafted so as to ensure that special interests do not use national interest as a guise for protectionism.

In the case of investment, there has been no formal review of the entire body of restrictions on investment in the Investment Negative List. Moreover, there is no certainty that the regulatory impact processes used by Timnas PEPI will continue. For proposed changes to the restrictions, formal consultations involving regulatory impact assessments could be required so as to ensure that Indonesia's national economic interest is being met, as called for in the 2007 Investment Law. A re-confirmation and strengthening of Timnas PEPI could be a useful way to move forward.

- ***Improve co-ordination between the central government and the periphery***

Better co-ordination between the central government and the periphery is a critical component of ensuring overall national interest. Toward this end, an objective review of sub-national regulations is important. This review could take place through empowerment of Bappenas or the Co-ordinating Ministry for Economic Affairs to review sub-national regulations beyond the time frames imposed by the bureaucratic process, arbitrate jurisdictional disputes between the national and sub-national governments, and ensure that the regulatory review covers all regulations impacting the business environment, not just those that impose taxes and user charges.

Other legal problems with the review process (e.g. the legal instruments used by MoHA to invalidate sub-national regulations) may also be usefully addressed by such reviews. It is important to create mechanisms to ensure that local governments cannot easily ignore national laws.

An essential aspect of improving co-ordination between the central government and the periphery involves improving human resource capacity. If officials reviewing new and existing laws and regulations do not have the proper training and incentives to carry out such a task, efficient regulatory outcomes will not happen. One way to improve co-ordination involves upgrading the analytical capability of policy institutions by creating permanent staff positions and career tracks. Developing the capacity of officials to implement effectively Indonesia's regulatory regime is an important long-term structural change.

Notes

1. There are four modes of supplying services: Mode 1, or cross-border supply (e.g. services provided electronically); Mode 2, or consumption abroad (e.g. tourism services); Mode 3, or commercial presence (e.g. establishment of a business in the host country); and Mode 4, or movement of natural persons (e.g. doctors or teachers who physically move to the host country).
2. The new investment policy package includes: Law 25/2007 (investment law); Government Regulations 1/2007 (taxes on investments), 38/2007 (division of government authority), 46-48/2007 (free trade zones), 77/2007 (Investment Negative List) and its amendment, 111/2007, which have been subsequently replaced by Presidential Regulation 36/2010 and Presidential Instruction 5/2008.

3. Government Regulation 20/1994, which was amended via Regulation 83/2001 and Decree 15/1994, requires all wholly foreign-owned companies to divest partial ownership to an Indonesian partner after 15 years of commercial operation. The percentage to be divested is not specified, but guidance from BKPM indicates a range of 1-5%. How this regulation will interact with the new investment law has contributed to uncertainty for foreign investors, although the government has stated that Regulation 20/1994 will not be revoked.

4. There were actually two regulations. The second regulation (Perpres 111/2007) was issued in 2007 soon after the first in order to correct for several ambiguities. Until the latest update in 2010, Perpres 111/2007 was commonly called the "Investment Negative List."

5. The more open sectors include health, creative industries, construction services, and multilevel marketing. The more closed sectors include telecommunications, security services and inspection services.

6. Under ASEAN's Agreement on Trade in Goods, the ASEAN Secretariat will establish the ASEAN Trade Repository (ATR) containing the regulations of each member state related to trade. A presidential instruction has been drafted that envisages the INTR as the legal reference for trade regulations in Indonesia.

7. The Ministry of Trade is in the process of revising regulations for the API licence.

8. TBTs apply to fertilizer, refined sugar, flour, flat-rolled iron or steel and products of iron or steel plated with zinc, tires, safety glass for motor vehicles, various types of electrical devices such as ballast lighting, lamp holders, automatic circuit breakers, AC switches, tubes, pipes, vulcanised rubber hoses, cement, and vacuum compressors.

9. For example, a regulation issued by the Ministry of Communication and Information Technology requires that telecommunication tools and equipment produced, assembled and imported for sale or domestic use must comply with technical requirements and national standards.

10. Previously, the government maintained export quotas that expired in August of 2011.

11. Examples include: fertilizers, automatic ballast lighting, tires, flat-rolled products of iron or steel plated with zinc, refined sugar and flour, flat-rolled iron or steel, safety glass for motor vehicles, automatic circuit breakers, electronic AC Switches, air or vacuum pump compressors, electrical lamp holders, cements, and tubes, pipes, and hoses of vulcanised rubber.

12. Ministry of Trade Decree 709/M-DAG/KEP/9/2011.

13. Timnas PEPI was established in 2003 by Presidential Decree 87.

14. Some examples include horticulture, telecommunication towers and security services.

15. Many business sectors appear to face greater restrictions on investment than in the past. However, determining whether the current investment environment is more or less restrictive than before 2007 is made difficult by the fact that before 2007, many restrictions on investment were contained in ministerial decrees or were otherwise not transparent. An objective of the Investment Law is to increase transparency by listing all restrictions in one presidential decree.

16. One notable exception was a ministerial decree banning foreign investment in telecommunication towers. This decree was eventually incorporated into the Investment Negative List.

17. Accounting, auditing and bookkeeping services as well as tax services.

18. For companies entering a services sector, the steps vary according to the type of service and can be more complicated than for manufacturing. The Ministry of Trade handles 122 types of business permits (KPPOD and Asia Foundation, 2008). According to the Indonesian Chamber of Commerce, 44 permits are needed by a retail firm (Samboh, 2011).

19. By 2011, the system should have been available in 33 provincial and 40 districts of Indonesia.

20. See LPEM (2008) and Asia Foundation (2007).

21. For example, quarantine inspections are reportedly carried out by the local government on all agricultural products entering or leaving a province. Fees are reportedly collected even if the inspections are not carried out (Ray and Goodpaster, 2001).

22. Some third-party contributions are in fact compulsory and serve as an unofficial tax on businesses (KPPOD and the Asia Foundation, 2008).

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Chapter 5

Regulatory and competition issues in ports, rail and shipping

This chapter is a summary of the background report Regulatory Settings for Ports, Rail and Shipping in Indonesia, available at www.oecd.org/regreform/backgroundreports. *It finds that recent changes to the law in Indonesia introduce important market disciplines and have the potential to stimulate a positive transformation of Indonesia's rail and maritime industries. However, while the laws are fundamentally sound, some provisions are at odds with the broad strategic direction and policy goals of the Indonesian government. The chapter recommends specific measures to clarify a number of practical administrative arrangements that will ensure the effective separation of regulatory and operational functions, increase competition and encourage private sector participation in the ports, rail and shipping sectors.*

Introduction

This chapter assesses Indonesia's regulatory settings for Ports, Rail and Shipping, and makes recommendations for improving the design and implementation of legal and institutional arrangements to improve economic performance in these sectors. Recent legislative changes in Indonesia – specifically the 2008 Law on Shipping and the 2007 Law on Railways– have the potential to radically transform Indonesia's rail and maritime industries. With the conspicuous exception of the provisions in the Law on Shipping that impose a strict cabotage regime for domestic shipping operations, 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.

However, in a number of instances the specific provisions of the Laws (or in some instances the supporting Regulations) are at odds with this broad strategic direction. In others, while the intent and direction of reform is clear, the expression of this direction remains vague or ambiguous, and will require more detailed articulation in order to provide an effective platform for improved governance and increased efficiency. The focus of this chapter is on identifying these limitations, and suggesting ways in which they might be overcome. This focus inevitably means that much of the paper takes the form of criticism of current arrangements and performance. It is therefore important, at the outset, to emphasise the fundamental soundness of the broad direction of reform, and to acknowledge the significant achievements that the government of Indonesia and public service have made in framing and implementing it.

5.1. Ports

Background

An assessment of the operational performance of Indonesia's ports is hampered by the lack of comprehensive, readily available data. However, there appears to be fairly general agreement that both the operational performance of and the level of investment in Indonesia's port sector leaves something to be desired. On the World Bank's Logistics Performance Index, Indonesia's overall performance is in line with the average for countries at its level of development, but one of the areas which is identified as clearly deficient is the quality of trade and transport related infrastructure.

The infrastructure quality deficiency identified by the World Bank is particularly marked in the case of port and rail infrastructure. It is worth noting that those sectors in which Indonesia's performance, relative to the comparator countries, is relatively strong are generally those sectors – such as telecommunications – in which competition and private sector activity are most intense.

This pattern can also be observed within the maritime and rail sectors. Nathan Associates concludes that performance at Tanjung Priok "is in line with worldwide terminals handling similar ships" (Nathan Associates, 2011c). Although data for TPS, the main terminal at Indonesia's second largest international container port, Tanjung Perak, is more limited, performance at this terminal was also assessed as "reasonable when compared with international standards".

Recent comments by the Indonesian National Shipowners' Association also highlights the variability of Indonesian ports' cargo handling performance. This association confirms that ineffective and inefficient sea transport connectivity has meant high logistics costs in Indonesia, resulting in Indonesia's low sixth ranking among ASEAN countries in the logistics performance index. It notes that, in many ports, shipowners are not happy with productivity and turnaround rates – but qualifies this with the observation that, in some ports the standards were acceptable (Embassy Freight, 2011).

The general picture that emerges from a consideration of these sources is of a port sector in which handling performance is, in general, relatively poor, but within which certain facilities – in particular the main international container terminals at Jakarta and Surabaya, all of which are now operated in partnership with leading global terminal operators – have been able to achieve international performance standards.

Under-investment in infrastructure is one of the major contributors to the poor performance of the port sector. There is general agreement that the capacity at many of Indonesia's main ports is already taxed, and anticipated high growth rates will result in serious congestion unless urgent action is taken.

Structural reforms under 2007 Law on Shipping

Prior to 2008, the framework for port administration in Indonesia was established by Shipping Law 21/1992. Under this law, four port corporations were established to administer the main commercial ports. Each port corporation (*Pelubahan Indonesia*, usually abbreviated to Pelindo) was given control of all commercial ports within a designated geographical region. In principle, the corporations were established as limited-liability, profit-making companies. However, the central government retained control of port tariffs, which were set at a national level, ensuring cross-subsidisation both between ports controlled by each IPC and between the IPCs themselves.

The main ports administered by each of the four Pelindos are shown in Table 5.1 below. Under this regime the Port Corporations were both the operators of port facilities and the port landlord. The 2008 Law on Shipping introduced significant changes to the structure of port administration in Indonesia. The law separates the functions of port operator and regulator. It provides for new port authorities to be formed, which will take over a number of the functions previously performed by the IPCs. The Shipping Law 2008 removes the IPC legislated monopoly on commercial ports and in so doing opens the sector up to participation by other operators, including those from the private sector. Under the new law, the role of the IPC, at least in principle, is limited to that of a port facilities operator and/or port services provider, operating in competition with other service providers.

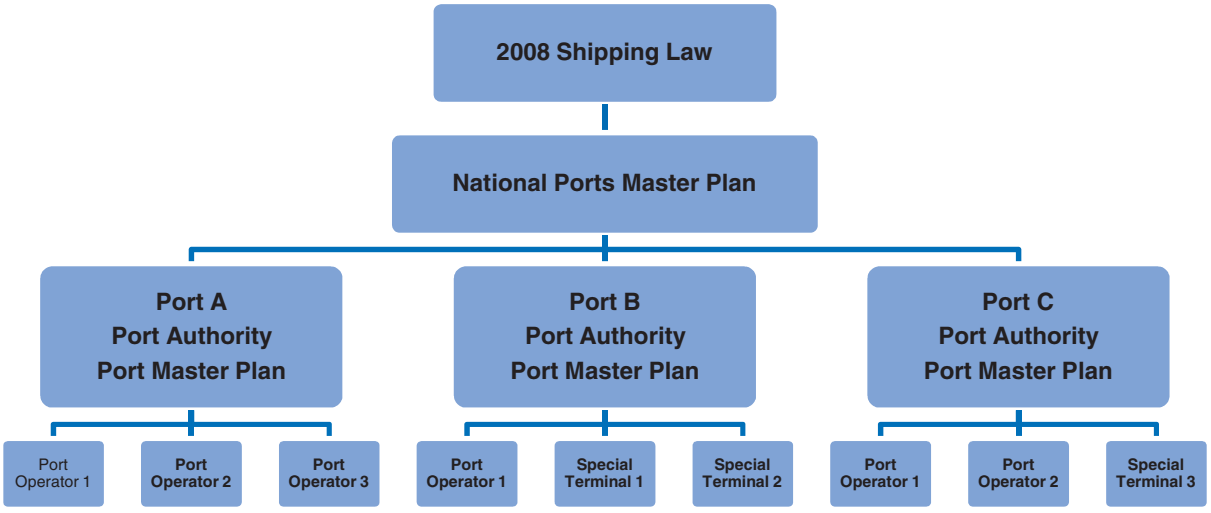
Table 5.1. Indonesia: Port corporations

Port corporation	Coverage (Provinces)	Ports administered
Pelindo I	Aceh, North Sumatera, Riau	Belawan, Pekanbaru, Dumai, Tanjung Pinang, Lhokseumawe
Pelindo II	West Sumatera, Jambi, South Sumatera, Bengkulu, Lampung, Jakarta	Tanjung Priok, Panjang, Palembang, Teluk Bayur, Pontianak, Cirebon, Jambi, Bengkulu, Banten, Pangkal Balam, Tanjung Pandan.
Pelindo III	Central Kalimantan, South Kalimanatn, West Nusa Tenggara, East Nusa Tenggara	Tanjung Perak, Tanjung Emas, Banjarmasin, Benoa, Tenau/Kupang
Pelindo IV	Sulawesi (S, SE, Central and North), Maluku, Irian Jaya.	Makassar, Balikpapan, Samarinda, Bitung, Ambon, Sorong, Biak, Jayapura

Source: Ray, David (2009), *Indonesian Port Sector Reform and the 2008 Shipping Law*, in Cribb Robert and Ford Michele (eds), *Indonesia Beyond the Water's Edge: Managing an Archipelagic State*, Institute of Southeast Asian Studies, Singapore.

As is frequently the case in Indonesian legislation, the Shipping Law itself is cast in general terms, leaving the operational detail of the concepts and strategies that it outlines to be fleshed out in subsidiary legislation.

Figure 5.1. Revised governance arrangements for the strategic ports of Indonesia



Source: Ray, David (2009), *Indonesian Port Sector Reform and the 2008 Shipping Law*, in Cribb Robert and Ford Michele (eds), *Indonesia Beyond the Water's Edge: Managing an Archipelagic State*, Institute of Southeast Asian Studies, Singapore.

Potentially, the 2008 Shipping Law and its subsidiary regulations provides a basis for a fundamental transformation of the national system of port governance that could lead to substantial efficiency improvements in the medium to long term. The law restructures the port sector along the lines of the "landlord" model that is standard in Northern Europe and Australia and has been promoted by many advocates of port reform, including the World Bank (World Bank, 2006).

However, realisation of the potential benefits of the Shipping Law reforms will depend on the interpretation that is made of certain provisions of the Law, and on the details of its implementation. Some of the more important issues that will need to be resolved are discussed in the sections below.

Port planning

One important initiative promoted by the new Shipping Law is integrated port planning. At the highest level, the Law calls for the development of a National Port Master Plan (NPMP) with a 20 year planning horizon. The responsibility for the development of the NPMP was subsequently assigned to the Directorate General of Sea Transport; the Plan and a draft Decree for the implementation of the plan been prepared, and a stakeholder consultation process is currently under way.

A framework for planning the national port system is hinted at by Article 70 of the Shipping Law, which categorises Indonesia's ports into two main types: marine ports; and river and lake ports. Marine ports are further divided into a functional hierarchy comprising three levels:

1. Main ports, which handle "large" volumes of cargo and serve both the domestic and foreign trades;

2. Collector ports, which handle "medium" levels of trade but serve domestic trades only;

3. Feeder ports which handle "limited" levels of trade and also serve only domestic trades.

However, the implications of this functional hierarchy– other than the specification that only main ports will be involved in international trade–for port administration and planning are not entirely clear. No precise meaning is given to the terms "limited", "medium" and "large" volumes of cargo. The picture is further confused by the addition of a further stratification in article 81 of the Shipping Law, which divides ports into "commercial" and "non-commercial" ports. Once again, these terms are not clearly defined, but in this case they are linked to clear implications for port administration: port authorities are to be established for "commercial" ports; and port management units are to be established for "non-commercial" ports.

Additionally, there is no clear and definitive link between either the functional classification (main collector or feeder port) or the commercial/non-commercial split and the level of government that is to be responsible for port administration. An indirect linkage can be made between commercial ports and the National government, as the law requires that commercial ports be administered by port authorities and only the National government can establish port authorities. But, according to Nathan Associates (2011d, p. 5), port management units can be formed at the National, provincial or district/city government level.

The need for clarity on which level of government is responsible for these matters is particularly important because decentralisation has been a major plank of the profound political reform programme that Indonesia has implemented over the last two decades. While responsibility for Indonesia's major ports remains with the central government (and will be executed through the port authority structure discussed above), the Shipping Law clearly envisages a continuing role for sub-national governments in the development of the port system, particularly collector and feeder ports. At present, while it is a legal requirement that port construction must occur based on the NPMP and individual plans, there is no requirement for sub-national governments to consult the central government in granting licences for port construction and port development.

Without greater certainty on which level of government is responsible for which ports, and greater clarity of how conformity of new port facility development in ports controlled by lower levels of government with the NPMP will be maintained, "there is a potential for haphazard expansion of the port system. It is possible, for example, that sub-national governments may permit port developments which are driven by local political and other considerations that conflict with national needs" (Nathan Associates, 2011c).

The Law requires that each port authority prepare a master plan for ports under its control with a similar time horizon. These plans must be consistent with the NPMP. Clear assignment of responsibility for implementation of this requirement of the Law will also be important in ensuring consistency and integration in future port development. Our understanding, based on discussions with Government of Indonesia officials, is that appropriate arrangements have been put in place. Responsibility for ensuring that port Master Plans are developed and that they are consistent with the NPMP has been assigned to the Director General of Sea Transport (DGST). The performance of DGST in discharging this responsibility will be monitored by President's Delivery Unit on Development Monitoring and Oversight (UKP4).

Clear policies and procedures be developed to clarify the responsibilities of various levels of government for future development of the port sector, and to ensure the appropriate integration of sub-national plans with the National Port Master Plan.

Structure and number of port authorities

The effectiveness of the port governance model established by the new Shipping Law will be critically dependent on the institutional capacity of the newly established port authorities.

Under current arrangements, port authorities and port management units are established as operating units within the Ministry of Transport. This is not ideal. The preferred model in most jurisdiction is for port authorities to operate outside of the normal civil service structure, with their own corporate existence and Board of Directors and a substantial degree of financial autonomy. This last element is particularly important in ensuring that finance is available for critical port functions – for example, maintenance dredging – independently of the normal budgetary processes of government. Nathan Associates (2011b) has suggested that it may be possible for Indonesia's port authorities to be transformed into public service organisations (BLU) – that is, stand-alone organisations within the public service with features that provide a measure of independence and financial self-sufficiency. This will be an important step towards achieving the autonomy that is normally considered to be an important element in ensuring the effectiveness of landlord port operations.

It is also important to ensure that port authorities have the resources and expertise required to discharge their responsibilities effectively. The duties and responsibilities of port authorities are complex and onerous and in many cases require access to specialised knowledge and skills that are likely to be in short supply. It has been reported that DGST intends to establish a total of 96 port authorities and 186 port management units (Nathan Associates, 2011b). This appears to be based on the establishment of a separate port authority for each significant port. This does not appear to be required by the shipping law; will make it difficult to ensure that each port authority has the skills required to exercise its functions effectively; and is likely to fail to take advantage of potential economies of scale in port authority staffing. It may well be worthwhile to consider

whether grouping ports regionally or according to some other criterion can significantly reduce the number of port authorities required. This may also facilitate the integrated planning of port facilities.

As at February 2012, it was reported that four port authorities had already been established: PA 1 [Belawan]; PA 2 (Tanjung Priok); PA 3 (Tanjung Perak) and PA IV (Makassar). From discussion with government officials, we understand that, for budgetary reasons, no additional port authorities will be created in the immediate future, and that port administrators from at least some other ports will be brought into one or other of the four port authorities that have been established. Cross-referencing to Table 5.1, it is clear that one of these port authorities falls within each of the geographical areas into which the port system of Indonesia has historically been divided, and within each of which a separate Pelindo has previously had responsibility for selected ports.

One approach to limiting the number of port authorities required would be simply to permanently limit the number of port authorities to the four that have already been established, and to extend the scope of each of these four port authorities to cover all commercial ports within a defined geographical area centred on the ports for which they were originally established.

One drawback of this approach would be that a geographically sensible allocation of responsibility between the port authorities may result in something approximating a one-to-one correspondence between the new port authorities and the pre-existing IPCs (Pelindos). This would heighten the risk of regulatory capture. The most appropriate solution to this is to break down the geographically based monopoly that the IPCs currently hold, through the pro-competitive measures outlined in the Section below on Encouraging Private Sector Participation and Competition. If these measures are not sufficient to create effective competition within the geographical area controlled by a particular port authority, then breaking up the IPC historically operating within that area should be considered.

If restricting the number of new port authorities to four is considered too radical a reduction in the (proposed) number of port authorities, the seventeen port development regions defined in the Draft National Port Master Plan may provide an alternative basis for rationalisation.

There may be scope for further consolidation, with several of these regions controlled by a single port authority. For example, it may be possible to combine the three Papuan port development regions (regions XV-XVII in the draft National Port Master Plan).

Before any further Port Authorities or Port Management Units are created, options for reducing the number of bodies required should be thoroughly explored.

Relationship between Port Authorities and IPCs

The Shipping Law envisages a continued role for the Indonesian Port Corporations: the Law provides that state-owned business enterprises (a definition that includes the IPCs) will continue to undertake "exploitation" activities at the ports in which they currently operate (Nathan Associates, 2011a, p. 6).

A narrow interpretation of this provision would be that it simply clarifies that IPCs can continue to exist and to provide port services in the future. This interpretation is compatible with the landlord model and the separation of roles that appears to inform the Shipping Law: IPCs would, as envisaged in Figure 5.1, continue to exist as one of a number of possible providers of port services in ports.

This will require that many of the powers and functions previously exercised by IPCs are unambiguously transferred to the new Port Authorities, and that IPCs are restructured to focus their activities exclusively on the provision of port services within a framework of concessions and licences managed by the Port Authority. Neither the Law nor supporting regulation GR61 appear to define a clear pathway by means of which this will be achieved.

The respective roles of Port Authorities and IPCs should be clarified by means of a Ministerial Direction, which should incorporate a redefinition of the charter of the IPCS and a clear time-bound transition plan for the transfer of those functions that have historically been performed by IPCs but will in future be undertaken by Port Authorities and Port Management Units.

Encouraging private sector participation and competition

One of the stated objects of the Shipping Law is to ensure efficiency and enhance global competitiveness, and GR61 specifically signals the eradication of port monopolies as one of the strategies by means of which this is to be achieved. But in practice both the current structure of the port industry and regulations governing the provision of port services by private parties present obstacles to private sector participation and the encouragement of competition.

The transfer of functions to port authorities and the assignment of assets discussed in the previous sections will go some way to reducing the structural impediments to increased competition. But the "exploitation" provision virtually guarantees that potential new entrants will face an entrenched, dominant incumbent that controls a wide range of port services. To counteract this and encourage new entry, port authorities may need to adopt policies and practices specifically to reduce the dominance of the existing IPCs over time. These may include:

- For those services for which simultaneous provision by competing operators is unlikely, setting a definite term to the current licence, after which the selection of the future licensee will be made through an open and competitive process;

- Excluding the incumbent from bidding for the right to operate a proposed new development unless there are demonstrable synergies that would arise from the incumbent also operating the new facility.

The development of competition could also be accelerated by removing limitations on operators of Special Terminals (terminals located outside the defined port areas that serve proprietary cargoes) and Own Interest Terminals (proprietary terminals within port areas). In both case, there are restrictions on the use of the terminal for third party cargoes that are clearly designed to protect the business of the established common user terminal.

Finally, with the redefined role of the IPCs as port service companies, there is no obvious reason that their operations should be confined to a particular geographical region. Encouraging IPCs, and joint ventures between an IPC and a private sector operator, to offer services in ports in which the IPC concerned has not historically operated, may also be an avenue for intensifying competitive pressure in the provision of port services. Discussions with government of Indonesia officials suggest that that some tentative movements have already been made in this direction, with Pelindo II undertaking a pre-feasibility study on the development of port facilities in Sorong, which lies within the geographical region historically served by Pelindo IV.

Even with these measures in place, however, it is doubtful that competition in the provision of port services will, in the short to medium term, be sufficiently strong to ensure efficient performance and competitive pricing by incumbent service providers. It may therefore be useful, at least in the short to medium term, for the Ministry of State-owned Enterprises, to define clear performance standards for key port services delivered by enterprises under its control, and to monitor the prices charged for the performance of these services.

An active strategy of encouraging the development of a competitive environment in Indonesia's ports should be adopted, including allowing private terminals to handle third party cargoes, competitive allocation of port services licences, restricting bidding for new opportunities from dominant operators and encouraging competition between IPCs.

Until competition in port services is clearly effective, the Ministry of State-owned enterprises should set clear performance standards for key port services delivered by enterprises under its control, and monitor the prices charges for the provision of these services.

Assignment of assets

An important foundation stone for the establishment of effective relationship between the Indonesian Port Corporations and the port authorities is the appropriate allocation of assets between the two parties.

It has been reported that discussions have been held between those port authorities that have been established, the relevant IPCs, and the Finance and Development Supervisory Board (BPKP) to identify and value the assets that will be transferred from the IPCs to the Port Authorities (Hutagalung, 2011). We have not been able to ascertain whether the process of asset identification and evaluation has been finalised, or whether the transfers have actually been effected.

It is important that the criteria for determining which assets should be transferred are appropriate. Future ownership and control of the relevant assets should be determined by reference to the future role and functions of each party. Basic infrastructure assets should be transferred to the relevant port authority. Operating equipment should be retained by the IPC. The ownership of specific site improvements – such as terminal paving and fencing – will need to be determined on a case-by-case basis with reference to the nature and term of the concession agreement that applies to the particular terminal.

Of particular importance in this context is the ownership – or at least effective control – of the land assets of the port. Effective control of port lands by the port authorities will be central to their ability to carry out the core functions assigned to them at the shipping law 2008. It is therefore imperative that this control should be a unambiguously transferred to them at the earliest possible date.

Decisions on the allocation of assets between IPCs and port authorities should be based solely on the relevance of those assets to the future roles and functions of those entities, and on this basis control of all port lands be allocated to Port Authorities (or PMUs).

Hub port development

The NPMP proposes the development of designated ports as Indonesia's major international gateways. For security and customs control reasons, all countries limit the number of points at which international trade can enter or leave the country. As international supply chains have become increasingly intermodal, the need for integrated planning of landside and maritime infrastructure have provided additional reasons for clearly identifying those ports that will play a key role in handling a country's imports and exports. The designation of selected ports as Indonesia's main international hubs is therefore appropriate and necessary. Clarity on which ports will be developed as the major international gateways helps to channel investment in inland infrastructure appropriately and avoid wasteful and environmentally damaging duplication of maritime infrastructure. It helps both to reduce the cost of developing the port system and to facilitate the timely delivery of needed infrastructure.

However, some parties appear to be interpreting the provisions of the NPMP as a return to the "gateway" port policies that prevailed in Indonesia in the early 1980s. This policy effectively prohibited movement of Indonesian general cargo exports through ports other than Belawan, Jakarta, Surabaya and Makassar (Dick, 2008). In December 2011, the government announced that it has limited the number of seaports open for international shipping to 25. This is well down from the previous 141 seaports, although far short of the outcome sought by Indonesia National Shipowners Association, which wants only four ports in Indonesia to be open for international shipping (Investor Daily, 2011).

While selective investment in hub ports within a clearly defined national port hierarchy is sensible – from both an environmental and economic perspective – this does not imply that coercive measures to constrain importers and exporters to use only these hubs for international trade are desirable. Artificially constraining the options available to the international trading community will almost certainly be economically damaging and undermine the objectives of the MP3EI (Republic of Indonesia, 2010).

For similar reasons, positive initiatives to co-ordinate and facilitate investments associated with a hub port policy should be preferred to restrictions on port investment at other ports, unless those prohibitions are necessary for environmental or safety reasons.

Those ports that will be the primary hubs should be clearly identified in the National Port Master Plan, and future development of international intermodal transport chains should be clearly focused on these ports. However, 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.

Improving the quality of statistical data

There is a lack of readily useable statistical information on maritime trade flows to, from and within Indonesia. Shipping records maintained by the Director General of Sea Transport (DGST) and the data collected by the IPCs contain much of the information required to build up a sound picture of port traffic, but this data is not cleaned, processed and compiled in a way that makes it readily accessible for planning purposes. Information on port performance is patchy and dependant on the processes and procedures of individual IPCs.

Timely and accurate data on port trade and performance is essential for sound port planning and effective port management. The Shipping Law includes provisions for the establishment of an integrated web-based Shipping Information System, which includes a Port Information System consisting of port physical, operational, cargo and tariff information (Nathan Associates, 2011b) that would address this need.

Clear responsibility for the development of the Shipping Information System mandated by the Shipping Law should be assigned to the DGST, which should as an immediate priority be required to develop and commit to a clear time bound action plan for implementation of the System.

5.2. Shipping

International shipping

Historically, Indonesia has employed a range of policies to support its national shipping industry, including the reservation of specific cargoes to Indonesian vessels, bilateral cargo-sharing agreements with trading partners on the sharing of cargoes carried between the two countries, and limiting the number of ports open to international shipping. However, most of these limitations were removed or substantially relaxed during the 1980s and early 1990s, and there now appear to be only very limited constraints on the carriage of Indonesia's international trade (Dick, 2008). Cargo reservation is now confined to government and state-owned enterprise import cargoes, which must be carried by Indonesian-flag vessels (PDP/Meyrick, 2005a).

The 2008 Shipping Law does not appear to be include any provisions in the new law that directly impose additional restrictions on foreign owned carriers competing for Indonesia's international cargoes. It does, however, include a useful simplification of the criteria for registration of Indonesian shipping companies, including those engaged in international shipping.

Domestic shipping

The general movement towards economic liberalisation during the 1990s was reflected in relaxation of Indonesia's cabotage requirements, which led to an increase in the share of domestic cargo carried on foreign flag vessels rising to around 45% in 2005 (Sutjipto, undated). The 2008 Shipping Law included a very significant strengthening of cabotage requirements, formally requiring that all foreign -flag vessels operating in the Indonesian domestic trades be replaced by (or re-registered as) Indonesian flag vessels and use Indonesian crews by 2011 (Simbolon, 2010).

However, while the 2008 Shipping Law (and the earlier Presidential Instruction 5/2005) appears to have reversed the tide of liberalisation by significantly strengthening cabotage requirements, it does not appear to have re-introduced any of the other restrictive measures (such has route licensing and capacity controls) that were part of earlier regulatory structures (Dick, 2008).

Unsurprisingly, the stricter cabotage regime has been welcomed by the Indonesian National Shipowners Association. It has led to a very significant increase in the volume of cargo carried on domestic routes by Indonesian ships:

> Since the first shipping restrictions were implemented in 2005, the freight transported by Indonesian ships has almost doubled from 114.5 million tonnes to 224.8 million tonnes last year. The number of ships operated by local companies has increased by 62.8%, from 6 041 in March 2005 to 9 835 ships at September 2010. (Asrofi, 2010)

While implementation of cabotage restrictions may be helpful for National ship-owners, the extent to which the notional ownership of companies operating the vessels reflects the real beneficial ownership is uncertain. During discussions held with Indonesian officials in February 2012, representatives of both DGST and Co-ordinating Ministry for Economic Affairs noted the difficulties that can be experienced in obtaining information on company ownership in Indonesia, and raised the possibility that a significant proportion of the purported benefits of the cabotage regulation may flow to non-national interests.

The stricter regulations are likely to increase costs to national shippers who are faced with reduced choice and higher costs as a result.

> Requiring Indonesian goods to be carried in Indonesian ships and restricting foreign-flag access to Indonesian ports raises an external tariff, while the inefficiencies of domestic transport by land and sea raise an internal tariff. Not surprisingly, the economy fails to grow as fast as expected, so unemployment and poverty remain stubbornly high. (Dick, 2008)

The interpretation of the cabotage requirements has been very broad, encompassing off-shore support vessels for the oil and gas industry as well as vessels actually involved in the carriage of cargo (Streifer, 2011). This could be particularly damaging as the domestic shipping industry is poorly equipped to provide for the needs of this industry.

Fortunately, this has been recognised in the recently approved Government Regulation 22/2011 on the Amendment of Government Regulation 20/2010 on Water Transport*, which* broadens the rules on use of foreign flagged vessels through definitional changes and excludes certain vessels from the cabotage requirements that do not provide domestic sea transport services of goods or persons.

It is widely accepted amongst economists and regulatory analysts that strict cabotage regulations are damaging to a nation's trade and economy. Protected domestic shipping operations everywhere tend to be less efficient than open market operations. This is because domestic shipping operators often lack the capital to make the investments that drive efficiency; in part because restricting the domestic trades to national operators precludes important sources of innovation and experience in international best practice; in part because cabotage limits or eliminates opportunities for integrating international and domestic shipping operations; and in part because protected markets easily fall under the sway of powerful operators who can dominate the market and exercise significant market power.

It would be unrealistic to call at this time for reversal of a recently introduced policy which has strong sectoral support and to which opposition is not as yet widespread, organised or vocal. However, useful steps could be taken to limit and ultimately ease the economic damage that will result from the policy.

One element of this would be to ensure that Indonesia's cabotage policy does not cut across the commitments it has to participation in the ASEAN single market project. The major relevant ASEAN initiative in the maritime area is the Roadmap Towards an Integrated and Competitive Maritime Transport in ASEAN. Recognising that the ASEAN countries are at different stages of economic development and have differing factor endowments, the Roadmap develops a set of principles rather than focusing on clear-cut goals. Amongst other things, ASEAN countries accepting the Roadmap commit themselves, to "work collectively and progressively towards the development of a single integrated ASEAN shipping market".

The Amendment limiting the application of the cabotage laws to vessels not involved in the transport of cargoes of persons should be strengthened by simplifying the requirements for obtaining a permit and extending the time period during which the permit is valid.

Indonesia should participate fully in the programme outlined by the Roadmap towards an Integrated and Competitive Maritime Transport in ASEAN.

Subsidised services

Providing the support for the provision of shipping services to the more remote regions of the archipelago has long been an element of Indonesian maritime policy, given effect (at various times) both through the provision of public sector services (through Pelni) and through the subsidisation of private operations on particular routes.

Subsidies are provided to Pelni through three main channels *i)* direct payments of compensation for associated costs, including an appropriate profit margin *ii)* subsidies for imports including fuel and *iii)* equity injections, mainly in the form of contributed ships. In 2010, 23 inter-provincial and intra-provincial operated by Pelni were the recipients of public service operator (PSO) support through one or other of these mechanisms.

Pioneer services provided by private operators are subsidised by the government through an explicit payment of the difference between the costs of operation (including a contractually agreed profit margin) and revenue from tariffs that are regulated by government. Pioneer service contracts are allocated annually through a competitive bidding process. In 2010, Pioneer service providers operated 56 routes covering 30 ports throughout Indonesia; 11 routes were for the western part of the country, while the remainder served the east. (Benson *et al.*, 2010)

The new Shipping Law makes provision for the continuation of such services, but the structure of the financial support offered, and the basis on which decisions will be made and subsidies allocated, is not at present completely clear.

A systematic and transparent approach to the subsidisation of "Pioneer" services is important both because it will help to ensure that the target communities actually receive the standard of service that is intended and because it will ensure that these services are provided at minimal cost to government.

Nefiadi (2010) identifies three key policy principles that should be adopted in determining and allocating subsidies for shipping services to remote communities:

- The provision of subsidies should be based on a contractual arrangement requiring the contractor to deliver minimum performance standards, rather than on a reimbursement of input costs;
- The service provider to receive the subsidy should be selected through an open, competitive tendering process open to all competent service providers, both government and private;
- Contracts and service provision should awarded for a period that is long enough to encourage the acquisition of suitable vessels and to broaden the pool of potential service providers.

The future provision of subsidised services should be based on multi-year contracts for the provision of clearly specified outputs and awarded on the basis of competitive tenders open to all competent suppliers.

5.3. Rail

Background

Indonesian rail infrastructure is largely a legacy of the colonial period, and is largely concentrated on the two most heavily populated islands of Java and Sumatera. The total length of the rail network is 4 553 kilometres, of which 4 327 kilometres is classified by the Directorate of Land Transport as mainline and 226 as branch line (Lubis *et al.*, 2005). The network, all of which is 1 067 mm gauge, consists of four unconnected subsystems: three in different parts of Sumatera, and one extending throughout Java.

For the most part, the Indonesian rail system is constructed using comparatively light rail and permissible axle loads are low: limits on the Java sub-system range from 15 to 18 tonnes per axle, compared with a typical axle loading on narrow gauge systems of 22.5 tonnes. The relatively light axle loading tends to limit the usefulness of the railway for freight purposes (HWTSK, 2010a).

The Indonesian public rail system, operated by PT Kereta Apu (PTKA) carries around 200 million passengers per year (approximately 7% of the non-metropolitan passenger market) and approximately 20 million tonnes of cargo (approximately 0.6% of goods moved (Hidayat, 2009).

During the preparation of the National Railway Master Plan, a comparison was made of PTKA performance with that of other narrow gauge railways with similar network length and geographical conditions. Overall, the picture that emerged from the benchmarking work is of a rail system that is performing reasonably, but in which there is scope for further improvement.

There has been no real growth in either the passenger or the general freight task over the last decade, and there is general agreement that the greatest opportunities for expanding rail share of the freight market lie in the development of lines serving commodity exports, and most particularly in lines linking coal mines to ports.

Reform history

From 1963, when all public railways in Indonesia were unified under a single administration, Indonesia's railways were operated by a government department (known from 1973 on as PJKA – Perusahaan Jawatan Kereta Api). Under legislation introduced in 1992 (Law 13/1992), PJKA was reformed into a Railways Public Corporation (Perumka) operating as a vertically integrated national monopoly. Its operations covered both passenger and freight services (PTKA, 2011).

Further reform was undertaken in the late 1990s. Under Regulation 19/1998, Perumka was, in June 1999, converted into a limited liability company (Persero) and renamed PT Kereta Api, formally paving the way for private sector investment of up to 49% (Australia Indonesia Partnership, 2010a). As well as increasing the scope for private investment, the creation of PT Kereta Api (PT KAI) was intended to promote a range of improvements in governance and corporate performance.

However, the reforms do not appear to have been conspicuously successful in either field. The World Bank's Completion Report on its Railway Efficiency Project, which provided some of the impetus for the corporatisation of the railway, notes that "in the field of the core business itself few companies have expressed their interest but did not follow up due to commercial considerations". The report also comments extensively on the difficulties in implementing proposed governance and commercial reforms.

The World Bank Rail Efficiency Project and subsequent reform initiatives have favoured the separation of at least the urban passenger business from the other businesses, partly because of their differing technical and commercial requirements but also because of the risk of distorting freight markets through the "leakage" of funds intended to support metropolitan transit services into rail freight operations.

This reform has been substantially achieved through the establishment of PTKA Commuter Jabodetabek (KCJ) as a subsidiary of PTKA with its own management structure and accounts.

As part of a broad range of transport sector reforms (including the 2007 Shipping Law referred to in Section 1), the government of Indonesia has passed the Railway Law 23/2007 and supporting Regulations 56/2009 and 72/2009.

The 2007 Law abolished the SOE [state-owned enterprise] monopoly and opened the opportunity for the private and the sub-national government in the railway business, made possible the separation of the previously integrated operations and infrastructure and established the Government as the advisor and the supervisor in charge of the railway operations.

However, while the new legislation appears to provide an appropriate framework for the future development of the Indonesian rail industry, in practice change appears to have been slow, with no clear champion for change and some resistance from established parties (Dikun, 2010b).

Vertical separation

One of the conceptual cornerstones of the reform programme is the vertical separation of rail infrastructure management from above-rail operations. This does not appear to have yet occurred. Amongst the prerequisites for effective segregation are:

- Clear identification of the assets to be assigned to the infrastructure manager;
- Establishment of an effective system for determining appropriate track access charges, including as a minimum clear accounting separation;
- Introduction of a system for the transparent and equitable allocation of train paths;
- Definition of the technical terms and conditions of track access.

It is not clear that all of the foundation stones for effective vertical separation are yet in place. The implementation of the "PSO, IMO, and TAC" reforms first proposed in Rail Efficiency Project has been particularly problematic (Muthohar and Sumi, 2010). These reforms allude to the intended implementation of a formal Public Service Obligation to compensate the rail organisation non-commercial services it was required by government to provide (PSO); establishing a mechanism to compensate the rail company for infrastructure maintenance and operation (IMO); and establishing a system of track access charges (TAC). Together with the conversion of Perumka to a limited liability company and developing a framework and strategy for private sector participation, these initiatives comprised the policy reform agenda of the project.

Dikun (2010b) makes it clear that some progress appears to have been made on the structural separation issue through a series of Ministerial Decrees made in April 2010. But full vertical separation has not yet been achieved, and the PSO-IMO-TAC arrangements are still not in place.

Technical complexities have been cited as one of the main reasons for delay in implementation of the PSO-IMO-TAC arrangements. It is true that there are complex conceptual and practical issues involved, particularly in the valuation of infrastructure assets for the purpose of estimating the appropriate TAC. But given the importance of these arrangements to the overall reform process, it is likely that the economic benefit from prompt implementation of a workable system is likely to exceed any economic cost of imperfect estimation. This is particularly the case as most of the assets to which the TAC charges relate will be sunk assets.

There may therefore be benefit in adopting a simplified approach to the TAC issue. One possibility is to simply set initial TAC with reference to benchmark rates charged on comparable rail systems, subject to a floor which ensures that total revenue from the TAC exceeds IMO costs. This could be construed as a "market" approach to setting the TAC, implicitly valuing the assets to which it relates on the basis of the net revenue that they can generate at "reasonable" price levels. Similar "line in the sand" approaches to asset valuation are not uncommon in the regulation of privatised enterprises during the initial regulatory period. The TAC can then be adjusted from year to year to account for new investment in rail infrastructure.

Under this approach, TAC receipts would necessarily equal or exceed the efficient IMO requirements of the infrastructure provider, so funding these requirements should not be a problem.

The main challenges with the PSO element appear to be practical rather than conceptual: in particular, ensuring the reliable and timely receipt of PSO payments from Government (Bisnis Indonesia, 2011). While formal contractual arrangements can be useful, there is no complete solution to this issue. But the consequences of any payment difficulties will obviously be reduced if the level of budgetary support required can itself be reduced. The Director of PT KAI has recently suggested that there is considerable scope for doing this, by reviewing commuter fares and linking them to the cheapest bus fares available on the routes (Kompas, 2011).

Implementation of the full structural separation arrangements and transparent PSO-IMO-TAC should be pursued as a matter of priority.

To facilitate this, a simplified "line in the sand" approach to the estimation of TAC should be adopted and the approaches to reducing KCJ/PKASI dependence on PSO payments be investigated.

Decentralisation

One of the major thrusts of the 2007 Law is to permit sub-national government to take independent action to develop rail infrastructure and even to establish rail operating companies if they so desire. These provisions appear to be having some effect in facilitating regional government participation in rail sector development.

Decentralisation is an important potential source of diversification of rail investment and rail operations. However, there are clear risks involved in this process, including lack of network integrity and duplication and inconsistency in technical and safety standards as well as redundant and inefficient investment. On the other hand, private sector and sub-national government investment in railways will be facilitated by clarity and consistency on the technical and other requirements of future rail developments.

For these reasons, effective integration of the plans of lower levels of government with the National Railway Master Plan is necessary. The 2007 legislation provides for this by requiring that the NRMP provide guidance and co-ordination for the development of sub-national plans.

Clear formal guidelines should be developed to inform sub-national governments of the division of responsibilities future railway development between national and sub-national governments, and the technical and other standards that railways were developed by sub-national governments or the private sector will be required to meet.

Private investment in rail infrastructure

The Indonesian regulatory framework provides two distinct mechanisms for facilitating private investment in the rail system: "special purpose railways" and public-private partnerships (PPPs).

The "special purpose railway" provisions apply to railways that will be used by a single user (there appears to be some ambiguity as to whether the railway owner needs to be a party related to the user or not). Facilitating the development of rail lines developed to cater for a single commodity, and (at least in the first instance) to serve a single producer is of some importance in Indonesia, as many of the key market opportunities for rail system expansion are in serving the mining industry – particularly coal in Sumatera and Kalimantan (Van der Den, 2010).

Recent reforms appear to have sparked renewed private sector interest in investing in special purpose railways. According to press reports, there are proposals for special purpose railway investments totalling nearly USD 8 billion that have been approved or are close to being approved.

While this is encouraging, the conditions that attach to the development and operation of special railways are very restrictive, and reduce both the private sector appetite for investment in this infrastructure and the potential economic benefits that can be derived from this investment. Additionally, some of these conditions are vaguely expressed in the relevant legislation and supporting regulations, and therefore subject to interpretation.

Public clarification of these conditions is important because, in the decentralised governance environment of Indonesia, potential investors may need to seek approval from a number of different levels of government, and interpretation may differ both within and between levels of government. This increases uncertainty and further chills the investment climate.

To fully rectify these deficiencies, modifications to the Railway Law are desirable. However, as HWTSK (2011) points out, modifying legislation is a lengthy and uncertain process and seeking modifications to the legislation will therefore, in itself, increase uncertainty for investors. HWTSK therefore advances an alternative proposal that would reduce the negative effects of current restrictions through modifications that could be made by means of Ministerial and Government Regulations. The most important of these changes are outlined below.

Government regulation

- Provide the Minister for Transport with the authority to waive Special Railway service restrictions where public transport capacity is demonstrably inadequate.

- Provide a Limited Public Railway (LPR) option as a sub-category of Public Railways, permitting a broader scope of services than the Special Railway, but an infrastructure access option to serve the broader public interest.

- Exclude an LPR from any government financial support or subsidy for the development, and from the PPP requirements of competitive tendering and inclusion in the National Railway Master Plan.

- Provide that negotiated Limited Public Railway licences (rather than the Regulation itself) will specify the details of the processes for securing access to the railway and other conditions of the railway operation.

- Simplify and consolidate the licensing requirements for both Special Railways and Limited Public Railways to avoid overlap and duplication between national and sub-national authorities.

Ministerial regulation

- Clarify the definition of primary enterprise control for Special Railways in a way that will allow the project developer greater flexibility to structure project financing, increase opportunities for local participation, and secure the commercial benefits of the railway.
- Clarify and specify the regulations and outcomes that will apply when a Special Railway interconnects with another Special Railway or a Public Railway service.
- Specify exceptions to the "point to point" rule so that service interconnections and spur lines to third-party facilities along the rail alignment may be approved as part of the Special Railway services.
- Specifically link, through consistent terminology and precise cross-references, proposed articles in the Ministerial Regulation with articles of existing Government Regulations, so as to minimise conflicting interpretations (HWTSK, 2011).

Develop and adopt changes to Government and Ministerial Regulations to increase flexibility and facilitate private investment in rail infrastructure intended to be used by a single user.

Railways intended to serve more than one user cannot be developed under the "Special Purpose Railway" provision, but may be constructed as Public-Private Partnerships. The PPP guidelines require that the project proponent take the proposed initiative to government (at the national or sub-national level). The right to construct the railway then becomes subject to a public tender process in which the original proponent enjoys some advantages but is not guaranteed success. The resulting railway must provide access to multiple above rail operators (HWTSK, 2011).

The PPP provisions are relatively new – the first provisions for such developments were made only five years ago, and the current regulations are less than two years old – and no projects have so far been committed to under this framework. However, the MP3EI project has identified a number of projects open to the private sector.

Under Presidential Regulation 83/2011, PKAI has been assigned responsibility to "organise infrastructures and facilities for Soekarno-Hatta Airport Railway and the Jabodetabek Circle Line Railway". Although the Regulation appears to allow PKAI, the public operator of Indonesian railways, to partner with private enterprise on delivering the project, such a framework may not necessarily be the most attractive option for a private investor – particularly if some of the potential patrons of the service might otherwise use PKAI routes. The Working Committee on Railways of the Indonesian House of Representatives has expressed its regret that this opportunity to attract new competition into the provision of rail infrastructure services, originally recognised in MP3EI, has been diminished or lost (Kompas, 2011).

Where opportunities for PPP participation in public rail projects have been identified, or are identified in the future, the processes should allow for potential private sector participants to develop and submit proposals that do not involve PKAI.

5.4. Policy options for consideration

Ports

- ***Clear policies and procedures should be developed to clarify the responsibilities of various levels of government for future development of the port sector, and to ensure the appropriate integration of sub-national plans with the National Port Master Plan.***
- ***Before any further Port Authorities or Port Management Units are created, options for reducing the number of bodies required should be thoroughly explored.***
- ***The respective roles of Port Authorities and IPCs should be clarified by means of a Ministerial Direction, which should incorporate a redefinition of the charter of the IPCS and a clear time-bound transition plan for the transfer of those functions that have historically been performed by IPCs but will in future be undertaken by Port Authorities and Port Management Units.***
- ***An active strategy of encouraging the development of a competitive environment in Indonesia's ports should be adopted, including allowing private terminals to handle third party cargoes, competitive allocation of port services licences, restricting bidding for new opportunities from dominant operators and encouraging competition between IPCs.***
- ***Until competition in port services is clearly effective, the Ministry of State-owned enterprises should set clear performance standards for key port services delivered by enterprises under its control, and monitor the prices charges for the provision of these services.***
- ***Decisions on the allocation of assets between IPCs and port authorities should be based solely on the relevance of those assets to the future roles and functions of those entities, and on this basis control of all port lands be allocated to Port Authorities (or PMUs).***
- ***Those ports that will be the primary hubs should be clearly identified in the National Port Master Plan, future development of international intermodal transport chains be clearly focussed on these ports. However, 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.***
- ***Clear responsibility for the development of the Shipping Information System mandated by the Shipping Law should be assigned to the DGST, which should as an immediate priority be required to develop and commit to a clear time bound action plan for implementation of the System.***

Shipping

- *The Amendment limiting the application of the cabotage laws to vessels not involved in the transport of cargoes of persons should be strengthened by simplifying the requirements for obtaining a permit and extending the time period during which the permit is valid.*
- *Indonesia should participate fully in the programme outlined by the Roadmap Towards an Integrated and Competitive Maritime Transport in ASEAN.*
- *The future provision of subsidised services should be based on multi-year contracts for the provision of clearly specified outputs and awarded on the basis of competitive tenders open to all competent suppliers.*

Rail

- *Implementation of the full structural separation arrangements and transparent PSO-IMO-TAC should be pursued as a matter of priority.*
- *To facilitate this, a simplified "line in the sand" approach to the estimation of TAC should be adopted and the approaches to reducing KCJ/PKASI dependence on PSO payments be investigated.*
- *Clear formal guidelines should be developed to inform sub-national governments of the division of responsibilities future railway development between national and sub-national governments, and the technical and other standards that railways were developed by sub-national governments or the private sector will be required to meet.*
- *The government should develop and adopt changes to Government and Ministerial Regulations to increase flexibility and facilitate private investment in rail infrastructure intended to be used by a single user.*
- *Where opportunities for PPP participation in public rail projects have been identified, or are identified in the future, the processes should allow for potential private sector participants to develop and submit proposals that do not involve PKAI.*

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Chapter 6

Public-private partnership governance: Policy, process and structure

This chapter is a summary of the background report Governance of Public-Private Partnerships (PPPs) in Indonesia. The background report is available at www.oecd.org/regreform/backgroundreports. *While the government of Indonesia has taken significant steps to define the legal and administrative framework for PPPs and identify a pipeline of projects, further measures are required if Indonesia is to meet its goals for private sector infrastructure investment. These include integrating the selection of PPP projects in the budget process, developing a public sector comparator for evaluating alternative bids, and strengthening the role of the Ministry of Finance to support government contracting agencies and act as a gateway on infrastructure investment decisions.*

Introduction

Following the Asian crisis Indonesia in the early and mid-2000s embarked on a reform process aimed at revitalising the Indonesian economy. Part of this process involved the implementation of a legal and institutional framework that could serve as basis for a larger degree of private participation in the form of public-private partnerships (PPPs). The legal and institutional framework establishes a basis for the involvement of private participation in infrastructure construction, finance and management. Although the development of the framework has come a long way, the government of Indonesia sees the framework as a work in progress and adjusts it to reflect lessons learned through its experience with PPPs.

Infrastructure investment as a percentage of government expenditure in Indonesia decreased sharply following the Asian crisis from just below 10% to about 4%. The use of PPPs has not yet enabled the government of Indonesia to increase its infrastructure investment. However, the government of Indonesia plans to change this through its Master Plan for Acceleration and Expansion of Indonesia's Economic Development, 2011-2025 (MP3EI) (Republic of Indonesia, 2010). The MP3EI focuses primary on increasing the connectivity in Indonesia through among other things the development of six corridors and various ports. In addition, the MP3EI seeks IDR 4 012 trillion (USD 440 billion) of investment, with IDR 1 786 trillion assigned to items such as highways, harbours and power plants. Through the significantly increased use of PPPs in toll roads, rail and power generation the government of Indonesia wants to significantly ratchet up infrastructure development, creating the necessary foundation to maintain the high economic growth rates it needs as a frontline emerging market economy intent on joining the BRICS.

This chapter first presents an overview of the main issues regarding PPPs and subsequently the changing scene for PPPs in Indonesia is discussed. This is followed by a discussion on the PPP contract award cycle and the role of the different institutions in the PPP contract award cycle. Based on this overview the challenges that PPPs in Indonesia face as well as possible solutions to these are discussed. This discussion is organised around the three categories of recommendations identified by the OECD that need to inform the procedural and institutional framework as well as the integrity of PPPs. The chapter ends with a number of conclusions and proposals. The OECD Recommendations are included in Box 6.2.

6.1. Defining PPPs and the challenges around it

PPPs deliver public services both with regards to infrastructure assets (bridges and roads) and social assets (schools, hospitals, prisons and utilities). The interest in PPPs has been growing in recent years across the world and the need for fiscal restraint in some countries is expected to further increase their use. While PPPs can be an effective way to achieve value for money for the public purse they also present policy makers with particular challenges that need to be met with prudent institutional answers. The OECD

works towards assisting countries to meet that challenge. Drawing upon lessons learnt by member countries, the OECD has developed recommendations for the institutional and procedural treatment of PPPs, focusing on particular challenges posed to the public authorities in charge of developing, regulating and supervising PPPs and responsible for budgetary discipline and integrity. These recommendations will be discussed further below.

There is no widely recognised definition of PPPs. PPPs can be viewed in a broad way as covering most interactions between the private and the public sectors and in a more narrow way as focusing on particular sets of risk-sharing and financial relationships aimed at service delivery. Even when viewed narrowly the stock of PPPs in a number of countries is already substantial and in most countries the number of new PPPs is rising. If used correctly and entrusted with competent authorities, PPPs can deliver value for money, yet under different conditions they can be dangerous for fiscal sustainability due to their complex nature in terms of risk sharing, costing, contract negotiation, affordability, as well as budget and accounting treatment. For instance, OECD research has shown that procurement rules in a number of countries create incentives to prefer PPPs over traditional procurement or vice versa, hindering the capacity of countries to assess adequately the costs and benefits of alternative options and ultimately from attaining the optimum value for money (Burger and Hawkesworth, 2011). The same research shows that for some countries the off-budget nature of PPPs, rather than value for money, makes them more attractive than traditional procurement of assets regardless of value for money considerations.

PPPs can be defined as ways of delivering and funding public services using a capital asset, where project risks are shared over the long term between the public and private sector (Box 6.1). A PPP is a contractual agreement between the government and a private partner where the service delivery objectives of the government are intended to be aligned with the profit objectives of the private partner. The effectiveness of the alignment depends on a sufficient and appropriate transfer of risk to the private partners. In a PPP contract, the government specifies the quality and quantity of the service it requires from the private partner. The private partner may be tasked with the design, construction, financing, operation and management of a capital asset required for service delivery as well as the delivery of a service to the government, or to the public, using that asset. A key element is the bundling of the construction and operation and maintenance of the underlying asset over the life of the contract. The private partner will receive either a stream of payments from the government for services provided or at least made available, user charges levied directly on the end users, or a combination of both.

Through harnessing the private sector's expertise in combining the design and operation of an asset a PPP can provide the service in a more efficient manner compared to traditional forms of procurement. There are a number of conditions that need to be in place for a PPP to be successful. The most important generic issues are set out in section three below.

The complexity of PPPs requires a number of capacities in government both in terms of skills, institutional structures and legal framework. There needs to be a robust system of assessing value for money using a prudent public sector comparator (or its equivalent) and transparent and consistent guidelines regarding non-quantifiable elements in the value-for-money judgment. It also involves being able to classify, measure and contractually allocate risk to the party best able to manage it and the ability to monitor the PPP contract through its life. It requires sound accounting and budgeting practices.

Box 6.1. Different country definitions of public-private partnerships

There is no widely recognised definition of PPPs and related accounting framework. Eurostat, International Accounting Standards Board, International Monetary Fund, International Financial Reporting Standards and others work with different definitions. As illustrated below there is variation between countries.

- **Korea** defines a PPP project as a project to build and operate infrastructure such as roads, ports, railways, schools and environmental facilities – which have traditionally been constructed and run by government funding – with private capital, thus tapping the creativity and efficiency of private sector.

- **South Africa** defines a PPP as a commercial transaction between a government institution and a private partner in which the private party either performs an institutional function on behalf of the institution for a specified or indefinite period, or acquires the use of state property for its own commercial purposes for a specified or indefinite period. The private party receives a benefit for performing the function or by utilising state property, either by way of compensation from a revenue fund, charges or fees collected by the private party from users or customers of a service provided to them, or a combination of such compensation and such charges or fees.

- The **United Kingdom** defines a PPP as "…arrangements typified by joint working between the public and private sectors. In their broadest sense they can cover all types of collaboration across the private-public sector interface involving collaborative working together and risk sharing to deliver policies, services and infrastructure." (HM Treasury, Infrastructure Procurement: Delivering Long-Term Value, March 2008). The most common type of PPP in the United Kingdom is the Private Finance Initiative. A Private Finance Initiative is an arrangement whereby the public sector contracts to purchase services, usually derived from an investment in assets, from the private sector on a long-term basis, often between 15 to 30 years.

Source: OECD (2008), *Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money*, OECD Publishing, Paris.

Value for money and the public sector comparator

Governments should assess whether or not a project represents value for money. Indeed, the drive to use PPPs is increasingly premised on the pursuit of value for money (OECD, 2008). Value for money is a relative measure or concept. The starting point for such a calculation is the public sector comparator. A public sector comparator compares the net present cost of bids for the PPP project against the most efficient form of delivery according to a traditionally procured public-sector reference project. The comparator takes into account both the risks that are transferable to a probable private party and those risks that will be retained by government. Thus, the public sector comparator serves as a hypothetical risk-adjusted cost of public delivery of the project. However, ensuring the robustness of a public sector comparator can be difficult and it may be open to manipulation with the purpose of either strengthening or weakening the case for PPPs (e.g. much depends on the discount rate chosen, the value attributed to a risk transferred or whether a cost is front or back loaded).

In addition to the quantitative aspects typically included in a hard public sector comparator, value for money includes qualitative aspects and typically involves an element of judgment on the part of government. Value for money can be defined as what government judges to be an optimal combination of quantity, quality, features and price (i.e. cost), expected (sometimes, but not always, calculated) over the whole of the project's lifetime. What makes value for money hard to assess at the beginning of a project is that it ultimately depends on a combination of factors working together such as risk transfer, output-based specifications, performance measurement and incentives, competition in and for the market, private sector management expertise and the benefits for end users and society as a whole.

Appropriate risk transfer

To ensure that the private partner operates efficiently and delivers value for money, a sufficient, but also appropriate, amount of risk needs to be transferred. In principle risk should be carried by the party best able to manage it. This may mean the party best able to prevent a risk from realising (*ex ante* risk management) or the party best able to deal with the results of realised risk (*ex post* risk management). Some risks can be managed, and are hence called endogenous risks. However, not all risks can be managed and cases may exist where one or more parties to a contract are unable to manage a risk. To those parties such unmanageable risks are exogenous risks (an example is uninsurable force majeure risk that affects all parties, while political and taxation risk is exogenous to the private party and endogenous to government). It should be noted, however, that statutory and political obligations can mean that ultimately the activities of a PPP that fails must be taken over by government. A takeover by the government means that the allocation of risk according to the PPP contract differs from the effective allocation of risk, with the government in effect carrying more risk than allocated to it in the PPP contract.

Contract negotiating skills

The ability to write and negotiate PPP contracts are an important public sector capacity requirement, especially given the long-term nature and the large transaction costs associated with PPPs.

Affordability

A project is affordable if government expenditure associated with a project, be it a PPP or other mode of delivery, can be accommodated within the intertemporal budget constraint of the government. A PPP can make a project more affordable if it improves the value for money compared to that realised through traditional public procurement, and then only if the increased value for money causes a project that did not fit into an intertemporal budget constraint of the government under public procurement to do so with a PPP. Some countries are tempted to ignore the affordability issue due to the fact that PPPs may be off-budget (as discussed below). Political considerations may also alter the decisions: due to the political cycle, the policy maker who makes the decision to enter the PPP often does not bear the long-term expenditures involved in the project.

Future budget flexibility

A possible difficulty could be that PPPs reduce spending flexibility, and thus potentially allocative efficiency, as spending is locked in for a number of years. Given that capital expenditures in national budgets are often accounted for as an expense when the investment outlay actually occurs, taking the PPP route allows a government to initiate the same amount of investments in one year while recording less expenditure for that same year. On the other hand, the obligation to pay an annual fee will increase expenditures in the future, reducing the scope for new investment in coming years. However, if the PPP represents more value for money compared to traditional procurement, and this saving is not spent up front, the government will have increased its fiscal space in coming years and thus increased flexibility. Government spending might also be affected if the government provides explicit or implicit guarantees to the PPP project and thus incurs contingent liabilities. In some cases concessions and PPPs may also provide a revenue stream to government as part of payment for using existing assets.

Fiscal impact of PPPs

The system of government budgeting and accounting should provide a clear, transparent and true record of all PPP activities in a manner that will ensure that the accounting treatment itself does not create an incentive to take the PPP route. In some cases systems make it possible to avoid normal spending controls and use PPPs to circumvent spending ceilings and fiscal rules.

PPPs should only be undertaken if they represent value for money and are affordable. However, there are those who argue that PPPs should be used to invest in times of fiscal restraint. The fiscal constraint argument for PPPs is driven by pressures on governments to reduce public spending to meet political, legislated and/or treaty-mandated fiscal targets. In parallel with this, many governments face an infrastructure deficit stemming from a variety of factors including a perceived bias against budgeting for capital expenditures in cash-based budgetary systems. However, when responding to fiscal constraints, governments should not bypass value for money and affordability. PPPs may also create future fiscal consequences if they violate the budgetary principle of unity, *i.e.* that all revenues and expenditures should be included in the budget at the same time. Potential projects should be compared against other competing projects and not be considered in isolation to avoid giving priority to the consideration and approval of lower value projects.

The OECD surveyed member countries in 2010 about the percentage of public sector infrastructure investment that takes place through PPPs (Burger & Hawkesworth, 2011). Table 6.1 indicates the percentage of public sector investment that takes place through PPPs and the number of countries to which each range applies. For instance, in 9 of the 20 countries PPPs constitute between 0% and 5% of public sector investment in infrastructure. Furthermore, in 9 countries PPPs constitute between 5% and 15% of total public sector infrastructure expenditure. The stock of PPPs in countries varies significantly. It ranges from one at the federal level in Canada, three each in Norway, Denmark and Austria, to 670 in the United Kingdom.[1] In between is France with 330,[2] Korea with 252, Mexico with 200, Germany with 144, Chile with 60, New South Wales (Australia) with 35, the Netherlands and Hungary each with 9 and Ireland with 8.

Table 6.1. What percentage of public sector infrastructure investment takes place through PPPs (2010)?

Range	No.	Country
0% - 5%	9	Austria, Germany, Canada, Denmark, France, Netherlands, Hungary, Norway, Spain
>5% - 10%	7	United Kingdom, Czech Republic, Slovak Republic, Greece, Italy, South Africa, Ireland
>10% - 15%	2	Korea, New South Wales (Australia)
>20%	2	Mexico, Chile
Total	20	

Note: No response for the >15% - 20% range. This section shows that while PPPs are viewed in many countries as an efficient way of delivering public services they also present the public sector with particular challenges. The following section discusses the changing approach to PPPs in Indonesia.

Source: OECD (2011), "How to Attain Value for Money: Comparing PPP and Traditional Infrastructure Public Procurement ", *OECD Journal on Budgeting,* Volume 2011/1, OECD Publishing, Paris, p. 7.

6.2. The changing scene for PPPs in Indonesia

Prior to 2001, decision making in Indonesia was largely centralised. However since 2003 the country experienced a significant degree of decentralisation following the passing of the 2003 Law on State Finance (Law 17/2003). This decentralisation largely entailed the decentralisation of democratic authority and decision-making powers. Government finance still remains largely centralised though. Provinces and districts/cities authorities receive an equitable share of national revenue based on a formula for the division of revenue, but sub-national authorities do not really possess a tax base of their own. Since 2010 sub-national authorities can raise property taxes. On sub-national government level there has so far not been much investment expenditure happening, but there are proposals currently that at least 20% of their expenditure should be investment. As discussed further below it is important to note that sub-national government is not obliged to follow central government rules for PPPs. This is only the case if guarantees or fiscal support is sought.

There are more than 490 sub-national governments in Indonesia, many with their own water state-owned enterprise (PDAMs) and regional bank state-owned enterprise. Most of the PDAMs are still indebted to the central government, following the serious financial troubles into which these SOEs ran following the Asian financial crisis of 1997. These SOEs are not allowed to borrow money unless they repay their debts to central government, which consequently limits such activity.

As part of the decentralisation that occurred since 2001, and in particular in terms of Law 17/2003, some decision-making power shifted from the National Development Planning Agency (Bappenas) to the Ministry of Finance (MoF). In addition, decision-making power also shifted to sub-national authorities, which means that the various sub-national development planning agencies (Bappedas) operating on lower tiers of government do not any longer primarily report to Bappenas, but to their respective sub-national authorities. On sub-national level Bappenas' role is largely limited to undertaking the promotion of PPP. This is done on its road trips to the various sub-national authorities, followed by an invitation to sub-national authorities and national government ministries to place possible future projects on Bappenas' PPP Book containing potential PPP projects.

Before the reform process started in the early 2000s most projects undertaken by the central, provincial or district/city government themselves were awarded through direct appointment to either SOEs or private firms. As part of the reform process the government of Indonesia wanted to improve the process and principles through which projects are awarded. This includes the introduction and use of competitive bidding. As a result the governmentintroduced Presidential Regulation 67/2005. This regulation was improved and augmented further by the introduction of Presidential Regulations 13/2010 and 56/2011. These regulations regulate what types of projects are considered as infrastructure, what the eligible contracting agencies are and the role of potential private participants. In addition, regulations set out the responsibilities of the MoF with respect to the granting of fiscal support and guarantees to specific projects in the procurement process.

Since the introduction of the reform and above mentioned presidential regulations three Infrastructure Summits were held, the product of which has been a list of possible PPP projects. Many countries seek to kick start a PPP programme by nominating a few (a handful) PPP projects based on both national priorities and their chances of success. The first Infrastructure Summit was held in 2005 and resulted in a list of 91 projects. The list increased to 101 potential projects and 10 model projects as part of the second Infrastructure Summit in 2006. By the time of the third Infrastructure Summit in 2010 there were 72 potential PPP projects, 27 priority projects and one ready for offer. However, this rather long list was subsequently shortened substantially so that by the fourth Infrastructure Summit held in April 2011 there were 5 showcase projects and 11 other projects. Nevertheless, by June 2011 the Bappenas PPP Book 2011 stood at 79 projects of which 45 were potential projects, 21 priority projects and 13 were ready for offer. In addition, contract award went to one project, the Central Java Power Plant (originally part of the 10 model projects identified in the 2006 Infrastructure Summit and signed on 6 October 2011), meaning that this projects is the only project to date to have passed through the project creation cycle specified in terms of the Presidential Regulations 67/2005, 13/2010 and 56/2011. The Central Java Power Plant cost about IDR 30 trillion (20-30% equity of which 60% will be provided by Japanese investors, 70-80% debt, including foreign investment) (Bappenas, 2011).

Most, if not all, PPPs in Indonesia are in the form of concession. Four groups of concession can be distinguished:

- Projects created before the reform process occurred. With regard to roads there are 28 of these projects, 17 of which are concessions awarded to the SOE for toll roads, PT. Jasa Marga, and further 11 concessions awarded to private concessionaires. Some of the later projects awarded to the private sector were awarded following a competitive bid process.
- Projects signed after the reform process commenced, but still in the pipeline due to process issues, in particular problems with the acquisition of the relevant land. With regard to roads there are 24 of these projects. Some of these concession agreements were signed as far back as 2006. However, because of problems regarding the acquisition of land, none of these projects can proceed. The private partners are responsible for paying for the land, but given that the land acquisition was not finalised when the concession agreements were signed, there is still a large degree of uncertainty about the viability of these projects. Uncertainty exists about whether all the land required for the project will be acquired and at what price it will be acquired.

While the new law for expropriation of land for public projects should make this easier, it is still too soon to say with certainty.

- New projects that are under consideration, not yet signed and therefore are still in the pipeline. These projects will be developed in terms of Presidential Regulations 67/2005, 13/2010 and 56/2011 and therefore will, unlike those mentioned under (2) above, be assessed by the MoF. This assessment may include scrutiny by the Indonesian Infrastructure Guarantee Fund (IIGF) if the project requires a guarantee, or by the Risk Management Unit in the MoF, if the project requires viability gap funding. Currently there are five water projects, two as potential PPPs and three as ready-to-offer PPPs, under this category.
- New projects that are signed and project award occurred. Only one such project exists, namely the Central Java Power Plant. This project went through the process set out in Presidential Regulations 67/2005, 13/2010 and 56/2011 and received an IIGF guarantee.

Table 6.2. Do the following make PPPs more attractive in comparison to traditional infrastructure procurement?

	Y	N	S
The project generates debt that is not on the balance sheet of government	X		
The project requires high level of constant maintenance			X
The project requires a high level of service delivery performance	X		
The project requires skills that are more readily available in the private sector, compared to the public sector	X		
Strong Public Unions in the public sector in the relevant sector			X

Legend: Y: Yes, N: No, S: Sometimes.

Source: MoF Indonesia response to OECD questionnaire, 2011.

Table 6.3. Do the following make traditional infrastructure procurement more attractive in comparison to PPPs?

	Y	N	S
The project is politically/strategically important (e.g. defence)	X		
The project is complex in management and design		X	
The project risk is difficult to quantify and measure (e.g. large IT investments)			X
The project requires a high level of maintenance			X
The project requires a high level of service delivery performance			X
The project requires skills that are more readily available in the public sector, compared to the private sector	X		
Strong Public Unions in the public sector in the relevant sector			X

Legend: Y: Yes, N: No, S: Sometimes.

Source: MoF Indonesia response to OECD questionnaire, 2011.

To establish the possible reasons why the government of Indonesia selects PPPs over traditionally procured infrastructure, a questionnaire was circulated to the MoF. The MoF was presented with a list of features that might either render a PPP more attractive than a traditionally procured infrastructure or vice versa. Factors that cause the government to prefer PPPs to traditional infrastructure procurement include that the projects generates debt that is not on the balance sheet of government, as well as factors relating to skills. Factors that cause the government to prefer traditional infrastructure procurement to PPPs include projects that are politically or strategically important and projects that require skills that are more available in the public sector than in the private sector. The reasons

listed making PPPs or traditional infrastructure procurement attractive are similar to those found in OECD countries (Burger and Hawkesworth, 2011). Apart from the balance sheet incentive they are sound and reflect accepted knowledge regarding the strength and weaknesses regarding PPPs.

6.3. The PPP contract award cycle and the role of the different institutions in Indonesia

This section sets out the roles of the different institutions involved in setting up a PPP in Indonesia. In Indonesia the government contracting agencies (GCAs) can be ministries, provincial authorities, as well as sub-national authorities. In addition, National Electricity Company (PLN)s also acts as a GCA.

As mentioned above, Presidential Regulations 67/2005, 13/2010 and 56/2011 regulate the creation of PPPs. In principle GCAs are free not to comply with these three presidential regulations and they do have the authority to conclude their own contract. However, should the GCA require a government guarantee or fiscal support for its project, it needs to submit the project to the MoF and comply with the three regulations. Since international banks increasingly expect a government guarantee, it is becoming increasingly difficult to engage in PPP contracts without either fiscal support or a government guarantee. Therefore, GCAs submit most new projects to the three presidential regulations and hence the scrutiny of the Risk Management Unit (RMU) of the MoF. Answering to the RMU the IIGF performs a key role in screening projects – indeed, its role comes closest to the gatekeeping role played by ministries of finance in New South Wales (Australia) South Africa and the United Kingdom, as well as Korea's Private Infrastructure Investment Management Center. The RMU also intends to follow a single-window policy whereby the IIGF performs the full project evaluation and assessment for the MoF. The IIGF operates within the terms set out in Government Regulation 35/2009.

Should a guarantee be required the GCA should obtain it from the IIGF prior to the bid taking place. The IIGF evaluates the project in terms of its economic/financial, technical and environmental viability. Only if it is satisfied by the evaluation will the IIGF extend a guarantee – thereby effectively green-lighting the project and thus effectively serving a key gatekeeping role. The IIGF will subsequently conclude a guarantee agreement with the winning bidder and a recourse agreement with the GCA. Though the IIGF own capital is limited, co-guarantors and a World Bank standby facility of approximately USD 480 million backstop it. In the final instance government, through the MoF can also increase its capital or give a guarantee to specific projects. Currently the IIGF is reviewing three projects (a water project, a rail road project and a toll road project) and has extended a guarantee to only one project, the Central Java Power Plant mentioned above.

The IIGF, answering to the RMU, also considers the risk-sharing arrangement of the contracts. It is willing to guarantee political risk, performance risk (i.e. the risk that the completed project does not perform as intended) and demand risk, which if mitigated, leaves availability risk as the one risk that should spur the private partner to being efficient. By having the IIGF undertake all the guarantees the MoF attempts to ring fence the amount of risk to which the government is exposed. Nevertheless the RMU notes that should the IIGF land into financial trouble, the government will support it. Thus, though the risk to which the government is exposed is ring-fenced in principle, it might not turn out so in practice.

In addition to the evaluation and screening roles of the RMU and the IIGF, there is also Investment Co-ordinating Board (BKPM), which is mainly responsible for the marketing of PPPs to possible foreign and domestic investors. The BPKM operates on the basis of an memorandum of understanding between the MoF, Bappenas and the BKPM.

Two institutions focus on the financing and in particular the viability gap funding of projects whilst answering to the RMU. These are PT Indonesian Infrastructure Financing Facility (PT IIFF) and PT Sarana Multi Infrastruktur (PT SMI). The PT SMI operates in terms of Government Regulation 75/2008 and is a conduit to channel funds into the PT IIFF, which is a private entity in which the World Bank, the International Finance Corporation, Asian Development Bank, KfW and DEG hold shares. The intention is also to bring in more private banks as shareholders of the PT SMI. The PT SMI provides sub-national financing complimentary to that of the international banks. In essence it implements viability gap funding where projects are considered borderline viable and thus not entirely bankable. However, the emphasis is on borderline viability. It is not the function of the PT SMI to save an unviable project.

The MoF also relies on the PT SMI for project development funding, rather than on the Project Development Fund (PDF), which means that the PDF has become largely inoperative. The PDF resides within Bappenas and is largely funded by the Asian Development Bank. Bappenas houses the PPP Central Unit (P3CU). P3CU role is largely to co-ordinate the identification of potential PPPs and putting them on the official PPP Book while the MoF assists in the preparation, finance and the provision of guarantees needed to create the PPP.

In response to the significant problems with regards to land acquisition, particularly prominent in road projects (see discussion below), there is a Land Acquisition Revolving Fund (LARF) that must assist the Roads Authority to acquire land that the private partner needs for the PPP. Since ultimately the private partner is responsible for the acquisition of land, the payments of the private partners must replenish LARF and ensure that the fund revolves. It needs to be emphasised that this is the intention with LARF, as no such funding has occurred at the time of writing. In light of the new land acquisition law passed by the DPR on 16 December 2012 this fund's mandate and function may have to be revisited.

In addition to the above institutions there is also the National Committee for the Acceleration of Infrastructure Provision (KKPPI), an inter-ministerial committee chaired by the Co-ordinating Minister of Economic Affairs. The Minister of National Development Planning is the executive chair of the committee as stipulated in Presidential Regulation Number 12 (2011). Other members of the KKPPI include the MoF and Bappenas. This committee is in principle responsible for co-ordination and the identification early on of priority projects. However, in deciding the priority of projects where such priority increasingly means the viability of the project, the RMU and IIGF increasingly fulfil the function of project approval. KKPPI has in recent years not been particularly active with regards to the PPP pipeline.

In the past GCA and other ministries could refer PPPs to the KKPPI when these PPPs encountered problematic regulations that were not suitable for the PPP. The KKPPI would then work towards solving these regulatory issues for the specific PPP. It thus dealt with problems in an *ex post*, and *ad hoc* manner. It may be preferable to set up *ex ante* a set of principles and institutions to guide the PPP process.

According to Presidential Regulations 67/2005, 13/2010 and 56/2011 the MoF plays a crucial role in the approval of PPPs. However, it might be argued that it comes into play quite late in the contract award cycle as the MoF seems to play little or no role in the identification of possible PPP projects.

Building on the above review of the contract award cycle and institutional roles regarding PPPs the following sections discuss the main challenges and possible solutions with respect to PPP governance. The sections are broadly based on the three categories contained in the *2012 OECD Recommendations for Public Governance of PPPs* (Box 6.2). Note that some of the subsections may also cross reference across categories.

Box 6.2. 2012 OECD Recommendation on Principles for Public Governance of Public-Private Parnerships

A. Establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities

1. The political leadership should ensure public awareness of the relative costs, benefits and risks of PPP and conventional procurement. Popular understanding of Public-Private Partnerships requires active consultation and engagement with stakeholders as well as involving end-users in defining the project and subsequently in monitoring service quality.
2. Key institutional roles and responsibilities should be maintained. This requires that procuring authorities, PPP units, the central budget authority, the supreme audit institution and sector regulators are entrusted with clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability.
3. Ensure that all significant regulation affecting the operation of PPPs is clear, transparent and enforced. Red tape should be minimised and new and existing regulations should be carefully evaluated.

B. Ground the selection of PPPs in Value for Money

4. All investment projects should be prioritised at senior political level. As there are many competing investment priorities, it is the responsibility of government to define and pursue strategic goals. The decision to invest should be based on a whole-of-government perspective and be separate from how to procure and finance the project. There should be no institutional, procedural or accounting bias either in favour of or against PPPs.
5. Carefully investigate which investment method is likely to yield most value for money. Key risk factors and characteristics of specific projects should be evaluated by conducting a procurement option pre-test. A procurement option pre-test should enable the government to decide on whether it is prudent to investigate a PPP option further.
6. Transfer the risks to those that manage them best. Risk should be defined, identified and measured and carried by the party for whom it costs the least to prevent the risk from realising or for whom realised risk costs the least.
7. The procuring authorities should be prepared for the operational phase of thePPPs. Securing value for money requires vigilance and effort of the same intensity as that necessary during the pre-operational phase. Particular care should be taken when switching to the operational phase of the PPP, as the actors on the public side are liable to change.

8. Value for money should be maintained when renegotiating. Only if conditions change due to discretionary public policy actions should the government consider compensating the private sector. Any re-negotiation should be made transparently and subject to the ordinary procedures of PPP approval. Clear, predictable and transparent rules for dispute resolution should be in place.

9. Government should ensure there is sufficient competition in the market by a competitive tender process and by possibly structuring the PPP programme so that there is an ongoing functional market. Where market operators are few, governments should ensure a level playing field in the tendering process so that non-incumbent operators can enter the market.

C. Use the budgetary process transparently to minimise fiscal risks and ensure the integrity of the procurement process

10. In line with the government's fiscal policy, the Central Budget Authority should ensure that the project is affordable and the overall investment envelope is sustainable.

11. The project should be treated transparently in the budget process. The budget documentation should disclose all costs and contingent liabilities. Special care should be taken to ensure that budget transparency of PPP covers the whole public sector.

12. Government should guard against waste and corruption by ensuring the integrity of the procurement process. The necessary procurement skills and powers should be made available to the relevant authorities.

6.4. Establish a clear, predictable and effective institutional framework supported by competent and well-resourced authorities

Challenges in Indonesia regarding institutional framework and capacities

While there are a number of challenges facing Indonesia with regards to the PPP programme emphasis should made of the fact that great strides have been made in the last years. Complex issues such as defining the PPP policy and legal framework, identifying a project pipeline, setting up PPP expertise units and developing concepts to guide projects have been undertaken. The following focuses on the potential next steps.

With regards to the population's perception of PPPs there does not at this time appear to be much controversy. This may, however, be a result of the fact that few new PPPs have been put into operation in later years. In particular there have not been recent examples of PPPs where the full or partial cost recovery has fallen directly on users. When and if the burden of new PPP investments falls on the users, experiences in Indonesia indicated that protest should not come as a surprise.

There is a great reluctance in GCAs with regards to the use of PPPs. For top decision makers in government it appears that GCAs do not wish to be responsible for PPP projects and have to be pressured by the political level into doing this. There also appears to be a lack of interest and capacity to follow up on projects which have been designated as potential PPPs. The process thus becomes weak in terms of quality and slow in terms of time.

The following two subsections focus on the lack of co-ordination between and capacity within the GCAs, Bappenas and the MoF and regulatory framework challenges.

Co-ordination between and capacity within the GCAs, Bappenas and the MoF

PPP activity in Indonesia mainly takes place in three centres in government: the GCAs (e.g. the ministries and sub-national authorities), Bappenas and the MoF. Unfortunately there seems to be a lack of co-ordination between these three centres. This lack of co-ordination manifests itself in the following:

- The GCAs develop project proposals in isolation. This means that very often project proposals and feasibility studies fall short of the requirements of the MoF and subsequently may not qualify for government (fiscal) support and a government guarantee. The projects are then either abandoned or delayed as more work is done on the proposals (an example of such a delayed project proposal is the Jakarta Airport link project). While the MoF through its various organisations such as the Risk Management Unit (RMU) and the Indonesian Infrastructure Guarantee Fund (IIGF) evaluates the financial and technical feasibility of projects, it does not assist the GCAs in putting together the feasibility studies.

- The P3CU in Bappenas is tasked with assisting GCAs with developing their PPP project proposals. However, the P3CU has limited resources to do this which makes its job difficult. Evidence also indicates that the procurement rules P3CU is subject to effectively bars it from hiring good advisors which impacts on project preparation. In this effort the P3CU is supposed to be assisted financially by the PDF. However, the PDF falls short of its initial intended role, with some of its functions relating to the funding of the development stage of projects by the GCAs being fulfilled by PT SMI. There also seems to be a lack of co-ordination between P3CU and the MoF, leaving the P3CU and Bappenas to update the PPP Book, while the MoF operates independent of what P3CU does.

- Questions have arisen concerning whether or not the P3CU has sufficient capacity to support GCAs in the identification and preparation of project proposals and feasibility studies.

With regard to PPPs the vastly different institutional cultures of Bappenas and the MoF somewhat weaken the co-ordination between the two institutions. Bappenas focuses on broad economic planning while the MoF has a stricter fiscal and financial focus. In most countries the evaluation of individual PPP project proposals rarely involves a consideration of the broader social costs and benefits. This is reflected typically in bids and public sector comparators (PSC) that focus exclusively on the direct (and not the broader social) outputs and costs of the project. This exclusive focus has its genesis in the nature of the project and financial management tools typically applied to PPPs. These tools very much reflect the strict criteria that the private sector applies to project finance, typically because their profitability depends on it. Because these stricter criteria do not include an explicit consideration of broader social benefits and costs, their application very often does not allow for an easy fit with the broader social and planning objectives typically found in ministries of planning. Indonesia seems to be no exception to this rule.

The lack of co-ordination between the P3CU and the MoF also means that there is a need to align the content and the level of detail and sophistication required by the MoF assessment process and the nature of the support provided by the P3CU. Currently there

seems to be a mismatch between the required level of detail and sophistication and the level of detail and sophistication of actual proposals that were put together with the support of the P3CU. Therefore, as in many other countries before, a need exists in Indonesia for better alignment. This alignment requires the proper location of the PPP unit to enhance co-operation with the MoF. As the experience of some of the countries that implemented successful PPP programmes show, there mainly are two options with regards to locating the PPP unit to enhance the co-operation with the MoF. These options are:

- Placement of the PPP unit inside the MoF. This is the model used by among other South Africa, and the Australian states of New South Wales and Victoria.

- Placement of the PPP unit as an independent agency that is closely aligned with the MoF. This is the model used in the United Kingdom.

PPP units are usually located within the MoF if they have their genesis in the MoF. However, if they have their genesis elsewhere, they often become an independent agency. Since P3CU in Indonesia has grown out of Bappenas one option is to develop it into an independent agency. Both options, i.e. locating it in the MoF or placing it as an independent agency, should ensure that the institutional culture of the PPP unit and that of the MoF are aligned and enables both the PPP unit and the MoF to have a stricter fiscal and financial focus. A stricter fiscal and financial focus will allow the PPP unit to assist GCAs with tailoring their proposals and feasibility studies to the MoF requirements. Given that PT SMI currently fulfils many of the functions originally intended for the PDF. The PDF could either move with the P3CU, or it could be incorporated with the PT SMI.

Since particularly large-scale projects would ideally also be open and attractive to international bidders, project proposals and feasibility studies should adhere to international standards. International investors and project managers may include both financial institutions interested in maintaining a transnational portfolio of projects, or construction firms that also maintain a diverse portfolio of projects. In its attempt to attract international investors Indonesia will be competing with a number of other developed and emerging market countries. The Indonesian authorities are clearly aware of this issue and are working towards resolving it. One approach would be to consider appointing international transaction advisors for large PPP projects to ensure that these projects adhere to the standards international investors usually require from PPP project proposals. Such advisory services will probably require central funding as the GCAs will not be able to afford it.

Regulatory challenges and land issues

The regulatory framework for PPPs needs to support the overarching principles of good regulation, i.e. that it is clear, effective, proportional, flexible, transparent, consistent, predictable and accountable. Presidential Decree 67/2005 improved the regulatory framework substantially. However, there remain some challenges. Historically there have been problems with the legal framework being applied in a transparent, consistent and predictable way. In the past this has led to cases subjected to international arbitration. Questions regarding the enforcement of the international arbitration decisions that went against the public side have been raised in the past. There are no recent experiences with regards to these issues.

The MP3EI sets out ambitious plans to create six corridors in Indonesia to improve connectivity in the country. Until the passing of new legislation in December 2011 this was hampered by the legislative framework which makes it extremely difficult for the authorities to expropriate privately owned land. Road projects, be these PPPs, or projects undertaken by the Ministry of Transport and the Toll Road Agency, thus suffered from significant problems relating to the acquisition of the relevant land. This had two effects. First, owners delayed selling their land to the government/consortium for as long as is possible in the hope that their bargaining position – and hence the price – would be strengthened as the project progressed. Secondly, because of the drawn-out negotiation process to acquire land, the extended time between identifying land for consideration and the GCA acquiring it allowed speculators to drive up the price of the relevant land. This lead to a significant escalation in the actual cost of the land and total project cost.

In response there a requirement was put in place that land ownership by the GCA should be established by the time the contract is concluded, so as to reduce cost uncertainty. The government also imposed a cap on the price of the land it is willing to pay (at a 110% of the initial valuation). A Land Acquisition Revolving Fund (LARF) was also set up to ease the acquisition of land.

The expropriation framework has changed with the new legislation passed on December 2011. The new law regarding expropriation of land for public works and PPPs is a considered a clear improvement. From the perspective of the investor it makes the timing of when the land will be available through expropriation more certain. The law sets rather tight deadlines for appeals of expropriation decisions and the level of compensation. While this is beneficial to speed up the process it may be a challenge for non-professional groups to handle. The law sets out the principle that compensation should be based on the market price of the land. It is, however, difficult to see how a clear valuation of the land is possible. Tax records are not directly useable as they appear to consistently understate the real value of land. The same can be said for the records of land sale prices. It should also be noted that the new law has not yet been promulgated in the form of a presidential regulation. In reality whether or not the new legislation solves the problems discussed above will to a great extent depend on the implementation regulation.

In addition, there are nevertheless still some unresolved issues with regards to land. There are cases where there are competing claims of ownership, but no documentation, e.g. in cases where there are claims that land is held in common by specific groups. The issue of overlapping jurisdictions can also impede PPPs. Where the resource/asset belongs to a lower-level authority, but the service crosses a jurisdictional border of those authorities, the higher-level authority becomes responsible for the PPP. The Umbalan (Bali) Water Supply project is an example of such a project. The provincial government is responsible for the development of this project, but the project is being held up due to differences among the five sub-national authorities that own the relevant water rights.

6.5. Ground the selection of PPPs in value for money

This section first discusses the lack of an overall government structure that ensures that PPP activity in Indonesia aligns and coheres with the government's overall policy framework. This is followed by two subsections, the first considering the rationale for undertaking PPPs in theory, before the second discusses the rationale for undertaking PPPs in Indonesia.

A new Presidential Committee prioritising and championing projects

As mentioned above the fiscal and financial criteria applied to specific PPPs are usually direct and strict. There is, however, also a need to consider the broader societal costs and benefits of projects as well as the political priority of individual projects. Thus, there is a need to ensure that policy choices cohere and are aligned with the governments overall strategy, priorities and objectives. In the United Kingdom GCAs engaging in major projects, be these PPP or traditional infrastructure projects, need to indicate how each of these projects fits within the overall policy strategy and objectives of government. In Indonesia the various ministries involved in the creation of PPPs and non-PPP projects (including the line ministries, the MoF and Bappenas) seem to rarely discuss, for instance, the alignment of their plans to the overall policy strategy and objectives of government as set out in the MP3EI.

The active management of ensuring coherence of the entire portfolio of PPP and non-PPP projects and their compliance with the overall policy strategy and objectives of government needs to occur on the highest level of government. Two possible options to manage it on the highest level of government include:

- Cabinet approval is required for all major projects against the background of the government's policy strategy and objectives;

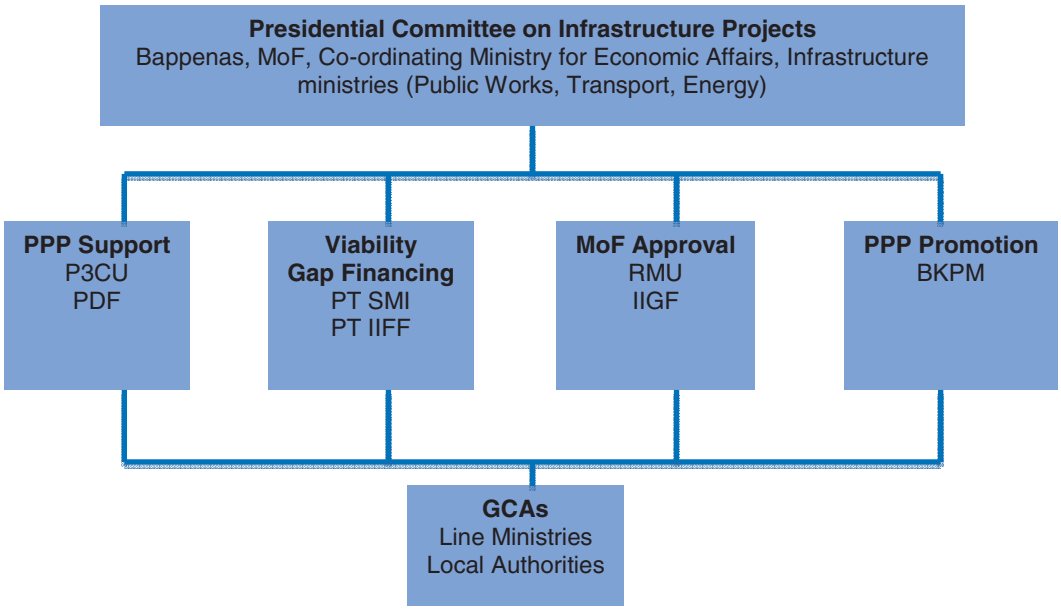
- The responsibility to ensure coherence is allocated to the president's office, with the president (or vice president) chairing a high-level inter-ministerial committee responsible for the prioritisation and governance of projects to ensure that the portfolio of projects comply with the overall policy strategy and objectives of government.

Given the existing government structures in Indonesia, the second option above seems to be the most appropriate. A presidential committee for infrastructure projects chaired by the president, in which Bappenas, the MoF, the Co-ordinating Ministry for Economic Affairs as well as some of the line ministries responsible for infrastructure development are represented, could be an efficient structure. In this committee especially Bappenas, the MoF and the Co-ordinating Ministry for Economic Affairs could be expected to play key roles. Compared to the more focused role of the line ministries, Bappenas' role follows from its more holistic tradition of economic planning, while the MoF role follows from the need to maintain sound budgetary practices and ensure that the planning conforms to the budgetary envelope. The Co-ordinating Ministry for Economic Affairs' role stems naturally from its function as co-ordinator of policy. The presidential committee would seem the ideal place to combine these three different views. Collectively this body would also work as a champion for PPPs creating a demand for line ministries and agencies developing such projects.

Bappenas' role in this committee can be further expanded to resemble that of the Australian Infrastructure Commission. This Commission ranks all infrastructure projects, be these PPP or non-PPP projects, according to cost-benefit analysis, the results of which are published and subsequently prioritised by government and parliament. The United Kingdom too has a committee that considers all major infrastructure projects, be these PPP or non-PPP projects. Therefore, Bappenas could undertake the broader social cost-benefit analysis, the results of which are then published and prioritised by the presidential committee on infrastructure projects.

The above proposal is summarised in Figure 6.1 that sets out a proposed institutional setup for PPPs in Indonesia. In Figure 6.1 the Presidential Committee on Infrastructure Projects ensures that all key players align their strategies and objectives to that of government. As mentioned above, Bappenas, the MoF and the Co-ordinating Ministry for Economic Affairs play key roles in this committee. The four boxes below this committee indicate the types of role players that GCAs need to engage in the PPP contract award cycle. These are PPP support (the P3CU and PDF), viability gap financing for projects that are borderline viable (PT SMI and PT IIFF), MoF approval (RMU and the IIGF) and PPP promotion (BKPM).

Figure 6.1. An institutional setup for PPPs in Indonesia



Note: See Acronyms and Abbreviations p. 11.

Once the presidential committee on infrastructure projects has approved a project, the GCA needs to initially assess whether delivering the project through a PPP or through traditional procurement represents the best value for money. If the PPP mode of delivery is selected the project enters the PPP project pipeline. In this pipeline the P3CU assists GCAs in preparing PPP documentation to ensure that the project proposal and documentation comply with the criteria set by, among other, the MoF and international and domestic investors. The PDF might provide financial support to GCAs to prepare the project proposal and documentation. Projects that are borderline viable might then also need to obtain viability gap financing to ensure that the project is fully viable before the MoF can provide final approval. While input from PT SMI and PT IIFF informs the decision-making process, viability gap financing is processed within the Ministry of Finance. MoF approval entails for the project to pass through the gateway process of approval discussed below. Note that obtaining viability gap funding and MoF approval are two processes that will probably run concurrently, though for final MoF approval the viability gap financing must be in place. Finally, BKPM undertakes the promotion of PPPs. Throughout all faces the GCA would be the key promoter of the PPP, but would be supported and scrutinised by the above-mentioned institutions at the various key stages.

Furthermore, throughout the contract cycle the different actors should report to the presidential committee on progress made.

Pursuing PPPs for reasons of value for money and/or augmenting the public purse

Historically there are several reasons why countries implemented PPPs. These included *inter alia*:

1. A pursuit of value for money, and the associated selection of PPPs because of public sector and bureaucratic inefficiency and perceived private sector efficiency;

2. Augmenting public sector financial resources and getting projects off the books of government to ensure that individual government entities and government as a whole do not exceed a pre-specified budget envelope and concomitant balance sheet liabilities.

However, through experience and a better theoretical understanding developed over time, value for money came to be accepted as the principal and foremost reason to consider using PPPs instead of traditional infrastructure procurement. In addition, the literature also shows that PPPs do not necessarily deliver the desired value for money. Indeed, the literature identifies a list of preconditions that need to exist for PPPs to outperform traditional infrastructure procurement and represent value for money. These include requirements regarding competition, risk transfer and the measurability of risk and demand. These requirements are identified in Burger and Hawkesworth (2011, pp. 129-133) and reflected in the OECD Recommendation Number 6. A main lesson is that deriving value for money from a PPP is not a given and depends on institutional, market and project-level conditions.

The second reason for undertaking PPPs, augmenting public sector financial resources, is much more contentious and often based on a fallacy. In the case of a pure PPP, i.e. where the private partner will receive payment directly from government and not from end-users, the choice between traditional infrastructure procurement and a PPP means a choice between the following two options:

- In the case of traditional infrastructure procurement government incurs the initial debt to finance the asset and thereafter pays the operational expenditure and interest on the debt.

- In the case of a PPP the government incurs no additional debt to finance the asset, as the private partner is financing the asset through raising capital in the form of loans and equity. However, since the private partner needs to service this debt and pay operational expenditure in future, it will need to raise enough income in future from government in the form of its annual payment of fees or user charges. Of course the payment of these fees is contingent on the private partner delivering in accordance with its contract. However, unlike contingent liabilities that are not expected to realise, the payments due under a PPP contract, though not certain, are nevertheless expected to realise. Therefore, PPPs create a less than certain, but nevertheless expected liability on the books of government in the form of the present value of all the service fees and user charges that government is expected to make to the private operator of the PPP.

Comparing points (1) and (2) shows that in both the case of traditional infrastructure procurement and a PPP government faces a liability. In both cases it will need to allocate revenue in future to service debt (either public debt in the case of traditional infrastructure projects or private debt in the case of a PPP) and pay operational expenditure. The only difference is that in the case of traditional infrastructure procurement government directly services the debt and pays the operational expenditure, while in the case of a PPP government pays these indirectly by paying the private partner a fee or user charge, with the private partner then servicing the debt and paying the operational expenditure.

In the case of a concession (without a subsidy of government) the concessionaire carries demand risk. Thus, it incurs the initial debt to build the asset and thereafter needs to raise a user fee on final users that is high enough to ensure that it can service its debt, pay operating costs (and of course yield a dividend to its shareholders). Thus, in this case, unless government subsidises the concession or provides guarantees, there seems to be no potential liability on the books of government. This option is very often contrasted with the project being delivered through traditional infrastructure procurement where government is seen as the one paying for the servicing of the debt and the operational cost of the project by raising tax revenue. If the amount of revenue that government can be expected to raise in future is limited, it may render the project unaffordable (i.e. the project cannot be fitted within the budget envelope of the government contracting agency or government in total), which, in turn, cause some governments to view a PPP in the form of a concession as the alternative to fill the funding gap.

However, this comparison is fallacious, as it confuses the mode of financing with the mode of raising the revenue needed to service debt and pay operating expenditure. The proper comparison is not between paying for the project through raising government tax revenue and paying for it using user fees levied by a concessionaire on final users. Making this comparison is wrong as it presumes that government cannot levy user fees. The correct comparison is between a traditionally procured infrastructure project where the debt servicing and operational costs are paid for by user fees levied on final users, and a PPP concession where the debt servicing and operational costs are also paid for by user fees levied on final users.

The rationale for PPPs in Indonesia – the role of value for money and the funding gap

The limited role of value-for-money assessments in Indonesia

Value-for-money assessment appears to play a somewhat limited role in the decision as to whether or not a project should be undertaken. It also plays a limited role when government identifies which projects are suitable for potential PPP status. This does not in itself mean that the elements of what would normally constitute part of a value-for-money assessment do not appear in the project identification process, just that the focus on value for money is not explicit. The focus of the PPP identification process is largely on economic, financial and technical viability and the possibility to transfer risk. For water projects there is also an analysis of the institutional capacity of the sub-national authority to manage the PPP contract cycle (including their ability to evaluate tenders).

In road projects the Road Authority makes an assessment of the user benefit of the toll road in terms of the time that road users will save when using the road versus the possible tariff that can be levied on the road users (the so-called vehicle operating cost to establish whether or not the project will yield a net benefit. Whether the project is then

identified as a PPP then depends on whether the project will deliver a return that is sufficient to draw a private partner. A need for high levels of maintenance and quality output also serves as motivation for selecting a project as a possible PPP candidate. In addition, the minimum levels of maintenance and output are defined as the minimum service levels of the project and in existing concessions are monitored on a six-month basis. Tariffs are usually renegotiated every two years and adjusted with inflation. However, should the concessionaire fall short of the minimum service levels the tariff adjustment can be postponed until such time that the concessionaire complies with the minimum service levels.

Following from the above, it is recommended that the government of Indonesia develops a sectoral value-for-money assessment tool. This tool should focus on both the absolute and relative elements of value for money. With absolute value for money the question is whether the project represents value for money, while establishing relative value for money concerns the levels of value for money that different procurement options can deliver. Thus, relative value for money entails a comparison of the value for money that traditional infrastructure procurement, procurement through a PPP or – as may be particularly relevant for Indonesia – procurement through an SOE can deliver.

Value-for-money assessment encompasses the financial and technical viability analyses that thegovernment of Indonesia currently undertakes. However, value for money also entails other elements such as economy, efficiency and effectiveness (see Appendix in Burger and Hawkesworth, 2011). In general value for money can be defined as the optimal combination of quality, quantity, features and price of the project, calculated over the whole of the projects life. Thus, a value-for-money assessment requires an intertemporal assessment across the whole of the project's life and not only for the current budget year. Only when a whole-of-life approach is followed, can government really assess whether the project delivers optimal value for money, i.e. whether the quality and quantity and features of the project justifies the price paid over its whole life.

The value-for-money assessment should also take fully account of risk, so that all comparisons across procurement options are done on a fully risk-adjusted basis. In addition, care should be taken to price risk correctly and not under- or overestimate it.

The funding gap as the main motivation for undertaking PPPs in Indonesia

Prior to the Asian crisis public investment in Indonesia was at just below 10% of government expenditure. Many of these projects were undertaken by Indonesian SOEs and through other arrangements with the private sector where private operators were directly appointed to build and operate assets. However, in the aftermath of the Asian crisis in 1997 many of these projects turned out to be not financially viable. In addition, in the almost a decade and a half since the crisis government investment decreased sharply to about 4% of government expenditure. As a result there has been a large underinvestment in public infrastructure during this period. This includes almost all types of public infrastructure, ranging from power generation, roads, rail, ports, airports and water purification and distribution. The lack of investment has been ascribed mainly to the so-called funding gap, i.e. the government's budget envelope is insufficient to undertake enough investment. Thus, there is limited scope for government to raise more taxes in future. In addition, many of the sub-national government SOEs in water still have large outstanding debts stemming from the period prior to the Asian crisis and they are not allowed to borrow again unless they have repaid these debts.

To address the by now large backlog in infrastructure investment, the government of Indonesia launched the MP3EI. The MP3EI sets out the intention of the government to increase investment in all the types of infrastructure that in particular relates to connectivity in Indonesia. Thus, a large emphasis is placed on the development of six corridors, as well as inter-island linkages.

Largely because of the abovementioned budgetary limitations the government plans to rely mostly on the private sector to undertake the infrastructure investment set out in the MP3EI. Part of the private sector's contribution is in the form of PPPs, with the MP3EI indicating that PPPs should contribute 21% to the infrastructure investment (compared to traditional infrastructure investment by central and provincial governments being at about 10%). Many, if not most, of these PPPs will be in the form of concessions. One example is the various toll road projects envisaged. Other examples include independent power generators supplying power to PLN (the SOE responsible for the generation of electricity and envisaged to act as the public partner in many projects), with PLN then selling the electricity to sub-national authorities, which, in turn, sell it to final users.

Unfortunately, it seems that due to significant limits on the budgetary envelope of government the preference for PPPs stems from a confusion of the mode of finance with the mode of raising the revenue needed to service debt and pay operating expenditure. Thus, because of the limits to which tax revenue in future can be raised (and thereby limits the amount of debt government is now willing and able to incur to pay for infrastructure) and because of the limited ability by among other the sub-national authority water sector SOEs to borrow, the government plans to use PPPs mostly as concessions. It has been argued that these concessions will be able to raise debt that the government could not raise since the concessions will mostly be dependent on user fees levied on final users (though large state guarantees will also be required for the project to go ahead in most cases).

While there may very well be practical issues that inhibit tax increasing in particular circumstances, the above argument is problematic. In principle the government or an SOE can also levy user fees on final users, changing the mode of raising revenue for the project does not automatically imply the use of a PPP. Changing the mode of raising revenue (i.e. tax revenue versus user fees) will not render these projects more viable since the tax revenue base of government largely overlaps with the consumer base upon which either government or a private producer will levy direct user fees (if anything, the consumer base might be narrower). Thus, shifting payment from taxpayers to consumers will not render the project viable.

Furthermore, if the saving pool accessible to Indonesia is insufficient to finance public sector debt (i.e. bonds issued by general government and SOEs), then it will presumably also be too small to finance those very same projects via the private sector (either as pure private sector projects or as PPPs). Conversely, if the pool that the private sector can access is large enough to finance the projects, then, in principle, the public sector should also be able to do so. Given the government of Indonesia's consistently improving credit rating and long-term strong growth prospects it is also unclear why the market should be very hesitant to buy government bonds at a reasonable yield.

It would consequently appear to be of value to the government of Indonesia to clarify the reason PPPs are expected to deliver such a large part of the infrastructure gap. This is not to say that this mode of delivery is flawed or that the potential is not there, but PPPs are only one of several alternative delivery mechanisms and do not in themselves change

the basic dynamics of the Indonesian economy. In addition, to ensure value for money it may be more productive to decide which projects should be PPPs on a case-by-case basis rather than by virtue of a target for the stock of PPPs.

The absence of a strong gate-way process to secure value for money

As discussed above, once the presidential committee approved a project and the GCA identifies the project as a PPP project, the GCA needs to conduct a feasibility study. P3CU will provide technical assistance to GCA to compile the feasibility study. The feasibility study needs to contain an assessment of the economic, financial and technical feasibility of the project. In addition, the GCA also needs to consider social and environmental aspects. Once this is done, should the GCA wish to obtain government guarantees and fiscal support, it needs to submit the project proposal and feasibility study to the MoF, which should act as the gate-keeper for value-for-money considerations. In the case of guarantees, which most of these projects require, the IIGF assesses the different feasibility studies. Should, on the basis of the criteria set for economic, financial and technical feasibility, the IIGF be satisfied with the different feasibility studies, it will issue a guarantee to the winning bidder. Since investors will probably not be interested in the PPP without the guarantee, the IIGF role is the closest that the Indonesian authorities come to a gateway process to green-light PPP projects. A gateway process typically involves several stages, in each of which the GCA needs approval (green-lighting), from the MoF – as in South Africa and Victoria (Australia) – before it can proceed with the next stage.

From the gateway processes followed in South Africa and Victoria (Australia) it is clear that approval is required from the MoF. However, what is also clear is that the approval activities of the MoF occur in lockstep with the support activities of the PPP unit. This seems to be an element that is somewhat missing in Indonesia, which impedes securing value for money. In terms of governance it is in principle better if the advisory and approval functions are separated into two institutions. The different phases of a PPP project typically involve the following stages:

1. Planning;
2. Feasibility study;
3. Tender preparation;
4. Bidding and contract signing;
5. Construction; and
6. Operation.

Typically gateways can be implemented at the end of phases (1) to (4). Thus, the PPP unit will advise the GCA in the planning of the project, after which the MoF will consider whether the plan adheres to certain key characteristics required from a PPP. This check would look both at whether or not the project overall is worth doing and whether or not it looks prudent to pursue a PPP-procurement option for this capital asset (ideally a procurement option pre-test – see Burger and Hawkesworth, 2011). Once the GCA receives the green light from the MoF the PPP unit assists the GCA in conducting its feasibility study. This feasibility study includes a whole-of-life approach to assessing

value for money. Again the feasibility study is submitted to the MoF. Once the MoF provides a green light, the GCA can proceed with the preparation of the tender documentation. Along with the tender documentation the GCA should also prepare a public sector comparator (PSC) or equivalent value-for-money assessment tool that creates a benchmark/reference model against which the PPP bids can be compared to assess value for money. Again, the PPP unit assists the GCA. The GCA submits the tender documentation together with the PSC or equivalent benchmark/reference model to the MoF. Only if the MoF approves the documentation can the project be put out on tender. Once the GCA receives the bids it needs to select a preferred bidder. In doing so it needs to weigh up every bid against the PSC or equivalent benchmark/reference model. It also needs to conduct a due diligence on the preferred bidder. Should only one bid be received, the projects should be retendered. The GCA should submit all bids as well as its rationale for selecting the preferred bidder to the MoF, which then considers the documentation for approval. Simultaneously the CGA should, with the assistance of the PPP unit, prepare and negotiate the PPP contract and also submit that to the MoF for approval. Once the MoF is satisfied with the selection of the preferred bidder as well as the PPP contract, can the contract be signed. Once the contract is signed construction starts, followed by the operation of the PPP. The GCA needs to monitor (and therefore have the capacity to monitor) the construction and operation of the PPP project until termination. Should either the private partner or the GCA renegotiate a substantial part of the agreement, that contract alteration should go through the same gateway processes that new contracts go through.

While the above gateway process that ensures value for money does not at this point seem to be institutionalised in Indonesia, there presently are elements of the process that can be built upon. The P3CU assists the GCA in the beginning of the process, the RMU, MoF and the IIGF scrutinise the project's viability. It is still early days for PPPs in Indonesia and it takes time to build up a robust process that ensures value for money. However, an explicit focus on a coherent gateway process and the development of an explicit value for money tool will be worth prioritising in the near term.

6.6. Use the budgetary process transparently and ensure the integrity of the procurement process

PPP-procurement, the ordinary budget process and measures taken to ensure the integrity of the PPP procurement cycle

It should be born in mind that to date only one project has been brought to financial close based on the new framework for PPPs. Processes, methods and procedures will consequently be developed in the coming months and years. Indeed, the MoF is presently working on developing guidelines for determining viability gap financing (fiscal support) of PPP projects. At this point there has not been any direct fiscal support to PPPs, apart from the guarantees and subsidised loans issued by IIGF.

Large traditional infrastructure projects need to be submitted to Bappenas, the Cabinet and the MoF for approval if above a certain threshold. As mentioned above only those PPPs that require a government guarantee and/or fiscal support are submitted to the MoF (estimated to be the great majority of potential projects).

The question of affordability (i.e. whether the project life cycle costs fit within the medium-long term budget envelope of the GCA or government in total) is not addressed explicitly. In addition, there are substantial liabilities associated with PPPs in certain

sectors, such as energy and water, due to the large subsidies needed to maintain maximum prices for users. This is illustrated by the fact that up to 40% of discretionary budgetary spending goes towards funding energy subsidies in Indonesia. A lack of a method for assessing affordability might consequently pose a fiscal problem for Indonesia in the years ahead as the PPP programme is enlarged.

The MoF RMU assesses the fiscal risks that PPP projects represent in terms of contingent liabilities. The RMU prepares the "fiscal risk statement". This has been a part of the budget documentation since 2009. It is about 20 pages in length and discusses risks to the budget such as external global risks, contingent liabilities related to guarantees and other infrastructure projects and risks stemming from SOEs.

With regard to capital budgeting for traditional infrastructure construction Indonesia has the problem that the budget is compiled solely on a one year basis. Consequently the plan is to set up an off-budget fund that can secure financing of capital projects. It is not entirely clear why an off-budget fund is necessary. The most common method of appropriating for capital investment in OECD countries (16 countries) is to provide funding incrementally each year until the project is completed. No OECD countries set up off-budget funds as a general way to finance capital investment (OECD, n.d.).

As discussed further below an SOE can act as the public side in a PPP deal. In terms of the annual budget SOEs receive a subsidy according to their "public sector obligations" – i.e. where they perform public service tasks, typically in the form of politically set maximum utility charges born by consumers. This is appropriated via the annual budget and adjusted according to the budgeted and later realised loss the SOE incurs as a consequence of the public sector obligation activities.

International donors may undermine the MoF efforts to build and maintain a coherent pipeline process for infrastructure projects. This happens when donors cherry pick a project in co-operation with the line ministries and then present it to the MoF as a done deal. It is important that any donor funds are integrated into the budget process in order to make sure projects adhere to the overall government priorities.

PPP procurement is not subject to particular integrity or anti-corruption initiatives. However, anecdotal evidence suggests that since PPPs are subject to extensive scrutiny by many parties they may be less subject to the risk of corrupt practices. In addition a more transparent treatment in the budget documentation of PPPs would probably also add to this benefit.

The challenges of SOEs

Special care should be taken to ensure budgetary transparency of PPP covers the whole public sector (central, provincial and district/city authorities as well as SOEs). Similarly the roles of the different players should be transparent and not represent a conflict of interest. Currently SOEs still play a substantial role in infrastructure delivery in Indonesia. However, this role is problematic for two reasons:

- In some sectors the regulator-operator roles have not yet been separated and in those cases where it has been separated the relationship between the regulator and the operator is still very close, thereby possibly upsetting potential private investors.

- Some SOEs act as "private" bidders in PPP bids. This creates a conflict of interest for government, which as the owner of the SOEs, have to decide between bids received from both the SOEs and private bidders.

The main sectors affected by these problems are some of the main infrastructure sectors, mainly roads, ports and airports as well as water, discussed below. In the energy sector PLN usually acts as the public partner and not a private partner.

There are 17 toll roads operated by the SOE and another 11 by private partners. Most of these projects had their genesis in the 1980s. Approximately 760 km of road are operated as toll roads, of which more than 50% are operated by the SOE. In addition, there are also 24 projects where award to a concessionaire occurred, but where the project stalled because of land acquisition problems. With the reform that occurred following the introduction of Law 38/2004 the role of the toll road authority and the toll road SOE changed significantly. Prior to the introduction of the law contracts were awarded to the SOE. However, after the introduction of the law a competitive bid process is followed, with private bidders bidding together with the SOE for contracts. Agreements are then concluded between the Roads Authority and the successful bidder, which therefore might be either a private bidder or the SOE. Therefore, the SOE might assume the role of the private partner in the PPP agreement. The possible role of the SOEs as potential "private" partners, competing with truly private bidders creates a clash of interest for the government, as the government has an ownership interest in the SOE and thus, in one of the parties competing for contracts. Such a clash of interest may undermine the integrity of the tender process and scare potential investors away.

PT Pelindo I, PT Pelindo II, PT Pelindo III, and PT Pelindo IV are SOEs that operate most ports in Indonesia. Legislation passed to separate the operator and regulator functions, leaving the Ministry of Transport as regulator and the Pelindos as the operators. However, the government has not yet finished writing the implementing regulations needed to fully operationalise the new legislation. It is planned for the Pelindos to operate as fully corporatised entities. There are two airports operating as corporatised SOEs, but as with ports, there is legislation to separate the operator and regulatory functions, with implementing regulations still being written.

Water is mainly a function of the sub-national authorities, of which there are roughly 400. Each sub-national authority also operates its own water SOE. As mentioned above, there are five PPPs in the pipeline, two of which are classified as potential PPPs and the other three as ready for offer. As with roads, SOEs are allowed to enter bids together with private bidders. Therefore, again, there is a clash of interest for the government.

Though SOEs are corporatised and therefore, in principle, operate at an arm's length from the government, concern may still exist about the closeness of the relationship between the regulating/contracting authorities and the various SOEs. This concern is further strengthened given that in some sectors such as ports government has not yet finalised the implementing regulations to give effect to the separation of the operator and regulator functions in those sectors.

There is also a possible conflict of interest, with the government having to decide between awarding a contract to a private firm, or a firm in which it, as the government, is the main (or in many cases the only) shareholder. To rectify this situation the government will have to distinguish clearly between PPP procurement (which excludes SOEs from the bidding process) and public-*public* partnerships procurement (which are agreements between the government and SOEs, but excludes private bidding). The government could

then still draw up a comparator to establish whether a PPP with a private firm or a public-*public* partnership with an SOE will deliver the most value for money. Nevertheless, making a clear distinction between the two forms of procurement and not allowing SOEs to bid against private firms will prevent a conflict of interest that would undermine the legitimacy of the bidding process. This is not an issue that has come to the fore as of yet. Indeed the only PPP gone through under the new regulation has been where the SOE represented the public side. However, as the PPP programme expands these issues should be addressed. If these issues are not addressed, they may undermine the integrity of the procurement process and scare investors away.

6.7. Policy options for consideration

Important elements of a good PPP framework for Indonesia are in place. This includes regulation and institutional roles. As with many countries there are some measures that should improve performance. This is to be expected as the new PPP framework is in its infancy. It should also be emphasised that a key element in developing a good framework for PPPs is by constantly refining the system based on lessons learnt in its application.

- ***The government should consider the creation of a presidential committee for infrastructure projects, chaired by the President, in which Bappenas, the MoF, the Co-ordinating Ministry for Economic Affairs, as well as some of the line ministries responsible for infrastructure development are represented.***

The committee should ensure that all actors in the government align their infrastructure decisions with the overall strategy and objectives of the government. It should prioritise projects and act as the champion of PPP policy in order to overcome bureaucratic inertia. By anchoring the process at the highest political level legitimacy, momentum and whole of the government prioritisation will be ensured.

- ***The government should take steps to strengthen capacity within the GCAs with regards to all the key phases of PPP procurement. A special emphasis on planning, feasibility studies and the preparation of tenders should be beneficial.***
- ***Such capacity enhancement requires a stronger PPP Unit that can support the GCAs throughout the procurement process.***

The most appropriate model for this PPP Unit might be as an independent agency that closely aligns with the MoF. This is the model used in the United Kingdom. In addition, the PDF and PT SMI should eliminate any duplication.

- ***The MoF should play a key role at all gateway stages of the project and act as a gate-keeper.***

All infrastructure investment decisions, be these PPP or non-PPP projects, should be subject to scrutiny and approval by the MoF. This will place PPP and non-PPP projects on the same footing. The link between the PPP project process, RMU and MoF budget process should be strengthened. Special care should be taken to identifying and assessing contingent liabilities. Affordability analysis should be strengthened.

- ***Value for money should be the basis on which to select projects.***

Filling the funding gap should not in itself be the main motivation for selecting PPPs as a mode of procurement. Value-for-money assessment should be done both for absolute and relative value for money. Absolute value for money concerns whether or not a project

represents value for money for society. Relative value for money concerns the relative value for money delivered by the various modes of procurement (traditional vs. PPP). In assessing value for money, the government should take a whole-of-life approach that considers the present value of future costs and benefits. Only on this basis can a proper assessment of value for money be made. In addition, the government should use a public sector comparator or equivalent benchmark/reference model against which it compares bids received.

- ***Effort should be put into developing a shortlist of a handful of relatively straight-forward PPP projects.***

A well known sector where the public side already has experience, such as roads, might be the relevant. There is human capacity to assess road projects in the Toll Road Authority and it is a fairly standard product. It should be set in motion at the central government level and rolled out to sub-national governments when a good standard model has been established based on experiences.

- ***A clear distinction should be made between PPPs procurement (which excludes SOEs from the bidding process) and public-public partnerships procurement (which are agreements between the government and SOEs, but excludes private bidding).***

The government could then still draw up a comparator to establish whether a PPP with a private firm, or a public-public partnership with an SOE will deliver the most value for money compared to traditional infrastructure procurement. Making a clear distinction between the two forms of procurement will prevent a conflict of interest undermining the legitimacy of the bidding process.

- ***The government should consider using international transaction advisors for high priority projects.***

This will ensure that project proposals and feasibility studies are done with the quality and sophistication required by international investors.

- ***Donors should not be able to cherry pick infrastructure projects and by-pass the ordinary gateway and budgetary process.***
- ***Preferably the government of Indonesia should follow the example of South Africa and not engage in unsolicited bids.***

However, should it decide to engage in unsolicited bids, it should, following the example of Korea, subject these bids to much higher standards than it applies to normal transactions to ensure the legitimacy and integrity of the procurement process.

Notes

1. The UK count includes only PFIs, and not PPPs falling under a wider definition. For Italy the number excludes approximately 2 000 concessions.
2. Excludes concessions, and includes only those PPPs falling under the authority of the PPP unit.

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Contents

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Chapter 2. Government capacity to assure high quality regulation
Chapter 3. Competition law and policy
Chapter 4. Market openness
Chapter 5. Regulatory and competition issues in ports, rail and shipping
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