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Regulatory reform

ENHANCING REGULATORY QUALITY AND COHERENCE THROUGH GOOD REGULATORY PRACTICE

- Regulatory quality and coherence, supported by the use of good regulatory practice, is essential to effectively deliver better economic and social outcomes.
- There is no single entity in Indonesia responsible for a whole-of-government approach to regulatory quality and for providing oversight and co-ordination.
- A review by the Indonesian Ministry of Finance recommended abrogating over one third of subnational regulations. Beyond revoking these regulations authorities need to sustain efforts to ensure regulations remain up to date, coherent and cost-effective at all levels of government.
- Indonesia is committed to openness and stakeholder engagement in rulemaking, but there are no guidelines or standards to ensure that regulation is informed by legitimate needs and serves the public interest.

What's the issue?

The advent of democracy and "big bang" decentralisation in Indonesia has not been sufficient to deliver a fit-for-purpose regulatory regime that facilitates trade and the functioning of the market economy. Rather, the extensive institutional transformation within the Indonesian administration over the past decade and a half has resulted in a complex and sometimes disorderly policy-making process. Likewise, rapid decentralisation has resulted in many instances of regulatory discord across the national economy. The Ministry of Finance examined over 13 000 sub-national regulations and recommended that 37% be abrogated. So far, only 36% of those recommended to be invalidated have been revoked.

Good regulatory practice is critical to improving productivity and competitiveness through reducing the regulatory burden on industries and facilitating the participation of micro, small and medium businesses in the formal economy. Good regulatory practice is also key for country's public sector governance, including evidence-based, open and inclusive stakeholder policy making.

As a result of poor regulatory practice, companies that do business in Indonesia suffer from substantial red tape and bureaucracy. The country ranks only 114 in the World Banks' Ease of Doing Business Index, behind countries such as the Philippines, China and Vietnam, and well behind Thailand and Malaysia. The country also imposes rather strict rules on Foreign Direct Investment (FDI) inflows as indicated by the OECD's FDI Regulatory Restrictiveness Index (see Figure). Compared to other countries, Indonesia is particularly strict with respect to foreign equity limitations and restrictions on the employment of foreigners as key personnel.

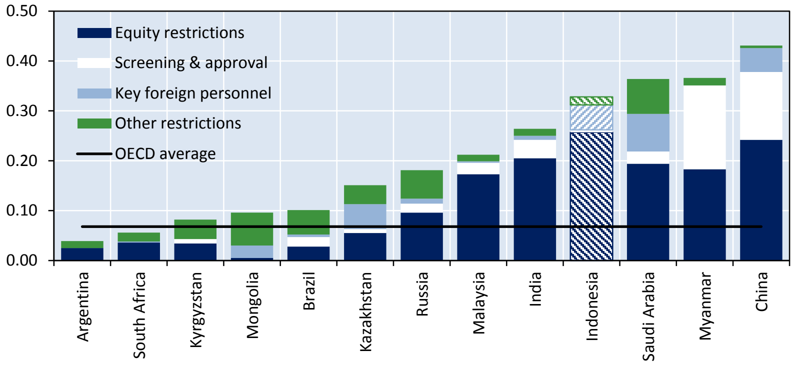
Why is this important for Indonesia?

Weaknesses in good regulatory practice remain a key challenge for improving government effectiveness, achieving greater coherence between different laws and regulations (both domestically and vis-à-vis other countries) and, ultimately, making it easier to do business in Indonesia. Improved evidence-based decision making is needed, together with widespread support for an agenda that cuts across ministerial responsibilities, levels of government and national borders. Such practices would allow Indonesia to realise the economic dividend from political democracy and to rationalise the regulatory complexities from decentralisation. Regulatory coherence will also be a critical condition for taking full advantage of the ASEAN Economic Community. This will in turn benefit consumers who will have access to a cheaper and wider range of goods and services and enjoy more extensive consumer protection.

There has been a growing awareness and understanding in Indonesia of the need for good regulatory practice for economic development and delivery of President Joko Widodo's Nine Priorities (Nawa Cita). The National Medium-Term Development Plan 2015-19 acknowledges the significance of regulatory coherence and each individual priority includes for the first time explicit strategies to strengthen the regulatory framework. Good regulatory practice is thus set to be the next major domain for public sector governance reform.

Indonesia imposes heavy restrictions on FDI inflows

FDI regulatory restrictiveness index, from 0 (least restrictive) to 1 (most restrictive)



Source: OECD, FDI Regulatory Restrictiveness Database, http://www.oecd.org/investment/fdiindex.htm.

What should policymakers do?

- Ensure strong co-ordination and rigorous oversight of national and subnational level regulatory frameworks, their coherence and insertion in international frameworks (such as ASEAN) by giving an institution positioned close to the centre of government formal responsibility for regulatory quality.
- Reduce unnecessary burdens on business by reviewing the stock of significant regulations, including FDI restrictions, in National Medium Term Development Plan priority sectors (especially SMEs) and taking steps to eliminate regulations that are no longer needed.
- Develop more effective stakeholder engagement mechanisms to generate genuinely open and user-centric regulation in rulemaking processes and accessible forward regulatory plans to enable early notification of regulatory initiatives.

Further reading

OECD (2014), *OECD Framework for Regulatory Policy Evaluation*, OECD Publishing. http://dx.doi.org/10.1787/9789264214453-en

OECD (2013), *International Regulatory Co-operation: Addressing Global Challenges*, OECD Publishing. http://dx.doi.org/10.1787/9789264200463-en

OECD (2012), *OECD Reviews of Regulatory Reform: Indonesia*, OECD Publishing. http://www.oecd.org/gov/regulatory-policy/indonesia.htm

OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*. http://www.oecd.org/gov/regulatory-policy/2012-recommendation.htm