

# Aid for Trade in Lowering Trade Costs

Overcoming Infrastructure and Institutional Constraints | Indonesia

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# Acknowledgements

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ANZTEC	The Agreement between New Zealand and the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu on Economic Cooperation
APEC	Asian Pacific Economic Cooperation Forum
ASTEP	The Agreement between Singapore and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu on Economic Partnership
ASEAN	Association of South East Asian Nations
CEP	Pacific Three Closer Economic Partnership
DPP	The Democratic Progressive Party (Taiwan)
ECFA	Cross-Strait Economic Cooperation Framework Agreement
EU	European Union
FTA	Free Trade Area or Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GPA	WTO Government Procurement Agreement
ICT	Information and Communications Technology
ITA	WTO Information Technology Agreement
KMT	The Kuomintang (political party in Taiwan)
KORUS	Free Trade Agreement between the United States of America and the Republic of Korea
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
P4	Pacific Four (Brunei Darussalam, Chile, Singapore, and New Zealand)
PPP	Purchasing Power Parity
PRC	Peoples' Republic of China
PTA	Preferential Trading Arrangements
RCEP	Regional Comprehensive Economic Partnership Agreement
ROOs	Rules of Origin
SPS	Sanitary and Phytosanitary
TBT	Technical Barrier to Trade
TPSEP	Trans-Pacific Economic Partnership Agreement
TPP	Trans-Pacific Partnership Agreement
TRIPS	WTO Agreement on Trade-Related Intellectual Property Rights
US	United States of America
USD	United States Dollars
WTO	World Trade Organization

# Executive Summary

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This study takes a hard and somewhat sobering look at the state of Indonesia's physical (hard) and institutional (soft) infrastructure as the country moves into its second year under the presidential leadership of the recently elected Joko Widodo. The study's focus is predominantly on how well (or poorly) the country is currently positioned to benefit from the positive and welfare enhancing effects of trade and investment liberalization, something that the country implicitly agreed to embrace when - together with over 120 other economies - it became a founding member of the World Trade Organization in 1995.

We first examine some critical infrastructure bottlenecks as they affect roads, electricity generation and ports and conclude that, although the country has made some progress in addressing these, there is still much that needs to be done. What is more is that policymakers – including President Widodo himself - are mistaken if they think the only thing missing is money. Recent efforts to attract foreign investment have not foundered on the lack of opportunities but rather the perceived deteriorating predictability and soundness of the business and investment climate in Indonesia. In this section we conclude that these hard infrastructure bottlenecks are ultimately holding back Indonesia's integration into regional value chains and the global trading system more generally by artificially raising both transaction and logistics costs by substantial margins, and that in the absence of genuine and concerted efforts to address them, no amount of Aid for Trade can significantly alleviate matters.

The next section of the report focuses on the institutional constraints holding back Indonesia's integration into the world trading system, particularly the glaring shortcomings that affect the judiciary and law enforcement, as well as the legislative and executive branches of government. We show here that without genuine and effective will at the highest levels of the country's political leadership, to both confront and effectively tackle the very real constraints undermining the smooth functioning of the country's legal system and bureaucratic administration, there can be no genuine or well-founded hope that the country will be able to move beyond the parochialism, patronage and corruption that currently afflicts it at every level, despite the best intentions of the cleanest and most unencumbered president the country has enjoyed for many generations. This section also discusses the role that Aid for Trade and other technical assistance and capacity building frameworks can and should play in addressing the very specific shortcomings that prevail in the Indonesian context.

Our report then turns to an analysis of the prevailing import and export regimes and finds that these are becoming more rather than less restrictive as various actors at different levels of government seek to establish and assert their permit-issuing powers in a barely concealed effort to generate rents as well as induce shortages that connected parties can benefit from commercially. This is a phenomenon that has not gone unnoticed by Indonesia's trading partners, and has seen a number of disputes initiated at the WTO. This section also discusses the contribution that some of the fixes prescribed under Aid for Trade frameworks could contribute to alleviating the constraints afflicting Indonesia in this policy area.

Finally our report turns to a brief discussion of the need to implement genuine and effective reform, arguing that this is what the Indonesian people voted for when they elected President Widodo, and discusses how the new president has fared in the face of entrenched elites and well-organized opposing interests. We conclude that policymakers in Indonesia need to take another long hard look at how they ultimately perceive the national economic interest and how trade and investment liberalization frameworks like the WTO, ASEAN and the still ongoing RCEP negotiations can be harnessed to realize the ambitions of the new president and the electorate who voted for him.

# Infrastructure Constraints

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## I. Preliminary Observations on Infrastructure

In this section we focus on three key infrastructure constraints that are most commonly cited in the economic development and competitiveness literature as it relates to Indonesia, namely roads, ports and power. A few comments are in order so as to place these properly in the context of Aid for Trade, or rather to assist the reader in understating precisely how these three components align themselves in terms of potentially positioning Indonesia to benefit more fully from the opportunities that greater integration into regional and global trade networks would inevitably afford the country.

**Roads** are of course an important element to a nation's transport infrastructure, and are generally the most important means of moving goods (and people) around, especially in the absence of effectively navigable rivers and/or sufficient railroad capacity. The availability and quality of roads affect such factors as the ease, speed and thus ultimately the cost at which goods can be moved overland, but they also affect how easily people can move around, particularly how quickly they can get to their places of work. In this way the quality of a nation's road infrastructure plays a not insignificant role in influencing levels of people's labor productivity, something that is not always recognized in the relevant literature. Productivity in turn is a key factor in determining how cost-effectively goods and services can be manufactured or provided, and so labor productivity plays an important role in determining a nation's overall competitiveness. Thus there are two very obvious ways in which road infrastructure affects a country's ability to trade competitively: (1) the cost of moving goods from where they are imported or manufactured to where they are consumed (logistics); and (2) the ease with which people can move from their homes to their workplaces (transport connectivity).

The role played by **ports** in facilitating international trade is pretty obvious and does not need to be elucidated in too much detail in these introductory remarks. Suffice to say that various factors affect the efficacy at which ports operate, including their frequency (i.e. how many ports are servicing a given geographical space), their size (how much freight they can manage), the quality of equipment used in on- and offloading, how professionally they are operated, and various other factors. Apart from the obvious constraints imposed by frequency, size and equipment-quality, the real game-changer in terms of improving the flow of goods in and out of ports in Indonesia seems to very much process-related constraints in the form of improving coordination between the different government agencies that must clear goods for entry (or exit) before they can physically leave the port. Thus the challenge here is simply to reduce red tape, as well as to harmonize and streamline procedures. We examine the problems faced here in Indonesia in more detail below.

Finally **power** is the lifeblood of any modern industrial economy without which simply nothing can work as intended. A country that cannot produce enough power and distribute it efficiently (cheaply) and effectively (to everyone that needs it) will inevitably suffer all kinds of negative knock-on effects up and down supply and production chains. In Indonesia this has been a long-festering sore that successive governments have either ignored or failed to address with sufficient vigor. And Indonesia is now starting to pay the cost of this lapse as it tries to move up value chains across a broad range of industrial and manufacturing processes. The ease and cost-effectiveness of access to reliable electricity affects so many processes in the manufacture, transport and consumption of goods and services in the modern era that it is inevitably a large part of any country's economic competitiveness and thus the contestability of its exports on global markets.

## II. Roads

### 1. Inadequacy of the Status Quo

Road transport plays an inordinately important role in moving goods and people around Indonesia representing the chosen mode of transport for some 70 percent of freight tonnage per kilometer and 82 percent of passengers per kilometer.<sup>1</sup> According to the most recently available data (2013), Indonesia has a reported 508,968 km of road network<sup>2</sup>, with the lion's share (80.7 percent) of these roads being district roads, and only 0.2 percent comprising the much faster and better-maintained toll roads. According to the two most important indicators, namely demographic road density<sup>3</sup> and spatial road density<sup>4</sup>, Indonesia ranks about average in comparison to its regional and international peers, coming in at number 84 from 134 countries surveyed in terms of just how much road infrastructure there is available. Based on survey data compiled by the World Economic Forum (2014-2015), the quality of Indonesia's roads, which ranks at 72 from a total of 144 countries surveyed, is inferior to that of regional leaders such as Singapore (6), Malaysia (19), China (49) and Thailand (50), but is slightly better than India (76) and the Philippines (87), as well as being considerably ahead of Vietnam (104).

Also in terms of its spatial distribution, there is a significant disconnect between Indonesia's existing road infrastructure and the centers of economic activity. Whereas some 81 percent of the nation's GDP is contributed by either Java or Sumatra, these two islands only enjoy approximately 58 percent of the country's road networks. Even between these two islands, glaring disparities exist with Sumatra being three times larger than Java, but having only 10% more roads.<sup>5</sup> Another factor often cited when discussing asymmetries in the country's road infrastructure is that resource rich areas such as Kalimantan, Sulawesi and Papua are massively underserved in terms of the availability and the quality of roads, and that this deficit is a key factor in holding back more rapid and inclusive economic development for these regions. In fact, outside of the main economic centers (particularly Jakarta), the quality of roads deteriorates rapidly and significantly, exacerbating the relative isolation of rural communities, with all kind of negative knock-on effects for local economies. This is discussed in more detail below.

Investment in improving the system of roads first built under Dutch colonial administration was almost entirely non-existent until the late 1970s and 1980s, when this was finally addressed. However investment in building new roads started to lag someone in the early 1990s and then stopped almost entirely as a result of the 1997 Asian Financial Crisis, the effects of which were particularly damaging for the Indonesian economy. The level of investment spending on roads only returned to pre-crisis levels after 2010, but given the rate of economic growth and the number of new vehicles being added to the

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<sup>1</sup> See: *Investing in Indonesia's Roads: Improving Efficiency and Closing the Financing Gap*, (Road Sector Public Expenditure Review 2012), available at: <http://documents.worldbank.org/curated/en/2012/06/16847940/investing-indonesias-roads-improving-efficiency-closing-financing-gap>, (accessed 15 May 2015.)

<sup>2</sup> This figure care of world highways, available at: <http://www.worldhighways.com/categories/road-highway-structures/news/indonesias-road-network-continues-to-grow/> (accessed 15 May 2015).

<sup>3</sup> 1.5 km per 1,000 people (2009)

<sup>4</sup> 190 km per 1,000 km<sup>2</sup> (2009)

<sup>5</sup> See: Standard Chartered, *Special Report Indonesia – Infrastructure bottlenecks*, 2011, available at: [https://research.standardchartered.com/configuration/ROW%20Documents/Indonesia%20-%20Infrastructure%20bottlenecks\\_14\\_02\\_11\\_06\\_16.pdf](https://research.standardchartered.com/configuration/ROW%20Documents/Indonesia%20-%20Infrastructure%20bottlenecks_14_02_11_06_16.pdf) (accessed 15 May 2015).

roads every year<sup>6</sup>, a significant increase in infrastructure spending on Indonesia's road network would have been necessary just to maintain the status quo.

## 2. Slow Pace of Road Infrastructure Development

The need to improve the quantity and quality of roads is slowly being recognized by policymakers and figured predominantly in the context of a broader infrastructure upgrading initiative championed by former President Susilo Bambang Yudhoyono (SBY), known as the "Masterplan for Acceleration and Expansion of Indonesia's Economic Development", which was published in 2011 and envisaged an implementation period running thru 2025. The Masterplan focuses on developing new and upgrading existing infrastructure across five different economic corridors<sup>7</sup>, with much of these efforts being directed at improving the availability and quality of road connectivity across these areas. It remains to be seen whether the Masterplan was just a vision document or is considered by policymakers to be a more practical roadmap guiding their decisions between now and 2025.

Most of the government's efforts in improving and expanding the stock of Indonesia's road infrastructure appears to be directed at building new toll roads, since this is the easiest way to attract investment from the private sector. The figure most often touted is the objective of building 1,095km of new toll roads<sup>8</sup>, including a 775 kilometer-long toll road linking the two main ports on Java, namely Tanjung Priok in Jakarta and Tanjung Perak in Surabaya (we discuss these two ports in more detail in the next section).<sup>9</sup> However, given the vast distances involved in a nation as geographically sizeable as Indonesia<sup>10</sup> and the very obvious shortcomings in the country's road network, the touted figure of 1,095km seems woefully inadequate. The construction of toll roads, which began in 1978, has been glacially slow, with the World Bank claiming that in the period spanning 1978 to 2013, only 742 km of toll roads had been successfully completed.<sup>11</sup> Another toll-road project that has suffered chronic delays, with no date yet in sight for its completion is the planned 900-kilometer Trans Java Toll Road. The latest phase of this route to be completed is the 116-kilometer long toll road connecting Cikampek (just outside Jakarta) to Palimanan, near the coastal city of Cirebon in West Java.<sup>12</sup> The Jakarta-Cirebon leg is just one of 20 segments on the Trans Java Toll Road, some of which are operational, while others are still very much at the planning stage.<sup>13</sup>

As alluded to above, the Government of Indonesia spends relatively little on building new or maintaining existing road infrastructure. Although different statistics exist, it is clear that infrastructure spending in general amounts to less than 2 percent of country GDP, with other large countries in the region, particularly India and China spending much closer to 10 percent of their respective GDPs on infrastructure. Of the 2 percent of GDP that is spent by the government on infrastructure, about 40% of that is earmarked for roads, which is surprisingly little given how important roads are to moving goods

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<sup>6</sup> The World Bank (2012) cited above, (KPMG 2013) claims that the number of vehicles on Indonesian roads has increased 300% since 2001.

<sup>7</sup> Sumatra, Java, Kalimantan, Sulawesi, Bali-Nusa Tenggara, and Papua Kepulauan Maluku.

<sup>8</sup> This figure cited in KPMG, Investing in Indonesia, 2013, available at: <http://www.kpmg.com/Ca/en/External%20Documents/investing-in-indonesia-2013.pdf> (accessed 15 May 2015).

<sup>9</sup> See <http://www.indonesia-investments.com/news/news-columns/indonesia-infrastructure-update-plans-for-toll-road-from-jakarta-to-surabaya/item1181>, (accessed 15 May 2015).

<sup>10</sup> Indonesia is the 15th largest country in the world.

<sup>11</sup> World Bank (2012), p. 32; KPMG (2013), p. 8 notes that only 85 km of the planned 1,095 km target for new toll roads had been developed in the five years prior to 2013.

<sup>12</sup> See the very poignant analysis of the road opening ceremony provided by Kevin O'Rourke in his June 19, 2015 installment of *Reformasi Weekly Review*, at p. 8 f.

<sup>13</sup> See Kevin O'Rourke in, *Reformasi Weekly Review*, 17 April 2015, p. 13.

and people around the country (see above). In addition to the fact that so little money is spent on the country's road infrastructure, it is generally recognized that a not insignificant portion of this funding is disbursed in ways that are sub-optimal (essentially wasted), due to mismanagement, lax oversight in the awarding of government procurement contracts, and the existence of a bloated and ineffective road bureaucracy.

A significant portion of the problems suffered on Indonesia's roads (congestion, poor quality of existing road network) stems from a number of key institutional constraints that can essentially be said to be all pervasive across the country as a whole. One such constraint is the legal environment as well as the policy-disconnect between national and local regulatory practices. Thus it is not uncommon that local governments are reported to be in the business of issuing permits and licenses, as well as imposing user charges, many of which have no basis in the law. According to one survey conducted by the Asia Foundation, these can include "local user charges; legal and illegal payments at weigh bridges; and payments to police or *preman* (criminal organizations)".<sup>14</sup> The same Asia Foundation survey reported that weight limits for transport vehicles (trucks) were also violated as a matter of routine and that weigh stations often engaged in rent-seeking behavior (soliciting illegal payments), allowing many overloaded trucks to pass as long as the necessary payments were made.<sup>15</sup>

The most commonly-cited bottleneck to faster rollout of road building is the land acquisition and clearance processes. As Standard Chartered points out in a recent (2011) report, Unlike say, China, in Indonesia, "relocating people who are living on land needed for [road construction] projects – even squatters, who have no legal right to live there – requires government compensation that must be approved by the parliament and the state auditor".<sup>16</sup> It was initially hoped that the 2012 Law on Land Procurement for Public Infrastructure would bring some relief in this regard but since its enactment it has been revised twice and is still widely viewed as in need of some serious tweaking before it is an effective tool in clearing the way for faster land acquisition.<sup>17</sup> The most recent developments to the 2012 Law on Land Procurement involve the coming into force in January 2015 of a 2012 implementing regulation. The implementing regulation allows the government to exercise eminent domain against recalcitrant landowners who refuse to accept independently appraised compensation values. However, so far government officials have seemed unwilling to invoke the land-acquisition powers newly entrusted to them under the implementing regulation.<sup>18</sup>

Be that as it may, the real issue affecting the slow pace of building more roads (apart from the lack of willingness by the national and provincial governments to earmark more funding for doing so as discussed above), seems to very closely linked with problems that go right to the heart of the very dysfunctional ways in which Indonesia has been governed in the past and in many ways continues to be governed today. As a recently published study points out, the system of governing by patronage so widely practiced in the Soeharto era resulted in rampant abuse in the administration of land with authorities manipulating land ownership in order to pursue economic rents, the legacy of which continued to encumber land acquisition procedures in the present day. Indeed, it was Soeharto who is

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<sup>14</sup> Asia Foundation, *The Cost of Moving Goods: Road Transportation, Regulations and Charges in Indonesia*, 2008, available at: <http://asiafoundation.org/resources/pdfs/movinggoodslightenglish.pdf>, (accessed on 15 May 2015), p. 5.

<sup>15</sup> The Asia Foundation survey reported that "trucks along the nine routes surveyed are typically overloaded by 45%, or 4 metric tons over the maximum legal load, because regulations on weigh stations are not enforced", *ibid*.

<sup>16</sup> Standard Chartered, *infra*, p. 4.

<sup>17</sup> See The Jakarta Post, *Land rule revised to speed up projects*, published on 17 February 2015, available at: <http://www.thejakartapost.com/news/2015/02/17/land-rule-revised-speed-projects.html> (accessed 15 May 2015).

<sup>18</sup> See Kevin O'Rourke, *Reformasi Weekly Review*, 19 June, 2015, at p. 9.

reported to have divided up the land comprising the planned Trans Java Toll Road into a total of twenty concessions, awarding concessions over these segments as a "form of patronage".<sup>19</sup> Today, many if not all of these 20 concessions are allegedly still owned by economically powerful and politically connected groups or individuals, including current Vice President Jusuf Kalla, and other heavyweights such as Aburizal Bakrie (the leader of the main opposition party Golkar and himself at the helm of a very powerful industrial conglomerate). The political influence players such as these enjoy is certainly sufficient to hinder efforts at revoking concessions when those awarded them are guilty of or complicit in non-performance that effectively chokes progress on completion of the planned Trans Java Toll Road.

### 3. Raising Costs - Reducing Competitiveness

As touched upon above under Preliminary Observations, the poor state of the country's road transport network has many knock-on effects that raise the cost of moving goods and people around, thus undermining the country's competitiveness. The lack of proper connectivity increases the relative isolation of rural areas, stunting the rural economy, meaning that for anyone living outside of the main economic centers (i.e. the majority of the country) there are few well-paying jobs, which in turn undermines economic growth, exacerbates the rural-urban divide, entrenches rural poverty and keeps the country as a whole from realizing anywhere near its full potential.

The most direct cost the lack of road connectivity imposes is of course on logistics. According to a much-cited study by the Indonesian Chamber of Commerce and Industry (Kadin), in Indonesia, approximately 17 percent of a given company's total outlays involve paying for logistics, with the comparative benchmark figure for other economies in the region being below ten percent.<sup>20</sup> Another telling statistic is the percentage of GDP absorbed by logistics costs, which a 2013 World Bank study estimated to be 27 percent, compared to 13 percent in Malaysia, 8 percent in Singapore or 9.9 percent in the United States.<sup>21</sup> The same study by the World Bank estimated that the main element of the various components that comprise logistics costs (namely transportation, administration and inventory) was transportation, which absorbed an estimated 12.04% of GDP.<sup>22</sup>

The link between good connectivity, low logistics costs and economic competitiveness are well established<sup>23</sup> and are being increasingly emphasized in the emerging literature on global value chains<sup>24</sup>. Donor-funded support initiatives for supply-side infrastructure under the WTO Aid for Trade program have also not been lacking in other countries that experience even worse logistics bottlenecks than Indonesia.<sup>25</sup> There is also no shortage of funding from multilateral lending agencies like the Asian Development Bank, which is heavily involved in the financing of road infrastructure throughout the region in countries like India and Bangladesh. The real question is the desirability of using the WTO Aid

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<sup>19</sup> Jamie S. Davidson, *Indonesia's Changing Political Economy: Governing the Roads*, Cambridge University Press 2015.

<sup>20</sup> See: <http://www.indonesia-investments.com/business/risks/infrastructure/item381> (accessed on 15 May 2015).

<sup>21</sup> See World Bank, *State of Logistics Indonesia 2013*, available at: <http://www.indonesia-investments.com/upload/documenten/world-bank-state-of-logistics-indonesia-2013.pdf>, (accessed on 15 May 2015). at p. 18

<sup>22</sup> *Ibid.*

<sup>23</sup> See for example: World Bank, *Connecting to Compete; Trade Logistics in the Global Economy*, 2014, available at: <http://www.worldbank.org/content/dam/Worldbank/document/Trade/LPI2014.pdf>, (accessed on 15 May 2015);

<sup>24</sup> See, by way of an introduction to the literature, Jeffrey Neilson, Bill Pritchard & Henry Wai-chung Yeung, "Global value chains and global production networks in the changing international political economy: An introduction", in: *Review of International Political Economy*, February 2014, available at: <http://www.tandfonline.com/doi/pdf/10.1080/09692290.2013.873369>, (accessed on 15 May 2015).

<sup>25</sup> See: Ben Shepherd (for OECD & WTO), *Aid for Trade and Value Chains in Transport and Logistics*, 2013, available at: [https://www.wto.org/english/tratop\\_e/devel\\_e/a4t\\_e/global\\_review13prog\\_e/transport\\_and\\_logistics\\_28june.pdf](https://www.wto.org/english/tratop_e/devel_e/a4t_e/global_review13prog_e/transport_and_logistics_28june.pdf), accessed on (15 May 2015). (Shepherd 2013)

for Trade initiative to help Indonesia in overcoming its road-infrastructure bottlenecks when so many of these problems seem to be self-inflicted. This is a topic we return to later in this publication, arguing that what Indonesia really needs is root-and-branch reform of existing systems of political governance and administration, as well as an overhaul of the institutional frameworks governing the enactment, interpretation and enforcement of the country's laws. In the absence of a commitment to such reform at the highest levels of the Indonesian government and both the willingness and capacity to see through reforms even in the face of opposition from entrenched and well-organized vested interests, there is little point in directing Aid for Trade funding or indeed any other form of development assistance to Indonesia, unless it is directed at pointing out the true costs incurred by the nation as a whole in perpetuating the status quo. This is an uncomfortable truth that much of the development community in Indonesia and indeed the Indonesian political and business elite or even the electorate as a whole has yet to confront. We return to this theme in subsequent sections of this report.

### III. Ports

#### 1. Poor Performance by Regional and Global Benchmarks

Despite Indonesia being a nation comprising some 17,508 islands, (of which about 6,000 are inhabited), and long being part of global shipping routes thanks to the historical spice trade, its port infrastructure is still characterized by chronic underinvestment and insufficient capacity. One particularly telling anecdote was offered by way of a remark made several years ago at the opening ceremony of a new construction project of Kalibaru Port in North Jakarta, where the official presiding over the ceremony noted the importance of the new project in light of the fact that existing port of Tanjung Priok (Indonesia's largest and most important port in Jakarta) had not benefited from any substantial expansion work for over 130 years.<sup>26</sup> But the lack of proper infrastructure is part of a larger problem, as summarized by the World Bank in its 2015 report *State of Logistics Indonesia* "inadequate port capacity and navigational aids, bunching of vessels, limited cargo handling facilities, high down time of equipment, low labor productivity and shortage of storage space, all contribute to the low efficiency of Indonesian ports".<sup>27</sup>

A 2011 study by Standard Chartered<sup>28</sup> (using data from 2009) reported that there were roughly 645 seaports operating in Indonesia, of which some 111 were commercial seaports operated by one of four SOEs entrusted with managing commercial shipping in Indonesia, with the remainder being government operated. Only four ports are classified as "Prime" meaning that they are suitable for international container shipping (Port Tanjung Priok Jakarta, Port Tanjung Perak Surabaya, Port Belawan Medan and Port Makassar), with another 14 categorized as "Class 1", also generally considered suitable to handle some international shipping activity (the most important such Class 1 port would arguably be Benoa Port in Denpasar, Bali).

Tanjung Priok in Jakarta is the country's most important commercial shipping hub, followed by Tanjung Perak in Surabaya, both of which are currently operating above capacity (Tanjung Priok significantly so). Tanjung Priok currently handles over two-thirds of Indonesia's international shipping volumes, which are rising at a steady clip, further exacerbating efforts to improve port-handling efficiency (see below). Reported processing volumes differ depending on sources, but according to statistics published by the World Shipping Council<sup>29</sup>, Tanjung Priok processed some 5.65 million TEU<sup>30</sup> in 2011, which in 2013, had

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<sup>26</sup> Quoted in World Bank, *State of Logistics Indonesia 2013*, *infra*, at p. 26.

<sup>27</sup> World Bank, *State of Logistics Indonesia 2015*, at p. 11. (World Bank 2015)

<sup>28</sup> Standard Chartered, *infra*, p. 13.

<sup>29</sup> See: <http://www.worldshipping.org/about-the-industry/global-trade/top-50-world-container-ports> (accessed on 15 May 2015).

risen to 6.59 million TEU. By way of comparison, in 2013, the port at Shanghai China is reported by the same source to have processed 33.62 million TEU (thus more than 5 times that achieved at Tanjung Priok), with the comparable figure for Singapore being 32.6 million TEU. Neighboring Tanjung Pelepas, in Malaysia processed some 7.63 million TEU in 2013. Expansion work is currently under way at Tanjung Priok to increase its annual capacity to 9 million TEU by 2020, however even this is unlikely to keep up with demand, since some sources report that as early as 2015, Tanjung Priok will be required to process up to 7 million TEU of container traffic. But it's not just in terms of its processing capacity that Tanjung Priok is behind regional peers. It also faces constraints in terms of the size of vessels it can cater to. It can only berth vessels of up to 50,000 deadweight tones (DWT). This compares very negatively with the port of Singapore, where maximum DWT levels are 150,000, or even with Port Klang in Malaysia which can berth vessels up to 130,000 DWT.<sup>31</sup>

The World Economic Forum has also commented on the problem, in the context of its research and cross-country comparisons on competitiveness<sup>32</sup>. In its most recent (2011) Indonesia Competitiveness Report, the WEF concluded that from the 139 countries surveyed, Indonesia's ports ranked low at 96<sup>th</sup> place, coming just ahead of Vietnam (97<sup>th</sup> place), and scored even worse than Cambodia's ports (82<sup>nd</sup>) despite the fact that Cambodia scores considerably lower on most other metrics of economic development than Indonesia (Cambodia is after all an LDC, whereas Indonesia is a lower middle income developing country). The only bright spot reported by the WEF was that Indonesia's ports seemed to score better than the Philippines (131<sup>st</sup>).<sup>33</sup> The WEF also cites UNCTAD's Liner Shipping Connectivity Index, noting that it "confirms the magnitude of the problem", with Indonesia's score remaining largely static since 2004, and where Indonesia ranks 41<sup>st</sup> out of the 162 countries that UNCTAD includes in the Index. The WEF calls this "... alarmingly low compared with best-performing China, 3rd-ranked Singapore and Malaysia (10<sup>th</sup> place)."

The World Bank, particularly its Indonesian office, is perhaps the organization that is currently the most intimately engaged with identifying and addressing the many constraints facing Indonesia's system of ports, particularly the slow flow of international container traffic through Tanjung Priok and Tanjung Perak.<sup>34</sup> The World Bank's focus has been on the slow turnaround times for container ships berthing at the two ports and offloading/onloading cargo (particularly containers). The Bank's interest in this is driven by the costs this imposes on logistics and the knock-on effects this has on prices for consumers (as well as the various implications this has on poverty alleviation, the Bank's core concern). In its report *State of Logistics 2013*, which includes a case study on Indonesia's busiest port at Tanjung Priok, the Bank notes that "the average import container dwell time (DT)<sup>35</sup> at Tanjung Priok has increased from 4.8

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<sup>30</sup> Twenty-foot equivalent unit (TEU or teu). Note that, although it is often used to compare the capacity of container terminals, it is in reality an inexact unit of cargo capacity often used to describe the capacity of container ships and container terminals.

<sup>31</sup> Standard and Chartered, *infra*, p. 14.

<sup>32</sup> World Economic Forum (WEF), *The Indonesia Competitiveness Report 2011: Sustaining the Growth Momentum*, available at: [http://www3.weforum.org/docs/WEF\\_GCR\\_Indonesia\\_Report\\_2011.pdf](http://www3.weforum.org/docs/WEF_GCR_Indonesia_Report_2011.pdf), p. 12.

<sup>33</sup> This statement seems to fly in the face of data presented by Standard Chartered, *infra*, at p. 15, where at least for Subic, the Philippine port scores considerably better than Tanjung Priok on a number of metrics including container cargo handling speeds, or vessel berthing times.

<sup>34</sup> See by way of an entry point to much of the World Bank's current and ongoing efforts on this particular area: <http://www.worldbank.org/en/news/feature/2014/02/19/moving-cargo-faster-in-indonesia-main-sea-port> (accessed on 15 May 2015).

<sup>35</sup> The World Bank focuses very heavily on the concept of "dwell time" or "DT" and uses it as an indicator for efficiency. In doing so it defines dwell time as "the moment of unloading the container of the vessel to the moment a container is out of the gate of the port area", whereby the central idea is that "reducing the average dwell time of containers is to be considered as a cost-effective measure to optimize terminal throughput". The World Bank notes that "[a] reduction in dwell time of import containers would not only increase the number of containers that a terminal can handle, but also reduce general logistics costs as it reduces the lead time in the supply chain.", World Bank (2015), at p. 11 and 12 and 15.

days in October 2010 to 6.4 days in November 2012".<sup>36</sup> In its 2015 report on the *State of Logistics in Indonesia*, the World Bank reveals that things are as bad if not worse at the country's second major port in Surabaya, Tanjung Perak, where the average dwell time in January and February 2013 was 8.98 days.<sup>37</sup> This stacks up fairly poorly in international comparisons. Dwell times in Rotterdam for the same time period were reported as being 6 days, whereas in Singapore it is just 1.1 days.<sup>38</sup> In fact the Bank's trade team in Jakarta has been so successful in highlighting this issue that it has made it on to the policy radar of the current presidential administration, with President Widodo making repeated visits to the port at Tanjung Priok and angrily reprimanding senior officials about the lack of progress in reducing dwell times.<sup>39</sup>

## 2. Identifying and Addressing Problems

In its analytical work, the World Bank breaks down the constraints causing excessively long and ever-lengthening dwell times into three basic components, namely (i) the so-called upstream phase, which covers the time between the arrival of the ship and the submission of the import declaration to Customs; (ii) the customs clearance phase; and finally (iii) the so-called down-stream phase, which comprises the time after which the goods have been cleared to enter the customs territory of Indonesia and they are physically removed from the port.<sup>40</sup> Interestingly the Bank notes that the actual customs clearance phase stacks up relatively well in comparison with international benchmarks, undoubtedly as a result of several decades worth of efforts to improve the professionalism of services delivery at Customs, starting in 1985 when President Suharto appointed a Swiss firm (Société Générale de Surveillance - SGS) to oversee and improve the efficiency of customs clearance procedures by instituting pre-shipment inspection.<sup>41</sup> The World Bank notes that customs clearance compromises just one day of an average container ship's 6 plus days of dwell time. When deciding on where to focus its efficiency-enhancing policy recommendations, the World Bank also notes that speeding up things in the down-stream segment would require a more comprehensive approach to improving the port and surrounding road infrastructure as well as what it refers to as a "deeper transformation of the trucking industry".<sup>42</sup> The following graphic demonstrates the problem and isolates the bottlenecks succinctly and neatly.

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<sup>36</sup> World Bank (2013), p. 27.

<sup>37</sup> The World Bank went on to disclose that in fact, dwell time would have been 10 days if the transfer of containers to other storage facilities were included (i.e. the full length of the downstream component); see World Bank (2015), at p. 10.

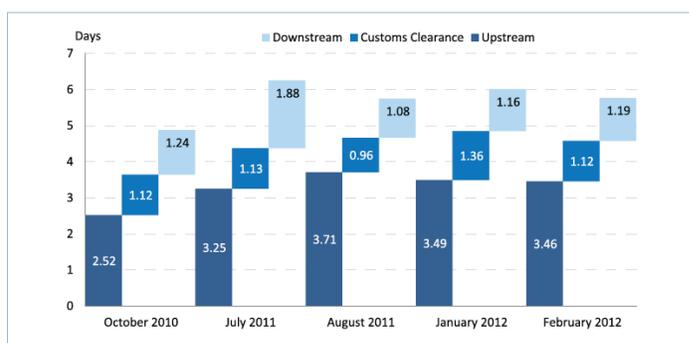
<sup>38</sup> World Bank (2015), p. 15.

<sup>39</sup> See "President Jokowi unhappy with long dwelling time at ports" at <http://www.republika.co.id/berita/en/national-politics/15/06/21/nq9asf-president-jokowi-unhappy-with-long-dwelling-time-at-ports> (accessed 30 June 2015).

<sup>40</sup> World Bank (2015), p. 15.

<sup>41</sup> See: Jeff Meyers and Julia Oliver (for SAIS), *Customs Reform in Indonesia: A Case Study*, 2010, available at: <http://www.sais-jhu.edu/sites/default/files/resource-article/files/Indonesia-Customs-Reform.pdf> (accessed 15 May 2015).

<sup>42</sup> World Bank (2013), p. 29.

**Figure 1 Dwell-Time Components and Average Times (in days)**

**Source: World Bank, *State of Logistics in Indonesia, 2013*, p. 29, citing data provided by Jakarta International Container Terminal (JICT) and DG Customs**

The situation is reported as being similar in Tanjung Perak in Surabaya, with the pre-clearance phase taking up the lion's share of average dwell times (53.79%), whereby this phase is understood to comprise unloading containers from the ship, stacking them in the container yard, preparing import declaration documentation ("PIB"), and payment of taxes and customs duties. Where customs clearance was contingent on physical inspection of containers, this phase went from being one that took up relatively little dwell time to one that on average takes up 41.94% of total DT.<sup>43</sup>

In the analytical work that the World Bank has been doing in both Tanjung Priok in Jakarta and Tanjung Perak in Surabaya, it has identified a number of process-related bottlenecks as the main problem in speeding up efficiency. One of the main issues is the lack of 24/7 operations, so that banking, customs, freight forwarding and other services are not available after hours (after 3pm in the case of banks for Tanjung Priok). Another (related) problem is that the other government agencies required to process approvals, particularly the National Agency for Food and Drug Control (BPOM) and the quarantine service of the Ministry of Agriculture (MOA) do not have people on site around the clock and seven days a week who have the decision-making authority on whether or not to clear specific shipments. Finally, implementation of the Indonesian National Single Window (INSW) has not so far extended to agencies like BPOM and the MOA so that they do not have access to the IT systems used by the INSW. Various efforts promoted by the World Bank to remedy these bottlenecks have all run into one form of policy inertia or another.

### **3. Broader Ramifications on Competitiveness and Poverty Alleviation Efforts**

Even during the days of the New Order regime the link between kick-starting a competitive manufacturing sector and the existence of reliable and efficient port procedures was recognized by Suharto and his team of Berkley-trained economists.<sup>44</sup> The more recent economic literature has also documented and quantified the very obvious links between economic development and trade facilitation - a major component of which is the availability, quality and efficiency of existing port infrastructure.<sup>45</sup>

<sup>43</sup> World Bank (2015), p. 10.

<sup>44</sup> See Meyers and Oliver (2010), *infra*.

<sup>45</sup> See for example, John S. Wilson, Catherine L. Mann and Tsunehiro Otsuki, "Trade Facilitation and Economic Development: A New Approach to Quantifying the Impact", in: *The World Bank Economic Review*, Vol. 17, No. 3 (2003), pp. 367-389.

Ever since the days of Adam Smith it has been recognized that ports have an important multiplier effect on commerce.<sup>46</sup> Historically ports have played a very important role in establishing major urban centers such as Constantinople or Venice, or in modern times New York, Montreal, Hong Kong and Shanghai. To paraphrase two well-known transport economists, Jean-Paul Rodrigue and Joseph Schulman, it is not surprising that most of the world's major cities, started out as port cities, even if other and ultimately more important areas of economic activity subsequently eclipsed their ports.<sup>47</sup> Jakarta also is a city that started out as a small port on the estuary of the Ciliwung River, and was chosen to be a trade and administrative center of the Dutch East India Company due to its proximity to the ocean and its navigable waterways.<sup>48</sup>

Much like transport infrastructure in general, the availability, quality and efficiency of port infrastructure can have three different kinds of impact, as has been well documented in the relevant economic literature.<sup>49</sup> The first, referred to as direct or induced, is where improvements to transport infrastructure have an enabling effect on employment, with knock-on effects for moving up value chains, providing access to larger markets, and producing time and cost savings. The second kind of impact, referred to as indirect, involves various outcomes attributable to the multiplier effects of falling prices for commodities, goods and services or alternatively an increase in the variety available thereof. Here it is the linkages between those sectors that benefit the most from improvements in transport infrastructure that are causal in an upswing in activity for other economic sectors that play an almost infinitely wide range of supporting roles (from providing office supplies to underwriting insurance). The third kind of impact is referred to as "related" and involves those businesses whose business models benefit partially from an improvement in transport infrastructure. For example, the luxury goods retail sector benefits when it becomes easier and cheaper to import luxury consumer items (and does not need to pass these savings on to consumers because of the inelastic nature of demand for these goods), or the hospitality industry benefits when importing alcoholic beverages becomes less cumbersome and more predictable.<sup>50</sup>

In Indonesia, the benefits of an improvement in logistics services in general and in the ease and efficiency of port operations in particular, are easily perceivable and would have far-reaching positive knock-on effects for all sectors of economic activity, with the benefits felt by firms involved in manufacturing, those involved in heavy industries (e.g. steel), extractive industries such as coal or iron ore or for Indonesia's very large retail sector. In today's economic reality, characterized by increasing levels of production and supply chain fragmentation, where inputs are sourced regionally and globally, the importance of an efficient network of ports far outweighs the benefits that were on offer back in the 1980s when President Suharto was seeking to give a boost to domestic manufacturing. The current presidential leadership seems to be more than aware of this, given statements made by President Jokowi at a recent visit conducted to the port of Tanjung Priok in Jakarta, his second since he was elected in 2014. The Indonesian President expressed anger at officials that dwell times had not

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<sup>46</sup> It was Adam Smith who argued in 1776 that "As by means of water-carriage, a more extensive market is opened to every sort of industry than what land-carriage alone can afford it, so it is upon the sea-coast, and along the banks of navigable rivers, that industry of every kind naturally begins to subdivide and improve itself ..."; cited by Claudio Ferrari (for the OECD) in: *Ports and Regional Economic Development*, 2011, available at: <http://www.oecd.org/gov/regional-policy/49456330.pdf> (accessed on 15 May 2015).

<sup>47</sup> See Jean-Paul Rodrigue and Joseph Schulman, *The Economic Impacts of Port Investments*, 1998 available at: <http://people.hofstra.edu/geotrans/eng/ch7en/appl7en/ch7a5en.html>, (accessed on 15 May 2015).

<sup>48</sup> Susan Abeyasekera, *Jakarta: A History*, Oxford University Press, 1990, at pp. 25 *et seq.*

<sup>49</sup> Jean-Paul Rodrigue, Claude Comtois and Brian Slack, *The Geography of Transport Systems*, Routledge, 3<sup>rd</sup> edition, 2013, p. 227.

<sup>50</sup> In 2008 Bali, and important holiday destination for western tourists, was essentially "dry" as the importation of alcoholic beverages became almost impossible due to sudden changes in import regulations that only made it possible to import these items through one of the country's ports (and no longer into Bali directly).

improved since his last visit and noted that improving the efficiency of port operations would have important ramifications on domestic prices across the whole island of Java.<sup>51</sup>

It is for this reason that so much of the World Bank's focus in Indonesian over the last few years has been on improving the state of logistics in the country, with a great deal of energy also expended on improving efficiency at the two major ports in Jakarta and Surabaya (as discussed in some detail above). As the World Bank puts it

"The deterioration of DT in Indonesia's most important international port adversely affects the country's economy in three ways. First, export-oriented industries are impacted by uncertainties due to the delays, reducing the competitiveness of Indonesian products abroad. Just-in-time inventory in manufacturing, in which firms tightly manage their schedules for importing raw materials and re-exporting finished goods, suffers even more, hampering Indonesia's transition to becoming an integral part of efficient worldwide supply-chains. It is important to note that about 19 percent of the inputs for foreign and export-oriented firms are imported. Second, the bottlenecks at the port have serious consequences in terms of costs for domestic businesses and ultimately in the prices paid by consumers. Lastly, Tanjung Priok is an integral part of the city environment, and the blockages add to the already dysfunctional traffic, which in turn also worsens the congestion in the port. As an example, the recent city floods caused the dwell-time to rise to 8 days in January 2013."<sup>52</sup>

Although improvements to the functioning of its ports is just one way in which Indonesia could reduce logistics costs, the experience of other developing countries in the region, particularly China, show that this is one part of the trade infrastructure puzzle that should not be neglected.

## IV. Power

### 1. Strong Demand Outstripping Weak Growth in Supply

Despite sitting on massive deposits of steam coal and natural gas, and despite its position as the world's biggest exporter of palm oil biodiesel and the most volcanically active country on the planet, (with the massive potential this entails for harnessing geothermal energy), Indonesia is remarkably energy insecure. This dichotomy is to a certain extent attributable to some truly daunting geographical obstacles, but more than any other factor, the deficiencies in the country's energy and electric power sectors are man-made and the legacy of bad politics as well as poor regulatory and institutional frameworks.

With only some 83 percent<sup>53</sup> of households in Indonesia enjoying access to publicly provided electricity, the country has one of the lowest electrification rates in the region<sup>54</sup>. Vietnam by way of comparison has an electrification rate of 96 percent, whereas Malaysia's is 99.3 percent.<sup>55</sup> But also across the country electrification levels vary enormously, with Jakarta enjoying a first-world electrification rate of 99.99%,

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<sup>51</sup> See: <http://nasional.news.viva.co.id/news/read/639349-jokowi-marah-marah-di-tanjung-priok--ini-kronologinya> (accessed on 20 June 2015).

<sup>52</sup> World Bank (2013), p. 27.

<sup>53</sup> See: Ernst and Young, *Opportunities and challenges of the Indonesian electrification drive*, March 2015, available at: [http://www.ey.com/Publication/vwLUAssets/opportunities-and-challenges-of-the-indonesian-electrification-drive-february-2015/\\$FILE/ey-opportunitiesand-challenges-of-the-indonesian-electrification-drive.pdf](http://www.ey.com/Publication/vwLUAssets/opportunities-and-challenges-of-the-indonesian-electrification-drive-february-2015/$FILE/ey-opportunitiesand-challenges-of-the-indonesian-electrification-drive.pdf) (accessed on 15 May 2015).

<sup>54</sup> PDR Lao and Myanmar both score considerably, at 34 and 49 percent respectively; See: IEA and ERIA, *South East Asia Energy Outlook, 2013*, available at: [https://www.iea.org/publications/freepublications/publication/SoutheastAsiaEnergyOutlook\\_WEO2013SpecialReport.pdf](https://www.iea.org/publications/freepublications/publication/SoutheastAsiaEnergyOutlook_WEO2013SpecialReport.pdf) (accessed on 15 May 2015), at p. 27.

<sup>55</sup> These figures from <http://data.worldbank.org/indicator/EG.ELC.ACCS.ZS>, (accessed on 15 May 2015).

whereas Papua languishes at the bottom of the scale at only 35.89%.<sup>56</sup> Although estimates vary, it is safe to say that between 60 and 70 million people currently lack access to electricity in Indonesia.

**Figure 2 Regional Electrification Rates**

Country	Electrification rate	Unelectrified population (million aprox)
Indonesia	83%	62.4
Philippines	89.7%	9.5
Vietnam	97.3%	2.1
Thailand	99.3%	0.5
Malaysia	99.4%	0.2
Singapore	100%	0.0

**Source:** PricewaterhouseCoopers, *Power in Indonesia, Investment and Tax Guide*, April 2013, 2<sup>nd</sup> edition, and Ernst and Young, *Opportunities and challenges of the Indonesian electrification drive*, March 2015

As is to be expected of any country with relatively robust economic growth and a quickly emerging middle class, electricity consumption in Indonesia has been growing rapidly from a total of 76 million MWh in 2000 to 187.54 million MWh in 2013.<sup>57</sup> The main "growth sector" in terms of electricity consumption has been households, which now consume more electricity than industry (65 million MWh as opposed to 55 million MWh for industry). Energy demand in Indonesia has in fact outstripped the rate of economic development and population growth. Demand for electricity is projected to continue its steep rise (growing at an average of about 9% per annum) to reach 328.3 million MWh by 2020.<sup>58</sup> The Indonesian power system consists of eight domestic interconnected systems and 600 isolated grids, with a state-owned enterprise (SOE) Perusahaan Listrik Negara (PLN) operating over 5000 power stations across the archipelago. The generating capacity of this grid in 2013 was 163.966 million MWh, considerably below the 187.54 million MWh that Indonesian consumers demanded. In 2013, the amount of electricity supplied (including electricity produced and purchased, amounted to some 216.19 million MWh, with the Government of Indonesia importing some 52.22 million MWh of that from neighboring countries. Indonesia's domestically produced electricity only manages to cover about 87.43% of the total electricity consumed.<sup>59</sup>

Production fell below consumption for the first time in 2004 and this situation has steadily deteriorated ever since. The result is rolling blackouts averaging just under 4 hours per day at repeated intervals during any given day across the main islands of economic activity including Java, Bali, Sulawesi and Sumatra (the latter is reported as being the worst hit by recurrent blackouts). This despite policy pronouncements by the highest levels of government that scheduled rolling blackouts were officially a thing of the past.<sup>60</sup>

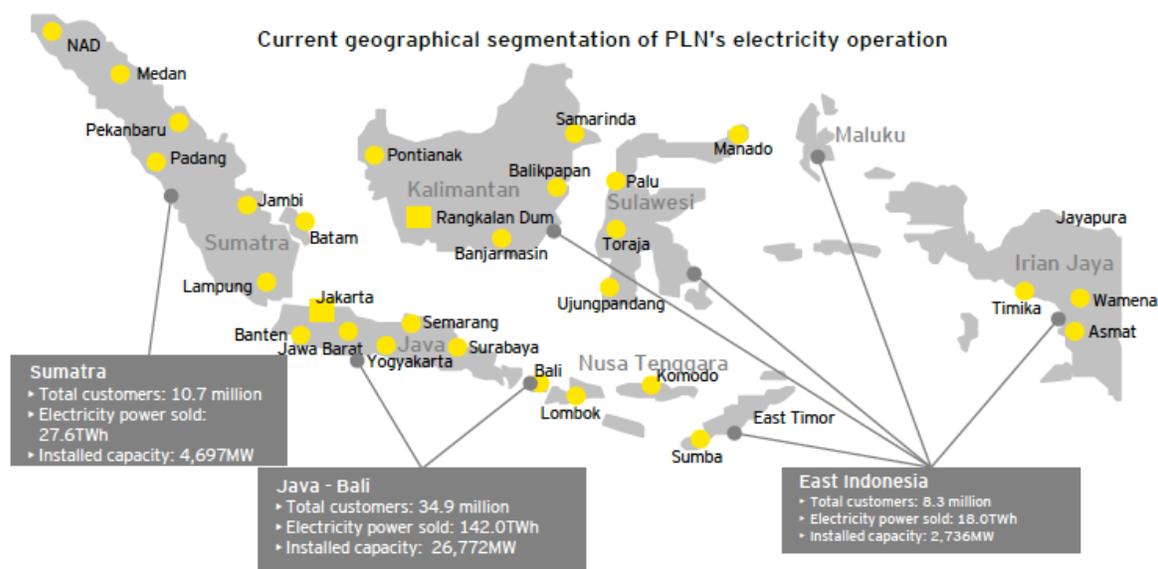
<sup>56</sup> See: presentation by Galih Honggo Baskoro, *Power generation and energy - Electricity Issues in Indonesia*, 28 April, 2014, available at: <http://www.slideshare.net/GalihBaskoro/power-generation-and-energy-electricity-issues-in-indonesia> (accessed on 15 May 2015).

<sup>57</sup> See: <http://www.ceicdata.com/en/blog/keeping-indonesia's-rising-energy-needs> (accessed on 15 May 2015).

<sup>58</sup> See: <http://www.powermag.com/indonesia-energy-rich-and-electricity-poor/> (accessed on 15 May 2015).

<sup>59</sup> See: <http://www.ceicdata.com/en/blog/keeping-indonesia's-rising-energy-needs> (accessed on 15 May 2015).

<sup>60</sup> See: <http://thejakartaglobe.beritasatu.com/archive/sby-inaugurates-blackout-free-era/> (accessed on 20 June 2015); see also: <http://thejakartaglobe.beritasatu.com/news/jakarta/power-outages-continue-jakarta-tangerang/> (accessed on 20 June 2015).

**Figure 3 Geographic Distribution of PLN's Generating Capacity**

Source: Ernst and Young, *Opportunities and challenges of the Indonesian electrification drive*, March 2015

## 2. Problems Looking for Solutions

Efforts to reform the electricity sector began in 2002, with the enactment of a new Electricity Law<sup>61</sup> intended to liberalize the Indonesian power sector, and allowing for the first time, independent power providers (IPPs) to both produce and sell electricity directly to customers. The previous law (enacted in 1985)<sup>62</sup> had allowed private entities to generate electricity but not to sell it to customers directly, since it was enacted to formalize the position of PLN as monopoly supplier. The 2002 Law sought to change this but was ultimately struck down by the Constitutional Court some two years after coming into force. It was only in 2009 that the government of SBY enacted Law No. 30 of 2009 concerning Electricity, which is the law in force today governing the electricity sector in Indonesia. The 2009 Electricity Law conserves the central role of PLN in the power supply of Indonesia, by giving it a right of first refusal to purchase electricity generated by IPPs and allows some scope for regional governments to outsource their power generation needs to regionally owned entities, private sector players or cooperatives, particularly where PLN has declined to do so due to lack of economic viability.

Starting in 2005, the government of SBY also enacted new legislation on public private partnerships primarily with a view to stimulating investment in infrastructure projects.<sup>63</sup> This was part of a broader push, championed by SBY, to revitalize the nation's infrastructure, the most visible symbols of which were two large-scale infrastructure summits in 2005 and 2006.<sup>64</sup> In 2006, the Government of Indonesia launched a program entitled Fast Track I, with the goal of building 42 coal-fired steam plants, some ten

<sup>61</sup> Law No. 20/2012 on Electricity, see PricewaterhouseCoopers, *infra*, at p. 18.

<sup>62</sup> Law No. 15 of 1985 on Electricity.

<sup>63</sup> Presidential Regulation No. 67 of 2005 on Cooperation Between Government and Business Entity in Provision of Infrastructure.

<sup>64</sup> See Aswicahyono, H. and D. Friawan (2008), *Infrastructure Development in Indonesia*, in: Kumar, N. (ed.), "International Infrastructure Development in East Asia – Towards Balanced Regional Development and Integration", ERIA Research Project Report 2007-2, Chiba: IDE-JETRO, pp.131-165, at p. 140.

of which were to be built on Java and Bali. The target capacity to be added as a result of Fast Track I was 10,000, MW by 2010. PLN was tasked with taking the lead in the construction of these plants. However, Fast Track I has been beset by various setbacks, so that by the end of 2013, only 63% of this total targeted capacity was being generated.<sup>65</sup> Exasperated with the slow pace of implementing Fast Track I, in 2010 the SBY Government announced the launch of Fast Track II with the aim of generating an additional 17,900 MW by 2016, involving 93 power plants (with hydro and geothermal set to play a role), and with 72 of these plants earmarked for PPPs. However Fast Track II has progressed even worse than Fast Track I, with private investors reluctant to step in. The recently elected President Jokowi has announced his own plans to launch a new program to build new plants to generate total capacity of 35 GW.<sup>66</sup>

Indonesia draws most of its electric power from oil (48%) with coal and gas providing almost all the rest (27 and 21 percent respectively). Although being itself the world's biggest producer and exporter of palm oil diesel, and despite it having the world's largest number of historically active volcanoes (78), geothermal and biofuel contribute relatively little to Indonesia's energy mix (as does hydropower), although this is slowly changing as geothermal power plants are slowly starting to be built and come online.

### 3. Identifying the Constraints

One of the many problems that plagues the power sector in Indonesia is the heavy reliance on subsidies, caused by the government imposing price ceilings on what the country's sole energy distributor PLN can charge for electricity that are considerably below its production costs. This means that consumers pay well below market rates for their electricity<sup>67</sup> and results in a situation where the revenue earned by producers only covers roughly two-thirds of the cost of producing it.<sup>68</sup> The market-distorting effects of this policy have been well documented, with many commentators calling for subsidized electricity to be phased out in a similar way to which subsidized gasoline was phased out at the start of 2015.<sup>69</sup>

The response of the Indonesian Government to its unfolding energy crisis has been somewhat slow in coming and relies on a very State-driven solution, without questioning the premise that a single state owned enterprise (PLN) should be allowed to dictate the future direction of Indonesia's electricity sector. Some commentators point to the dual role played by PLN as both the largest single supplier and regulator as being the principle factor restricting competition and inhibiting innovation in Indonesia's energy markets.<sup>70</sup> Although PLN no longer enjoys a monopoly in the generation of electricity its preeminence on the Indonesian electricity market is assured since it enjoys generous subsidies, still exercises a monopoly on transmission and distribution of electricity and presides over the Indonesian

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<sup>65</sup> See Ernst and Young, *infra*.

<sup>66</sup> See: <http://www.thejakartapost.com/news/2015/05/05/jokowi-launches-mega-power-plant-projects.html>. (accessed on 20 June 2015).

<sup>67</sup> The same was true until quite recently for gasoline, where successive governments had long provided massively distorting fuel subsidies. These were finally abolished on 1 January 2015; see: <http://www.wsj.com/articles/indonesia-scrap-gasoline-subsidies-1420004528> (accessed on 15 May 2015).

<sup>68</sup> See McKinsey and Company, *Ten ideas to reshape Indonesia's energy sector*, 2014, available at: [http://www.mckinsey.com/global\\_locations/asia/indonesia](http://www.mckinsey.com/global_locations/asia/indonesia), p. 3.

<sup>69</sup> *Ibid*.

<sup>70</sup> See: <http://www.powermag.com/indonesia-energy-rich-and-electricity-poor> (accessed on 15 May 2015).

power grid as the system operator. By some estimates, PLN controls about 77% of the power generating assets in the country.<sup>71</sup>

Despite ambitious plans to build a new generation of coal-fired plants (Indonesia has plenty of coal) as well as make a more robust move into geothermal energy (another power source where Indonesia could be a world leader), the roll-out of new power plants has equally been beset by various headaches, the most prominent of which revolve around the difficulties inherent to land acquisition (already discussed above in the section on road infrastructure) and the many problems linked in Indonesia to the exercise of permitting and license issuing powers. Among the many permits required to build and operate a power plant, there are those that must be obtained from the Ministry of Forestry in order to be able to build on forest land, as well as an approval resulting from an environmental impact assessment, a business/operating license, something called an electricity business license and finally something called a certificate of operation worthiness.<sup>72</sup>

Permits can take many months or even years to obtain and are often subject to a whole range of informal payments as ministerial departments exercise their discretionary powers to speed up or slow down decision-making processes and to withhold or issue whatever licenses, permits and recommendations are required. In fact, there seems to be very little appetite at present from private investors, especially from outside Indonesia, to pick up the challenge thrown down by successive governments in Indonesia to pitch in and help the country meet its gapping infrastructure deficits. <sup>73</sup>

A recent case shows the very real dangers of acting decisively and forcefully to overcome the many systemic challenges inherent to building new generation capacity as mandated under the government's Fast Track reforms (discussed above). A former CEO of PLN Dahlan Iskan, who was broadly credited with being an advocate of assertive action and administrative temerity, is now in the dock on corruption charges that are far from clear-cut and which relate to actions that were ultimately carried out after he had left PLN to become Minister for State Enterprises at the end of the SBY administration.<sup>74</sup> This case shows the dangers of a predatory justice system (discussed in more detail in subsequent sections) that seeks to use the threat or the event of criminal proceedings - where many due process requirements or the ability to be meaningfully compensated when wrongfully charged are blatantly lacking - as yet another avenue to generate rents from the accused.<sup>75</sup> This case also shows the danger of acting assertively on the part of bureaucrats given the possibility of future legal and criminal repercussions.<sup>76</sup> In a country where civil-service modernization and improved service delivery are some of the highest items on the reform agenda, this latest case can be construed as yet another serious setback to efforts to encourage a more effective and results-driven bureaucracy.<sup>77</sup>

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<sup>71</sup> See: PricewaterhouseCoopers, *Power in Indonesia, Investment and Taxation Guide*, April 2012, 2<sup>nd</sup> edition, available at: <http://www.pwc.com/id/en/publications/assets/electricity-guide-2013.pdf> at p. 14.

<sup>72</sup> See: <http://www.powermag.com/indonesia-energy-rich-and-electricity-poor/> (accessed on 15 May 2015).

<sup>73</sup> <http://thejakartaglobe.beritasatu.com/business/indonesia-infrastructure-just-not-appealing-foreign-investors-conference-hears/> (accessed on 20 June 2015).

<sup>74</sup> See *Tempo* English language edition, June 15-21 for a detailed exposé on the case.

<sup>75</sup> See for example: <http://www.themalaymailonline.com/opinion/devi-asmarani/article/the-justice-system-indonesias-most-shameful-non-secret> (accessed on 20 June 2015).

<sup>76</sup> See Kevin O'Rourke, *Reformasi Weekly Review*, 19 June 2015, at p. 7 for his analysis of the case and its implications for the Indonesian bureaucracy.

<sup>77</sup> See: Prijono Tjiptoherijanto, *Civil Service Reform in Indonesia: Culture and Institution Issues*, July 2012, available at: <http://econ.feb.ui.ac.id/uploads/201207.pdf> (accessed on 20 June 2015).

The costs imposed by Indonesia's shortcomings in power generation are very obvious, since electricity is an input to the production and supply of just about any good or service one cares to imagine in the modern industrial economy. Efforts by Indonesia to ramp up production in a number of sectors, including textiles, automobiles and industrial smelters are all subject to the very real constraints imposed by the insufficient and erratic supply of electricity. The costs imposed by the policy of providing electricity subsidies are also high, and ultimately result in fewer resources from the state budget being available to fund areas of public and social policy where Indonesia is quickly falling behind its regional peers, such as education and health. Until Indonesia tackles the underlying systemic constraints holding back its electricity sector in particular and its energy sector more generally, it won't be in a position to achieve its long-run economic growth ambitions. This is just one of the factors effecting the nation's overall economic competitiveness, the contestability of its exports, and thus its integration into the global trading system.

# Institutional and Legal Constraints

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## I. Preliminary Observations on Institutional and Legal Constraints

An effective state has been defined as “one that establishes an enabling environment for the delivery of high-quality and cost effective public services and the eradication of poverty in a manner that involves accountability to its citizens through both core State functions and processes.”<sup>78</sup> This definition reflects at least three elements of good governance: accountability, transparency and the rule of law. Also, it highlights the importance of poverty eradication.

Implementing the elements of good governance is one of the effective ways to prevent corruption. Corruption undeniably undermines any efforts to promote equality and economic growth. The eradication of corruption is a big challenge in Indonesia. Indonesia often receives a low score regarding the absence of corruption from international NGOs such as Transparency International and the World Justice Project (WJP). Indonesia, for instance, is ranked 107 of 175 countries on the Transparency International Corruption Perceptions Index in 2014, although this position has improved somewhat from 114<sup>th</sup> place in 2013.<sup>79</sup>

Supply-side constraints such as inadequate logistics and infrastructure encountered by Indonesia are ultimately the result of a historical legacy of pervasive and systemic corruption at every level of the country's public institutions. It is widely accepted that corruption, once it reaches the kind of levels commonly seen in Indonesia, acts as a break on economic activity, negatively affects international trade and impedes economic growth.<sup>80</sup> Pervasive corruption also contributes significantly to poor infrastructure and logistics performance. Ikerson of the Cato Institute has demonstrated the strong connection between levels of corruption and logistics performance. Countries where the perception of corruption is lower are more likely to perform better in terms of how the quality of their logistics is perceived.<sup>81</sup>

In this part, we examine legal and institutional frameworks governing the business climates in Indonesia. We look at corruption, governance and the rule of law in Indonesia as well as the rise of economic nationalism and an increasing tendency to use legal institutions such as the Constitutional Court to annul laws perceived as favoring gradual liberalization of trade and investment in Indonesia. We find that the conservative judicial activism practiced by the Constitutional Court has led to a situation of increased uncertainty and unpredictability which has undermined business and investment climates in Indonesia to the detriment of the country's long-run economic growth prospects. We also conclude that if donor-funded trade related technical assistance such as that on offer under Aid for Trade is to be effective in Indonesia it must be coupled with genuine political commitment for reforms that are capable of overcoming these institutional constraints.

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<sup>78</sup> Manila Statement on Partnering to Strengthen and Support Effective States, 2011. See also <http://www.oecd.org/derec/unitedkingdom/50313780.pdf>

<sup>79</sup> <https://www.transparency.org/country/#IDN>

<sup>80</sup> See Alan Beattie, *False Economy: A Surprising Economic History of the World*, Riverhead Books, 2010, particularly chapter 8 on corruption.

<sup>81</sup> <http://object.cato.org/sites/cato.org/files/pubs/pdf/tpa-037.pdf>, p. 9.

## II. Corruption and the Justice System

### 1. Corruption an Unsolved Problem in Indonesia

The World Economic Forum's Global Competitiveness Report 2014-2015 has listed corruption to be the most problematic factor for conducting business in Indonesia. It is followed by access to financing, inflation inefficient government bureaucracy, inadequate supply of infrastructure and policy instability.<sup>82</sup>

The above-cited World Justice Project (WJP) has developed nine factors in its Rule of Law Index based on the four universal principles of the rule of law adopted by the organization.<sup>83</sup> They are: limited government powers, absence of corruption, open government, fundamental rights, order and security, regulatory enforcement, criminal justice, and informal justice.<sup>84</sup>

According to the WJP Rule of Law Index, Indonesia in general is in the top half of ranking of lower middle income countries.<sup>85</sup> Indonesia scores quite well for limited government powers, open government, fundamental rights and regulatory enforcement. In contrast, it scores low and faces challenges in the functioning of government agencies and courts. Another finding by the WJP is that corruption is pervasive in Indonesia. The country ranked second last in terms of the absence of corruption by the WJP. The decentralization process initiated by the central government in 1999 has exacerbated existing problems of inefficiency in service delivery and limited bureaucratic capabilities, as well as increasing corruption at the local and regional levels.<sup>86</sup>

While corruption is rampant in Indonesia, efforts to eradicate corruption are not a new phenomenon. Anti-corruption drives have been carried out since the 1950s. For example, an agency called *Panitia Retooling Aparatur Negara* (Paran) to which government officials had to submit a form detailing their personal wealth, was formed during the Old Order regime under President Sukarno.<sup>87</sup> However, corruption eradication activities prior to the post New-Order *Reformasi* era were generally perceived as ineffective and the established anti-corruption institutions were later dissolved or became dysfunctional.

To date, the only anti-corruption agency that still exists and operates is the Corruption Eradication Commission (KPK), which was established in 2003. Over the years, the KPK has had quite a remarkable record in arresting public officials over alleged corruption. The work of the KPK is undoubtedly a factor that has contributed to a marked improvement in corruption eradication efforts in Indonesia in the past decade. It is still too early to assess the impact that anti-corruption efforts by the new administration of President "Jokowi" have had and to determine the genuineness of its stated commitment to eradicate corruption. However, there have been disappointments and frustrations with the President's handling of a recently escalated dispute between the national police force (Polri) and the KPK.<sup>88</sup>

<sup>82</sup> Klaus Schwab (ed) *The Global Competitiveness Report 2014-2015* (2014, World Economic Forum), P. 230.

<sup>83</sup> The WJP defines the rule of law as a system which the four following universal principles are upheld: (1) the government and its officials and agents as well as individuals and private entities are accountable under the law; (2) the laws are clear, publicized, stable and just, are applied evenly, and protect fundamental rights, including the security of persons and property ; (3) the process by which the laws are enacted, administered and enforced is accessible, fair and efficient; (4) justice is delivered [in a] timely [manner] by competent, ethical and independent representatives and neutrals who are of sufficient number, have adequate resources, and reflect the makeup of the communities they serve. See <http://worldjusticeproject.org/what-rule-law>.

<sup>84</sup> <http://worldjusticeproject.org/what-rule-law> (accessed on 20 June 2015).

<sup>85</sup> <http://data.worldjusticeproject.org/#/index/IDN>

<sup>86</sup> Organization for Economic Cooperation and Development, *OECD Economic Surveys: Indonesia 2015*, p. 37. (Organization for Economic Cooperation and Development 2015)

<sup>87</sup> <http://www.menpan.go.id/tentang-kami/tentang-kami/kiprah-pengabdian-kementerian-panrb>

<sup>88</sup> <http://thediplomat.com/2015/01/indonesia-police-chief-scandal-jokowis-first-real-test/>

There is no doubt that the level of corruption in Indonesia has reached levels that are detrimental to business certainty and that critically undermine predictability in the business environment. This means that the pervasiveness of corruption in Indonesia is a threat to the country's future economic growth. For this reason the eradication of corruption should be one of the very top policy priorities for any Indonesian government.

## 2. Improving Governance, Upholding the Rule of Law, Civil Service Reform

Poor governance has often been cited as one of the root causes of dysfunction and long-run breakdown within societies.<sup>89</sup> Corruption is one of the major and most visible outcomes of inadequate governance. International donors and institutions are increasingly focusing their financial resources and assistance efforts towards improving and ensuring good governance. Good governance, according to UNESCAP, follows the rule of law. It is also transparent, participatory, accountable, consensus oriented, responsive, effective and efficient.<sup>90</sup>

Improving the rule of law has long-term benefits that are far-reaching and generally beneficial to broad sections of the population, meaning that they also promote inclusiveness. For example, a 2015 IMF report entitled "Regional Economic Outlook: Sub-Saharan Africa" posits that increasing the rankings of Sub-Saharan Africa countries on the Rule of Law Index to the average level elsewhere in the world would help to generate an increase of approximately 28 percent in Sub-Saharan African countries' trade flows.<sup>91</sup> The rule of law is an integral part of economic development since it provides the market with certainty, predictability and due process.

An accepted definition of what the notion of the rule of law involves has proven elusive. A report of the European Commission for Democracy through Law (the so-called Venice Commission) entitled "The Rule of Law: Concept, Guiding Principle and Framework" assessed several international documents concerning the rule of law and concluded that "the collected documents demonstrate that a relatively thin concept can gain widespread acceptance across cultures". As regards the substantive content of what constitutes the rule of law, the common consensus is reported to comprise the following factors: (1) independence and impartiality of the judiciary; (2) legal certainty; (3) non-discrimination and equality before the law; (4) respect for (judicial) human rights; (5) separation of powers; (6) the principle that the State is bound by the law; and (7) the substantive coherence of the legal framework.<sup>92</sup>

Corruption in Indonesia is highly pervasive in most areas of public governance, two of the most prominent of which are the civil service and the justice system. The civil service is an integral part of any country, and plays a significant role in either undermining or supporting a given country's system of governance. The mission of any civil service should ideally be to improve the availability, quality and affordability of public goods such as health and education services. Civil servants in Indonesia are generally perceived to be slow, inefficient, corrupt and mostly underperforming.<sup>93</sup> Government procurement is a good example of an area where funds are often misappropriated.<sup>94</sup> Consequently, it undermines the quality of public sector development and investment. Thus, the major challenge for

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<sup>89</sup> <http://www.unescap.org/sites/default/files/good-governance.pdf>.

<sup>90</sup> <http://www.unescap.org/sites/default/files/good-governance.pdf>.

<sup>91</sup> <http://www.imf.org/external/pubs/ft/reo/2015/afr/eng/pdf/sreo0415.pdf>, p. 55.

<sup>92</sup> Frithjof EHM "The Rule of Law: Concept, Guiding Principle and Framework", European Commission for Democracy Through Law (Venice Commission), Strasbourg, 10 May 2010, p. 8.

<sup>93</sup> Michael Buehler *Indonesia's Law on Public Services: Changing State-Society Relations or Continuing Politics as Usual?* 47(1) (2011) "Bulletin of Indonesian Economic Studies" at pp. 65 - 66.

<sup>94</sup> <http://www.transparency-usa.org/documents/IndonesiaTIRReportFINAL-May2011.pdf>.

Indonesia in realizing its development goals is enhancing the effectiveness and capabilities of public servants through a long-term program of institutional reform and process transformation.<sup>95</sup>

There has been an effort from Indonesian government to develop the capacities of its public servants. Regulatory and institutional reform was a priority of the 2010-2015 National Medium Term Development Plan (RPJMN) and continues to be so in the corresponding 2015-2019 Plan.<sup>96</sup> Moreover, the Indonesian National Public Procurement Agency (LKPP) was established in 2007 to evaluate and monitor procurement practices. According to the 2015 OECD Economics Survey on Indonesia, while there has been progress in enhancing civil service performance, overstaffing, nepotism and difficulties in laying-off staff has considerably slowed down the pace of adjusting and reforming ministerial and agency staffing.<sup>97</sup>

### 3. A Criminal Justice System Failing to Provide Justice

In the area of criminal justice, defective investigations, an ineffective correctional system and due process violations are the primary areas of concern in Indonesia.<sup>98</sup> Following a recent criminal verdict against two Jakarta International School educators in a child sex abuse case that was fraught with substantive errors and procedural irregularities, The American Chamber of Commerce (Amcham) in Indonesia released a statement questioning the investigative process and the lack of credible evidence used to convict the two accused (one of whom was a dual Canadian and British citizen). Amcham's concern was that the reported irregularities and abuses would have a negative impact on the prospective and actual investors regarding the rule of law, due process and legal certainty and therefore would undermine the investment climate in Indonesia.<sup>99</sup>

As stated previously, Indonesia scores well among lower middle-income countries for checks on government power, open government and individuals' participation in the administration of laws. Indonesia's state administration system has essentially adopted mechanisms that act as checks and balances. The establishment of the Indonesia Constitutional Court is one of several of these mechanisms. Lawmakers in exercising their legislative powers are limited by the possibility of having laws reviewed and annulled by the Constitutional Court. The Court's decision itself is final and binding. The Constitutional Court, however, is not without controversy. Its Chief Justice Akil Mochtar was arrested in October 2013 for allegedly accepting bribes in a case concerning a regional election dispute<sup>100</sup>, but has otherwise the Court has enjoyed a fairly solid record.<sup>101</sup>

The 2013 Global Corruption Barometer provides that public households in Indonesia perceive the judiciary as the second most corrupt public institution in the country.<sup>102</sup> The survey finding also shows that in the last 12 months, 66 percent reported paying a bribe to the judiciary and 75 percent reported paying a bribe to the police.<sup>103</sup> This result demonstrates that majority public households in Indonesia have a negative perception and do not have trust toward judicial system in Indonesia. Given the deep-rooted systemic shortcomings pervading the country's system of courts, prosecutors, and law

<sup>95</sup> [http://siteresources.worldbank.org/EXTGOVANTICORR/Resources/3035863-1289428746337/Transforming\\_Public\\_Sector\\_Indonesia.pdf](http://siteresources.worldbank.org/EXTGOVANTICORR/Resources/3035863-1289428746337/Transforming_Public_Sector_Indonesia.pdf)

<sup>96</sup> See Peraturan Presiden Republik Indonesia No 2/2015 and Keputusan Presiden Republik Indonesia No 15/2015.

<sup>97</sup> OECD Economic Surveys: Indonesia 2015, *infra*, p. 38.

<sup>98</sup> [http://worldjusticeproject.org/sites/default/files/indonesia\\_report\\_011315\\_eng.pdf](http://worldjusticeproject.org/sites/default/files/indonesia_report_011315_eng.pdf), p. 24.

<sup>99</sup> <http://www.amcham.or.id/component/content/article/2-uncategorised/4923-amcham-statement>

<sup>100</sup> [http://www.nytimes.com/2013/10/04/world/asia/indonesias-top-judge-held-in-corruption-case.html?\\_r=0](http://www.nytimes.com/2013/10/04/world/asia/indonesias-top-judge-held-in-corruption-case.html?_r=0)

<sup>101</sup> See for example, Simon Butt, *The Constitutional Court and Democracy in Indonesia*, Brill | Nijhoff, 2015.

<sup>102</sup> <http://www.transparency.org/gcb2013/country/?country=indonesia>.

<sup>103</sup> <http://www.transparency.org/gcb2013/country/?country=indonesia>.

enforcement agencies, it is no surprise that Indonesia scores so low in international league tables that seek to compare the rule of law across different countries and regions. What is surprising is the failure of any single actor or group of actors across the Indonesian political landscape to effect meaningful change. This is an issue that the country seems to be going backwards on instead of making steady or even incremental progress on.

### III. Economic Nationalism the New Normal

#### 1. The Rise of Economic Nationalism in Indonesia

Economic nationalism can be understood as a set of policies or practices intended to boost and protect the national economy against global market forces.<sup>104</sup> The rise of economic nationalism in the 20<sup>th</sup> century was the result of several concurrent phenomena including globalization, economic insecurity and income inequality. The quickening pace of globalization can and is often perceived by certain elements to constitute a threat to national autonomy and cultural identity. Economic insecurity and income inequality can also trigger a revival in nationalist sentiments. Such sentiments often find expression in the form of restrictive economic measures such as trade barriers, policies that favor local workers and industries, and in some cases a ground swell against prominent or visible foreign investors.

Sometimes, the role played by international organizations in advocating policies that are viewed as pro globalization and thus anti-nationalist has also causes them to attract the ire of economic nationalists which have proven adept at whipping up populist sentiment against such organizations and the policies they advocate. President Joko Widodo in his opening speech at the 60<sup>th</sup> Asian-African Conference, for example, emphasized his view that the fate of the global economy should not be left to three international institutions (IMF, World Bank and the ADB).<sup>105</sup>

Economic instability often opens the door to protectionist policies, and situations where the bad performance of the domestic economy is blamed on foreign trade and an influx of immigrant labor. Income inequality leads to a widely-held (and not wholly unjustified) view that it is only the elites who enjoy the benefits generated by globalization. These realities have culminated to make economic nationalism an appealing and popular dogma for a broad range of domestic constituents. Economic nationalism distracts electorates from inherent structural weaknesses in a given economy with promises to preserve cultural heritage, defend the national interests and uphold autonomy in an increasingly globalized world.<sup>106</sup>

Indonesia was a Dutch colony for more than 300 years until it declared its independence in 1945. The narrative of colonial exploitation of Indonesia's wealth during the colonial era resulting in the Netherlands growing rich and powerful while the Indonesian people suffered in poverty and political suppression is still taught in schools in Indonesia and felt very deeply by a broad section of the population to be true. Whatever the impact of the Dutch colonial model on the Indonesian economy, the experience continues today to frame public attitudes and to underlie opposition to foreign business operators in the country. This is also the case for foreign investment, where a negative list prohibits foreign business interests from any involvement in a wide range of economic sectors.<sup>107</sup>

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<sup>104</sup> <http://www.globalpolicyjournal.com/articles/world-economy-trade-and-finance/economic-nationalism-theory-history-and-prospects>.

<sup>105</sup> <http://blogs.wsj.com/indonesiarealtime/2015/04/23/what-message-is-jokowi-delivering/>.

<sup>106</sup> [http://www.sras.org/economic\\_nationalism\\_under\\_globalization](http://www.sras.org/economic_nationalism_under_globalization).

<sup>107</sup> <http://www4.bkpm.go.id/contents/general/117139/negative-investment-list%20#.VV7oZUbdVB8>; see also <http://www.lowyinterpreter.org/post/2014/06/03/Indonesia-economic-nationalism.aspx?COLLCC=2562434951&>.

## 2. A Campaign to Revoke Existing Laws on Constitutional Grounds

Another recent addition to the domestic legal architecture is a growing tendency on the part of a group of NGOs to file a judicial review to the Constitutional Court in order to strike down provisions of a number of laws that are related to trade and investment. In the following section, we discuss several legal provisions that are being challenged before the Indonesian Constitutional Court and the possible implications on the international trade and investment climate in Indonesia.

A group led by the chairman of Muhammadiyah (the second largest Muslim organization in Indonesia), Mr. Din Syamsuddin, has filed applications for judicial review in order to overturn several provisions of various laws relating to investment, foreign exchange<sup>108</sup> and electricity (both discussed in more detail below).<sup>109</sup> Early this year, a similar request for judicial review concerning the 2004 Law on Water Resources<sup>110</sup> was granted by the Constitutional Court. The Court revoked the 2004 Law and reinstated the 1974 Water Law, which will remain in force until a new law can be adopted. The same group of Islamic legal activists is also reportedly planning to bring further claims against some one hundred and fifteen existing laws,<sup>111</sup> which it believes to be contrary to the constitutionally enshrined principle by which land and all other natural resources must be controlled by the State for the welfare of the Indonesian people in general.<sup>112</sup> The activists in question have dubbed their coordinated assault on the country's legal system a "constitutional jihad".<sup>113</sup>

In a similar lawsuit aimed at the foreign exchange regime, the same organization is trying to have Article 2 of Law 24/1999 annulled to the extent this article affords every resident the freedom to possess and use foreign exchange.<sup>114</sup> The explanatory text of the 1999 Exchange Law provides that the freedom "to possess foreign exchange" means that residents who obtain and own foreign exchange are not required by law to sell it to government. The same explanatory text provides that the term "free to use foreign exchange" means that residents can freely carry out activities using foreign exchange among other things for international trade transactions or transactions on money or capital markets. The main objection that Muhammadiyah seems to have voiced towards this provision of the 1999 Foreign Exchange Law is that it has facilitated the country moving towards a free market economy, which Muhammadiyah claims is contrary to the underlying values inherent to the Indonesian Constitution. If the Court were to accept the organization's claim, the convertibility of the Indonesian Rupiah would lack any legal basis.<sup>115</sup>

Muhammadiyah is also challenging Articles 4.2, 11.1 and 17.2 of Law 30/2009 on Electricity. Here the organization seeks to eliminate any possibility for private entities to supply electricity and operate power plants. In 2004, the Constitutional Court already annulled the previous 2002 Electricity Law that had been enacted as part of broader efforts to liberalize the power sector in Java and Bali and allowed

<sup>108</sup> Kevin O'Rourke 'Reformasi Weekly Review', 24 April 2015, p. 9.

<sup>109</sup> <http://www.amcham.or.id/nf/features/4945-muhammadiyah-challenges-foreign-economic-intervention>

<sup>110</sup> Law No. 7/2004 on Water Resources.

<sup>111</sup> See "Legal 'jihad' against private sector gathers pace in Indonesia" published on 24 April 2015 by Reuters, available at: <http://www.reuters.com/article/2015/04/24/indonesia-investment-idUSL4N0XL2Z920150424> (accessed 20 Jun 2015).

<sup>112</sup> Article 33 of Indonesian Constitution. See also <http://www.hukumonline.com/berita/baca/lt55505f23aac65/sulitnya-merealisasikan-pasal-33-uud-1945>

<sup>113</sup> <http://www.reuters.com/article/2015/04/24/indonesia-investment-idUSL4N0XL2Z920150424>

<sup>114</sup> The Explanatory text of the Law provides that 'free to possess foreign exchange' means that Residents who obtain and own foreign exchange are not required to sell it to government. 'Free to use foreign exchange' means that Residents can freely carry out activities using foreign exchange among other things for international trade, transactions in the money market and transactions in capital market.

<sup>115</sup> Kevin O'Rourke 'Reformasi Weekly Review', 24 April 2015, p. 8.

greater scope for private sector operators to produce and distribute electricity to the public.<sup>116</sup> The revised 2009 Law, although it affirms the preeminence of the State-owned electricity provider PLN's position on the nation's electricity markets, nevertheless continued to allow some scope for private operators to produce and supply electricity, which is what seems to have attracted the ire of Muhammadiyah.

### 3. The True Cost of Economic Nationalism for Indonesia

To date, it is still unclear how the Constitutional Court will rule on these issues. If it strikes down entirely or votes to annul certain provisions of these laws, such rulings would have far-reaching implications for many sectors of the Indonesia economy, undermining the very premise that the private sector has any role to play in areas of the economy where the government or one of its many state owned enterprises (SOEs) is already preeminent. Adverse rulings would not only weaken the business and investment climates in Indonesia, but also sharply undermine the rule-making authority of the executive and legislative branches to experiment with new mixed (private-public) business models or attract private investors from at home or abroad.

Extreme forms of economic nationalism that impose sever constraints on the degree to which a country can interact economically and commercially with other countries are generally recognized as a poor way to solve poverty and income inequality problems, particularly where they limit technology transfer or access to overseas capital or financing.<sup>117</sup> In a 2012 discussion paper, UNCTAD posits that rules restricting the movement of goods and services, the choice of an exchange rate regime and the governance of economic sectors, will inevitably have important downside effects on the different channels and mechanisms through which trade has been historically proven to contribute to improvements in national welfare.<sup>118</sup> On the contrary, the same UNCTAD discussion paper argues that there is hardly any evidence suggesting that trade openness is bad for economic growth but that instead the evidence seems to suggest on balance that trade liberalization generally improves aggregate welfare although gains can be of varying sizes and are often unevenly distributed.<sup>119</sup> Where income inequality does exist, it is often the result of endogenous factors such as insufficient infrastructure, skills gaps and poor domestic policy choices. Thus, policies aiming at reducing trade barriers, improving infrastructure and broadening access to education could go a long way to allowing the benefits of globalization to be shared more equally. Additionally, as has been pointed out by many trade and development economists, trade liberalization in and of itself is insufficient to boost economic growth, but requires a conducive and facilitative set of domestic institutions and mechanisms (such as rule of law, clean and transparent bureaucracy) in order to translate into inclusive and broad-based economic growth.<sup>120</sup> These institutions and mechanisms are largely lacking in Indonesia, which is why the country as a whole can be expected to remain at best ambivalent and at worse hostile to globalization.

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<sup>116</sup> <http://www.mahkamahkonstitusi.go.id/putusan/Putusan001021022PUUI2003.pdf>

<sup>117</sup> [http://scholar.harvard.edu/files/jfrieden/files/global\\_inequalities\\_2.pdf](http://scholar.harvard.edu/files/jfrieden/files/global_inequalities_2.pdf)

<sup>118</sup> [http://unctad.org/en/PublicationsLibrary/osgdp20121\\_en.pdf](http://unctad.org/en/PublicationsLibrary/osgdp20121_en.pdf), p. 16.

<sup>119</sup> [http://unctad.org/en/PublicationsLibrary/osgdp20121\\_en.pdf](http://unctad.org/en/PublicationsLibrary/osgdp20121_en.pdf), p. 17.

<sup>120</sup> [http://www.cer.ethz.ch/resec/teaching/seminar\\_aussenwirtschaft\\_wt\\_04\\_05/winters\\_EJ.pdf](http://www.cer.ethz.ch/resec/teaching/seminar_aussenwirtschaft_wt_04_05/winters_EJ.pdf), F16.

## IV. The Role of Aid for Trade in Tackling Governance Shortcomings in Indonesia

### 1. The Role of Aid for Trade in Disrupting a Dysfunctional Status Quo

Research conducted by Aaronson and Abouharb provides that the WTO may gradually or partially help Member States to reduce corruption through norm diffusion processes and policy monitoring.<sup>121</sup> However, the WTO cannot sanction Members for inadequate governance. Aaronson and Abouharb admit that it is difficult and takes time to translate these norms into the behavior of policymakers and government elites. They are likely to resist change since they have a vested interest in maintaining the *status quo* or they may simply lack the capacity, funding or political will to implement reforms.<sup>122</sup> In the face of such constraints, externally funded and directed donor assistance programs like Aid for Trade can play a constructive role in identifying and elucidating the broadly dispersed costs imposed by the *status quo* and nudging policymaking elites towards a genuine conviction that change can be so broadly welfare enhancing that it would also be in their own best interests as well as those of the country as a whole. As it claims, the Aid for Trade initiative aims to provide assistance to developing countries to overcome structural and capacity constraints that undermine their ability to absorb the benefits from trade opportunities.<sup>123</sup>

There are various ways in which Aid for Trade and similar trade-related technical assistance programs can have an impact on disrupting a dysfunctional status quo, some of which are discussed in the next section. However, the section after that likewise seeks to make the point that irrespective of how much technical assistance or capacity building a developing country receives, under the auspices of Aid for Trade or any similar initiative, in the absence of sufficient and determined political will to enact and implement reform, there are very clear limits to just how effective such initiatives can be in achieving their objectives. As the old saying goes: you can lead a horse to water but you can't force it to drink.

### 2. Aid for Trade as a Catalyst for Tackling Corruption in Indonesia

Corruption is a domestic political and governance problem which can largely only be overcome by domestically inspired and driven political and governance solutions. Nevertheless, initiatives like Aid for Trade can make a meaningful contribution to nudging policymakers in the right directions, by means of a number of interventions, all of which need to remain as technical and de-politicized as possible, so as to avoid the charge of trying to meddle in domestic politics. One such intervention is by simply raising awareness of the true cost of corruption when it distorts outcomes that would otherwise not arise if an economy were adhering more closely to WTO rules. The restrictive import regime governing commodities such as rice, horticultural products, beef and chicken impose clear and quantifiable costs on Indonesian consumers which have to a certain extent been examined by various stakeholders, both foreign and domestic. Initiatives launched under the auspices of Aid for Trade should do more to highlight and disseminate these costs and to help consumer groups and other public interest NGOs rally, agitate and advocate for change.

Another way in which initiatives like Aid for Trade can nudge policymakers in the right direction towards policy reform and eradicating corruption is to educate them on the benefits of WTO-complaint rule-making in the form of capacity building programs that the WTO already excels in. However such training

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<sup>121</sup> Susan Ariel Aaronson and M Rodwan Abouharb, *Chapter 13: Corruption, conflicts of interests and the WTO*, in: Jean-Bernard Auby, Emmanuel Breen and Thomas Perroud (eds.) *Corruption and Conflicts of Interest A Comparative Law Approach*, Edward Elgar Publishing, pp. 183–197, at p. 188-195.

<sup>122</sup> *Ibid*, p. 197.

<sup>123</sup> OECD & WTO, *Aid for Trade: Is it Working*, 2010, available at: <http://www.oecd.org/trade/aft/45581702.pdf>.

should go beyond a dry reiteration of what the rules are to include examples of when WTO Members have strayed from those rules and what the political-economy cost and other fallout has been in those instances.

Finally, by using Aid for Trade to produce tangible outcomes such as ratification of the newly adopted Trade Facilitation Agreement, or implementation of Indonesia's commitments under both the Import Licensing Agreement and the Agreement on Agriculture, initiatives like Aid for Trade can effectively contribute to constraining the policy space of political elites to impose economic governance outcomes that are both WTO inconsistent and run contrary to the national economic interest.<sup>124</sup>

### **3. The Limits of Aid for Trade in Addressing Governance Shortcomings**

As alluded to above, any effort to introduce and bring about genuine reform to domestic policymaking and governance structures must come from within and cannot be imposed by any kind of outside top-down process, as has been adequately demonstrated by how quickly the 1997/98 IMF conditionalities so reluctantly "accepted" by Indonesia were unwound within a decade of having been imposed. Initiatives like Aid for Trade can show the way and guide a given WTO Member along the right path, but the political leadership of the Member in question must have already arrived at the conclusion that this is the right way forward.

This is something that is arguably still lacking in Indonesia. Policymakers seem united in decrying the negative impact of collusion, corruption and nepotism, especially after the disastrous economic collapse that followed the Suharto presidency – largely seen as the embodiment of these governance shortcomings. However very few policymakers and almost nobody in the country's political elite seem conscious of or prepared to ask the really tough questions pertaining to how much of the country's underlying economic governance model has really changed since the democratic and political reforms that transpired in the wake of the monetary crisis that ensued as a result of the Asian Financial Crisis. Many observers would likely be surprised by how little had actually changed, especially given the continuing weakness and/or shortcomings of many of the country's governing institutions, such as the public service, the judiciary and law enforcement bodies.

Nor is there much enthusiasm in economic policy circles for embracing a liberalized trade and investment regime or for increasing the country's openness to competition from foreign economic interests. This is understandable in light of the relative weakness of many domestic economic actors, but the response so far has been to restrict competition from abroad without forcing domestic players to step up and become more competitive. This is most clearly apparent in a range of sectors such as education, medical services and other professional services, where the door has been tightly sealed against foreign competition, only to see the quality of services being provided on the domestic market slipping further and further behind regional and international benchmarks. The role of Aid for Trade and similar initiatives in this context is arguably limited to raising awareness of the continued costs involved in staying closed and reducing the fear factor for allowing even incremental openness in future.

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<sup>124</sup> Ratification and effective implementation of the Trade Facilitation Agreement would for example go a long way to improving transparency with regard to import and export procedures in Indonesia, and would thus contribute to reducing trade costs more generally.

# Import and Export Policies

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## I. Preliminary Observations on Import and Export Policies in Indonesia

It is universally accepted that Indonesia suffers from complicated, overlapping, inconsistent, lengthy and costly procedures for the import and export of a wide range of goods, which is why the country ranks 62<sup>nd</sup> out of 189 on the ease of Trading Across Borders Index.<sup>125</sup> Individual indicators used to assess the ease of trading across borders include the transparency and efficiency of border administration, the costs associated with importing and exporting goods, the range, quality and comprehensiveness of key services offered by customs and related agencies, and finally the average time, costs and number of documents required to both import and export goods.<sup>126</sup> In addition, the aforementioned Index also analyzes the availability and quality of information provided by border agencies and the prevalence of corruption.<sup>127</sup>

Compared to its ASEAN partners, Indonesia actually ranks fairly well, coming in third after Singapore and Malaysia, particularly in areas of fees and charges, harmonization and simplification of documents, automation and internal border agency co-operation, but Indonesia's performance in information availability and streamlining of procedures is below average in terms of its relative rank across global performance indicators.<sup>128</sup> To further complicate matters for traders, the Government of Indonesia often implements regulations with far-reaching and detrimental effects on the speed with which goods can be imported, the most notorious of which are non-automatic import licensing procedures and permit requirements, product labeling requirements, local content and domestic manufacturing requirements, as well as quantitative import restrictions.<sup>129</sup> Indonesia together with Russia, China and India, have been ranked as the four countries with the most trade-restrictive measures currently in place.<sup>130</sup>

According to a survey published by the International Trade Centre (ITC), approximately 37% of exporters and importers in Indonesia are negatively impacted by various forms of the trade-restrictive measures referred to above.<sup>131</sup> What is more, this percentage is set to rise in the near future as a new slew of trade-restricted measures is currently being contemplated by the country's parliament (Dewan

<sup>125</sup> World Bank, *Doing Business 2015: going beyond efficiency - Indonesia*, 2015, World Bank Group, available at <http://documents.worldbank.org/curated/en/2014/10/20346336/doing-business-2915-going-beyond-efficiency-indonesia> (accessed on 15 May 2015). (World Bank 2015)

<sup>126</sup> Margareta Drzeniek Hanouz, Thierry Geiger, and Sean Doherty, *The Global Enabling Trade Report 2014*, World Economic Forum, 2014, available at: [http://www3.weforum.org/docs/WEF\\_GlobalEnablingTrade\\_Report\\_2014.pdf](http://www3.weforum.org/docs/WEF_GlobalEnablingTrade_Report_2014.pdf), (accessed on 15 May 2015).

<sup>127</sup> *Ibid.*

<sup>128</sup> Organization for Economic Cooperation and Development, *OECD Trade Facilitation Indicators—Indonesia*, 2014, available at: <http://www.oecd.org/tad/facilitation/indonesia-oecd-trade-facilitation-indicators-april-2014.pdf> (accessed on 15 May 2015).

<sup>129</sup> More than a third of Indonesia's exporters affected by non-tariff measures, International Trade Center, 27 November 2013, Available at: [http://www.intracen.org/uploadedFiles/intracen.org/Content/About\\_ITC/Press/Articles/More%20than%20a%20third%20of%20Indonesia%E2%80%99s%20exporters%20affected%20by%20non-tariff%20measures%2815%29.pdf](http://www.intracen.org/uploadedFiles/intracen.org/Content/About_ITC/Press/Articles/More%20than%20a%20third%20of%20Indonesia%E2%80%99s%20exporters%20affected%20by%20non-tariff%20measures%2815%29.pdf)

<sup>130</sup> European Commission Directorate-General For Trade 11th Report On Potentially Trade-Restrictive Measures Identified In The Context Of The Financial And Economic Crisis 1 June 2013 – 30 June 2014, available at: [http://trade.ec.europa.eu/doclib/docs/2014/november/tradoc\\_152872.pdf](http://trade.ec.europa.eu/doclib/docs/2014/november/tradoc_152872.pdf)

<sup>131</sup> More than a third of Indonesia's exporters affected by non-tariff measures, International Trade Center, 27 November 2013, Available at: [http://www.intracen.org/uploadedFiles/intracen.org/Content/About\\_ITC/Press/Articles/More%20than%20a%20third%20of%20Indonesia%E2%80%99s%20exporters%20affected%20by%20non-tariff%20measures%2815%29.pdf](http://www.intracen.org/uploadedFiles/intracen.org/Content/About_ITC/Press/Articles/More%20than%20a%20third%20of%20Indonesia%E2%80%99s%20exporters%20affected%20by%20non-tariff%20measures%2815%29.pdf)

Perwakilan Rakyat or DPR).<sup>132</sup> The latest measure currently being deliberated is a 40% local content requirement for smartphones imported into Indonesia, which could be implemented as early as January 2017.<sup>133</sup> This particular draft measure has attracted the ire of many stakeholders including the two dominant smartphone manufacturers Samsung and Apple, but also other major industry players such as Huawei and Blackberry.<sup>134</sup>

From a comparative regional perspective, although Indonesia actually has fewer trade-restrictive measures in place than its northerly neighbor Malaysia, the latter's measures are not as harshly criticized by traders since they are on the most part perceived to be administered in a relatively efficient and transparent manner, thus providing more certainty and predictability for traders.<sup>135</sup> Where Indonesia falls down on the other hand, is that many aspects of its border administration are prone to a lack of reliable information, deficient notification procedures, and a lack of coordination between the various border agencies, all of which increases the burden for traders and adds to the costs of doing business in Indonesia. In the next section we examine a number of these constraints in more detail.

## II. Identifying Some Existing Shortcomings

### 1. Non-Automatic Import Licensing

Import licensing refers to "administrative procedures used for the operation of import licensing regimes requiring the submission of an application or other documentation (other than that required for customs purposes) to the relevant administrative body as a prior condition for importation into the customs territory of the importing Member".<sup>136</sup> Import licensing regimes are typically divided into two broad categories namely 1) automatic and 2) non-automatic. Automatic import licensing is defined as import licensing where approval of the application is granted in all cases,<sup>137</sup> while non-automatic import licensing involves approval being subject to the discretion of one or more agencies of the government in the importing country.<sup>138</sup> Non-automatic import-licensing procedures are typically used to administer quantitative restrictions or in application of sanitary and phytosanitary measure, but may also be used for a range of other perfectly legitimate policy objectives, for example to exercise more restrictive import control procedures for hazardous products like chemicals or waste.<sup>139</sup>

By way of example, Indonesia's import licensing requirements for agricultural, horticultural and food products are both labyrinthian and byzantine and almost seem to have been devised in order to frustrate anyone wishing to import such products into Indonesia. This may in fact well have been the legislative intent, since Article 36 of the Indonesian Food Law<sup>140</sup> provides that imports of food are only permitted if domestic food production is not sufficient or if the food items in question cannot be

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<sup>132</sup> Office of the United States Trade Representative, *National Trade Estimate Report on Foreign Trade Barriers*, 2015, available at: <https://ustr.gov/sites/default/files/2015%20NTE%20Combined.pdf> (accessed on 15 May 2015).

<sup>133</sup> Menkominfo : 2017 TKDN Minimal 40 Persen Untuk Smartphone 4G yang Masuk Indonesia, 30 Januari 2015, available at: [http://kominfo.go.id/index.php/content/detail/4397/Menkominfo+%3A+2017+TKDN+Minimal+40+Persen+Untuk+Smartphone+4G+yang+Masuk+Indonesia/0/berita\\_satker#.VXVDN-fl1FU](http://kominfo.go.id/index.php/content/detail/4397/Menkominfo+%3A+2017+TKDN+Minimal+40+Persen+Untuk+Smartphone+4G+yang+Masuk+Indonesia/0/berita_satker#.VXVDN-fl1FU)

<sup>134</sup> The Jakarta Post, *Phone imports threatened by new measure*, 22 January 2015, available at: <http://www.thejakartapost.com/news/2015/01/22/phone-imports-threatened-new-measure.html>

<sup>135</sup> Gloria O. Pasadilla, 2013, *Addressing Non-tariff Measures in ASEAN*, ARTNeT Working Paper No. 130, September, 2013, Bangkok, ESCAP, Available at [www.artnetontrade.org](http://www.artnetontrade.org).

<sup>136</sup> Article 1.1 of Agreement on Import Licensing Procedures

<sup>137</sup> Article 2.1 of Agreement on Import Licensing Procedures

<sup>138</sup> Article 3.1 of Agreement on Import Licensing Procedures

<sup>139</sup> Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, 3<sup>rd</sup> edition, Cambridge University Press, p. 456.

<sup>140</sup> Law 18/2012 on Food.

produced domestically. The process of obtaining all the paperwork required to import agricultural or foods products seems to have been specifically designed in order to maximize the number of approvals required in a way that gives enormous leverage to each and every one of the many issuing agencies or bodies. In light of the very real concerns involving corruption of government institutions in Indonesia, the system of non-automatic import licensing as it is currently conceived and operates seems to be little more than a rent-generating scheme that is maintained for the benefit of between 10 and 20 different government agencies and bodies.

An as yet unpublished internal research note prepared by the Jakarta office of the World Bank documents the various issues in great detail.<sup>141</sup> The research note discusses the many problems regularly experienced by a large multinational company that operates in the food and alimentation sector under a well-known brand, and that is required to import fresh cheese, which is then processed in Indonesia and sold on the domestic market. Four permits are required in order to import the item in question, namely (1) a Registered Importer Permit; (2) an Import Approval; (3) an Import Certificate; (4) a Quarantine Permit. The second of these permits (Import Approval) is allegedly the hardest to obtain, since it requires substantial supporting documentation in the form of letters of recommendation from the Ministry of Agriculture (MoA) and the National Agency of Drug and Food Control (BPOM). However, before a letter of recommendation can be obtained from the MoA, pre-recommendation letters from local government agencies must first be acquired namely (1) Livestock Services, District Agricultural Office; (2) Livestock Services Provincial Agricultural Office; and (3) Integrated Provincial Licensing Bodies (BPPT). Because it is inconceivable that any of these pre-recommendation letters are obtainable without the payment of some kind of formal and/or informal fees, the current framework essentially operates as an intricate pyramid scheme for the generation of rents.

What is more, the rules and procedures on import licensing have clearly been designed without taking into account the realities of business operators, so that they are highly impracticable. For example, each of the above mentioned pre-recommendation letters needs to be applied for in careful sequence, meaning that it typically takes 10 to 14 weeks to obtain all pre-recommendation letters before then being submitted to the MoA which can take anywhere from 4 to 8 weeks to issue the final recommendation letter -recalling that this is just the recommendation letter required to apply for the Import Approval from the Ministry of Trade, one of 4 such approvals. In addition to this, the information required when applying for a pre-recommendation letter includes an indication of the specific volumes to be imported through which specific ports. This requires a decision on the mode of transport to be taken months before the goods are effectively shipped and has the effect of reducing the flexibility of business operators to take the most economical and efficient decisions on when, how and where to ship their products to.

The procedures at BPOM are even more obscure. According to the aforementioned research note the experience of the aforementioned multinational is that "there are no clear, consistent and transparent rules for obtaining the recommendation letter from BPOM", so that "BPOM officials may ask for new supporting documents when the importer submits an application". Recommendation letters from BPOM are reported to typically take up to 2 weeks to be issued. The note goes on to conclude that "in the case of [the aforementioned multinational], the company needs to renew 37 separate licenses every six months, while the lead time for import license renewal is 4 to 5 months". The implications of these findings are quite shocking, since they entail that any company which regularly imports (or exports) goods subject to non-automatic import licensing must keep a small contingent of staff continuously

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<sup>141</sup> Available on request from the authors.

occupied with shuffling these papers through the maze of administrative agencies. In addition to the staff costs this inevitably causes, there are the many payments required to apply for and obtain these permits, both formal and informal, so that one is left to concede that there is little wonder why logistics costs in Indonesia are so high, nor that a number of Indonesia's trading partners are seeking recourse against these heavy-handed procedures in different cases currently before the WTO Dispute Settlement Body.<sup>142</sup>

## 2. Quantitative Restrictions on Imports and Exports

Indonesia either bans or imposes strictly applied quantitative restriction on a range of products either for import or export. Indonesia also imposes seasonal bans on the import of politically sensitive agricultural products such as rice during the harvesting season, or sugar on the basis of domestic production and consumption forecasts.<sup>143</sup> Starting in 2012, Indonesia introduced new quotas for the importation of horticultural, animal and animal products, which proved particularly troublesome for a range of Indonesia's trading partners. These policy rationale underlying the imposition of these measures was, as elucidated by the Ministry of Trade (MoT) to achieve price and supply stability for basic staples as well as to protect local farmers and breeders.<sup>144</sup> In the context of implementing regulations to the 2010 Law on Horticulture, The MoT has also expressed its intention to ban the import of a number of products in the event prices for these commodities fall below established reference prices.<sup>145</sup> These measures, described in some detail in the requests for the establishment of a panel in two cases brought against them at the WTO by the United States and New Zealand, seem to be in violation of the WTO provisions banning the use of quantitative restrictions<sup>146</sup> and it is hard to see at this point how Indonesia will justify them given the very tightly circumscribed language in which the exceptions to the ban on quantitative restrictions are formulated, and the very narrow way this language has consistently been interpreted throughout both the history of the GATT and the WTO.<sup>147</sup>

However it's not just horticultural, agricultural and animal products that are the subject of quantitative restrictions or import bans. Other products that pose a risk to entrenched economic interests or which form part of a targeted policy of sectorial industrialization can also find themselves on the receiving end of such measures. This has been the case recently with electronic cigarette products, which are facing a total sales (and import) ban.<sup>148</sup> Putting aside the obvious desirability of this measure in light of public

<sup>142</sup> See in particular *Indonesia - Measures Concerning the Importation of Chicken Meat and Chicken Products*, complaint by Brazil (DS481); and *Indonesia - Importation of Horticultural Products, Animals and Animal Products*, complaints by the United States and New Zealand (DS477 and 478).

<sup>143</sup> Organization for Economic Cooperation and Development, *OECD Review of Agricultural Policies: Indonesia 2012*, OECD Publishing. <http://dx.doi.org/10.1787/9789264179011-en>, page 181-182

<sup>144</sup> Kemendag Revisi Dua Ketentuan Terkait Impor: Stabilisasi Harga Bahan Pokok dan Kepastian Usaha kepada Petani dan Peternak, 3 September 2013, available at: <http://www.kemendag.go.id/id/news/2013/09/03/kemendag-revisi-dua-ketentuan-terkait-impor-stabilisasi-harga-bahan-pokok-dan-kepastian-usaha-kepada>

<sup>145</sup> See for example with reference to red peppers: Kemendag Revisi Dua Ketentuan Terkait Impor: Stabilisasi Harga Bahan Pokok dan Kepastian Usaha kepada Petani dan Peternak, 3 September 2013, available at: <http://www.kemendag.go.id/id/news/2013/09/03/kemendag-revisi-dua-ketentuan-terkait-impor-stabilisasi-harga-bahan-pokok-dan-kepastian-usaha-kepada>; or with reference to animal products, see: Kemendag Revisi Dua Ketentuan Terkait Impor: Stabilisasi Harga Bahan Pokok dan Kepastian Usaha kepada Petani dan Peternak, 3 September 2013, available at: <http://www.kemendag.go.id/id/news/2013/09/03/kemendag-revisi-dua-ketentuan-terkait-impor-stabilisasi-harga-bahan-pokok-dan-kepastian-usaha-kepada>, (both accessed on 15 May 2015).

<sup>146</sup> In particular Art. XI of GATT 1994 and Article 4.2 of the Agreement on Agriculture.

<sup>147</sup> See Van den Bosshe and Zdouc (2013), at. pp. 483, for a relatively up-to-date and succinct synopsis of these rules under the WTO.

<sup>148</sup> See *RI bans e-cigarettes on health concerns*, 19 May 2015, available at: <http://www.thejakartapost.com/news/2015/05/19/ri-bans-e-cigarettes-health-concerns.html>, (accessed on 15 May 2015).

health concerns, the reasons cited for the proposed ban (to protect the health of Indonesian consumers), seems almost comically cynical in light of the fact that tobacco products (which are consumed much more broadly in Indonesia) have so far escaped many of the very sensible regulatory proposals contained in the WHO Framework Convention on Tobacco Control, since Indonesia is one of only nine countries in the world that has not become a signatory to the Convention. The power both economically and politically of the tobacco industry in Indonesia, although waning, remains very strong<sup>149</sup>, and with no domestic production of e-cigarettes to advocate for their being allowed to be sold, it is the political-economy imperatives of the tobacco lobby that has prevailed in this instance with a total ban on the sale or import of e-cigarettes.

An export ban on raw minerals that was enacted in 2009<sup>150</sup> and came into force in January 2014 has also been the concern of a number of Indonesia's trading partners.<sup>151</sup> This ban, which was imposed as part of a broader and (largely unobjectionable) industrial policy to develop domestic smelter capacity, was imposed despite the fact that China had very recently lost two disputes at the WTO that imposed similar bans (albeit with slightly different policy objectives).<sup>152</sup> However, it was not the inevitable WTO-inconsistency of the new rules that forced Indonesian policymakers to backtrack on implementation of this law, but rather the fact that during the 5-year transition period between its enactment and entry into force, very little additional smelter capacity had been created domestically. Enforcing the ban threatened to put thousands of tens of miners out of work and also had dire implications for government revenues, both of which were very undesirable outcomes in an election year. To resolve this dilemma, the Government temporarily relaxed the ban, imposing lower purity-level requirements for exports of minerals for which domestic smelter capacity was lacking and taxing exports of these minerals on a progressively increasing scale over time. However, for those minerals for which domestic smelter capacity was deemed sufficient (nickel, bauxite, chromium, gold, silver and tin), the Government of Indonesia has let the export ban stand.<sup>153</sup> It remains to be seen whether commercial interests in Indonesia's trading partners are sufficiently impacted by the ban to seek recourse to the WTO dispute settlement system. So far, only Japan has threatened to do so but has not followed up on initial steps taken in this direction.<sup>154</sup>

### 3. Labeling Requirements and Halal Certification

New labeling requirements and mandatory Halal certification for a broad range of products are also two issues looming fairly large on the trade policy horizon in Indonesia and are likely to see a significant rise in trade costs. The first of these is a new regulation<sup>155</sup> issued in late 2013 which requires the use of pre-approved labels in the Indonesian language on a broad selection of goods including some information

<sup>149</sup> See Andrew Rosser, *Challenging times for big tobacco*, available at: <http://www.insideindonesia.org/challenging-times-for-big-tobacco-4>.

<sup>150</sup> Law No. 4 of 2009 on Mineral and Coal Mining.

<sup>151</sup> See ICTSD, *Indonesia Enacts Mineral Export Ban*, published on 16 January 2014 in: "Bridges", Volume 18 - Number 1, available at: <http://www.ictsd.org/bridges-news/bridges/news/indonesia-enacts-mineral-export-ban> (accessed on 15 May 2015),

<sup>152</sup> See *China - Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum* (DS431-433) and *China - Measures Related to the Exportation of Various Raw Materials* (DS394, 395 and 398).

<sup>153</sup> See Chris Scott and Lian Yok Tan, *Indonesian Mining Law – What's Going On?* published on 28 January 2014, available at: [http://m.klgates.com/Indonesian-Mining-Law--Whats-Going-On-01-24-2014/?utm\\_source=Mondaq&utm\\_medium=syndication&utm\\_campaign=View-Original](http://m.klgates.com/Indonesian-Mining-Law--Whats-Going-On-01-24-2014/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original) (accessed on 15 May 2015).

<sup>154</sup> See <http://www.thejakartapost.com/news/2014/12/05/japan-unlikely-file-complaint-ore-export-ban-with-wto.html>. (accessed on 15 May 2015).

<sup>155</sup> *Daftar Produk Impor yang Wajib Pakai Label Bahasa Indonesia*, 10 Juni 2014, <http://bisnis.liputan6.com/read/2061248/daftar-produk-impor-yang-wajib-pakai-label-bahasa-indonesia>

and communications technology (ICT) products, building materials, motor vehicle goods, household products, and apparel and textiles.<sup>156</sup> Importers are required to submit a sample label for approval to the Ministry of Trade. The regulation originally required that the new Indonesian-language labels be embossed or printed on the goods, or wholly attached to the goods but since then the MoT has relented and stated that stickers can be used as long as they are "permanent" (presumably meaning that they cannot be removed). The new regulation also require that the labels be attached "upon entering the customs territory" which effectively removed the option previously available to simply attach stickers to the products after they had cleared customs and entered into the customs territory but before being distributed to wholesalers and retailers. The main complaints coming from the business community is that the new regulation significantly increases the costs for foreign goods to enter the Indonesian market and is likely to also result in even longer dwell times (already discussed above), since the new labels must presumably be attached before the goods can leave the port.<sup>157</sup>

Mandatory Halal certification is also set to become a source of increased trade costs for many economic operators in Indonesia.<sup>158</sup> In late 2014 the House of Representatives (DPR) enacted a hitherto highly controversial piece of legislation, namely the Halal Product Assurance Act (*Undang-Undang Jaminan Produk Halal* – UU JPH). This new law has since attracted a lot of attention from domestic economic operators as well as from Indonesia's trading partners, since it is likely to have far-reaching implications for the manufacture and sale of any products intended for human consumption in Indonesia. The scope of application of the new Act is very broad - affecting "goods and/or services that are related to foods, beverages, as well as consumer goods that are worn, used or utilized by the public" (Art 1.1) - and seems to provide for no exceptions - "products that enter, circulate, and are traded in the territory of Indonesia must be certified halal" (Art. 4). This means that anybody producing or importing the affected goods will have to not only obtain certification that they are halal, but also make far-reaching and potentially costly changes to existing production processes that could render them less efficient and certainly more costly.

The Act has a five-year transition period before it will be subject to strict enforcement with various penalties provided for non-compliance, primarily in the form of stiff fines. Most economic actors that stand to bear the brunt of the Act's impact once its transition period expires are relying on the hope that the government will either repeal it or weaken its provisions in various ways, so that it does not exude the very disruptive effects it promises in its current form. If the government does not take such steps, it risks one or several of Indonesia's trade partners challenging the act at the WTO. In any event, the uncertainty surrounding what will ultimately transpire at the end of the transition period, and what form the Act will ultimately take, as well as how vigorously its provisions will be enforced, is also not irrelevant to the cost of trading with Indonesia,

### III. Enhancing Trade Facilitation Frameworks in Indonesia

There is admittedly many aspects of improving trade facilitation that this paper could examine. In light of the time and space constraints, we have chosen to focus on three of the most poignant and at the same time deficient in the Indonesian context, namely i) the publication and availability of trade-relevant information; ii) the lack of prior notification and consultation with stakeholders in the

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<sup>156</sup> Office of the United States Trade Representative, National Trade Estimate Report on Foreign Trade Barriers, 2015, available at: <https://ustr.gov/sites/default/files/2015%20NTE%20Combined.pdf>

<sup>157</sup> USTR Trade Barriers Estimate Report, *infra*.

<sup>158</sup> Some of the findings in this section have been published previously in CITI's Indonesian Trade and Investment Quarterly, 1<sup>st</sup> Quarter 2015, available at [http://www.uph-citi.org/uploads//temp/ITIQ\\_First\\_Quarter\\_2015.pdf](http://www.uph-citi.org/uploads//temp/ITIQ_First_Quarter_2015.pdf), accessed on 15 May 2015).

legislative and regulatory process; and iii) the lack of inter-agency coordination in the enactment and implementation of the country's foreign economic policies.

## 1. Publication of Regulations and Availability of Information

The publication and availability of updated and currently-valid regulations on the import and export of goods has long been recognized as one of the critical first steps in enhancing trade facilitation.<sup>159</sup> It is for this reason that this issue figures so prominently in Article 1 of the new WTO Trade Facilitation Agreement. Some commentators have even gone so far as to contend that the lack of transparent and publicly available regulations governing trade constitutes a non-tariff barrier.<sup>160</sup>

In Indonesia, the most widely used mechanism used by the government to publish laws, regulations or other official information is the State Gazette.<sup>161</sup> However, the shortcomings of the State Gazette are fairly obvious, since it is not very widely disseminated (at least not beyond Jakarta), is only published two times per week, and only appears in hardcopy, i.e. is not published online. What is more, the GOI paints in a very broad brush when deciding what information to publish in the State Gazette, meaning that it does not focus specifically on those laws and regulations likely to impact traders directly, nor is it published in any other language besides Indonesian. This invariably means that any entities regularly performing import or export operations into or out of Indonesia, are more often than not only likely to learn about a change in applicable requirements after these have come into force and it is too late to take such steps are necessary to meet them.

This is essentially what happened to the dairy-product importing multinational discussed above, where a change in requirements that it only learned about once its product was waiting to be offloaded at Tanjung Priok, ultimately resulted in the purchase price for its imports almost doubling from 8 to 15 billion rupiah (i.e. from approximately USD 800,000 to 150,000 at the then prevailing exchange rate), as well as in lost domestic sales of over 1.1 trillion rupiah (or about 1.1 million dollars). The OECD's Trade Facilitation Indicators also recognize the various shortcomings experienced by Indonesia in this respect, ranking Indonesia's performance for the availability of information as considerably below average compared to other Asian economies and lower middle-income countries.<sup>162</sup>

A number of government agencies in Indonesia have sought to remedy this and to circumvent the constraints posed by the very outdated manner in which the State Gazette is disseminated, by publishing information on their own rules and procedures on their respective websites. However, this information is almost invariably published in Indonesian rather than English and each agency follows its own procedures and publication formats, invariably raising the burden on economic operators seeking to be comprehensively informed on all the most recent developments and requirements.

This is ultimately an issue that the Indonesian National Single Window (INSW) was established to address, with a range of harmonizing measures intended to make it easy for the many government agencies to publish and update their respective information and requirements on the INSW's online portal. However, the INSW relies too heavily on the active participation of the line ministries and

<sup>159</sup> Asian Development Bank and the United Nations, *Designing and Implementing Trade Facilitation in Asia and The Pacific 2013 Update*, 2013, available at: [http://aric.adb.org/pdf/Trade\\_Facilitation\\_Reference\\_Book.pdf](http://aric.adb.org/pdf/Trade_Facilitation_Reference_Book.pdf) (accessed on 15 June 2015).

<sup>160</sup> *Ibid.*

<sup>161</sup> Yose Rizal Damuri, *An Evaluation of the Need for Selected Trade Facilitation Measures in Indonesia: Implications for the WTO Negotiations on Trade Facilitation*, Asia-Pacific Research and Training Network on Trade Working Paper Series, No. 10, April 2006 (rev. 8/06), available at: <http://www.unescap.org/sites/default/files/AWP%20No.%2010.pdf> (accessed on 15 June 2015).

<sup>162</sup> Organization for Economic Cooperation and Development, *OECD Trade Facilitation Indicators–Indonesia*, 2014 available at: <http://www.oecd.org/tad/facilitation/indonesia-oecd-trade-facilitation-indicators-april-2014.pdf>, (accessed on 15 June 2015).

agencies, which are not under any binding or vigorously enforced obligation to notify the INSW of changes to laws, regulations, procedures and practices, and are generally content to simply provide the INSW with news and general guidelines without providing the sort of detailed and practical substantive information that economic operators require in order to be able to import and export with the desired degree of predictability.<sup>163</sup> For many, the only way to obtain information that can be considered relatively reliable is to actually visit the administrative agency or ministry in question, a process that takes time and involves high transaction costs.

## 2. Lack of Prior Notification and Consultation with Stakeholders

Before introducing new or amending existing laws that could have an impact on commerce and international trade, it is important that governments provide advance notification of their intention to do so, and consult with stakeholders on how to minimize the negative impact or disruptive effect of any planned changes.<sup>164</sup> Consultations and public discourse allow for different approaches to be examined in the pursuit of a given regulatory objective, and allows governments to enact laws in a way that reduces the burden and the cost of these changes upon producers and consumers, thereby promoting efficiency and maximizing welfare.<sup>165</sup> It is this consideration that underlies the enhanced transparency obligations being sought in the context of the new WTO Trade Facilitation Agreement.

Unfortunately, Indonesia has no system of formal public notification nor consultation prior to the enactment of new regulations.<sup>166</sup> As a result, there is generally a great deal of uncertainty surrounding the enactment of new laws and in particular their implementing regulations by the competent ministries. Business associations for foreign economic operators in Indonesia such as AmCham and EuroCham spend an inordinate amount of their time trying to obtain information from the relevant ministries and government agencies about the issuance of new regulations on behalf of their members. In many instances the only way for a company to express its views and advocate for its interests when new rules are being formulated is by seeking meetings with high-ranking officials in the ministry in question. There is no mechanism set up for interested citizens or organized interests to file submissions online as is common in many developed countries. This problem is exacerbated by the fact that government agencies are frequently replacing and revising existing regulations without providing prior notification.<sup>167</sup>

The same is true of changes to Indonesia's applied tariffs. A relatively high percentage of Indonesia's tariff bindings are bound at 40 percent and upwards.<sup>168</sup> However applied MFN rates are considerably lower, in almost all cases very close to or below 10%, with the simple average MFN applied rate being steadily reduced over the last few years, to a reported 6.9%.<sup>169</sup> The Ministry of Finance possesses and

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<sup>163</sup> Yose Rizal Damuri, *infra*.

<sup>164</sup> International Trade Centre (ITC), *WTO Trade Facilitation Agreement: A Business Guide for Developing Countries*, Geneva, 16 December 2013, available at: <http://www.intracen.org/wto-trade-facilitation-agreement-business-guide-for-developing-countries/>

<sup>165</sup> International Trade Centre (ITC), *WTO Trade Facilitation Agreement: A Business Guide for Developing Countries*, Geneva, 16 December 2013, available at: <http://www.intracen.org/wto-trade-facilitation-agreement-business-guide-for-developing-countries/>

<sup>166</sup> Yose Rizal Damuri, *infra*.

<sup>167</sup> *Ibid*.

<sup>168</sup> WTO Secretariat, *Trade Policy Review of Indonesia, Report by the Secretariat, 2013*, (WT/TPR/S/278), p. 34, available at: [https://www.wto.org/english/tratop\\_e/tp\\_r\\_e/tp378\\_e.htm](https://www.wto.org/english/tratop_e/tp_r_e/tp378_e.htm) (accessed on 15 June 2015).

<sup>169</sup> This is the figure cited in United States Trade Representative (USTR), *National Trade Barriers Estimate Report, 2015*, at p. 186, available at <https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2015/2015-national-trade-estimate>, (accessed on 15 June 2015).

exercises the flexibility to make temporary changes to customs duties on an MFN basis at the request of another ministry or government agency usually as part of efforts to stabilize domestic commodity prices (this is particularly common for staples such as rice, sugar, and soybeans).<sup>170</sup> This constitutes a source of considerable uncertainty for traders and can represent a barrier to both market entry as well as undermining the predictability of existing market access, and is exacerbated by the fact that when making changes to applied tariff rates, the Ministry of Finance announces tariff rate hikes with immediate effect, thus confounding any traders with shipments already inbound who have concluded contracts on the basis of tariff expectations that now no longer apply.

### 3. Lack of Inter-Agency Coordination

As trade policy now involves a growing number of regulatory agencies, and as trade barriers shift from the relatively simple application of border instruments such as tariffs, behind the border to much more complex areas of countries' policy sovereignty an increasing degree of inter-agency cooperation at the domestic level is required in order to maintain the free and unencumbered flow of goods and services across borders. In any given country, various government agencies have a stake in trade policy, from issuing licenses to conducting inspections, performing testing to certifying conformity with applicable regulations, a whole range of different ministerial and agency stakeholders need to cooperate and coordinate with each other in order to facilitate trade flows.<sup>171</sup>

Indonesia is plagued by a chronic lack of inter-ministerial and inter-agency cooperation or coordination, to the extent that entirely new ministerial portfolios and agencies have been created for the sole purpose of addressing this problem.<sup>172</sup> It is not uncommon that regulations from different government bodies governing the same subject exist and are implemented in conflicting ways, depending on the specific regulatory objective each agency is pursuing, with little to no coordination or even awareness of the rule-making activities of the other agency in question.<sup>173</sup>

This is admittedly a problem in Indonesia because the coordinating ministries lack any mechanism by which to coerce the ministries they are nominally charged with overseeing into adopting unified or coordinated policies or actions. Likewise, the Investment Coordinating Board, which was established in order to serve the needs of foreign investors as a one-stop shop and help them to obtain the many licenses and permits they require to start or invest in a business, is not equipped with any powers by which it can force recalcitrant or inefficient line ministries or agencies to issue licenses more promptly or to goad them out of their bureaucratic inertia. This less than optimal situation is made possible due to the fact that each ministry or agency acts with a large degree of impunity vis-à-vis all others and has broadly formulated powers to issue and implement regulations without the need to consult any other ministry or agency as to what impact new regulations may have on any conflicting regulations already in force.

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<sup>170</sup> *Ibid*, p. 39.

<sup>171</sup> Asian Development Bank and the United Nations, *infra*, page 159

<sup>172</sup> For example, there are four coordinating ministers, one for Political, Legal and Security Affairs, another for Economic Affairs, yet another for Maritime Affairs, and finally another for Human Development and Culture. In addition to this, there is an Investment Coordinating Board (BKPM) that is the first point of contact for foreign investors in Indonesia, created with the intention of helping them navigate the almost impenetrable thicket of conflicting and overlapping regulations and government competencies.

<sup>173</sup> Yose Rizal Damuri, *infra*.

The 2014 Trade Act<sup>174</sup> is a case in point. This law was enacted in order to formalize and codify the wide-ranging powers the Ministry of Trade already enjoyed over many sectors of commercial activity, which had hitherto only been governed to a limited extent by the *Bedrijfsreglementerings Ordonnantie* of 1934 that essentially regulated the issuance of business licenses. Throughout the entire Act, which comprises just over 120 articles, the term "coordinate" is only used a handful of times, and only in connection with either enforcing the Act's criminal provisions<sup>175</sup> (where the MOT has no resources to arrest or jail offenders), for promoting Brand Indonesia<sup>176</sup> (where the MOT is acutely aware of its resource constraints), or in the conclusion of so-called border trade agreements<sup>177</sup> (where the MOT must be sensitive of established and entrenched interests, particularly at the local or regional lever). The Act uses the term "cooperate" even more sparsely, and only in the context of empowering small business operators<sup>178</sup> or export development.<sup>179</sup> Many of the Act's provisions make it clear that the MOT considers itself the sole or at least final arbiter of any commercial activity in Indonesia that involves domestic or international trade. The only consultation obligations that the Act imposes on the MOT in the context of negotiating and concluding international trade agreements is with the Indonesian House of Representatives (DPR).<sup>180</sup>

However the most telling provision in terms of pointing out the lack of inter-agency cooperation and coordination is Article 97 on the National Trade Committee. In most WTO Members such a body, usually convened in the context of either WTO accession or in order to coordinate views and positions in connection with impending FTA negotiations, comprises a broad and representative swathe of line ministries and agencies having some form of regulatory authority in any aspect of the country's international economic relations.<sup>181</sup> However the Indonesian Trade Act of 2014 provides for the establishment of a National Trade Committee that is comprised almost solely of sub-level directorates under the authority of the Ministry of Trade, or academics and experts presumably to be recruited by the MOT itself. The drafters of the Act (primarily people with in the MOT itself) seemed unconcerned or unaware of the need to coordinate more broadly with other stakeholders within the executive branch. This lack of concern goes a long way towards explaining the apparent dysfunction that pervades much of the economic policy-making process that currently besets Indonesia in its foreign economic relations, much to the consternation of many of its trading partners.

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<sup>174</sup> An unofficial translation of the Trade Act made by AmCham Indonesia can be downloaded from the US Department of Agriculture's (USDA) website at: <http://usdaindonesia.org/wp-content/uploads/2014/04/Bill-Trade-Law-ENGLISH-FINAL-140219.pdf>, (accessed on 15 June 2015).

<sup>175</sup> See for example Article 103 (5) of the 2014 Trade Act

<sup>176</sup> See for example the explanatory notes (elucidations) to Article 79 (1).

<sup>177</sup> See for example, Article 56 (3).

<sup>178</sup> See for example, Art. 73 (3).

<sup>179</sup> See for example, Art. 74 (4).

<sup>180</sup> See Art. 83 f.

<sup>181</sup> For an example of how this works in the context of services negotiations, see Pierre Sauvé and Simon Lacey, A Handbook on Negotiating Preferential Trade Agreements: Services Liberalization, Asia-Pacific Research and Training Network on Trade (ARTNeT), 2013, available at: <http://www.simonlacey.net/assets/upload/b3ce10cad2fe5b4a25faecef7230ec2.pdf> (accessed on 15 June 2015), at p. 2 f.

# Implementing Genuine and Effective Reform

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## 1. Indonesia's Vision of its Future Self

In September 2012 the McKinsey Global Institute published a study entitled "The archipelago economy: Unleashing Indonesia's potential".<sup>182</sup> The study was enthusiastically received among Indonesian business and policy circles, and seemed to affirm what many observers had long been saying about the country, namely that for various demographic, economic, and other reasons linked to its generous natural resource endowments, the country stood on the brink of becoming one of the preeminent economies and geopolitical powers in the region. The McKinsey report followed on the heels of a similar document, (already referred to above), published in 2011 by the National Development Planning Agency (Bappenas) entitled the "Masterplan for Acceleration and Expansion of Indonesia Economic Development".<sup>183</sup> In the Masterplan, prefaced by none other than the then President Susilo Bambang Yudhoyono, Indonesia's policymaking elite and political leadership portrayed the country as being on the cusp of assuming the status of a "great economic power" and taking up its "rightful place among the leading economies of the world."<sup>184</sup>

More recent pronouncements by the country's current political leaders likewise paint the country as waiting to take its place among a top tier of self-selected prime nations. In his inaugural speech on assuming the presidency in October 2014, the current president Widodo urged different elements of the country, both at the grassroots level and among the nation's elites, to work together in order for the country to "build its own civilization, to become a creative, great nation that will contribute to the greatness of the global civilization".<sup>185</sup> Such ambition is hardly surprising given the country's relative size both geographically and in terms of its population.<sup>186</sup> Nor is it particularly new, since from the earliest days of the country's independence its politicians have been imbued with various visions on how the country can play a preeminent and leading role both globally and in the region, from Sukarno's very prominent role in the Non-Aligned Movement<sup>187</sup>, to Suharto's efforts to have Indonesia play a dominant role in ASEAN.

Irrespective of whether or not one shares the vision of Indonesia ever taking up its place in the G8<sup>188</sup>, most Indonesians today tend to view their country as well on the way to eventually becoming a developed, industrialized nation, which is not surprising given that the country has today enjoyed more than a decade of uninterrupted economic growth, a trend that has only recently started to slow. Many, if not most Indonesians also consider that the collusion, corruption and nepotism that so held the country back in the past is something that is slowly relegated to the country's history by successive generations of democratically elected leaders and a steady strengthening of those institutions

<sup>182</sup> See: [http://www.mckinsey.com/insights/asia-pacific/the\\_archipelago\\_economy](http://www.mckinsey.com/insights/asia-pacific/the_archipelago_economy) (last visited on 20 June 2015).

<sup>183</sup> The original document can be downloaded from various sources, including the website of Bappenas itself: <http://www.bappenas.go.id> (last visited on 20 June 2015).

<sup>184</sup> These two quotes taken from the document's preface.

<sup>185</sup> This from a non-official translation, provided by the Jakarta Globe, available at:

<http://jakartaglobe.beritasatu.com/news/jokowis-inaugural-speech-nations-seventh-president/> (last visited on 20 June 2015).

<sup>186</sup> Indonesia is the largest island nation in the world, has a population of 240 million people, and is the largest economy within ASEAN.

<sup>187</sup> See: Guy Arnold, *The A to Z of the Non-Aligned Movement*, The Scarecrow Press, 2010, at p. 85 and numerous other places in the volume that discuss the role Sukarno played in convening the 1955 Bandung Conference that officially launched the NAM.

<sup>188</sup> Indonesia is already a member of the G20.

established to promote and enforce accountability. In short, Indonesia's vision of its future self is of itself as a more prosperous nation, but also one with more equality of opportunities and a fairer allocation of the country's vast wealth. Where the country saw itself as wanting to go was very much on display during the 2014 presidential elections, when the electorate was given the choice between a politician that very much represented the old guard (Prabowo Subianto) and the (relatively) young and charismatic Joko Widodo, who himself had very few ties to the established and entrenched political elites or institutions that had played such a dominant role in the country's post-independence history.

## 2. Fulfilling the Promises of a Reformist President

In 2014 the Indonesian people voted for change and for a politician who promised them a break with what was widely perceived as a dysfunctional past. Since he was inaugurated as president, Widodo's popularity has risen and fallen as a function of voters' perceptions of his ability to deliver on these promises and implement both a change in the country's underlying political and economic power dynamics, as well as oversee a rise in equality in terms of access to opportunities and economic outcomes. So far, it is probably safe to say that he has fallen somewhat short of the promises he made or the enthusiasm he engendered, as well as likewise failing to live up to the (albeit limited) track-record he established in his two previous positions of elected political office, the first as the mayor of Solo (a medium-sized city in central Java), and then as the governor of Jakarta.

Widodo's election victory was arguably secured thanks to the public's perception of how he had been a very pragmatic, results-driven, and above all, clean mayor of Solo and subsequently governor of Jakarta. Widodo was seen to be a man who, unlike his predecessor as governor of Jakarta Fauzi Bowo, was not perceived as simply coddling up to and colluding with the city's developer elites. Instead Widodo was seen to have been a governor who worked hard to tackle the real problems that affected the lives of everyday people, such as the annual flooding that regularly inflicted misery on tens of thousands of the city's inhabitants during the rainy season. Widodo also scored a lot of points as governor by regularly showing up unannounced in the offices of the city's administration and demanding to know why municipal leaders were failing to deliver public services more efficiently. This is a leadership style he has likewise sought to continue as the country's president, despite the obvious difficulties it imposes on his security detail and the press corps.

President Widodo assumed office on the basis of an election manifesto and promises to boost the country's economic performance, as well as to tackle corruption and waste in the public sector. He also promised to re-prioritize spending and bring about tangible improvements to such areas as education, healthcare and transport infrastructure.<sup>189</sup> As was to be expected, he has faced a number of setbacks, which is hardly surprising given the fact that he is himself part of a broader party organization very much rooted in the political legacies and political/economy elites that so successfully established and perpetuated themselves in post-independence Indonesia.<sup>190</sup> We discuss some of the realities the new reformist president has had to contend with in the next section.

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<sup>189</sup> See: <http://www.theguardian.com/australia-news/2014/oct/20/joko-widodo-takes-office-in-indonesia> (last visited on 20 June 2015).

<sup>190</sup> President Widodo came to power as the candidate of the Indonesian Democratic Party of Struggle, an opposition party that was established by and to this day remains firmly in the hands of Megawati Sukarnoputri, the daughter of the country's first post-independence president, and herself the 5<sup>th</sup> president of Indonesia from 2001 to 2004. Megawati is without doubt very firmly part of the country's economic and political elite.

### **3. The Realities Imposed by Entrenched Elites and an Inert Bureaucracy**

Although he swept to power on the crest of a popular groundswell of public opinion, President Widodo, unlike his predecessor, did not emerge from the ranks of wealthy and connected political families or from established institutions like the armed forces. Apart from his popularity, it was never very clear where his powerbase resided, and this has become an increasingly acute problem whenever policy choices have forced him to confront entrenched elites or tackle vested interests head on. One such confrontation occurred in early 2015, just a few months after taking office, and involved the choice of a new national police chief. The controversy centered around Comr. Gen. Budi Gunawan, a figure with longstanding ties to Megawati. A few days after being nominated for the position he was named a suspect in a graft case by the Corruption Eradication Commission (KPK). Other civil society organizations were also displeased by the choice of Gunawan, since he was widely perceived to be part of the very real problem of endemic corruption in the police force (given his well-known personal wealth). When President Widodo sought to distance himself from Gunawan, he faced the opposition of his own party and of parliament, who quickly approved the nomination. The initiation of a graft case by the KPK also unleashed a wave of attacks against it by members of the police, with the entire KPK effectively having to resign as the police itself initiated criminal cases against them. Although this affair was ultimately resolved by Gunawan being appointed to the position of deputy police chief instead of the top job, it led to the (arguably irreparable) weakening of the KPK and also was an episode where President Widodo's leadership was generally perceived to have been less than firm.

The prevailing power-dynamics and the existence of a plurality of stakeholders and interests has forced Widodo to tread very carefully and to play his hand very delicately. If he oversteps the very limited authority the presidency gives him, he could easily find himself the target of impeachment proceedings in parliament, although this would itself be a hugely destabilizing move given the popularity Widodo currently still enjoys at the grassroots level. For now, Widodo has very little choice but to cajole and delicately coerce opposing sides and interests into compromises that are ultimately in the interest of long-term reform, without forcing the hand of any powerful interest group that could successfully mobilize opposition to him. For now, the country's business and political elites are playing along with President Jokowi, hoping that the reforms that he seeks to introduce can ultimately be harnessed to their own benefit.

## Concluding Remarks

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Indonesia is an economy on the verge of realizing its long-held ambitions to become a great regional power, a position that, thanks to favorable demographics, it would be able to maintain for many decades. Indonesia is also a nation that has weathered many storms and has always managed to emerge stronger, more focused and more resilient. Sadly, or perhaps somewhat typically of many democracies, both old and young, Indonesia also seems to realize the most rational and broadly welfare-enhancing policy breakthroughs when faced with an unfolding or imminent crisis. Economic commentators and political observers are currently debating whether Indonesia likewise stands on the verge of such a crisis, with output and employment both taking a downward turn, and many years of economic growth seeming to sputter. Whether or not this turns out to be true, going into the second year of the newly elected president Widodo's term seems as good a time as any to enact a set of bold reforms that would sweep away a number of the more entrenched structural bottlenecks plaguing the economy. This is especially true, as the new president emerges wiser and more confident from the very steep learning curve that was his first twelve months in office.

In this study we have analyzed a number of hard and soft constraints currently holding the country back from achieving its vision of itself. We conclude that the main thing missing is a significant awareness on the part of policymakers of the need to change, as well as the will to take and implement the hard policy choices that change would inevitably entail. As the very nature of international trade and investment flows is rapidly changing, the thinking and policy orientation of the country's leaders and established institutions are failing to keep up with the demands placed on Indonesia by the 21st Century global economy. Indonesia, like so many countries, finds itself in a competitive race to cultivate, attract and retain both skills and capital and to then deploy both in order to maximize economic outcomes for the largest possible number of its people. Instead, many parts of the Indonesian economy are run, as they have been for many decades, for the sole purpose of continuing to enrich entrenched elites.

Aid for Trade and other initiatives like it can make many contributions, not least of which would be to shed some light on both the short and long-term costs of these failures, and to show policymakers the benefits and the practicalities of finding a way out of the status quo, thereby helping them to garner significant political will to do so. An awareness of both the existing bottlenecks and the costs they impose on the wider economy, (particularly the role they play in perpetuating income inequality and thus poverty), would likely be enough to generate sufficient political will to usher in some degree of significant change. This is particularly true when viewed in the context of how other regional economies – when faced with similar constraints – have mobilized to increase their own relative competitiveness.

This is where Aid for Trade and organizations like the WTO, the World Bank, the OECD, APEC and the Asian Development Bank can contribute to a better understanding among electorates and elites of the ultimate failure of policies that seek to stymie properly sequenced, sensible and economically meaningful trade and investment liberalization that enhances competition and benefits both consumers and businesses. We sincerely hope that this study has made a modest contribution to that effort.

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