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Economic Openness

Indonesia Case Study

2019

CREATING THE PATHWAYS FROM POVERTY TO PROSPERITY

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The Legatum Institute is a London-based think tank with a global vision: to see all people lifted out of poverty. Our mission is to create the pathways from poverty to prosperity, by fostering Open Economies, Inclusive Societies and Empowered People.

We do this in three ways:

Our **Centre for Metrics** which creates indexes and datasets to measure and explain how poverty and prosperity are changing.

Our **Research Programmes** which analyse the many complex drivers of poverty and prosperity at the local, national and global level.

Our **Practical Programmes** which identify the actions required to enable transformational change.

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FOREWORD



Stephen Brien
Director of Policy,
Legatum Institute

Our mission at the Legatum Institute is to create pathways from poverty to prosperity by fostering open economies, inclusive societies, and empowered people. Our work is focused on understanding how prosperity is created and perpetuated. Prosperity is much more than material wealth; it also encompasses welfare, security, wellbeing, freedom, and opportunity. Without an open, competitive economy, however, it is very challenging to create lasting social and economic wellbeing where individuals, communities, and businesses are empowered to reach their full potential, explaining our emphasis on Economic Openness.

With the generous support of the Templeton World Charitable Foundation, we have created a Global Index of Economic Openness to rank 157 countries' openness to commerce, assessing the environment that enables, or hinders, their ability to trade both domestically and internationally. We aim to create a valued tool for leaders and advisers around the world, helping to set their agendas for economic growth and development. As part of this program of work, we are undertaking a series of in-depth country case studies based on the Index, including this report on Indonesia, in which we analyse Indonesian performance in the key characteristics of openness to trade, investment, ideas, competition, and talent.

Trade between countries, regions, and communities is fundamental to the advance of innovation, knowledge-transfer and productivity that all serve to create economic growth and prosperity. The spread of free trade has enabled more and more people to participate in commerce, allowing them to move from subsistence farming towards a more stable and prosperous existence. More recently, the technological revolution has enabled millions of people to take part in commercial, political, and social discourse thanks to the accessibility and affordability of new technology.

Our research shows that economically open countries are more productive, with a clear correlation between increased openness over time and productivity growth. Conversely, in an uncompetitive market, or one that is not designed to enhance the engagement and wellbeing of all, growth stagnates, protected industries become entrenched, and crony capitalism thrives.

While most policymakers focus on the big fiscal and macroeconomic policy tools at their disposal, the microeconomic factors are sometimes overlooked, and their potential to drive openness and growth is underestimated. A notable feature of this Index is a focus on these microeconomic drivers of productivity. By bringing the full range of disparate policy choices that influence and drive openness and competition together in one report, we hope to shift the focus of policymakers, in Indonesia and around the world, towards the broader implications of microeconomic policy by emphasising the relationship between productivity and Economic Openness.

Indonesia is a country with extraordinary potential. It has the world's fourth largest population and will become one of the largest economies in the world. With its economy growing around 5% per year, there are many reasons to be optimistic about Indonesia's future. As well as having a large domestic market to sell to, through membership of the

Association of Southeast Asian Nations (ASEAN) it has access to a number of markets around the world. The banking system is strong, and businesses are improving access to finance. In particular, its venture capital market has been improving as well, helping to fund a dynamic start-up scene.

On top of that, it is also one of the world's youngest and largest democracies. Its institutions are fragile but surprisingly robust for a new democracy. Elections are considered free and fair, and it is politically stable. While the government faces many policy challenges, fiscal and monetary policy has been effective and disciplined.

However, Indonesia still has a challenge to bridge the gap with some of its better performing peers. Since 1990, GDP per capita has grown at a slower rate than many of its peers, such as Thailand, Malaysia and China. Underlying many of Indonesia's challenges is a legacy of economic nationalism that has sought to protect and promote Indonesian industry at the expense of foreign companies, which can bring much needed, capital, goods and expertise into the Indonesian market.

As President Joko Widodo enters his second term, his administration is addressing major challenges, not least in building infrastructure, attracting international investment, and creating a labour force for the 21st century.

Some of the reforms required are not straightforward and call for political courage. It requires confronting vested interests in government and private sector. It also requires creating a new consensus around the policies that promote Economic Openness.

It is our conviction that greater Economic Openness will bring greater prosperity to Indonesia. The recent re-election of Joko Widodo is promising in that Indonesians have chosen a President committed to infrastructure, human capital, investment, and reforming the bureaucracy – all critical elements underpinning Economic Openness.

These changes bode well for Indonesia's future. We are hopeful that Indonesia will seize the opportunities available to it.

A handwritten signature in black ink, appearing to be 'Joko Widodo', written in a cursive style.

EXECUTIVE SUMMARY

The Legatum Institute's mission is to create the pathways from poverty to prosperity, by fostering open economies, inclusive societies and empowered people. Our work is focused on understanding how prosperity is created, by providing the research, ideas, and metrics to help leaders make informed choices.

We believe that prosperity is the result of economic and social wellbeing working together. This report on Indonesia is part of a series examining Economic Openness around the world, and its links to prosperity. The analysis is informed by the insights generated by our Global Index of Economic Openness.

Our definition of Economic Openness in this report is broad, developed out of decades of established academic theory and in conjunction with leading thinkers on this issue.¹ It is about more than just trade and regulation – it is about the wider conditions that exist in a country that can either help or hinder that country's economy.

Indonesia's potential is enormous. The sheer size of the Indonesian market is an advantage that allows for growth and development of Indonesian firms, as well as attracting foreign firms and investors. As a member of ASEAN it can make use of important trade connections in Southeast Asia and around the world.

In macroeconomic, monetary and fiscal policy, Indonesia has performed well. The trauma of the 1998 Asian Financial Crisis resulted in a more consolidated financial sector, and a political consensus around competent, sober fiscal and monetary policy.

Importantly, it has a stable political environment and reasonably robust democratic processes. It has an active civil society and media that has influence. It also has a strong banking system and sound economic policy, as well as an expanding availability of finance. And Indonesia has proven to have the entrepreneurial spirit that will continue to enhance the lives of its people, as evidenced by its dynamic start-up scene in e-commerce.

All of these provide some of the prerequisites for further development. However, as Indonesia enters the coming five years of President Widodo's new term, it faces other policy challenges across a number of areas. In this report, we assess the extent of these challenges across four fundamental characteristics of open economies:

- **Market Access and Infrastructure**, such that products and services can be easily produced and delivered to customers;
- **Investment Environment**, such that domestic and foreign sources of finance are widely available;
- **Enterprise Conditions** that ensure markets are contestable and free from burdensome regulation;
- **Governance** that is underpinned by the rule of law, in addition to government integrity and effectiveness.

1. We have benefitted from the input of 40+ advisors. Full details can be found on www.li.com.

Our analysis indicates a clear link between the extent to which a country's economy exhibits these characteristics and its productive capacity (see the Global Index of Economic Openness Report). This link is supported by a long history of academic literature, also evident in economic histories of those countries that have achieved a high level of economic wellbeing. Indonesia's Economic Openness is improving. It is ranked 68th in the world, having risen six places in the last decade. This improvement has been across the board, but most notably in the strengthening of its investment environment, and its environment for business creation.

MARKET ACCESS AND INFRASTRUCTURE (INDONESIA RANK: 85TH)

Indonesia's Market Access and Infrastructure is improving, rising five global ranks over the last decade. However, it remains a point of weakness for its economy. The provision of communications, supply of power and movement of goods and people across Indonesia have all been hindered by infrastructure that has not developed at the pace of the economy. Mobile bandwidth is low, and broadband access is very limited, at just 2.4 subscriptions per 100 people. Private investment in electricity generation is constrained by price caps and local content rules. Blackouts and distribution problems persist, as a result of the poor performance of PLN, the state-owned electricity distributor.

The unique geography of the Indonesian archipelago adds to the challenge of developing infrastructure to support a modern economy. Reliance on state-owned enterprises (SOEs) to deliver infrastructure projects, has seen only partial success. Private investment has been crowded out by a combination of over-reliance on SOEs and burdensome regulations, such as local content requirements.

Recognising that the country requires significant investment, particularly outside of Java, President Widodo has placed a much-needed emphasis on infrastructure, by increasing the budget for necessary projects to address the challenge. Given fiscal constraints, securing private investment in infrastructure is a critical alternative financing mechanism. To do so will mean reforming regulations that stifle investment (such as local content requirements), making better use of techniques, such as public-private partnerships, to deliver projects and creating genuine tender processes for government projects, thereby granting more major project contracts to private companies. This will be needed to fund the 5,400 kilometres of roads planned by the government in coming years.

Economic Openness is particularly sensitive to the quality of logistics and infrastructure at border points and ports. Dwell times at Indonesian ports are worse than surrounding countries, where it takes an average of 80 hours to comply with border regulations, causing significant costs to importers. These delays are due to poor infrastructure and administrative delays. Yet, improvements have been made, thanks to the government's renewed focus on improving the trade dwell times of containers. Nonetheless, further investment in infrastructure around ports and a reduction of bureaucratic delays would help to shrink high logistical costs.

Indonesia has made significant progress in establishing trade deals with most major trade partners through its membership of ASEAN; it has trade agreements with countries equating to roughly 30% of world GDP. Although Indonesia has privileged access to EU and U.S.

markets, through the generalised system of preferences (GSP), it has no trade deal with EU and the U.S., with the existing GSP constantly subject to withdrawal (as the U.S. has recently done with India).

However, beyond the ASEAN nations, tariffs and import quotas are used to protect domestic industries such as food, textiles and the auto industry. Import quotas and tariffs also hand power to importer cartels, which drives up the cost of imported goods, and stifles the creation of a dynamic and competitive industry. Indonesia also uses non-tariff measures (NTMs) extensively, with 634 NTMs registered with WTO. There are also local content rules, as well as subsidies on energy and fertilisers. These subsidies favour domestic production, leading to a lack of choice and competitively-priced goods in sectors where Indonesia's establishment of a long-term competitive advantage is unclear. Collectively, these policies have had the effect of inhibiting foreign capital, and more importantly, foreign expertise, entering Indonesia.

For consumers to see better-priced goods and for the development of its industries (through competition and foreign investment), Indonesia should continue to remove protective measures, as each one ultimately costs consumers. Further competition would benefit Indonesian industry and eventually lead to more efficient and productive manufacturing and agriculture.

INVESTMENT ENVIRONMENT (INDONESIA RANK: 53RD)

Indonesia's Investment Environment is a source of strength for the economy, and has seen the most dramatic improvement of all four pillars, rising 34 global ranks over the last decade.

The strength of Indonesia's investment environment is underpinned by its improving financing ecosystem and investor protections. It has a solid banking system and a relatively high savings rate at 34% of GDP, compared to the global average of 25%. While relatively small, the stock market is growing, and there are increased inflows of venture capital. SMEs have better access to finance through technology and more bank branches. Investor protections have been improving, through better insolvency practices and comparatively good recovery rates from insolvent companies. Corporate governance is also improving, as is reporting and auditing.

At the beginning of the second term, the President has prioritised increasing investment. To enable further investment from a wider range of sources, the government could consider strengthening investor protections by granting shareholders the ability to sue directors, and also to facilitate the development of more diverse investment products to serve their needs.

Clear property rights are a critical safeguard for investors, and Indonesia has mechanisms in place to settle disputes between private parties, with improvements becoming evident over time. Yet there is a moderate expropriation risk in sectors where the government has a strategic interest, such as in mining. Similarly, intellectual property law is increasingly conforming with international norms, but there are still incidents of theft and 83% of all software is estimated to be unlicensed. The government also has power to remove patent rights where they are not being used or for reasons of public interest. In both cases, reducing the real or perceived risk of government expropriation would facilitate greater investor interest.

The primary risk for those seeking to enforce a contract is that, in practice, enforcement of judgments is not timely. In addition, due to the lack of following precedent, the decisions of the courts can be unpredictable. The most important opportunity for improvement is to increase predictability in decision-making.

At 2% of GDP, Indonesia's level of FDI is less than half of the global average. Restrictions on international investment are more extensive than many other countries, and slow the inflow of foreign capital and foreign expertise. Negative lists banning foreign ownership exist, although these are being reduced. There are also restrictions on foreign ownership of land, and Indonesia's termination of numerous bilateral investor treaties has reduced certainty for foreign investors. To encourage increased investment from overseas, the government should continue to reduce the domestic investment list, or even announce a "positive investment list" of sectors in which investment is encouraged and incentivised.

ENTERPRISE CONDITIONS (INDONESIA RANK: 61ST)

Indonesia has made progress towards creating better Enterprise Conditions across the archipelago, although not quite at the rate of its peers – falling three global ranks over the last decade. In certain sectors, Indonesia has a dynamic and open economy, home to some of the largest e-commerce companies in Southeast Asia, as well as a vibrant start-up environment. However, in others the informal sector dominates, leading to a lack of access to finance and constrained growth opportunities.

Many industries are highly concentrated or dominated by SOEs, in which the government has a vested interest. The SOEs expose the government to financial risk, as they raise money privately, as well as crowding out private competition. The competition authority (KPPU) is relatively weak, and has limited ability to bring cases. Indonesia could improve contestability by reducing state dependence on SOEs and strengthening the role of the KPPU in tackling anti-competitive behaviours.

The widespread existence of informal businesses is evidence of the high degree of regulation in the formal sector, burdening mostly larger and international companies. The lack of businesses entering the formal sector means Indonesia loses potential tax revenue, and results in a lack of ambitious, growing businesses. To address this, the government has made it easier to start and run businesses, reducing the time it takes to register a business from 181 days in 2004 to 20 days in 2019. However, it is not clear whether these changes are implemented well across Indonesia's regional governments.

The government could go further to make it easier to run a business across Indonesia, which would lead to businesses expanding through greater access to capital. Registration of business, the ease of paying taxes, and the obtaining of permits (specifically construction ones) could all be simplified further. Indonesia's dynamic start-up scene should provide inspiration.

Indonesia's labour market is both an opportunity and a risk. With the labour force expanding by millions of people annually, Indonesia stands to reap a significant demographic dividend from its young population. However, a large and growing skills gap threatens to stifle economic growth. By one estimate, Indonesia will have a shortage of 3.8 million workers with post-secondary education in 2030. As the President has himself identified,

improvements to education are paramount. Increased immigration is only a short-term option; the education system is pivotal to longer-term benefits, as firms must commit to training their workforce.

A compounding challenge is Indonesia's set of labour regulations, which work against businesses hiring permanent staff. Indonesia has some of the world's highest redundancy costs at 108 weeks of salary, leading many employers to avoid (formal) hires. More favourably, the mechanism for adjusting the minimum wage has been streamlined, which has provided more clarity for employers. Nonetheless, Indonesia could reduce the burdens for firms entering the formal sector by reducing redundancy payments and making hiring and firing easier.

GOVERNANCE (INDONESIA RANK: 63RD)

The quality of Governance in Indonesia has been improving at a rate faster than peers, resulting in a rise of nine places in the global rankings over the last decade. However, this rate of improvement has slowed in recent years.

Indonesia's systems of government are reasonably effective and robust. Elections are free and fair, with a vibrant civil society, resulting in a large and diverse legislature that champions fixed roles. Consequently, the executive is reasonably constrained by the legislature. Any ruling coalition will contain a myriad of political interests with differing agendas. This is a feature of Indonesian political life unlikely to change, thus requiring a strong president who is able to command his agenda.

As a multi-faith country with the world's largest Muslim population, religion plays a major political role. Muslim and non-Muslim groups have polarised, evident in the trial of the former Jakarta governor for blasphemy. There is a risk of politicians appealing to anti-capitalist and anti-globalist sentiment, further polarising the system and promoting economic nationalism.

A particular point of weakness for Indonesia's governance is the inconsistent application of the rule of law. The courts are not particularly effective for businesses, lacking binding precedent – making court proceedings an unpredictable route for businesses to resolve disputes. This is partly due to corruption, which is pervasive throughout all areas of government, including the national parliament.

Aside from misappropriated funds, the true cost of corruption lies in lost opportunity. Nonetheless, the corruption eradication commission has been moderately effective at tackling corruption. As of September 2017, there were 343 regents or mayors and 18 governors who had been investigated for corruption. There have also been improvements in the transparency of government policy, and civil society will often publicly highlight examples of corruption.

More importantly, however, government often does not deliver services and projects in a timely or efficient manner. The willingness to radically decentralise power demonstrates a desire to bring government services closer to ordinary Indonesian citizens, rendering them more responsive to local economic conditions. While this has arguably led to greater accountability, it has failed to deliver its full potential to improve service delivery across Indonesia.

There are often misaligned incentives and overlapping jurisdictions between central and local governments. Yet any problems at this level are exacerbated by the lack of coordination both within the central government and in their relation to decentralised governments. The central government has 34 ministries with many overlapping jurisdictions, and could benefit from simplification by reducing roles and streamlining responsibilities. Simplification of central government departments, and greater coordination between ministries and with local governments, would ensure policy can be delivered effectively.

Many central government agencies lack good project management practices. Local governments also generally lack the competence and ability to implement projects, and regulatory quality is poor. It is not clear that the tools exist to develop well thought-out regulations, at either a central or local level. There is pressing need for capacity building across government. In particular, encouraging the use of tools, like regulatory impact analysis, would ensure an efficient use of public resources. Assisting governments to build the capacity needed to deliver projects should ensure greater successes in policy delivery.

LOOKING FORWARD

Analysing Economic Openness and assessing its positive effects on prosperity is now a time-sensitive task, with the benefits of globalisation and Economic Openness being questioned in the wake of the global financial crisis. We continue to see the impact of the crisis in public debate ten years on, with the rise of nationalism and populist politics in Indonesia, and across the world.

Yet globalization continues apace. The degree of connectivity, the exchange of ideas, and the levels of cross-border trade and commerce have fully recovered in the decade since the crisis. Trade between communities, countries and regions continues to spread innovation and transfer knowledge, to boost productivity and ultimately foster economic growth. However there is a question as to whether the level of international trade will outpace overall economic growth in future (thereby enhancing the spread of innovation), or merely keep pace with overall output.

One of the choices for policymakers around the world seeking to ensure sustainable prosperity is to resist protectionism, and instead reinvigorate the trade liberalization agenda. In the aftermath of the crisis, when global trade flows slowed dramatically, many governments in both developed and developing countries contemplated or were pushed into using trade policy instruments, especially in the form of non-tariff measures, to protect their domestic industries and producers.

As Joko Widodo starts his second term, his challenge is to continue improving the openness of Indonesia's economy, paying particular attention to encouraging greater competition, both domestically and internationally, while maintaining enough broad-based political support for reform programmes.

INTRODUCTION

This case study on Indonesia is part of a series we have published on Economic Openness. We have produced a Global Index of Economic Openness, providing rankings and analysis of the performance of the different nations of the world. We are also publishing ten in-depth case studies of countries at a range of stages of economic development.

We have chosen Indonesia as one of these case studies because it has enormous economic potential. With the world's fourth largest population, it is the largest economy in Southeast Asia, and the 16th largest globally. By 2050, it could be the world's fourth largest economy.¹

Since the Asian Financial Crisis in 1998, Indonesia has become a fully-fledged democracy, maintaining an economic growth rate of around 5% annually. Over the last five years, this has corresponded to a per capita growth rate of approximately 4%. Key features of Indonesian policy during the last 20 years include increased fiscal prudence through restricting annual deficits to 3% of GDP and keeping overall government debt below 60% of GDP, decentralisation of most government functions to the sub-regional level, increased openness to international investment, and greater integration into the global economy through membership of ASEAN and bilateral trade deals. In more recent years, there has also been a large focus on the building infrastructure, with the Widodo administration massively increasing infrastructure investment since 2014.

We examine past performance, present conditions, and identify how the government might strengthen opportunities and neutralise potential threats moving forward. The analysis of Indonesia's performance in this report focuses on what we consider to be the key drivers of economic wellbeing across the world. These are organised around four pillars.

Market Access and Infrastructure measures the quality of the infrastructure that enables trade (Communications, Transport and Resources), and the inhibitors on the flow of goods and services to and from a country's trading partners. Where markets have sufficient infrastructure, few barriers to trade, and smooth border clearance, commerce can flourish. Such trade leads to more competitive and efficient markets, enabling new products and ideas to be tested, funded, commercialized and ultimately benefiting consumers, through a greater variety of goods at more competitive prices.

Investment Environment measures the extent to which investments are protected adequately through the existence of Property Rights, Investor Protections and Contract Enforcement, and also the extent to which domestic and international capital (both debt and equity) is available for investment. The more a legal system protects investments, for example through Property Rights, the more that investment can drive economic growth.

Enterprise Conditions measures how easy it is for businesses to start, compete, and expand. Contestable markets with low entry barriers are important for businesses to innovate and develop new ideas. This is essential for a dynamic and enterprising economy, where regulation enables business and responds to the changing needs of society.

1. See, for example: "The World in 2050," PwC, last accessed September 10, 2019, <https://www.pwc.com/gx/en/issues/economy/the-world-in-2050.html>

MARKET ACCESS AND INFRASTRUCTURE	INVESTMENT ENVIRONMENT	ENTERPRISE CONDITIONS	GOVERNANCE
<ul style="list-style-type: none"> • Communications • Resources • Transport • Border Administration • Open Market Scale • Import Tariff Barriers • Market Distortions 	<ul style="list-style-type: none"> • Property rights • Investor Protection • Contract Enforcement • Financing Ecosystem • Restrictions on International Investment 	<ul style="list-style-type: none"> • Domestic Market Contestability • Environment for Business Creation • Burden of Regulation • Labour Market Flexibility 	<ul style="list-style-type: none"> • Executive Constraints • Political Accountability • Rule of Law • Government Integrity • Government Effectiveness • Regulatory Quality

Governance measures the extent to which there are checks and restraints on power and whether governments operate effectively and without corruption. The nature of a country's Governance has a material impact on its prosperity. The Rule of Law, strong institutions, and Regulatory Quality contribute significantly to economic growth, as do competent governments that enact policy efficiently and design regulations that deliver policy objectives without being overly burdensome. The following chapters examine in detail Indonesia's performance across the four pillars and the discrete elements that constitute our measure of Economic Openness. Our assessment of Indonesia is based on its rankings in global datasets, from sources including the World Bank, World Economic Forum and International Monetary Fund. (See the appendix for a complete list of data sources).

It is important to note that Economic Openness is not consistent across Indonesia. Firstly, there are significant regional differences. Indonesia is a hugely diverse country, with diverse ethnicities, languages and cultures. Not only that, but decentralisation empowers local governments to enact regulations or enforce national regulations differently. Additionally, in many places where our index captures regulations, there is often a significant gap between a regulatory change and that which happens on the ground. Often a regulation is implemented badly, or differently across Indonesia.

Furthermore, the index mostly captures characteristics of the formal economy, yet Indonesia's large informal economy plays a significant role. For example, much of the data on starting a business will not capture the experience of millions of informal businesses across Indonesia. As the Indonesian economy grows, however, more businesses will be brought into the formal sector, with regulatory encouragement and incentivisation. Where the publicly available data used in the index does not capture the full and varied picture of economic openness in Indonesia, this report seeks to expand on that data through additional analysis.

We hope that this analysis will be of use to policymakers elsewhere who might seek to draw lessons from Indonesia economic prosperity.



MARKET ACCESS AND INFRASTRUCTURE (INDONESIA RANK: 85TH)

An environment supportive of trade and commerce will allow new products and ideas to be tested, funded, commercialized, and more easily delivered to customers. Our Market Access and Infrastructure pillar comprises both the critical enablers of trade (Communications, Transport, and Resources) as well as the inhibitors (Border Administration, Open Market Scale, Import Tariff Barriers, and Market Distortions).

The benefits of free trade are often explained in terms of Ricardian comparative advantage and enhancing consumer choice. Trade empowers individuals and encourages competition. Offering choices to consumers and businesses about which products, services, and ideas they can buy domestically and internationally is at the core of free trade.

Crucially, trade also communicates new ideas and raises productivity.¹ Competition from international trade ensures that businesses exporting goods must respond to new ideas from the increased domestic market competition.

INDONESIA. SWOT Analysis of Market Access and Infrastructure

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • Cheap and accessible mobile broadband • The Widodo administration is committed to investing in infrastructure • Indonesia contains a large domestic market with world's fourth largest population • Membership of ASEAN and other bilateral trade agreements give access to several trade deals with countries around the world 	<ul style="list-style-type: none"> • Severe strains on electricity generation and supply across Indonesia • Disparate infrastructure across the archipelago, with ports poor at processing cargo • Immature project management and procurement processes in Indonesian government • National growth strategy relies on SOEs • Large number of import tariff quotas, subsidies and other barriers to the free trade of many goods and services
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Increased access to broadband and 4G to enable a digital economy • Continued reform of energy subsidies • More private infrastructure providers • Reduced dwell time at ports • Ratification of trade agreement with Australia • Conclusion of trade negotiations with the EU • Enormous renewable energy resources for electricity generation • It occupies a strategic location on global trade routes, between the economic powerhouses of China and India 	<ul style="list-style-type: none"> • Indonesia loses preferential access to U.S. and European markets • Asian competitors outperform Indonesia • SOEs inhibit private investment in infrastructure

1. Sebastian Edwards, "Openness, productivity and growth: What do we really know?" The Economic Journal 108, no. 447 (1998): 383-398.

Evaluating Market Infrastructure and Access

The infrastructure that enables trade and commerce to operate can be measured by both the critical enablers of trade, predominantly infrastructure, and also inhibitors to access to markets.

The first enabler of trade is **Communications**, including fixed line and mobile telecoms and internet penetration, which facilitate mass participation in the formation, ownership, and monetisation of ideas.

The second enabler of trade is **Resources**, which includes water and energy. We measure both the availability and reliability of these critical elements.

The third enabler of trade is **Transport**, which makes possible both physical trade in goods and trade in services, which often requires the movement of people.

In addition to the enablers of trade, we also assess the policies and procedures that inhibit trade.

The first inhibitor to trade is **Border Administration**, which measures the financial and time cost of the documentation necessary to move goods across a border.

The second inhibitor to trade is **Open Market Scale**, which measures the size of the market to which providers of goods and services have privileged access. Countries with greater access to other markets trade more than those that do not.

The third inhibitor to trade is **Import Tariff Barriers**, which we measure in terms of the trade weighted average tariff goods face when coming into a given country.

The fourth inhibitor to trade is **Market Distortions**, which includes subsidies, taxes, and regulatory barriers.

Indonesia's Market Access and Infrastructure is improving, and now ranks 85th globally. President Widodo has placed a much-needed emphasis on infrastructure, by increasing the budget for necessary projects. In the following sections, we review the performance of Indonesia in each of the distinct elements of Market Access and Infrastructure, from Communications through to Market Distortions.

COMMUNICATIONS (INDONESIA RANK: 114TH)

The free exchange of information, underpinned by good communications infrastructure, is a vital component of Economic Openness. Moreover, the advent of communications technology as an end-product has created economic opportunity for innovative companies and countries. Whole societies have been transformed by this evolution in communications technology. Our measure looks at a wide range of forms and measures of communication, from fixed line and mobile telecoms to broadband speeds and penetration rates.

Businesses are constrained by slow internet speeds and low mobile network bandwidth.

Indonesia ranks 114th in the world for Communications, up six places in 10 years. Fundamental to Indonesia's success is a good telecommunications infrastructure, with estimates that the online commerce industry will grow eight-fold from 2017-2022, supporting 26 million jobs.^{2,3} Yet businesses are constrained by slow speeds and low mobile network bandwidth.

The number of fixed broadband subscriptions has increased, but it remains relatively low at 2.4 per 100 people, compared to 3.2 in Philippines, 8.5 in Malaysia, 11.9 in Thailand, and 11.8 in Vietnam. Furthermore, attempts to increase the number of households using broadband has stalled. A 2014 regulation had targeted that, by 2019, 71% of total urban households would be using fixed broadband by 2019. In 2018, this number stood at just 2.4%, (or 9.38% of population).⁴

The government has responded by investing in better broadband infrastructure. Completed in 2019, the Palapa Ring project connects all regencies and cities in both urban and rural areas with a fibre optic network of over 35,000 kilometres.^{5,6,7} Remote areas left uncovered by this project will benefit from a satellite worth \$500 million, which intends to provide internet by 2022.^{8,9}

Low fixed-line broadband has rendered people reliant on cellular providers for access.¹⁰ Mobile coverage of Indonesia is relatively good. With 1.64 mobile subscriptions for every person in the country, cell phone use has increased drastically.¹¹ Furthermore, Indonesia has some of the most affordable broadband data in the world, ranking 17th globally.¹² The cost of mobile broadband is cheaper, as a percentage of GNI, than Malaysia, Thailand, India and the Philippines.¹³

2. Kaushik Das, Toshan Tamhane, Ben Vatterott, Phillia Wibowo, and Simon Wintels, "The digital archipelago: How online commerce is driving Indonesia's economic development." *McKinsey & Company, August* (2018). <https://www.mckinsey.com/~media/McKinsey/Featured%20Insights/Asia%20Pacific/The%20digital%20archipelago%20How%20online%20commerce%20is%20driving%20Indonesias%20economic%20development/The-digital-archipelago-Executive-summary.ashx>

3. Frost & Sullivan, "Digital Market Overview: Indonesia," last accessed September 10, 2019, https://ww3.frost.com/files/3115/2878/4354/Digital_Market_Overview_FCO_Indonesia_25May18.pdf

4. "Indonesia struggling to achieve fixed broadband target," *The Jakarta Post*, December 19, 2018, <https://www.thejakartapost.com/news/2018/12/19/indonesia-struggling-to-achieve-fixed-broadband-target.html>

5. "Palapa Ring central package broadband project undergoes speed test," *The Jakarta Post*, January 3, 2019, <https://www.thejakartapost.com/news/2019/01/03/palapa-ring-central-package-broadband-project-undergoes-speed-test.html>

6. This is the administrative level below *Provinsi* (Province), of which there are 34.

7. "Internet Infrastructure Indonesia: what about progress on the Palapa Ring?," *Indonesia Investments*, last accessed September 10, 2019, <https://www.indonesia-investments.com/news/todays-headlines/internet-infrastructure-indonesia-what-about-progress-on-the-palapa-ring/item8737?>

8. "Indonesia moves ahead with US\$568.3m multi-function satellite," *The Insider Stories*, December 27, 2017, last accessed September 10, 2019, <http://theinsiderstories.com/indonesia-moves-ahead-with-us568-3m-multi-function-satellite/>

9. Teresa Umali, "Internet connectivity: still a key priority for Indonesia in 2019," *OpenGov*, January 8, 2019, last accessed on September 10, 2019, <https://www.opengovasia.com/internet-connectivity-still-a-key-priority-for-indonesia-in-2019/>

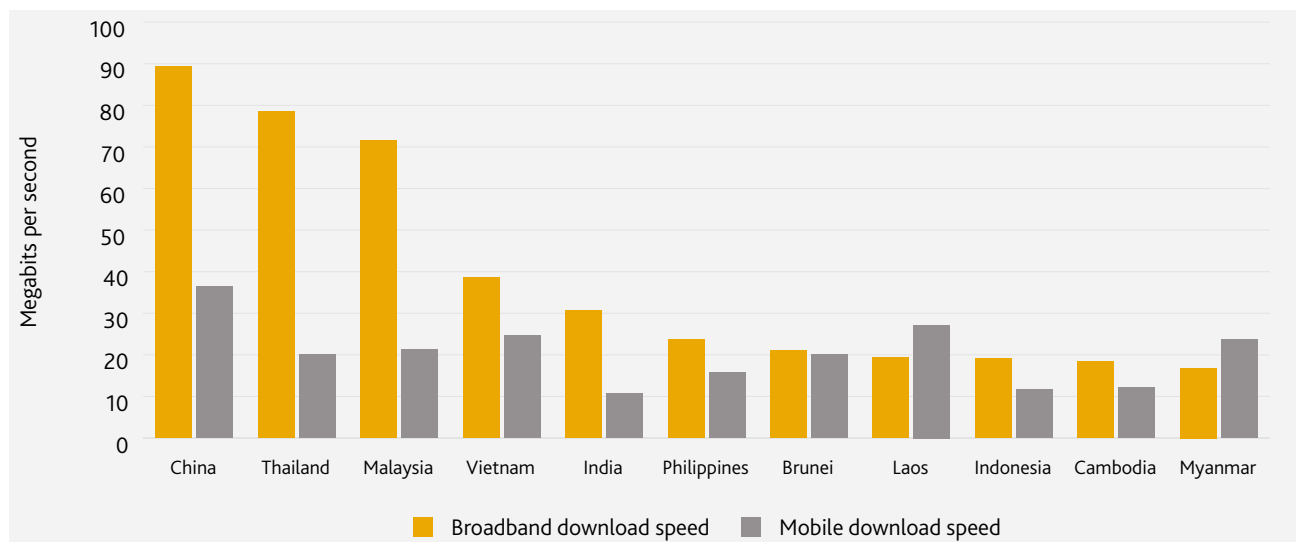
10. "Indonesia – Telecommunications," *Export.Gov*, last modified on February 4, 2019, <https://www.export.gov/article?id=Indonesia-telecommunications>

11. "Mobile cellular subscriptions (per 100 people)," *World Bank*, last accessed July 15, 2019, <https://data.worldbank.org/indicator/IT.CEL.SETS.P2?locations=ID>

12. "Worldwide mobile data pricing: The cost of 1GB of mobile data in 230 countries," *Cable.co.uk*, last accessed July 15, 2019, <https://www.cable.co.uk/mobiles/worldwide-data-pricing/>

13. "Mobile Broadband Data Costs," *Alliance for Affordable Internet*, last accessed July 15, 2019, <https://a4ai.org/mobile-broadband-pricing-data/>

Figure 1: Download speeds in selected countries



Source: Speedtest Global Index, July 2019

While mobile coverage is widespread in Indonesia, speeds are relatively slow, faring worse in quality and capacity. According to Speedtest, Indonesia has some of the slowest download speeds compared to regional peers, for both mobile broadband and fixed broadband (see Figure 1). While bandwidth has increased to 6.9 kilobits per person, this is still a long way behind other countries in the region, like Singapore, Malaysia and Thailand. In 2015, the Asian Development Bank noted that “heavy reliance on mobile networks for internet access is straining capacity and adversely affecting internet and telephony quality.”¹⁴

Dominated by four companies, the structure of the Indonesian market is problematic.¹⁵ The largest provider Telkomsel, which is 65% state-owned, is the only one to have consistently posted an annual profit since 1995. Investment is also hampered by the costly challenge of providing network coverage across multiple islands.¹⁶

Heavy regulations and restrictions further compound the challenge faced by potential investors. Equipment requires a minimum amount of local content, notably 30% for certain wireless equipment, with a minimum of 50% within 5 years. As of 2015, all 4G enabled devices require 30% local content, with 4G base stations requiring 40%.¹⁷ These conditions limit investment into Indonesian telecommunications, likely slowing growth. It is difficult to justify these requirements. Promoting usage is more impactful than protecting production, yet the regulations informing Indonesia’s telecommunications infrastructure focus primarily on production.

14. Steven Tabor, “Constraints to Indonesia’s Economic Growth,” *ADB Papers on Indonesia*, No. 10 (2015), <https://www.adb.org/sites/default/files/publication/178041/ino-paper-10-2015.pdf>

15. Joseph Waring, “Telkomsel win 2.3Hz spectrum with \$75m bid,” *Mobile World Live*, October 19, 2017, last accessed September 10, 2019, <https://www.mobileworldlive.com/asia/asia-news/telkomsel-takes-2-3ghz-spectrum-with-75m-bid/>

16. Harry Suhartono, “It’s not just regulation hampering Indonesian Telco deals,” *Bloomerg*, February 26, 2019, last accessed September 10, 2019, <https://www.bloomerg.com/news/articles/2019-02-26/it-s-not-just-regulation-plenty-hampers-indonesian-telcos-m-a>

17. “Indonesia – Telecommunications,” *Export.Gov*, last modified on February 4, 2019, <https://www.export.gov/article?id=Indonesia-telecommunications>

Opportunity

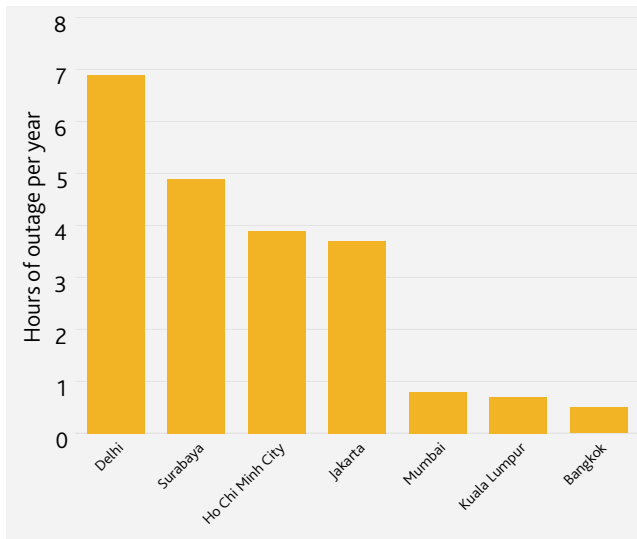
The biggest opportunity for Indonesia will come from ensuring that sufficient communication infrastructure is being developed to support a digital economy. This will involve building on the now-completed Palapa Ring project, to extend broadband and 4/5G to more outlying areas as well as increasing overall bandwidth. To do so at the necessary pace will likely require more international providers and private investment. The government could take a number of steps to facilitate such engagement, including reducing local content requirements

RESOURCES (INDONESIA RANK: 76TH)

Access to reliable and affordable resources, including water and energy, is crucial to a well-functioning economy. An unreliable energy supply can limit the growth of a potential business and hamper effective trade. Our measure of Resources aims to capture the quality, reliability and affordability of a country's energy network, as well the accessibility and usability of water resources. Indonesia's wealth of natural resources has not been translated into economic benefits for the general population. Indonesia is ranked 76th in the world for Resources, and 13th in Asia-Pacific.

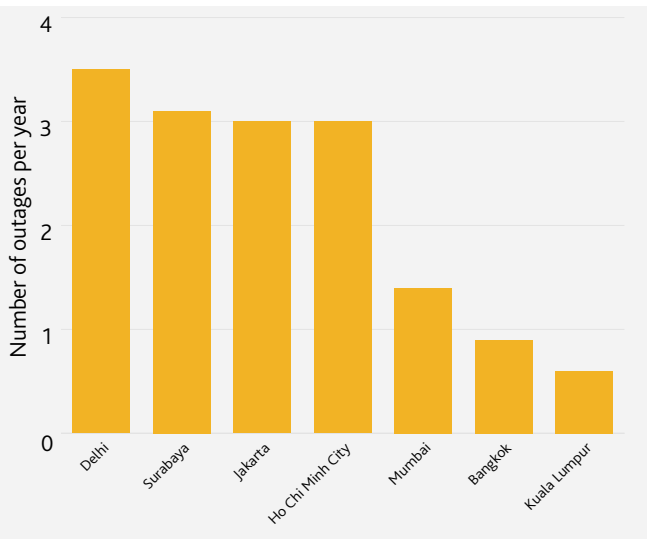
The electricity sector is struggling to meet demands. Indonesia ranks 55th in the reliability of electricity. Because of difficulties in meeting a surging demand, blackouts have increased.¹⁸ Reserve margins, are below the recommended levels everywhere except Java-Bali.¹⁹ However, as demonstrated by Java's blackout in August, even this region experiences significant capacity

Figure 2: System average interruption duration index



Source: World Bank Doing Business, 2019

Figure 3: System average interruption frequency index



18. "Private Power Utilities: The economic benefits of captive power in industrial estates in Indonesia," PwC, March 2016, p.18, <https://www.pwc.com/id/en/publications/assets/eumpublications/utilities/Private%20Power%20Utilities%20-%20Economic%20Benefits%20of%20Captive%20Power%20in%20Industrial%20Estates%20in%20Indonesia.pdf>

19. The difference between capacity and peak demand



Shutterstock.com

An additional 56.6 gigawatts of power projects are planned for 2028, with over half of these to be built by independent power producers.

problems.^{20,21} It has been estimated that these blackouts cost between \$233 million and \$871 million in diesel fuel costs (many businesses have backup diesel generators). Employee overtime and lost production incur further costs.²² Given the growing demand for electricity, worsening reliability is likely.

Meeting this demand growth is a major challenge. The 2019-2028 Electricity Procurement Plan stated that demand would continue to grow at 6.42% per annum. In 2014, the President announced plans to target an additional 35 gigawatts of generation capacity by 2019, which Indonesia is unlikely to achieve.²³ An additional 56.6 gigawatts of power projects are planned for 2028, with over half of these to be built by independent power producers.²⁴ The plan also aims to increase the share of renewable electricity up to 23% by 2025.

Given that private investment is needed to meet the shortfall in electricity generation, the challenge to install the right investment incentives remains. Local content rules apply to

20. Ibid.

21. "Power restored to some areas in Indonesia capital, parts of Java after 9 hours," *Nikkei Asian Review*, August 5, 2019, last accessed September 10, 2019, <https://asia.nikkei.com/Economy/Power-restored-to-some-areas-in-Indonesia-capital-parts-of-java-after-9-hours>

22. "Private Power Utilities: The economic benefits of captive power in industrial estates in Indonesia," *PwC*, March 2016, p.27, <https://www.pwc.com/id/en/publications/assets/eumpublications/utilities/Private%20Power%20Utilities%20-%20Economic%20Benefits%20of%20Captive%20Power%20in%20Industrial%20Estates%20in%20Indonesia.pdf>

23. "Indonesia – Power Generation," *Export.Gov*, last modified February 4, 2019, <https://www.export.gov/article?id=Indonesia-Power-Generation>

24. Benny Bernato, "Indonesia announces new electricity procurement plan," *Norton Rose Fulbright*, February 2019, <https://www.nortonrosefulbright.com/en/knowledge/publications/66c608e1/indonesia-announces-new-electricity-procurement-plan>

the construction of power plants and transmission lines, involving, for example, a minimum amount of domestically produced goods and services.²⁵ The capping of power prices, particularly for renewable energy prices, is also a major risk for private investors as purchase prices are too low to recover investment.²⁶

Furthermore, the supply and provision of electricity is monopolised by Perusahaan Listrik Negara (PLN), the state-owned energy company which also sometimes acts as a self-regulator.²⁷ In 2004, the Constitutional Court restricted attempts to allow for more private competition in the electricity market.²⁸ Since then efforts to attract private investment have been restricted to generation rather than supply.

Indonesia's resources

The total water available is 690 billion cubic metres, while the annual demand for water is roughly 175 billion cubic metres.²⁹ Most agriculture is rain-fed, with only 17%-20% reliant on irrigation.³⁰

According to OPEC, at the end of 2017 Indonesia had 3.3 billion barrels of proven oil reserves (0.2% of the world total), which is expected to last around 24 years.^{31,32} It has around 1.5% of the world's natural gas and 2.2% of the global coal reserves; at current production levels, there is enough coal to last 60 years.^{33,34,35}

Indonesia also has vast potential renewable energy resources. For example, the potential hydropower resource is estimated at 75 gigawatts compared to the total electricity installed capacity of 60 gigawatts at present.^{36,37}

25. "Power in Indonesia," *PwC*, November 2018, 6, p.40, <https://www.pwc.com/id/en/publications/assets/eumpublications/utilities/power-guide-2018.pdf>

26. Richard Bridle, "Missing the 23 Per Cent Target: Roadblocks to the development of renewable energy in Indonesia," *International Institute for Sustainable Development*, 2018, p.v <https://www.iisd.org/sites/default/files/publications/roadblocks-indonesia-renewable-energy.pdf>

27. "Ten ideas to reshape Indonesia's energy sector," *McKinsey & Company*, September 2014, https://www.mckinsey.com/~media/McKinsey/Locations/Asia/Indonesia/Our%20Insights/Ten%20ideas%20to%20reshape%20Indonesias%20energy%20sector/Ten_ideas_to_reshape_Indonesias_energy_sector.ashx

28. "Power in Indonesia," *PwC*, November 2018, 6, p.28, <https://www.pwc.com/id/en/publications/assets/eumpublications/utilities/power-guide-2018.pdf>

29. "Indonesia Country Water Assessment," *Asian Development Bank*, 2016, p.11 <https://www.adb.org/sites/default/files/institutional-document/183339/ino-water-assessment.pdf>

30. "Indonesia Country Water Assessment," *Asian Development Bank*, 2016, p.38 <https://www.adb.org/sites/default/files/institutional-document/183339/ino-water-assessment.pdf>

31. Organization of the Petroleum Exporting Countries, <https://www.opec.org>

32. "Power in Indonesia," *PwC*, November 2018, 6, p.106, <https://www.pwc.com/id/en/publications/assets/eumpublications/utilities/power-guide-2018.pdf>

33. "The Report: Indonesia 2019," *Oxford Business Group*, 2019 p 122.

34. Bob Dudley, "BP statistical review of world energy." BP Statistical Review, London, UK, August 6, 2018. of world energy

35. Stefania Palma, "Indonesia keeps faith with coal to meet growing energy demand," *The Financial Times*, July 31, 2018, <https://www.ft.com/content/0fd3ed3e-89b9-11e8-affd-da9960227309>

36. "Power in Indonesia," *PwC*, November 2017, 5, p.19, <https://www.pwc.com/id/en/energy-utilities-mining/assets/power/power-guide-2017.pdf>

37. "Power in Indonesia," *PwC*, November 2017, 5, p.16, <https://www.pwc.com/id/en/energy-utilities-mining/assets/power/power-guide-2017.pdf>

Opportunity

An opportunity exists to strengthen the energy markets by supply-side and demand-side reforms. Firstly, there is scope for continued reform of energy subsidies, which will reduce marginal demand and also reduce the price/cost traps in the supply and distribution markets. On the distribution side, the industry structure could be reviewed to encourage competition and also to more clearly separate the role of regulator from operator in the distribution market. Many other countries have done this, with significant benefits to both the industry and consumers.

TRANSPORT (INDONESIA RANK: 61ST)

Transport underpins the ability for products and people to move efficiently, easily, and reliably. An interconnected freight transportation network contributes to economic growth by supporting resource development and expanding interstate commerce. We evaluate both the quality of physical infrastructure, including road, rail, ports, and air, in addition to logistical performance, which measures the efficiency of shipping products in and out of a country.

Ranked 61st globally, Indonesia is up 12 places since 2009 to fourth best ASEAN performer for transport. Being an archipelago made up of over 17,000 islands, with mountainous topography and 5,000 kilometres from east to west, Indonesia has one of the most challenging environments in which to build a modern and efficient transport network. With the majority of the population living on Java (57%) and Sumatra (20%), low population density and underinvestment has led to poor infrastructure in eastern Indonesia.³⁸

However, the Widodo government is committed to building infrastructure (particularly transport infrastructure) across the nation, spending vastly more on infrastructure than the previous administration.³⁹ From 2014 to 2019, the government reinvested money from fuel subsidies into a transport and energy infrastructure programme worth approximately \$353 billion, which mainly focuses on remoter parts of the archipelago.⁴⁰

Due to historical problems in attracting private investment, the government has massively expanded the role of state-owned enterprises (SOEs).⁴¹ The strategy has succeeded, with the building of roads, power plants, airports and other infrastructure. Furthermore, state-owned banks can give confidence to private investors when funding infrastructure projects.⁴²

SOEs dominate a number of industries, including energy, mining, and telecommunications.⁴³ While they have delivered major projects, their dominating presence crowds out private and foreign investment. The direct assignment of infrastructure projects to SOEs can “create the

While state-owned enterprises have delivered several major projects, their dominating presence crowds out private and foreign investment.

38. The more rural regions of Kalimantan and Papua, and Maluku, have large landmasses but a much smaller share of Indonesia's roads see: “Structural policy country notes – Indonesia,” *OECD*, 2013, p. 3-4, <https://www.oecd.org/dev/asia-pacific/Indonesia.pdf>

39. “Indonesia's leader, Jokowi, is splurging on infrastructure,” *The Economist*, May 5, 2018, <https://www.economist.com/asia/2018/05/05/indonesias-leader-jokowi-is-splurging-on-infrastructure>

40. Dikanaya Tarahita and Muhammad Zulfikar, “Solving Indonesia's Infrastructure Gap,” *The Diplomat*, May 16, 2017, <https://thediplomat.com/2017/05/solving-indonesias-infrastructure-gap/>

41. Kyunghoon Kim, “Jokowi wakes up the leviathan,” *New Mandala*, December 2, 2016, <https://www.newmandala.org/jokowi-wakes-leviathan>

42. Ditya Harnindam and Aulia Gislir, “The urgency for expansive development and the role of state-owned enterprises in Indonesia,” *CSIS Asia Program*, March 19, 2019, <https://www.cogitasia.com/the-urgency-for-expansive-development-the-role-of-state-owned-enterprises-in-indonesia/>

43. Kyunghoon Kim, “Matchmaking: Establishment of state-owned holding companies in Indonesia.” *Asia & the Pacific Policy Studies* 5, no. 2 (2018): 313-330, at 316

market perception that the more viable projects are assigned to SOEs, further deterring private sector interest.”⁴⁴ Their effect on deterring foreign investment was recently acknowledged by the Head of the Investment Coordinating Board.⁴⁵ Theoretically, private companies can compete equally with SOEs, yet many point to discriminatory treatment.⁴⁶

A recent article noted that, despite setting up a public procurement system, public contracting “is still highly vulnerable to political interference or corruption, including bribes, abuse of conflicts of interest, patronage, cronyism, trading in influence, bidding collusion by third parties, related-party trading and the trading of illegal insider information.”⁴⁷

Opportunity

On its own, the Indonesian government cannot fund the required infrastructure. The government faces financial shortfalls, due to limited revenue and the government’s ‘three percent deficit’ rule, thus securing private investment in infrastructure is an important alternative financing mechanism.

Better use of private investment has the potential to bring in additional finance and maximise the use of resources. An increase in private investment involves reducing the role of SOEs, better project planning and procurement, improving the regulatory environment for PPPs, and better financing options for private companies.⁴⁸

PwC notes that there are a number of opportunities to improve governmental management of major projects, specifically better training for government officials. It would also “benefit from faster and more transparent procurement as well as better project preparation at the feasibility study stage.”⁴⁹ A better oversight of procurement is also a route to improved outputs. The government could make better use of techniques such as PPPs to deliver projects, whilst also granting more major project contracts to private companies.

44. “World Bank Indonesia Economic Quarterly,” *The World Bank*, October 3, 2017, p. page 46.

45. Dimas Jarot Bayu, “Kepala BKPM: Dominasi BUMN Hambat Investasi Asing Masuk ke Indonesia,” *Katadata*, September 11, 2019,

<https://katadata.co.id/berita/2019/09/11/kepala-bkpm-dominasi-bumn-hambat-investasi-asing-masuk-ke-indonesia>

46. For example: “2018 Investment Climate Statements: Indonesia,” *US Department of State*, July 19 2018, <https://www.state.gov/reports/2018-investment-climate-statements/indonesia/>

47. Editorial Board, “Corrupt procurement system,” *The Jakarta Post*, March 7, 2018, <https://www.thejakartapost.com/academia/2018/03/07/editorial-corrupt-procurement-system.html>

48. “World Bank Indonesia Economic Quarterly,” *The World Bank*, October 3, 2017, p. 35-54.

49. “Indonesian Infrastructure,” *PwC*, 2, p.13, last accessed September 10, 2019, <https://www.pwc.com/id/en/capital-projects-infrastructure/capital-project-service/indonesian-infrastructure-stable-foundations-for-growth.pdf>



Transport in Indonesia

Roads

Given the land area, Indonesia ranks 75th globally for road density, and 6th in ASEAN. Road quality is also an issue, with Indonesia ranking 77th. Roads are crucial, transporting 90% of people and 70% of goods.⁵⁰ Despite a large increase in the extent of the road network, the scale of road building has failed to keep up with the acquisition of private vehicles by Indonesian consumers. From 2001 to 2009, road length increased by an average of 2%, while private ownership of vehicles increased by up to 13%.⁵¹

Private investment and the associated toll roads provide one means of funding. From 2015-2018, 942 kilometres of toll roads were added, with a further 5,400 kilometre promised by the government.^{52,53} Costing around \$70 billion, funds will come from bank loans and private investment, in addition to government spending.

Shipping

Being an island nation, shipping should be a comparative strength for Indonesia. The country ranks 42nd in the world for liner shipping connectivity, rising 16 places.^{54,55} However, it ranks 64th for the efficiency of seaport services, which is fourth in ASEAN. Despite improvements, however, it is relatively poor.

Shipping goods around Indonesia is difficult. The World Bank noted that it was cheaper to ship a container of Chinese mandarin oranges from Shanghai to Jakarta than send similar freight from Jakarta to Padang in Western Sumatra, despite the distance being six times longer.⁵⁶ At 24% of GDP, logistics costs are the highest in Southeast Asia - far higher than comparable countries like Malaysia (13%) and Thailand (15%), according to the Indonesia Logistics Association.⁵⁷

Although there are many small ports throughout Indonesia, there are only 11 container ports.⁵⁸ More than 50% of transshipment of cargo traffic goes through Tanjung Priok in Jakarta, which handles 5.51 million TEU of cargo.^{59,60} The second largest, Tanjung Perak in Surabaya, handles 3.35 million TEU. These ports still fall significantly behind the volume of ports in Malaysia, Singapore, Thailand and Sri Lanka. According to the Asian Development Bank, the number of public ports is insufficient in serving the number of islands, requiring significant investment to strengthen maritime infrastructure and encourage the competitiveness of ports.⁶¹

50. "Transport in Indonesia: Roads & Railways," *WPC Logistics*, February 20, 2017, https://www.wpclogistics.com/news/transport_in_indonesia_roads_railways

51. "Transport in Indonesia: Roads & Railways," *WPC Logistics*, February 20, 2017, https://www.wpclogistics.com/news/transport_in_indonesia_roads_railways

52. "Infrastructure in Indonesia: 13 new toll road projects to be completed," *Indonesia Investments*, 15 October 2018, <https://www.indonesia-investments.com/news/todays-headlines/infrastructure-in-indonesia-13-new-toll-road-projects-to-be-completed/item9008>

53. Rieka Rahadiana and Harry Suhartono, "\$70 billion toll-road plan to connect Indonesia's sprawl," *Bloomberg*, June 19, 2019, <https://www.bloomberg.com/news/articles/2019-06-19/-70-billion-toll-road-splurge-aims-to-connect-indonesia-s-sprawl>

54. "Maritime Transport Connectivity," UNCTAD, last accessed September 26, 2019, https://unctad.org/en/PublicationChapters/rmt2017ch6_en.pdf

55. WEF – "Global Competitiveness Report 2018," WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

56. "Indonesia: \$400 million approved for logistics reform," *The World Bank*, November 2, 2016, <http://www.worldbank.org/en/news/press-release/2016/11/02/indonesia-400-million-approved-for-logistics-reform>

57. Fauzal Muna, "Indonesia's logistics performance remains poor," *The Insider Stories*, July 25, 2018, <https://theinsiderstories.com/indonesias-logistics-performance-remains-poor/>

58. "Indonesia's shipping sector," *Global Business Guide Indonesia*, 2012, last accessed September 10, 2019, http://www.gbgingonesia.com/en/services/article/2011/indonesia_s_shipping_sector.php

59. "Berita Logistik Dan Transportasi Indonesia," *Kargo*, July 10, 2017, <https://kargo.tech/artikel/the-busiest-port-in-indonesia-tanjung-priok/>

60. "Top 50 World Container Ports," *World Shipping Council*, last accessed September 10, 2019, <http://www.worldshipping.org/about-the-industry/global-trade/top-50-world-container-ports>

61. Kang Leung, "Indonesia's Summary Transport Assessment," *ADB Papers on Indonesia*, No. 15 (2016), <https://www.adb.org/sites/default/files/publication/217196/ino-paper-15-2016.pdf>

Even though the state's legal monopoly over port management was ended in 2008, SOEs still dominate. There is also an over-reliance on the state-owned ship operator PT Pelayaran Nasional Indonesia (Pelni). Rather than opening up a tender process, the transport ministry assigned over half of all shipping routes to Pelni, generating criticism from the National Ship-owner Association.⁶²

After becoming president, Joko Widodo announced plans to expand port facilities across Indonesia, by creating a 'Sea Tollway'.⁶³ One of the major projects in Eastern Indonesia has been the development of port facilities in Makassar (on the island of Sulawesi) at a cost of around \$108 million. Operations began at the end of 2018, managing between 500,000 to 1 million containers.⁶⁴

Air transport

Following significant deregulation of the industry after the Asian financial crisis, air travel is becoming an increasingly important way to travel. Indonesia ranks 65th for airport connectivity, having declined from 58th.⁶⁵ It is 5th in ASEAN, behind Singapore, Malaysia, Thailand, and Vietnam.

It is one of the world's largest aviation markets, forecast to have 242 million passengers by 2035.^{66,67} In terms of economic impact, the aviation industry is estimated to have added \$9.4 billion to GDP in 2014, directly employing 190,000 people.⁶⁸ The sector supports many areas, specifically tourism, which in 2014 added \$14 billion to the economy.⁶⁹ The rapid increase in passenger numbers has led to an infrastructure deficit, where 70% of commercial airports are over-capacity.⁷⁰ There is more investment into airports. The state owned operator of 16 airports Angkasa Pura II is investing in Jakarta's main airport and looking to build a new airport for the city.⁷¹

A further issue is that air transport is dominated by a duopoly. In 2018, the Garuda group acquired the Srijawa group, which in 2017 had 13% market share. This meant that the two largest carriers (Garuda and Lion Air) control roughly 90% of the domestic market, with the third largest airline controlling just 2% of the market.⁷² This duopoly is at least partly blamed by some for ticket prices becoming significantly more expensive.⁷³

62. Susantry, Farida, "Govt assigns Pelni to manage ships on pioneering routes," *The Jakarta Post*, January 8, 2016, <https://www.thejakartapost.com/news/2016/01/08/govt-assigns-pelni-manage-ships-pioneering-routes>.

63. "Here comes Indonesia's sea toll road: The Jakarta Post," *The Straits Times*, November 11, 2015, <https://www.straitstimes.com/asia/se-asia/here-comes-indonesias-sea-toll-road-the-jakarta-post>

64. "Makassar New Port project to complete by October," *PwC*, September 13, 2018, <https://www.pwc.com/id/en/media-centre/infrastructure-news/september-2018/makassar-new-port-project-to-complete.html>

65. "Global Competitiveness Report 2018," WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

66. "The Report: Indonesia 2019," *Oxford Business Group*, 2019 p 144.

67. *Ibid.*

68. "The importance of air transport to Indonesia," *International Air Transport Association*, 2017, last accessed September 10, 2019, <https://www.iata.org/policy/Documents/benefits-of-aviation-indonesia-2017.pdf>

69. "The importance of air transport to Indonesia," *International Air Transport Association*, 2017, last accessed September 10, 2019, <https://www.iata.org/policy/Documents/benefits-of-aviation-indonesia-2017.pdf>

70. "The Report: Indonesia 2019," *Oxford Business Group*, 2019 p 144.

71. "Jakarta to get new airport as Indonesia pumps billions into expansion amid travel boom," *South China Morning Post*, February 13, 2019, <https://www.scmp.com/news/asia/southeast-asia/article/2185971/indonesia-pump-billions-airports-expansion-amid-travel-boom>

72. "Indonesia's domestic flight industry: an unstoppable duopoly?," *The Australia-Indonesia Centre*, June 13, 2019, <https://australiaindonesiacentre.org/commentary/indonesias-domestic-flight-industry-an-unstoppable-duopoly/>

73. "Indonesia's domestic flight industry: the impact of a duopoly," *The Australia-Indonesia Centre*, June 19, 2019, <https://australiaindonesiacentre.org/commentary/indonesias-domestic-flight-industry-the-impact-of-a-duopoly/>

Rail

Rail plays a large role in the movement of passengers, but not in the movement of goods.⁷⁴ Railways were monopolised by the state before 2007; however, since then the tracks remain under state control with private companies paying an operational fee.⁷⁵ The total rail length is 4,684 kilometres, down from 6,000 in the 1990s, with four rail lines in Sumatra and Java primarily for passengers. Relative to its land area, this places Indonesia at 84th.

The development of railways are a government priority: by 2020 rail capacity is forecast to reach 600 million passengers per year (up from around 270 million in 2014), and freight to reach 60 million tons per year (up from 24 million tons in 2014).^{76,77} Funded by Chinese investment, the flagship project is a 142 kilometre high speed rail link between Jakarta and Bandung.⁷⁸ Jakarta is one of the world's most gridlocked cities, incurring costs of \$4.6 billion per year according to the President. The first Mass Rapid Transport line opened in March 2019.⁷⁹ On other islands, the government plans to build more than 3,200 kilometres worth of rail lines in Sumatra, Sulawesi, Papua and Kalimantan.⁸⁰ Yet these have been beset with delays. Construction for the trans-Sulawesi railway began in 2015, but it remains uncompleted. In March, the Director of Railways revealed that 232 kilometres of the total 304 kilometres of rail lines in West Sumatra had yet to be operated.⁸¹ In 2016, the high-speed Jakarta-Bandung rail link was delayed because the Ministry of Transportation did not issue a construction permit in time.⁸²

74. In 2017, Indonesia was ninth highest in terms of passenger kilometres (25,654 million passenger kilometres). In 2010 (latest data available for Indonesia), it was 32nd for goods transported per kilometre (7,166 million tonnes). "Railways, goods transported (million ton-km)," *The World Bank*, last accessed September 16, 2019, <https://data.worldbank.org/indicator/IS.RRS.GOOD.MT.K6>; "Railways, passengers carried (million passenger-km)," *The World Bank*, last accessed September 16, 2019, <https://data.worldbank.org/indicator/IS.RRS.PASG.KM>

75. "Transport in Indonesia: Roads & Railways," *WPC Logistics*, February 20, 2017, https://www.wpclogistics.com/news/transport_in_indonesia_roads_railways

76. Linda Silaen, "14 Indonesia's Railway Projects Finances with Government SUKUK," *The Insider Stories*, August 23, 2018, <https://theinsiderstories.com/14-indonesias-railway-projects-finances-with-government-sukuk/>

77. "List of tables: Transportation," *Badan Pusat Statistik*, November 13, 2015, <https://wayback.archive-it.org/all/20151113184513/http://www.bps.go.id/index.php/Subjek/view/17#subjekViewTab3>

78. "Indonesia's railways; just the ticket to improve logistics," *Global Business Guide Indonesia*, 2016, last accessed September 10, 2019, http://www.gbgindonesia.com/en/services/article/2016/indonesia_s_railways_just_the_ticket_to_improve_logistics_11542.php

79. "We cannot continue like this: Jokowi on Jakarta's traffic," *The Jakarta Post*, January 9, 2019, <https://www.thejakartapost.com/news/2019/01/09/we-cannot-continue-like-this-jokowi-on-jakartas-traffic.html>

80. "Indonesia's national rail network aims for more growth, less inequality," *The Straits Times*, September 4, 2017, <https://www.straitstimes.com/asia/se-asia/aim-more-growth-less-inequality>

81. "232 kilometers of West Sumatra's railway lines not yet operational," *Antara News*, March 22, 2019, <https://en.antaranews.com/news/122872/232-kilometers-of-west-sumatras-railway-lines-not-yet-operational>

82. Amy Chew, "Discontent in Indonesia over high-speed rail project jointly developed with China may turn the current impasse into a more protracted one," *South China Morning Post*, February 19, 2016, <https://www.scmp.com/news/asia/southeast-asia/article/1913995/discontent-indonesia-over-high-speed-rail-project-jointly>

BORDER ADMINISTRATION (INDONESIA RANK: 87TH)

Inefficient and slow bureaucratic trade barriers limit the effectiveness, efficiency, and dynamism of economies, with greater problems posed by corruption and cronyism. Our measure of Border Administration considers the time and cost of a country's customs procedures. Indonesia is 87th in Border Administration, down 14 places from 10 years ago. Although improving, cargo at Indonesian ports face a significant dwell time, due to both poor infrastructure and bureaucratic processes.⁸³

The main cost to business is lost time. The time taken to comply with border regulations is 80 hours, down from 92.2 in 2009. As evidenced by Figure 4, this is far more than comparable countries like Thailand (29 hours), Singapore (12 hours), and Malaysia (33.5 hours). That said, recent improvements have been recorded.

At a cost of \$234.9 for a typical shipment, import costs are high, when compared to countries like Thailand (\$149), Singapore (\$158), Malaysia (\$130), or India (\$190) (see Figure 5). One of the government's aims is to reduce the "dwell time" – the time containers spend dormant in ports. In 2016, dwell times were between 3.7 and 4.2 days at Tanjung Priok.⁸⁴ This was down from more than a week the previous year. Reforms to boost port efficiency include a greater use of electronic filing, and the streamlining of procedures. Indonesia has a "National Single Window", which is intended to provide a single place where importers and exporters can hand in documentation. In 2018, the World Bank noted that Indonesia's introduction of a single electronic billing system made importing faster.

Figure 4: Time to comply with border regulations and procedures

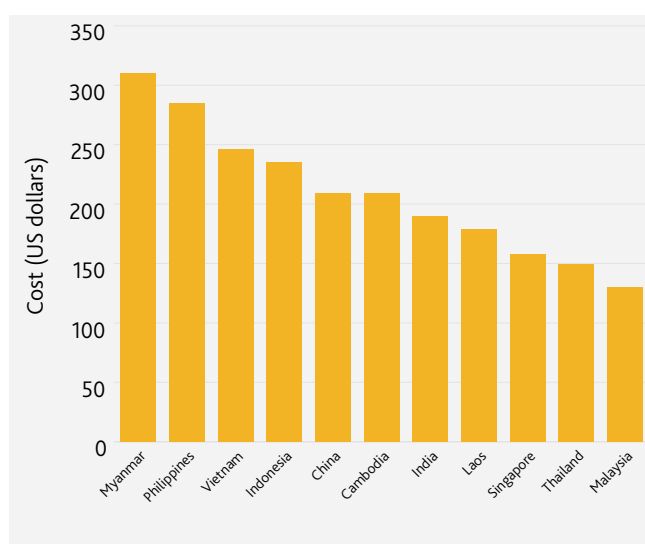
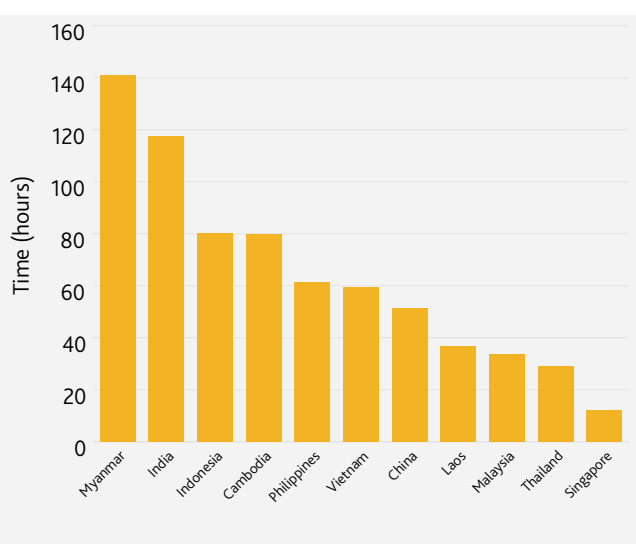


Figure 5: Cost to comply with border regulations and procedures



Source: World Bank Doing Business, 2019

83. Hasan Nur, Christino Permana, Tri Achmadi, Eka Ardhi and Achmad Mustakim, "Study of Container Swelling Time in Indonesia: Current Condition & Challenge," *ICSTI 2018, October 19-20, Yogyakarta, Indonesia*, last accessed September 10, 2019, <https://eudl.eu/pdf/10.4108/eai.19-10-2018.2281290>

84. Turloch Mooney, "Indonesia seeks to further cut container dwell times," *JOC*, September 21, 2016, https://www.joc.com/port-news/asian-ports/port-tanjung-priok/indonesia-seeks-further-cut-container-dwell-times_20160921.html



Dani Daniar / Shutterstock.com

Indonesia is also part of the ASEAN single window, an initiative to “expedite cargo clearance and promote ASEAN economic integration by enabling the electronic exchange of border documents among ASEAN Member States.”⁸⁵ At present, Indonesia, Malaysia, Singapore and Thailand are using the single window to exchange electronic certificates of origin. This should improve border clearance times.

Opportunity

Importing and exporting could be made easier. More investment in infrastructure around ports and a reduction of bureaucratic delays would help to shrink high logistical costs. Increased digitisation of processes and advanced processing would both help.

OPEN MARKET SCALE (INDONESIA RANK: 55TH)

Indonesia has trade agreements with countries equating to roughly 30% of world GDP.

The size of the economic opportunity for producers is constrained by the extent of the domestic and international market openness. Exporters face tariffs on goods in many countries, preventing sales and inhibiting their ability to compete in the global market. We measure the extent to which producers have unhindered access to domestic and international markets, and the tariffs faced in destination markets.

Indonesia is 55th in the world for its open market scale, up four places. Most Indonesian trade occurs with countries where some sort of agreement is in place; overall, Indonesia has trade agreements with countries equating to roughly 30% of world GDP. Consequently, its trade weighted average tariff faced in destination markets is relatively low at 3.3% (36th in the world).⁸⁶

As a member of the ASEAN Free Trade Area since 1993, Indonesia has close economic ties to Brunei, Myanmar, Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Vietnam, and Thailand. In 2003, as ASEAN chair, Indonesia endorsed the decision to establish an ASEAN Economic Community. The country also supported the ASEAN-China Free Trade Area (ACFTA). Several free trade agreements with other nations have since been signed or ratified. Moreover, since 2012 Indonesia both initiated and led negotiations for a Regional Comprehensive

85. “What is the ASEAN Single Window?,” ASEAN, last accessed September 10, 2019, <http://asw.asean.org/>

86. “Global Competitiveness Report 2018,” WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

Indonesian trade

Each year, \$159.9 billion worth of products are imported and \$168.8 billion are exported (20% of GDP in 2017 according to the World Bank).⁸⁷ Since the beginning of the millennium, the trade-to-GDP ratio fell from 71% to about 40% while in 2017, the world average increased to almost 58%.⁸⁸ According to our analysis, this level of trade is expected for the size of Indonesia's population.⁸⁹

Its top exports are to China (14%), U.S. (11%) Japan (10%), India (8%), Singapore (7.6%), South Korea (4.9%) and Malaysia (4.7%). The largest export categories are mineral products (23%), animal and vegetable bi-products (14%), machines (9.6%), and textiles (8%). High-tech exports make up just 3.3% of total trade, compared to 33% in Malaysia, 27% in Singapore, and 30% in Vietnam.⁹⁰

The largest exports are coal briquettes (\$18.9 billion), palm oil (\$18.2 billion) and petroleum gas (\$9.0 billion). Palm oil is mainly exported to Asia (63%) and Africa (14%). 36% goes to China and India and 8% goes to Pakistan, which recently abolished import tariffs on Indonesian palm oil.^{91,92} Until recently Indonesia was exporting a significant amount to the EU, until controls were put in place because of concerns over deforestation.⁹³

Rubber is also a major export. It makes up 3% of Indonesian exports, primarily exported to the U.S. (21%), China (14%), Japan (14%), or India (8.2%) – all of which have some sort of arrangement with Indonesia. Cars, at \$3.34 billion, are the most significant exported manufactured goods, of which almost half go to the Philippines. Petroleum gas is almost exclusively exported to Asian countries, with Japan (29%) and Singapore (27%) being the largest recipients.

Economic Partnership (RCEP) between all 10 ASEAN nations, plus China, India, Japan, Australia, New Zealand and South Korea. ASEAN has also signed a free trade deal with Hong Kong, which is yet to enter into force.⁹⁴ As a result, Indonesia has domestic and international market access for goods and services worth \$25 trillion, which ranks 52nd for services and 59th for goods.

87. "Indonesia Import Data," last accessed September 10, 2019, <https://www.seair.co.in/global-trade-data/indonesia-import-data.aspx>

88. "Trade (% of GDP)," *The World Bank*, last accessed September 10, 2019, data: <https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS>

89. We regressed trade as a percentage of GDP against the population (logged) of all our countries in the Global Index of Economic Openness. The resulting trend line gave us an indication of the level of trade a country would engage in relative to its population size. Compared to this trendline, Indonesia exports about as much as would be expected for its population size, which is 37%

90. The Atlas of Economic Complexity, last accessed September 10, 2019, <http://atlas.cid.harvard.edu/explore/stack?country=103&year=2017&startYear=undefined&productClass=HS&product=undefined&target=Product&partner=undefined>

91. "Pakistan abolishes import tariff on Indonesia origin palm oil," *Palm Oil Analytics*, December 6, 2018, <http://www.palmoilanalytics.com/article/5c0878400c89083364c2555d>

92. "Indonesia to ratify Pakistan trade deal to protect palm oil exports," *Reuters*, November 8, 2018, <https://www.reuters.com/article/indonesia-trade-pakistan/indonesia-to-ratify-pakistan-trade-deal-to-protect-palm-oil-exports-idUSL4N1XJ1ZF>

93. "The next trade war? Indonesia threatens the EU," *Aljazeera*, August 9 2019, <https://www.aljazeera.com/ajimpact/trade-war-indonesia-threatens-eu-190809112014149.html>

94. "The Signing of the ASEAN-Hongkong, China Free Trade Agreement and ASEAN-Hongkong, China Investment Agreement." *ASEAN*, November 12, 2017, <https://asean.org/the-signing-of-the-asean-hongkong-china-free-trade-agreement-and-asean-hongkong-china-investment-agreement/>

Trade with the U.S. and EU harbours potential risks for Indonesia. Despite currently enjoying lower tariffs on goods through the generalised system of preferences (GSP), these two large markets do not have a trade agreement with Indonesia.⁹⁵ Indonesia could be at risk of losing its status under the U.S.'s GSP, which gives preferential tariff treatment to over 3,500 products from developing countries. India and Turkey have recently been excluded, making it a priority for the Indonesian government to remain in this scheme.^{96,97}

A number of Indonesia's main trading partners have expressed a desire to boost trade. A meeting between the Indonesian Trade Minister and U.S. Secretary of Commerce in 2018 sought to boost bilateral trade to \$50 billion over next few years, from nearly \$26 billion in 2017.⁹⁸ In March 2018, India and Indonesia aimed to boost bilateral trade to \$50 billion by 2025.⁹⁹ Furthermore, since 2016 the EU and Indonesia have been negotiating a free trade agreement.¹⁰⁰ The latest round of negotiations were held from 17 to 21 June 2019. Indonesia and Australia have also signed (but Indonesia has not yet ratified) the Comprehensive Economic Partnership Agreement.¹⁰¹

While the Economic Minister recently expressed concern that the trade war between China and the U.S. may damage Indonesia (as slowing economies would reduce imports), others have said that economies in the ASEAN region might benefit "from shifting global production chains, because of the growing uncertainty".^{102,103} Indonesia's own tariffs from China have also faced recent retaliation. Following Indonesia's renewed tariff on Chinese steel, China responded with its own anti-dumping import duties on Indonesian steel products.¹⁰⁴

Opportunity

The main opportunity is for Indonesia to ratify the trade agreement with Australia. Following this, the next priority would be to conclude a trade agreement with the EU.

95. "Indonesia." *European Commission*, last updated July 23, 2019, http://ec.europa.eu/trade/policy/countries-and-regions/countries/indonesia/index_en.htm EU

96. Alex Fang, "US move to end India trade benefit rattles Indonesia and Thailand," *Nikkei Asian Review*, March 6, 2019, <https://asia.nikkei.com/Economy/US-move-to-end-India-trade-benefit-rattles-Indonesia-and-Thailand>

97. "Economy in brief: Indonesia secures US' GSP, for now," *The Jakarta Post*, January 19, 2019, <https://www.thejakartapost.com/news/2019/01/19/economy-brief-indonesia-secures-us-gsp-now.html>

98. Linda Yulisman, "Indonesia lobbying to maintain US trade ties," *The Strait Times*, July 28, 2018, <https://www.straitstimes.com/asia/se-asia/indonesia-lobbying-to-maintain-us-trade-ties>

99. "India, Indonesia agree to nearly triple bilateral trade to USD 50 billion," *The Economic Times*, May 30, 2018, <https://economictimes.indiatimes.com/news/economy/foreign-trade/india-indonesia-agree-to-nearly-triple-bilateral-trade-to-usd-50-billion/articleshow/64382782.cms>

100. "Indonesia." *European Commission*, last updated July 23, 2019, http://ec.europa.eu/trade/policy/countries-and-regions/countries/indonesia/index_en.htm

101. "Indonesia-Australia Comprehensive Economic Partnership Agreement," Australian Government Department of Foreign Affairs and Trade, accessed 13 September 2019, <https://dfat.gov.au/trade/agreements/not-yet-in-force/iceapa/pages/indonesia-australia-comprehensive-economic-partnership-agreement.aspx>

102. "Trade war badly affects Indonesia's exports: Economic chief," *The Jakarta Post*, March 12, 2019, <https://www.thejakartapost.com/news/2019/03/12/trade-war-badly-affects-indonesias-exports-economic-chief.html>

103. Jason Thomas, "ASEAN to gain most from trade war," *The Asean Post*, May 13, 2019, <https://theaseanpost.com/article/asean-gain-most-trade->

104. "Indonesia, China slap anti-dumping duties on each other's steel products," *Reuters*, March 22, 2019, <https://www.reuters.com/article/us-indonesia-antidumping-steel/indonesia-china-slap-anti-dumping-duties-on-each-others-steel-products-idUSKCN1R30G4>

IMPORT TARIFF BARRIERS (INDONESIA RANK: 63RD)

Typically, trade tariffs raise the price of products and reduce the volume of trade, creating barriers between people and the true market value of goods. We evaluate the average applied tariff rate, the complexity of tariffs, and the share of imports free of tariff duties. Indonesia's global position at 63rd for Import Tariff Barriers reflects the roles tariffs play in protecting some of its domestic sector, particularly food production and consumer products.

For trade partners where a trade deal is in place, tariffs have been reducing over time. According to the World Economic Forum, the average applied tariff rate is 4.4%, third best in ASEAN. The share of imports free of tariffs is 62.1%. As part of the ASEAN Economic Community, Indonesia and other ASEAN members have lowered their tariffs to between 0% and 5%, on 99% of all products from other ASEAN members.¹⁰⁵ Indonesia has also acted bilaterally with some of its trade partners. For example, in March 2019 Indonesia and Australia signed Comprehensive Economic Partnership Agreement, which will reduce the number of tariffs faced by Australian firms, so that by 2020, 99% of imports from Australia will be tariff-free or receive preferential access.¹⁰⁶ Once ratified, this will result in an increase in the quota for Australian beef.¹⁰⁷

Yet tariffs and quotas are still used to protect certain sectors (see table). The highest tariffs are faced for beverages and tobacco (45.9% average most-favoured nation applied duty), clothing (23.9%), and transport equipment (13.5% average MFN applied duty).¹⁰⁸ There are also high tariffs on textiles (11.5%), and coffee & tea (13.2%). Many of these industries are either strong (such as coffee), or seek protection from more competitive imports.

The tariffs on transport equipment reflects Indonesia's ambition to grow its automotive sector and create a significant export market.¹⁰⁹ Indonesia has imposed relatively high tariffs on transport equipment for non-ASEAN members, while seeking to protect its own steel industry by recently extending anti-dumping import duties on steel products from seven countries, including China.¹¹⁰

A domestic paradigm that has long prioritised food self-sufficiency over food trade has led to rampant restrictions on the international food trade. The import quota on raw sugar is 2.83 million tonnes, for example.¹¹¹ Indonesia is the respondent in a number of WTO cases relating

The highest tariffs for importers are for beverages and tobacco, clothing, and transport equipment.

105. "The ASEAN Free Trade Area," *ASEAN*, last accessed September 10, 2019, <https://asean.org/asean-economic-community/asean-free-trade-area-afta-council/>

106. "Indonesia and Australia sign pact eliminating many tariffs," *The Asahi Shimbun*, March 4, 2019, <http://www.asahi.com/ajw/articles/AJ201903040028.html>

107. "Indonesian trade agreement to benefit beef, live cattle exports," *Beef Central*, March 4, 2019, <https://www.beefcentral.com/news/indonesian-trade-agreement-to-benefit-beef-live-cattle-exports/>

108. "World Tariff Profiles," *WTO*, 2018, p.95, https://www.wto.org/english/res_e/booksp_e/tariff_profiles18_e.pdf

109. "The ASEAN automotive race," *Economist Intelligence Unit*, April 30, 2019, <http://www.eiu.com/industry/article/657959249/the-asean-automotive-race/2019-04-30>

110. "Indonesia, China slap anti-dumping duties on each other's steel products," *Reuters*, March 22, 2019, <https://www.reuters.com/article/us-indonesia-antidumping-steel/indonesia-china-slap-anti-dumping-duties-on-each-others-steel-products-idUSKCN1R30G4>

111. "Indonesia – Government sets 2019 raw sugar import quota at 2.83 million tonnes," *Agribusiness Intelligence*, December 21, 2018, <https://www.agra-net.com/agra/international-sugar-and-sweetener-report/analysis/policy/indonesia---government-sets-2019-raw-sugar-import-quota-at-2.83-mln-t--1.htm>

to imports of various food products: in 2017, the U.S. won a WTO case against Indonesia for import restrictions on food, plants and animal products.¹¹²

Import quotas and tariffs also hand power to importers and raise prices, while not necessarily creating the dynamic and competitive industry that Indonesia wants to develop. The ultimate cost falls on Indonesian consumers. An OECD report calculated that, between 2013 and 2015, Indonesians were 'taxed' the equivalent of \$98 billion, because of import restrictions as well as market and agricultural interventions by the government.¹¹³ These policies significantly alter domestic food prices. The nominal rates of protection, which indicate the percentage by which all trade policies raise the food producer price inside Indonesia relative to the border price, increased from 10.6% in 2008 to 27.7% in 2015.¹¹⁴

Another resultant problem is the cartel-like behaviour of many of Indonesia's food importers. For example, imports of soybeans, beef and maize are controlled by quota holders, who may collude to inflate prices.¹¹⁵ In 2018, the Supreme Court upheld penalties imposed by the KPPU on 19 garlic importers who were accused of fixing prices and restricting output, thereby raising prices.¹¹⁶ Similar inflation involving salt importers has occurred.¹¹⁷

Opportunity

For consumers to see better-priced goods and for the development of its industries (through competition and foreign investment), Indonesia should continue to remove protective measures, as each one ultimately costs consumers.

112. "US seeks US\$350 million annual sanctions in Indonesia trade dispute," *South China Morning Post*, August 6, 2018, <https://www.scmp.com/news/world/united-states-canada/article/2158535/us-seeks-us350-million-annual-sanctions-indonesia>

113. "Managing Food Insecurity Risk. Analytical Framework and Application in Indonesia," *OECD*, June 1, 2015.

114. Stephen V. Marks, "Non-tariff trade regulations in Indonesia: Nominal and effective rates of protection." *Bulletin of Indonesian Economic Studies* 53, no. 3 (2017): 333-357.

115. Jonathan Pincus, "Jakarta starts to move against food cartels," *Nikkei Asian Review*, September 30, 2015, <https://asia.nikkei.com/Politics/Jakarta-starts-to-move-against-food-cartels>

116. "Asia-Pacific Competition Update," *OECD*, no. 23 (2018): 7, <https://www.oecd.org/daf/competition/OECD-KPC-Asia-Pacific-Comp-News-October%202018.pdf>

117. Jonathan Pincus, "Jakarta starts to move against food cartels," *Nikkei Asian Review*, September 30, 2015, <https://asia.nikkei.com/Politics/Jakarta-starts-to-move-against-food-cartels>

Most-favoured nation (MFN) applied tariffs

PRODUCT GROUPS	MFN APPLIED DUTIES, AVERAGE %
Beverages & tobacco	45.8
Clothing	23.9
Transport equipment	13.5
Coffee, tea	13.2
Textiles	11.5
Leather, footwear, etc.	9.9
Manufactures, n.e.s.	7.5
Cereals & preparations	7.4
Sugars and confectionery	7.2
Animal products	7.1
Minerals & metals	7.1
Fish & fish products	6.3
Electrical machinery	6.0
Fruit, vegetables, plants	5.7
Dairy products	5.5
Non-electrical machinery	5.4
Chemicals	5.3
Wood, paper, etc.	5.0
Oilseeds, fats & oils	4.4
Other agricultural products	4.1
Cotton	4.0
Petroleum	0.2

Source: "World Tariff Profiles," WTO, 2018

MARKET DISTORTIONS (INDONESIA RANK: 82ND)

Fair competition – a powerful and compelling market force – is hindered by Market Distortions. The true value of goods changes price through state interference, resulting in a society that supports inefficient and ineffective industries. These distortions can arise from both regulatory restrictions as well as subsidies; this damages the prosperity of a nation, as the state's finite resources are inefficiently managed and diverted from projects that could deliver much greater benefits to society.

Our measure of Market Distortions evidences the disruption of competitive markets, due to subsidies, taxes, and non-tariff measures. By their very nature, market distortions can be difficult to measure, and broader conclusions often have to be drawn from proxy measures. Indonesia ranks 82nd for Market Distortions, down 22 places from 10 years ago.

Indonesia's attitude to foreign trade continues to be ambivalent and contradictory. Internationally, the country engages in free trade negotiations, while domestically the prevailing economic nationalism renders a free trade agenda highly unpopular. As a member of ASEAN, Indonesia has publicly committed to work on the elimination of non-tariff barriers, particularly in agriculture.¹¹⁸

However, while engaged in this economic diplomacy, a deep suspicion towards imports and free trade remains. After the financial crisis of 1997-98, unilateral reforms initially triggered a degree of trade liberalisation. This initiative faded when a 10-year commodity super-cycle, largely buoyed by Chinese buying, presented Indonesia with a resource-based export boom. The cycle coincided with the presidency of Susilo Bambang Yudhoyono (2004-14) whose government increasingly resorted to trade restrictions before the end of his tenure.

When the commodity cycle ended and President Joko Widodo took office in 2014, the country sought to revive its domestic manufacturing and service sectors. Former Trade Minister Mari Elka Pangestu called for a new paradigm, in which production networks and global value chains form the basis of production.¹¹⁹ As the Lowy Institute observed in 2015, by focussing on domestic production Indonesia might miss the chance to be part of global supply chains; it noted that between 2005 and 2011, the amount of imported content in exports declined, contrasting to other East Asian economies such as Malaysia, the Philippines, and Thailand.¹²⁰

Three main types of market distortions impact the Indonesian economy: import licences, non-tariff measures, and subsidies.

118. "The ASEAN Free Trade Area," *ASEAN*, last accessed September 10, 2019, <https://asean.org/asean-economic-community/asean-free-trade-area-afta-council/>

119. Mari Pangestu, Sjamsu Rahardja, Lili Yan Ing, "Fifty Years of Trade Policy in Indonesia: New World Trade, Old Treatments," in *Bulletin of Indonesian Economic Studies*, Vol. 51, No. 2, (2015): 239-61

120. Arianto Patunru and Sjamsu Rahardja, "Trade protectionism in Indonesia: bad times and bad policy," Lowy Institute, last accessed September 16 2019, <https://www.lowyinstitute.org/publications/trade-protectionism-indonesia-bad-times-and-bad-policy>

Import licences

For foreign companies wanting to import or export, there are significant bureaucratic hurdles. Concerningly, Indonesia requires all importers to hold a licence, but the process of procurement takes 4-5 months. One way around this, however, is to use an Indonesian company willing to import and distribute goods on behalf of a foreign company.¹²¹

For horticultural products, animals and animal products, there are additional requirements. Meat exporters, for example, must complete an extensive questionnaire (that includes proprietary information), and the associated meat establishment must be inspected by Indonesian inspectors.¹²² Imported meat is also subject to inspection fees.¹²³

Non-tariff measures

Non-tariff measures (NTMs) "are policy measures other than ordinary customs tariffs that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both."¹²⁴

Indonesia has 634 NTMs registered with WTO.¹²⁵ Most Indonesian NTMs were issued by the Ministries of Trade (29%), Industry (22%), Agriculture (14%) and Marine and Fisheries (11%). The largest share (22%) of all NTMs are in the food trade (HS Code 01 – 24) followed by 15% in the textile trade (HS Code 50 – 63). Almost all NTMs (88%) restrict imports, and almost all import NTMs (89%) are technical measures, including sanitary and phyto-sanitary measures, technical barriers to trade, as well as pre-shipment inspections and other formalities.¹²⁶

Non-tariff barriers (NTBs) are a subset of NTMs, which "imply a negative impact on trade". Indonesia, like much of the world, is increasing the number of non-tariff barriers faced by importers. Services is an area with major NTBs. According to the OECD's Services Trade Restrictiveness Index (STRI), Indonesia is more restrictive across all sectors than the STRI average, which includes 45 countries. The OECD states this is largely due to economy-wide regulations, such as local presence requirements, investment screening, or restrictions on land acquisition.¹²⁷ The most restrictive sectors are distribution services, telecommunications and legal services. Consequently, Indonesia ranks 80th for the prevalence of non-tariff barriers, having fallen from 34th 10 years ago.

Indonesia has 634 non-tariff measures registered with the WTO.

121. "Undername import: importing goods to Indonesia without licenses and incorporating." *Emerhub*, June 15, 2016, <https://emerhub.com/indonesia/import-indonesia-without-licenses-incorporating/>

122. "Indonesia." *USTR*, March 22, 2015, pp.188-190, <https://ustr.gov/sites/default/files/files/reports/2015/NTE/2015%20NTE%20Indonesia.pdf>

123. "2019 National Trade Estimate Report on Foreign Trade Barriers," *USTR*, p.263, last accessed September 10, 2019, https://ustr.gov/sites/default/files/2019_National_Trade_Estimate_Report.pdf

124. "Classification of NTMs," *UNCTAD*, last accessed September 10, 2019, <https://unctad.org/en/Pages/DITC/Trade-Analysis/Non-Tariff-Measures/NTMs-Classification.aspx>

125. TRAINS: Non-Tariff Measures (NTMs) based on official regulations", *UNCTAD*, last accessed September 2019, <https://trains.unctad.org/>

126. Ernawati Munadi, "Indonesia's Non-tariff Measures: An Overview," in Lili Yan Ing, Santiago de Cordoba, Olivier Cadot (eds.), "Non-Tariff Measures in ASEAN," (, ERIA and UNCTAD 2016): 65-77.

127. "Services trade in the global economy – Indonesia Report," *OECD*, last accessed September 10, 2019, <http://www.oecd.org/trade/topics/services-trade/>

Local content requirements are another NTB. In telecommunications, 4G-LTE enabled devices needed to contain 30% local content, with 40% local content required for 4G-LTE base stations.¹²⁸ There are also local content requirements for infrastructure projects, potentially dissuading investment.¹²⁹ In many cases, local content rules are a barrier for companies that already take significant risks by investing in Indonesia.

Subsidies

Indonesia still provides a number of subsidies to both consumers and producers. It spends 7.6% of its GDP on energy subsidies. A significant portion are fuel subsidies, which went up last year because of strengthening oil prices.¹³⁰ As a result, Indonesia is 128th in the world for energy subsidies.

President Joko Widodo removed subsidies on Premium gasoline, introducing a fixed diesel subsidy at the beginning of his first term in 2014.¹³¹ This freed up large funds for infrastructure development and the nine priorities of the President's 'Nawacita' program for national development. The scrapping of some fuel subsidies also improved contestability for foreign oil firms.¹³²

Yet after this initial success, import costs were increased by higher global oil prices as well as the devaluation of the Indonesian rupiah; the government did not raise retail prices of fuel and electricity, while continuing a coal price-cap and suspending the liquified petroleum gas reform announced in early 2017. As a result, \$8 billion was spent on energy subsidies in the first 10 months of 2018, although the government had budgeted only \$6.5 billion for the entire year.¹³³

As part of its aims to be food self-sufficient, there are also subsidies for agriculture – in 2017 fertiliser subsidies were \$2.31 billion.¹³⁴ Despite all of these subsidies, Indonesia performs well on the expert perceptions of whether taxes and subsidies have a distortive effect, coming 35th globally.¹³⁵

Opportunity

Further competition would benefit Indonesian industry, and eventually lead to more efficient and productive manufacturing and agriculture. Reducing local content rules and subsidies to domestic producers would both stimulate further competition.

128. "2019 National Trade Estimate Report on Foreign Trade Barriers," *USTR*, p.268, last accessed September 10, 2019, https://ustr.gov/sites/default/files/2019_National_Trade_Estimate_Report.pdf

129. "Going local: understanding Indonesia's local content requirements," *Global Business Guide Indonesia*, May 5, 2014, http://www.gbgindonesia.com/en/main/business_updates/2014/upd_going_local_understanding_indonesia_s_local_content_requirements.php

130. "Indonesia's energy subsidy spending far above target in 2018," *Indonesia Investments*, November 19, 2018, <https://www.indonesia-investments.com/news/news-columns/indonesia-s-energy-subsidy-spending-far-above-target-in-2018/item9036?>

131. "Indonesia Energy Subsidy Review," *International Institute for Sustainable Development*, Issue 1, Vol. 2, (March 2015).

132. "In Indonesia, fresh chance to break gas pump monopoly," *CNBC*, February 15, 2015, <https://www.cnbc.com/2015/02/15/in-indonesia-fresh-chance-to-break-gas-pump-monopoly.html>

133. "Indonesia's energy subsidy spending far above target in 2018," *Indonesia Investments*, November 19, 2018, <https://www.indonesia-investments.com/news/news-columns/indonesia-s-energy-subsidy-spending-far-above-target-in-2018/item9036?>

134. Tahlim Sudaryanto, "An Overview of Indonesia's Agricultural Policies in 2018," *FFTC Agricultural Policy Platform*, October 15, 2018, http://ap.fttc.agnet.org/ap_db.php?id=903

135. "Global Competitiveness Report 2018," WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>



INVESTMENT ENVIRONMENT (INDONESIA RANK: 53RD)

Ideas and businesses need investment to develop and grow effectively. Both long-established businesses and new entrepreneurs need investment, while investors need protection and confidence to back them. If investors do not have secure property rights, investment becomes scarce.

The growth in international financial market sophistication over the last four decades has been considerable. Economists' understanding of the role of capital in economic growth and prosperity has also grown over this period.^{1,2} A good investment environment will ensure that domestic and foreign financing is available for commercial ventures, allowing micro-enterprises to grow into Fortune 500 companies.

INDONESIA SWOT Analysis of Investment Environment

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • Patent laws are adequate, and improving • Improving financial standards that are more in line with international standards • Comparatively good competition law • Ownership of foreign bank accounts, and visits for foreigners, are becoming easier • Improvements in the ease of doing business scores • A new 2014 law involving stricter provisions against copyright infringements 	<ul style="list-style-type: none"> • Limited foreign ownership of land • A gap between investor protections as written in law, and practice on the ground • Weak judicial system puts minority shareholders at a disadvantage • Compulsory licensing forces patents to be 'worked' by a locally-owned facility in Indonesia within three years • Investment protection has been withdrawn for a number of countries • Obstacles for foreign managers to get work/stay permits • Decentralisation adds regional investment restrictions
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Growing capital markets, and improving access to finance for SMEs • Increasing use of technology for banking • Further development of intellectual property protections • Strengthening shareholder rights vis-à-vis company directors • Increasing predictability in court decision-making • Increasing international investment, with further reduction of the negative investment list 	<ul style="list-style-type: none"> • Tightening U.S. monetary policy means that investors may withdraw their capital • Dominant state-owned enterprises could crowd out foreign investors • After the 2nd and last term of President Widodo the country may elect a more protectionist leader who restricts foreign trade and investment • The central government cannot effectively stop local governments from issuing investment hurdles

1. Anne O. Krueger, "Financial markets and economic growth," IMF, September 28, 2006, <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp092806>.

2. Stanley Fisher, "The importance of financial markets in economic growth" (speech, Campos de Jordao, Brazil, August 21, 2003), Citigroup. <https://piie.com/fischer/pdf/fischer081103.pdf>.

Evaluating Investment Environment

The structural aspects of how to measure an Investment Environment reveals two overriding concerns: how effectively investments are protected, and whether the infrastructure to facilitate the flow of investment to opportunities is present.

We measure the extent to which **Property Rights** are protected. The more property rights are genuinely protected and enforced in an economy, the more that investment can drive economic growth. Where ideas are welcome and legally protected, they can be backed by investment.

Investor Protection is one of the key responsibilities of any government that wishes to attract any sustained investment, either foreign or domestic. It ranges from legal safeguards to the availability and disclosure of a company's financial performance.

An investor also needs to be confident that commercial agreements can be upheld, rendering the quality of **Contract Enforcement** a crucial factor.

We measure the quality of a given Investment Environment through analysing a number of indicators regarding the health of the **Financing Ecosystem**, including the availability of equity and debt financing, and the availability and costs of bank lending.

Finally, we assess the **Restrictions on International Investment**. The benefit of international investment goes beyond supporting the accumulation of capital - it also facilitates the transfer of technology, know-how, and skills, while helping local firms to access foreign markets.

Indonesia ranks 53rd in the world for the strength of its Investment Environment. It also recognises the need to attract more investment, with the President prioritising increasing investment at the beginning of the second term. Strengthening the investment environment, and consequential certainty for investors, is an important route to continued economic development. In the following sections, we review the performance of Indonesia in each of the distinct elements of the Investment Environment, from Property Rights through to the Restrictions on International Investment.

PROPERTY RIGHTS (INDONESIA RANK: 72ND)

Property rights are the key institution that make it possible to accumulate wealth and effectively participate in commerce. Where property rights are weak, people avoid taking risks; this substantially impacts investment, the levels of effective entrepreneurial activity, and wealth accumulation. The risks to property rights range from expropriation to limits on repatriations of profits and restrictions on the sale or transfer of assets. Our measure of Property Rights captures how well rights over land, assets, and intellectual property are protected.

In the protection of both real and intellectual property rights, Indonesia has seen significant improvement, where it has risen 45 places in 10 years, to rank 72nd. Generally, property rights are well protected between private parties; yet expropriation is seen as a particular risk when the government is interested in acquiring the property. Indonesia's regime surrounding intellectual property is improving but remains immature.

Indonesia is reasonably well set up to help settle property disputes between private parties. The World Bank records that particular infrastructure is designed to settle land disputes, informed by the legal and documentary requirements.³ The view that property rights are protected has improved dramatically – Indonesia now ranks 49th, up from 133rd, ranking 11th in the Asia-Pacific region.⁴ This steady increase over the past decade, occurring under both administrations, reflects a growing confidence in the protection of property rights for business.

Yet some improvements could be made to land administration. Although there are few procedures necessary to property registration, more time and money is spent than in comparable countries (see Figures 6 and 7).

Figure 6: Time to register a property

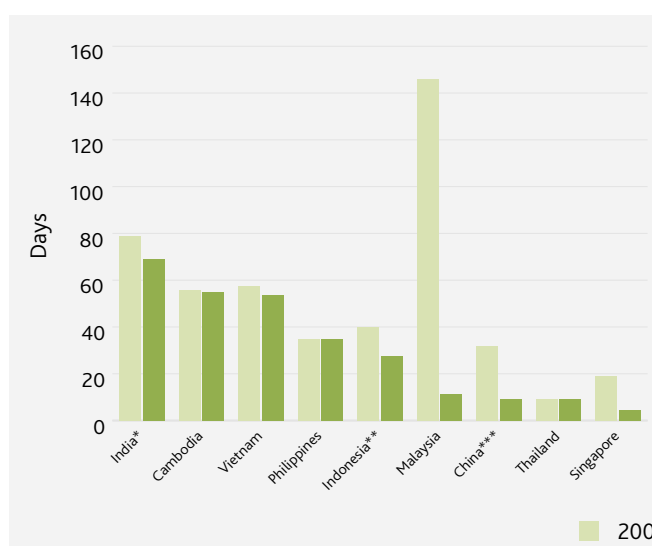
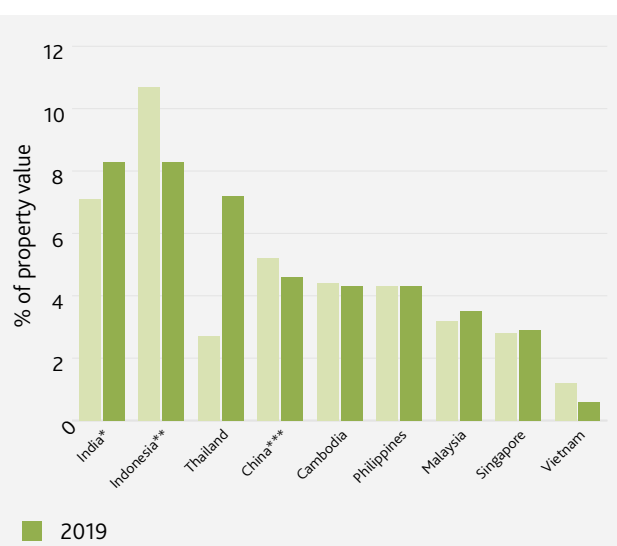


Figure 7: Cost to register a property



Source: World Bank Doing Business, 2019

* 2009 score is Mumbai only; **2009 score is Jakarta only; ***2009 score is Shanghai only

Expropriation risk

While the settlement of private land disputes is well administered, there is a perceived moderate expropriation risk.

While the settlement of land disputes between private actors is relatively well administered, there is a perceived moderate expropriation risk. The World Justice Project states that Indonesia ranks 70th in the world for lawful expropriation, second in ASEAN. Credendo, a credit insurance company, ranks Indonesia four out of seven (with seven being the worst for expropriation risk), and the Australian export credit agency recently described the risk as “moderate”.^{5,6} A prominent example is mining, where all new and existing mining companies must divest 51% of shares to the Indonesian government or Indonesian companies by the tenth year of production: the risk is mostly present in sectors where the government

3. “Training for Reform: Economy Profile – Indonesia.” *Doing Business 2019*. A World Bank Group Flagship Report, 16, last accessed September 11, 2019, <http://www.doingbusiness.org/content/dam/doingBusiness/country/i/indonesia/IDN.pdf>

4. “Global Competitiveness Report 2018,” WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

5. “Indonesia.” *Credendo*, last accessed September 11, 2019, <https://www.credendo.com/country-risk/indonesia>

6. “Indonesia Country Profile.” *Export Finance Australia*, last accessed September 11, 2019, <https://www.efic.gov.au/resources-news/country-profiles/asia/indonesia/country-risk/>

has an interest in engaging.⁷ The central government, followed by local government, has priority over purchase. This recently led Freeport, which operates the world's largest gold mine in Western Papua, to accuse the government's new rules as "in effect, a form of expropriation".^{8,9}

Intellectual property

Intellectual property protection is improving, as Indonesia is gradually making its regime comply with international standards, although violations are still widespread.¹⁰ Under Indonesian patent law, one can obtain a patent for an invention if it is novel, involves an inventive step, and is industrially applicable, aligning with the law in Singapore, Malaysia, India, Hong Kong, and the Philippines.^{11,12} Furthermore, Indonesia is signatory to a number of international intellectual property treaties, including the Patent Cooperation Treaty, which allows an applicant to file an international patent in one state while simultaneously seeking protection for an invention in other compliant countries.¹³

In copyright law, Indonesia has ratified the Protocol relating to the Madrid Agreement Concerning the International Registration of Marks.¹⁴ In 2014, Indonesia updated its copyright regulations, extending protection to "non-traditional" trademarks such as sound or three-dimensional trademarks, in 2016.¹⁵ The government has also created an "online regulation system for right holders to request action against allegedly infringing websites".¹⁶ Likely as a result, business executives see an improvement in intellectual property protection, with Indonesia now ranking 46th, up from 117th 10 years ago.¹⁷

Despite these improvements, significant issues remain. Legally, a patent holder must manufacture the patented product in Indonesia, and failure to do so may cause the patent to

7. "Indonesia ushers in 2017 with changes to mining law." *Ashurst.Com*, February 8, 2019, <https://www.ashurst.com/en/news-and-insights/legal-updates/indonesia-ushers-in-2017-with-changes-to-mining-law/>

8. Fergus Jensen, "Indonesia eyes truce with Freeport as losses mount for both sides." *Reuters*, April 12, 2017, <https://www.reuters.com/article/us-indonesia-freeport/indonesia-eyes-truce-with-freeport-as-losses-mount-for-both-sides-idUSKBN17E0XT>

9. This dispute has now been resolved. See: Stefano Sulaiman, "A guide to understanding the Freeport divestment deal." *The Jakarta Post*, July 16, 2018, <https://www.thejakartapost.com/news/2018/07/13/a-guide-to-understanding-the-freeport-divestment-deal.html>; Augustinus Da Costa and Wilda Asmarini, "Indonesia closes long-awaited \$3.85 billion Freeport deal." *Reuters*, December 21, 2018, <https://www.reuters.com/article/us-indonesia-freeport/indonesia-closes-long-awaited-3-85-billion-freeport-deal-idUSKCN1OK0XU> This dispute has now been resolved.

10. "Making your mark." *Asia Business Law Journal*, April 25, 2017, <https://www.vantageasia.com/making-your-mark/>

11. Risti Wulansari and Bhredipta Socaran, "Patents, trade marks, copyright and designs in Indonesia: overview." *Thomas Reuters Practical Law*, last accessed September 11, 2019, [https://uk.practicallaw.thomsonreuters.com/8-523-7908?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhpc=1](https://uk.practicallaw.thomsonreuters.com/8-523-7908?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhpc=1). See equivalent pages for Singapore, Malaysia, India, Philippines, and Hong Kong. See also "Intellectual Property in Indonesia." *Tilleke & Gibbins*, 2017, https://www.tilleke.com/sites/default/files/2017_Mar_Tilleke_Indonesia_IP_Guide.pdf

12. Prithipal Singh, Juvelyn Cubilla, Prem Sai Chandrasekaran and Aditi Desai, "Patents, trade marks, copyright and designs in Singapore: overview." *Thomas Reuters Practical Law*, last accessed September 11, 2019, [https://uk.practicallaw.thomsonreuters.com/w-008-1119?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhpc=1](https://uk.practicallaw.thomsonreuters.com/w-008-1119?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhpc=1). See equivalent pages for Malaysia, India, Philippines, and Hong Kong.

13. "PCT – The International Patent System." *World Intellectual Property Organization*, last accessed September 11, 2019, <https://www.wipo.int/pct/en/>

14. "Commission Staff Working Document." *European Commission*, February 21, 2018, p.15-16, http://trade.ec.europa.eu/doclib/docs/2018/march/tradoc_156634.pdf

15. "Making your mark." *Asia Business Law Journal*, April 25, 2017, <https://www.vantageasia.com/making-your-mark/>

16. "Commission Staff Working Document." *European Commission*, February 21, 2018, p.16, http://trade.ec.europa.eu/doclib/docs/2018/march/tradoc_156634.pdf

17. "Global Competitiveness Report 2018," WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

The cost of intellectual property infringements is up to half a billion dollars.

be abolished.¹⁸ Ministerial Regulation No 39 of 2018 on Procedures for Compulsory Patent Licensing states that a Minister can grant a compulsory licence in several cases, such as when a patent holder did not manufacture their product in Indonesia within three years of the patent being granted, or where the use of the patent is detrimental to the public interest.¹⁹

There are also enforcement issues. The UK foreign office also notes that, while legislation is strong, there is still "lack of public awareness of [intellectual property] and lack of law enforcement [intellectual property] infringements".²⁰ Furthermore, the number of investigations by the Director General for Intellectual Property has dropped from 58 in 2016, to 16 in 2017.²¹ Indonesia is currently on the priority watch-list of the U.S. Trade Representative's Special 301 Report on the state of intellectual property protection, which notes concerns around piracy, counterfeiting, and "lack of enforcement against dangerous counterfeit products".²²

The cost of these issues is high, with infringements draining the economy of up to half a billion dollars per year.²³ According to the Software Alliance, Indonesia has one of the highest rates of unlicensed software installation, standing at 83% of all software.²⁴ The EU also notes that local Indonesian companies often register a trademark in bad faith, meaning that a foreign company has to initiate expensive and lengthy legal proceedings to cancel them. Improvements are possible. For example, a recent agreement between ASEAN and the EU to help improve intellectual property protection and enforcement could help Indonesia build its own capability to tackle intellectual property infringements.²⁵

Opportunity

To strengthen property rights, the government should avoid the real or perceived risk of expropriation. Increased economic nationalism is a risk to foreign companies. As noted by Bloomberg, Indonesia's leaders want to encourage more value-added manufacturing so are seeking more control over national resources.²⁶ The government could do so by moderating its interference in foreign companies in some sectors, such as mining, where it has previously been keen to assert control.

Furthermore, Indonesia could benefit from continuing to mature its intellectual property protections. In particular, it should curtail ministerial ability to remove the rights of patent holders and better enforce intellectual property rights. Helping with these improvements are Indonesia's partnerships with overseas institutions such as the EU and ASEAN.

18. "Commission Staff Working Document." *European Commission*, February 21, 2018, p.17, http://trade.ec.europa.eu/doclib/docs/2018/march/tradoc_156634.pdf

19. Nick Redfean, "Compulsory patent licensing in Indonesia." *Rouse Magazine*, February 3, 2019, <https://www.rouse.com/magazine/news/compulsory-patent-licensing-in-indonesia/>

20. "Overseas Business Risk – Indonesia." *UK Government*, updated May 18, 2018, <https://www.gov.uk/government/publications/overseas-business-risk-indonesia/overseas-business-risk-indonesia>

21. "Indonesia – Protecting Intellectual Property." *Export.Gov*, last modified February 4, 2019, <https://www.export.gov/article?id=Indonesia-Protecting-Intellectual-Property>

22. "2019 Special 301 Report," *USTR*, April 2019, p.49, https://ustr.gov/sites/default/files/2019_Special_301_Report.pdf

23. "Making your mark." *Asia Business Law Journal*, April 25, 2017, <https://www.vantageasia.com/making-your-mark/>

24. "Software Management: Security Imperative, Business Opportunity." *BSA Global Software Survey*, June 2018, p.10, https://torrentfreak.com/images/2018_BSA_GSS_Report_en.pdf

25. "South-East Asia." *IP Key*, last accessed September 11, 2019, <https://ipkey.eu/en/south-east-asia>

26. Thomas Abraham, "Indonesia's Nationalism." *Bloomberg*, December 20, 2018, <https://www.bloomberg.com/quicktake/indonesias-nationalism>

INVESTOR PROTECTION (INDONESIA RANK: 36TH)

Investor Protection is key for any country wishing to enjoy sustained economic growth, necessary to enabling the flow of capital to ventures.²⁷ Our measure of Investor Protection covers a range of indicators that gauge investor protection, from insolvency to minority shareholder rights.

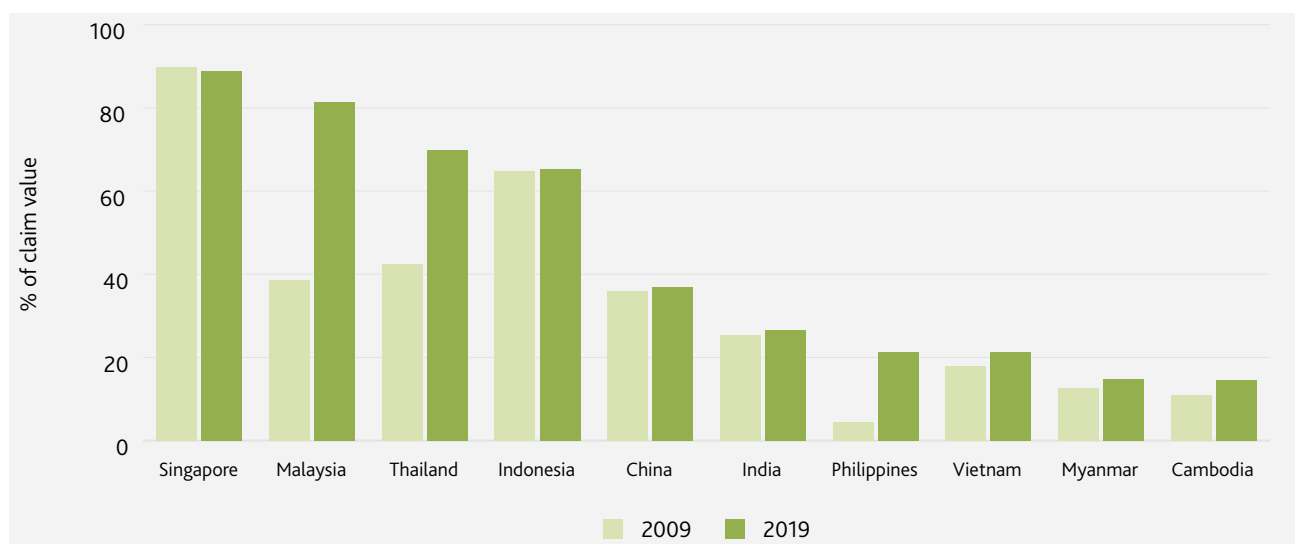
Indonesia's investor protections are a relative strength, ranking 36th in the world. Overall, Indonesia has relatively good investor protections as a matter of law, with most measures covering Jakarta and Surabaya.

Insolvency

The time spent closing cases to resolve insolvency is indicative of Indonesia's strong surrounding framework; Jakarta, for instance, saw a reduction from 72 months in 2004 to 13 months in 2012, when dealing with small and medium-size enterprises (SMEs). Further improvements, however, are yet to be seen. The number of incoming reorganization cases in Jakarta kept increasing from 66 applications in 2012, to 146 in 2016, but the Commercial Court of Central Jakarta continued its pace, increasing the number of closed cases from 55 in 2012, to 118 in 2016.²⁸

Investors can expect to recover 65 cents on the dollar through insolvency. Although this level is lower than Thailand (70 cents), and Singapore and Malaysia (both over 80 cents), Indonesia is faring better than most countries (see Figure 8).

Figure 8: Insolvency recovery rate



Source: World Bank Doing Business, 2019

27. Paula Ramona Rachisan, Cristina Bota-Avram, and Adrian Grosanu, "Investor protection and country-level governance: Crosscountry empirical panel data evidence." *Economic Research | Ekonomska Istraživanja* 30, no. 1 (2017): 806-817.

28. "Training for Reform: Economy Profile – Indonesia." *Doing Business 2019*. A World Bank Group Flagship Report, 16, last accessed September 11, 2019, <http://www.doingbusiness.org/content/dam/doingBusiness/country/i/indonesia/IDN.pdf> World Bank

It can still be difficult to wind down a business. For example, voluntary liquidation for a foreign-owned company takes about two years.²⁹ The World Bank has also advocated an update to the insolvency framework that would require the creditor's approval for the sale of the debtor's substantial assets and allow creditors to request information from the insolvency representative.³⁰

Insolvency law in Indonesia

The insolvency regime in Indonesia has strengthened slightly, but has fallen behind the progress of peers. Insolvency law in Indonesia has two challenges.³¹ Firstly, transparency is lacking as creditors are limited in their knowledge of their legal options. Nevertheless, the International Comparative Legal Guide (ICLG) considers that bankruptcy law in Indonesia is creditor-friendly, as they help to determine issues that are involved in proceedings.³² For example, creditors can file a petition of bankruptcy or suspension of payments against a debtor. Secondly, Indonesian courts are not bound by precedent, sometimes leaving the application of the law unclear. This has sometimes led to counterintuitive results. In 2012, Telkomsel (Indonesia's largest telecommunications company) was declared bankrupt after it failed to pay another company whose contract it supposedly breached.³³ The unpaid debt was a small fraction of its annual revenue, yet Telkomsel's appeal was unsuccessful. This ruling, however, was overturned soon after.

A similar case occurred in 2002, when a subsidiary of a Canadian-based insurance company, Manulife Financial Corp., was declared bankrupt after allegedly failing to pay a dividend to shareholders in 1999. The issue arose after Manulife found itself in conflict with the powerful Gondokusumo family business empire.³⁴ Two years later, in 2004, PT Prudential Life Assurance (the Indonesian unit of British insurer Prudential PLC) was declared bankrupt because of a disputed fee of \$400,000.³⁵ Both cases influenced foreign investors' perceptions of Indonesia's legal system as unpredictable. The judiciary was seen as a major challenge to Indonesia's investment climate with many foreign investors questioning Indonesia's court rulings.

29. "Your journey through Indonesia." PwC, p.27, last accessed September 11, 2019, <https://www.pwc.com/id/en/investment/foreign-direct-investment-faq-2017.pdf>

30. "Training for Reform: Economy Profile – Indonesia." *Doing Business 2019*. A World Bank Group Flagship Report, 16, p.97, last accessed September 11, 2019, <http://www.doingbusiness.org/content/dam/doingBusiness/country/i/indonesia/IDN.pdf>

31. Debby Sulaiman, "Indonesia," *The Asia-Pacific Restructuring Review 2019*, September 28, 2018, <https://globalrestructuringreview.com/benchmarking/the-asia-pacific-restructuring-review-2019/1174951/indonesia>

32. "Indonesia: Corporate Recovery & Insolvency 2019." *ICGL*, last accessed September 11, 2019, <https://icgl.com/practice-areas/corporate-recovery-and-insolvency-laws-and-regulations/indonesia>

33. Ben Bland, "Indonesia's biggest telco declared bankrupt on debt technicality," *Financial Times*, September 21, 2012, <https://www.ft.com/content/7b7ac8ea-95c7-35fb-8937-57b452225d15>

34. Jane Perlez, "Ruling Shakes Investors in Indonesia." *The New York Times*, June 21, 2002, <https://www.nytimes.com/2002/06/21/business/ruling-shakes-investors-in-indonesia.html>

35. Timothy Mapes, "Prudential's Indonesia unit Declared Bankrupt by Court." *The Wall Street Journal*, April 26, 2004, <https://www.wsj.com/articles/SB108297508115993385>

Since 1998, Indonesia has been steadily improving corporate governance practices.

Corporate governance

Since the Asian Financial Crisis in 1997-98, Indonesia has been improving corporate governance.³⁶ The most recent set of proposed reforms were outlined in the 2014 Corporate Governance roadmap, which among other things, recommended a better governance framework and increased protection of shareholders. The roadmap has been accompanied by an "Indonesia Corporate Governance Manual", which is written in conjunction with the World Bank's International Finance Corporation.³⁷

On the extent of shareholder governance, based on the World Bank Doing Business measure, Indonesia has improved from 56th to 29th since 2009. According to the World Bank, this improvement is due to "increasing shareholder rights and role in major corporate decisions and requiring greater corporate transparency".³⁸

Indonesia should continue to progress its corporate governance framework. It is particularly weak in terms of the ability for shareholders to sue directors, and conflict of interest regulation is also weak. Indonesia ranks 74th in the world for this measure.³⁹

Auditing and reporting

Indonesia ranks 65th for its auditing and reporting standards.⁴⁰ Requirements dictate that certain types of companies must be audited, including publicly listed companies, banks, insurance companies, and companies with assets of more than IDR 25 billion (approximately \$1.8 million).⁴¹

By the end of 2012, the task of supervising the non-bank financial industry and capital market officially shifted from the Ministry of Finance to the Financial Services Authority (OJK). Financial reports of all publicly listed companies and state-owned enterprises must follow Indonesia's Financial Accounting Standards (PSAK) with companies required to deliver their financial reports to OJK annually. Whilst some positive steps have been taken towards International Financial Reporting Standards, these standards have reportedly not been adopted wholesale, nor translated into Bahasa Indonesian.⁴²

Improvements in Indonesia's PSAK were made by the IFAS Board (DSAK-IAI) with the aim to align local standards with the International Financial Reporting Standards (IFRS). In 2017, DSAK-IAI issued PSAK 71 Financial Instruments, PSAK 72 Revenues from Contracts with Customers

36. Tony Budidjaja and Edly Widjaja, "Corporate governance and directors' duties in Indonesia: overview." *Thomson Reuters Practical Law*, last accessed September 11, 2019, <https://uk.practicallaw.thomsonreuters.com/8-506-7779?transitioType=Default&contextData=%28sc.Default%29>

37. "Indonesia Corporate Governance Manual." *International Finance Corporation World Bank Group*, 2nd edition, June 2018, https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/toolkits+and+manuals/indonesia+corporate+governance+manual%2C+2nd+edition

38. "Business reforms in Indonesia." *Doing Business 2019*. World Bank, last accessed September 11, 2019, <https://www.doingbusiness.org/en/reforms/overview/economy/indonesia>

39. "Training for Reform: Economy Profile – Indonesia." *Doing Business 2019*. A World Bank Group Flagship Report, 16, p.63, last accessed September 11, 2019, <http://www.doingbusiness.org/content/dam/doingBusiness/country/i/indonesia/IDN.pdf>

40. "Global Competitiveness Report 2018," WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

41. "Your journey through Indonesia." *PwC*, p.17, last accessed September 11, 2019, <https://www.pwc.com/id/en/investment/foreign-direct-investment-faq-2017.pdf>

42. "Indonesia." *IFRS*, last accessed September 11, 2019, <https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/indonesia/>

and PSAK 73 Leases, equivalent to the international standards IFRS 9, IFRS 15, and IFRS 16, respectively. With IFRS 17 Insurance Contracts and other standards and interpretations in preparation, there is currently a two-year gap for new international standards to be applied in Indonesia.⁴³

43. "PSAK Pocket Guide 2018." PwC Indonesia, last accessed September 11, 2019, <https://www.pwc.com/id/en/publications/assurance/psak-2018.pdf>



Opportunity

To enable further investment from a wider range of sources, the government could consider strengthening investor protections by granting shareholders the ability to sue directors and speeding up the time taken to close a business, especially in insolvency cases.

CONTRACT ENFORCEMENT (INDONESIA RANK: 99TH)

Contract enforcement is a critical proxy for trust, allowing economies of scale to grow beyond one's immediate circle of associates and family. Delays and costs in resolving contract disputes benefit neither party. Our measure captures both the efficacy and efficiency of a country's system to enforce the rights of a contract holder. Indonesia is ranked 99th for Contract Enforcement, up 26 places from 10 years ago.

According to the World Bank, one of Indonesia's relative strengths is the time taken to resolve commercial cases: at 134 days, Indonesia ranks 26th in the world, third best in ASEAN. On the other hand, legal costs remain high, at 23% of the claim value, and ranking 150th in the world.

The quality of its judicial administration has improved, as it is now easier to bring small claims to court.⁴⁴ Yet, improvements involving better court automation and electronic case management tools could be made. Indonesia's e-payment system intends to remove corruption from the payment of court fees and costs.^{45,46} Indonesia's Supreme Court signalled an intention to implement digital systems to help speed up small claims disputes and improve the ease of filing bankruptcy proceedings.

Despite these improvements, the primary problem for business is uncertainty of outcome. According to the U.S. State Department, the "court system often does not provide effective recourse for resolving property and contractual disputes".⁴⁷ Due mainly to corruption, and inadequate training of judges and the legal profession, it further notes that commercial law is applied unevenly. Unlike common law systems, Indonesian courts are not bound by precedent, sometimes leading to unpredictable judgements.

The enforcement of judgements is also a challenge. Generally, a judgement by an Indonesian Court is immediately enforceable.⁴⁸ If a party refuses to comply with a judgement, then there are procedures in place to enforce proceedings, including the court seizing assets, although there is no statutory time limit for when a court must enforce a judgement. However, in

Despite improvements in the court system, the primary problem for business is uncertainty of outcome.

44. "Training for Reform: Economy Profile – Indonesia." *Doing Business* 2019. A World Bank Group Flagship Report, p.87, last accessed September 11, 2019, <http://www.doingbusiness.org/content/dam/doingBusiness/country/i/indonesia/IDN.pdf>

45. Narada Kumara and Michelle Yosefanny, "Legal Alert: Introduction of the Indonesian E-Court System." *Budidjaja*, September 14, 2018, <https://www.budidjaja.id/en/indonesian-e-court-system/>

46. Medha Basu and Nurfilzah Rohaidi, "Exclusive: Cutting corruption in Indonesia's courts." *GovInsider*, February 2, 2018, <https://govinsider.asia/innovation/aria-suyudi-supreme-court-indonesia-payment-system-govpay/>

47. "2018 Investment Climate Statements: Indonesia." *U.S. Department of State*, July 19, 2018, <https://www.state.gov/reports/2018-investment-climate-statements/indonesia/>

48. Tony Budidjaja, "Enforcement of judgments and arbitral awards in Indonesia: overview." *Thomson Reuters Practical Law*, last accessed September 11, 2019, [https://uk.practicallaw.thomsonreuters.com/2-619-0724?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/2-619-0724?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1)

practice, enforcement is difficult and “serious reform to secure proper enforcement of commercial contracts is needed.”⁴⁹ Without the losing party being cooperative, seizure of assets can take months to complete.⁵⁰

An alternative to the court system, especially for international disputes, is alternative dispute resolution.⁵¹ There have been some improvement in alternative dispute mechanisms, where Indonesia has risen to 113th this year, 3rd in the Asia-Pacific region.⁵² Under Indonesian law, judges presiding over civil cases must order parties to try and mediate their dispute before it is heard in court.⁵³ The most common methods are mediation and conciliation.⁵⁴ However, international arbitration is widely discouraged by the government of Indonesia and it is difficult to have foreign arbitration awards enforced in Indonesia.⁵⁵

Opportunity

The most important opportunity for improvement is to increase predictability and reduce corruption in decision-making, otherwise the trend to seek overseas jurisdiction will likely continue.

FINANCING ECOSYSTEM (INDONESIA RANK: 31ST)

The financing ecosystem ensures that money is available for investment from sources including banking, bank debt, corporate debt, and more sophisticated financial markets. A wide range of financing options for businesses is also desirable; basic financing options are better suited for businesses at differing stages of maturity, involving individuating revenue and risk profiles. Our Financing Ecosystem measure captures the availability of money, from banking to corporate debt and more sophisticated financial markets. Indonesia’s Financing Ecosystem is a relative strength, where it ranks 31st, up 34 places since 2009, becoming one of Indonesia’s success stories.

From very small to very large firms, access to credit has improved. This has been helped by a relatively high savings rate. Gross domestic savings are 34% of GDP, similar to Malaysia

49. “Chapter VI: Business Law.” *ASEAN Law Association*, p.155, last accessed September 11, 2019 <http://www.aseanlawassociation.org/papers/BusinessLaw.pdf>

50. Tony Budidjaja, “Enforcement of judgments and arbitral awards in Indonesia: overview.” *Thomson Reuters Practical Law*, last accessed September 11, 2019, [https://uk.practicallaw.thomsonreuters.com/2-619-0724?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/2-619-0724?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1)

51. “Dispute resolution in Indonesia.” *International Financial Law Review*, November 1, 2012, <https://www.iflr.com/Article/3121386/Dispute-resolution-in-Indonesia.html?ArticleId=3121386>

52. “Rule of Law Index 2019,” WJP, last accessed September 26, 2019, https://worldjusticeproject.org/sites/default/files/documents/WJP-ROLI-2019-Single%20Page%20View-Reduced_0.pdf

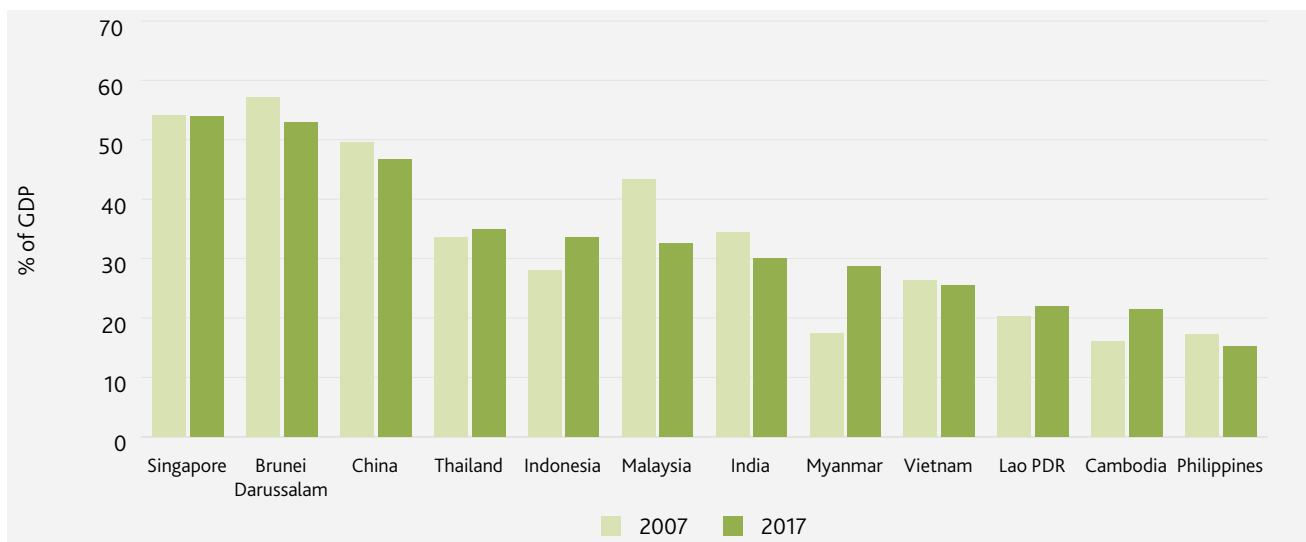
53. Timur Sukirno and Ferry Aritonang, “Litigation and enforcement in Indonesia: overview.” *Thomson Reuters Practical Law*, last accessed September 11, 2019, [https://content.next.westlaw.com/Document/12ef129bc1ed511e38578f7ccc38dcbee/View/FullText.html?contextData=\(sc.Default\)&transitionType=Default&firstPage=true&bhcp=1#co_anchor_a191139](https://content.next.westlaw.com/Document/12ef129bc1ed511e38578f7ccc38dcbee/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true&bhcp=1#co_anchor_a191139)

54. Timur Sukirno and Ferry Aritonang, “Litigation and enforcement in Indonesia: overview.” *Thomson Reuters Practical Law*, last accessed September 11, 2019, [https://content.next.westlaw.com/Document/12ef129bc1ed511e38578f7ccc38dcbee/View/FullText.html?contextData=\(sc.Default\)&transitionType=Default&firstPage=true&bhcp=1#co_anchor_a191139](https://content.next.westlaw.com/Document/12ef129bc1ed511e38578f7ccc38dcbee/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true&bhcp=1#co_anchor_a191139)

55. “Indonesia - Market Challenges,” *Export.Gov*, last modified February 4, 2019, <https://www.export.gov/article?id=Indonesia-Market-Challenges>

(33%), and higher than the world average of 25%.⁵⁶ Since the Asian Financial Crisis, Indonesia has been steadily increasing the domestic credit that is provided to the private sector, from 21% of GDP in 1999 to 39% in 2017. Although this is behind other regional peers, such as Malaysia (119%) and Thailand (145%), the improvement is promising (see Figure 9).⁵⁷

Figure 9: Gross domestic savings



Source: World Bank Development Indicators

Market capitalisation of listed domestic companies has increased from \$26.8 billion in 2000 to \$486.8 billion in 2018.

This is backed up by a fairly solid banking system and prudent fiscal policy. S&P recently upgraded Indonesia's sovereign credit rating to BBB (from BBB-).⁵⁸ Furthermore, according to BTI, the quality of the banking system and capital market has improved, from 96th in the world, to 34th. An improving bank-capital-to-asset ratio and capital adequacy ratio, and non-performing loans, while rising, are still lower than the global average.⁵⁹ The soundness of banks has drastically improved, from 128th to 74th. In 2018, Moody's upgraded its rating for the Indonesian banking system, saying that "over the next 12-18 months, banks in Indonesia will show stabilizing asset quality in a robust macroeconomic environment."⁶⁰

Access to finance for large companies

Though relatively small in comparison to other regional and global stock markets, Indonesia's

56. "Gross domestic savings (% of GDP)," *World Bank*, last accessed September 11, 2019, <https://data.worldbank.org/indicator/NY.GDS.TOTL.ZS> WBDB Gross Domestic Savings

57. "Domestic credit to private sector (% of GDP)," *World Bank*, last accessed September 11, 2019, <https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS?locations=ID-MY-SG-TH-IN>

58. Jun Suzuki, "Indonesia expects more foreign investment after ratings bump," *Nikkei Asian Review*, June 16, 2019, <https://asia.nikkei.com/Economy/Indonesia-expects-more-foreign-investment-after-ratings-bump>

59. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

60. "Moody's changes outlook for Indonesian banking system to stable after recent upgrade of sovereign and bank ratings," *Moody's Investors Service*, August 8, 2018, https://www.moody.com/research/Moodys-changes-outlook-for-Indonesian-banking-system-to-stable-after--PR_387535

stock market is growing. The market capitalisation of listed domestic companies has increased from \$26.8 billion in 2000 to \$486.8 billion in 2018 (in current U.S. dollars), which is roughly half of Indonesia's GDP.⁶¹ The number of listed companies, while still only fourth best in ASEAN, has increased from 286 in 2000, to 619 in 2018.⁶² In the most recent Global Financial Centres Index, Jakarta moved up eight places between September 2018 and March 2019 to be 68th globally and 18th in the Asia-Pacific region. Yet, this is still relatively low for a country the size of Indonesia.⁶³

Extending the scale of the stock market will bring opportunities to Indonesia. Participation of individual investors is among the lowest in Asia, thus one challenge will be to increase the number of retail investors in the stock market.⁶⁴ Millennials have been encouraged to invest; for example, in October 2018, people in their 20s represented more than 34% of all retail investors.

The massive potential of the Indonesian market has attracted large sums of venture capital, with Indonesia now boasting 60 venture capital funds.⁶⁵ Home to 4 of Southeast Asia's 10 unicorns (all of which are e-commerce ventures), venture capitalists see major opportunity in Indonesia's e-commerce market.^{66,67} For example, in 2016, ride-sharing company Go-Jek raised \$550 million through a venture capital consortium.⁶⁸ At the mid-point of 2017, Chinese investment made up 94% of venture capital investment.⁶⁹ The transactions in 2017 were mostly directly into three firms, which took almost all of the investment. According to the World Economic Forum's expert survey, Indonesia comes 25th in the world and 3rd in ASEAN for venture capital availability.

Small-medium enterprises

There are also better ways to provide small and medium enterprises with funding. Commercial bank branches increased from 6 per 100,000 people to 17 per 100,000 in 2019, which is the greatest increase amongst all ASEAN countries.

According to the World Bank, Indonesia has good rules and practices affecting the coverage, scope and accessibility of credit information available to lenders. There have been several positive reforms for Indonesia in the last few years, most recently the distribution of data from retailers and utility companies.⁷⁰

61. "Market capitalization of listed domestic companies (% of GDP)," *The World Bank*, last accessed September 16, 2019, <https://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS>

62. "Listed domestic companies, total," *The World Bank*, last accessed September 16, 2019, <https://data.worldbank.org/indicator/CM.MKT.LDOM.NO>

63. "The Global Financial Centres Index 25," *Long Finance*, March 2019, p.22, https://www.longfinance.net/media/documents/GFCI_25_Report.pdf

64. Harry Suhartono, "Millennials are the biggest investors in Indonesian stocks." *Bloomberg*, November 22, 2018, <https://www.bloomberg.com/news/articles/2018-11-22/millennials-rule-over-indonesian-stock-market-as-foreigners-flee>

65. "Venture Capital Funds in Indonesia." *Tracxn*, last modified June 26, 2019, <https://tracxn.com/d/investor-lists/Venture-Capital-Funds-in-Indonesia/>

66. "Singapore investors urged to tap in Indonesia's digital economy." *East Ventures*, February 22, 2019, <https://east.vc/east-ventures/indonesia-digital-startup-ecosystem/>

67. Norman Harsono, "What are unicorn companies?," *The Jakarta Post*, February 19, 2019, <https://www.thejakartapost.com/news/2019/02/19/what-are-unicorn-companies.html>

68. Norman Harsano, "Tech unicorns lead venture capital upsurge to Indonesia: Discussion." *The Jakarta Post*, January 29, 2019, <https://www.thejakartapost.com/news/2019/01/29/tech-unicorns-lead-venture-capital-upsurge-to-indonesia-discussion.html>

69. "Indonesian startup scene draws over \$3 billion in venture capital." *Consultancy Asia*, January 9, 2018, <https://www.consultancy.asia/news/181/indonesian-startup-scene-draws-over-3-billion-in-venture-capital>

70. "Business Reforms in Indonesia." *World Bank Doing Business*, World Bank Group, last accessed September 25, 2019, <https://www.doingbusiness.org/en/reforms/overview/economy/indonesia>

A recent study by the World Bank drew attention to SMEs accessing products beyond loans and basic transactions accounts, with senior managers (who were spoken to by the World Bank) expressing an interest in the provision of more advanced products.⁷¹ These services, however, were often not being provided to SMEs, most likely due to the inefficient implementation of SME initiatives.

Finance and fintech

There are significant opportunities for Indonesian finance. Fintech firms can offer peer to peer lending to millions of consumers and businesses across Indonesia.⁷² These are being encouraged by the financial regulator in order to reach many people who cannot access traditional bank loans. Go-Jek, a ride-hailing company (like Uber), uses e-payments, and this (along with other firms) has meant more Indonesians are accessing formal financial tools, particularly through e-wallets.⁷³

PwC notes that, in a survey of banks, an estimated 35% of customer transactions were taking place through digital channels.⁷⁴ With smartphone ownership increasing, and given that micro, small and medium enterprises make up 60% of Indonesia's GDP, there is much potential for improved access to financial services.⁷⁵

Opportunity

Opportunity lies in the extension of lending services to SMEs. To enable further investment from a wider range of sources, the government could facilitate the development of more diverse investment products to serve their needs.

The further development of capital markets will serve to increase sources of finance for much-needed infrastructure development, as it would supplement and reduce the reliance on banking and fiscal sources.

A joint IMF-World Bank mission has made a number of recommendations for strengthening Indonesia's financing ecosystem.⁷⁶ These include reviewing the overall tax framework for financial products, enhancing the role of institutional investors in capital markets, and developing more derivative markets around foreign exchange and interest rates. They also recommend improving the financial literacy of issuers and investors.

71. "Serving the Needs of Indonesian SMEs." *International Finance Corporation*, World Bank Group, p.iii, last accessed September 11, 2019, <http://documents.worldbank.org/curated/en/556861495102658074/pdf/115101-WP-ID-SME-Banking-Study-Main-Findings-PUBLIC.pdf>

72. Fransiska Nangoy and Tabita Diela, "Indonesia's fintech lending boom exploits shortfall in bank loans," *Reuters*, January 30, 2018, <https://uk.reuters.com/article/us-indonesia-fintech/indonesias-fintech-lending-boom-exploits-shortfall-in-bank-loans-idUKKBN1FJ0F4>

73. Erwida Maulia, "Go-Jek sparks an Indonesian banking revolution," *Nikkei Asian Review*, August 29, 2018, <https://asia.nikkei.com/Spotlight/Cover-Story/Go-Jek-sparks-an-Indonesian-banking-revolution>

74. "2018 Indonesia Banking Survey." *PwC*, February 2018, p.23, <https://www.pwc.com/id/en/publications/assets/financialservices/2018-indonesia-banking-survey.pdf>

75. Aries Setiadi, "Fintech lending opens up opportunities for SMEs," *The Jakarta Post*, January 18, 2017, <https://www.thejakartapost.com/academia/2017/01/18/fintech-lending-opens-up-opportunities-for-smes.html>

76. "Financial Sector Assessment: Republic of Indonesia" *World Bank*, June 2017, <http://documents.worldbank.org/curated/en/104191505745150824/Indonesia-FSAP-Update-FSA-07072017.docx>

There is also significant potential from increasing use of technology for banking, given the dispersed nature of the nation's population across the archipelago.⁷⁷ Partnership between the private and public sectors is critical to the success of Indonesia's digital revolution in financial services, not least in ensuring that the necessary communications infrastructure is accessible throughout the country.

RESTRICTIONS ON INTERNATIONAL INVESTMENT (INDONESIA RANK: 74TH)

Indonesia maintains a negative investment list, comprising sectors where foreign investment is closed or restricted.

International investment has been shown to have a positive overall effect on economic growth. Research suggests that international investment is typically more productive than domestic, given the higher risks it faces. The benefit of foreign direct investment (FDI) is not only the inflow of capital, but also the accompanying infusion of managerial competence. FDI brings healthy competition in the form of product and service innovation, new working practices, and new efficiencies in productivity.

Indonesia ranks 74th for Restrictions on International Investment, up two places from 2009 (although its score has declined slightly since then). Given its size, Indonesia is an attractive market for foreign investment. According to the OECD's FDI Restrictiveness Index, Indonesia is the third-weakest in terms of four main types of restrictions: foreign equity restrictions; discriminatory screening or approval mechanisms; restrictions on key foreign personnel, and operational restrictions.⁷⁸ This is to Indonesia's detriment, as it would benefit from the inflow of ideas and expertise that come with capital.

How much foreign investment goes into Indonesia?

Foreign direct investment net inflows were \$21.5 billion in 2017, which is 1.1% of world total net inflows, behind Singapore on \$63.6 billion, India on \$40.0 billion, and China on \$168.2 billion.⁷⁹ In 2018, 47.3% of direct investment into Indonesia (\$10.3 billion) was recorded as originating from Singapore, followed by Japan on 22.2% (\$4.8 billion) and China on 9.7% (\$2.1 billion).⁸⁰ Direct investment flows in Indonesia in 2018 saw \$13.1 billion go into manufacturing, \$6.7 billion into wholesale and trade, and \$3.2 billion into agriculture, hunting and forestry.⁸¹

77. "Digital banking in Indonesia: Building loyalty and generating growth," *McKinsey & Company*, February 2019, <https://www.mckinsey.com/~media/McKinsey/Industries/Financial%20Services/Our%20Insights/Digital%20banking%20in%20Indonesia%20Building%20loyalty%20and%20generating%20growth/Digital-banking-in-Indonesia-final.ashx>

78. "FDI restrictiveness." *OECD*, last accessed September 11, 2019, <https://data.oecd.org/fdi/fdi-restrictiveness.htm>

79. "Foreign direct investment, net inflows (BoP, current US\$)," *The World Bank*, last accessed September 16, 2019, <https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD>

80. "Table V.33. Direct Investment Flows in Indonesia by Country of Origin," Indonesian Financial Statistics, *Bank Indonesia*, last accessed September 12, 2019, <https://www.bi.go.id/en/statistik/seki/terkini/eksternal/Contents/Default.aspx>. Note that these are gross figures and may not be the original source of inflow.

81. "Table V.36. Direct Investment Flows in Indonesia by Economic Sectors," Indonesian Financial Statistics, *Bank Indonesia*, last accessed September 12, 2019, <https://www.bi.go.id/en/statistik/seki/terkini/eksternal/Contents/Default.aspx.V.36>.

Foreign ownership

First, Indonesia maintains a negative investment list, comprising sectors that are closed for foreign investment and those that are open, but subject to some requirements.⁸² For example, foreign ownership of the broadcast media is banned, and there are restrictions in energy and natural resources, telecommunications, health care and pharmaceuticals, manufacturing and transport.^{83,84} Indonesia is one of five ASEAN countries with restrictions on foreign participation in the telecommunications sector.⁸⁵

There have been some improvements, such as opening hotels and restaurants to 100% foreign ownership, but there are still opportunities to remove foreign restrictions on investment in particular industries.⁸⁶ For increasing FDI, the World Bank in its December 2018 report noted removing foreign equity limits in all sectors would create an estimated additional \$4 billion and \$2 billion in foreign and domestic investments.⁸⁷

Property ownership

Second, foreigners face restrictions when trying to own land; they cannot hold land titles, but can buy apartments. They can also 'buy' landed houses for up to 80 years, subject to two renewal processes in that time.⁸⁸ There is also a price limit for the land that foreigners can buy, driven in part by fears of foreign speculators driving up prices. In Jakarta this is up to IDR 10 billion (approximately \$700,000) for houses and IDR 5 billion for apartments.⁸⁹ A foreigner cannot rent out the property they have purchased, and a legal stay permit is necessary if they are to own the property. If they leave Indonesia, they must sell or transfer the property.⁹⁰ In practice, many foreigners bend the rules of property ownership, often putting the title in the name of an Indonesian citizen.⁹¹ Indonesia Real Estate Broker Chairman Lukas Bong predicts that relaxed regulations for foreigners could mean that property market growth could reach 30% (up from 6%).⁹²

Regulatory regime

Thirdly, the regulatory environment discourages investors, primarily because it creates uncertainty. The business impact of rules on FDI has also deteriorated, from 10th in the

Foreigners can also buy landed houses for up to 80 years, subject to two renewal processes in that time.

82. "Your journey through Indonesia." PwC, p.9, last accessed September 11, 2019, <https://www.pwc.com/id/en/investment/foreign-direct-investment-faq-2017.pdf>

83. "Freedom of the Press 2017: Indonesia profile." *Freedom House*, last accessed September 11, 2019, <https://freedomhouse.org/report/freedom-press/2017/indonesia>

84. "Indonesia to relax foreign investment rules." *Hogan Lovells*, November 23, 2018, https://www.hoganlovells.com/~media/hogan-lovell/pdf/2018/2018_11_23_indonesia_to_relax_foreign_investment_rules_v2.pdf?la=en

85. "Foreign Direct Investment and the Digital Economy in ASEAN." *ASEAN Investment Report 2018*, p.233, last accessed September 11, 2019, <https://asean.org/storage/2018/11/ASEAN-Investment-Report-2018-for-Website.pdf>

86. James Guild, "Indonesia's booming tourism industry." *The Diplomat*, June 7, 2018, <https://thediplomat.com/2018/06/indonesias-booming-tourism-industry/>

87. "Indonesia Economic Quarterly: Strengthening Competitiveness." *The World Bank*, December 2018, p.46, <https://openknowledge.worldbank.org/bitstream/handle/10986/30969/IEQ2018Dec.pdf>

88. "Still not buying it; foreign property ownership in Indonesia." *Global Business Guide Indonesia*, 2016, last accessed September 11, 2019, http://www.gbgingonesia.com/en/property/article/2016/still_not_buying_it_foreign_property_ownership_in_indonesia_11639.php

89. *Ibid.*

90. *Ibid.*

91. *Ibid.*

92. Riza Mufti, "Govt told to relax property ownership for foreigners to boost growth." *The Jakarta Post*, January 28, 2019, <https://www.thejakartapost.com/news/2019/01/28/govt-told-to-relax-property-ownership-for-foreigners-to-boost-growth.html>

world to 95th.⁹³ The U.S. State Department notes that while the government officially welcomes FDI, “vague and conflicting regulations, inefficient bureaucracy, inconsistent tax enforcement, poor existing infrastructure, rigid labour laws, sanctity of contract issues, and corruption remain significant concerns for foreign investors”.⁹⁴

For example, in 2014, Indonesia announced it was terminating most of its bilateral investment treaties with foreign countries.⁹⁵ These treaties sought to provide a dispute resolution process for foreign investors in Indonesia. It has since terminated agreements with 29 countries (although Singapore has been replaced).⁹⁶ The reason for their removal was that, according to the Indonesian government, they did not assign obligations and benefits equally between investor and contracting state.⁹⁷ The announcement raised concerns that foreign investors would prevent protection against government expropriation.⁹⁸ Importantly, investors remain protected for up to 15 years, as each agreement has a sunset clause. Furthermore, Indonesia has said it will renegotiate the contracts by seeking to replace them with multi-lateral agreements.

Furthermore, to be enforceable in Indonesia, contracts are legally obliged to be written in Indonesian, even in the agreement is between private parties (as ruled by the Supreme Court in 2016).⁹⁹ This is not case in comparable countries like Malaysia, Vietnam (with some exceptions), and China.^{100,101,102}

Capital restrictions

Fourthly, there are a number of restrictions on particular types of financial transactions. The percentage of exemptions for capital controls has remained the same at 15%, with Indonesia ranking 99th. In ASEAN, this is behind Singapore, Cambodia, and Laos (see Figure 10). Promisingly, in June 2018, the central bank governor announced that capital controls would not be used to stabilise the rupiah in a time of global uncertainty.¹⁰³

93. “Global Competitiveness Report 2018,” WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

94. “2018 Investment Climate Statements: Indonesia,” *U.S. Department of State*, July 19, 2018, <https://www.state.gov/reports/2018-investment-climate-statements/indonesia/>

95. “What is going on with Indonesia’s bilateral investment treaties?,” *Global Business Guide Indonesia*, June 13, 2016, http://www.gbgingonesia.com/en/main/legal_updates/what_is_going_on_with_indonesia_s_bilateral_investment_treaties.php

96. Lampung Univesity Hamzah, “Bilateral investment treaties (BITs) in Indonesia: A paradigm shift, issues and challenges.” *Journal of Legal, Ethical and Regulatory Issues* 21, no. 1 (2018), p 10-11.

97. *Ibid.*, p.8-9.

98. “What is going on with Indonesia’s bilateral investment treaties?,” *Global Business Guide Indonesia*, June 13, 2016, http://www.gbgingonesia.com/en/main/legal_updates/what_is_going_on_with_indonesia_s_bilateral_investment_treaties.php

99. “Indonesian Supreme Court rules that commercial agreements which are not in the Indonesian language are void.” *Lexology*, February 5, 2016, <https://www.lexology.com/library/detail.aspx?g=33ad3285-7512-4e4f-812c-d29cac71cced>

100. Lim Huan and Manshan Singh, “Sale and storage of goods in Malaysia: overview.” *Thomson Reuters Practical Law*, last accessed September 11, 2019, [https://uk.practicallaw.thomsonreuters.com/w-017-9601?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhpc=1](https://uk.practicallaw.thomsonreuters.com/w-017-9601?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhpc=1)

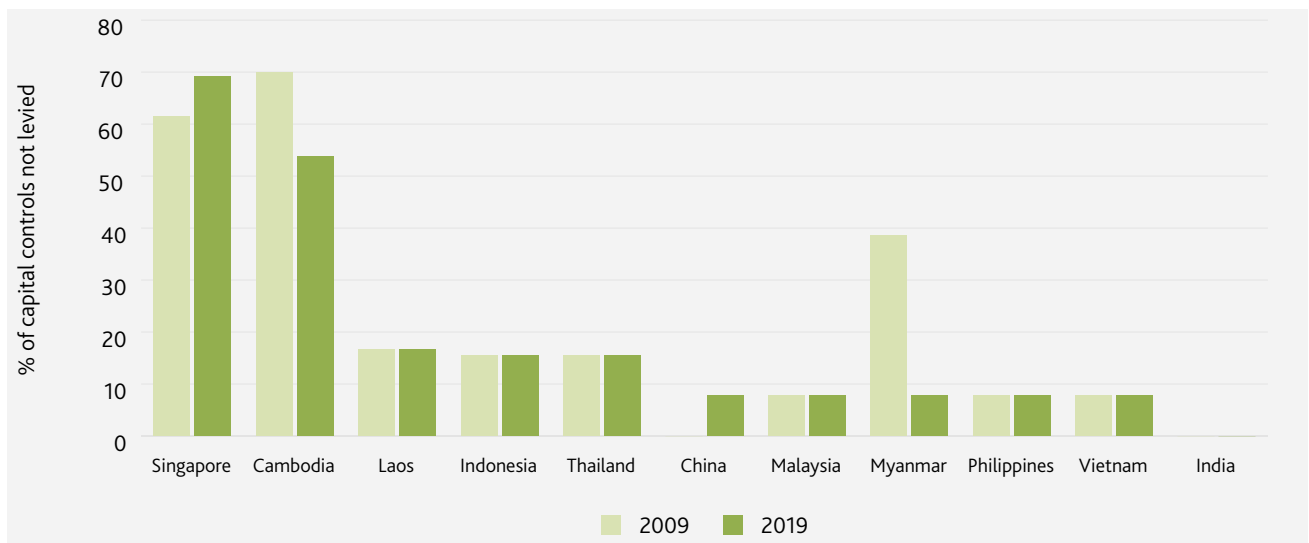
101. “Foreign language contract laws vary in Vietnam.” *Vietnam Investment Review*, June 15, 2016, <https://www.vir.com.vn/foreign-language-contract-laws-vary-in-vietnam-42750.html>

102. “The language used for a China contract is very important,” *Liuming International*, March 23, 2016, <http://www.liuminginternational.com/the-language-used-for-a-china-contract-is-very-important/>

103. “Indonesian central bank says no plan for capital controls.” *The Business Times*, June 7, 2018, <https://www.business-times.com.sg/banking-finance/indonesian-central-bank-says-no-plan-for-capital-controls>

Restrictions on financial transactions has also worsened, from 67th to 85th. While there are no foreign exchange controls, Indonesia has mandated that all domestic financial transactions must be conducted in rupiah, although there are a number of exceptions that lessen the impact on foreign firms.^{104,105} The freedom to own foreign bank accounts in Indonesia has improved and there are now no restrictions on holding foreign currency bank accounts.

Figure 10: Capital controls



Source: Fraser Institute

104. Ira Eddymurthy and Revaldi Wirabuana, "Doing business in Indonesia: overview," *Thomson Reuters Practical Law*, last accessed September 11, 2019, [https://uk.practicallaw.thomsonreuters.com/5-501-2646?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/5-501-2646?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1)

105. "Indonesia – foreign exchange controls," *Export.Gov*, last modified February 4, 2019, <https://www.export.gov/article?id=Indonesia-Foreign-Exchange-Controls>



There is also a limit of \$1 million for commercial banks engaging in derivative transactions with foreign parties.¹⁰⁶ The exception to this is when "the derivative transactions are conducted for hedging purposes within the framework of an investment in Indonesia that will last for at least three months".¹⁰⁷ Foreign currency borrowing must be through banks registered with the central bank, which now also requires parties to disclose information on risk participation agreements as part of a foreign exchange activity report.¹⁰⁸

Travel restrictions

Finally, Indonesia has also seen an improvement in the freedom of foreigners to visit, improving from 113th to 48th in 10 years. This is far better than India or China, but behind Cambodia, Laos, Malaysia, Philippines, and Singapore. Since 2015, Indonesia has opened up visa-free travel, boasting short-term visa-free travel in over 169 countries.¹⁰⁹ Certain business travellers, in addition to tourists, can get visa-free travel.¹¹⁰

The true cost of all of the above restrictions is the loss of capital ideas and expertise, either because capital is prevented from entering in the first place, or because businesses are reluctant to invest. Many international investors hold hope that after the 2019 elections the President will open up the country to more foreign investment; promisingly, he announced that one of his five priorities would be removing obstacles to investment.^{111,112}

Opportunity

A politically acceptable way of increasing international investment has the potential to kick-start a further round of financing. To do so, the government could continue to reduce the domestic investment list. President Widodo has recently announced plans to shorten the negative investment list.¹¹³ The government could also announce sectors in which investment is encouraged, perhaps through a 'positive investment list'. Companies investing into these sectors could receive government benefits.

The government also ought to replace the dispute mechanisms for its bilateral investment treaties, such that investors have certainty over the rules in coming years. This is particularly critical before those treaties annulled in 2015 come to an end in the mid-2020s.

106. Ibid.

107. Ibid.

108. "New bank Indonesia regulation on report of foreign exchange activities require additional information on risk participation transaction," *Baker McKenzie*, March 5, 2019, <https://www.bakermckenzie.com/en/insight/publications/2019/03/new-bank-indonesia-regulation>

109. "Visa free for 169 countries to travel to Indonesia," *Indonesia.Travel*, July 6, 2018, <https://www.indonesia.travel/sg/en/trip-ideas/visa-free-for-169-countries-to-travel-to-indonesia>

110. "169 countries get visa-free facility," *Directorate General of Immigration*, last accessed September 11, 2019, <http://www.imigrasi.go.id/index.php/en/berita/berita-utama/998-169-countries-get-visa-free-facility>

111. Tom Allard and John Chalmers, "Jokowi 2.0 could open Indonesia's door to foreign investors." *Reuters*, April 17, 2019, <https://www.reuters.com/article/us-indonesia-election-reform-analysis/jokowi-2-0-could-open-indonesias-door-to-foreign-investors-idUSKCN1RT1Y1>

112. Editorial Board, "Jokowi's march of progress." *The Jakarta Post*, July 16, 2019, <https://www.thejakartapost.com/academia/2019/07/16/jokowis-march-of-progress.html>

113. "Indonesia plans 'surprises' in easing foreign ownership caps – investment chief," *Reuters*, August 15, 2019, <https://uk.reuters.com/article/indonesia-economy-investment/indonesia-plans-surprises-in-easing-foreign-ownership-caps-investment-chief-idUKL4N25A0ZK>



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ENTERPRISE CONDITIONS (INDONESIA RANK: 61ST)

A healthy economy is both dynamic and competitive, where regulations support businesses by allowing and encouraging them to respond to the changing priorities of society. An economy focused on protecting incumbents, however, will enjoy lacklustre growth and job creation. Entrepreneurial activity is one of the key drivers of long-term prosperity, and its importance will only grow as the pace of technological change increases alongside the drive of the supporting workforce. Given the pace of change inherent to the information age, a society's ability to react quickly to new firms – and market-level opportunities – is critical to overall Economic Openness.

INDONESIA SWOT Analysis of Enterprise Conditions

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • A flourishing business environment in consumer markets, particularly in e-commerce • Dynamic start-up scene in some urban centres • A rapidly growing middle class which will provide increased opportunities for businesses • A rapidly growing labour force 	<ul style="list-style-type: none"> • State-owned enterprises dominate the provision of many services • Restrictive labour laws • Lack of skilled labour • Weak Business Competition Supervisory Commission (KPPU) that cannot effectively fight cartels that dominate the markets • Decentralisation adds regional import restrictions
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Increasing market contestability with reduced dependence on state-owned enterprises and stronger regulation of anti-competitive behaviours • Reducing burden for firms entering the formal sector • Improving tax administration • Improving the skills of the expanding labour force • Easing labour restrictions to facilitate the expansion of the formal labour market 	<ul style="list-style-type: none"> • A lack of skilled labour • Uncertain and unpredictable legal and regulatory environment

Evaluating Enterprise Conditions

These factors can, in part, be measured by considering the regulatory and bureaucratic impediments to starting and growing a business, alongside the cultural attitudes of a nation's workforce. We examine the Domestic Market Contestability, the Environment for Business Creation, Regulatory Burdens, and Labour Market Flexibility.

The most critical element for enterprise conditions is **Domestic Market Contestability**, which measures competitiveness and openness as the essential stimulators of innovation and efficiency. While there is no such thing as a perfectly contestable market, it has long been understood that basic principles – from anti-monopoly policy to limitations on market dominance – reap considerable benefits.¹

The **Environment for Business Creation** captures the legislation and policies encouraging start-ups. A supportive business environment is critical. If the framework of enterprise is important, so too are the prevailing views and attitudes of a populace. This entails various market freedoms, namely an entrepreneurial environment with active entrepreneurship.

We also measure the **Burden of Regulation**. In markets where sufficient trust and self-regulation allows industries and services to focus on innovation and production, a good government must ensure that regulation does not generate unnecessary administration. Taxation is a necessary part of any society. While the shape of the optimal tax system has long been debated, the manner in which the tax is raised can be critical, ideally being as simple and non-distortive as possible.²

Finally, we measure **Labour Market Flexibility**. While the debate over the degree to which labour markets might be liberalised remains unsolved, evidence proves that highly restrictive labour markets entail costs associated with facilitating enterprise.³

Indonesia displays signs of an increasingly dynamic economy. The new registrations of businesses are around 0.33 per 100 people aged 15-64, which has doubled since 2006. However, this rate is low, when compared to Malaysia (2.26) and Singapore (8.62). Indonesia also has an increasing number of patents, although it is far behind others. In 2017, there were 2,320 patent applications, which in per capita terms places it fourth among ASEAN nations.

Indonesia ranks 61st globally for Enterprise Conditions. It has made progress towards creating better enterprise conditions across the archipelago. In certain sectors, Indonesia has a dynamic and open economy, home to some of the largest e-commerce companies in Southeast Asia. It is easier to start a business, yet there are still areas that need attention. In the following sections, we review the performance of Indonesia in each of the distinct elements of Enterprise Conditions, from Domestic Market Contestability through to Labour Market Flexibility.

1. William J. Baumol, John C. Panzar, and Robert D. Willig, "On the theory of perfectly-contestable markets," chap. 12 in *New developments in the analysis of market structure*. (London, Palgrave Macmillan, 1986): 339-370.

2. N. Mankiw, Gregory, Matthew Weinzierl, and Danny Yagan, "Optimal taxation in theory and practice." *Journal of Economic Perspectives* 23, no. 4 (2009): 147-74.

3. Roxana Radulescu and Martin Robson, "Does labour market flexibility matter for investment? A study of manufacturing in the OECD." *Applied Economics* 45, no. 5 (2013): 581-592.

DOMESTIC MARKET CONTESTABILITY (INDONESIA RANK: 70TH)

Progress and prosperity often comes as a consequence of an open, fair and competitive market. Crucially, governments can ensure that there is both domestic and international competition, as well as a strong and effective anti-monopoly policy. A fair and effectively enforced competitive market benefits all by helping to stimulate improvements in efficiency and innovation. Our measure of Domestic Market Contestability captures how open the market is to new participants, versus protection of the incumbents.

Indonesia is 70th in the world for Domestic Market Contestability, down 10 places in a decade. Like many countries, a significant number of sectors are dominated by only a few major players.

When Indonesia transitioned to democracy in 1998, it inherited a high level of internal market dominance. In 1996, the top 10 families owned 58% of listed corporate assets. While ownership changed with the Asian Financial Crisis of 1997-98, the level of market dominance persisted. From 1990 to 2005, the four largest firms in over half of the industry groups held at least 60% of the market shares.⁴

The “level of concentration in many business sectors remains very high, including in the food industry and the media.”⁵ Furthermore, state-owned enterprises (SOEs) were common during the Suharto years, and continue to be favoured as agents of development by the government, thereby dominating many sectors.⁶ Besides the government’s dominance in natural resources, about 80% of public construction projects are being handled by SOEs.⁷ The finance sector is dominated by state-owned banks, and has concentration ratios (CR4) in the loan and deposit markets that reach levels above 40%, indicating loose oligopoly or monopolistic competition.⁸

Furthermore, since 2014, the government negotiated the sale of Freeport’s controlling shares in the world’s largest gold mine to a SOE. It also transferred the operating rights for the Mahakam gas block from the French company Total to another SOE, while helping an Indonesian company to acquire shares of the Batu Hijau copper mine from Newmont.⁹

Competition commission

Indonesia’s competition commission has relatively weak powers. Following the Asian Financial Crisis, the IMF agreed to provide financial assistance in exchange for numerous

The level of concentration in many business sectors remains very high, including the food industry and media.

4. Haryo Aswicahyono, Hal Hill, and Dionisius Narjoko, “Industrialization: Patterns, issues, and constraints.” In *Diagnosing the Indonesian Economy: Toward Inclusive and Green Growth*. Anthem Press, 2012, p.183-226.

5. “Indonesia Country Report,” *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

6. “Voluntary peer review on competition policy.” *UNCTAD*, New York and Geneva, 2009, p.48, https://unctad.org/en/Docs/ditccplp20091_en.pdf

7. “Private sector left in dust in Indonesia’s infrastructure push.” *The Business Times*, October 23, October 2017, <https://www.business-times.com.sg/government-economy/private-sector-left-in-dust-in-indonesias-infrastructure-push-0>

8. Sapto Jumono, Abdurrahman, Chajar Matari Fath Mala, “ (2017), Market Concentration Index and Performance: Evidence from Indonesian Banking Industry,” *International Journal of Economics and Financial Issues*, 2017, 7(2), p.249-258.

9. Warburton, Eve, “Nationalism, developmentalism and politics in Indonesia’s mining sector.” *Indonesia in the New World: Globalisation, Nationalism and Sovereignty* (2018): 90-108.



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reforms, some particularly geared towards competition law.¹⁰ One outcome is the Commission for Supervision of Business Competition (known as the KPPU), now responsible for enforcing competition law and advocating for better competition law practices.¹¹ Set out in a 1999 statute, competition law only applies to business actors – those that engage in 'business activities' in Indonesia (this definition includes SOEs).¹² Prosecutions are relatively rare, due in part to the KPPU's limited ability to bring cases, and its small budget.

A 2013 OECD survey of 49 countries highlighted Indonesia's rank at 47th in terms of being conducive to competition, also noting that the KPPU is the only competition agency that cannot perform unannounced inspections for firms that are being investigated for anti-trust infringements.¹³

10. See for example: "Indonesia: supplementary memorandum of economic and financial policies." *IMF*, October 19, 1998, <https://www.imf.org/external/np/loi/101998.htm>; "The Dominance and Monopolies Review," *The Law Reviews*, 2019, 7, <https://thelawreviews.co.uk/edition/the-dominance-and-monopolies-review-edition-4/1136443/indonesia#footnote-052>

11. "The Dominance and Monopolies Review," *The Law Reviews*, 2019, 7, <https://thelawreviews.co.uk/edition/the-dominance-and-monopolies-review-edition-4/1136443/indonesia#footnote-044>

12. "The Dominance and Monopolies Review," *The Law Reviews*, 2019, 7, <https://thelawreviews.co.uk/edition/the-dominance-and-monopolies-review-edition-4/1136443/indonesia#footnote-044>

13. "Indonesia Economic Quarterly: Strengthening Competitiveness," *The World Bank*, December 13, 2018, p.42, <https://openknowledge.worldbank.org/bitstream/handle/10986/30969/IEQ2018Dec.pdf>; see also Alemani, Enrico, Caroline Klein, Isabell Koske, Cristiana Vitale, and Isabelle Wanner, "New Indicators of Competition Law and Policy in 2013 for OECD and non-OECD Countries." In *Competition law enforcement in the BRICS and in developing countries*, pp. 59-102. Springer, Cham, 2016.

Policy developments

According to UNCTAD, “Many public policy makers and regulators are unfamiliar with the goals or benefits of competition policy. Moreover, they are not used to incorporating competition as a goal of their public policy.”¹⁴ That said, President Joko Widodo has acknowledged that a lack of competition in the airline industry is potentially impacting consumers (see our Transport element).¹⁵

The Indonesian Parliament recently approved an amendment of the Indonesian Competition Law (ICL). The Draft Law on Prohibition of Monopoly Practices and Unfair Business Competition is meant to replace the current Competition Law, and will proceed to the executive branch for further deliberations. The draft law contains seven new features that supposedly empower the KPPU’s handling of monopolies and unfair competitions.¹⁶ It is comprised of administrative fines, merger notifications, leniency programmes, exemptions from the application of ICL, interim orders by the KPPU, extra-territorial application, and repeal of KPPU-related provisions.¹⁷

During the discussions, KPPU declared its urgent need to apply the new sanctions offered by the draft law to amplify deterrent effects on cartels. One of the recent cartel cases involves two Japanese producers of automatic scooters – Yamaha and Honda – found guilty of forming a price cartel.¹⁸

Emerging competitive sectors

In contrast to industries dominated by SOEs or long-standing companies, the most competitive forces emerge in sectors that are largely free from dominance (and state interest), especially the consumer markets and digital economy. Companies that engage in e-commerce, financial technologies and the sharing economy thrive on the growth of private consumption expenditures, which increased by almost a third from 2014 to 2018.

Entrepreneurship flourishes in this area, where market-based competition meets increasing internet connectivity and the purchase power of a rapidly growing consumer class. Since 2016, the Indonesian tech ecosystem saw the rise of local unicorns (private companies valued at \$1 billion or above), including the ride-hailing company Go-Jek as well as e-commerce platforms Traveloka, Tokopedia, and Bukalapak. Go-Jek sought a valuation of \$9 billion in 2018 and Tokopedia raised \$2.4 billion in nine funding rounds. All of these companies developed business platforms, e-money or e-payment systems instrumental to the market access of small enterprises in Indonesia.

14. “Voluntary peer review on competition policy.” *UNCTAD*, New York and Geneva, 2009, p.48, https://unctad.org/en/Docs/ditccp20091_en.pdf

15. “Widodo bemoans lack of competition in Indonesia.” *Flight Global*, June 4, 2019, <https://www.flightglobal.com/news/articles/widodo-bemoans-lack-of-competition-in-indonesia-458680/>

16. “The Parliament finished drafting its new competition law.” *KPPU*, April 29, 2017, <http://eng.kppu.go.id/the-parliament-finished-drafting-its-new-competition-law/>

17. “New completion target on the amendment of the Indonesian Competition Law.” *Assegaf Hamzah & Partners*, June 2018, <https://id.rajahtannasia.com/media/3049/ahpclientupdate-25june2018.pdf>

18. Rachmadea Aisyah, “Supreme Court rejects appeal to verdict on Yamaha-Honda price cartel.” *The Jakarta Post*, May 2, 2019, <https://www.thejakartapost.com/news/2019/05/02/supreme-court-rejects-appeal-to-verdict-on-yamaha-honda-price-cartel.html>

Opportunity

Indonesia can improve contestability by reducing dependence on SOEs, removing import restrictions, and ending subsidies. A further option should be to strengthen the role of the KPPU in tackling anti-competitive behaviours. The World Bank argues that the KPPU should be given more power to stop cartels operating.¹⁹ Other suggestions include clarifying the impact of sanctions on firms and individuals; specifying the definition of 'business actor', "so that it comprises all legal entities operating as a single economic unit in the market"; and streamlining enforcement, through the use of settlements.

ENVIRONMENT FOR BUSINESS CREATION (INDONESIA RANK: 43RD)

Entrepreneurial activity is the manifestation of a healthy and dynamic society, in which ideas are constantly being created, developed, and tested. Crucially, the process of translating ideas into success must be as easy and accessible as possible. Government, and hence society, can benefit by providing a supportive environment that appreciates and values entrepreneurial contributions towards improvements in prosperity.

Up 10 places since 2009, Indonesia have a relatively good business environment, ranking 43rd in the world for Environment for Business Creation. The private sector is generally viewed positively, and "much of the government's long-term economic planning relies on investment by and the role of private businesses".²⁰

Regulatory reform

Recently, the government has taken steps to create a business-friendly environment. In 2017, Indonesia established a ministerial, provincial and regional task force, intending to improve the inefficiencies of starting a business. The Coordinating Ministry for Economic Affairs stated that in February 2018, 90% of regencies had implemented one-stop licencing services.²¹ Additionally, in July 2018, the government launched the online single submission (OSS) system, expediting a number of business licencing procedures.²²

As a result of reforms making it easier to start a business, Indonesia has almost doubled its World Bank scores in the last 10 years. For example, in 2018 it reduced the fees to set up a limited-liability company.²³ In Jakarta for example, it took 181 days to start a business in 2004, at a cost equivalent to 137% of GDP per capita. Now it only takes 20 days at a cost of 6.1% (on paper at least). Paid-in capital required to start a business has also dropped to 0% of GDP per capita.

19. "Indonesia Economic Quarterly: Strengthening Competitiveness," *The World Bank*, December 13, 2018, p. 47, <https://openknowledge.worldbank.org/bitstream/handle/10986/30969/IEQ2018Dec.pdf>

20. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

21. "2019 Investment Climate Statements: Indonesia," *U.S. Department of State*, July 11, 2019, <https://www.state.gov/reports/2019-investment-climate-statements/indonesia/>

22. *Ibid.*

23. "Training for Reform: Economy Profile – Indonesia." *Doing Business 2019*. A World Bank Group Flagship Report, 16, last accessed September 11, 2019, <http://www.doingbusiness.org/content/dam/doingBusiness/country/i/indonesia/IDN.pdf>
WB Doing Business

While these are strong improvements, Indonesia still falls short of regional leaders. For example, in Singapore it takes just 1.5 days to register a business at a cost of just 0.4% of GDP. It is also important to note that, due to local bylaws, central government initiatives to improve the ease of starting a business cannot be felt in all regions.

Scaling up

One challenge facing Indonesia is the need to encourage businesses to enter into the formal economy. It appears many of these entrepreneurs are driven by necessity, rather than opportunity. In 2016, there were 0.33 new business registrations per 1,000 people aged 15-64, reflecting the large number of businesses choosing to remain informal; this compares poorly to other ASEAN countries such as Malaysia (2.26), and Singapore (8.62) (see Figure 11). Perhaps most telling is the expectation of job creation – just 1.6% expect that they will create six or more jobs within five years, far below the regional average of 23%.

Ambitious start-ups lie at the other end of the scale, harbouring other challenges. Nicko Widjaja, CEO of MDI Ventures, argues that Indonesia has too many digital start-ups in pursuit of “venture-scale” growth, when, as SMEs, they should be chasing more moderate growth.²⁴ Noting challenges facing Indonesia, he references the lack of credit cards and proportion of unbanked, while arguing for greater collaboration between start-ups and their incubators.

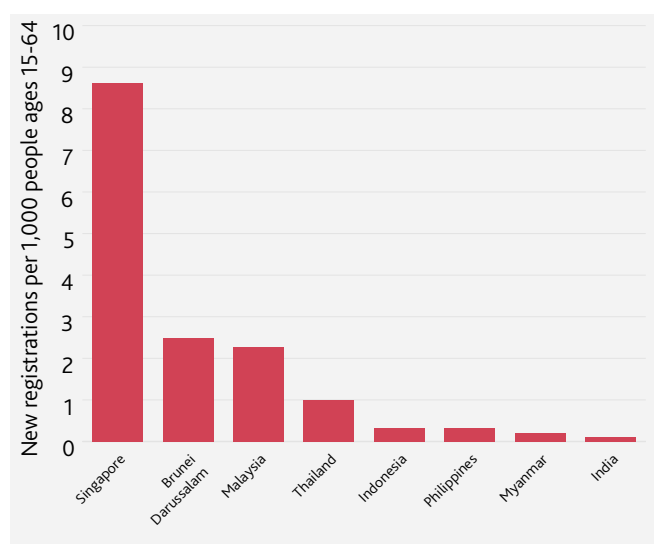
Availability of labour

Indonesian businesses can only take advantage of a better business environment if they have access to skilled labour, the shortage of which is becoming more acute with 10.8% of businesses identifying this as a significant constraint, up from 4.5%. Currently, 17% of 127 million Indonesians with jobs finished high school, with less than 10% qualifying from university.²⁵ Korn Ferry, a management consulting company, estimates that by 2030 Indonesia will have a shortage of 3.8

million workers with post-secondary education.²⁶ And this deficit also applies across the skill range. By 2030, there will be a shortage of 7.5 million workers with upper secondary education, and a shortage of 6.7 million lower skilled workers. Altogether, talent shortages could cost Indonesia up to \$440 billion of economic activity annually.

A large number of businesses choose to remain informal, with just 0.33 new business registrations per 1,000 people in 2016.

Figure 11: New business density



Source: World Bank Development Indicators

24. Nicko Widjaja, “Opinion: Indonesia needs more scale-ups, not more startups.” *Forbes*, December 11, 2017, <https://www.forbes.com/sites/outofasia/2017/12/11/opinion-indonesia-needs-more-scale-ups-not-more-startups/#45410db3ee28>

25. “Yawning skills gap threatens Indonesia’s path to prosperity,” *The Straits Times*, October 9, 2018, <https://www.straitstimes.com/asia/se-asia/yawning-skills-gap-threatens-indonesias-path-to-prosperity>

26. “Country Perspective: Indonesia,” in *The Global Talent Crunch*, Korn Ferry, p.4, last accessed September 12, 2019, <https://focus.kornferry.com/wp-content/uploads/2015/02/KF-Talent-Crunch-Country-Report-Indonesia-Digital-2.pdf> <https://focus.kornferry.com/wp-content/uploads/2015/02/KF-Talent-Crunch-Country-Report-Indonesia-Digital-2.pdf>

Start-ups in Indonesia

Start-ups, particularly digital ones, are succeeding, with the Indonesian government projecting a 20-30% growth in the overall number of start-ups.²⁷ The digital economy offers significant benefits: according to research by McKinsey, Indonesia could realise an additional \$150 billion by 2025 through embracing digital technologies.²⁸

One of the national initiatives is the “National 1000 start-ups movement”, which aims to create 1000 new start-ups that will develop solutions using technology.²⁹ The greatest successes are Go-Jek (a ride-hailing company), Tokopedia (an online market to buy and sell goods), and Traveloka (an accommodation and airfare site).

According to the Global Entrepreneurship Monitor, Indonesia has a high rate of entrepreneurial activity with 14% of 19-64 year olds either nascent entrepreneurs or owner-manager of new businesses, above both the global and regional average.³⁰ A further 11.8% of 18-64 year olds run their own business, far ahead of the global average of 8.4%.

More specific examples include a \$5 billion industrial park in Central Sulawesi, which received 9 applications for 500 positions.³¹ Or take the example of Go-Jek, which bought a Bangalore-based recruitment company that specialises in hiring software developers to make up for Indonesia’s skills gap.³²

President Widodo’s declaration to “develop world-class human resources” followed his election victory this year, comprising one of his five priorities for his final term in power.³³ Increasing the number of foreign workers in Indonesia is one short-term solution, according to the World Bank. At present, just 0.06% of Indonesia’s labour force is foreign, compared to 4.47% in Thailand and 12.35% in Malaysia.³⁴ In 2018, restrictions on hiring workers were lowered.^{35,36}

27. “Number of start-ups projected to grow 20-30 percent this year, Bekraf says.” *The Jakarta Post*, April 16, 2019, <https://www.thejakartapost.com/news/2019/04/16/number-of-start-ups-projected-to-grow-20-30-percent-this-year-bekraf-says.html>

28. “Unlocking Indonesia’s digital opportunity.” *McKinsey & Company*, October 2016, https://www.mckinsey.com/~/media/McKinsey/Locations/Asia/Indonesia/Our%20Insights/Unlocking%20Indonesias%20digital%20opportunity/Unlocking_Indonesias_digital_opportunity.ashx

29. “1000 Digital Startups.” *National Movement*, last accessed September 12, 2019, <https://1000startupidigital.id/>

30. “Entrepreneurial Behaviour and Attitudes,” *Global Entrepreneurship Monitor*, last accessed September 12, 2019, <https://www.gemconsortium.org/economy-profiles/indonesia>

31. “Yawning skills gap threatens Indonesia’s path to prosperity,” *The Straits Times*, October 9, 2018, <https://www.straitstimes.com/asia/se-asia/yawning-skills-gap-threatens-indonesias-path-to-prosperity>

32. Shotaro Tani, “Jokowi vows to invest in tech skills for an Indonesian ‘Golden Age’,” *Nikkei Asian Review*, July 3, 2019, <https://asia.nikkei.com/Spotlight/Cover-Story/Jokowi-vows-to-invest-in-tech-skills-for-an-Indonesian-Golden-Age>

33. Shotaro Tani, “Jokowi vows to invest in tech skills for an Indonesian ‘Golden Age’,” *Nikkei Asian Review*, July 3, 2019, <https://asia.nikkei.com/Spotlight/Cover-Story/Jokowi-vows-to-invest-in-tech-skills-for-an-Indonesian-Golden-Age>

34. “Indonesia Economic Quarterly: Strengthening Competitiveness,” *The World Bank*, December 13, Dec 2018, p.46, <https://openknowledge.worldbank.org/bitstream/handle/10986/30969/IEQ2018Dec.pdf>

35. “Knowing the advantages of Perpres No. 20 of 2018 in hiring expatriate (part I),” *Elson*, June 28, 2018, <https://elson.co.id/2018/06/knowing-the-advantages-of-perpres-no-20-of-2018-in-hiring-expatriate-part-i/>

36. For signs that it has improved making hiring easier, see “Work permit regulations in indonesia,” *Emerhub*, August 29, 2018, <https://emerhub.com/indonesia/2015-new-work-permit-regulations-indonesia/>; and “Simplified Indonesian work permit – how simple is it really?,” *CCI Consulting*, February 1, 2019, <https://www.cciindonesia.com/simplified-indonesian-work-permit-process-how-simple-is-it-really/> For signs that it has improved making hiring easier,

Indonesia is also improving its education system. The post-secondary level has seen an increase in institutions. Increasing the quality of training, however, is proving difficult.³⁷ Furthermore, many employees are on short-term contracts, dis-incentivising employers who provide vocational training. One improvement, recommended by the Asian Development Bank, is to invest more into workers' training, through offering incentives.³⁸ The recent announcement to provide tax relief for industries that invest in vocational training should help achieve this objective.³⁹

Opportunity

Indonesia could reduce the burdens for firms entering the formal sector. This involves reducing redundancy payments and making hiring and firing easier. Registration of business, the ease of paying taxes, and the obtaining of permits (specifically construction ones) should be simplified.

Furthermore, the removal of restrictions on hiring foreign labour, such as foreign-to-domestic worker ratios, would be a natural step to further increase dynamism.⁴⁰

37. "Indonesia: Enhancing productivity through quality jobs." *Asian Development Bank (2018)*, p.179, last accessed September 12, 2019, <https://www.adb.org/sites/default/files/publication/400586/indonesia-enhancing-productivity-quality-jobs.pdf>

38. "Indonesia: Enhancing productivity through quality jobs." *Asian Development Bank (2018)*, p.194, last accessed September 12, 2019, <https://www.adb.org/sites/default/files/publication/400586/indonesia-enhancing-productivity-quality-jobs.pdf>

39. Lexy Nantu, "Indonesia Incentivizes Industry with Super Deductible Tax," *The Insider Stories*, June 14 2019, <https://theinsiderstories.com/indonesia-incentivizes-industry-with-super-deductible-tax/>

40. "Indonesia Economic Quarterly: Strengthening Competitiveness," *The World Bank*, December 13 2018, p.46, <https://openknowledge.worldbank.org/bitstream/handle/10986/30969/IEQ2018Dec.pdf>



BURDEN OF REGULATION (INDONESIA RANK: 51ST)

A large administrative burden results in companies focusing resources on compliance, rather than innovation and creation. In particular, complying with tax regulations should be uncomplicated and quick. The possibility for taxation to detrimentally affect businesses, the associated method of taxation, and complexity of levying taxes, are all widely understood. Our measure captures how much time and effort are needed to comply.

Indonesia has improved its Burden of Regulation, ranking 51st in the world. Many businesses operate informally, not subject to many regulations, meaning Indonesian businesses report having to spend less than 1% of senior managers' time complying with regulations – one of the lowest in the world. Furthermore, business executives do not describe regulations as overly burdensome, putting Indonesia at 27th globally for this indicator – although this response could be as much driven by the presence of informal work-arounds as the lack of a formal burden.⁴¹

The situation is different for foreign firms. For example, the UK export office warns that a complex bureaucracy and an uncertain and unpredictable legal and regulatory environment are the challenges facing businesses exporting to Indonesia.⁴²

The number of tax payments per year has fallen from 65 to 43 since 2009, which is still among the world's worst, more burdensome than all other ASEAN partners (see Figure 12). In addition, the time spent filing taxes has fallen from 259 hours per year to 208, which is comparable to countries like China (207) and India (216) (see Figure 13). Indonesia is also middling in the Financial Complexity Index, which measures the ease with which companies can deal with taxes, meet reporting requirements and maintain company accounts. This Index ranks Indonesia as the 46th most financially complex jurisdiction in the world.⁴³

While behind other countries, Indonesia is modernising its tax system and bringing more taxpayers into the system. An important step for increasing tax compliance was the tax amnesty that ran from July 2016 to March 2017, which resulted in an additional \$9 billion in payments, \$329 billion of assets declared, and 52,700 new taxpayers.⁴⁴

The government has also announced that the technology of its tax system will be upgraded.⁴⁵ Administrative challenges remain; earlier this year the tax authority sent emails reminding taxpayers to submit annual returns.⁴⁶ There is also the need for more than twice as

41. "Global Competitiveness Report 2018," WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

42. "Challenges doing business in Indonesia." *UK Government*, last accessed September 12, 2019, <https://www.gov.uk/government/publications/exporting-to-indonesia/exporting-to-indonesia#challenges-doing-business-in-indonesia>

43. "TMF Group." Last accessed September 12, 2019, <https://www.tmf-group.com/en/>

44. Lewis, Christine, "Raising more public revenue in Indonesia in a growth- and equity-friendly way," *OECD Economics Department Working Papers*, no. 1534 (2019): 7, p.11, last accessed September 10, 2019, <https://doi.org/10.1787/a487771f-en>

45. Gayatri Suroyo and Maikel Jefriando, "Indonesia goes hi-tech in hunt for tax assets after amnesty," *Reuters*, April 4, 2018, <https://www.reuters.com/article/us-indonesia-tax/indonesia-goes-hi-tech-in-hunt-for-tax-assets-after-amnesty-idUSKCN1HBOGQ>

46. Marchio Gorbiano, "Tax authority goes above, beyond to reach out to taxpayers." *The Jakarta Post*, March 19, 2019, <https://www.thejakartapost.com/news/2019/03/18/tax-authority-goes-above-beyond-to-reach-out-to-taxpayers.html>

many tax officials to collect taxation, according to the Taxation Director General.⁴⁷ Indonesia is also aiming to tackle international tax avoidance, particularly by digital companies.⁴⁸

Figure 12: Tax payments

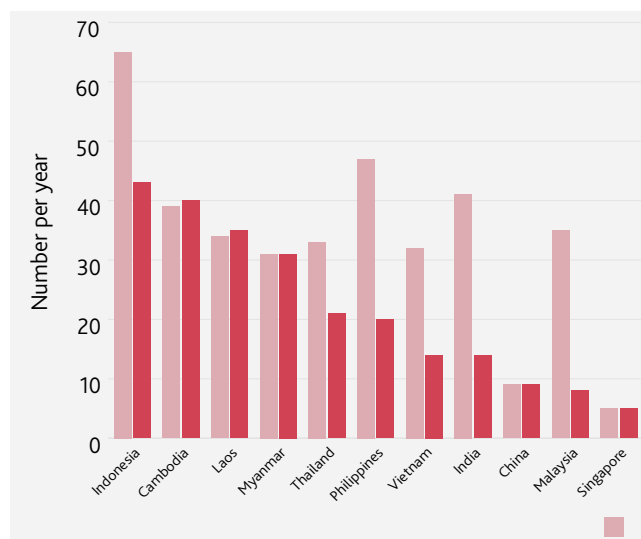
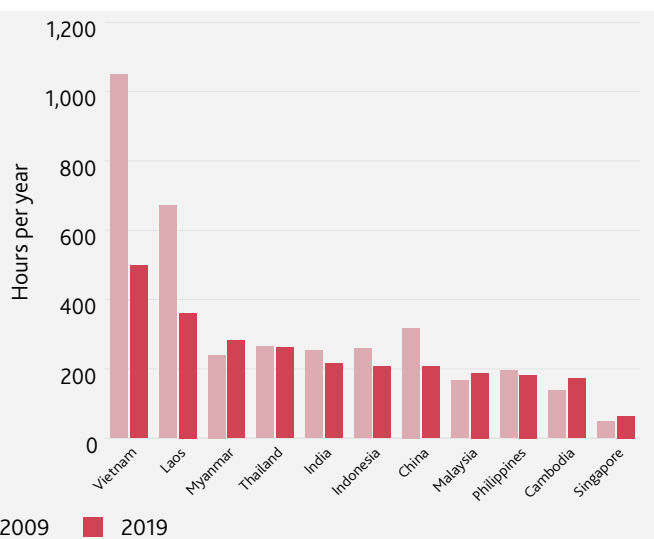


Figure 13: Time spent filing taxes



Source: World Bank Doing Business, 2019

Construction regulation

Construction procedures are overly burdensome. Indonesia is 112th in the world on the burden of obtaining a building permit; currently, in 2019, it takes 200 days to obtain one. Contrastingly, it takes 122 days in the Philippines, 11 days in Malaysia, and 10 days in Singapore.

In the main cities at least, Indonesia has relatively good standards of regulations and quality control during the construction process. It is not always clear that these standards are upheld, however, or that they are appropriate for particular environments in the country.

Like other countries on the Pacific's "ring of fire", Indonesia is prone to earthquakes. Yet many buildings are not built to adequate standards. A recent earthquake on Lombok Island saw up to 70% of building suffered serious damage, leaving 98 people dead and 20,000 homeless.^{49,50}

47. "What is the problem with tax collection in Indonesia?," *Indonesia Investments*, October 10, 2015, <https://www.indonesia-investments.com/finance/financial-columns/what-is-the-problem-with-tax-collection-in-indonesia/item6023?>

48. Gayatri Suroyo and Bernadette Munthe, "Indonesia finance minister says to tackle tax avoidance by MNCs," *Reuters*, July 12, 2017, <https://www.reuters.com/article/us-indonesia-taxation-finmin/indonesia-finance-minister-says-to-tackle-tax-avoidance-by-mnocs-idUSKBN19X125>

49. Graeme MacRae, "Lombok earthquakes: different building designs could lessen future damage." *The Conversation*, August 20, 2018, <https://theconversation.com/lombok-earthquakes-different-building-designs-could-lessen-future-damage-101440>

50. Jonatan Lassa, "After devastating earthquakes, Indonesia must embrace radical change." *The Conversation*, August 8, 2018, <https://theconversation.com/after-devastating-earthquakes-indonesia-must-embrace-radical-change-101247>

Opportunity

Improving tax administration and creating a culture in which citizens pay their taxes, is crucial. In order to lessen its dependence on mineral exports, Indonesia will need to extend its tax base. One of the immediate steps that can be taken is increasing the resources available to the tax department while finding simple ways to tax SMEs.

The OECD, in a recent report, identified further measures that could be taken, including investing resources and building capacity in tax administration; broadening the tax base by removing exemptions; lowering thresholds on personal income (including fringe benefits); and bringing very small firms into the tax system.⁵¹

LABOUR MARKET FLEXIBILITY (INDONESIA RANK: 114TH)

Labour market flexibility helps to simultaneously ensure the availability of jobs and the protection of workers. Without a well-functioning labour market, jobs are likely to be scarce, with those available potentially unappealing and sometimes lacking in the necessary redress. Our measure captures the dynamism and flexibility of the workplace, for both employer and employee. Indonesia is 114th in the world for Labour Market Flexibility, down 30 places from 10 years ago.

Indonesia's labour force is fourth-largest in the world; between 2000 and 2015, an average 2.7 million people were added each year.⁵² Aggregate labour force statistics are improving, despite some restrictive labour market laws. Unemployment has improved from 8.1% in 2007 to 4.3% in 2018, which is still the worst of any ASEAN country. Youth unemployment is 15.8%, far above the next highest ASEAN economy, Malaysia at 11.2%.

The total proportion of waged and salaried workers is increasing. In 2018, almost 50% of the workforce was in waged or salaried employment, up from 32.8% in 2000. This is sixth in ASEAN, far behind Brunei (91.2%) and Singapore (85.4%). Over time, employment in agriculture has been steadily falling, down from 55% in 1991 to 30% in 2018. Despite these relatively strong statistics, Indonesia's major challenge involves stimulating an increase in the level of formal employment, which only surpassed informal employment in 2011; by 2016, however, 40% of those employed were done so formally.⁵³

Further growth of formal employment is mainly restricted by the country's labour laws. Beginning in 1996, Indonesia steadily raised the cost of redundancy to become one of the highest in the world, before beginning to reduce them again.⁵⁴ Indonesian employment contracts are also inflexible. Fixed-term contracts are prohibited for permanent tasks (in ASEAN, only Thailand is the same). Concerningly, contract workers do not receive any severance pay, generating a strong incentive for employers to use short-term contracts.⁵⁵

Beginning in 1996, Indonesia steadily raised the cost of redundancy to become one of the highest in the world.

51. Lewis, Christine, "Raising more public revenue in Indonesia in a growth- and equity-friendly way," *OECD Economics Department Working Papers*, no. 1534 (2019): 7, p.39, last accessed September 10, 2019, <https://doi.org/10.1787/a487771f-en>

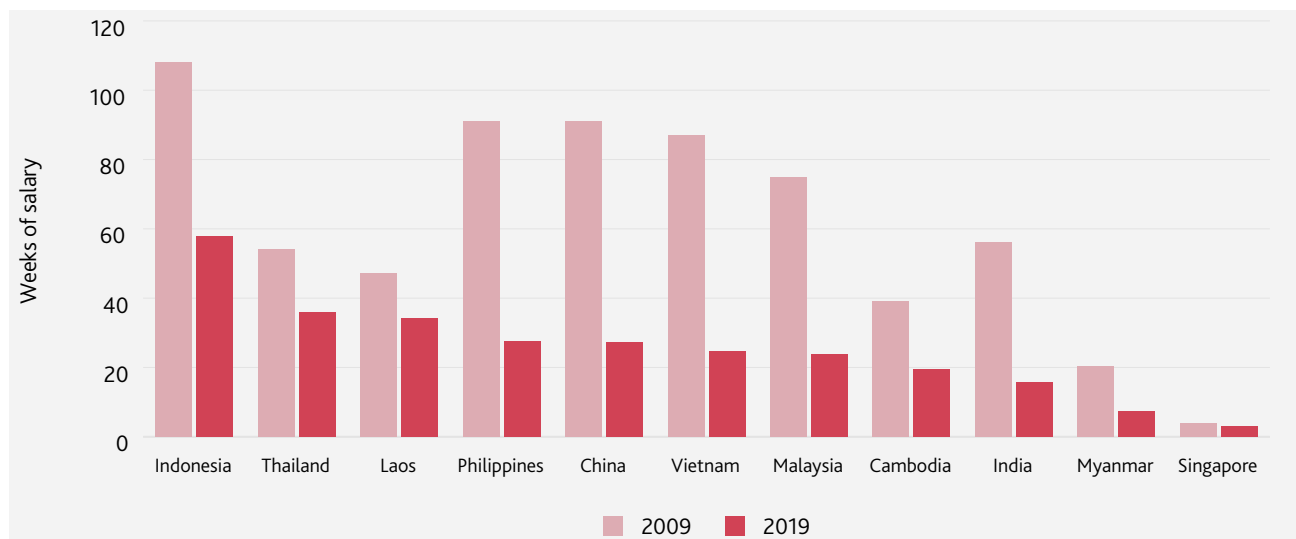
52. "Labor force, total," *The World Bank*, last accessed September 16, 2019, <https://data.worldbank.org/indicator/SL.TLF.TOTL.IN>

53. Sarah Xue Dong and Chris Manning, "Labour-Market Developments at a Time of Heightened Uncertainty," *Bulletin of Indonesian Economic Studies*, 53:1, 1-25, DOI: 10.1080/00074918.2017.1326201

54. "Indonesia Jobs Report : Towards Better Jobs and Security for All," *The World Bank*, 2010, p. 75-76, <https://openknowledge.worldbank.org/handle/10986/27901>

55. "Indonesia: Enhancing productivity through quality jobs." *Asian Development Bank (2018)*, p.224, last accessed September 12, 2019, <https://www.adb.org/sites/default/files/publication/400586/indonesia-enhancing-productivity-quality-jobs.pdf>

Figure 14: Redundancy costs



Source: World Economic Forum

There is a limit of 36 months for fixed-term contracts (in ASEAN, only Cambodia is lower). As a result, Indonesia ranks 134th in the world for flexibility of employment contracts.

Under the Widodo administration, Indonesia has made the minimum wage more certain. Unlike his predecessor, who wanted to end cheap wages, President Widodo “has placed greater emphasis on creating more jobs, together with improved but predictable minimum wages, as the cornerstone of his government’s policy”.⁵⁶ Prior to 2015, minimum wages were set in each province, with the input of local wage councils (made up of union, employer, and central government representatives), with local government leaders making decisions.⁵⁷ This created considerable uncertainty; from 2012 to 2015, minimum wages experienced a high growth rate, from 67% of the average wage to 83%.⁵⁸ Rising minimum wages have pushed up production costs, exceeding gains in labour productivity.⁵⁹

In 2015, the government passed a regulation setting the increase of the minimum wage “equal to the national rate of economic growth plus the increase in the national consumer price index in the previous year.”⁶⁰ The purpose was to provide more certainty for business regarding the cost of future labour, while reducing strikes and protests.⁶¹

Reported minimum wage increases are broadly in line with Vietnam and Cambodia. In 2017, the monthly minimum wage in Indonesia ranged from \$100 in Yogyakarta to \$252 in Jakarta.

56. Sarah Xue Dong and Chris Manning, “Labour-Market Developments at a Time of Heightened Uncertainty,” *Bulletin of Indonesian Economic Studies*, 53:1, 1-25, DOI: 10.1080/00074918.2017.1326201”

57. “Indonesia: Enhancing productivity through quality jobs.” *Asian Development Bank (2018)*, p.206, last accessed September 12, 2019, <https://www.adb.org/sites/default/files/publication/400586/indonesia-enhancing-productivity-quality-jobs.pdf>

58. “Indonesia: Enhancing productivity through quality jobs.” *Asian Development Bank (2018)*, p.207, last accessed September 12, 2019, <https://www.adb.org/sites/default/files/publication/400586/indonesia-enhancing-productivity-quality-jobs.pdf>

59. Emma Allen, “Analysis of trends and challenges in the Indonesian labor market.” *ADB Papers on Indonesia*, 16, p.22, March 2016, <https://www.adb.org/sites/default/files/publication/182935/ino-paper-16-2016.pdf>

60. Sarah Xue Dong and Chris Manning, “Labour-Market Developments at a Time of Heightened Uncertainty,” *Bulletin of Indonesian Economic Studies*, 53:1, 1-25, DOI: 10.1080/00074918.2017.1326201

61. “Indonesia: Enhancing productivity through quality jobs.” *Asian Development Bank (2018)*, p.208, last accessed September 12, 2019, <https://www.adb.org/sites/default/files/publication/400586/indonesia-enhancing-productivity-quality-jobs.pdf>

It was between \$116 and \$166 in Vietnam, and \$153 in Cambodia (for garment workers).⁶² Emma Allen, writing for the Asian Development Bank, suggests that a further possible reform is the provision of special lower minimum wage for youth in order to reduce their high rate of unemployment.⁶³

Union participation is low, with 18% of all employees reporting membership, or 9% of the total employed (which includes those in the informal economy).⁶⁴ Consequently raising minimum wages is seen as an important means to raising incomes. Collective bargaining in Indonesia has been increasing, but limitedly so: in 2013, there were 12,113 collective agreements registered across the country, increasing from 10,959 in 2010.⁶⁵ Nevertheless, the cooperation in labour-employer relations has declined from 21st to 51st, which puts it ahead of only Vietnam (99th) and Laos (55th) in the ASEAN region. On the flexibility of wage determination, Indonesia comes 76th.⁶⁶

Redundancy rules in Indonesia

A redundancy or layoff is not defined in Indonesian law, instead it is treated as a “dismissal without cause”, where the employee is not at fault. Severance pay is then calculated on the basis of monthly salary, period of service, and any allowances. In the case of dismissal without cause, an employee is entitled to twice the severance pay “plus the standard service appreciation pay and compensation.”⁶⁷

The average cost of redundancy in Indonesia is 57.8 weeks of salary, ranking 154th globally. By comparison, in Malaysia it costs 34.2 weeks, in Thailand 36 weeks, and in Singapore just 3 weeks (see Figure 14). The cost of redundancy increases depending on job tenure. For workers in Indonesia with 10 years of tenure, the cost is equivalent to 95.3 weeks.

Opportunity

Indonesia’s labour market is both an opportunity and a risk. With the labour force expanding by millions of people annually, Indonesia stands to reap a significant demographic dividend from its young population. Taking advantage of that opportunity, however, requires a number of steps. Most importantly, it requires upskilling at all levels. As the President has himself identified, improvements to education are paramount. Increased immigration is only a short-term option; the education system is pivotal to longer-term benefits, as firms must commit to training their workforce. Easing labour restrictions would enable firms to commit to this long-term development of their employees.

62. Ibid., p. 209

63. Ibid., p. 210

64. “Indonesia: Enhancing productivity through quality jobs.” *Asian Development Bank (2018)*, p.212, last accessed September 12, 2019, <https://www.adb.org/sites/default/files/publication/400586/indonesia-enhancing-productivity-quality-jobs.pdf>

65. Emma Allen, “Analysis of trends and challenges in the Indonesian labor market.” *ADB Papers on Indonesia*, 16, p.23, March 2016, <https://www.adb.org/sites/default/files/publication/182935/ino-paper-16-2016.pdf>

66. “Global Competitiveness Report 2018,” WEF, last accessed September 26, 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>

67. Nafis Adwani and Ali Budiardjo, “Employment and employee benefits in Indonesia: overview.” *Thomson Reuters Practical Law*, last accessed September 12, 2019, [https://uk.practicallaw.thomsonreuters.com/0-508-0242?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/0-508-0242?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1)



GOVERNANCE (INDONESIA RANK: 63RD)

The importance of good governance to long run economic growth cannot be overstated.¹ Even when controlling for extraneous factors such as culture, there is evidence that economic institutions are one of the main determinants of differences in prosperity across countries.² Governance underpins economic activity; unless and until good governance is established, attracting investment and enterprise is nearly impossible. Investment and prosperity require the effective rule of law, which itself is dependent upon trust in a robust set of effective and accountable state institutions.^{3,4} Good governance is most robust when it has been established over time through natural evolution and is essentially a codification of cultural expectations and behaviours.

INDONESIA SWOT Analysis of Governance

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> • A young democracy with free and fair elections • Competent and effective fiscal and monetary policy • A constitution that sets out powers for both legislature, judiciary and executive • Strong influence of civil society in policy making • High political stability 	<ul style="list-style-type: none"> • The military still engages in national life • Religious faith in politics plays a large role • A lack of policy making expertise at all levels, and especially in local government. • Corruption is widespread at many levels, including the national parliament • Lack of horizontal and vertical coordination between government agencies • Rampant corruption and unpredictable judiciary create substantial risks for foreign investors
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> • Promoting more effective citizen engagement • Reforming the civil code and commercial code • Simplifying government structures, by reducing roles and streamlining responsibilities • Strengthening capacity in both central and local administrations • Increasing local accountability and responsiveness to local needs, through effective decentralisation 	<ul style="list-style-type: none"> • Increasing polarization between Muslim and non-Muslim groups • There is a risk of politicians appealing to anti-capitalist and anti-globalist sentiment, polarising the system and promoting economic nationalism • After the second and last term of President Widodo, a less democratic successor might undermine individual freedom and destabilize the country • Terror attacks, that have plagued Indonesia in recent history, may deter foreign investors from entering Indonesia

1. Douglass C. North. *Institutions, institutional change, and economic performance*. Cambridge: Cambridge University Press, 1990.

2. Daron Acemoglu and James Robinson, "The role of institutions in growth and development." *Leadership and Growth* 135 (2010).

3. Guillermo A. O'Donnell, "Why the rule of law matters." *Journal of Democracy* 15, no. 4 (2004): 32-46.

4. Stephan Haggard and Lydia Tiede, "The rule of law and economic growth: Where are we?" *World Development* 39, no. 5 (2011): 673-685.

Evaluating Governance

Governance can be conceptually split between the structural and operational aspects of how political and administrative power is checked and how it is applied.

The first of these structural aspects of Governance is **Executive Constraints**, which includes the existence of the separation of powers and the level of checks and balances in a governing system, particularly with respect to the executive. The second is **Political Accountability**, or the degree to which the public can hold public institutions accountable. The third is the **Rule of Law**, which encompasses the fairness, independence, and the effectiveness of the judiciary (in applying both civil and criminal law), along with the accountability of the public to the law.

We assess three different ways in which administrative power is applied. The first is **Government Integrity** (e.g., transparency and the absence of corruption). The second is **Government Effectiveness**, which is the ability of government to set and implement a policy. The final area is **Regulatory Quality**, which captures the extent to which regulations are administered and enforced in a manner that supports economic activity.

Indonesia ranks 63rd for the quality of its governance. For a relatively young state, with an even younger democracy, Indonesia's systems of government are effective and robust. Elections are free and fair, resulting in a large and diverse legislature that champions fixed roles. The willingness to radically decentralise power demonstrates a desire to bring government services closer to ordinary Indonesian citizens, rendering them more responsive to local economic conditions. In the following sections, we review the performance of Indonesia in each of the distinct elements of Governance, from Executive Constraints through to Regulatory Quality.

EXECUTIVE CONSTRAINTS (INDONESIA RANK: 52ND)

A well-functioning government relies upon clearly defined separated powers, with bodies such as the judiciary, media, and civil society exerting appropriate levels of checks and balances on the executive. Appropriate action also needs to be taken when officials violate their power. Our measure accounts for the extent of institutionalized constraints on the executive's decision-making powers, such as through the separation of powers into different bodies, and the degree to which checks and balances are in practice.

Indonesia is 52nd for Executive Constraints, up two places from 10 years ago, with relatively robust constraints on executive power.

Legislature

The People's Consultative Assembly (MPR) is a bicameral legislature made up of the People's Representative Council (DPR) and the Regional Representative Council (DPD); the latter is weaker, unable to directly make laws. The president cannot freeze or dissolve the DPR.⁵ The president and/or the vice-president may be dismissed by an MPR session, if they have violated the law, or they no longer meet the qualifications required to serve.⁶ The president is limited to two five-year terms.⁷

5. *State Constitution of the Republic of Indonesia*. 1945 (Indonesia) article 7C.

6. *Ibid.*, article 7A.

7. *Ibid.*, article 7.

Indonesian presidents need to create a coalition of multiple parties in order to govern.

One limiting factor is the need for presidential candidates to be nominated by political parties totalling 20% of the seats in the DPR, or 25% of the popular vote. Previously, parliamentary elections were held three months before presidential elections, with thresholds based on the newly elected parliament. In 2019 however, presidential and legislative elections were held simultaneously with nominations based on the old parliament, “determined according to a parliamentary composition that will be obsolete by the time the winning candidate takes office.”⁸

Coalition-building in Indonesia

Given the party structures, any president needs to create a coalition of multiple parties in order to govern. The coalition-building by the current President has led some commentators to argue that illiberal tendencies have emerged. For example, Mietzner argues that “Jokowi cemented his authority in a multi-party environment by using interventionist methods lying outside of the conventional tool box of coalitional presidentialism in democracies”⁹ and that “it is evident that he grew his parliamentary majority from 37% to 69% by exerting pressure on two opposition parties”.¹⁰ Yet the fact that a president must build a coalition and negotiate (sometimes forcefully), does not necessarily mean that Indonesia is becoming a more authoritarian state.

The President faces significant barriers to ruling. Firstly, any ruling coalition will contain a myriad of political interests with differing agendas. This is a feature of Indonesian political life unlikely to change, thus requiring a strong president who is able to command his agenda. Yet any problems at this level are exacerbated by the lack of coordination both within the central government, and their relation to decentralised governments.

Military involvement

Indonesia ranks 112th for military involvement in the rule of law and politics.¹¹ Under Suharto, the military maintained a strong role in civilian life justified by the principle of 'dwifungsi', which states that the military, alongside its role for national defence, would also be engaged in domestic affairs. This also included having reserved seats in parliament.

Despite this history of military involvement in politics, Indonesia’s executive generally operates within constraints imposed by the constitution and legislature. In the post-Suharto era, the role of the military has been reduced, but there have been fears it would manage to expand its domestic influence when the President started using the military to combat drugs, terrorism, and corruption in 2015.¹² In 2018, he announced new funding for the military’s village-level non-commissioned officers.¹³ That year he also encouraged military officers to promote his country’s achievements.¹⁴

8. Thomas P. Power, “Jokowi’s authoritarian turn and Indonesia’s democratic decline.” *Bulletin of Indonesian Economic Studies* 54, no. 3 (2018): 307-338.

9. Marcus Mietzner, “Coercing Loyalty: Coalitional Presidentialism and Party Politics in Jokowi’s Indonesia.” *Contemporary Southeast Asia* (2016): 209-232.

10. Ibid.

11. “Economic Freedom of the World: 2018 Annual Report”, *Fraser Institute*, September 25, 2018, <https://www.fraserinstitute.org/studies/economic-freedom>

12. Kanupriya Kapoor and Randy Fabi, “Indonesia’s military creeps back into civilian affairs.” *Reuters*, May 24, 2015, <https://www.reuters.com/article/us-indonesia-military/indonesias-military-creeps-back-into-civilian-affairs-idUSKBN0O90ZQ20150524>

13. Marguerite Sapiie, “Jokowi increases Babinsa income by up to 771%.” *The Jakarta Post*, June 6, 2018, <https://www.thejakartapost.com/news/2018/06/06/jokowi-increases-babinsa-income-by-up-to-771.html>

14. Thomas P Power, “Jokowi’s authoritarian turn and Indonesia’s democratic decline.” *Bulletin of Indonesian Economic Studies* 54, no. 3 (2018): 307-338.

POLITICAL ACCOUNTABILITY (INDONESIA RANK: 65TH)

Political accountability is important for promoting democracy and ensuring prosperity. It provides a democratic means to monitor government, while conducting and preventing both the concentration of power and collusion between the state and big businesses. Our measure of Political Accountability captures the degree to which the public can hold public institutions to account, which covers a range of mechanisms of accountability such as periodic elections and the degree of political pluralism.

As the world's third largest democracy, Indonesia ranks 65th in the world for Political Accountability, down one place in a decade.

Elections

The president and legislature are both elected in a free and fair way, with impartial implementation of electoral laws and framework. The voting system has made it hard to steal elections, due to numerous voting stations (each of which caters to only a few hundred voters), and a continued openness of the initial count.¹⁵ Independent observers have confirmed that the most recent elections were free and fair.¹⁶

Civil society

Furthermore, one of Indonesia's great strengths is the influence of civil society in policy making and national debates. The 2014 protests that led to leaders annulling a bill proposing the removal of direct elections for regional leaders was an institutional response to civil society.¹⁷ While there are always challenges to securing real change, leaders of civil society organisations, have an active voice in political life in both central and regional governance.¹⁸

The role of religion and populism in politics

As a multi-faith country with the world's largest Muslim population, religion plays a significant role. On one hand, the state supports freedom of religion, officially recognising six religions: Islam, Protestantism, Catholicism, Hinduism, Buddhism and Confucianism. Many minority religions, however, are excluded.

However, that consensus among the socio-political elite regarding the maintenance of democratic systems has weakened, with Bertelsmann Stiftung noting that recently, "Islamist actors have taken the lead in Indonesia's counter-democratic discourse. Their demands range from the full implementation of Islamic law in Indonesia to, in their most extreme form, calls for a cross-national caliphate."¹⁹

One of the most damaging examples of this was during the 2017 campaign for Jakarta's governor. The incumbent, a Christian of Chinese descent, was jailed for blasphemy; he made an off-the-cuff statement about a verse from the Koran being used to convince people to

15. Ben Bland, "The world's most complicated single-day election is a feat of democracy." *The Atlantic*, April 15, 2019, <https://www.theatlantic.com/international/archive/2019/04/indonesias-elections-are-feat-democracy/587143/>

16. "Indonesia's Prabowo challenges election result in court," *Aljazeera*, May 24, 2019, <https://www.aljazeera.com/news/2019/05/indonesia-prabowo-set-challenge-election-result-court-190524063239486.html>

17. Ken Miichi, "Democratization and the changing role of civil society in Indonesia." *Middle East Institute*, October 13, 2015, <https://www.mei.edu/publications/democratization-and-changing-role-civil-society-indonesia>

18. Amalinda Savirani, "Indonesia's regions a test bed for civil society influence," *New Mandala*, April 24, 2018, <https://www.newmandala.org/indonesias-regions-test-bed-civil-society-influence/>

19. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

There has been an increasing anti-capitalist and anti-globalism sentiment in politics.

vote against him.²⁰ Prior to this, he lost the campaign for re-election following a divisive campaign based on his faith and ethnicity.²¹

In 2017, the President issued a regulation empowering the government to outlaw "social organisations that they deemed a threat to the national ideology of Pancasila".²² This has been used to outlaw a large Islamist organisation that rejects pluralism and democracy, alongside arrests for charges of treason.

The pressure from political elites was evident in Joko Widodo's campaign. While he is the first President from outside the political elite, in choosing his vice-presidential candidate for the 2019 election, was made to choose Ma'ruf Amin, chairman of the Indonesian Council of Islamic Scholars (MUI).²³

There has been an increasing anti-capitalist and anti-globalism sentiment, in the way politicians attract voters. Politicians will "use anti-free-market and protectionist rhetoric to attract support from their constituencies, while highlighting the constitutionally anchored obligation of the state to directly manage the nation's wealth to the benefit of all Indonesians."²⁴ As we have seen in other elements, there is a strong streak of economic nationalism through Indonesian policy-making, harbouring potentially damaging consequences for business activity, specifically foreign investment.

RULE OF LAW (INDONESIA RANK: 96TH)

An independent, impartial, and effective judiciary is a cornerstone of democracy, ensuring that both the criminal and civil law is applied fairly and appropriately. It also means that business disputes are settled in an open, unbiased, transparent, and predictable manner, which is essential for business development and investment. There needs to be a level playing field for state agents and firms so the latter can thrive. Our measure of the Rule of Law captures these elements, along with the accountability of the public to the law.

Indonesia ranks 96th for Rule of Law, up eight places from 2009. While the judiciary is largely free from political influence, the lack of binding precedent and general corruption means that recourse is not consistently given to businesses.

One of the challenges to improving the legal system is the general lack of binding precedent.²⁵ Further, although Constitutional Court decisions are binding, decisions are

20. Kate Lamb, "Jakarta governor Ahok sentenced to two years in prison for blasphemy," *The Guardian*, May 9, 2017, <https://www.theguardian.com/world/2017/may/09/jakarta-governor-ahok-found-guilty-of-blasphemy-jailed-for-two-years>

21. "Indonesia has been mercifully resistant to extremism – until now," *The Economist*, April 20, 2017, <https://www.economist.com/leaders/2017/04/20/indonesia-has-been-mercifully-resistant-to-extremism-until-now>

22. Edward Aspinall, "Twenty years of Indonesian democracy – how many more?," *New Mandala*, May 24, 2018, <https://www.newmandala.org/20-years-reformasi/>

23. Thomas P. Power, "Jokowi's authoritarian turn and Indonesia's democratic decline." *Bulletin of Indonesian Economic Studies* 54, no. 3 (2018): 307-338. Thomas Power at 326

24. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

25. Leoni Silitonga, Sianti Candra and Hanim Hamzah, "Legal systems in Indonesia: overview." *Thomson Reuters Practical Law*, last accessed September 12, 2019, [https://uk.practicallaw.thomsonreuters.com/w-010-7310?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/w-010-7310?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)

sometimes not followed because of a lack of reporting of earlier decisions.²⁶ Another challenge is that business and regulatory disputes, which would generally be considered administrative or civil matters in other jurisdictions, can sometimes be considered criminal cases in Indonesia.²⁷

Court corruption also poses problems, even though the judiciary is reasonably free from political influence: "Bribes can influence judicial procedures at all levels, from police investigations to indictments by the Attorney General's Office to court verdicts and appeals."²⁸ Recently, the Secretary General of the Supreme Court had to resign, following investigations revealing "he had been at the centre of a case brokerage system that mediated between plaintiffs, defendants and judges."²⁹ In 2017, the Corruption Eradication Commission also arrested another member of the Constitutional Court, who then spent eight years in jail.³⁰

According to the 2017 Global Corruption Barometer, 6% of Indonesians reported having paid a bribe to the courts in the previous year.³¹ This is lower than bribes paid to other public services, including police, ID services, and hospitals. Court fees are one aspect of corruption in the administration of justice, as claimants have had to pay more than the advertised amount. The introduction of an electronic payments system should help to mitigate this problem.³²

As a result, the judiciary does not necessarily give effective recourse for businesses. The number of businesses identifying the court system as a major constraint is just 3.5%, behind East Asia and Pacific on 6.7% and a global average of 13.9%.³³

Opportunity

These challenges have been recognised by President Widodo, who has told his cabinet "I realised the goal of being a state of justice has not been reached, neither by the state administration, nor in the social life".³⁴ Reforming the civil code and commercial code could create significant opportunities to facilitate greater formalisation of domestic commerce and increase international investment.

26. Muhammad Aziezi, "Why Indonesia's judiciary ignores Constitutional Court decisions – and how to fix that," *The Conversation*, December 21, 2018, <https://theconversation.com/why-indonesias-judiciary-ignores-constitutional-court-decisions-and-how-to-fix-that-104970>

27. "Indonesia - Market Challenges," *Export.Gov*, last modified February 4, 2019, <https://www.export.gov/article?id=Indonesia-Market-Challenges>

28. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

29. *Ibid.*

30. "Indonesian court jails ex-judge for eight years in graft case," *Reuters*, September 4, 2017, <https://www.reuters.com/article/us-indonesia-corruption/indonesian-court-jails-ex-judge-for-eight-years-in-graft-case-idUSKCN1BF142>

31. "Global corruption barometer 2015/16/17," *Transparency International*, last accessed September 12, 2019, https://www.transparency.org/research/gcb/gcb_2015_16/0

32. Medha Basu and Nurfilzah Rohaidi, "Exclusive: Cutting corruption in Indonesia's courts," *GovInsider*, February 2, 2018, <https://govinsider.asia/innovation/aria-suyudi-supreme-court-indonesia-payment-system-govpay/>

33. "Indonesia (2015)," *Enterprise Surveys*, World Bank Group, last accessed September 12, 2019, <http://www.enterprisesurveys.org/data/exploreeconomies/2015/indonesia>

34. "Massive Legal Reforms Needed for Indonesia to Become a State of Law: Jokowi," *Jakarta Globe*, October 11 2016, <https://jakartaglobe.id/context/massive-legal-reforms-needed-indonesia-become-state-law-jokowi>

GOVERNMENT INTEGRITY (INDONESIA RANK: 83RD)

Corruption has a serious and significant negative economic impact, reducing public trust and state legitimacy. It raises inequality, discouraging private sector development, and, by reducing government revenue, limits the ability of governments to invest in productivity-enhancing projects. Transparency supports public accountability and helps to build trust in the government, which in turn supports social stability and economic growth. Our measure considers corruption within each branch of government and public office, also measuring transparency, while capturing the degree to which government fosters citizens' participation and engagement through open information and transparent practices.

Indonesia comes 83rd for Government Integrity, seeing improvements by rising 12 places over the last 10 years. For example, the view among business executives about diversion of public funds for private gains has improved dramatically.³⁵ In 1995, Indonesia was the worst performing country in the first edition of Transparency International's Corruption Perceptions Index.³⁶ This was a legacy of former President Suharto, who was estimated to have stolen between \$15 billion and \$35 billion during his 31 years of rule.³⁷ Since then Indonesia has steadily seen significant improvements, ranking 89th out of 180 countries in the most recent Corruption Perceptions Index.³⁸

Improvements in Government Integrity

The improvements can partly be attributed to aforementioned elements: the increased accountability of the directly elected executives and legislatures to the electorate; a separation of power between local legislatures and executives on all levels of government.

The threat of severe punishments by the Indonesian Corruption Eradication Commission (KPK) has been important factor in reducing corruption. The award-winning KPK has sent scores of parliamentarians, judges, ministers, governors, politicians, business people and public servants to jail. In 2018 alone, they conducted preliminary investigations on 164 cases and full investigations on 274 cases.³⁹ While this reflects a significant improvement in the tackling of corruption, many perpetrators are not prosecuted. For example, in 2015 the Speaker of the House Setya Novanto returned to his position after being caught on tape asking for favours from a large mining company (the evidence was ruled inadmissible in court).⁴⁰ Eventually, in 2017, he was sent to jail for 15 years for involvement in a graft case concerning electronic identity cards that cost Indonesian citizens \$170 million.

The risk of corruption investigations

Corruption also affects Indonesia's bureaucracy. A 2014 study by AT Kearney stated that \$4

35. "Suharto tops corruption rankings," *BBC News*, last updated March 25, 2004, <http://news.bbc.co.uk/1/hi/business/3567745.stm>

36. "Corruption perceptions index: early editions," *Transparency International*, last accessed September 12, 2019, https://www.transparency.org/research/cpi/cpi_early/0

37. "Rule of Law Index 2019," WJP, last accessed September 26, 2019, https://worldjusticeproject.org/sites/default/files/documents/WJP-ROLI-2019-Single%20Page%20View-Reduced_0.pdf

38. "Corruption perceptions index 2018," *Transparency International*, last accessed September 12, 2019, <https://www.transparency.org/cpi2018>

39. "KPK Annual Report 2018," Appendix Deputy of Enforcement, retrieved from: <https://www.kpk.go.id/images/Integrito/LampiranLaptah2019/Bahasalnggris/Enforcement.pdf>

40. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

billion was lost every year due to poor procurement practices.⁴¹ Importantly, fears regarding the KPK's purview may have caused the prevention, or slowing, of government projects. As more pressure has been placed to root out bureaucratic corruption, bureaucrats have been increasingly disinclined to push larger projects along, in case they get caught in an anti-corruption probe. This has led the President to say that he does not want anti-corruption investigations to slow down infrastructure projects.⁴²

Corruption is still endemic

Corruption and abuse of power remains prevalent in Indonesia, with the country ranking 116th for the use of public office for private gain.⁴³ The problem starts with expenditures made by political candidates to gain public office. The estimated proportion of people engaging in vote-buying lies between 25% and 33% of voters.⁴⁴ In the 2019 legislative elections, some candidates have 'invested' up to US \$500,000 for vote-buying, expecting a significant 'return on investment' once taking their public office.

Corruption appears in all public offices and is generally considered to be part of the perks that come with public office, stretching from the traffic police to any government office. Political corruption, however, is specific to those in a position of power, thus involves more money.⁴⁵ Corruption is also pervasive in regional governments. As of September 2017, there were 343 regents and mayors, and 18 governors who had been investigated for corruption.⁴⁶

Transparency is improving

However, there are reasons for optimism, in part due to the role of civil society in making government policy making more transparent. Firstly, Indonesia generally allows investigations by a free press and civil society. The country has supported civic participation through public information offices, legal protection for whistle-blowers, public involvement in service monitoring, participatory forums for national and local development planning, and civil society involvement in developing the Open Government Partnership (OGP) Action Plan. Moreover, efforts are being made for citizen feedback channels and complaint services, an open and digital government, as well as budget transparency and citizen participation in public financial management.⁴⁷

Secondly, Indonesia has improved in the transparency of government policy, rising from 156th to 51st in the world, with budget transparency also improving. Indonesia has been a founding member of the OGP and a member of the OGP Steering Committee since its launch in 2011. The OECD commended that the government made continuous progress in promoting transparent and inclusive policy making since democratic reforms began in 1998.

41. Julie DiMauro, "Indonesia loses \$4 billion annually to procurement fraud, study finds." *The FCPA Blog*, June 5, 2014, <http://www.fcpablog.com/blog/2014/6/5/indonesia-loses-4-billion-annually-to-procurement-fraud-stud.html>

42. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

43. "Rule of Law Index 2019," WJP, last accessed September 26, 2019, https://worldjusticeproject.org/sites/default/files/documents/WJP-ROLI-2019-Single%20Page%20View-Reduced_0.pdf

44. Burhanuddin Muhtadi, "Muhtadi (2019), Vote Buying in Indonesia: The Mechanics of Electoral Bribery.", Palgrave Macmillan, 2019. Singapore

45. Todung Lubis and Mulya Lubis, "Political Corruption in Indonesia," *CSIS*, 2017, Jakarta

46. "Indonesia's decentralisation and corruption: The Jakarta Post." *The Straits Times*, September 25, 2017, <https://www.straitstimes.com/asia/se-asia/indonesias-decentralisation-and-corruption-the-jakarta-post>

47. "Indonesia Highlights," OECD Public Governance Review (2016), *Open Government Review*, 2016, last accessed September 12, 2019, <https://www.oecd.org/gov/open-gov-review-indonesia.pdf> in Indonesia, Paris

GOVERNMENT EFFECTIVENESS (INDONESIA RANK: 66TH)

Government Effectiveness includes, but extends beyond, the efficient use of resources and spending through effective government policy design and implementation, to also consider the ability of a government to enact its stated strategies. Our measure includes the quality of both public services and government officials, alongside their independence from government pressures.

Indonesia ranks 66th for Government Effectiveness, having improved 23 places in the last 10 years. This is ahead of China and most countries in the ASEAN region (but not India).

In contrast to the centralised, top-down rule of the Suharto years, a decentralised governance in modern Indonesia is driven by numerous competing interests. At central government, competing interests in Cabinet are exacerbated by numerous ministries with overlapping jurisdictions. Local governments are responsible for a large number of functions, which they are often not equipped to do, as well as complicating coordination with the central government.

Central government effectiveness

Central government effectiveness has improved, but its success is partial. The central government's consistent area of success is macroeconomic policy, due to a political consensus around fiscal prudence, which subsequently entrusts technocrats to deliver macroeconomic policies. As a result, macroeconomic and monetary policy has been successful in constraining government spending and controlling inflation.

The Widodo administration has had successes in commencing and delivering projects. Indonesia has improved in its implementation of policy, rising from 82nd to 62nd.⁴⁸ The Widodo administration has indeed shown some policy innovation, including the initial eradication of fuel subsidies.

Yet Indonesia faces difficulties in other areas of government. The challenge begins with cabinet (made up of a mix of politicians and technocrats) and the legislature. President Widodo has faced challenges in ensuring that his cabinet is aligned. The prioritisation of projects is constrained by the fragmented nature of ruling coalition governments, as well as the "time-consuming bargaining processes within the legislature", although the current government has managed to reduce legislative resistance to executive priorities.⁴⁹

Beyond cabinet and the legislature, coordination between government departments is poor. The structure of government ministries is overly complicated. There are 34 ministries, many of which have overlapping functions, and four coordinating ministers across all ministries.⁵⁰ For example, while the Ministry of Agriculture oversees grain storage, the Ministry of Public Works manages irrigation.⁵¹ State-owned enterprises, which are key players in development, are governed by the Ministry of State-Owned Enterprises, but also receive directions from other ministries (including the Ministry of Finance).

48. "Indonesia Country Report," *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

49. *Ibid.*

50. See for example: Raymond Saner and Poppy s Winanti, "Policy Coordination and consultation in Indonesia" *Strategic Review* (April-June 2015), vol 5: no 2.

51. "Filling the gap: Improving institutional capacity and inter-ministry coordination," *Oxford Business Group*, last accessed September 12, 2019, <https://oxfordbusinessgroup.com/analysis/filling-gap-improving-institutional-capacity-and-inter-ministry-coordination>

The central government's consistent area of success is macroeconomic policy, due to a political consensus around fiscal prudence.

Attempts to improve coordination include a presidential instruction issued in 2017, which required lead ministries to coordinate with other relevant ministries when issuing regulations, but this has not yet been seen to address a lack of coordination between government departments.⁵²

In any case, an aligned cabinet would “face the problem of amalgamating the interests of the executive, Parliament, the Constitutional Court, several levels of local government and public opinion into a coherent set of government policies”.⁵³

52. “2018 Investment Climate Statements: Indonesia,” *U.S. Department of State*, July 19, 2018, <https://www.state.gov/reports/2018-investment-climate-statements/indonesia/>

53. “Indonesia Country Report,” *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>



Decentralisation

Decentralisation of central government also leads to challenges. The major reform, following the exit of Suharto, was the decentralisation of government functions to a sub-provincial level. In a very short space of time, Indonesia went from being one of the most centralised states, to one of the most decentralised.

Yet decentralisation has not necessarily resulted in better service delivery: “after over 15 years of reform, institutions have yet to be built to allow both the provincial and sub-provincial governments to implement the newly acquired responsibilities.”⁵⁴ This is affirmed in a recent OECD report: “regional autonomy has not delivered the improvements that were expected when launched in 2001, in terms of the provision of public services or in the management of natural resources”.⁵⁵

One of the issues is the alignment between central and local government. The division of responsibility between different governments is unclear, resulting in regulatory overlaps.⁵⁶ Incentives may also be misaligned. For example, while central government officials have incentives to advance projects when acquiring land for major projects, local government officials, who are confronted by angry locals, have little incentive to do so.⁵⁷

The efficient use of assets across Indonesia has not improved, with over 200 regions (out of 535) spending more than 50% of their budget on personnel costs.⁵⁸ While budget deficits have increased, government agencies often fail to reach spending targets for specific purposes, in addition to a lack of natural resource management.

The administration has attempted to overcome the difficulties of a decentralised system. For example, it sought to repeal 3,143 regional bylaws that overlapped with other regulations, although this power was limited by the Constitutional Court.⁵⁹

54. Anwar Nasution, “Government decentralization program in Indonesia,” *ADB Working Paper Series*, No. 601, p.20, October 2016, <https://www.adb.org/sites/default/files/publication/201116/adbi-wp601.pdf>

55. Petar Vujanovic, “Decentralisation to promote regional development in Indonesia,” *OECD Economics Department Working Papers*, No. 1380, p.7, OECD Publishing, Paris, <https://doi.org/10.1787/d9cabd0a-en>.

56. Petar Vujanovic, “Decentralisation to promote regional development in Indonesia,” *OECD Economics Department Working Papers*, No. 1380, p.30, OECD Publishing, Paris, <https://doi.org/10.1787/d9cabd0a-en>.

57. Jamie S Davidson, “Eminent domain and infrastructure under the Yudhoyono and Widodo administrations.” in *Land and Development in Indonesia: Searching for the people’s sovereignty* (2016): 167-185.

58. “Indonesia Country Report,” *BTI Project 2018*, last accessed September 11, 2019, <https://www.bti-project.org/en/reports/country-reports/detail/itc/idn/ity/2018/itr/aso/>

59. “2018 Investment Climate Statements: Indonesia,” *U.S. Department of State*, July 19, 2018, <https://www.state.gov/reports/2018-investment-climate-statements/indonesia/>

Devolved government in Indonesia

In Indonesia there are five levels of government: Central, Provincial (Provinsi), Regency and City (Kabupaten and Kota), District (Kecamatan), and Village (Desa & Kelurahan).⁶⁰ In contrast to other countries, autonomy is given directly to the regency and city level, rather than to provincial governments, whose role is relatively limited.⁶¹ As a result of the 2014 Village law, more power has been devolved to Indonesia's 74,000 villages. While there is significant scope to determine expenditure, 89% of revenue is raised at a national level and distributed.^{62,63}

It was hoped that, at a local level, decentralisation would result in better service delivery.⁶⁴ Decentralisation can improve performance by ensuring better responsiveness to local needs, as well as encouraging competition and inter-regional learning.⁶⁵ However, decentralisation has failed to deliver its full potential.

There are significant issues with service delivery at local levels and issues with overlapping jurisdictions between central and local governments. Examples include the Online Single Submission (OSS) system for licenses as well as the One Data and One Map policies.

The OSS licensing system is designed to simplify business registration in Indonesia, rendering permits available within hours if all required data is submitted into the system. Progress has been made, yet problems persist with the local government's application of the system.⁶⁶

The One Data policy aims to provide a regulatory framework to improve internal government data governance practices, but it meets different levels of cooperation by local government leaders and data custodians.⁶⁷

The One Map policy aims to resolve overlaps in land utilization planning needs to synchronize 85 thematic maps by 19 government agencies and authorities in 34 provinces. Yet to be accomplished, the task faces strong resistance; however, progress has been made and President Widodo launched the One Map Policy Geoportal (KSP Geoportal) in December 2018.

60. Petar Vujanovic, "Decentralisation to promote regional development in Indonesia," *OECD Economics Department Working Papers*, No. 1380, p.30, OECD Publishing, Paris, <https://doi.org/10.1787/d9cabd0a-en>.

61. Anwar Nasution, "Government decentralization program in Indonesia," *ADBI Working Paper Series*, No. 601, p.4, October 2016, <https://www.adb.org/sites/default/files/publication/201116/adbi-wp601.pdf>

62. Ibid.

63. Petar Vujanovic, "Decentralisation to promote regional development in Indonesia," *OECD Economics Department Working Papers*, No. 1380, p.30, OECD Publishing, Paris, <https://doi.org/10.1787/d9cabd0a-en>.

64. Anwar Nasution, "Government decentralization program in Indonesia," *ADBI Working Paper Series*, No. 601, p.7, October 2016, <https://www.adb.org/sites/default/files/publication/201116/adbi-wp601.pdf>

65. Petar Vujanovic, "Decentralisation to promote regional development in Indonesia," *OECD Economics Department Working Papers*, No. 1380, p.30, OECD Publishing, Paris, <https://doi.org/10.1787/d9cabd0a-en>.

66. Freddy, Imelda M. and Novani K Saputri, "Elevating Indonesia's Performance in Ease of Doing Business Index," *Policy Reforms to Improve the 'Starting a Business' Indicator*, Center for Indonesian Policy Studies, 2018, Jakarta

67. Arthur G. Mmail, "One Data Policy in Indonesia," *ITU Journal: ICT Discoveries* 1, no. 2 (2018).



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Opportunity

The central government ministries could benefit from simplification, by reducing roles and streamlining responsibilities. The World Bank in 2017 recommended a number of measures to improve the performance of Indonesia's devolved governments. These suggestions included selecting appropriate performance indicators, making fiscal transfers conditional on government performance, and promoting more effective citizen engagement.⁶⁸

Greater efforts to coordinate ministries and public consultation would help avoid some of this conflict. At a regional level, the IMF has argued that a "regional coordination forum" would help coordinate nationwide policy.⁶⁹

68. "Indonesia Economic Quarterly: Decentralization that delivers." *World Bank*, December 2017, <http://documents.worldbank.org/curated/en/377621523883164713/pdf/125302-WP-P165633-PUBLIC-december-2017.pdf>

69. T Kinda, J Shin, A Isnawangsih, H Kang, and Y Lu, "Indonesia: Selected Issues Paper." *International Monetary Fund*, (2018), <https://www.imf.org/en/Publications/CR/Issues/2018/02/06/Indonesia-Selected-Issues-45615>

REGULATORY QUALITY (INDONESIA RANK: 56TH)

Regulatory quality encompasses all aspects of the running of the regulatory state – whether it be burdensome by impeding private sector development, or smoothly and efficiently run. Our Regulatory Quality measure encompasses both the quality of, and burden imposed by, governmental regulation.

Indonesia ranks 56th for Regulatory Quality, up 16 places from 10 years ago, now the third-ranked country in ASEAN, and ahead of India (but behind China). Despite this improvement, there are still issues with the quality of regulation.

The “big bang decentralisation” at the turn of the century “has resulted in a complex and sometimes disorderly policy making process”.⁷⁰ Furthermore, laws and regulations are often poorly thought through, and badly implemented. For example, industrial regulations and environmental regulations are often contradictory.⁷¹ In one case, an edict banning exports of unprocessed ore was passed, inducing harm by ceasing the operations of mining firms.⁷²

There are several causes, including the lack of law-making expertise, corruption, the fact that consensus is prized, and the compounding problem of regional legislation, and weak coordination between government departments.

The lack of law-making expertise is also evident in the lack of functional tools that could achieve better regulatory quality, such as a regulatory impact assessment (RIA). RIA's capacity is only partially used in Indonesia.⁷³ Furthermore, regional leaders do not completely support their use; this perception is costly and complex, revealing their lack of expertise regarding the use of RIA.

Indonesia is also poor for the enforcement of regulations, coming 77th. For example, enforcing food standards is poor due to limited resources to police food safety, limited working facilities, consumer preferences for cheaper products, public awareness and lack of regulation of producers.⁷⁴

Opportunity

There is need for capacity building. In particular, encouraging the use of tools, like regulatory impact analysis, would ensure an efficient use of public resources. Assisting governments to build the capacity needed to deliver projects should ensure greater successes in policy delivery.

70. “Indonesia Policy Brief: Regulatory Reform” *OECD Better Policy Series*, March 2015, <https://www.oecd.org/policy-briefs/indonesia-regulatory%20reform.pdf>

71. T Kinda, J Shin, A Isnawangsih, H Kang, and Y Lu, “Indonesia: Selected Issues Paper.” *International Monetary Fund*, (2018), <https://www.imf.org/en/Publications/CR/Issues/2018/02/06/Indonesia-Selected-Issues-45615>

72. “Why Indonesia is so bad at lawmaking,” *The Economist*, June 21, 2018, <https://www.economist.com/asia/2018/06/21/why-indonesia-is-so-bad-at-lawmaking>

73. Kurniawan, Teguh, Muh Azis Muslim, and Eko Sakapurnama, “Regulatory impact assessment and its challenges: An empirical analysis from Indonesia.” *Kasetsart Journal of Social Sciences* 39, no. 1 (2018): 105-108. <https://www.sciencedirect.com/science/article/pii/S2452315117306197>

74. Stephanie A. Putri, “Challenge to Enforce Food Safety Law and Regulation in Indonesia.” In *IOP Conference Series: Earth and Environmental Science*, vol. 175, no. 1, p. 012216. IOP Publishing, 2018. <https://iopscience.iop.org/article/10.1088/1755-1315/175/1/012216/pdf>



CONCLUSIONS

Our work at the Legatum Institute is framed by our perspective that prosperity is created when economic and social wellbeing work together. True prosperity is about much more than economic success and material wealth, but every nation needs a successful economy to build sustainable prosperity. Our intention in publishing this case study of Indonesian Economic Openness has been to highlight the country's great achievements that led to continued impressive growth rates, while also highlighting further opportunities for reform. We hope to provide a holistic and systematic assessment of the policy environment underpinning the Indonesian economy and, in doing so, seek to highlight both its strengths and weaknesses in a comparative perspective.

Importantly, it has a stable political environment and reasonably robust democratic processes. It has an active civil society and media that has influence. It also has a strong banking system and sound fiscal policy, as well as an expanding availability of finance. And Indonesia has proven to have the entrepreneurial spirit that will continue to enhance the lives of its people, as evidenced by its dynamic start-up scene in e-commerce.

All of these provide some of the prerequisites for further development. However, as Indonesia enters the coming five years of President Widodo's new term, it faces other policy challenges across a number of areas.

Firstly, infrastructure is severely constrained. In particular, poor infrastructure is preventing the supply of electricity, and movement of goods and people across Indonesia. If Indonesia wants to continue the progress made in President Widodo's first term it will need to attract more private investment to infrastructure development. This requires reforming regulations that stifle investment (such as preferential treatment of state-owned enterprises and local content requirements) and creating genuine tender processes for government projects.



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Secondly, Indonesia's history of protectionist policies and rhetoric means that, ultimately, the government and consumers have been paying the price of inefficiently-operating enterprises that provide products and services of insufficient quality that cannot meet the needs and demands of a modern Indonesia. These policies have the effect of preventing new domestic players but also foreign capital and more importantly, foreign expertise, entering the Indonesian market. For Indonesian consumers to see better-priced goods and the development of its industries (through competition and foreign investment), revisiting policies on the negative investment list, tariffs, quotas and subsidies has the potential to open markets.

Thirdly, various regulations and policies dis-incentivise business activity and the entry of firms into the formal sector. For example, labour market regulations work against businesses hiring permanent staff. The lack of businesses entering the formal sector means Indonesia loses potential tax revenue and results in a lack of ambitious, growing businesses. The government should continue to make it easier to run a business across Indonesia, which will lead to businesses expanding through greater access to capital. Indonesia's dynamic start-up scene should provide inspiration.

Finally, the government is constrained in multiple ways. This is partly due to corruption, which is pervasive throughout all areas of government. More importantly, however, government often fails to deliver services and projects in a timely or efficient manner. Simplification of central government departments, and greater coordination between ministries and with local governments, would ensure policy can be delivered effectively.

APPENDIX





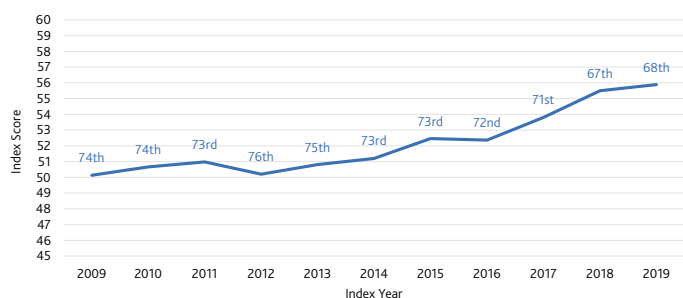
Indonesia: Index score 55.9 (68th)



GDP (US\$) per Capita: \$3,847 (97th)

GDP (US\$): \$1,016bn (16th)

Economic Openness over time



Pillar Performance

Pillar	Rank - Global (1 to 157) 2019	Score 2009	Score 10-year trend	Score 2019
Market Access & Infrastructure	85	39.2	39.2	48.0
Investment Environment	53	52.9	52.9	62.0
Enterprise Conditions	61	56.7	56.7	59.6
Governance	63	51.6	51.6	53.8

Breakdown of performance

Category	2009	Score 10-year trend	2019	Rank - Global (1 to 157) 2019	10-year rank change
Economic Openness	50.1		55.9	68	▲ 6
Market Access & Infrastructure	39.2		48.0	85	▲ 5
Communication	4.1		10.2	114	▲ 6
Resources	9.6		10.8	76	▲ 8
Transport	9.2		10.5	61	▲ 12
Border Administration	2.2		2.2	87	▼ 14
Open Market Scale	1.5		2.6	55	▲ 4
Import Tariff Barriers	3.6		3.7	63	▼ 1
Market Distortions	9.0		8.1	82	▼ 22
Investment Environment	52.9		62.0	53	▲ 27
Property Rights	8.5		11.8	72	▲ 45
Investor Protection	12.4		13.1	36	▼ 2
Contract Enforcement	7.3		8.9	99	▲ 26
Financing Ecosystem	18.8		22.3	31	▲ 34
Restrictions on International Investment	6.0		5.9	74	▲ 2
Enterprise Conditions	56.7		59.6	61	▼ 3
Domestic Market Contestability	20.6		18.8	70	▼ 10
Environment for Business Creation	18.1		21.4	43	▲ 16
Burden of Regulation	12.8		14.4	51	-
Labour Market Flexibility	5.2		5.0	114	▼ 30
Governance	51.6		53.8	63	▲ 9
Executive Constraints	9.2		9.3	52	▲ 2
Political Accountability	10.9		10.7	65	▼ 1
Rule of Law	6.7		6.8	96	▲ 8
Government Integrity	8.3		9.1	83	▲ 12
Government Effectiveness	9.4		10.5	66	▲ 23
Regulatory quality	7.1		7.5	56	▲ 16



Italics: Indicator contains imputed values

Communication (114th)		Source	Unit	Value		Global Rank	
			2009	10-yr trend	2019	2009	2019
International internet bandwidth	ITU	kilobits per person	0.0		6.9	110	109
2G, 3G and 4G network coverage	GSMA	index score, 0-100	34.3		59.3	127	116
Fixed broadband subscriptions	ITU	number per 100 people	0.3		2.3	95	110
Internet Usage	ITU	percentage of population	5.8		32.3	110	106

Resources (76th)		Source	Unit	Value		Global Rank	
			2009	10-yr trend	2019	2009	2019
Installed electric capacity	UNESD	kilowatts per capita	0.1		0.2	116	104
<i>Gross fixed water assets</i>	<i>IBNWS</i>	<i>USD per population served</i>	<i>192.3</i>		<i>192.3</i>	<i>70</i>	<i>70</i>
Reliability of electricity supply	WBDB	index score, 0-7	5.2		5.0	49	55
Ease of establishing an electricity connection	WBDB	index score, 0-100	59.5		91.1	105	19
Water production	IBNWS	litres per person per day	186.9		186.9	114	114
Reliability of water supply	WEF	expert survey, 1-7	4.6		4.6	80	80

Transport (61st)		Source	Unit	Value		Global Rank	
			2009	10-yr trend	2019	2009	2019
Logistics performance	WBPLI	index score, 1-5	3.1		3.0	46	60
Airport Connectivity	WEF	index based on seats and size of airport	4.5		3.7	58	65
Efficiency of seaport services	WEF	expert survey, 1-7	3.0		4.2	117	64
Liner shipping connectivity	UNCTAD	index score, rebased to 100 in 2004	24.9		47.8	58	42
Quality of roads	WEF	expert survey, 1-7	3.9		3.9	77	77
Road density	FAO	km per 100 sq km of land area	22.9		26.0	80	75
Rail density	WBDI	km per sq km of land area	0.0		0.0	98	98

Border Administration (87th)		Source	Unit	Value		Global Rank	
			2009	10-yr trend	2019	2009	2019
Efficiency of customs clearance process	WBPLI	survey, 1-5	2.7		2.7	46	62
Time to comply with border regulations and procedures	WBDB	hours	92.2		80.1	115	112
Cost to comply with border regulations and procedures	WBDB	USD (current)	242.7		234.9	82	81

Open Market Scale (55th)		Source	Unit	Value		Global Rank	
			2009	10-yr trend	2019	2009	2019
Domestic and international market access for goods	WTO	constant 2010 USD \$bn	13,396.5		25,731.5	67	59
Domestic and international market access for services	WTO	constant 2010 USD \$bn	13,396.5		25,731.5	58	52
Trade-weighted average tariff faced in destination markets	WEF	percentage	3.7		3.3	38	36
Index of margin of preference in destination markets	WEF	index score, 1-100	15.3		24.6	133	123

Import Tariff Barriers (63rd)		Source	Unit	Value		Global Rank	
			2009	10-yr trend	2019	2009	2019
Share of imports free of tariff duties	WEF	percentage	61.2		62.1	75	77
Average applied tariff rate	WEF	percentage	4.6		4.4	60	61
Complexity of tariffs	WEF	index score, 1-7	6.2		6.3	70	66

Market Distortions (82nd)		Source	Unit	Value		Global Rank	
			2009	10-yr trend	2019	2009	2019
Extent of liberalisation of foreign trade	BTI	expert survey, 1-10	6.0		6.0	111	114
Prevalence of non-tariff barriers	WEF	expert survey, 1-7	5.3		4.3	34	80
Non-tariff measures	UNCTAD	number	634.0		634.0	89	88
Distortive effect of taxes and subsidies	WEF	expert survey, 1-7	4.3		4.3	35	35
Energy subsidies	IMF	percentage of GDP	11.1		7.6	132	128



Italics: Indicator contains imputed values

Property Rights (72nd)	Source	Unit	Value			Global Rank	
			2009	10-yr trend	2019	2009	2019
Protection of property rights	WEF	expert survey, 1-7	3.5		4.8	133	49
Lawful process for expropriation	WJP	index score, 0-1	0.6		0.6	74	70
Intellectual property protection	WEF	expert survey, 1-7	2.9		4.6	117	46
Quality of land administration	WBDB	index score, 0-30	1.0		4.0	118	83
Procedures to register property	WBDB	index score, 0-100	54.0		64.9	119	107
Regulation of property possession and exchange	BTI	expert survey, 1-10	7.0		6.0	67	82

Investor Protection (36th)	Source	Unit	Value			Global Rank	
			2009	10-yr trend	2019	2009	2019
Strength of insolvency framework	WBDB	index score, 0-16	10.5		10.5	45	59
Insolvency recovery rate	WBDB	percentage	64.7		65.2	25	32
Auditing and reporting standards	WEF	expert survey, 1-7	4.6		4.7	76	65
Extent of shareholder governance index	WBDB	index score, 0-10	5.7		7.0	56	29
Conflict of interest regulation	WBDB	index score, 0-10	5.7		5.7	62	74

Contract Enforcement (99th)	Source	Unit	Value			Global Rank	
			2009	10-yr trend	2019	2009	2019
Quality of judicial administration	WBDB	index score, 0-18	6.4		7.9	110	85
Time to resolve commercial cases	WBDB	days	157.0		134.4	50	26
Legal costs	WBDB	percentage	23.4		23.4	148	150
Alternative dispute resolution mechanisms	WJP	index score, 0-1	0.5		0.6	132	113

Financing Ecosystem (31st)	Source	Unit	Value			Global Rank	
			2009	10-yr trend	2019	2009	2019
Access to finance	WBES	percentage	14.3		16.5	44	71
Financing of SMEs	WEF	expert survey, 1-7	4.6		4.6	23	23
Venture capital availability	WEF	expert survey, 1-7	3.5		3.8	40	25
Quality of banking system and capital markets	BTI	expert survey, 1-10	6.0		9.0	96	34
Commercial bank branches	WBDI	branches per 100,000 adults	6.0		16.9	102	55
Soundness of banks	WEF	expert survey, 1-7	4.6		4.9	128	74
Depth of credit information	WBDB	index score, 0-8	6.0		8.0	60	1

Restrictions on International Investment (74th)	Source	Unit	Value			Global Rank	
			2009	10-yr trend	2019	2009	2019
Business impact of rules on FDI	WEF	expert survey, 1-7	5.9		4.3	10	95
Capital controls	FI	percentage	15.4		15.4	102	99
Freedom to own foreign currency bank accounts	FI	expert judgement, 0-10	5.0		10.0	85	3
Restrictions on financial transactions	CII	index score, 0-1	0.7		0.4	67	85
Prevalence of foreign ownership of companies	WEF	expert survey, 1-7	6.1		4.6	3	63
Freedom of foreigners to visit	FI	index score, 0-10	1.2		8.3	113	48



Italics: Indicator contains imputed values

Domestic Market Contestability (70th)	Source	Unit	Value			Global Rank		Environment for Business Creation (43rd)	Source	Unit	Value			Global Rank	
			2009	10-yr trend	2019	2009	2019				2009	10-yr trend	2019	2009	2019
Market-based competition	BTI	expert survey, 1-10	6.0		6.0	72	71	Private companies are protected and permitted	BTI	expert survey, 1-10	6.0		7.0	91	67
Anti-monopoly policy	BTI	expert survey, 1-10	5.0		5.0	96	95	Ease of starting a business	WBDB	index score, 0-100	48.9		81.1	138	113
Extent of market dominance	WEF	expert survey, 1-7	4.7		4.1	27	41	State of cluster development	WEF	expert survey, 1-7	4.6		4.6	18	29
								Labour skill a business constraint	WBES	percentage	4.5		10.8	7	34
								Availability of skilled workers	WEF	expert survey, 1-7	4.7		4.7	36	36
Burden of Regulation (51st)	Source	Unit	Value			Global Rank		Labour Market Flexibility (114th)	Source	Unit	Value			Global Rank	
2009	10-yr trend	2019	2009	2019	2009	10-yr trend	2019				2009	10-yr trend	2019	2009	2019
Burden of government regulation	WEF	expert survey, 1-7	3.9		4.1	28	27	Cooperation in labour-employer relations	WEF	expert survey, 1-7	5.1		4.6	21	51
Time spent complying with regulations	WBES	percentage	1.6		0.9	9	6	Flexibility of hiring practices	WEF	expert survey, 1-7	4.7		4.5	19	19
Number of tax payments	WBDB	number per year	65.0		43.0	145	134	Redundancy costs	WEF	weeks	108.0		57.8	148	154
Time spent filing taxes	WBDB	hours per year	259.0		207.5	73	78	Flexibility of employment contracts	WBDB	index score, 0-1	0.3		0.4	126	134
Burden of obtaining a building permit	WBDB	index score, 0-100	57.0		60.4	90	112	Flexibility of wage determination	WEF	expert survey, 1-7	5.0		4.9	88	76
Building quality control index	WBDB	index score, 0-15	13.0		13.0	12	17								

List of data sources and acronyms

Code	Organisation
BTI	Bertelsmann Stiftung Transformation Index
CII	Chinn-Ito Index
CSP	Center for Systemic Peace
FAO	Food and Agriculture Organisation
FH	Freedom House
FI	Fraser Institute
GSMA	Groupe Spéciale Mobile Association
IBNWS	International Benchmarking Network for Water and Sanitation Utilities
IBP	International Budget Partnership
IMF	International Monetary Fund
ITU	International Telecommunications Union
UNCTAD	United Nations Trade Data
UNESD	United Nations Energy Statistics Database
WBDB	World Bank Doing Business Index
WBDI	World Bank Development Indicators
WBES	World Bank Enterprise Surveys
WBLPI	World Bank Logistics Performance Index
WEF	World Economic Forum
WGI	Worldwide Governance Indicators
WJP	World Justice Project
WTO	World Trade Organisation



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