TRADE AND INVESTMENT

MEASURE PLUS: INDONESIA

April 2011

This publication was prepared by Weidemann Associates, Inc. for the Business Growth Initiative Project and financed by the Office of Economic Growth of EGAT/USAID.

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Submitted to:
USAID/EGAT/EG

Contract No.:
EEM-C-00-06-00022-00

April, 2011

http://egateg.usaidallnet.gov/bgi

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Trends and Patterns

Indonesia has always exported a smaller share of its GDP than have its Southeast Asian neighbors. In 2009, for example, Indonesian exports were equivalent to 24% of GDP, versus 96% for Malaysia, 68% for Thailand and Vietnam, and 32% for the Philippines. One reason for this striking difference is that Indonesia is a much larger country than these comparators; larger countries tend to export smaller shares of GDP than do smaller countries. Even so, the comparison strongly suggests that Indonesia has been less successful than other countries in the region in establishing the competitiveness needed to expand and diversify its export trade.

Despite its massive low wage labor force, moreover, Indonesia has tended to rely more on resource-intensive export products than on labor-intensive goods. Until the 1990s, its most important industrial export was plywood, an industry created by heavy overseas demand for tropical hardwoods combined with a ban on Indonesian log exports.

In current dollar terms, Indonesian exports doubled between 1990 and 1997, growing from $29 billion to $60 billion. After slumping in 1998-99 because of the Asian financial crisis, growth in export value resumed, reaching $151 billion in 2008 before dipping to $130 billion in 2009 as a result of the recent global recession. Despite this growth, Indonesian exports remained significantly smaller in dollar terms than those of either Malaysia or Thailand, even though the Indonesian population is eight times as large as that of Malaysia and three times as large as Thailand's.

Gross capital formation was equivalent to 31% of GDP in 2009, no higher than the investment rate in 1990. After collapsing to 17% of GDP in 1998 and 11% in 1999, investment recovered, but only slowly. It took until 1999 for it to regain its 1990 share of GDP. Parenthetically, other ASEAN countries have also had trouble maintaining high rates of national investment since 1999. Indonesia's 31% rate in 2009 is significantly higher than the investment rates in Malaysia (14%), the Philippines (15%), and Thailand (22%). The only country in the region that invests a higher share of GDP is Vietnam, where the rate of investment soared from 13% in 1990 to 43% in 2007 before declining to 38% in 2009.

In terms of economic growth, Indonesia did relatively well up to 1998, but the Asian financial crisis hit it harder than any of the other ASEAN countries, causing GDP to fall by 13.1% in 1998. By 2007-08, the growth rate of GDP had recovered to 6% or more, and even after dropping to 4.5% in 2009 it remained ahead of other ASEAN countries, except for Vietnam. Per capita income in Indonesia rose from $1,440 in current purchasing power in 1990 to $3,720 in 2009. This left the country with about one-quarter the per capita income level of Malaysia, less than one-half the level of Thailand, slightly less than the Philippines, and about $1,000 more than hard-charging Vietnam.

Economic growth in Indonesia has failed to dent the pervasive problems of poverty and unemployment. Some 60% of the population still lived on less than $2 per capita per day (in purchasing power parity) in 2007. Poverty was more pervasive in Indonesia than in either Vietnam (where it was 48% in 2006) or the Philippines (48%), and far greater than in Thailand and Malaysia (11% and12% respectively in 2004).

The World Bank (2010) has recently highlighted the problem of slow growth of formal sector employment in Indonesia, terming the 1999-2003 period an era of jobless growth and noting that even now the great majority of labor force entrants each year cannot find decent jobs and end up working for low wages in agriculture or the informal sector. This problem is clearly a large part of the difficulty of reducing the rate of poverty in the country, since earnings from employment are the main income source for the poor.

6% annual GDP growth is insufficient to provide good jobs for the labor force, which is growing at about 2% per year, and thus reduce poverty. To achieve this goal, faster economic growth and a different pattern of investment are required. The key lies in a higher rate of job creation in manufacturing and the better-paid service sector jobs. This in turn requires stronger export performance. The latter, finally, depends primarily on improving Indonesia's investment climate. The studies reviewed below agree that the major constraints on export growth and job creation lie on the supply side, not on potential demand for Indonesian exports.

Policy Changes Over the Years

Up to the mid-1980s, Indonesia pursued a course of import-substituting industrialization behind a high, protective wall. Many of its larger firms (in cement, fertilizer, steel, and other industries) were state owned, frequently former Dutch-owned enterprises that had been nationalized around 1960. The economy and the government both relied heavily on income from oil exports to fund their expenditures. Opinion among the ruling elites and much of the public was highly nationalistic and deeply skeptical about the potential benefits from involvement in foreign trade and foreign investment, which were popularly regarded as features of the exploitative regime that existed in colonial days. The private sector was highly regulated. Such non-oil private investment as took place during this period was directed toward the domestic market.

The policy framework at this time discouraged private investment through extensive government intervention, delays and high transaction costs arising from bureaucratic complexity accompanied by corruption, weak infrastructure, and severe restrictions on foreign investment. Firms with 100% foreign ownership were barred and foreign investors who owned partial shares in companies were required to divest their holdings to Indonesians after a specified period of time.

This situation was not sustainable because Indonesia's oil resources were running down and no alternative replacement source of foreign exchange earnings was readily at hand. When international oil prices plunged in 1986 the need for policy reform became obvious. Efforts were launched to boost exports and improve the investment climate. The move was timely because it coincided with a tendency for firms from Japan, South Korea, and Taiwan, challenged by appreciating currencies and rising wages at home, to search for lower cost production sites.

Actions taken in the 1980's included a 50% devaluation of the rupiah, improvements in the duty exemption scheme for imported inputs, reform of customs implementation, relaxation of restrictions on foreign investment in export-oriented industries, and a broad reduction in the level of protection. The tariff structure was rationalized and some non-tariff barriers were replaced by tariffs. The average (un-weighted) tariff rate was cut from 27% in 1986 to 15% by 1995 and the percentage of tariff lines subject to non-tariff barriers fell from 32% to 12%. Major exceptions to these liberalizing moves were the automotive sector (where tariffs and luxury taxes remained high) and agriculture (where non-tariff barriers persisted).

Deregulation of foreign investment was more gradual. In 1985-86, foreign ownership restrictions and divestment requirements were relaxed for export-oriented investments and those located in bonded zones. In 1992 further relaxation occurred: 100% foreign ownership and less stringent divestment requirements were permitted for investments larger than $50 million and those located in Eastern Indonesia or in bonded zones. In 1993 foreign companies were encouraged to enter the electronic components industry by permitting 100% foreign ownership for companies that invested $2 million or more. Finally, in 1994, 100% foreign ownership with few restrictions was generally allowed and the divestment requirements were virtually eliminated. New sectors, such as power generation and telecommunications, were opened up to foreign participation.

These measures led to dramatic increases in export-oriented investments as well as in exports. From a small base of $2.6 billion in 1986, exports of manufactures grew to $20.1 billion by 1994, raising their share in total exports from 18% to 52%. The main industries that grew up in response to these incentives were textiles, garments, and electronics.

In the mid-1990s, however, the growth of manufactured exports slowed down. The textile and garment industries experienced growing competition from China and other emerging low wage countries. Increases in the minimum wage also hurt these labor-intensive industries. Meanwhile, growth of the plywood industry diminished as a shortage of raw materials developed.

Foreign investment increased substantially during this period. Net inflows, as recorded in the balance of payments, climbed from $300 million in 1986 to $2 billion by 1994. This increase can be attributed both to Indonesia's liberalization over this period and to the regional search for lower cost production locations.

In 1997, however, Indonesia was struck a severe blow by the Asian financial crisis. Following several unsuccessful attempts to stabilize the rupiah, the government turned to the IMF for assistance. The Fund's prescription for Indonesia's included further trade reform. The structural adjustment program called for gradual reduction of import duties to 5-10% and included previously protected industries such as chemicals, iron and steel, and fisheries products. In addition, various commodities, including wheat and wheat flour, soybeans, and garlic, could now be imported freely under a general importer license. In January 1998 trade in agricultural products was totally deregulated. The clove marketing board was eliminated. The following month, all other marketing arrangements were abolished. The cement, paper, and plywood cartels were dissolved.

Also, in February 1998, formal and informal barriers to investment in palm oil plantations were removed. This was followed by removal of all restrictions on investment in wholesale and retail trade. Internal and external restrictions on trade in cement were removed, allowing traders to buy and sell all brands of cement in all provinces and export under a general exporter license. The government also discontinued special tax, customs, and credit privileges for the national car project.

As a result of these bold measures, Indonesia became a relatively open economy. Average tariff levels declined and high rates persisted only for alcoholic beverages and completely built-up motor vehicles. By 2002, the overall average MFN tariff was 7.2%, down from 9.8% in 1998. For industrial products, the average was 7%, while for agricultural products it was 8.4%. These rates were lower than those levied by Thailand and China. Calculations showed the effective rate of protection was much higher in the manufacturing sector than in agriculture. Yet agriculture probably remained more highly protected overall because non-tariff barriers in manufacturing had been converted to tariffs while agriculture continued to receive protection in the form of subsidies, import quotas, and special provisions for commodities such as sugar and rice.

As Indonesia recovered from the crisis, its key markets for non-oil exports were developing Asia (26%), NAFTA (16%), and Japan (15%). Export growth was sluggish in 2000-03, the period that the recent World Bank Jobs Report characterizes as one of "jobless growth." Exports stagnated at 30% of GDP from 2003 until 2008, and then fell to 24% in recession of 2009.

As of 2005, Soesastro and Basri observed that "serious problems persist and appear to be systemic." They cited the high cost of doing business, weak industrial relations policy, minimum wage hikes, and poor quality infrastructure. They also noted that most Indonesian exports (especially textiles and garments) had experienced a decline in market share, exceptions being palm oil, printing and writing paper, and electronics.

Soesastro and Basri noted that this decline in competitiveness was compounded by a tendency toward "creeping protectionism," characterized by them as an inappropriate response to the internal problems that were weakening Indonesia's competitiveness. Beginning in 2001, tariffs were increased on wheat flour and trade regulations and licensing were introduced in textiles, steel, sugar, and cloves. Most of the new protective measures were non-tariff barriers, which fall under the jurisdiction of the Ministry of Trade, a ministry that appears subject to influence from crony capitalists and interest groups. The Trade Ministry is far more inclined to protectionism than the Ministry of Finance, which is responsible for tariffs. The Ministries of Agriculture and Industry is also avowedly protectionist. Tariff levels in Indonesia remained lower than in most other Asian countries but there is continual pressure for new non-tariff barriers.

Finally, Soesastro and Basri commented that labor productivity was low in Indonesia compared to neighboring countries, in large part because of sluggish investment. The lack of investment led to rapid obsolescence of equipment and rising production costs. In particular, the Indonesian textile and garment industries faced strong competition from more recent entrants into the world market, especially China and Vietnam. In both the U.S. market and the EU, Indonesia was continuously losing market share.

Importantly, Soesastro and Basri comment that

> "It would be imprudent to conclude that pressures for trade protectionism will subside. While it is true that the [Asian] economic crisis has forced Indonesia to further liberalize its economy, it should also be remembered that liberalization has been blamed by some as the main cause of the crisis. In addition, resistance to market reform from protectionist groups cannot be underestimated. These groups are still prevalent and hold some key positions in the government and in the business sector. They can create obstacles to further trade liberalization."

In a 2005 review of the Indonesian investment climate, the Asian Development Bank concluded, "it is essential that Indonesia should attain a much higher rate of investment by improving the investment climate." It noted that recent moves of foreign firms from Indonesia to China and Vietnam lent great urgency to this need.

The ADB polled firms to develop a list of perceived obstacles to investment. The content of the list is as follows:

- Macroeconomic and regulatory policy uncertainty and corruption were reported to be the most severe obstacles to doing business. Despite improvement in macroeconomic indicators, 60% of firms still considered macroeconomic instability to be a major or very severe obstacle. Corruption was also a major issue; 38% of surveyed businesses reported that corruption was a major or very severe obstacle. Illicit payments at the national level were estimated to average 4.6% of sales, a higher percentage than was found in China, the Philippines, Malaysia, or Thailand.

- For the larger firms, the cost of formal finance was regarded as a bigger problem than access to it. Smaller firms had access problems. The lack of a well-functioning credit information system impeded the flow of credit.
- Labor regulations (especially hiring and layoff procedures) were a serious concern, more so than labor skills. One-half of the firms surveyed saw labor regulations as a moderate to very severe obstacle. Rising wages and the establishment of a minimum wage system was troubling and a source of declining competitiveness.
- Large firms, foreign firms, and exporters felt the constraints most acutely.
- Firms outside Jakarta had to deal with more serious regulatory constraints but they experienced less corruption than those in the capital.
- Decentralization implemented since 2001 had led to greater economic and regulatory uncertainty and increased corruption.
- The effects of declining investment in infrastructure following the Asian financial crisis were being felt. Power outages, transport failures, and inadequate water supply were experienced in most regions, interrupting business operations. Recurrent power outages forced many firms to rely on private generators. Starting a business was complicated by delays in installing telephone and electrical connections. Indonesia lagged behind other ASEAN countries in the use of ICT to speed communications and broaden markets.

The ADB concluded that more firms in Indonesia are concerned about the quality of the investment climate than in other countries in the region. Their report recommended improvements in three key areas:

1. Undertake urgently needed institutional reforms to reduce uncertainty and do away with unnecessary red tape and bureaucratic burdens. Better assurance of property rights should be achieved through reforms of the judicial and legal system to improve enforcement of contracts and ensure property rights. The on-going efforts to establish a "one-stop" investment service and improve the investment law were good but needed to be supplemented by more comprehensive policies such as streamlining the central and local governments' roles in investment procedures. Many local governments were unprepared to take on the new responsibilities devolved to them and too many were resorting to nuisance taxes and retributions.
2. Improvements in physical infrastructure were critical. Investments were needed across the board and notably in ICT.
3. The government should consider a new package of policy incentives for investment. The incentives should be made available on equal terms to foreign and domestic investors. Care should be taken to ensure that regional governments do not compete with each other to the extent of offering incentives that exceed the benefits to be obtained.

Unfortunately, Indonesia's investment climate does not seem to have improved very much since the ADB report in 2005, at least not relative to those of other developing countries. In 2006, the first year of the World Bank's *Doing Business* reports, Indonesia ranked a mediocre 115th in the world on the overall ease of doing business index. This ranking slipped to 135th in 2007, then improved gradually to 123rd in 2008 and 115th in 2009. In 2010, Indonesia's ranking declined again, this time to 121st in the world. Indonesia ranked even lower in several aspects of the business regulatory environment in 2010, namely closing a business (141st), enforcing contracts (146th), employing workers (149th), and starting a business (161st). Clearly the government's performance in improving the investment climate has not been vigorous enough to place Indonesia among the world's leading reformers.

The World Trade Organization reviewed Indonesia's trade and investment policies and performance in 2003 and again in 2007, just prior to the global economic crisis. In 2007 it found that GDP growth was averaging 5% a year, not fast enough to create sufficient employment opportunities to reduce unemployment (officially running at 10% but far more pervasive if underemployment and discouraged workers are taken into account) and reduce the number of people living below the poverty line. After recovering strongly in 2000-01 after the Asian financial crisis, gross domestic investment remained relatively flat. Similarly, net inflows of foreign direct investment, which had turned negative in the crisis, had only recently begun to resume.

In an effort to improve Indonesia's investment climate, the government announced an investment policy package in early 2006 in the form of a Presidential Instruction. The package included submission of a new investment law, which was passed by Parliament in March 2007. Elements of the law included creation of a new negative list of sectors where private investment is not permitted or where foreign investors are subject to restrictions, reduction in the time required to start a business, accelerated review of local regulations that were not business-friendly and streamlined customs procedures and regulations.

The WTO (2007) observed that these changes did not appear to have had a real effect on inbound FDI as yet. (Also, as noted above, they are not evident in the World Bank's doing business rankings for 2010.) However, the balance of payments statistics suggest that significant increases in net FDI did occur in 2007 (to $6.9 billion) and 2008 ($9.3 billion), before the global economic crisis cut into the flow in 2009, reducing it to $4.9 billion.

The government tried to stimulate investment in infrastructure, which had languished since the 1998-99 crises, with an Infrastructure Reform Package in 2006. This wide-ranging package reportedly covered power generation, telecoms, water and sanitation, roads, and port and airport modernization.

The tariff has remained Indonesia's main trade policy instrument. Over 99% of tariffs are *ad valorem*, which contributes to the transparency of the tariff. Yet the tariff system was still complex in 2007, with 16 *ad valorem* rates and three specific rates. The tariff structure also embodied a degree of escalation, with higher rates for semi-processed food, beverage, and tobacco products as well as for paper, printing, and publishing. Despite recent reductions, 141 tariff lines remained subject to import restrictions. Bans for sanitary and other reasons had affected chicken parts, rice, and salt. No origin-related restrictions were applied, except those affecting Israel.

Government procurement remained an important instrument of industrial policy and a tool for assisting *pribumis* (indigenous Indonesians). Indonesia was not a signatory of the WTO Agreement on Government Procurement. It had revised its government procurement rules with the aims of increasing domestic procurement, reducing corruption, and bringing its procurement framework closer to international standards.

Indonesia has been a relatively active user of anti-dumping measures, mainly involving base metals and chemicals from the region. These are industries in which state-owned firms are prominent.

Indonesia also has export licensing, prohibitions, and restrictions aimed at protecting natural resources and endangered species, providing an adequate domestic supply of essential products, promoting higher-value downstream industries, and upgrading the quality of export products. Products subject to restrictive measures include coffee, textiles, rubber, and certain types of wood. These products can only be exported by registered and approved exporters.

In 2004 the government ended several credit programs that offered subsidized loans from *Bank Export Indonesia* to support exports.

Support for production and trade has been provided through financial assistance for research and development as well as industry- and/or region-specific tax incentives.

Rising global oil prices forced the government to reduce fuel subsidies in 2005 and bring domestic prices closer to world prices. The WTO estimated that eliminating remaining fuel subsidies could free up $6-8 billion annually for development expenditure.

Measures to assist domestic production and/or control or restrain trade in several sectors remain in place. They include exclusive import rights given to domestic producers of certain sensitive items such as rice, alcoholic beverages, sugar, hot- and cold-rolled iron, and steel products. State-owned enterprises continued to play a central role in the economy and were estimated to account for 40% of Indonesia's GDP in 2007. A handful of commodities and services, including gasoline, electricity, cement, and transportation, remained subject to administered prices.

The WTO noted that Indonesia has sought to strengthen protection of intellectual property rights by expanding its international commitments and improving its legal framework to combat IPR violations. Although institutional constraints continued to impede effective implementation of the laws, the government did appear to have made some progress in controlling piracy with the seizure of sizable amounts of pirated optical disc products. A Presidential Decree in 2006 established a National Task Force for IPR Violation Prevention, which is tasked with coordinating law enforcement efforts by customs authorities and the police and increasing the numbers of qualified judges, prosecutors, and IP lawyers.

The government also tried to lay the groundwork for judicial and civil service reform and mount an effective anti-corruption campaign focused on strengthening the institutional framework against corruption. New institutions – an Anti-Corruption Commission (KPK), Anti-Corruption Court, an Interagency Corruption Eradicating Team, a Judicial Commission, a Police Commission, and a Prosecutorial Commission – were established and given considerable authority, while existing institutions such as the Supreme Audit Commission and the Attorney General's Office became more active in combating corruption. Corruption investigations were launched at all levels of government and among state-owned enterprises, leading to a number of successful prosecutions.

Foreign-owned companies receive the same tax treatment as domestic ones, but the proliferation of local taxes has added to the burden on investors. Tax administration has become more efficient, which has significantly raised revenues. Indonesia has concluded 59 bilateral tax treaties.

Recently, however, the Economist Intelligence Unit (2011) reported indications that the President's efforts to improve the business environment may be faltering in the face of resistance from vested interests. The departure in May 2010 of Sri Mulyani Indrawati, the former finance minister, for a major position at the World Bank was apparently not opposed (and may even have been prompted) by the President. It deprived the government of its most capable minister and raised doubts about the President's true commitment to reform. The EIU predicts that the anti-corruption drive will continue, but thinks that the Anti-Corruption Commission (KPK) will face constant opposition, as will other statutory bodies assigned to tackle graft. Several changes, including comprehensive reform of the country's restrictive labor laws and removal of energy subsidies, may prove unfeasible politically. Reform of the inefficient civil service, which was cited by the President as a priority for his second term, is making only slow progress. The government does; however, appear to be moving ahead on the preparation of legislation aimed at making it easier for the state to acquire private land for development. If such legislation is passed, one of the major obstacles to a series of much-needed infrastructure projects will be removed.

Prospects

Indonesia's recent economic performance coming out of the global recession has been relatively strong. According to estimates made by the Economist Intelligence Unit (2011), GDP grew at 5.9% in 2010 while gross fixed investment increased by 8.4% and exports of goods and services increased strongly at 12.6%. The EIU expects GDP to rise by 6% this year and by a further 6.4% in 2012. These data suggest that GFI will rise marginally to 33% of GDP by 2012 while exports will remain at 26% of GDP. These growth rates are respectable but will not be high enough to make a significant dent in poverty or unemployment, which would probably require a growth rate of 8-10%.

Moreover, continued openness to permit growth at the predicted rates is not assured. Soesastro and Basri (2005) have warned that the erosion of Indonesia's global competitiveness is increasing demands for protection. On the other hand, they note that Indonesia's commitment to the WTO as well as to AFTA and the creation of an ASEAN Economic Community should help counterbalance these protective pressures. Basri and Hill (2007) agree that while historically Indonesia's trade policy has generally swung from closed to open and the trade regime remains open, this openness can be precarious. The rent-seeking elements have certainly not disappeared – indeed they are participants in the current government -- and the public is skeptical of openness. There is no deep support for openness in the bureaucracy or polity.

More particularly, Basri and Hill argue that export growth since the 1990s has been hurt by Indonesia's failure to participate extensively in the rapidly expanding East Asian production and buying networks, especially in electronics and autos.

> "The key here is for countries to link to these highly competitive global production factories and networks. For countries to get into the loop they need commercial policy regimes and logistics systems that enable goods and services to flow seamlessly across international boundaries. Specifically, this requires open trade and investment regimes, and the removal of other trade frictions, through high-quality 'factory to market' logistics and smooth customs procedures…In these respects, Indonesia lags behind most of its East Asian neighbors. FDI into Indonesia was negative over the period 1998-2004, and the country has always been ambivalent towards majority-owned FDI, the usual practice in these MNE-dominated, and vertically integrated production networks. Customs procedures are slower than regional norms, while post productivity and other infrastructure provision are also weaker. Therefore, as with labor-intensive manufacturing more generally, the country's slower export growth is primarily associated with problems on the supply side, with demand-side constraints being generally minor. This indifferent export performance in turn weakens the constituency for a more liberal trade regime."

The latest assessment of Indonesian trade and investment policy and performance, carried out by the OECD in 2010, presents a somewhat more positive picture. Noting the long-term trend toward opening up the economy, the OECD says that FDI has recovered since the Asian financial crisis and especially since the passage of the Investment Law in 2007. Indonesia has demonstrated a new resilience to external shocks by maintaining a reasonably high capital inflow during the recent global economic crisis. The OECD says that while FDI has historically been a small fraction of gross capital formation, it has been important for raising productivity and employment and for generating exports. FDI, they say, is responsible for nearly one-half of the new jobs created in recent years, as well as for an increasing share of exports.

The OECD observes that while economic policy certainty is improving some implementation regulations continue to lag. Public consultation is becoming more institutionalized and the appeals process has been strengthened. Red tape remains a problem for business, but procedures are being simplified. The government is trying to register land and property and protect intellectual property rights. Despite judicial reforms, however, firms often prefer alternative dispute resolution mechanisms. The 2007 Investment Law protects investors from expropriation and provides for international arbitration of disputes between the government and foreign investors.

In infrastructure, public spending has not yet filled the gap left by the disappearance of public-private partnerships after the 1998-99 crisis. As a result, Indonesian infrastructure continues to lag behind that of its regional peers. Increasing investment in infrastructure is now a national priority.

Under President S. B. Yudhoyono, Indonesia has been pressing ahead in forming bilateral free trade agreements. Also, a recent article (Hookway, 2011) in the *Wall Street Journal* reports that on a visit to India President Yudhoyono signed investment pacts with Indian firms that envisage $15 billion of investment in Indonesia, including a titanium plant and new terminals at the Yogyakarta and Bali airports. The *Journal* sees these deals as an indication of rapid growth in south-south trade and investment.

Further Reform of Trade and Investment

The above review suggests three major areas of emphasis in promoting further policy and regulatory reform to maintain openness and accelerate the growth of investment and exports, leading to faster employment growth. These areas stand out in this brief overview, but detailed specification of the actions that most urgently need to be taken will require further analysis.

First, the campaign against corruption, which may be flagging, needs to be rejuvenated. Business people rate corruption as a major barrier to investment and say that it is more unpredictable than prior years and decentralization comes from a wider range of sources. Early in the Yudhoyono regime, vigorous steps were taken to prosecute corrupt officials, business people, and judges. Ways need to be found to reinvigorate this effort.

Second, the business environment still needs substantial improvement. The situation is somewhat paradoxical, in that the Indonesian government claims to have made significant reforms by liberalizing investment rules and simplifying regulatory procedures that impinge on businesses – yet the World Bank continues to give Indonesia low ratings in its annual Doing Business surveys. One can infer the improvements in implementation have not kept up with legislative changes. Again, further analysis is needed, but one clear point is that labor regulations not yet been reformed and indeed may have worsened in recent years. Since the aim is not only to increase private investment but also to make it more labor-intensive, reforming labor markets is a definite priority. The World Bank's recent "Indonesia Jobs Report" contains many useful suggestions for reducing labor market segmentation, simplifying hiring and firing regulations, avoiding the use of the minimum wage as a wage-setting mechanism, improving collective bargaining and dispute resolution, and improving the skills of the work force. These suggestions merit serious consideration.

Third, Indonesia's infrastructure has always been inferior to those of its neighbors and competitors. Moreover, investment in roads, power, communications, water and sewerage, ports, and airports has languished for the past decade or longer. This situation places a heavy burden on business as well as the general public. Public and private investment needs to be accelerated, among other things through the revival of public-private partnerships.

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Annex 1: Annotated Bibliography

Asian Development Bank. 2005. "Improving the Investment Climate in Indonesia."
This report provides information on constraints and opportunities for investing in Indonesia. It is based on the results of the Investment Climate and Productivity Study (ICS), which was conducted in 2003 and surveyed 713 firms in 11 regions and ten subsectors of manufacturing, namely food and beverages, tobacco, textiles, garments, leather and footwear, wood, paper, chemicals and chemical products, electronics and electrical machinery, and transport equipment.

The study highlights the importance of institutional reforms, especially at the local level, since local governments did not have a full capacity to act on their own Thus decentralization increased the corruption risks and uncertainty for both Indonesian and foreign investors. The report contains quantitative analysis of indicators and international comparison of Indonesia with other countries in the East Asian region, such as the Philippines and China.

Basri, M. Chatib and Hal Hill. 2008. "Indonesia – Trade Policy Review 2007," *The World Economy.*
This paper examines the 2007 WTO review of Indonesian trade policy. Indonesia undertook major policy liberalization in the late 1960s. Serious protectionist pressures emerged in the 1970s but for most of this period, and especially since the mid-1980s, the economy has remained broadly open. It provides a summary of the WTO 2007 report, updates some of its analysis, highlight its key findings, and points to trade policy issues that in the authors' opinion warranted greater attention.

The main theme of the paper is that Indonesia is a largely open economy, but that this openness remains precarious. There are rent-seeking forces opposed to the current openness and, perhaps more important, much of the country's influential public opinion is skeptical of the merits of an open economy and deeper global commercial integration. Nor is there deeply institutionalized support for openness in the country's bureaucracy and policy. Seen from this perspective, a key question to answer is why the country has remained open, particularly since the deep economic and political crises of 1997-98.

Buxbaum, H. "Joint Venture in Indonesian Foreign Direct Investment." PowerPoint presentation. http://www.law/Indiana.edu
The presentation provides information about requirements for forming a joint venture as one of the forms for attracting Foreign Direct Investment (FDI) in Indonesia. It presents investment regulations and laws that govern foreign joint venture creation.

Chaudri, Shubham. 2009. "Indonesia Economic Update: Clearing Skies and the Road Ahead. September. World Bank.
The report synthesizes the key developments in Indonesia's economy in the second quarter of 2009. It provides updates on Indonesia GDP, Consumer Sentiment Indicators, trade flows, consumer prices, unemployment rate, etc. The report is a good summary or snapshot of the Indonesia Macroeconomic Indicators, prepared by economists from the World Bank. The authors have also started a blog to share views on Indonesian economic developments, available at http://eapblog.worldbank.org/

Chemonics. 2009. Indonesia Trade Assistance Project (ITAP). 2008 Annual Report. February.
The report summarizes achievements of the ITAP project, carried out by Chemonics International, Inc. It is helpful in understanding what areas the project targeted and what challenges and results emerged. The project has closely worked with the Indonesia Trade Research and Development Agency (TREDA) to improve its research skills and ensure that policy decisions are made based on solid analysis. ITAP provided training on research methods and mentoring on subjects related to domestic production and consumption as well as international trade.

According to the report, ITAP trade economists organized 40 interactive training sessions and 165 in-depth research consultations on the above-mentioned issues. ITAP supported the institution of a Masters in International Trade Policy (MITP) at the University of Indonesia (UI). The first class provided 14 graduates who began their new roles within the Ministry of Trade (MOT). ITAP has also launched the second class of 23 MITP students at UI.

Damuri, Yose Rizal. 2006. "An Evaluation of the Need for Selected Trade Facilitation Measures in Indonesia: Implications for the WTO Negotiations on Trade Facilitation." Asia-Pacific Research and Training Network on Trade Working Paper Series No. 10 (April). Center for Strategic and International Studies, Jakarta.
As a member of WTO, Indonesia has been involved in the discussion of the WTO negotiating group on trade facilitation (NGTF). This study examines the situation of trade facilitation in Indonesia and assesses the needs for various measures related to the trade facilitation negotiations as of 2006.

Embassy of the Republic of Indonesia, Kuala Lumpur. 2010. "Investment Policies Statement."
http://kbrikualalumpur.org/web/index.php?option=com_content&view=article&id=109&itemid=117
This policy statement emphasizes the importance of attracting Foreign Direct Investment (FDI) into Indonesia. The document provides a concise summary of current laws and regulations for company formation, taxation, labor practices, and arbitration. The information is limited to the Government of Indonesia priorities and commitments and no links or sources are listed for potential investors.

Hookway, James. 2011. "India, Indonesia Deals Signal Trend: Emerging Nations' Investing in Each Other Gives Global Economy a New Direction: South to South." *Wall Street Journal,* January 26.
This article reports on President Yudhoyono's recent visit to India, where he signed several agreements for Indian investment in Indonesia. The reporter sees these deals as indicators of a trend toward increased investment by emerging countries in other emerging countries.

Horn, Michael S. 1997. "Direct Investment in Indonesia: A Sectoral Review." The
http://library.findlaw.com/1997/Oct/1/126276.html
The review highlights two sectors -- telecommunications and retail trade -- that appeared to be of particular interest to foreign parties considering investment in Indonesia in the late 1990s.

Narjoko, Dionisius A. 2008. "2008 Export Competitiveness Report. Footwear, Furniture, Home Accessories, Automotive Components and Garment Industry Value Chains. DAI. September.

This report presents quantitative analyses of Indonesia's share and ongoing capture of global markets for each of the industry value chain (IVC) sectors, as well as the key products that comprise Indonesia's export efforts within these sectors.

It also examines the global share of Indonesia and its major competitors, such as China, India, and major Association of Southeast Asian Nations (ASEAN) economies, in each of these IVC sectors. The report is based on data from the Global Trade Atlas.

Organization for Economic Cooperation and Development. 2010. "OECD Investment Policy Reviews: Indonesia 2010.
This review presents institutional and legislative framework for investment in Indonesia as of 2010. It examines the investment climate in Indonesia by using the Policy Framework for Investment (PFI) developed at the OECD by participants from 60 countries. The PFI provides a checklist of important policy issues for consideration by any government interested in creating an environment that is attractive to investors and in enhancing the development benefits of investment to society, especially the poor. It consists of a series of questions in ten policy chapters: investment; investment promotion and facilitation; trade; competition; tax; corporate governance; responsible business conduct; human resource development; infrastructure and financial sector development; and public governance.

The review was conducted in collaboration with the Government of Indonesia and provides an assessment of progress in Indonesia and the reform challenges that remain. It also states policy options to address these challenges.

Pangestu, Mari. "Indonesia: Trade and Foreign Investment Linkages." International Development Research Centre. 1997. http://www.idrc.ca/en/ev-68161-201-1-DO_TOPIC.html
This study analyzes how firms that are engaged in international production may be integrating the region through trade. The analysis is based on a firm-level survey of foreign and domestic firms in three industrial sectors -- textiles and garments, electronics, and automobiles -- which were selected based on their importance in regional trade.

First, it describes the patterns of trade and investment in Indonesia and analyzes intraregional-trade developments at the aggregate level. Second, it reports and analyzes the survey results for foreign and dominant local firms' sales and procurement behavior in the three industries. The final section analyzes policy implications.

Soesastro, Hadi and M/ Chatib Basri. 2005. "The Political Economy of Trade Policy in Indonesia, CSIS Working Paper Series WPE 092. March. Available at http://saber.eaber.org/intranet/documents/22/1110/CSIS_Soesastro_2005_4.pdf.
This paper focuses on Indonesia's trade policies after the economic crisis of 1997. It examines the trend towards protectionism and addresses the issue of competitiveness. The concluding part briefly discusses Indonesia's policies on and involvement in free trade agreements (FTAs), which have proliferated in the Asia Pacific region. It provides a background on trade deregulation, which was triggered by the IMF-prompted trade reform program in 1998 that lowered tariffs and removed most of the non-tariff barriers.

World Bank 2006-2010. "Doing Business in Indonesia."
These annual reports show Indonesia's world ranking with respect to the general ease of doing business as well as rankings, numbers of procedures, and costs of specific aspects of doing

business, such as opening and closing a business, enforcing contracts, employing workers, dealing with construction permits, etc.

World Bank. 2010. "Indonesia Trade Brief." World Trade Indicators 2009/10: Country Trade Briefs. Washington, DC: World Bank. Available at http://www.worldbank.org/wti
The brief provides information on recent developments in Indonesia's trade policy, external environment, behind the border constraints, and trade outcomes. It emphasizes positive developments in reducing tariffs since the 1998 reforms. It also mentions negative developments such as increasing restrictions on number of commodities during late 2008 as world economic growth slowed and protectionist tendencies rose. The brief is based on data drawn from the World Trade Indicators 2009/10 Database.

World Bank. 2010. "Indonesia Economic Quarterly. Maximizing Opportunities, Managing Risks." December.
The repost synthesizes key developments in Indonesia's economy during October-December 2010. It places them in a longer-term and global context and assesses the implications of these developments and other changes in policy for the outlook for Indonesia's economic and social welfare.

Its coverage ranges from the macro economy to financial markets to indicators of human welfare and development. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Indonesia's evolving economy.

World Trade Organization. 2007. "Trade Policy Review Indonesia. Report by the Secretariat."
The WTO received Indonesia's trade policies in 2003 and again in 2007. The 2007 review, conducted just before the global economic crisis, found that Indonesia had made steady progress since 2003 but was not growing fast enough to reduce unemployment and cut poverty levels. It noted the government had started a comprehensive reform program aimed at improving the investment climate, the financial sector, and infrastructure. The report analyzes the framework and objectives of Indonesia's trade policy regime, trade policies and practices by measure and trade policies by sector.

Zavadji, Milan. 2007. "Indonesia: Sustaining the Recovery." IMF Survey Magazine. October 10. http://www.imf.org/external/pubs/ft/survey/so/2007/car1010a.htm
This article reviews the macroeconomic situation in Indonesia as of 2007. It also emphasizes that despite fairly rapid GDP growth poverty and unemployment remained high. It talks about the need for monetary and fiscal interventions to keep inflation under control and to further boost growth to improve social conditions.

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