

WITH THE START OF THE REFORMASI ERA IN 1998, INDONESIA EMBARKED ON THE PATH OF ECONOMIC CHANGE. WHILE IMPERFECT, PROGRESS HAS BEEN SUBSTANTIAL. IN THIS REPORT, WE START WITH 2014 AND TRY TO ASSESS THE CHANGES DURING PRESIDENT JOKO WIDODO'S FIRST TERM. WE ARE ENCOURAGED, BUT CRITICAL WHEN NECESSARY, AS WE REMAIN COMMITTED TO THE COUNTRY & ITS GOALS.

# INDONESIA'S JOURNEY

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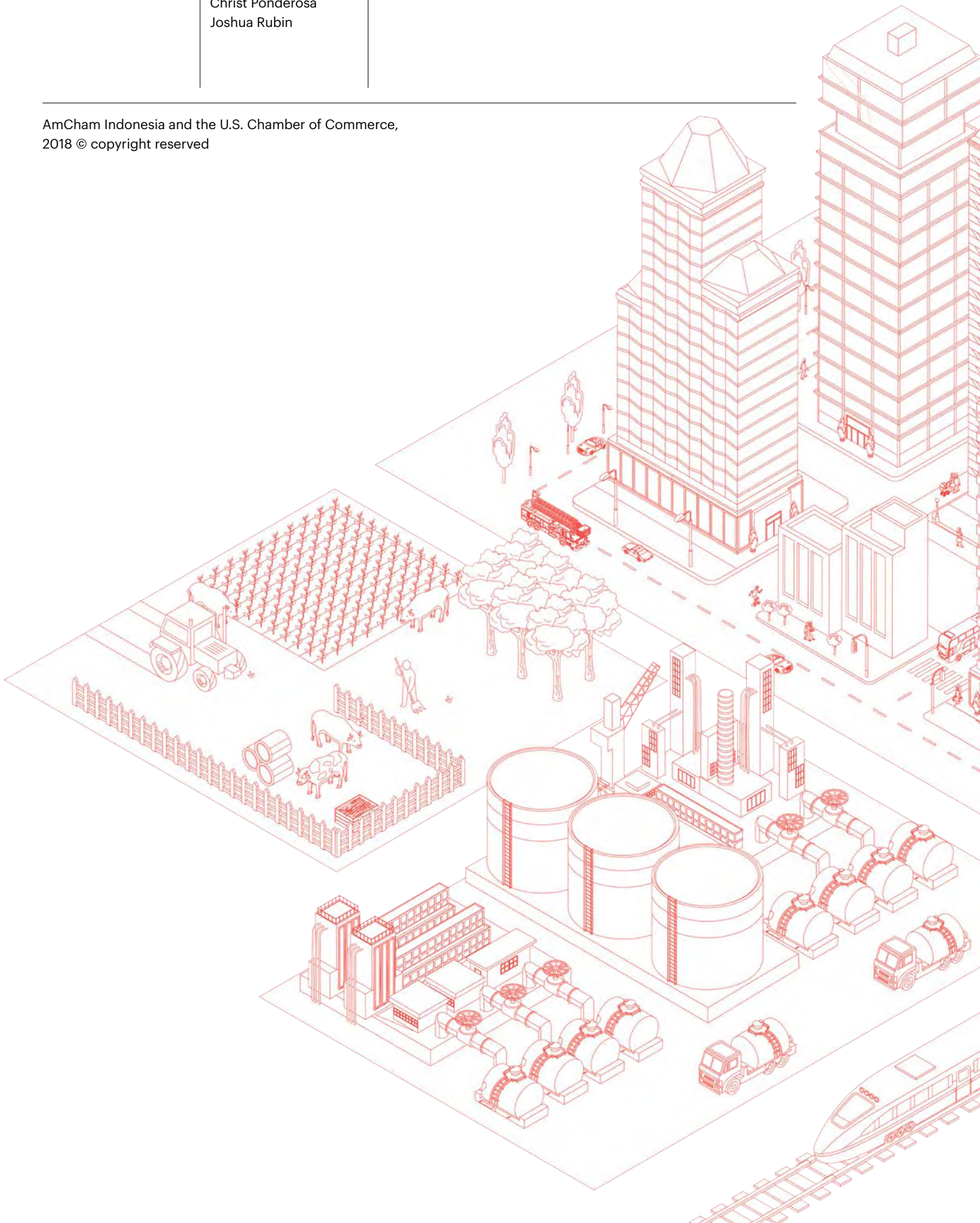
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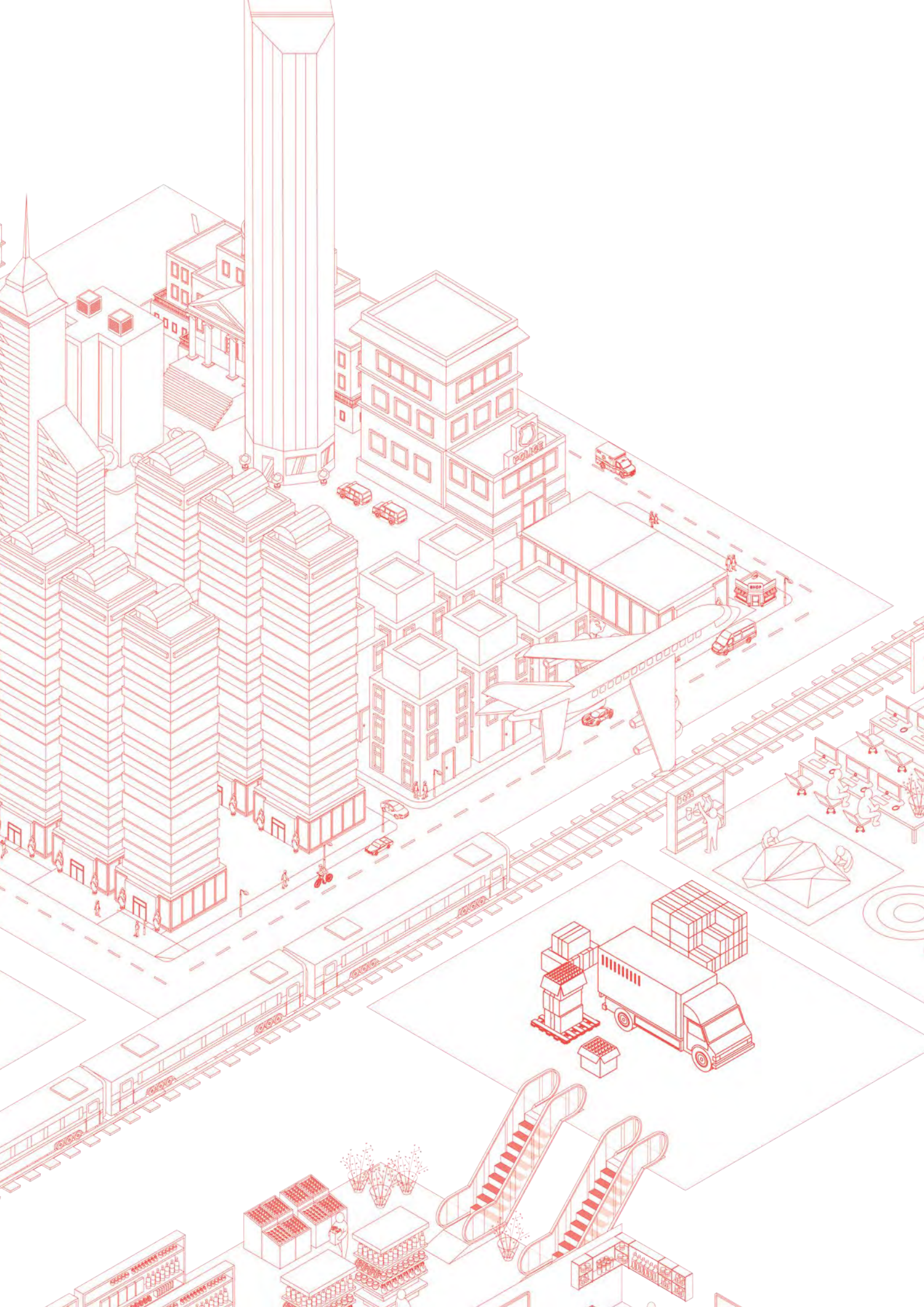
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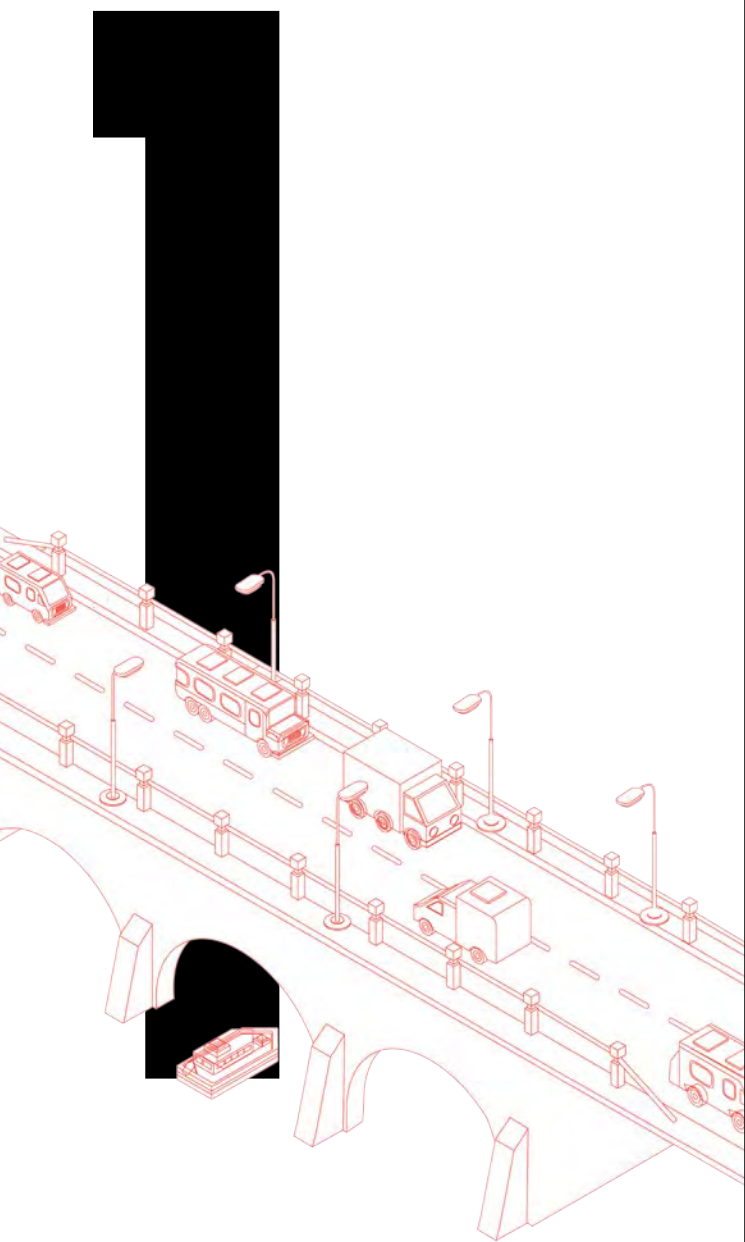
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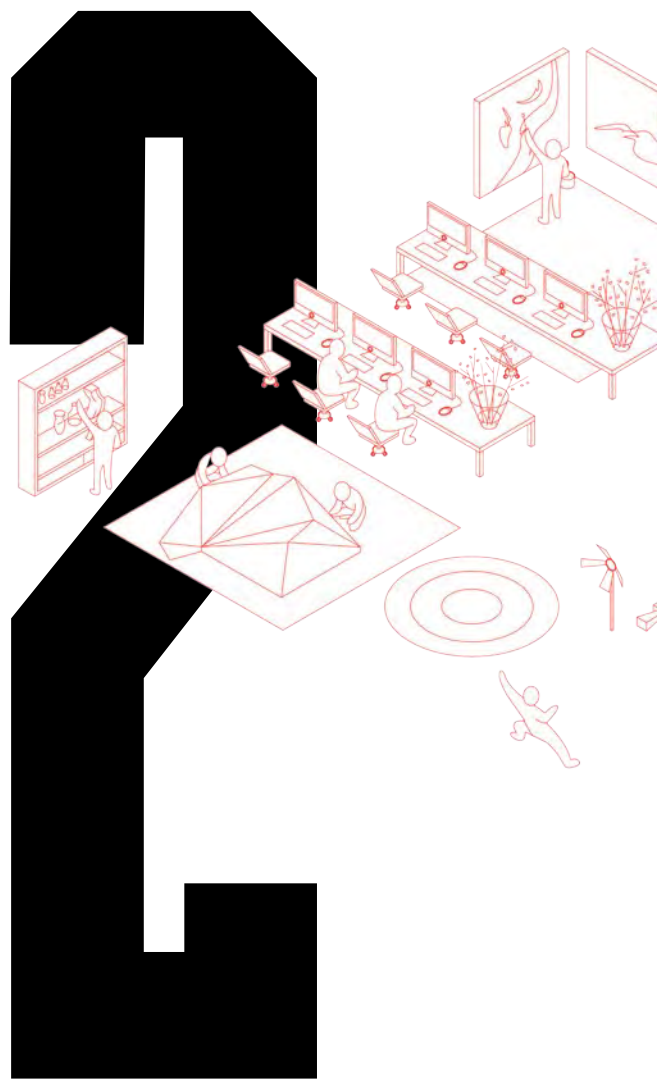






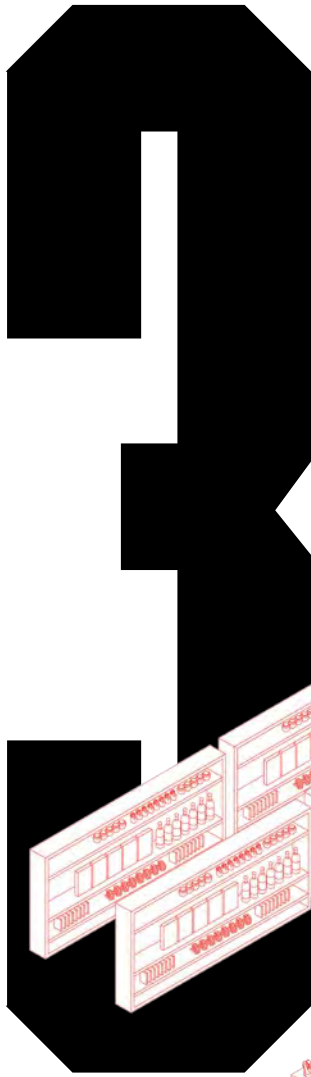
# THE JOKOWI CHAPTER

PAGE 01

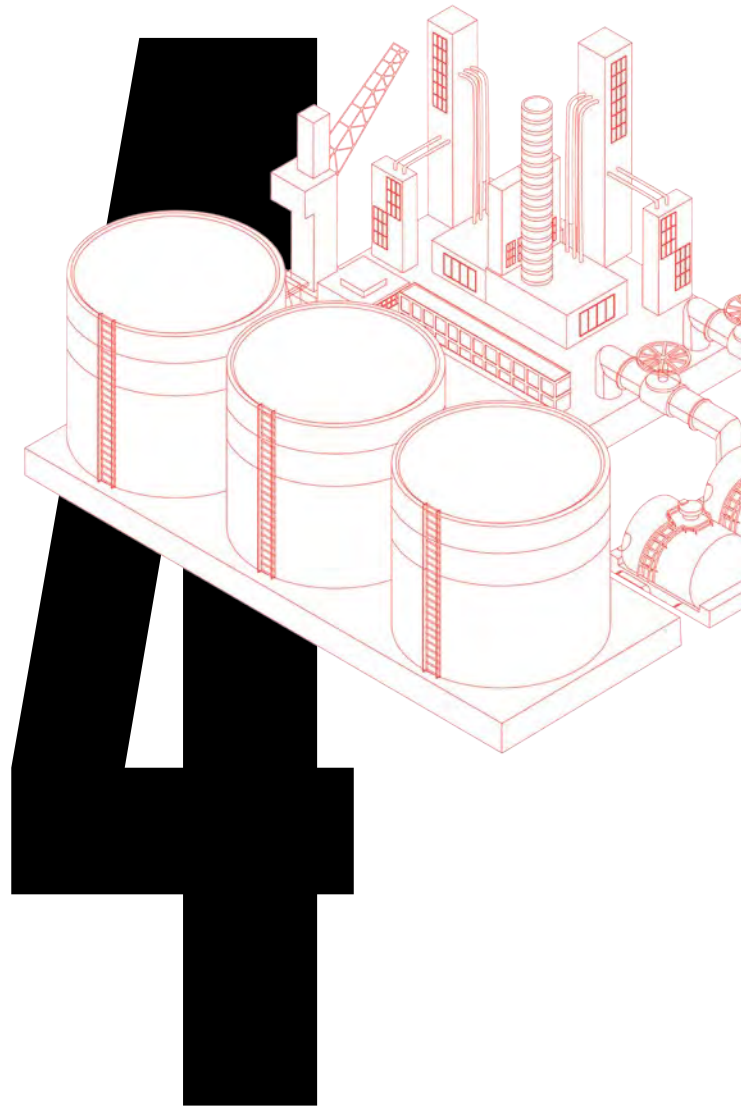


# INDONESIA & THE ASEAN-5

PAGE 11



# TRADE & INVESTMENT



# SECTORS



# EXECUTIVE SUMMARY

The journey toward reform and economic transformation for Indonesia did not begin with the current government, nor will it end when the next government's term is over in 2024. The era of greater growth, democracy and transparency began with the coming of the *reformasi* period in 1998, two decades ago. Over this period, Indonesia's GDP grew from \$115 billion to more than \$1 trillion, millions were lifted out of poverty and the country joined the G20, among many other milestones.

But much remains to be done.

For our sixth annual Investment Report, we pick up the story in 2014, with the election of President Joko Widodo and his pledge to build a more open and investor-friendly economy as a way to boost prosperity. As Indonesia heads toward another presidential election in 2019, we take a look at how much progress has been made over the past four years and how the country now fares against its neighbors in ASEAN, who are all also vying for increased investment.

Inarguably, the most recognizable legacy of Widodo's first term is infrastructure development - the largest program ever undertaken by the Indonesian government. From roads and ports to power plants and fiber optic networks, Indonesia is investing hundreds of millions of dollars into building a stronger foundation for more equitable economic growth. In addition to helping businesses through improved logistics, connectivity and electricity, this infrastructure drive is also generating

jobs, paving the way for increased access and consequently reducing poverty.

The ambitious program, however, is being slowed down by budgetary pressures, an overreliance on state-owned enterprises and limited success with Public-Private Partnership (PPP) schemes, despite considerable interest from foreign investors. Issues related to permits, licenses and land acquisition also continue to hamper the preparation of financially feasible infrastructure projects.

On the soft infrastructure side, progress in increasing access to healthcare has also been palpable. More than 200 million of the estimated 268 million population are now covered by the national healthcare insurance program that was only launched in 2014. Though the program still has sustainability issues that need to be addressed, the fact is that universal healthcare is here to stay in Indonesia.

In education, some 20 million students now benefit from a program that gives underprivileged students allowances to encourage attendance and reduce dropout rates, a commendable achievement though not as impressive as those in healthcare.

But while increased access to healthcare and education is certainly important, including to improve the country's investment climate, little attention has been given to raising the quality of these services. The lack of serious reform in education, for instance, means Indonesia risks not having workers equipped

with the right skills for a technology-driven and research-based modern economy.

To attract the investment needed to power Indonesia's economic growth, Widodo has made bureaucratic reform a priority and released 16 economic reform packages covering hundreds of regulations from more than 160 ministries and agencies. This year, the ambitious Online Single Submission (OSS) system was finally launched to significantly streamline business registration and licensing, though it has been marred with implementation issues.

On this front, progress has also been mixed. On one hand, Indonesia gained 42 spots from 2014 to 2018 to 72nd place in the World Bank's 2018 Ease of Doing Business ranking, and is now enjoying upgraded international credit ratings.

On the other hand, the reforms have yet to lead to increased regulatory certainty, a major concern among local and foreign investors alike. Conflicting policies from different ministries and frequent changes in regulations mean the regulatory risks businesses face remain high. For many, it has been the familiar pattern of two steps forward, one step back.

One notable improvement has been the government's increased effort to consult with the private sector on regulatory issues, which has led to important compromises on contentious issues such as data localization, mandatory halal certification, local content requirements and local manufacturing for patented products. Investors are hoping consultative policymaking becomes a standard procedure across all ministries and regulators, which would go a long way toward increasing regulatory certainty in the country.

On their own, some of the regulatory changes over the past four years may have been small, but together they have collectively moved Indonesia forward along a recognizable path toward reform that began in 1998.

Indonesia's progress thus far, however, is not yet enough to make it the most attractive investment destination in ASEAN, despite its inherent advantage as home to the largest population in the region. Against its closest competitors - Vietnam, the Philippines, Malaysia and Thailand - Indonesia has made bigger gains in terms of ease of doing business and corruption perception. But these gains have not yet propelled it to the top of the list.

At the same time, the country continues to score low on indicators that look at labor market efficiencies and logistics. Even though Indonesia made strong improvements in the World Bank's latest Logistics Performance Index, it still ranks behind most of its competitors in ASEAN. Vietnam, for example, made a bigger improvement. This means that while Indonesia is furiously working to improve its infrastructure and logistics services, Vietnam appears to be working harder.

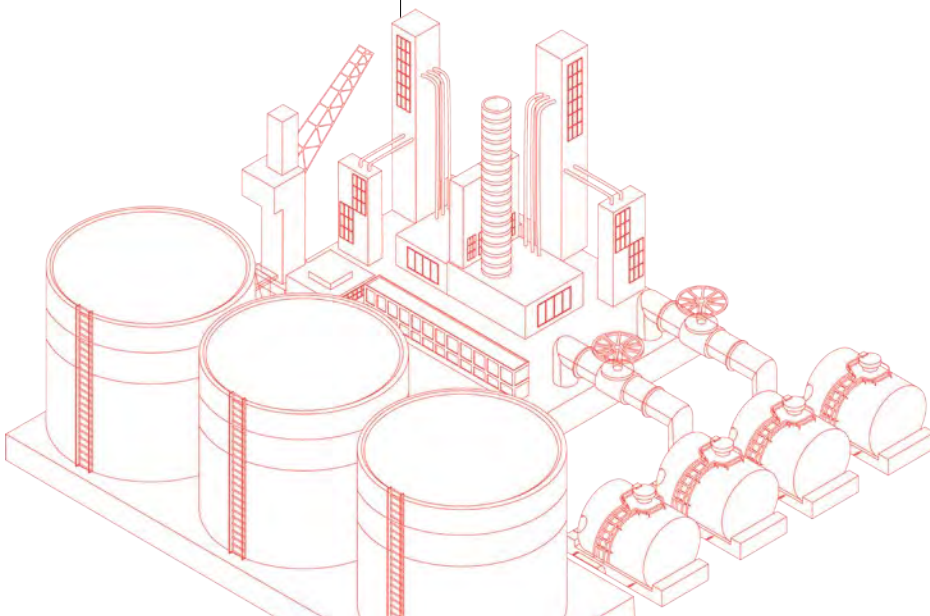
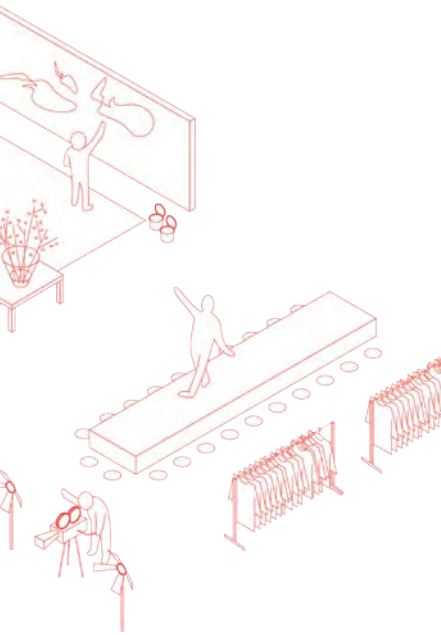
Better labor market efficiencies and logistics, when combined with more open economies, have meant that foreign investors are drawn to these neighboring countries. In the OECD's FDI Regulatory Restrictiveness Index, Indonesia was ranked the fifth most restrictive economy in 2015 among the 58 countries covered, well behind Vietnam, Thailand and Malaysia in terms of openness to foreign investment, particularly on equity limits.

Indonesia, it seems, is headed in the right direction; it's just not moving fast enough.

Amid intensifying global trade tensions, however, Indonesia appears to be falling back on more protectionist policies that could undo some of its progress. According to data from the Ministry of Trade, product lines subject to some form of import restriction rose from 9 percent in 2011 to 35 percent in 2016.

We realize that systemic changes are no longer possible before the end of Widodo's first term. However, we hope that Indonesia does not retreat from its goal of creating a more open economy, and that the progress already made on a number of key issues is followed up with proper implementation.

We look forward to continuing our partnership with the next government, which we hope would immediately prioritize much-needed legal amendments, improving coordination among government bodies and the harmonization of various regulations - all of which would lead to the increased regulatory certainty that investors need to effectively contribute to Indonesia's growth story.



# THE JOKOWI



04  
BRIDGES, ROADS,  
RAIL AND MORE

06  
MORE  
HEALTHCARE &  
MORE EDUCATION

07  
THE REGULATORY  
AND BUSINESS  
CLIMATE

09  
ECONOMIC  
POLICIES

*Indonesia's journey toward reform may have been slower than hoped but it has been steady, extending a track record of political, social and economic stability that began with reformasi in 1998*

In April 2015, some six months after he took office, President Joko Widodo, better known as Jokowi, gave a rare speech in English addressed to foreign investors: "Please come and invest in Indonesia. Because where we see challenges, I see opportunity," he said during a World Economic Forum meeting in Jakarta.<sup>1</sup>

"And if you have any problems," he added, "call me."

Three years later, the former furniture manufacturer from Solo in Central Java is still

making basically the same appeal to investors in his trademark approachable manner.

"There are still many regulations and procedures that need to be trimmed down and I want to know any regulations that still give you concerns," he told a gathering of oil and gas executives in May 2018.<sup>2</sup>

<sup>1</sup> <https://finance.yahoo.com/news/indonesias-widodo-investors-problem-call-115407788.html>

<sup>2</sup> <http://www.ipa.or.id/news/president-widodo-streamlining-of-upstream-oil-and-gas-bureaucracy-will-continue>





# CHAPTER

This illustrates what Widodo has mostly been for the business community so far: not an instigator of radical change, but a hands-on, approachable leader who has diligently strived to deliver on what he promised during a remarkable 2014 campaign that combined elements of grass roots appeal with rock-star excitement. Despite political constraints, a stubborn bureaucracy and global headwinds that have made his job more difficult than anticipated, he insists that the country is more open all the time to foreign investment.

On their own, some of the changes of the past four years may have been small - from removing some redundant regulations

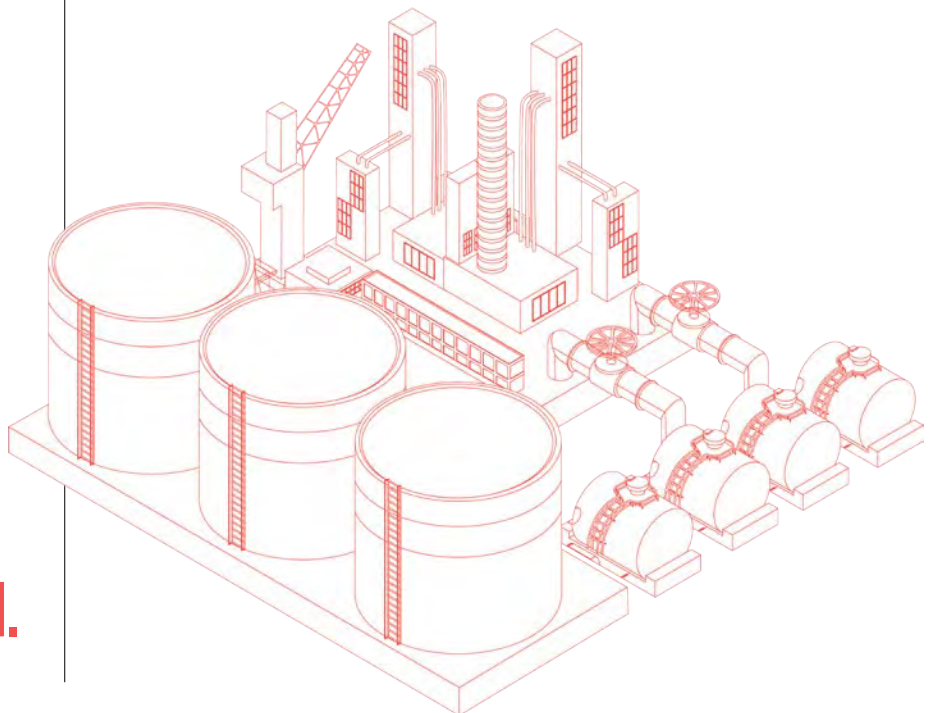
and toning down improbable laws, to a gradual opening to foreign investors despite nationalist counter pressures. But together they have collectively moved Indonesia forward along a recognizable path toward reform that began after the fall of former President Soeharto in 1998.

Though it is clear there is still a long checklist of things to fix in Indonesia, as Chevron Indonesia Managing Director Chuck Taylor puts it, the Widodo administration isn't the problem; rather it has mostly been the solution.



PHOTO BY NUGROHO ADIWEDA

**THOUGH IT IS CLEAR THERE IS STILL A LONG CHECKLIST OF THINGS TO FIX IN INDONESIA, AS CHEVRON INDONESIA MANAGING DIRECTOR CHUCK TAYLOR PUTS IT, THE WIDODO ADMINISTRATION ISN'T THE PROBLEM; RATHER IT HAS MOSTLY BEEN THE SOLUTION.**



# \$ 400 BILLION

WIDODO  
ADMINISTRATION  
INFRASTRUCTURE  
PROGRAM

The broad public and the elite – cab drivers, factory workers, business executives, academic experts and government officials – share the consensus that the landmark feature of the Widodo administration is its massive \$400 billion infrastructure program – the largest ever undertaken by the Indonesian government.

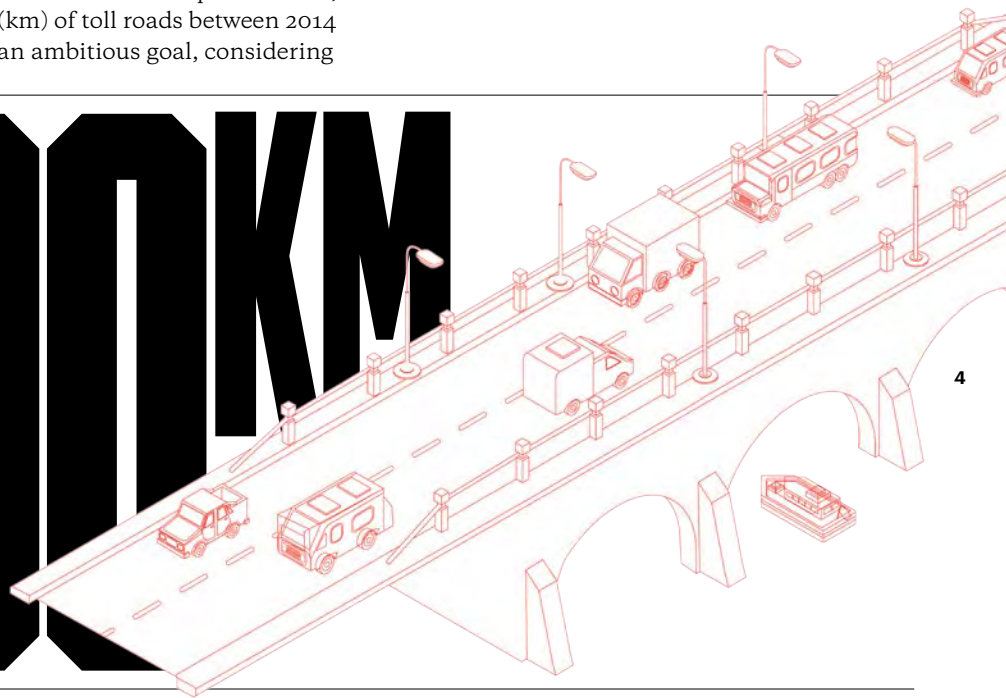
“The toll roads built over the past three years were more than double than in the previous 10 years,” Indonesia Deposit Insurance Corporation (LPS) Chief Executive Officer Fauzi Ichsan said.

The government aims to complete some 1,800 kilometers (km) of toll roads between 2014 and 2019 – an ambitious goal, considering

only 780 km were built in the decade before Widodo became president.

Among the hundreds of projects, the standouts include the Jakarta Mass Rapid Transit (MRT) system that had been under discussion since 1980, and the 1,167 km Trans-Java toll road from Merak in Banten province to Banyuwangi in East Java province, both of which are expected to be operational or completed by next year. There are also new sea ports and modernized airports connecting the vast archipelago, and new rural roads linking farms across the country to markets.

# 1800 KM



**THE GOVERNMENT  
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THE DECADE  
BEFORE JOKO  
WIDODO BECAME  
PRESIDENT.**

Beyond transportation, the government has also focused on building the infrastructure needed to power the country’s homes and buildings, and connect the entire country to high-speed internet. The Palapa Ring project is making good progress, with the last of the three broadband network packages – covering eastern Indonesia – likely to be completed by 2019. On energy, only a small percentage of new power plants under the 35,000 megawatt (MW) program have come online as of the first quarter of 2018, but most of the rest are either already contracted or under construction. By 2019, according to the Ministry of Energy and Mineral Resources, some 20,000 MW of new generating capacity should be operational.<sup>3</sup>

All this infrastructure improvement should not only help businesses in the long run through improved logistics, transportation

and electricity, according to Ichsan. “It also generates jobs amid a softer private economy, and helps reduce poverty.”

Some have argued that the furious pace of development has led to compromises on safety issues, resulting in a number of deadly accidents. Others have said the infrastructure program could be completed faster, had the government pushed for more public-private partnerships (PPP) and not relied as much on state-owned enterprises (SOEs).

Sofjan Wanandi, a business tycoon and expert advisor to the vice president, argues that the reliance on SOEs is largely because many of the infrastructure projects are not financially feasible. Critics claim otherwise, saying the least commercially viable projects are the ones being offered to the private sector.

<sup>3</sup> <http://www.en.netralnews.com/news/business/read/17888/indonesian.government...s.35.000.mw.electricity.program.is.at.48.percent>

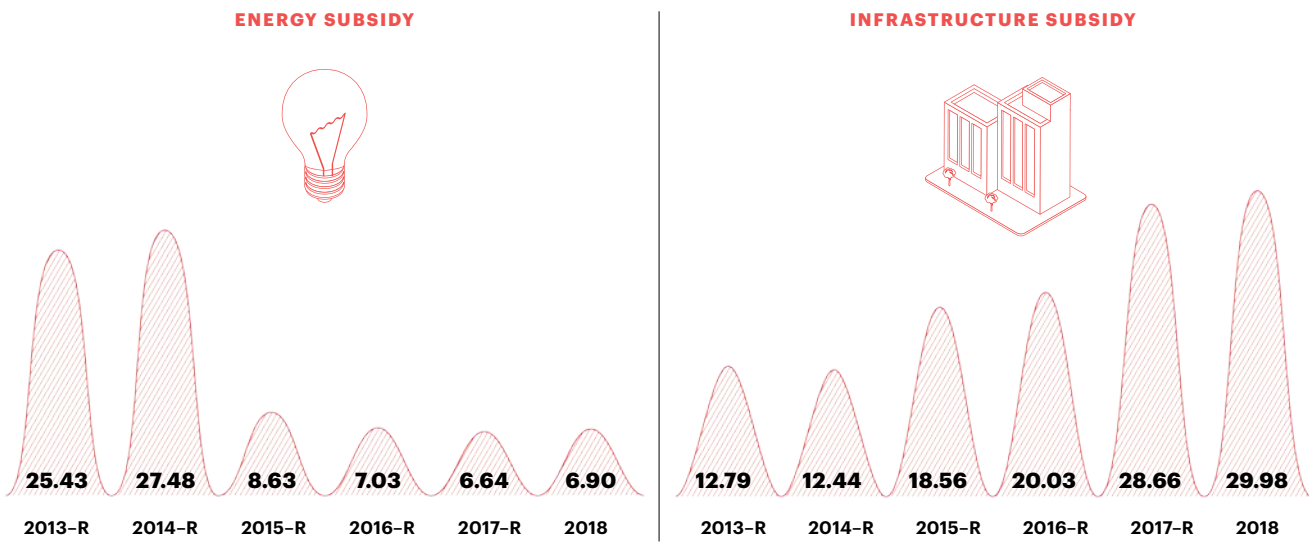
It's more complicated than that, according to Prasetyo Singgih, the former chief operating officer of the PINA Center for Private Investment at the Ministry of National Development Planning (BAPPENAS). Singgih, now a managing partner of the law firm Singgih, Bustaman & Partners, points to issues related to permits, licenses and

execution of land acquisition as among those hampering investment in infrastructure.

But what everyone agrees on is that Indonesia needs to increase the private sector's participation in the government's infrastructure program in order to achieve its targets.

**FIGURE 1.1**  
Indonesia's state budget allocation for energy subsidy and infrastructure, in billion of USD

Source: Committee for Acceleration of Priority Infrastructure Delivery (KPPIP) and Indonesia Presentation Book, January 2018



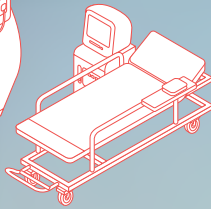
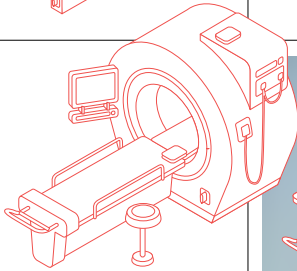
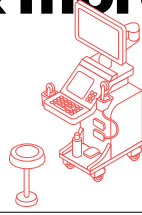
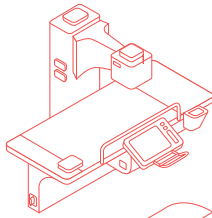
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**WHAT EVERYONE AGREES ON IS THAT INDONESIA NEEDS TO INCREASE THE PRIVATE SECTOR'S PARTICIPATION IN THE GOVERNMENT'S INFRASTRUCTURE PROGRAM IN ORDER TO ACHIEVE TARGETS**



## 1.2

# More healthcare & more education



**>200  
MILLION**

OF THE ESTIMATED  
268 MILLION TOTAL  
POPULATION COVERED  
BY THE NATIONAL  
HEALTHCARE INSURANCE  
PROGRAM SINCE IT WAS  
LAUNCHED IN 2014

On the soft infrastructure side, analysts say lesser appreciated achievements of the current government from a business standpoint are improvements in access to healthcare and education.

“Survey results in the past year and a half among voters across the country are consistent on what has made the biggest improvement in their lives - the national healthcare system, improved education access and infrastructure,” Douglas Ramage, Managing Director of BowerGroupAsia Indonesia, said.

He was referring to the National Health Insurance (JKN) program administered by Indonesia’s Healthcare and Social Security Agency (BPJS Kesehatan).

“All these things are absolutely critical to an improved investment climate: A better educated Indonesia with better access to healthcare, and reduced logistics costs because of improved infrastructure,” Ramage added.

As of Aug. 1, 2018, more than 200 million of the estimated 268 million total population were already covered by the healthcare program that only started in 2014. This includes more than 92 million government subsidy recipients through the *Kartu Indonesia Sehat* (KIS) or Healthy Indonesian Card.

“The political will to drive JKN - now the largest, single payer mechanism in the world - is truly commendable,” Pfizer Indonesia Country Manager and President Director Anil Argilla said.

“Whilst there are still some challenges in the structure and sustainability of JKN, I am confident that post 2019 there will be new solutions to this, including top up insurance or cost sharing opportunities. Universal Healthcare is here to stay.”

Funding JKN has also meant that the government’s healthcare spending went from about 2.5 percent of the state budget in 2014 to almost 5 percent today, meeting the statutory amount set by law for the first time ever.

“The doubling of healthcare spending in four years is extraordinary,” Ramage said.

In education, some 20 million students benefit from the *Kartu Indonesia Pintar* (KIP) or Smart Indonesia Card, a variation of a program first launched in 2008. Depending on their household income, the students receive between Rp 450,000 and Rp 1 million per year to encourage attendance and reduce dropout rates.

But a survey by Indonesia Corruption Watch released in 2018 found the program was

marred by problems related to coverage and fund misuse.<sup>4</sup> Inaccurate data – a longstanding government problem that affects other sectors like agriculture – meant that some 40 percent of registered beneficiaries do not actually have their smart cards. Among those who do have their cards, funds were not always efficiently used or spent for educational purposes.

“The government’s achievements are more positive on health than education,” according to Mari Elka Pangestu, a former minister for trade and for tourism and creative economy, and a senior fellow at the Centre for Strategic and International Studies (CSIS).

She added that while the government’s focus on these sectors was right, the bigger question was whether it had the right policy. The government’s programs have mostly focused on increasing access to healthcare and education, while it seems quality has been left behind.

“We can’t improve quality if we don’t open education and healthcare to foreign investment,” Ramage said, noting longstanding restrictions in both sectors.

The lack of investment in quality education also ultimately affects the quality of healthcare, with Indonesia’s research and development (R&D) capability left wanting.

“We would like to see the government further invest in R&D capability and look to reduce regulatory barriers to improve access to healthcare,” Ramage added.

There is talk that the next revision of the country’s Negative Investment List (DNI) would see relaxed foreign ownership rules in 13 sectors, including education and health. Until that happens, experts warn that Indonesia will continue to be left behind by its ASEAN neighbors.

<sup>4</sup> [https://antikorupsi.org/sites/default/files/hasil\\_survey\\_kartu\\_indonesia\\_pintar.pdf](https://antikorupsi.org/sites/default/files/hasil_survey_kartu_indonesia_pintar.pdf)

## 1.3

# The regulatory & business climate

As Indonesia is learning, however, simply opening the economy to foreign ownership won’t automatically produce the investment dollars the country needs to not only fuel growth and create jobs, but to also raise standards and increase expertise.

Continuous bureaucratic reform has been a top priority of every government since 1998, but with only incremental gains. Widodo’s approach to the problem has been to try to ignite a “mental revolution” to fix what he sees as the root of the problem: a mind-set stuck in the old era, when the country was ruled with an iron fist and by a privileged elite.

“Some traditions or cultures that flourished during the repressive era of the New Order still remain, such as corruption, intolerance of differences, greed, selfishness, the tendency to use force to settle matters, law violations and opportunism,” Widodo wrote in an opinion piece in 2014, when he was still on the campaign trail.

When he became president, he translated this mental revolution into 16 economic reform packages covering more than 200 regulations from 167 ministries and agencies and at least 50 presidential regulations to further deregulate and sort out overlapping regulations, culminating in the launch of the ambitious Online Single Submission (OSS) system in June 2018. Though the integrated licensing system’s initial rollout has been

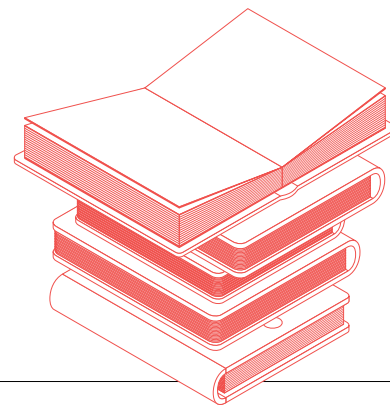
problematic, as is typical with these types of programs, the government has generally been commended for the leap toward a more transparent and efficient bureaucracy.

“Everyone welcomes the OSS – it can definitely simplify the licensing process,” said Lydia Ruddy, the director of communications for the Economic Research Institute for ASEAN and East Asia. “There have been some initial challenges with implementation, but hopefully these technical issues can be addressed soon.”

Among others, the policy would also help to encourage the harmonization of any conflicting provincial or local regulations with national regulations. The inconsistencies have created difficulties for companies that operate across different provinces, as to adjust their business practices to comply with varying local regulations comes at high business and efficiency costs. The harmonization of these regulations would facilitate new business development and lead to more investment in the regions.

Even though there is still room for improvement, all this has led to improved perceptions about the ease of doing business in Indonesia, evidenced by the country’s 42-spot improvement to 72nd place in the World Bank’s 2018 Ease of Doing Business ranking, and increases in its international credit ratings.

**“PROGRESS HAS BEEN MADE,” FORMER FOREIGN AFFAIRS MINISTER MARTY NATALEGAWA SAID. “UNFORTUNATELY, THE FULL POTENTIAL OF THESE EFFORTS IS NOT FULFILLED BECAUSE OF SIGNS OF CONFLICTING SIGNALS, STATEMENTS BY DIFFERENT MINISTRIES, OR CONSTANTLY CHANGING REGULATIONS.”**



Foreign companies have also noted how a number of ministries and regulators have become more approachable and consultative, leading to key compromises on contentious issues such as the 2016 Patent Law and the 2014 Halal Law, as well as the gross-split mechanism for conventional oil and gas contracts.

“Progress has been made,” former Foreign Affairs Minister Marty Natalegawa said. “Unfortunately, the full potential of these efforts is not fulfilled because of signs of conflicting signals, statements by different ministries, or constantly changing regulations.”

For instance, despite grand invitations to foreign investors, policies restricting what foreign companies can do in Indonesia are still being issued. Despite repeated orders to consult and to coordinate with stakeholders in the private sector, ministries often still go their own way, issuing poorly prepared regulations that would later have to be amended, or failing to communicate and cooperate with each other. Despite efforts to deregulate, government agencies are still having a hard time fighting off the ingrained tendency to overregulate.

As a Jakarta Post editorial explains, the very word Indonesians have for government – *pemerintah* – stems from the word *perintah*, which means to order.<sup>5</sup> Therefore, the Indonesian concept of government is one that orders.

“[Widodo] is trying to change the way the government works, he is trying to reform the bureaucracy,” Sofjan said. “But it’s not easy, it takes time.”

For many businesses, it has been the usual Indonesian pattern of two steps forward, one step back. Even with the government’s signature OSS program that was created to make setting up a business easier, the minimum investment was raised to Rp 10 billion in fully paid-up capital, up from the Rp 2.5 billion previously required by Indonesia’s Investment Coordinating Board (BKPM).

“This speaks to a need for an overall rationalization of the process,” Ruddy said.

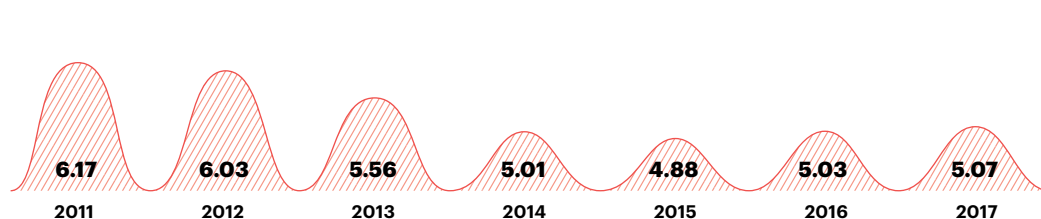
But at least Indonesia is moving forward.

As Sofjan points out: Indonesia is headed in the right direction; it’s just not moving fast enough.

<sup>5</sup> <http://www.thejakartapost.com/academia/2017/10/20/editorial-a-work-in-progress.html>

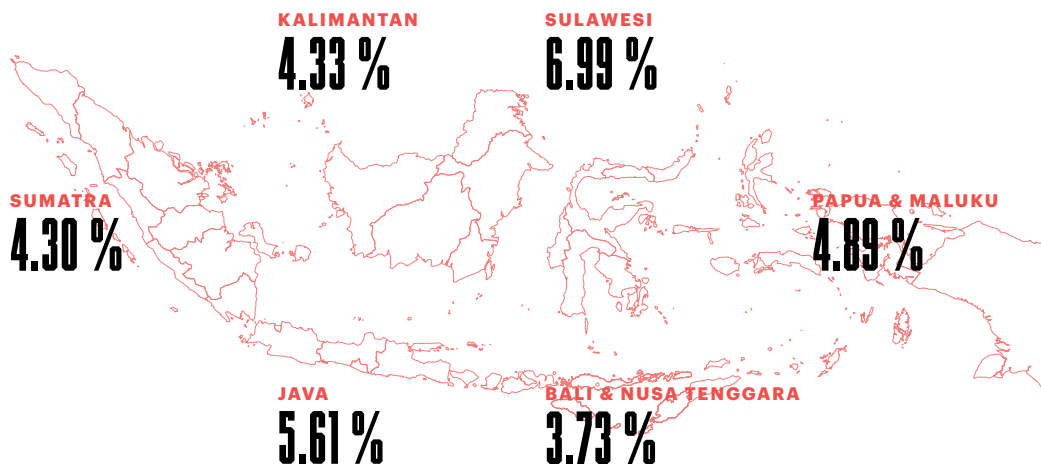
**FIGURE 1.2**  
Indonesia's Economic Growth 2011–2017, percent

Source: International Monetary Fund, Bank Indonesia and BPS-Statistics Indonesia



**FIGURE 1.3**  
Indonesia's Regional GDP Growth in 2017, percent

Source: International Monetary Fund, Bank Indonesia and BPS-Statistics Indonesia



According to Mari Pangestu, it seems Widodo himself is frustrated with slow pace of reforms and achievement of stated goals.

Indonesia has failed to meet the president's 7 percent economic growth target, hovering at just around 5 percent over the past four years, albeit largely due to global economic issues.

"As an open economy with substantial reliance on commodity exports, Indonesia is certainly affected by the global economy," LPS's Ichsan said. "The government is trying to reduce the impact of external factors to the domestic economy by restructuring the nation's production pattern toward manufacturing and services."

At the same time, the country's economic managers have defended their policies by saying the government is focused on sustainable and equitable growth. "You can have 7 percent growth but if it's driven by the commodity sector, benefitting corporates in Kalimantan, it really doesn't have that much impact on poverty reduction," Ichsan said.

The former banker said the government has also been forced to shift its focus to maintaining stability amid a rout in the currency. "We must accept slower economic growth as a trade-off for stability," he added.

But the reality is that as the rupiah is depreciating, the prices of basic goods are rising, and consumers are struggling to remain confident.

Critics have also pointed to the government's expensive infrastructure program as one of the reasons behind the weak economy. When energy subsidies were removed to help finance the infrastructure spending, analysts say consumer spending was immediately hit while the new roads and bridges would take time before they generate economic returns.

Furthermore, Indonesia needs to do more to create a conducive regulatory environment that would nurture the growth of innovative

technology and products at various points along the value chain, including R&D and manufacturing. This would increase the value-add of Indonesian workers to finished goods and attract more foreign investment.

In the end, what is probably needed is time for the government's programs - infrastructure development and bureaucratic reform, shifting from a commodity-reliant economy to a manufacturing-powered one, investing in healthcare and education - to show results.

"Given the government's goals, one must have a long-term perspective," Marty said. "It's a process, not an event."

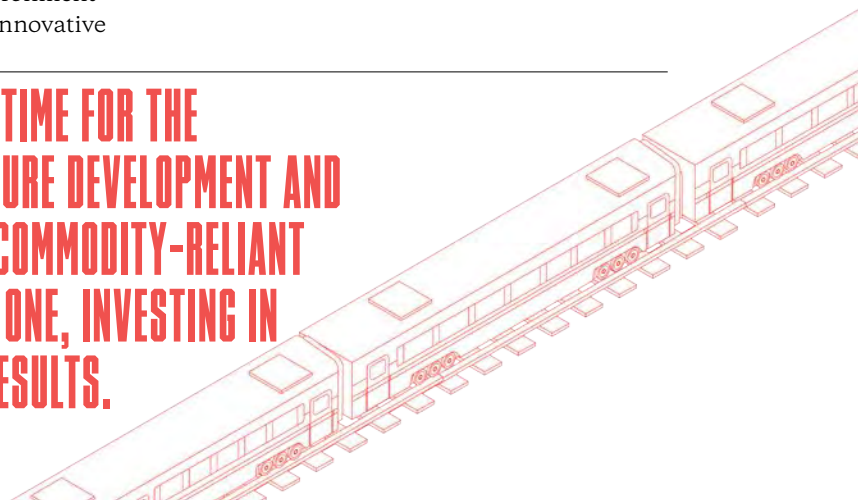
The caveat is that Indonesia must keep pressing forward on the path to reform, and resist the temptation to react to global economic uncertainty by closing off from the world and increasing its protectionist policies.

Under Widodo, though, the trend toward nationalism has strengthened despite his campaign rhetoric, according to "Indonesia in the New World," a book edited by Mari Pangestu and economists M. Chatib Basri and Arianto Patunru. Citing Ministry of Trade data, it says product lines subject to some form of import restriction rose from 9 percent in 2011 to 35 percent in 2016. This is despite the wealth of economic data pointing to the negative consequences of protectionist policies.

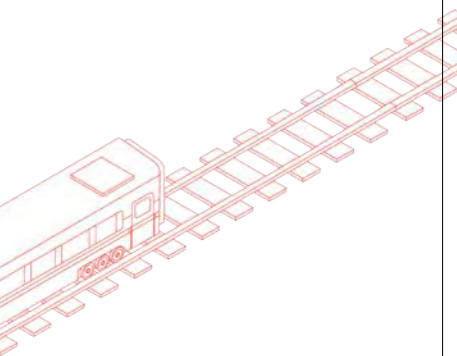
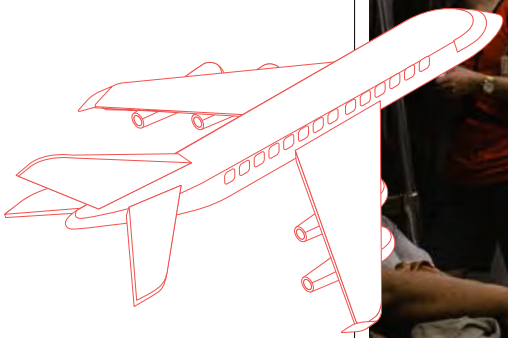
Ironically, Widodo's supporters and the country's increasingly educated youth have a more positive attitude toward globalization, according to a CSIS survey in 2017.

"There is a perception of rising protectionist policy, but a review on perceptions of globalization shows Indonesians are in favor of free trade," Marty said. "There's a gap between policymaking and what the general public appear to want."

**IN THE END, WHAT IS PROBABLY NEEDED IS TIME FOR THE GOVERNMENT'S PROGRAMS – INFRASTRUCTURE DEVELOPMENT AND BUREAUCRATIC REFORM, SHIFTING FROM A COMMODITY-RELIANT ECONOMY TO A MANUFACTURING-POWERED ONE, INVESTING IN HEALTHCARE AND EDUCATION – TO SHOW RESULTS.**







02

# INDONESIA &



11

13  
DOING BUSINESS

18  
INFRASTRUCTURE

20  
REGULATORY  
ENVIRONMENT

21  
ECONOMIC  
MANAGEMENT

# ASEAN-5



# THE

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## *Indonesia's market potential and ongoing reform make it an attractive destination for foreign investments. But this is also true of its neighbors. How does Indonesia compare?*

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By 2025, the so-called ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand and Vietnam) could attract some \$113 billion in foreign direct investment (FDI) - almost double the 2017 level, according to a report by Japanese investment bank Nomura.<sup>6</sup> These five "striving tiger cubs" along with India, the report argues, are well placed to attract FDI turned off by rising labor costs in China and an ageing population in Northeast Asia.

But among the five, which one will be most attractive to foreign investors?

Indonesia already has an inherent competitive advantage by simply having the

largest population in the group - more than double that of the Philippines or Vietnam. In the Global Competitiveness Report for 2017-2018 by the World Economic Forum (WEF), Indonesia's market size is ranked ninth among 137 economies.

*But that's obviously not enough.*

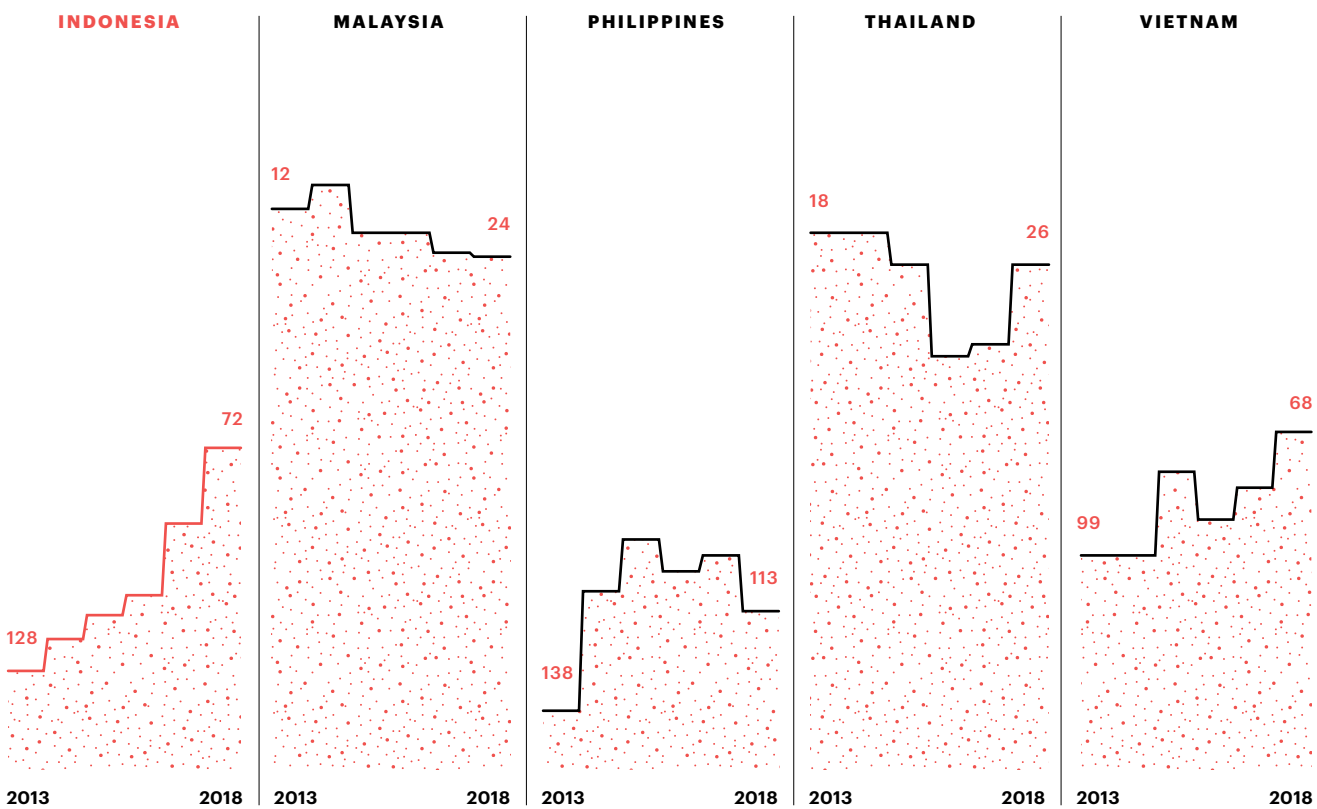
In this section, we look at how Indonesia fares against its neighbors and competitors in terms of other "pull factors" identified by foreign investors. These include government policies and programs, the ease and cost of doing business, infrastructure, regulatory environment and economic management.

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<sup>6</sup> <https://www.nomuraconnects.com/focused-thinking-posts/india-and-asean-asias-next-fdi-magnets/>

**FIGURE 2.1**  
Ease of doing business  
global ranking

Source: World Bank  
'Doing Business'  
reports



**72<sup>ND</sup>**

REFORMS UNDER THE  
CURRENT GOVERNMENT  
PROPELLED A LEAP  
OVER 42 SLOTS TO 72<sup>ND</sup>  
PLACE BETWEEN 2014  
AND 2018

**Ease of doing business**

The key indicator that the Indonesian government perhaps pays closest attention to, the World Bank’s Ease of Doing Business (EoDB) index, ranks countries based on how conducive their regulatory environment is to business operations.

When Joko Widodo came into office, Indonesia was languishing in 114th place – last among the ASEAN-5. The former laggard, the Philippines, overtook it by jumping an impressive 43 slots to 95th place in just two years, following reforms by then-President Benigno Aquino III.

But Widodo made improving the ease of doing business in Indonesia a government priority. By the time the 2018 EoDB report was released in November 2017 – after the release of 15 economic policy packages that revised or revoked around 300 regulations – Indonesia owned the “most improved” title among the ASEAN-5. Reforms under the current government propelled a leap over

42 slots to 72nd place, showing not only the largest but the most consistent overall improvement among the five countries.

In fact, the 2017 EoDB report listed Indonesia among the 10 economies improving the most across three or more areas. Starting a business, getting electricity, registering property, getting credit, paying taxes, trading across borders, and enforcing contracts all became easier under Widodo. No other ASEAN-5 country was on the list.

Indonesia’s neighbors, meanwhile, struggled to maintain their improvements. The Philippines, for instance, lost much of its gains under the new government of Rodrigo Duterte and retreated to 113th place in the latest report. Malaysia and Thailand, which have had their shares of struggles with corruption scandals and political instability, declined 11 spots and eight spots, respectively. While Vietnam moved up 31 slots from 2014 to 2018, to 68th place, its gains have been inconsistent.

Widodo, though, wasn't satisfied. Indonesia still ranked far behind Malaysia and Thailand, and even two spots behind Vietnam.

"The target is at least the 50th next year and the 40th in the following year," he said in response to the release of the 2018 EoDB report.<sup>7</sup>

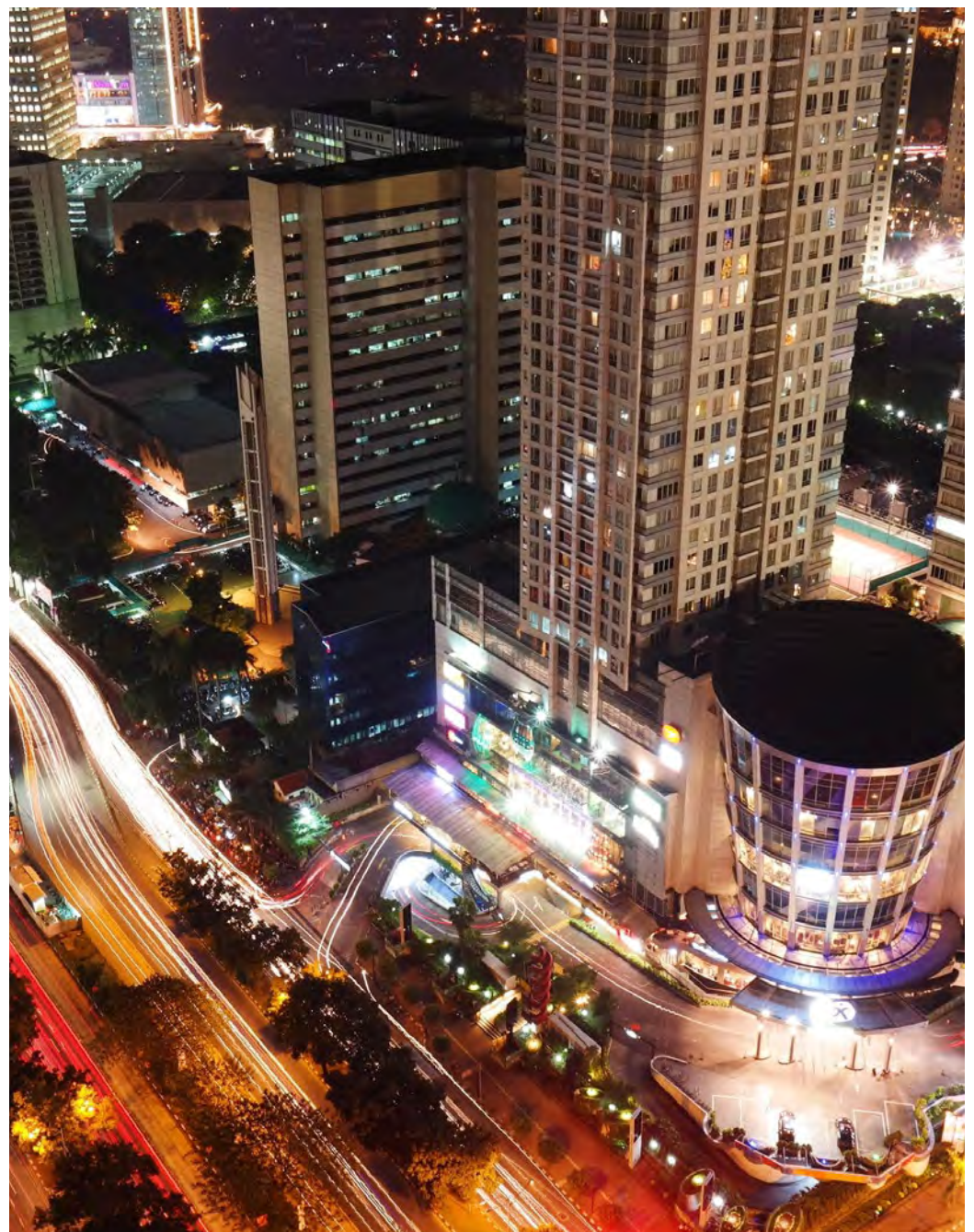
A week later, Coordinating Minister for Economic Affairs Darmin Nasution announced the government was setting up task forces "for the acceleration of the ease of doing business" in Indonesia.<sup>8</sup>

<sup>7</sup> <https://en.antaranews.com/news/113303/jokowi-wants-much-better-rating-in-ease-of-doing-business>

<sup>8</sup> <https://en.antaranews.com/news/113406/task-forces-to-be-to-accelerate-ease-of-doing-business>

**"THE TARGET IS AT LEAST THE 50<sup>TH</sup> NEXT YEAR AND THE 40<sup>TH</sup> IN THE FOLLOWING YEAR,"**

—Joko Widodo in response to the release of the 2018 EoDB report, where Indonesia was ranked 72nd



## Corruption Correlation

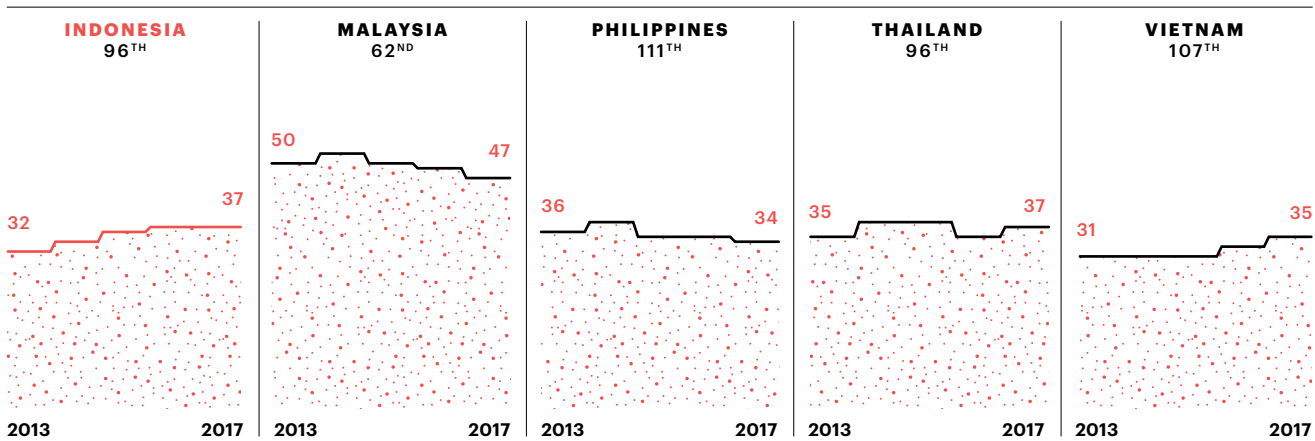
This improvement in the ease of doing business rankings has apparently come alongside gains on the corruption perception front as well.

According to the World Bank, improvements in doing business indicators are positively correlated with improvements in institutional

and governance measures, including Transparency International's Corruption Perceptions Index. This annual survey of experts and businesspeople scores 180 countries and territories on their perceived levels of public sector corruption, where 0 is highly corrupt and 100 is very clean.

**FIGURE 2.2**  
Corruption Perceptions Index

Source: Transparency International



As with the EoDB, Indonesia is again the most improved among the ASEAN-5. Its score increased by five points to 37 in the last five years, ranking alongside Thailand.

Vietnam also saw a four-point increase in its corruption perception score over the same period, but remains two points behind Indonesia. While Malaysia still leads among the ASEAN-5, its score has declined over the past four years to 47. The Philippines has also deteriorated since 2014 to occupy last place in the group.

Nonetheless, Indonesia's fight against corruption still has a long way to go. In the WEF's Executive Opinion Survey 2017,

corruption was still the top problematic factor cited for doing business in the country. Inefficient government bureaucracy comes second.

In noting Indonesia's gains, Transparency International was also cautious about reading too much into the country's rising score. It said the improvement "could stem from the work of Indonesia's leading anti-corruption agency in taking action against corrupt individuals, despite strong opposition from the government and parliament."<sup>9</sup>

<sup>9</sup> [https://www.transparency.org/news/feature/slow\\_imperfect\\_progress\\_across\\_asia\\_pacific](https://www.transparency.org/news/feature/slow_imperfect_progress_across_asia_pacific)

**INDONESIA'S  
CORRUPTION  
PERCEPTIONS INDEX  
SCORE INCREASED  
5 POINTS TO  
37 IN THE LAST  
FIVE YEARS,  
MAKING IT THE  
MOST IMPROVED  
COUNTRY AMONG  
THE ASEAN-5.**

**37 PTS**



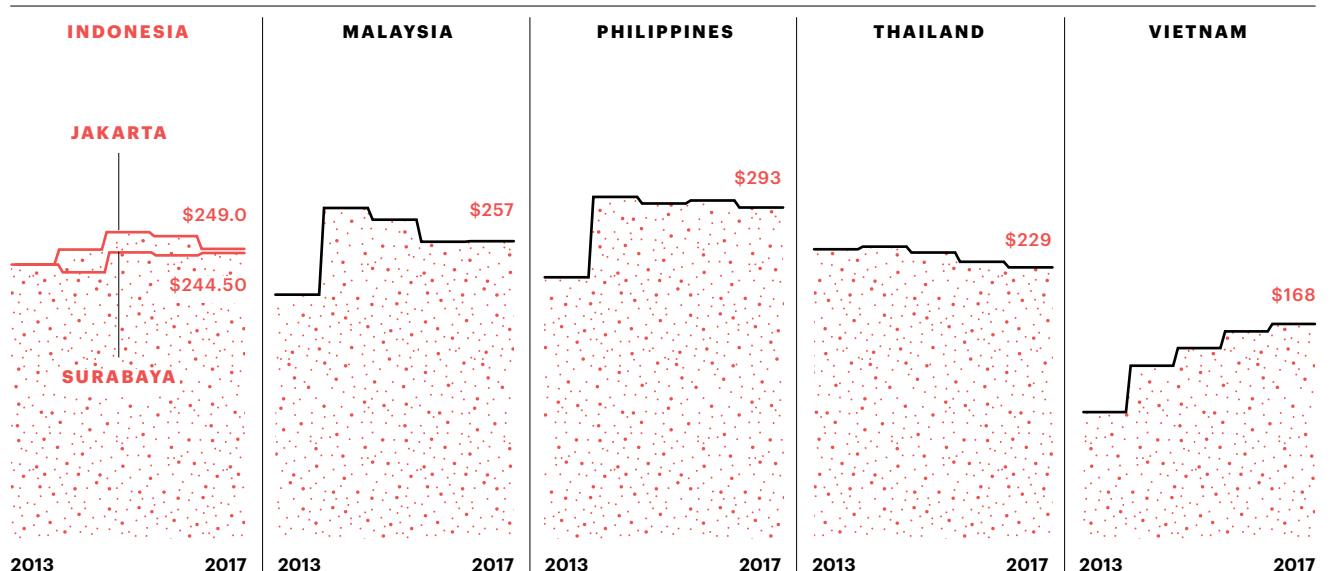
### Labor

If the ASEAN-5 are projected to attract FDI from investors turned off by increasing labor costs in China, then it stands to reason that the wage rate is an important factor to take

into consideration. Among the five countries, it is clear that Vietnam has successfully positioned itself as an attractive alternative for export-focused foreign investments in part due to its supply of cheap labor.

**FIGURE 2.3**  
**Minimum wage:** Referring to the monthly salary of a cashier, age 19, with one year of work experience

Source: World Bank 'Doing Business' reports, converted to USD based on prevailing exchange rate for the respective year



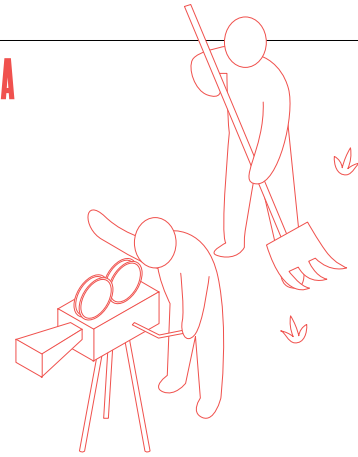
# 83%

OF INDONESIA'S  
PRODUCTION WORKERS  
IN MANUFACTURING  
FIRMS CONSIDERED  
SKILLED

Indonesia knows its labor is no longer cheap, and isn't trying to compete on this aspect. In terms of skilled workers, it fares slightly better, with 82.8 percent of its production workers in manufacturing firms considered skilled, on par with the Philippines, but behind Malaysia and Thailand, according to the latest World Bank Enterprise Survey. Vietnam scores lowest here with 73.9 percent.

A bigger concern could be in what firms say are their major labor-related constraints: 9.9 percent of those surveyed in Indonesia as of 2015 identified labor regulations and 10.8 percent cited an inadequately educated workforce. In Vietnam, only 3.8 percent of companies said labor regulations were problematic.

**IN TERMS OF SKILLED WORKERS, INDONESIA FARES SLIGHTLY BETTER, WITH 82.8 PERCENT OF ITS PRODUCTION WORKERS IN MANUFACTURING FIRMS CONSIDERED SKILLED, ON PAR WITH THE PHILIPPINES, BUT BEHIND MALAYSIA AND THAILAND, ACCORDING TO THE LATEST WORLD BANK ENTERPRISE SURVEY.**



**TABLE 2.1**  
**Workforce**

Source: World Bank Enterprise Surveys  
<http://www.enterprisesurveys.org/>  
\*Refers to data from manufacturing firms

COUNTRY	YEAR	PERCENT OF SKILLED WORKERS OUT OF ALL PRODUCTION WORKERS	PERCENT OF FIRMS IDENTIFYING LABOR REGULATIONS AS A MAJOR CONSTRAINT	PERCENT OF FIRMS IDENTIFYING AN INADEQUATELY EDUCATED WORKFORCE AS A MAJOR CONSTRAINT
<b>INDONESIA</b>	<b>2015</b>	<b>82.8</b>	<b>9.9</b>	<b>10.8</b>
<b>MALAYSIA</b>	<b>2015</b>	<b>88.9</b>	<b>9.2</b>	<b>12.2</b>
<b>PHILIPPINES</b>	<b>2015</b>	<b>82.8</b>	<b>3.5</b>	<b>10.1</b>
<b>THAILAND</b>	<b>2016</b>	<b>87.2</b>	<b>10.6</b>	<b>2.1</b>
<b>VIETNAM</b>	<b>2015</b>	<b>73.9</b>	<b>3.8</b>	<b>8.1</b>

This is consistent with the analysis of Indonesia's competitiveness in the WEF's Global Competitiveness Report for 2017-2018, which said the country's overall score was dragged down by labor market inefficiencies. While Indonesia enjoys a 36th overall ranking in global competitiveness among 137

economies, in the labor market pillar, it sits way down at 96th. According to the report, this is largely due to factors like excessive redundancy costs and limited flexibility in wage determination. In these indicators, Indonesia is at or near the bottom of the ASEAN-5.

**TABLE 2.2**  
**Labor Competitiveness Ranking out of 137 Countries**

COUNTRY	LABOR MARKET EFFICIENCY	REDUNDANCY COSTS (WEEKS OF SALARY)	FLEXIBILITY OF WAGE DETERMINATION
<b>INDONESIA</b>	<b>96</b>	<b>133</b>	<b>99</b>
<b>MALAYSIA</b>	<b>26</b>	<b>120</b>	<b>31</b>
<b>PHILIPPINES</b>	<b>84</b>	<b>116</b>	<b>86</b>
<b>THAILAND</b>	<b>65</b>	<b>128</b>	<b>103</b>
<b>VIETNAM</b>	<b>57</b>	<b>103</b>	<b>81</b>

Source: World Economic Forum's Global Competitiveness Report 2017-2018



## 2.2

# Infrastructure

### Logistics

High logistics costs due to inefficiencies have long been an issue in Indonesia, estimated to account for some 25 percent of manufacturing costs – significantly higher than the 15 percent in Thailand and 13 percent in Malaysia, according to the World Bank.

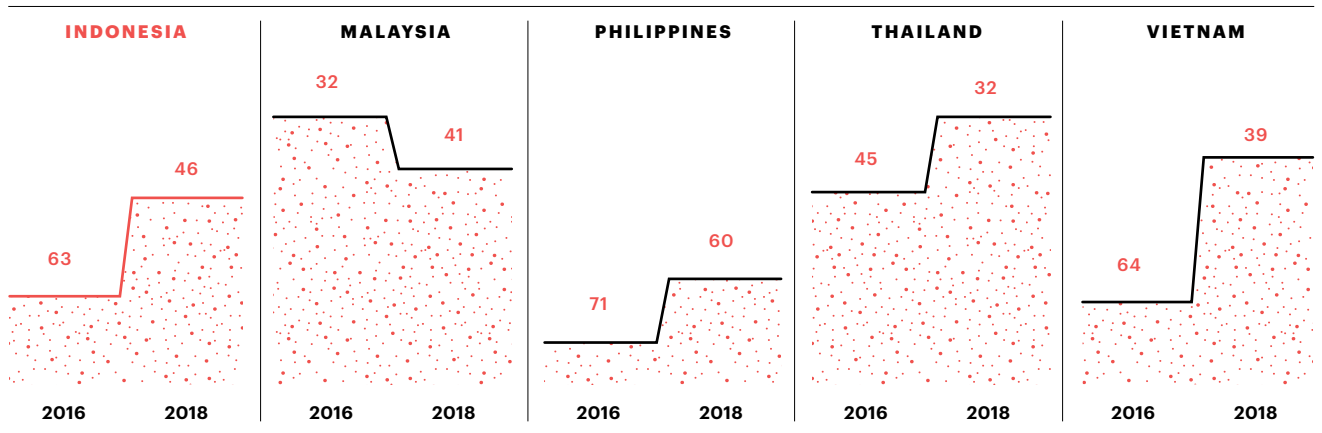
With the Widodo administration’s massive infrastructure push, it’s not surprising to see that Indonesia has also fared well in the World Bank’s latest Logistics Performance Index (LPI). The 2018 LPI report released in July shows Indonesia making significant progress not just in the quality of its trade- and transport-related infrastructure, but in all other logistics indicators, including customs efficiency and timeliness of shipments.

WITH THE WIDODO ADMINISTRATION’S MASSIVE INFRASTRUCTURE PUSH, IT’S NOT SURPRISING TO SEE THAT INDONESIA HAS ALSO FARED WELL IN THE WORLD BANK’S LATEST LOGISTICS PERFORMANCE INDEX (LPI)



**FIGURE 2.4**  
Logistics Performance Index Ranking

Source: World Bank



However, unlike in the EoDB ranking and Corruption Perceptions Index, Indonesia’s improvement isn’t the most impressive among the ASEAN-5. Vietnam takes that title with a jump from 64th place in 2016 to 39th place – a 25-spot improvement compared with Indonesia’s 17-spot increase to 46th.

This means that while Indonesia is furiously working to improve its infrastructure and logistics services, Vietnam appears to be working harder. This is also reflected by the number of infrastructure projects in the two countries: Indonesia’s 116 projects as of 2017 trails behind Vietnam’s 152. Thailand is close behind with 115 projects.

**TABLE 2.3**  
Infrastructure development  
projects as of FY2017

Source: Economic  
Research Institute for  
ASEAN and East Asia

COUNTRY	TOTAL PROJECTS	CONCEPTUAL STAGE	FEASIBILITY STAGE	CONSTRUCTION STAGE	OPERATION STAGE
INDONESIA	116	2	46	52	16
MALAYSIA	25	1	10	9	5
PHILIPPINES	77	8	41	23	5
THAILAND	115	3	75	30	7
VIETNAM	152	12	70	53	17

## ICT Infrastructure

In terms of physical ICT infrastructure, Indonesia isn't faring all that well either. Its average internet speed, according to Akamai Technologies' Global State of the Internet Report, was the second lowest in the group as of the first quarter of 2017, though its peak speed was the second highest.<sup>10</sup>

Indonesia's average peak connection speed of 66.1 Mbps in the first quarter of 2017, though, was a 40 percent decline from the previous year, according to the report. All its neighbors had positive year-over-year changes, with Vietnam having a 73 percent increase to 59 Mbps - the largest gain in the region.

The WEF Global Competitiveness Report 2017-2018 likewise notes that despite Indonesia's steady progress over the past

decade in terms of technological readiness, it is still lagging quite far behind at 80th place. The report gave it a technological readiness score of 3.9, behind even Vietnam's score of 4.0.

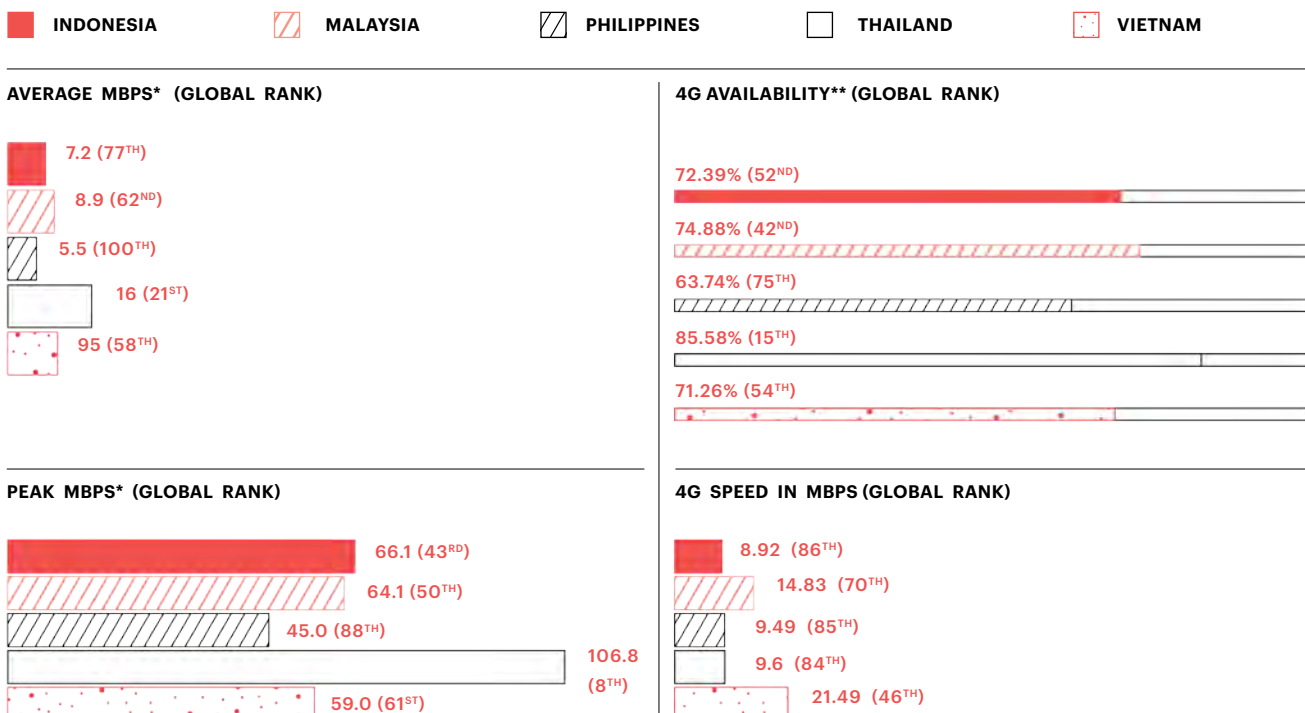
But with the planned completion of the Palapa Ring project to link the country together with broadband, International Telecommunication Union Secretary-General Houlin Zhou has projected Indonesia's ICT infrastructure could be second only to Singapore within the next two years<sup>11</sup> - a projection backed by industry players and regional analysts alike.

10 <https://www.akamai.com/us/en/about/news/press/2017-press/akamai-releases-first-quarter-2017-state-of-the-internet-connectivity-report.jsp>

11 <https://en.antaraneews.com/news/114458/indonesias-ict-infrastructure-would-rank-second-in-asean-in-two-years-itu>

**FIGURE 2.5**  
Internet Infrastructure

Sources: \*Akamai Technologies' Global State of the Internet Report, 1Q2017 \*\*OpenSignal's The State of LTE report covering 88 countries, February 2018



## Regulatory Restrictiveness

Can foreign investors exercise sufficient control over their local operations? Will they be able to maintain this control over the long term? Will their investments be protected? These considerations are crucial to investment decisions, and on this pillar, Indonesia is struggling to keep up with its neighbors.

In the OECD's FDI Regulatory Restrictiveness Index (RRI),<sup>12</sup> which measures statutory restrictions on FDI across 22 sectors, Indonesia was ranked the fifth

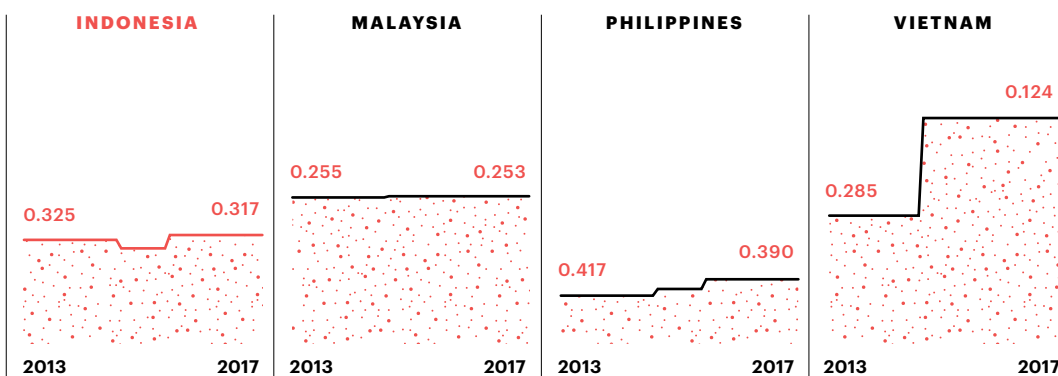
most restrictive economy in 2015 among the 58 countries covered.

This puts it well behind Vietnam, Thailand and Malaysia in terms of openness to foreign investment, particularly on equity limits. The only ASEAN-5 country that scores worse than Indonesia is the Philippines – the most discriminatory against foreign investors in the OECD's list.

**12** The OECD FDI Regulatory Restrictiveness Index is calculated based on the level of foreign equity ownership permitted, the screening and approval procedures applied to inward foreign direct investment, restrictions on key foreign personnel and other restrictions such as on land ownership and corporate organization.

**FIGURE 2.6**  
OECD  
Regulatory  
Restrictiveness  
Index Score

Source: World Economic Forum's Global Competitiveness Report 2017-2018



Since the early 1990s, the RRI shows Indonesia has generally become more open toward FDI, though restrictiveness trended slightly upward between 2007 and 2015. Under Widodo's administration, Indonesia began easing up again.

Among the ASEAN-5, Vietnam leads in terms of the most drastic change: It was the most restrictive economy in the 1980s among the five, but it's now the most open. According to the OECD, the decline in Vietnam's RRI is inversely correlated with its FDI as a percentage of GDP.

## Intellectual Property

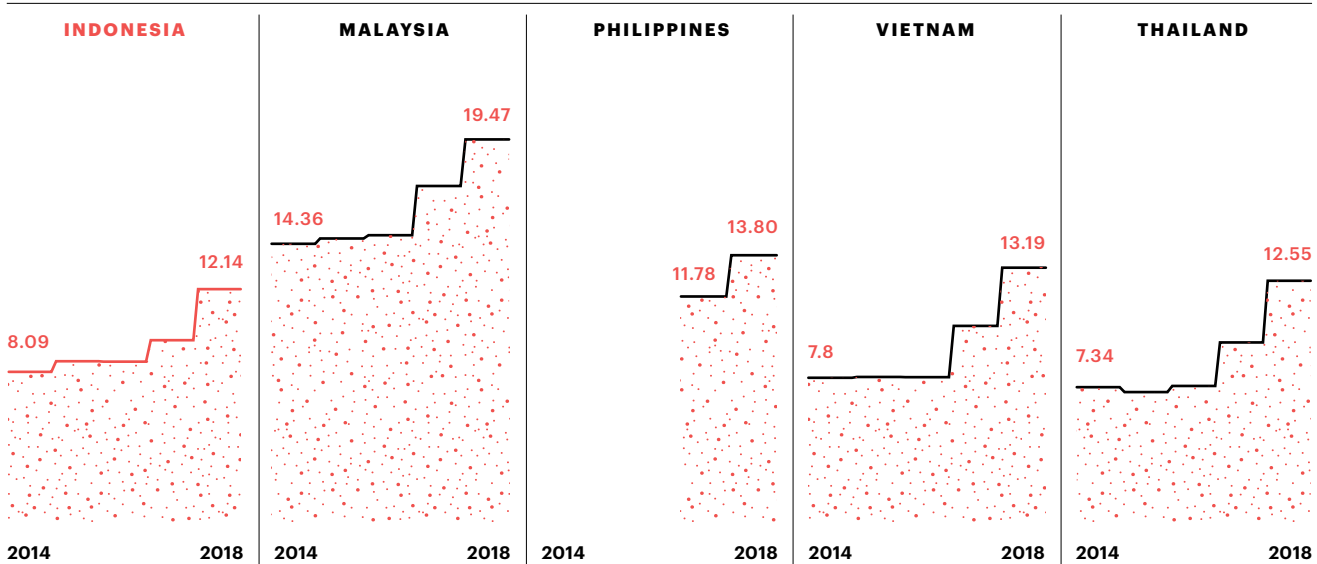
As Indonesia tries to develop its creative sectors and foster a knowledge-based economy, regulations that create an effective intellectual property (IP) architecture are also an important consideration for foreign investors.

The U.S. Chamber of Commerce International IP Index shows that Indonesia's overall score has increased from 27.5 percent (a score of 9.64 out of 35 indicators at the time) in 2017 to 30 percent (12.14 out of 40 indicators) in 2018.<sup>13</sup> Despite this, its score still lags behind its main competitors in the region.

<sup>13</sup> <https://www.theglobalipcenter.com/wp-content/uploads/2018/02/Indonesia.pdf>

**FIGURE 2.7**  
Global IP Index Scores

Source: <https://www.theglobalipcenter.com/ipindex2018/>



While administrative relief is available for copyright infringement online, Indonesia's copyright environment is still considered challenging with high levels of piracy. The heightened efficacy requirement targeting biopharmaceutical patents and localization

barriers in place, including the 2016 Patent Law that includes a requirement for technology transfer of all patented technologies and processes in Indonesia, also constrains its IP index score.

## 2.4

## Economic Management

**>\$130  
BILLION**

INDONESIA'S FOREIGN EXCHANGE RESERVES, THE LARGEST IN THE REGION. THE COUNTRY'S MACROECONOMIC FUNDAMENTALS REMAIN STRONG.

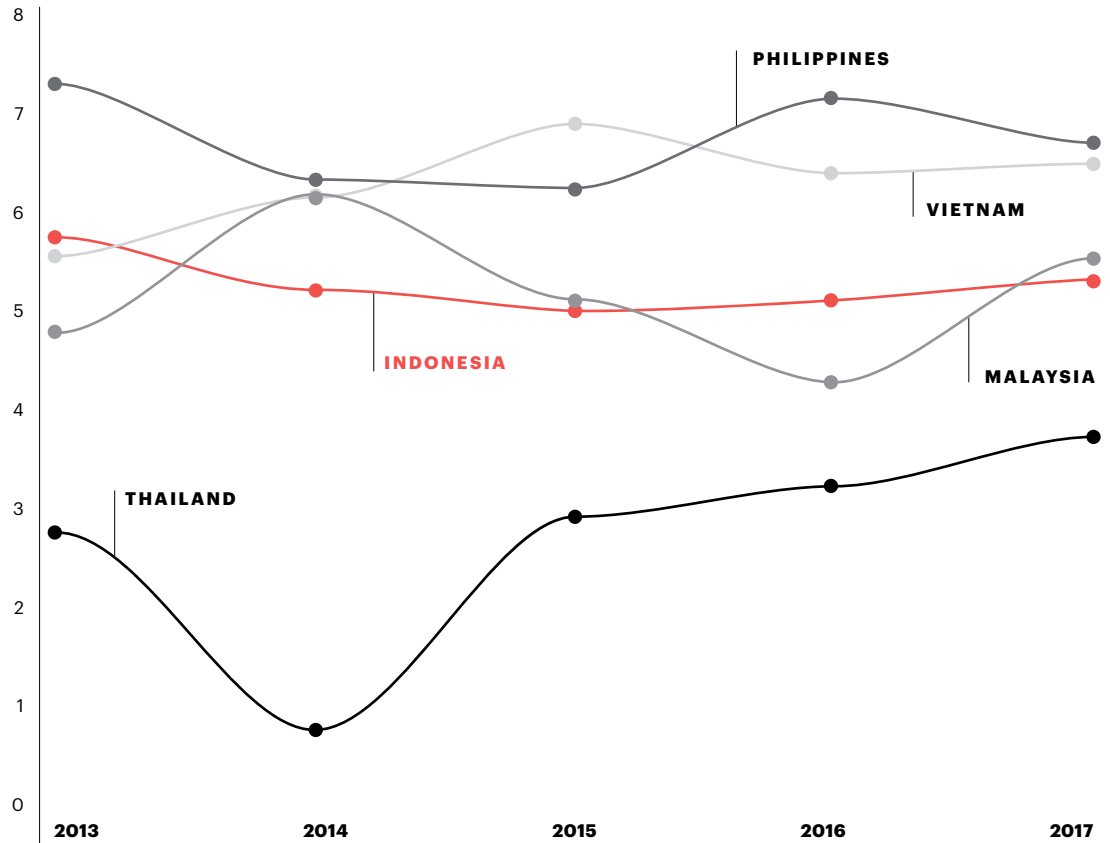
The ASEAN region is home to some of the highest economic growth rates in the world, led by the Philippines and Vietnam. But when asked about Indonesia's failure to achieve its 7 percent GDP growth target, the country's economic managers say the goal isn't just high growth per se, but stable and inclusive growth.

"We can easily reach high growth, but it's not necessarily inclusive. We have to make sure people can participate," Finance Minister Sri Mulyani Indrawati told Bloomberg in June.

Indonesia Deposit Insurance Corporation (LPS) Chief Executive Officer Fauzi Ichsan explained that pouring more FDI into the extractives sectors, for example, could help Indonesia reach its high growth targets again, but it wouldn't have much of an impact on poverty reduction and social inclusion.

At the same time, economic managers maintain that Indonesia's macroeconomic fundamentals remain among the strongest in the region: largest foreign exchange reserves at more than \$130 billion, a current account deficit below 2 percent, and a growth rate above 5 percent with a strong and expanding middle class.

**FIGURE 2.8**  
GDP Growth Rate



Source: <https://data.worldbank.org/indicator/nY.GDP.MKTP.KD.ZG?locations=MY>

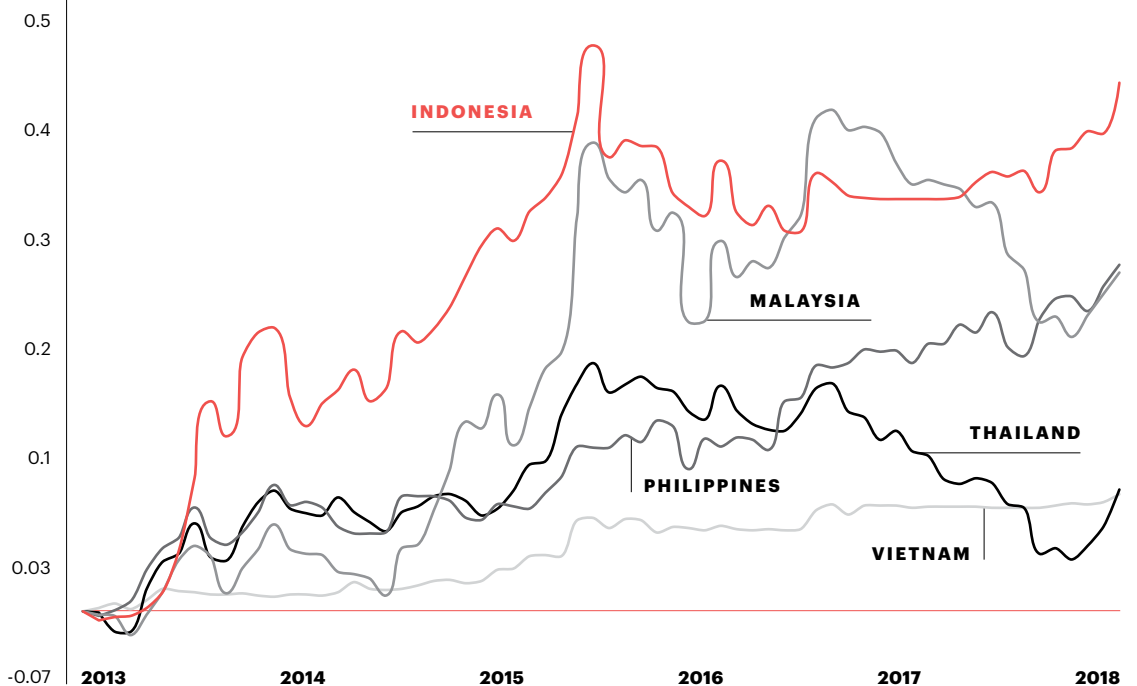
But if we look at how the currencies of these emerging markets performed over the past year as a test of the strength of their respective macroeconomic fundamentals, we see that the rupiah hasn't been any more resistant to pressure from rising U.S. interest rates and global market volatility than the Philippine peso or the Vietnamese dong.

Despite a strong defense from Bank Indonesia, hiking rates by 100 basis points and drawing heavily on foreign reserves, the rupiah declined more than 6 percent in the first half of the year. The Philippine peso performed slightly worse, falling some 6.7

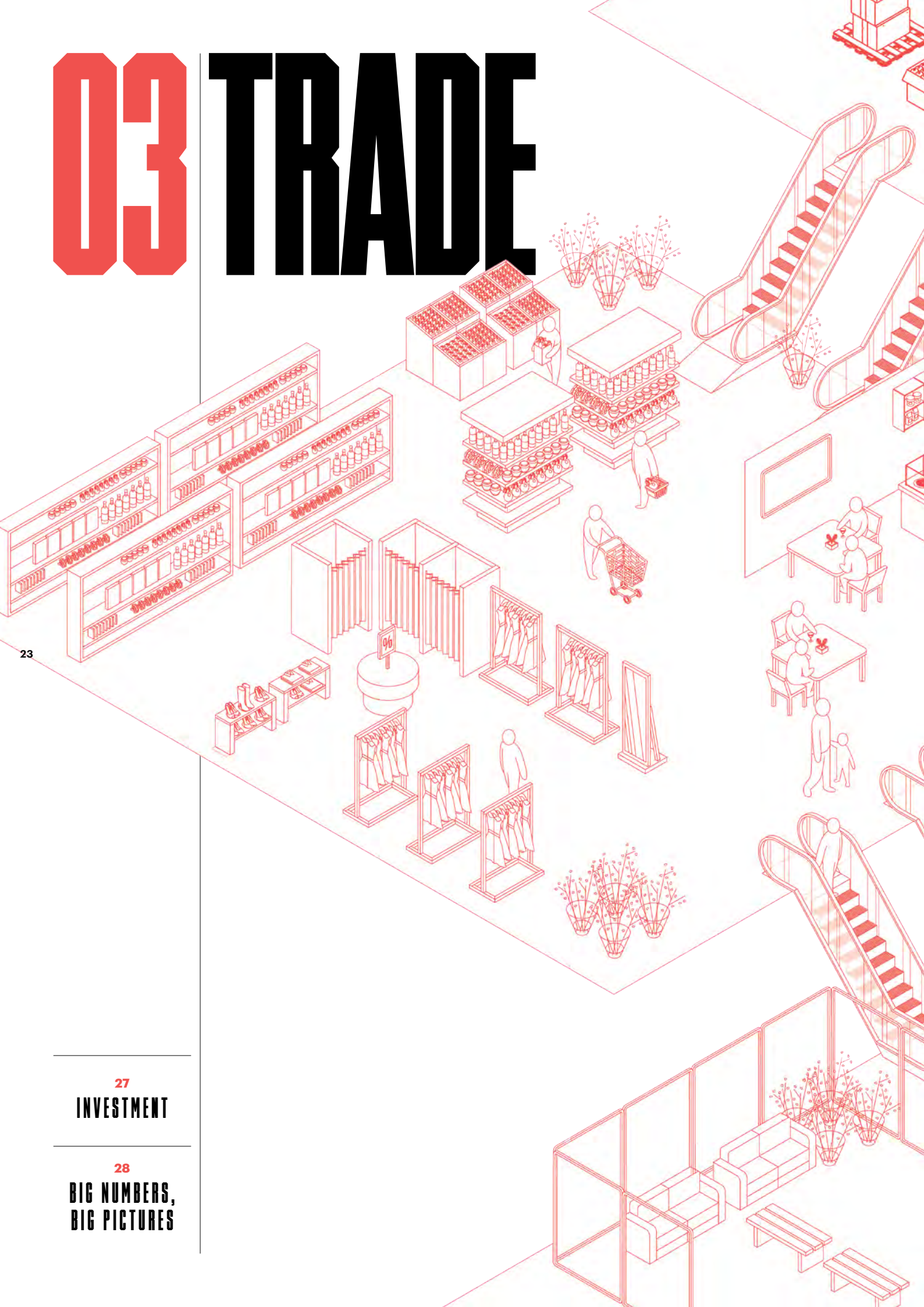
percent in the same period, but its central bank has been less active than Indonesia's. The Malaysian ringgit and the Thai baht have performed better on the back of current account surpluses.

All of these show where Indonesia should perhaps focus next. While the country is making important strides forward, especially on the ease of doing business front, it needs to pay more attention to other issues like regulatory reform and labor market competitiveness. Because while Indonesia is working to reform and improve, so are its neighbors.

**FIGURE 2.9**  
January 2013  
– May 2018  
currency exchange rates of Indonesia vs. other ASEAN countries (normalized value)



# 03 TRADE



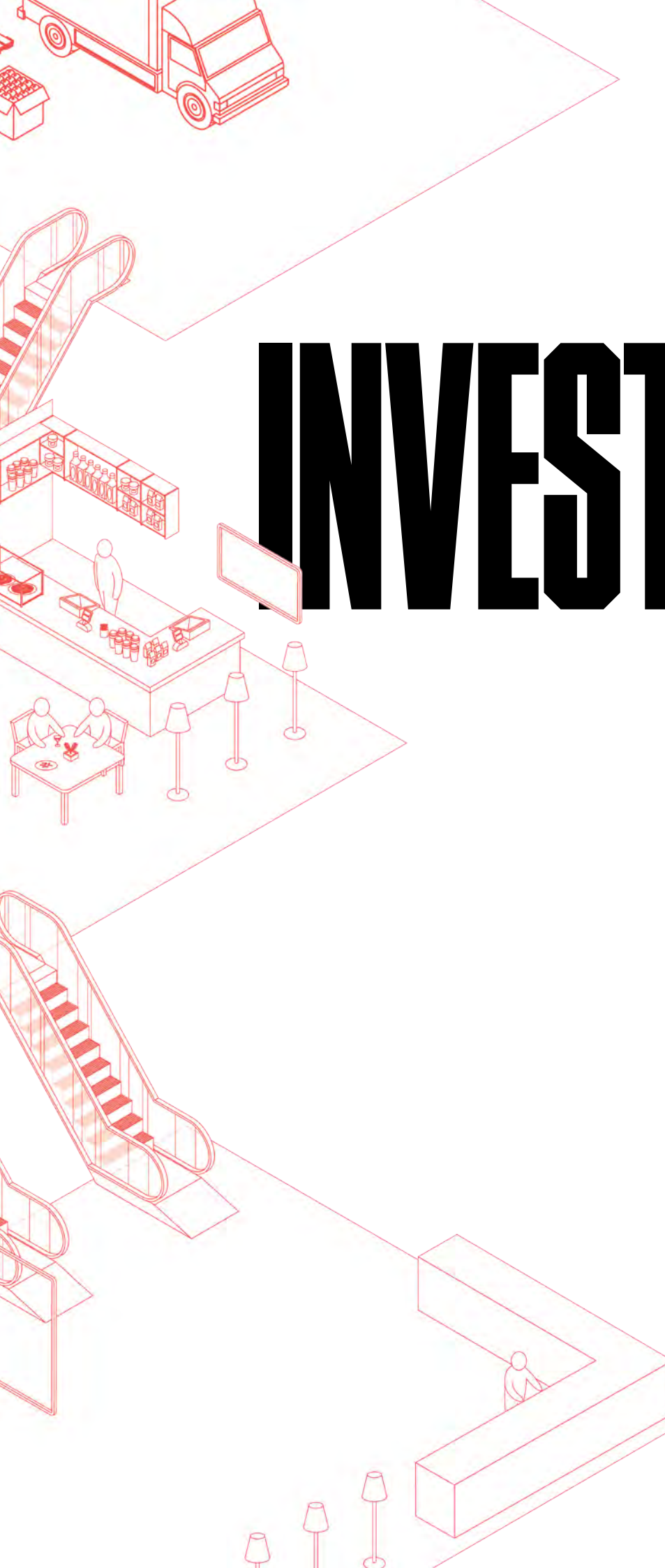
23

27

INVESTMENT

28

BIG NUMBERS,  
BIG PICTURES



# &

# INVESTMENT

24

The United States-Indonesia trade relationship is surprisingly small given the size of the two economies involved. Indonesia has a population of 263 million and a \$1 trillion economy, yet U.S. goods exports to the country last year totaled only \$6.9 billion, against merchandise imports of \$20.2 billion. U.S. exports of services to Indonesia were \$2.4 billion in 2016 (the latest year for which data are available), against services imports of \$908 million.

Indonesia ranked as the 36th largest U.S. goods export market in 2017, behind much smaller countries such as the Dominican Republic (33), and Guatemala (35).<sup>14</sup> For Indonesia, the United States was the second largest export market in 2017, behind China, and just slightly ahead of Japan.<sup>15</sup>

The top U.S. exports to Indonesia are oil seeds and other agricultural products, machinery, aircraft, cotton, and animal feed and other food products. The top U.S. imports from Indonesia include clothing and apparel, rubber and rubber products, footwear, machinery, and animal and vegetable fats and related oils. These products collectively account for more than half of all U.S. imports from Indonesia.<sup>16</sup>

<sup>14</sup> Data from the U.S. Bureau of the Census, U.S. International Trade Data. <https://www.census.gov/foreign-trade/data/index.html>.

<sup>15</sup> International Monetary Fund, Direction of Trade Statistics Database. <http://data.imf.org/?sk=9D6028D4-F14A-464C-A2F2-59B2CD424B85&sid=1515619375491>.

<sup>16</sup> U.S. International Trade Administration Dataweb. <https://dataweb.usitc.gov>.

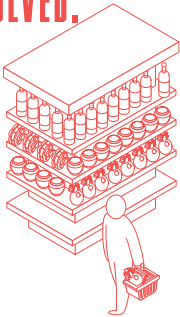
**268  
MILLION**

INDONESIA'S  
POPULATION

**\$1  
TRILLION**

INDONESIA'S  
ANNUAL GDP

**THE UNITED STATES-INDONESIA TRADE RELATIONSHIP IS SURPRISINGLY SMALL GIVEN THE SIZE OF THE TWO ECONOMIES INVOLVED.**



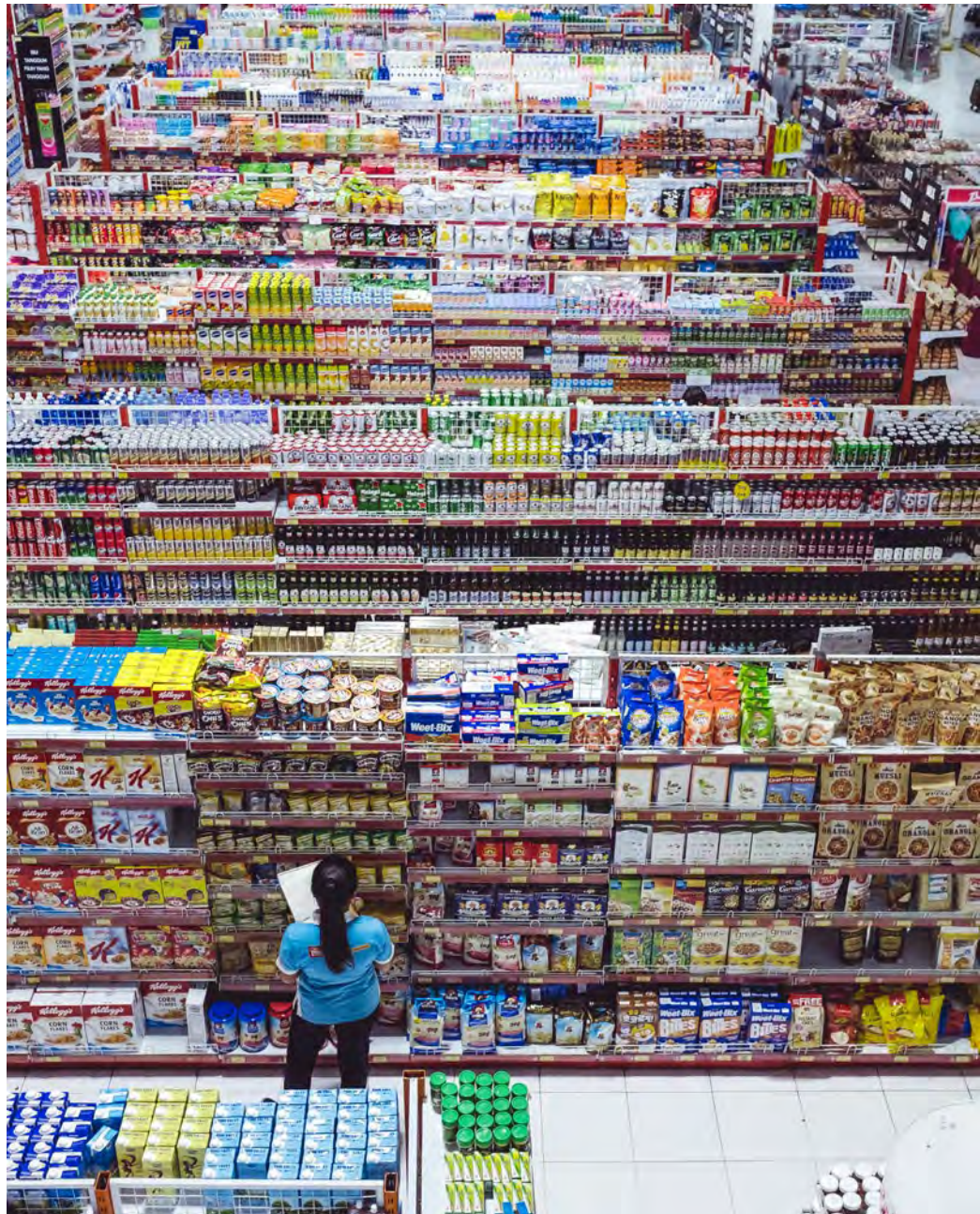
The Indonesian market represents only 0.4 percent of total U.S. exports, and accounts for only 0.9 percent of total imports.<sup>17</sup> There are a number of reasons why trade flows are so underwhelming, which are discussed in detail in this report. Certainly the array of tariff and non-tariff barriers plays a role, as does legal uncertainty, economic nationalism, domestic vested interests, opacity and corruption. Despite these challenges, it is clear that there is substantial scope for increased bilateral trade. The question that this report attempts to address is how to realize that potential.

Indonesia was on a list of 16 countries that the Trump Administration identified in early 2017 as those with which the United States had a significant trade deficit. China accounted for the largest portion of the U.S. trade deficit by a very large margin.

While the U.S. trade deficit with Indonesia was \$13.1 billion in 2016 (the year on which the Administration's list was based), this represented only 1.8 percent of the U.S.'s global trade deficit that year. As of the time of this writing, no actions have been announced against Indonesia stemming from that report.

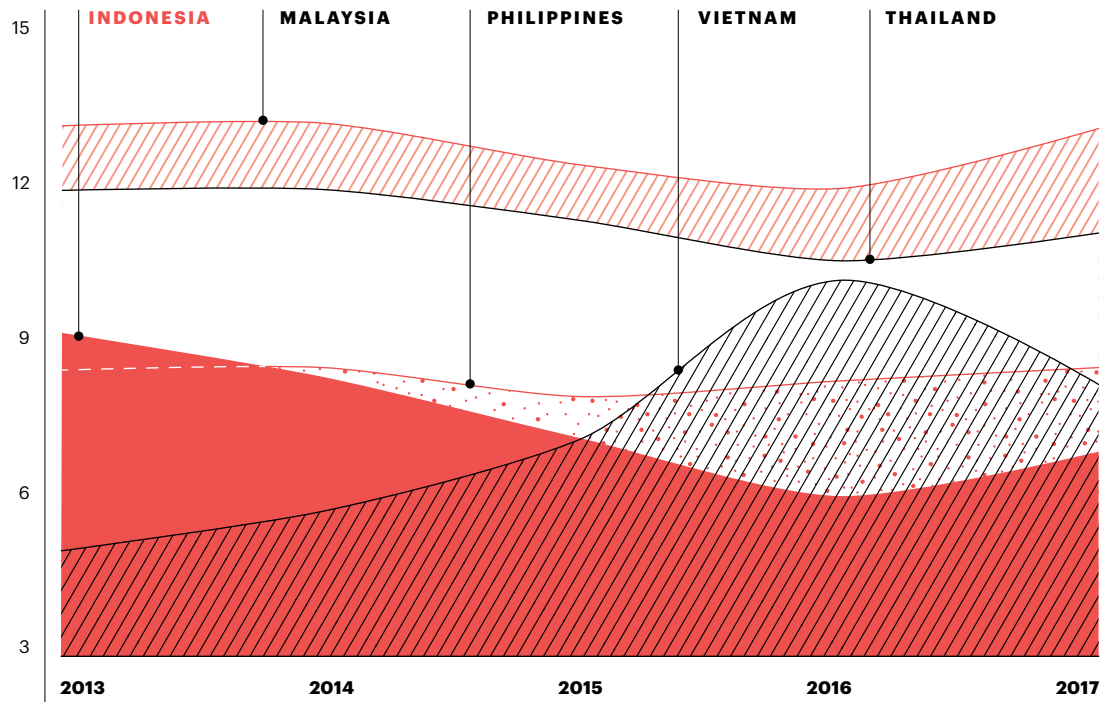
Separately, the Office of the U.S. Trade Representative has initiated a review of the country's tariff preferences under the Generalized System of Preferences (GSP) program, on the basis of longstanding market access complaints. Less consequentially, the Administration's Section 232 investigation of steel and aluminum imports will have some limited impact on Indonesia, though exports of these products to the United States are quite modest. Indonesia is seeking an exemption to these tariffs.

17 U.S. Bureau of the Census.



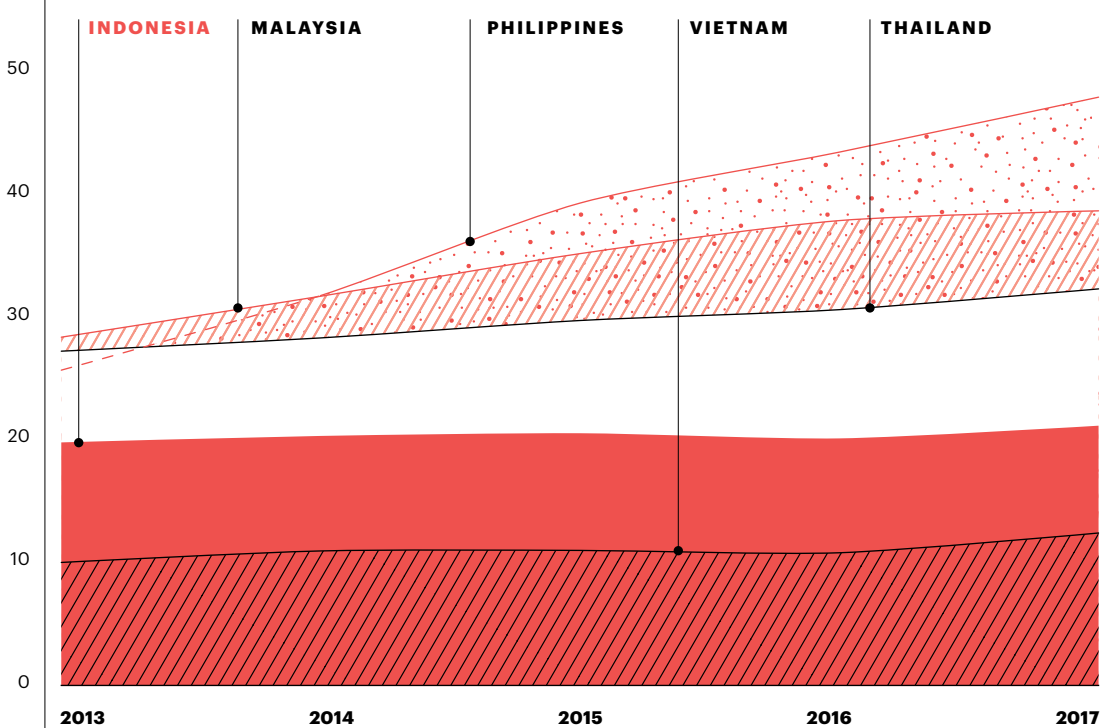


**FIGURE 3.1**  
U.S. Exports to ASEAN-5, in billions of USD



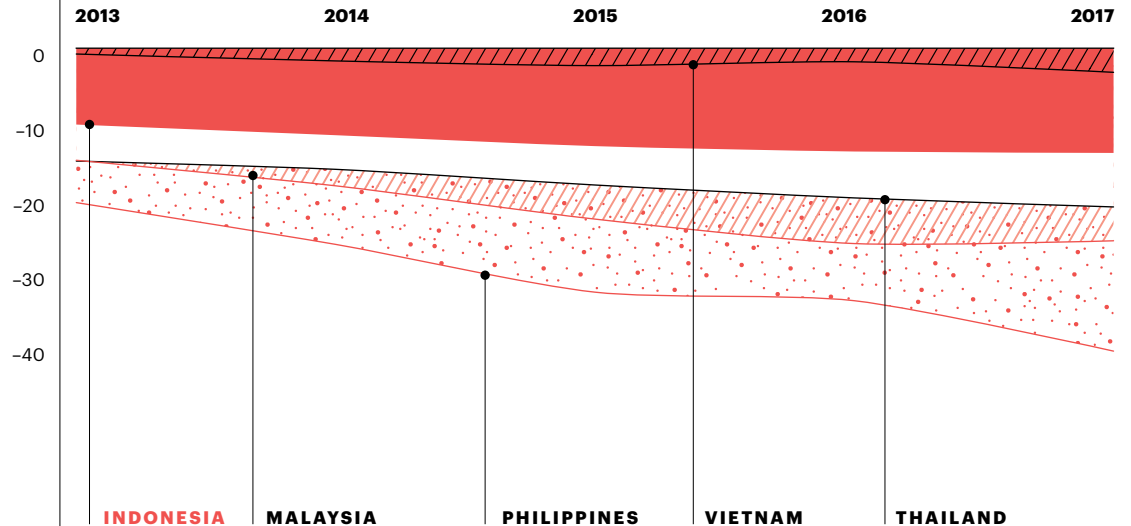
Source: Census.gov

**FIGURE 3.2**  
U.S. Imports From ASEAN-5, in billions of USD



Source: Census.gov

**FIGURE 3.3**  
U.S. Trade Balance With ASEAN-5, in billions of USD



Source: Census.gov

# 3.1

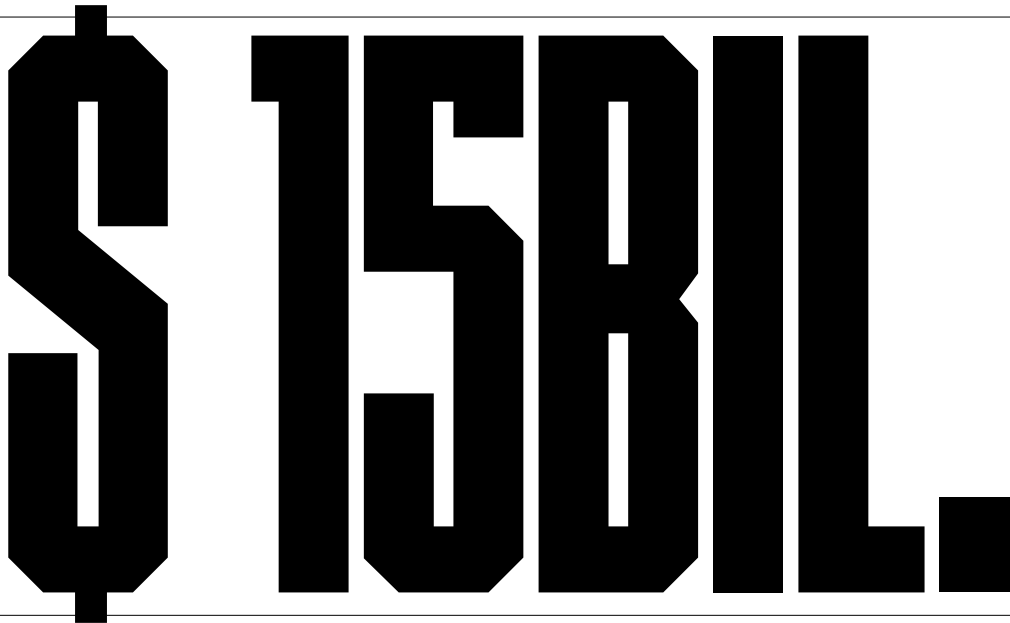
# Investment

According to the US Bureau of Economic Analysis, U.S. investment in Indonesia stood at \$15.1 billion at the end of 2017, up from \$11.4 billion at the end of 2012. However, as previous Initiative Indonesia reports have noted, this figure likely understates the actual level of U.S. investment by a substantial margin. In particular, U.S. investment in neighboring Singapore, at \$274 billion, is

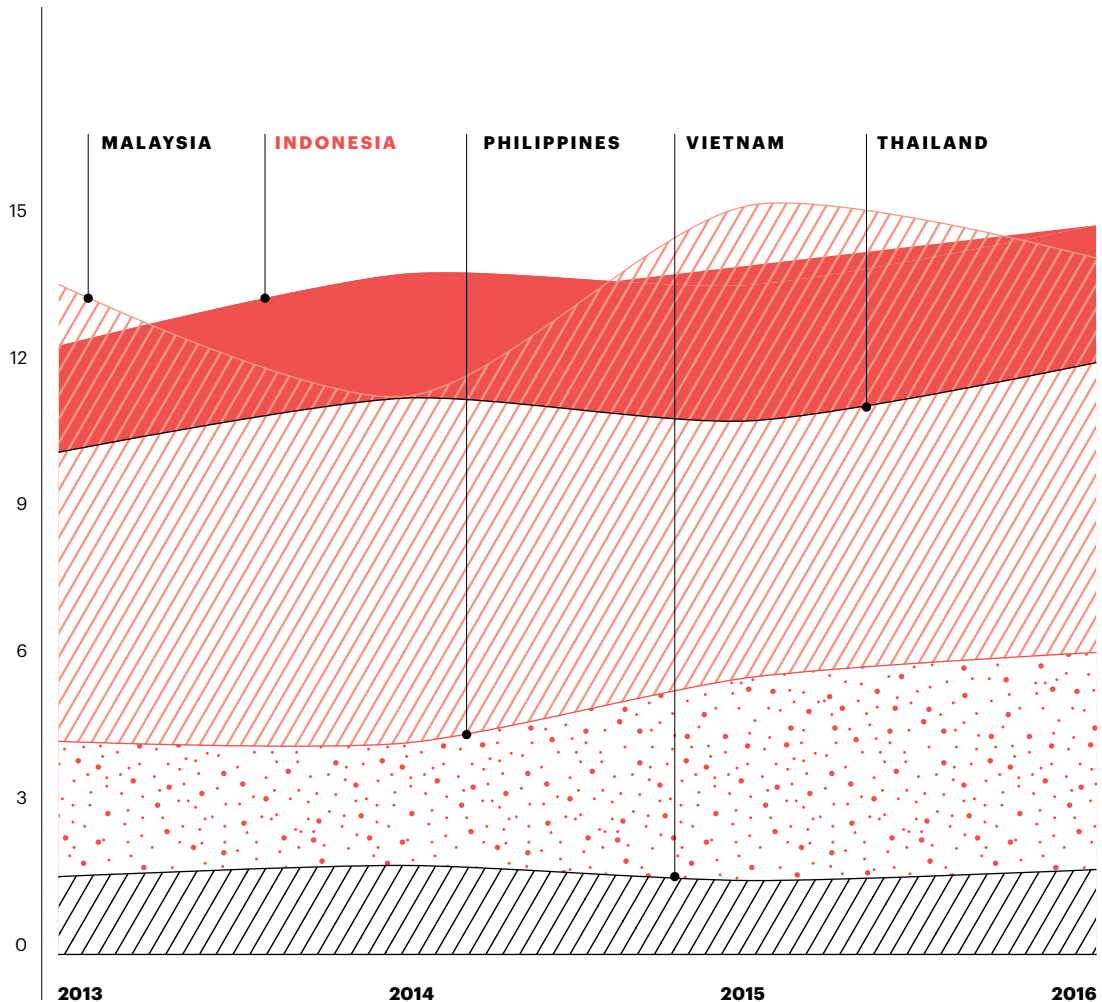
18 times greater,<sup>18</sup> but some portion of this investment is then re-invested by Singapore-based U.S. affiliates elsewhere in the region, including Indonesia. Therefore, official data should be interpreted with caution; some amount of “Singaporean” investment in Indonesia is actually U.S. investment.

18 U.S. Bureau of the Census.

ACCORDING TO THE US BUREAU OF ECONOMIC ANALYSIS, US INVESTMENT IN INDONESIA STOOD AT \$15.1 BILLION AT THE END OF 2017, UP FROM \$11.4 BILLION AT THE END OF 2012.



**FIGURE 3.4**  
U.S. FDI to ASEAN-5, in billions USD



Source: <https://www.bea.gov/international/factsheet/factsheet.cfm?Area=653>

## 3.2

# Big Numbers, Big Pictures

In “The ASEAN-U.S. Big Number,” released last year, the U.S. Chamber of Commerce took a new approach to describing the totality of the U.S.-ASEAN commercial relationship. In addition to flows of trade and investment, the Big Number analysis also examined flows of financing, sales in each other’s domestic market by U.S.- and ASEAN-based affiliates, and government revenues derived from the operations of U.S. companies in ASEAN.

The total number for ASEAN was striking; adding up all these components, using a conservative methodology, yielded a figure of \$672 billion for the ASEAN countries collectively. But again, Indonesia seemed underrepresented, as the figure for that country was \$62 billion, less than 10 percent of the ASEAN total.<sup>19</sup>

<sup>19</sup> See U.S. Chamber of Commerce, “The ASEAN Big Number Report: Big, Bigger, Biggest.” September 2017. [https://www.uschamber.com/sites/default/files/aseans\\_bignumber\\_2017.pdf](https://www.uschamber.com/sites/default/files/aseans_bignumber_2017.pdf).



# 04

31  
CONSUMER  
GOODS

33  
CREATIVE  
ECONOMY

35  
ICT

37  
INFRASTRUCTURE

39  
AGRICULTURE

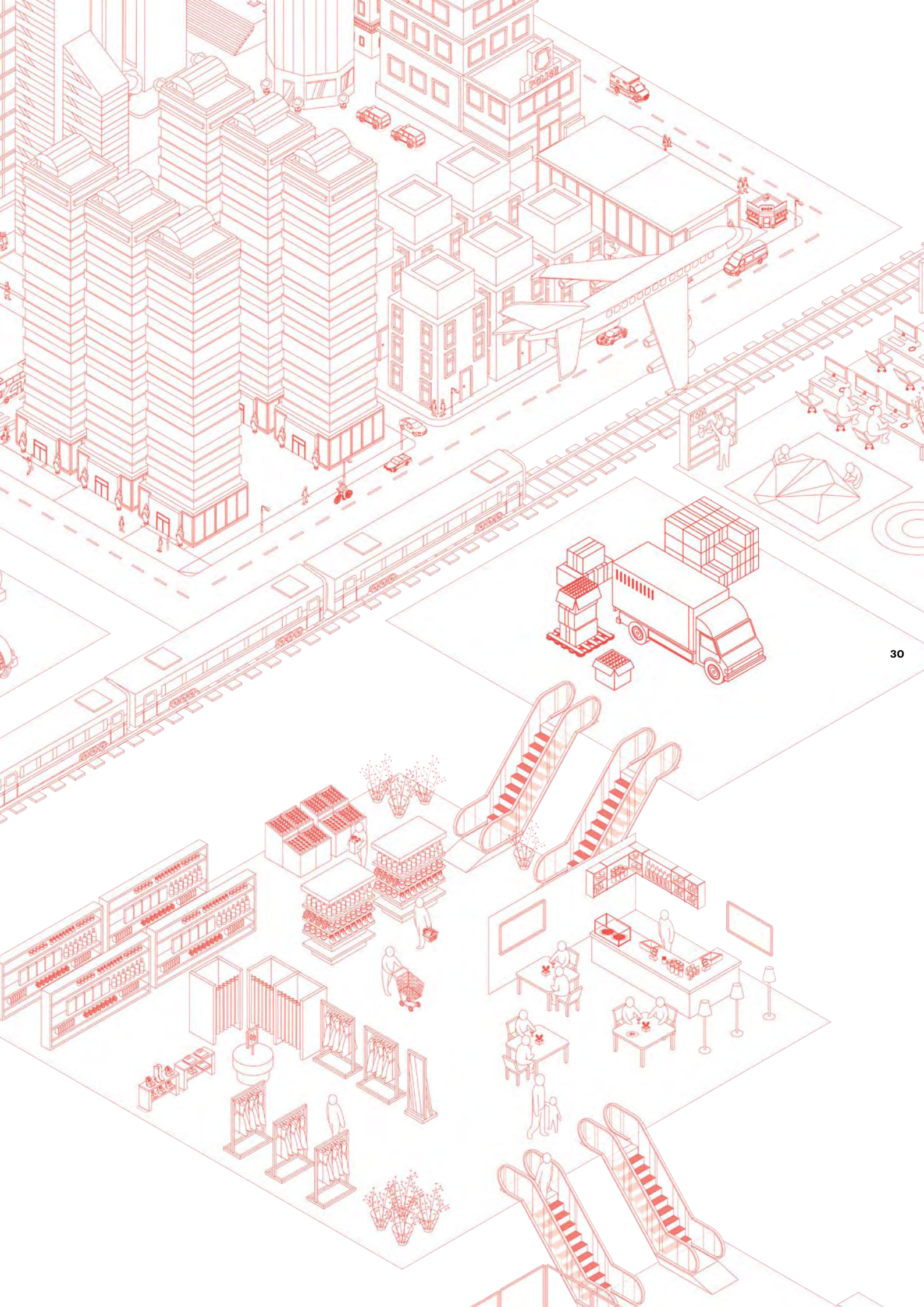
41  
EXTRACTIVES

43  
FINANCIAL  
SERVICES

45  
PHARMA

# SECTORS





*The consumer goods industry is facing a number of challenges due to domestic and global economic issues, but more consultative regulators and Indonesia's expanding middle class continue to make the sector appealing*



31

# 18.5 %

CONSUMER  
GOODS INDUSTRY  
CONTRIBUTION TO  
INDONESIA'S GDP  
IN 2016

The consumer goods industry has long been a major component of the Indonesian economy, contributing 18.5 percent to the country's GDP in 2016.<sup>20</sup> Despite slower-than-expected consumer spending growth over the past few years – due to changing consumption patterns, reduced government subsidies and increased tax collection, among others – the sector is still projected to account for 30 percent of GDP by 2030 on the back of a growing middle class.

But in September, as the country's current account deficit widened and the rupiah approached critical levels last seen in 2008, the government responded by raising import taxes to up to 10 percent on 1,147 mostly consumer goods, from an existing 2.5 percent to 7.5 percent.<sup>21</sup> While tariffs for raw materials used by the manufacturing industry will be kept at 2.5 percent, domestic and foreign industry players have expressed worry about the move's impact on inflation and the sector's overall growth.

"The government must be careful in determining which commodities will be stopped, because the implications are quite broad," Shinta W. Kamdani, deputy chair for international relations at the Indonesian Chamber of Commerce and Industry (Kadin), has been quoted as saying.<sup>22</sup>

The move does not come as a surprise, as the government has long been trying to get companies to switch to local alternatives for foreign goods through import restrictions. But executives say the quality or specifications of what is available domestically does not always meet what they need.

Last year, for example, the Ministry of Agriculture issued a regulation requiring dairy businesses to "partner" with local milk producers to either buy or promote their products as a condition for obtaining import permits.<sup>23</sup> The move was sharply criticized by U.S. officials and also created other problems, as the quality of local milk often does not meet the requirements of foreign manufacturers.

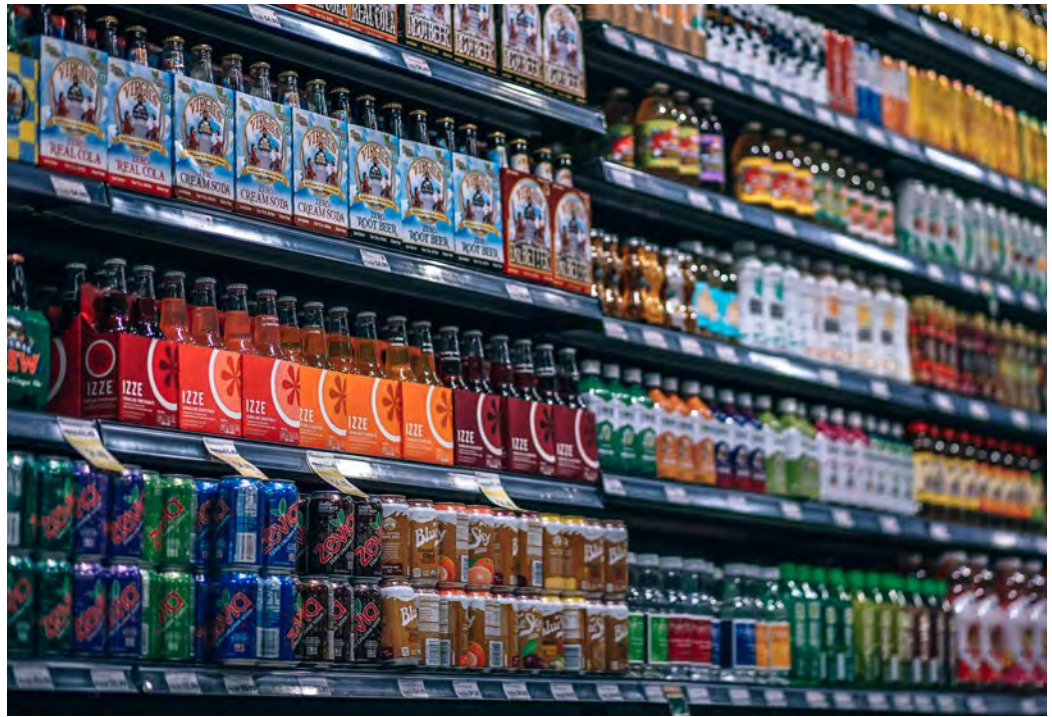
<sup>20</sup> <https://www.business.hsbc.co.id/en-gb/id/article/fmcg-industry-in-indonesia>

<sup>21</sup> <https://www.reuters.com/article/indonesia-imports/update-1-indonesia-raises-import-taxes-on-1000-plus-goods-to-support-rupiah-idUSL3n1VR3ZT>

<sup>22</sup> <http://en.industry.co.id/read/6626/kadin-export-control-must-be-careful>

<sup>23</sup> [https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Indonesia%20issues%20new%20regulation%20on%20milk%20supply%20and%20distribution\\_Jakarta\\_Indonesia\\_8-10-2017.pdf](https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Indonesia%20issues%20new%20regulation%20on%20milk%20supply%20and%20distribution_Jakarta_Indonesia_8-10-2017.pdf)

## INDONESIA'S REGULATORS HAVE PROVEN TO BE INCREASINGLY CONSULTATIVE OVER THE PAST FEW YEARS, AS SEEN IN THE EXPERIENCE WITH THE MINISTRY OF AGRICULTURE'S AMENDMENT OF ITS DAIRY POLICY AND THE EXTENSIVE DISCUSSIONS THAT WENT INTO DRAFTING THE IMPLEMENTING REGULATIONS OF THE 2014 HALAL LAW



But following a series of productive discussions with companies in the industry, the ministry eventually dropped the mandatory partnership requirement and changed it into a voluntary one.

The import tariffs, however, add to concerns over ongoing regulatory issues, ranging from new laws being drafted by lawmakers, to the lack of coordination among ministries and inconsistent policies between the central and local governments.

In terms of new laws, the draft of the Water Resources Bill has raised worries because of articles that require 10 percent of profits to go to water conservation, and other clauses that limit licenses for drinking-water products to state-owned enterprises.

On the issue of coordination, the Ministry of Trade last year announced that industrial sugar would be sold through an online auction facilitated by futures and commodity trader PT Pasar Komoditas Jakarta. But a lack of coordination within the government and a subsequent rise in costs due to the new policy meant the resulting pushback forced the ministry to cancel the plan.

The continued disconnect between national and local governments also means companies have been faced with regulatory uncertainty in various regions across Indonesia. In a number of districts and cities outside Jakarta, distributors can face varying retail regulations.

On the bright side, however, Indonesia's regulators have proven to be increasingly consultative over the past few years, as seen in the experience with the Ministry of Agriculture's amendment of its dairy policy and the extensive discussions that went into drafting the implementing regulations of the 2014 Halal Law. Led by the Office of the Vice President, the finalized draft government regulation was able to maintain the intent of the Halal Law to protect Muslim consumers while reducing some additional burdens on businesses.

In another example, the Indonesian Food and Drug Monitoring Agency (BPOM) earlier this year proposed a new system of using QR codes for all food and drug products. While industry players raised several concerns over the proposal, they expressed appreciation for BPOM's new consultative approach.

*Indonesia has made much progress in capitalizing on the huge potential of its creative economy, but despite greater openness to foreign investment, weak intellectual property enforcement and other regulatory issues still hold back growth*

**IN 2016, SOME MARKET ACCESS CONCERNS WERE ADDRESSED WITH THE REMOVAL OF FILM PRODUCTION AND DISTRIBUTION PLUS RECORDING STUDIOS FROM THE NEGATIVE INVESTMENT LIST, PAVING THE WAY FOR 100 PERCENT FOREIGN DIRECT INVESTMENT IN FILM AND SOUND RECORDING PRODUCTION, AND FILM DISTRIBUTION AND EXHIBITION.**



When investors look at Indonesia's creative economy, two things jump out at them: The immense potential offered by the diverse culture of the fourth most populous nation in the world, and the scale of the challenges hampering its development.

But it's also important to look at how far Indonesia has come over the past few years.

Back in 2014, the International Intellectual Property Alliance (IIPA) was still recommending that Indonesia remain on the Priority Watch List,<sup>24</sup> which means it is under U.S. government scrutiny for rampant intellectual property piracy. The IIPA also supported a U.S. government investigation into the country's intellectual property system and related concerns over market access, which could have removed the country from the Generalized System of Preferences (GSP) program that allows duty-free exports to the U.S. for a range of products.

Since that report was issued, the 2014 Copyright Law was passed, with implementing regulations issued the following year.

In 2015, President Joko Widodo established the special Creative Economy Agency (*Badan Ekonomi Kreatif* or Bekraf) to nurture the sector's growth. Shortly after, an inter-agency task force was formed within the government to address the massive piracy problem that was costing Indonesian film producers an estimated Rp 4.3 billion (\$322,260) per film and the Indonesian recording industry about Rp 14 trillion (\$1.05 billion) annually.

In 2016, some market access concerns were addressed with the removal of film production and distribution plus recording studios from the negative investment list, paving the way for 100 percent foreign direct investment in film and sound recording production, and film distribution and exhibition.

By the end of 2017, the music industry said around two-thirds of the websites it had reported for infringing on copyrighted material were already inactive. By mid-2018, the task force had shut down 392 illegal film websites that distributed or streamed pirated content. In collaboration with industry associations, Bekraf also helped launch an Infringing Websites List that informed advertisers of which sites to stay away from.

<sup>24</sup> <https://iipa.org/files/uploads/2017/12/2014SPEC301InDOOnESIA.pdf>



**BY THE END OF 2017, THE MUSIC INDUSTRY SAID AROUND TWO-THIRDS OF THE WEBSITES IT HAD REPORTED FOR INFRINGING ON COPYRIGHTED MATERIAL WERE ALREADY INACTIVE.**



34

In recognition of these continued improvements, the IIPA recommended that Indonesia be upgraded to the non-priority “watch list” in its reports from 2016 to 2018.

It also recommended in its most recent report that the U.S. government terminate the GSP investigation into Indonesia’s intellectual property system “once it is satisfied that adequate progress has been made” on remaining concerns.<sup>25</sup>

Those remaining concerns center on the still “damagingly high” levels of internet piracy in the country despite improvements in the area of enforcement, and on government plans to implement the 60 percent local content quota stated in the 2009 Film Law that even the Association of Indonesian Film Producers (APROFI) doesn’t support.

“If we want to keep this quota and later we have a lot of films that lack quality, do you think audiences will watch them?” APROFI Chair Fauzan Zidni told AmCham Indonesia. Instead of a quota, he recommended setting a target backed by supportive policies.

But even if the government provides all the incentives and opportunities for the various creative sectors to thrive, without adequate intellectual property protection, growth will continue to be hampered.

“The only way you can get value is if your idea, your innovation, your creativity is protected,” the former minister for tourism and creative economy, Mari Elka Pangestu, told last year’s U.S.-Indonesia Investment Summit.

Addressing piracy is also important to protect the nascent yet promising over-the-top (OTT) film and television industry. The sector’s growth over the past few years has been encouraging, with major foreign players such as Netflix, iFlix, Viu and Hooq all trying to capitalize on the huge untapped, and increasingly connected market. But failing to clamp down on illegal streaming websites could lead to an early death for the industry.

<sup>25</sup> <https://iipa.org/files/uploads/2018/02/2018SPEC301InDOnESIA.pdf>

# 4.3

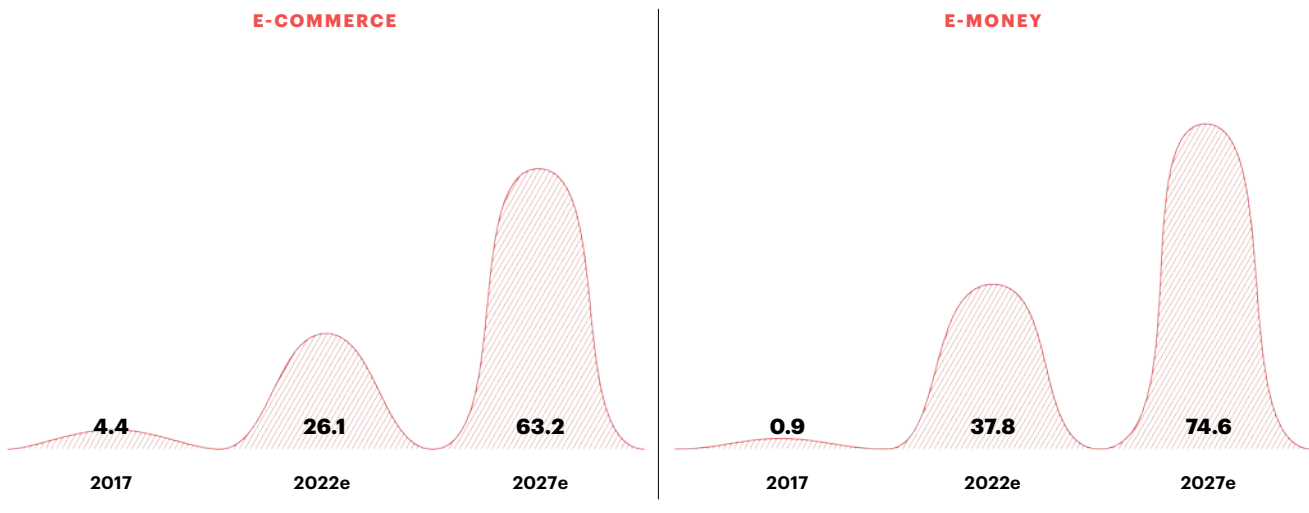
# Information & Communications Technology

*After a slow regulatory start, Indonesia now has the potential to become a regional leader in ICT if it becomes more agile and progressive in responding to new industry developments*

**FIGURE 4.1**  
Indonesia's Digitalization. Sizing the market 2017–2027, in billions of USD

e=Morgan Stanley Research estimates

Source: Euromonitor, Bank Indonesia, Morgan Stanley Research



## \$63.2 B

BY 2027, ONLINE RETAIL IN INDONESIA IS PROJECTED TO INCREASE TO \$63.2 BILLION FROM JUST \$4.4 BILLION IN 2017, ACCORDING TO MORGAN STANLEY.

There is little question about it: ICT is the hottest sector in Indonesia today.

By 2027, online retail in Indonesia is projected to increase to \$63.2 billion from just \$4.4 billion in 2017, according to Morgan Stanley.<sup>26</sup> By then, about 24 percent of all transactions would be paid using e-money, up from just 2 percent in 2017. This digital economic boom is expected to help Indonesia’s overall economy expand from \$1 trillion in 2017 to \$2.7 trillion by 2027.

Backing this growth is the ambitious \$23 billion Palapa Ring Project to connect Southeast Asia’s most populous nation to broadband internet by the end of 2019.

The picture wasn’t always this rosy. A number of regulatory issues used to cloud the scene, starting with a local content requirement for electronic gadgets that manufacturers said would have made them more expensive or simply unavailable in the local market.

After lengthy discussions, the Ministry of Information and Communications Technology (Kominfo) last year exempted non-smartphone devices from the requirement. It also redefined “local content” beyond hardware and software to include innovation development. This allowed Apple, for example, to open a developer academy

and use it to comply with the local content requirement.

Kominfo is also expected to soon release the amendment to Government Regulation No. 82/2012, which required electronic system operators for “public services” to locate their data centers and disaster recovery centers in Indonesia. In the face of concerns over the lack of clarity over what constituted a public service and the availability of local infrastructure to support this requirement, the government agreed to require only “strategic electronic data” be stored and processed locally.

Despite delays, Indonesia’s long-awaited e-commerce roadmap for 2017 to 2019 was also released last year. With an ambitious list of 26 programs covering areas like funding, customer protection, infrastructure and cybersecurity, the roadmap is expected to start paving the way toward realizing the subsector’s vast potential, though a longer-term development plan for the sector is needed.

Indeed, industry players have credited the sector’s regulators for being consultative and proactive. ICT Minister Rudiantara has

<sup>26</sup> <https://www.businesstimes.com.sg/executive-money/indonesias-coming-digital-disruption>



been widely lauded for working closely with industry players, while the Financial Services Authority (OJK) has been credited for the timely release of fintech regulations.

The openness of the OJK and the Ministry of Finance to utilizing blockchain could also help Indonesia leapfrog over its neighbors in terms of IT development, according to Inge Halim, the country manager for the financial services sector at IBM Indonesia.

However, existing hurdles remain. For instance, regulations regarding venture capitalists remain restrictive, allowing them only to invest in brick-and-mortar SMEs. Import taxes on raw materials also continue to make local manufacturing less competitive, given that the importation of finished goods is tax free.

The country's cybersecurity situation is still perceived as fragile, with Indonesia having the lowest spending on cybersecurity among the ASEAN-5, at 0.02 percent of GDP in 2017, according to a cybersecurity report from A.T. Kearney.<sup>27</sup> By comparison, Vietnam and the

Philippines spend 0.04 percent of their GDP on cybersecurity, and mature economies spend an average of 0.35 percent of GDP, which would equate to around \$24 billion for Indonesia. Though a National Cybersecurity Agency was recently established, it remains to be seen how effective it would be in protecting Indonesia's burgeoning financial services and e-commerce sectors from the growing threat of cyberattacks.

Industry players say that if Indonesia is to become a regional leader in the ICT space, regulators need to be more agile in responding to tech developments, such as the use of big data and the future roll-out of the 5G mobile network.

A recent speech<sup>28</sup> by the ICT minister could provide some reassurance: "The government must be ahead of the curve in terms of facilitating and accelerating so that the digital ecosystem can develop," Rudiantara said, pointing out that the ministry has already reduced the number of licenses required and also implemented same-day services. "I believe the best regulations regulate less."

<sup>27</sup> <http://www.southeast-asia.atkearney.com/documents/766402/15958324/Cybersecurity+in+ASEAN%E2%80%9494An+Urgent+Call+to+Action.pdf/ffd3e1ef-d44a-ac3a-9729-22afbec39364>

<sup>28</sup> [https://www.kominfo.go.id/content/detail/14133/siaran-pers-no-206hmkominfo082018-tentang-siapkan-indonesia-lebih-kompetitif-di-era-digital/0/siaran\\_pers](https://www.kominfo.go.id/content/detail/14133/siaran-pers-no-206hmkominfo082018-tentang-siapkan-indonesia-lebih-kompetitif-di-era-digital/0/siaran_pers)

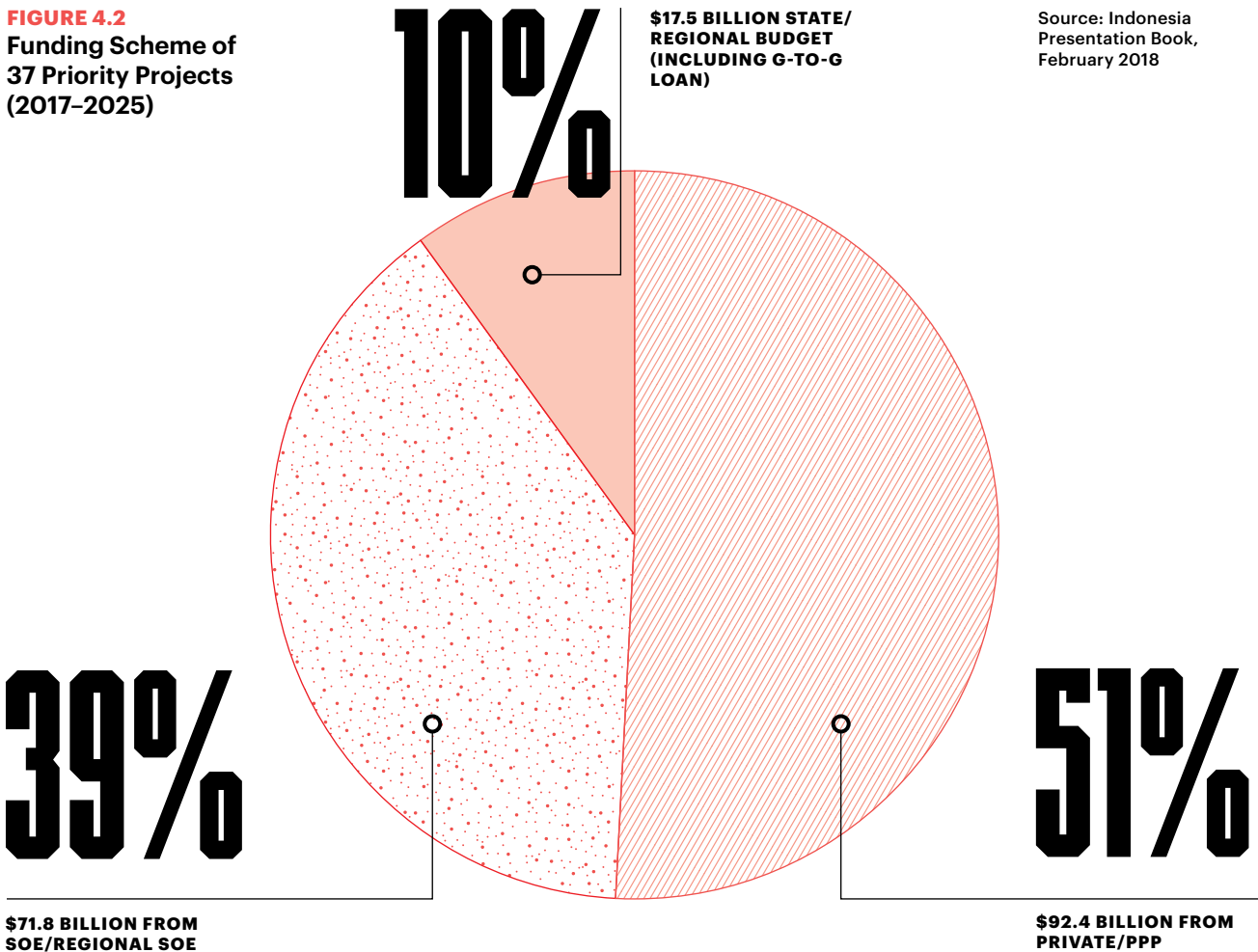
# 4.4

# Infrastructure

*The largest infrastructure program ever undertaken by Indonesia has been backed by a number of important regulatory reforms, but implementation issues continue to make attracting private financing a challenge*

**FIGURE 4.2**  
Funding Scheme of  
37 Priority Projects  
(2017-2025)

Source: Indonesia  
Presentation Book,  
February 2018



Total financing gap for 37 priority projects is **\$164.2 billion** or **90%** of total infrastructure financing needs >using PPP scheme or Blended Finance mechanism

In 2017, Indonesia received \$15.4 billion in private investment across 11 infrastructure projects, the second highest level among emerging markets and developing economies after China's \$17.5 billion, according to the World Bank.<sup>29</sup> Topping the list of projects was the \$6 billion Jakarta-Bandung high-speed railway that is now 40 percent funded by the China Railway Construction Corp., followed by two coal megaprojects worth \$4.2 billion and \$2.2 billion.

This indicates that Indonesia's efforts to attract private sector funds for its massive infrastructure push are starting to pay off.

In 2014, the government's Committee for the Acceleration of Priority Infrastructure Delivery (KPPIP) was formed to push for strategic projects, such as by jump-starting project preparation, sorting out land acquisition issues, and debottlenecking procurement problems.<sup>30</sup>

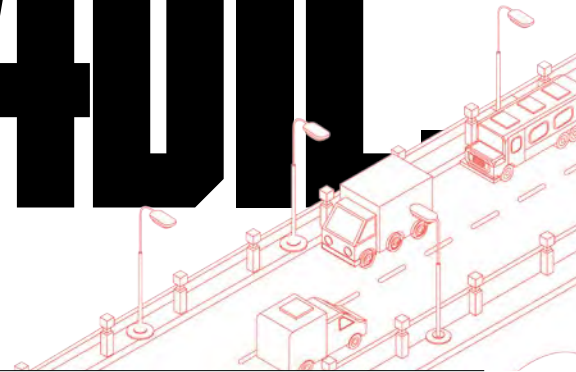
In 2015, the government improved the framework for public-private partnerships (PPP) to bring in the funds needed to help finance more than 260 infrastructure projects estimated to cost almost \$400 billion. This was done through a presidential regulation

29 [http://ppi.worldbank.org/-/media/GIAWB/PPI/Documents/Global-notes/PPI\\_2017\\_AnnualReport.pdf](http://ppi.worldbank.org/-/media/GIAWB/PPI/Documents/Global-notes/PPI_2017_AnnualReport.pdf)

30 <https://kppip.go.id/en/about-kppip/kppip-achievements/kppip-achievements-semester-1-2015/>

IN 2017, INDONESIA RECEIVED \$15.4 BILLION IN PRIVATE INVESTMENT ACROSS 11 INFRASTRUCTURE PROJECTS, THE SECOND HIGHEST LEVEL AMONG EMERGING MARKETS AND DEVELOPING ECONOMIES AFTER CHINA'S \$17.5 BILLION

# \$ 15.4 BILLION



that expanded the types of projects eligible for PPP schemes, allowed developers to submit unsolicited proposals, and created a guarantee mechanism, among others.

In the same year, the office of the president also sought to fix what is seen as the biggest hurdle to infrastructure development: land acquisition. To address the weaknesses of the 2012 Land Acquisition Law, Presidential Decree No. 30 of 2015 expanded the coverage of infrastructure projects that the law was applicable to, and allowed the private sector to finance land procurement.

Land issues also became more manageable with the establishment of the State Assets Management Agency (LMAN), according to Prasetyo Singgih, the former chief operating officer of the PINA Center for Private Investment at the Ministry of National Development Planning (BAPPENAS) and now a managing partner of Singgih, Bustaman & Partners.

As the country pushes to secure some \$160 billion more to help finance its next set of priority infrastructure projects to 2025, efforts at regulatory reform need to translate to better implementation on the ground to clear bottlenecks and create bankable projects.

The Asian Development Bank's country director for Indonesia, Winfried Wicklein, told the *Jakarta Globe* in an interview that while Indonesia has considerably strengthened the legal and institutional framework for PPPs, work still needs to be done in terms of improving the quality of project preparation and ensuring fair and transparent procurement processes.<sup>31</sup>

Prasetyo also acknowledged that "getting the projects ready is difficult," pointing to continued problems with land issues and getting permits and licenses in place.

For example, the completion date for the Jakarta-Bandung high-speed railway has been pushed to October 2020 from 2019 because of land acquisition problems.<sup>32</sup> Despite the government's reforms, only about half the land for the 140-kilometer-long railway had been acquired as of February 2018.

Improved coordination between different levels of government and among various ministries is also still needed.

The opening of the Kuala namu International Airport in Medan, north Sumatra, was postponed because the lack of a centralized strategy delayed the construction of the 14-kilometer road linking Medan to the airport, according to a PricewaterhouseCoopers report.<sup>33</sup>

The ambitious 500 Island Project - signed in 2015 in the presence of President Joko Widodo to provide electricity to 1.5 million people in remote villages and islands by Caterpillar, Fluidic Inc. and PT Perusahaan Listrik Negara (PLN) - still hasn't taken off because it doesn't have all the government approvals it needs yet.

While much work still needs to be done, Prasetyo pointed out that "a lot of the important changes" have already been done by the government.

"As Indonesians, we would like to appeal to foreign investors that Indonesia has come a long way from an investment climate point of view. It's time for foreign investors to take advantage of the better climate," he said.

31 <http://jakartaglobe.id/business/indonesia-among-top-5-countries-utilizing-the-most-private-money-for-infrastructure-last-year/>

32 <http://www.thejakartapost.com/news/2018/02/19/jakarta-bandung-railway-project-wont-meet-target-minister.html>

33 <https://www.pwc.com/id/en/capital-projects-infrastructure/Building%20Indonesia's%20future.pdf>

*Achieving food self-sufficiency remains an insurmountable challenge for the world's fourth most populous nation, but it should continue to fight protectionist tendencies that are only making the country less food secure*



In 2014, the Ministry of Agriculture said the new administration's focus over the short term was to achieve self-sufficiency – as opposed to security of supply – in rice, corn, soybeans and sugar<sup>34</sup> – four basic food commodities that Indonesia can't produce enough of domestically. Indeed, it produces very low quantities of soybeans relative to demand.

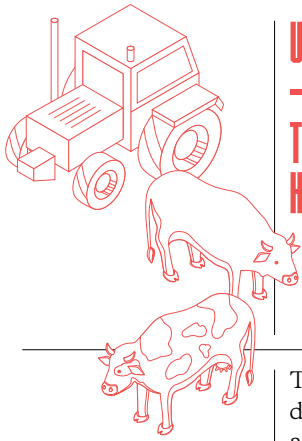
Despite the government's efforts over the past few years – distributing millions of seeds and free fertilizer, revitalizing irrigation infrastructure, and giving away more

modern agricultural tools, among others – achieving food self-sufficiency remains an insurmountable challenge for the world's fourth most populous nation.

In fact, Indonesia hasn't been able to reverse the decline of the agriculture sector's contribution to GDP, which fell to 13.45 percent in 2016 from 22.09 percent in 1990.<sup>35</sup>

<sup>34</sup> <http://www.thejakartapost.com/news/2014/12/27/jokowi-aims-food-self-sufficiency-three-years.html>

<sup>35</sup> <http://www.thejakartapost.com/news/2017/03/31/plunging-agriculture-share->



## U.S. OFFICIALS HAVE POINTED TO INCREASING IMPORTS OF FOOD PRODUCTS FROM THE U.S. – ANYTHING FROM APPLES TO BEEF, RICE AND CORN – AS A WAY TO ADDRESS THE U.S. TRADE DEFICIT WITH INDONESIA AND HELP LOCAL CONSUMERS WHO FACE SOME OF THE HIGHEST FOOD PRICES IN THE WORLD.

The massive conversion of farming land, the decline in the number of people working in agriculture to 31.9 percent of the workforce in 2016 from 55.1 percent in 1990, and lack of access to financing are among the many complex issues facing the sector, which could take decades to solve.

Amid all this, though, the desire to support local farmers often leads to protectionist tendencies that could ironically make Indonesia less food secure.

For instance, though the majority of Indonesia's soybeans are imported from the U.S., agriculture officials have repeatedly raised the idea of increasing import tariffs for the product in order to protect local farmers.

However, ahead of the review of Indonesia's eligibility for the Generalized System of Preferences (GSP) program by the Office of the United States Trade Representative (USTR) in June 2018, government officials acknowledged the move could hurt local consumers.

"Tofu and tempeh use soybeans from them [the United States] and they are hard to replace, so we can't put up a tariff as a barrier," Trade Minister Enggartiasto Lukita said.<sup>36</sup>

At the GSP review hearing in Washington later that month, Indonesia's representative said that if the country restricted imports when local production was insufficient to meet demand, "the price will go up and then people will go strike. Because tempeh is like rice, it is our staple food in Indonesia."<sup>37</sup>

In 2017, the Ministry of Agriculture also tried to make the issuance of import permits for dairy products dependent on "partnerships" with local milk producers. A year later, the government again amended the regulation after realizing no sufficient local alternative was available for the dairy products imported from the U.S., particularly skim milk.

These reversals indicate a willingness from Indonesian officials to ensure that agricultural trade routes remain open despite rhetoric to the contrary.

Minister Enggartiasto also said Indonesia was committed to removing trade barriers in order to comply with a 2017 World Trade

Organization ruling on a case filed by the U.S. and New Zealand. The two countries went to the WTO in 2014 to challenge 18 import measures Indonesia had imposed on horticulture and animal products in 2012.

U.S. officials have pointed to increasing imports of food products from the U.S. – anything from apples to beef, rice and corn – as a way to address the U.S. trade deficit with Indonesia and help local consumers who face some of the highest food prices in the world.

Aside from food commodities, it is also interesting to note that the U.S. has been Indonesia's second largest source of tobacco imports since the past few years. Unfortunately, we observed a similar pattern to tighten tobacco imports despite a shortage of locally produced tobacco. The quota restrictions proposed by the Ministry of Trade remain unclear, and the government should encourage more cooperation between business and local farmers to improve productivity and the farmers' livelihood.

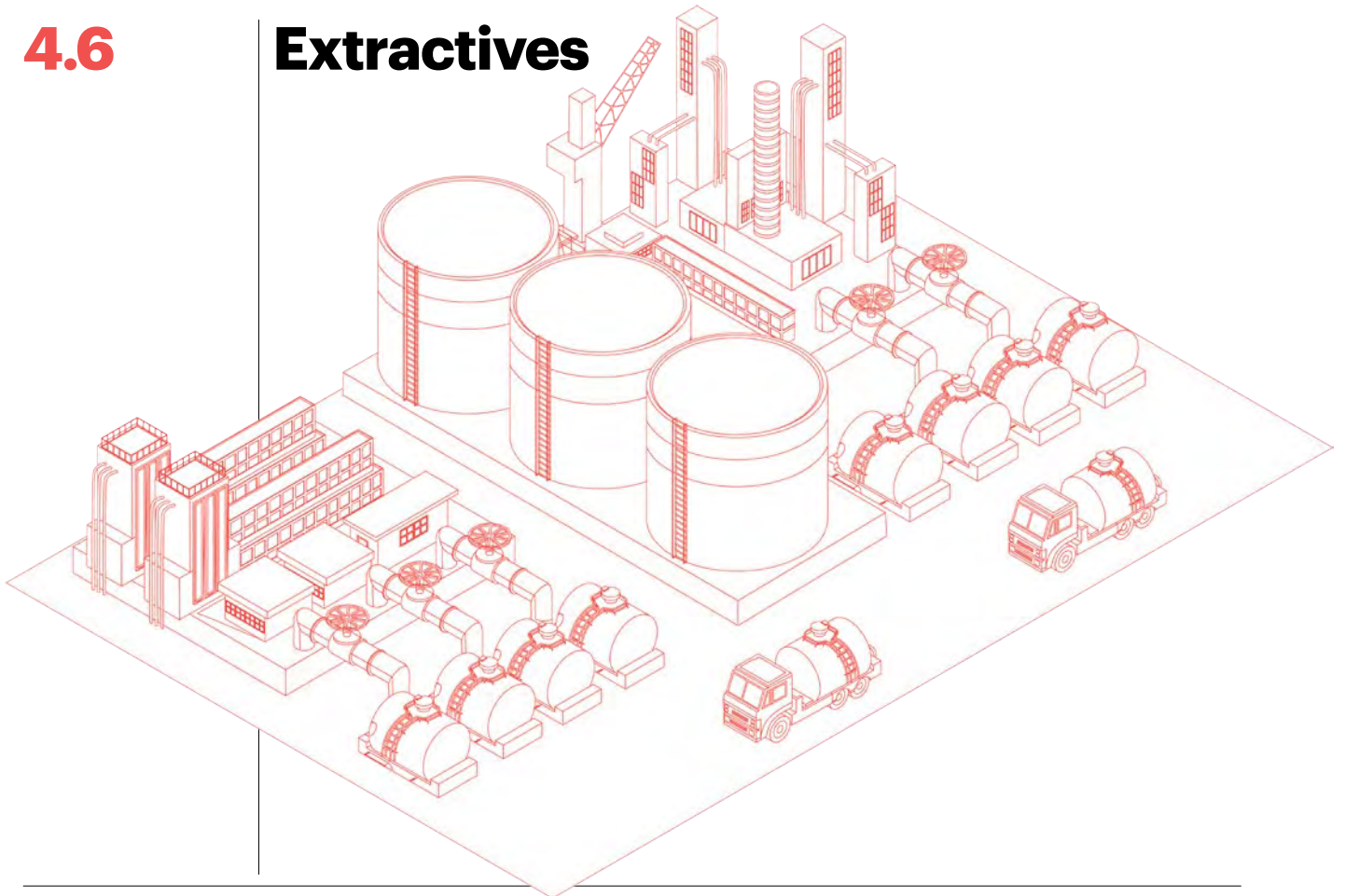
One challenge Indonesia could more readily resolve is ensuring its agricultural policies are backed by reliable data. In January 2018, for example, just a month after the agriculture ministry announced that Indonesia had produced more rice than it needed last year, the government was forced to suddenly import 500,000 tons of rice to address a looming shortage.

Forced to admit the government had unreliable and inconsistent data, the Central Statistics Agency (BPS) said it would use a satellite-based method to calculate rice production for more accurate data.<sup>38</sup> Having this, according to industry players, could lead to better informed policymaking.

<sup>36</sup> <https://www.reuters.com/article/us-usa-trade-indonesia/indonesia-says-scrapping-plans-to-bring-back-soybean-import-tax-idUSKbn1K10Q9-to-gdp-major-concern-for-policymakers.html>

<sup>37</sup> <https://www.regulations.gov/document?D=USTR-2018-0007-0023>

<sup>38</sup> <http://www.thejakartapost.com/news/2018/01/18/new-calculation-method-ensure-rice-data-accuracy.html>



*The outlook for investment in the oil and gas and mining sectors remains weak over the medium term, as regulatory uncertainty continues to cloud the horizon despite government efforts to streamline the bureaucracy*

There's little debate about it: Much work still needs to be done to make the regulatory environment for Indonesia's extractives sector conducive enough to attract the investment it needs. No less than President Joko Widodo himself said this during the 42nd Indonesian Petroleum Association Exhibition and Convention in May 2018.

"There are still many regulations and procedures that need to be trimmed down and I want to know any regulations that still give you concerns," the president told the oil and gas executives gathered at the conference.

It's easy to see where the president is coming from. Investment in the once mighty oil and gas industry dropped by half, from \$20.72 billion in 2014 to just \$10.18 billion in 2017. Its contribution to state revenue dropped from 14 percent in 2014 to 3 percent in 2016, before recovering to 5 percent in 2017.<sup>39</sup>

In the mining sector, investment has been channeled to the downstream sector to build smelters in line with the domestic processing requirements of the 2009 Mining Law.

However, concerns over the sustainability of these investments were triggered by a relaxation of the export ban on low-grade nickel ore and washed bauxite in January 2017.

At the same time, industry players warn that the continued lack of spending on exploration will cut off the lifeblood of the industry, further jeopardizing the future of these new smelters.

To its credit, the government has made efforts to improve the regulatory environment.

Soon after he was appointed to his current portfolio in October 2016, Energy and Mineral Resources Minister Ignasius Jonan quickly went to work cutting red tape, removing more than 180 regulations in the oil and gas sector.

The ministry was also lauded for listening to industry input on how to revise the gross-split model it introduced in 2017 to replace the traditional production-sharing contract regime. The amended version gives the minister flexibility in adjusting the overall

# -180

SOON AFTER HE WAS APPOINTED TO HIS CURRENT PORTFOLIO IN OCTOBER 2016, ENERGY AND MINERAL RESOURCES MINISTER IGNASIOUS JONAN QUICKLY WENT TO WORK CUTTING RED TAPE, REMOVING MORE THAN 180 REGULATIONS IN THE OIL AND GAS SECTOR.

<sup>39</sup> <https://www.pwc.com/id/en/energy-utilities-mining/assets/oil-and-gas/oil-and-gas-guide-2018.pdf>





## CREATING A TRACK RECORD TO PROVE LONG-TERM REGULATORY CERTAINTY CANNOT BE ACHIEVED BY ONE ADMINISTRATION, BUT HAVING REGULATORS WILLING TO LISTEN AND RESPOND TO INDUSTRY PLAYERS IS AN IMPORTANT START.

# 5000<sup>HA</sup>

THE MINISTRY HAS ISSUED A REGULATION ALLOWING FOREIGN INVESTORS TO PARTICIPATE IN TENDERS FOR MINING AREAS LESS THAN 5,000 HECTARES.

split to make a contract more attractive to investors, though how this will be put to actual use remains to be seen.

In the mining sector, some 32 regulations and 64 requirements for certifications and permits have been revoked as of March 2018. The ministry has also issued a regulation allowing foreign investors to participate in tenders for mining areas less than 5,000 hectares.<sup>40</sup>

Despite these, regulatory uncertainty continues to make the investment risk in both Indonesia's oil and gas and mining sectors too high for many investors. While cutting down regulations and procedures is important to improve the ease of doing business in Indonesia, investors in the extractives sectors have repeatedly underscored that the most important factor for them is long-term regulatory certainty.

In the mining sector, for instance, foreign ownership divestment rules have changed several times since the Mining Law was enacted. The government's efforts to nationalize assets in the extractives sector could also cool some of the foreign interest that would otherwise be generated by the streamlined bureaucracy.

Even with a more responsive Ministry of Energy and Mineral Resources, coordination problems with other government agencies and conflicting forestry and environmental regulations also continue to pose operational challenges on the ground.

Creating a track record to prove long-term regulatory certainty cannot be achieved by one administration, but having regulators willing to listen and respond to industry players is an important start.

<sup>40</sup> <https://www.pwc.com/id/en/publications/assets/eumpublications/mining/Mining-Guide-2018.pdf>

*Financial technology is fueling growth in the financial services sector, but a number of policies driven by nationalistic and protectionist motivations could keep Indonesia from reaching its potential*

**THERE ARE NOW MORE THAN 230 FINTECH COMPANIES IN INDONESIA, AND E-MONEY TRANSACTIONS HAVE GROWN SIXFOLD FROM 2012 TO RP 12.3 TRILLION (\$840 MILLION) IN 2017.**

**\$840M**

For years, until the emergence of financial technology (fintech), Indonesia's financial services sector was characterized by limited access and penetration. More than 60 percent of the population was unbanked, less than 7 percent had credit cards and only 2.5 percent owned insurance policies.

Fintech is changing the story. Today, it is the biggest source of growth in the sector, and the main driver of the government's push to reach 75 percent financial inclusion by 2019. There are now more than 230 fintech companies in Indonesia, and e-money transactions have grown sixfold since 2012, to Rp 12.3 trillion (\$840 million) in 2017. Fintech solutions offer consumers a way to make and receive electronic payments through their smartphones and other devices without having to use traditional banking services.

Part of this growth can be credited to the Financial Services Authority (OJK), which issued a regulatory framework for peer-to-peer lending at the end of December 2016 and an umbrella framework covering a wider range of fintech applications in August 2018. The latest regulation set up a regulatory "sandbox" where registered fintech operators can test innovative business models for up to a year without having to comply with all of the regulations governing financial-services providers, after which OJK will decide whether to recommend them for registration, reject them or require more testing.

But there's much work ahead, especially if fintech is to help meet the \$166 billion estimated financing gap for Indonesia's small and medium-sized enterprises.

The sector needs a similarly progressive approach to creating regulations in areas such as digital signatures and know-your-customer procedures, which could significantly and quickly expand the reach of fintech firms.

That may be a tall order, as the regulatory environment in the financial services sector in general has been moving in a nationalistic and protectionist direction over the past few years.

From Jan. 1, 2016, the OJK mandated that Indonesian insurers place all reinsurance of "simple risks" - life insurance and most property and casualty insurance - with domestic reinsurers, primarily the new Indonesia Re (PT Reasuransi Indonesia utama), a holding company for two of the three state-owned reinsurers. Only "non-simple risk," such as coverage of satellites or a natural disaster, can be dealt with directly offshore.

By restricting competition and forcing insurance companies to rely on domestic reinsurers that have less capital and a lower credit rating than most global companies, the regulation ironically raises the overall risk in the country's insurance industry because

Indonesia Re and others retrocede coverage offshore at an increased cost and with less transparency.

This, and a number of other issues in OJK's regulatory oversight of the insurance sector, requires an increased commitment on the part of the supervisory body to established global best practices.

In 2017, Bank Indonesia launched the National Payment Gateway (NPG) system, which requires that all domestic electronic payments in the country be processed solely through four authorized switching companies that are at least 80 percent domestically owned. Cross-border payments can still be processed by international networks.

The establishment of the NPG and the new rules force international payment companies to find a local partner that will own 80 percent of their business - an unattractive proposition for companies with decades of proprietary and innovative technology in use - or to enter into commercial agreements with the domestic switching companies that will add a layer of cost and inefficiency.

But beyond concerns over the NPG and the insurance issues mentioned earlier, industry players say that the country's financial and economic sectors have generally been well managed, creating optimism that existing regulatory issues can be resolved through dialogue and consultation.

For instance, the Ministry of Information and Communications Technology is expected to come through this year on a long-promised amendment of the strict data onshoring requirement for public services, including

financial services, under Government Regulation No. 82/2012. The revision will allow data to be classified into certain tiers, some of which can be stored offshore, and reportedly does not allow line ministries to independently determine which data is "strategic" and therefore must be onshore. Industry players, both local and foreign, have worried for years that strict data onshoring requirements could undermine Indonesia's digital development and ultimately prove to be less secure than widely used cloud solutions.

In another example, President Joko Widodo earlier this year signed a long-awaited regulation setting the foreign ownership ceiling of new insurance companies at 80 percent, ending years of contentious debate stemming from the 2014 Insurance Law that was also designed to promote the development of domestic insurers.

Though protectionist interests lobbied hard for much lower limits, the 80 percent cap is seen as a win for more progressive voices who argued that anything less would be too disruptive. The limit will apply to new foreign joint-venture insurance companies and existing ones that have not yet reached the 80 percent threshold. Existing insurers that have exceeded the foreign ownership limit have been grandfathered in for the time being.

Unfortunately, existing market entry barriers in the form of forced local partnership requirements for international insurance companies continue to be a hindrance to growth in the market. Given Indonesia's extremely low insurance penetration rates, policymakers should prioritize continued liberalization in this sector.



*Consultative processes have pointed toward solutions to problems posed by the patent and halal laws, showing a way forward for other regulatory issues, such as on local content requirements and clinical trials*

Over the past few months, two major regulatory issues that had been worrying executives of foreign pharmaceutical companies were at least partially resolved: Article 20 of the 2016 Patent Law that requires patented products to be manufactured in Indonesia, and the 2014 Halal Law that mandates certification and labeling for practically all consumable products, including pharmaceuticals and medical devices.

After two years of discussions among relevant government agencies, foreign companies, and the foreign chambers and industry associations representing them, the ministerial regulation containing the workaround for the contentious Article 20 was signed in July 2018. A result of consultative policymaking, the solution to the unworkable article is to allow companies to obtain an extendable five-year delay in complying with the local manufacturing requirement.

“Forcing patent holders to manufacture all patents locally would have reduced innovation and held back growth,” AmCham Managing Director Lin Neumann said. “Fortunately, we were able to work with the team at the ministry of law to find a solution and we hope to continue our partnership to address other regulatory issues in the Patent Law, including patentability and compulsory licensing.”

Similarly, discussions and consultations led to the drafting of implementing regulations for the Halal Law that supports the government and industry aspirations to provide quality healthcare. Under the leadership of the Office of the Vice President, the overall implementing regulation, or PP, introduced a phased approach over time, narrowed the list of categories falling under mandatory halal certification, and deferred implementation of the regulation for medicine, biological products and medical devices after October 2019. One official called it an approach of “maximum flexibility” in the face of what is likely the world’s most stringent halal law.

While these solutions do not solve all the problems, they create workable scenarios and buy time until the laws themselves can be amended. In addition, both solutions were crafted in consultation with the private sector and concerned stakeholders.

But a new issue is now again threatening existing and potential foreign investment in the sector. The government wants to enforce local content requirements in the pharmaceutical and medical devices industry, but the current proposed system for calculating this “local content” spans the entire process from research to manufacturing. Instead of encouraging companies to localize, the move could instead discourage more foreign investment in pharmaceuticals.

Economists have always said Indonesia should not try to enforce local content on pharmaceuticals because patients require choices of access to effective healthcare. Instead, the government should focus on creating incentive-based mechanisms for the pharmaceutical industry through proper capacity-building frameworks.

“We believe there are opportunities for the private sector to support the government’s healthcare goals. The pharmaceutical industry has experience in developing healthcare sector capacity and is committed to providing expertise to help the country turn its healthcare sector development roadmap into reality,” Pfizer Indonesia Country Manager and President Director Anil Argilla said.

“We believe that having policies in place that foster collaboration between industry and government through the advanced manufacturing technologies and R&D will help accelerate the development of the healthcare sector.”

Unfortunately, amid all this regulatory activity, clinical trials - the one area that foreign pharmaceutical companies have long been saying the government should pay attention to - have seen little movement.

Indonesia continues to have one of the lowest number of clinical trials in the world, at 345 in 2017, just above Vietnam’s 338, and far below Thailand’s 2,221. Aside from limitations in terms of laboratories and trained researchers, Indonesia hasn’t been able to benefit from the pharmaceutical industry’s research and development market that is expected to be worth \$180 billion by 2020 because of regulatory barriers. There are also strict

**\$180  
BILLION**

ESTIMATED VALUE  
OF THE GLOBAL  
PHARMACEUTICAL  
INDUSTRY’S RESEARCH  
AND DEVELOPMENT  
MARKET BY 2020.

regulations prohibiting local blood samples from being exported or analyzed abroad due to Material Transfer Agreement restrictions, another factor holding back trials.

Among others, the country needs to set up proper technology transfer frameworks and allow parallel regulatory submissions to other jurisdictions. Registration timelines in Indonesia are among the longest in the Asia-Pacific market, and can be shortened by leveraging registration approvals in markets like the U.S. and the European Union to bring innovation more quickly to Indonesia. Incentives, such as on taxes and equitable pricing, would also help accelerate investment in this area.

Two years ago, the Ministry of Health asked the pharmaceutical industry association to create a roadmap for clinical research in Indonesia, a request that was promptly fulfilled. The critical next step is for discussion and agreement to align industry and patient aspirations on how to implement the roadmap comprehensively and ensure sustainable access of high-quality therapies in the country.

But with the consultative policymaking approach seen in other discussions, there is optimism the private sector can work with the government in creating sustainable higher value in its pharmaceutical supply chain.



# RECOMMME

*Indonesia has made significant strides along the path to reform over the past four years. Continuing this journey, we believe, can help the country realize its vast potential. As always, we offer our recommendations in the spirit of the continuing partnership between foreign investors and the people of Indonesia for the development of the country. Given that 2019 is an election year, we break down our recommendations here into what we believe can realistically be accomplished before the end of President Joko Widodo's first term, and what foreign investors are hoping for from the next government.*

## 01 SHORT TERM

The government has made progress on a number of key issues over the past few years that need to be followed up with proper implementation amid the increased focus on the election campaign leading up to Election Day, April 17, 2019.

**01** The government has pledged that the much-needed amendment to the data localization requirements in Government Regulation No. 82/2012 would be signed before the end of 2018. The latest draft is clearer and seems to answer many questions companies have raised, especially with regard to the classification of data. It is important that this amendment be issued soon, as any more delays would only prolong the lengthy debate over this and further increase uncertainty.

**02** The launch of the Online Single Submission (OSS) system is an important start. But the government needs to quickly iron out the problems that faced its rollout, including remaining inconsistencies with other bureaucratic processes and technological issues, for it to truly make an impact on the ease of doing business.

**03** The new regulation on the employment of expatriates released earlier this year promises greater openness in the country's manpower regime by abolishing the requirement for a Foreign Worker Utilization Permit (IMTA) and shortening the overall processing time. But in our view, the regulation remains overly complex and did not go far enough to streamline the process, perhaps through a single-agency approach. Questions remain over how it will actually be implemented. The ministries of manpower and human rights and law, which oversees immigration, need to coordinate to ensure a smooth documentation process and an integrated system by the November 2018 target.

**04** The Ministry of Health has likewise promised changes to the procurement system for the e-catalogue of the Social Security Organizing Body (BPJS) to address issues over the procurement of pharmaceutical products and medical devices; delivering on this promptly would contribute significantly to the efficiency of the national healthcare insurance system.

**05** Considerable progress has been made in terms of explaining the implementation of the 2014 Halal Law to industry and being open to phased implementation by sectors. There remain concerns about the harmonization of international halal certification bodies with the new standards to go into effect here. We encourage the government to recognize accreditation by international halal certification bodies for reasons of expense and convenience for companies and consumers.

**06** The Negative Investment List (DNI), which is undergoing revision, remains a hindrance to investment in our view. We have long recommended scrapping the list entirely and opening up investment in more sectors. We believe that forced partnerships, equity caps and keeping areas like universities and healthcare mostly closed to foreign investment harm innovation and are a drag on the economy. Investment guidelines could be developed to handle areas related to national security or other sensitive sectors.

# INDICATIONS

## 02 LOOKING AHEAD

For the next government, placing greater priority on improving regulatory certainty through legal amendments, boosting coordination among government bodies, and harmonizing various regulations would go a long way toward increasing Indonesia's attractiveness to investors.

**01** A transparent and balanced approach toward the laws and regulations governing Indonesia's natural resources – water, oil and gas, minerals – is needed to both protect the country's interests and attract the foreign capital and technology needed to efficiently develop these resources for the benefit of the Indonesian people. Laws that severely restrict the ability of the private sector to participate in these sectors only curtail investment and slow economic growth.

**02** Problematic legislation – like the 2016 Patent Law – also needs to be amended to create legal certainty. While the government has addressed one weakness of the Patent Law, Article 20, with an acceptable work-around that was developed with industry input, this is still a short-term fix that does not provide long-term guarantees.

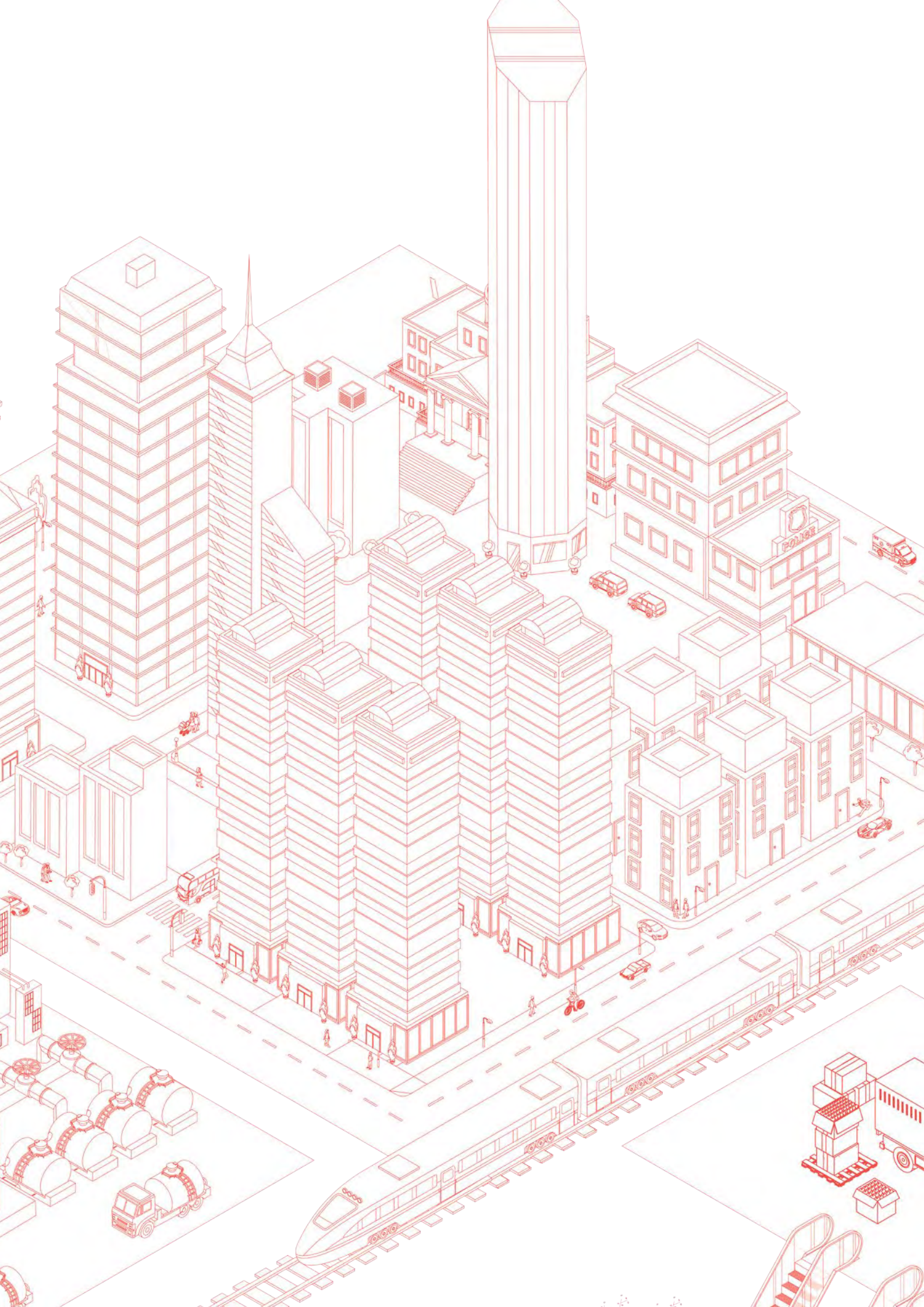
**03** A number of government institutions can be strengthened to improve consistency within the bureaucracy. For example, the Special Task Force for Upstream Oil and Gas Business Activities (SKKMigas) can be empowered to advocate for the oil and gas industry to address conflicting policies from other ministries like environment and forestry.

**04** Greater progress needs to be made on public-private partnership (PPP) opportunities for the private sector in infrastructure development. We are concerned that much of the massive – and commendable – infrastructure drive underway currently could stall due to budgetary pressures and the fact that the sector is dominated by state-owned companies. There is considerable interest by foreign investors to enter the sector under PPP schemes, but so far there has been little progress in this direction.

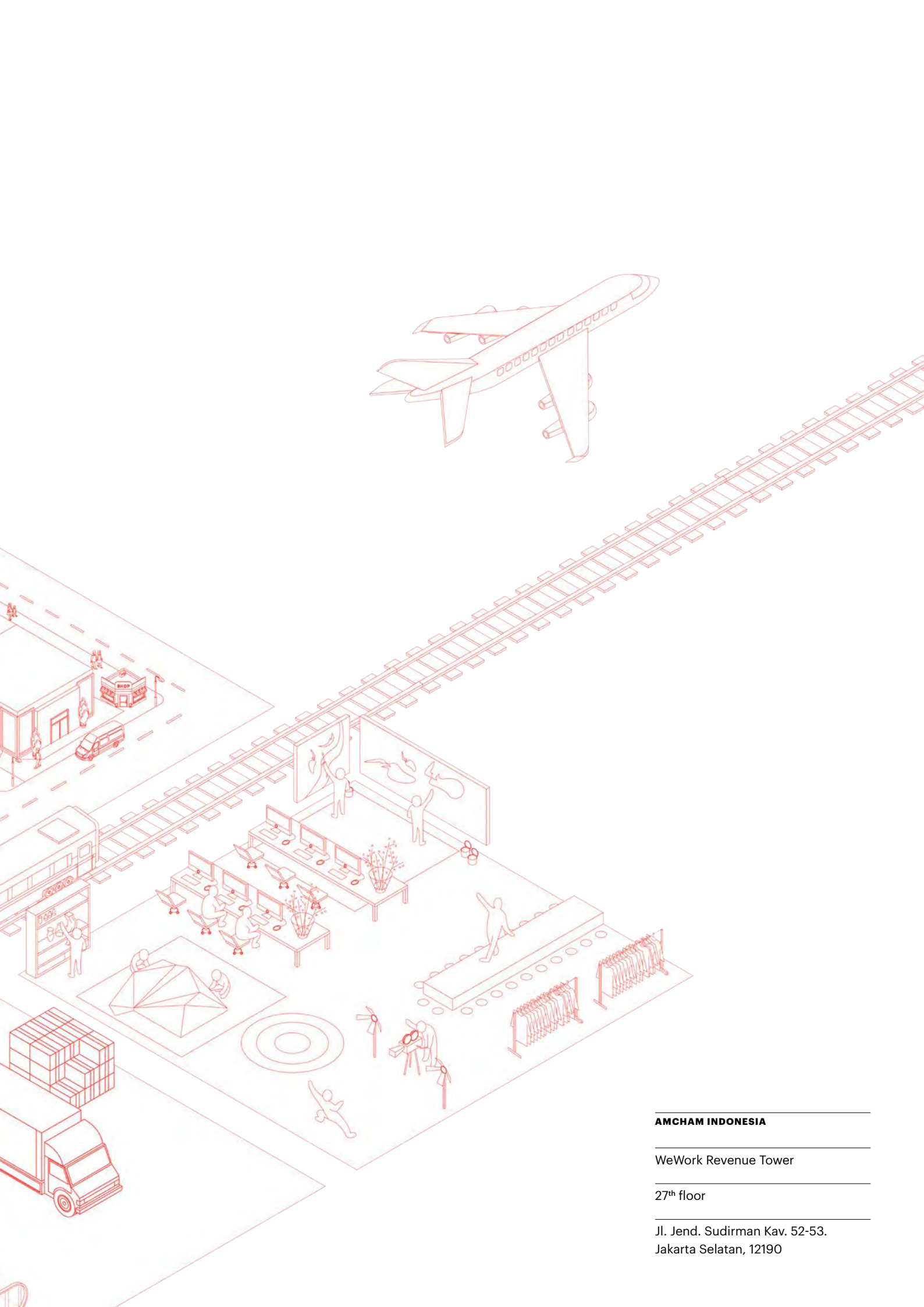
**05** The new government should also nurture innovation in sectors such as the digital economy, pharmaceuticals and education. The tremendous pace of change enabled by technology should be guided by a progressive regulatory framework. The increased trend toward automation and digitalization in what is being called Industry 4.0 also requires a more conducive research and development environment, not just in the ICT sector but also in the pharmaceutical industry, where the country holds vast potential. Finally, producing workers able to handle tomorrow's economic challenges requires changes in today's education system. Allowing foreign institutions to invest in campuses in Indonesia can raise the standards of education in the country and help Indonesia keep pace.

In general, we applaud the increased effort to engage the business community and are hopeful the government will continue to expand dialogue with the private sector and institutionalize consultations in the policymaking process.

At the same time, we are concerned about the increase in protectionist policies over the past few years, despite the government's stated intention to create an economy more open to foreign investors. Focusing on policies that leverage the country's inherent strengths while capitalizing on what the foreign investment community can contribute will help create a more sustainable path toward economic prosperity and cement Indonesia's place as one of the world's fastest-growing economies.







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