



# Completion Report

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Project Number: 31644  
Loan Number: 1738  
December 2008

## Indonesia: Industrial Competitiveness and Small and Medium Enterprise Development Program

Asian Development Bank

## CURRENCY EQUIVALENTS

Currency Unit – rupiah (Rp)

		<b>At Appraisal</b> (2 April 1999)	<b>At Program Completion</b> (31 December 2004)
Rp1.00	=	\$0.000141	\$0.000108
\$1.00	=	Rp7,085	Rp9,290

## ABBREVIATIONS

ADB	–	Asian Development Bank
BAPPENAS	–	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
BKPM	–	Badan Koordinasi Penanaman Modal (Investment Coordination Board)
BULOG	–	Badan Urusan Logistik (Agency for National Logistics)
EKUIIN	–	Menteri Koordinator Bidang Ekonomi Keuangan dan Industri (Coordinating Ministry for Economic Affairs)
KKP	–	Kredit Ketahanan Program (Food Stability Program)
KPPU	–	Komisi Pengawas Persaingan Usaha Republik Indonesia (Commission for Competition Supervision)
MOF	–	Ministry of Finance
MOIT	–	Ministry of Industry and Trade
MTAP	–	medium-term action plan
PIU	–	project implementation unit
PSC	–	program steering committee
SME	–	small and medium-sized enterprise
TA	–	technical assistance
TCR	–	technical assistance completion report

## NOTE

In this report, "\$" refers to US dollars.

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## BASIC DATA

### A. Loan Identification

1.	Country	INO
2.	Loan Number	1738
3.	Program Title	Industrial Competitiveness and Small and Medium Enterprise Development Program
4.	Borrower	Republic of Indonesia
5.	Executing Agency	Ministry of Finance
6.	Amount of Loan	\$200,000,000
7.	Program Completion Report Number	PCR: 1085

### B. Loan Data

1.	Appraisal		
	– Date Started	21 March 1999	
	– Date Completed	3 April 1999	
2.	Loan Negotiations		
	– Date Started	7 February 2000	
	– Date Completed	11 February 2000	
3.	Date of Board Approval	16 March 2000	
4.	Date of Loan Agreement	28 March 2000	
5.	Date of Loan Effectiveness		
	– In Loan Agreement	28 June 2000	
	– Actual	29 March 2000	
	– Number of Extensions	0	
6.	Closing Date		
	– In Loan Agreement	31 March 2002	
	– Actual	31 December 2004	
	– Number of Extensions	4	
7.	Terms of Loan		
	– Interest Rate	0	
	– Maturity (number of years)	15	
	– Grace Period (number of years)	3	
8.	Disbursements		
a.	Dates		
		<b>Initial Disbursement</b>	<b>Final Disbursement</b>
		<b>Effective Date</b>	<b>Original Closing Date</b>
		29 March 2000	19 February 2002
		29 March 2000	31 March 2002
			22 months and 21 days
			<b>Time Interval</b>
		29 March 2000	31 March 2002
			24 months and 2 days
b.	Amount (\$ million)		
		<b>Original Allocation</b>	<b>Amount Disbursed</b>
		200	150
			<b>Undisbursed Balance</b>
			50

**C. Program Data**

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
From Mar 2000 to Nov 2000	Satisfactory	Satisfactory
From 1 Dec 2000 to 31 Dec 2000	Highly Satisfactory	Satisfactory
From Jan 2001 to Feb 2001	Satisfactory	Satisfactory
From Mar 2001 to Jan 2002	Partly Satisfactory	Partly Satisfactory
From 1 Feb 2002 to 28 Feb 2002	Partly Satisfactory	Satisfactory
From Mar 2002 to Jun 2002	Satisfactory	Satisfactory
From Jul 2002 to Oct 2003	Satisfactory	Partly Satisfactory
From Nov 2003 to Dec 2004	Partly Satisfactory	Partly Satisfactory

**D. Data on Asian Development Bank Missions**

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members <sup>a</sup>
Reconnaissance 1	6–17 April 1998	4	37	a, b, c, d
Reconnaissance 2	18–22 June 1998	1	5	a
Fact Finding	14 Sep–2 Oct 1999	3	60	a, b, c
Appraisal	21 Mar–3 Apr 1999	6	70	a, b, f, g, h, i
Policy Consultation 1	19–21 May 1999	2	6	a, b
Policy Consultation 2	14–23 Jul 1999	3	30	a, b, j
Policy Consultation 3	29 Nov–10 Dec 1999	1	12	a
Loan Review 1	19–23 Jun 2000	1	5	c
Loan Review 2	20 Nov 2000	7	7	k, l, a, j, m
Special Loan Admin (SLA) Review 1	14 Dec 2000	1	1	c
Loan Review 3	15 Jan 2001	1	1	k
Loan Review 4	25–31 Jul 2001	1	7	g
Loan Review 5	4–6 Feb 2002	1	3	g
Loan Review 6	17–21 Mar 2002	1	5	g
Loan Review 7	10–15 Apr 2002	1	6	g
Loan Review 8	17–19 May 2002	2	6	g, n
Loan Review 9	23–25 Jul 2002	1	3	g
Loan Review 10	7–11 Oct 2002	2	10	g, n
Loan Review 11	28–29 Apr 2003	1	2	g
Loan Review 12	22–25 Feb 2003	1	4	g
Loan Review 13	2–6 Jun 2003	1	5	g
Loan Review 14	10–12 Nov 2003	2	5	g, n
Loan Review 15	26–30 Jan 2004	2	10	g, n
SLA Review 2	27 Sep 2004	1	1	g
SLA Review 3	29 Sep 2004	1	1	j
Project Completion Review <sup>b</sup>	17–23 Apr 2008	2	14	n, o

<sup>a</sup> a – sr. economist, b – sr. programs officer, c – sr. financial analyst, d – financial analyst, e – capital market specialist, f – sr. development policy officer, g – economist (SME), h – project economist, i – counsel, j – manager or director, k – financial economist, l – sr. financial economist, m – young professional, n – national officer, o – economist (financial sector).

<sup>b</sup> The delay in the fielding of PCR mission and preparation of PCR was due to (i) limited staff resources in the original administering division since the mission leader who implemented the loan left ADB in 2004; and (ii) adjustments in staff assignments because of the reorganization of ADB in mid-2006. After loan closure in December 2004, preparation of the PCR was not programmed during 2005-2007.

## I. PROGRAM DESCRIPTION

1. On 16 March 2000, the Asian Development Bank (ADB) approved a loan of \$200 million from its ordinary capital resources to support the Industrial Competitiveness and Small and Medium Enterprise Development Program (the Program) in Indonesia. The overall goal of the Program was to achieve higher and sustained growth by (i) improving efficiency of resource allocation, (ii) increasing market competition and outward orientation, and (iii) promoting efficient growth of the small and medium-sized enterprise (SME) sector. The expected outcome was to achieve economic recovery by encouraging a more diversified and efficient industrial structure through deregulation and adoption of policies that promote greater competition and outward orientation; and provide equal access and opportunities for all enterprises, including SMEs. These policies were expected to contribute to restoring investor confidence and lead to renewed growth. The Program focused on three main areas:

- (i) strengthening competition by establishing an appropriate legal and regulatory framework and removing barriers to competition and trade;
- (ii) facilitating investment and trade by strengthening the framework governing domestic and foreign investment and customs procedures; and
- (iii) developing a comprehensive and sustainable SME development policy.

2. The loan was structured in two tranches of \$100 million each, with the second tranche being divided into incentive and final subtranches of \$50 million each. The first tranche was released on 29 March 2000 upon loan effectiveness, and the incentive subtranche of \$50 million was released on 19 February 2002 after the Government's compliance with six release conditions and 10 monitorable actions. Disbursement of the final subtranche of \$50 million, which had five conditions and 12 policy actions, was canceled. The loan was closed on 31 December 2004. Two attached technical assistance (TA) grants complemented program implementation by providing support for deregulation, strengthening of competition,<sup>1</sup> and SME development.<sup>2</sup> The framework summarizing the Program's goal, purpose, outputs and performance targets is attached as Appendix 1.

## II. EVALUATION OF DESIGN AND IMPLEMENTATION

### A. Relevance of Design and Formulation

3. Consistent with ADB and Government strategies, the Program was designed and formulated to support Indonesia's economic recovery after the 1997 economic crisis, therefore relevant at the time of formulation. The design drew on ongoing policy dialogue between the Government and ADB and was supported by a TA<sup>3</sup> and in-depth economic and sector work that looked at policy, regulatory, and institutional issues constraining private sector development.

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<sup>1</sup> ADB. 2000. *Technical Assistance to the Republic of Indonesia for Promoting Deregulation and Competition*. Manila (for \$1.5 million from the Asian Currency Crisis Support Facility).

<sup>2</sup> ADB. 2000. *Technical Assistance to the Republic of Indonesia for Small and Medium Enterprise Development*. Manila (for \$2.0 million from the Asian Currency Crisis Support Facility).

<sup>3</sup> ADB. 1996. *Technical Assistance to the Republic of Indonesia for Trade and Industry Planning and Strategy Formulation for Repelita VII*. Manila (for \$860,000, approved on 12 December 1996; a supplementary increase of \$140,000 was approved on 22 December 1998).

4. The industry sector, which had strongly contributed to Indonesia's economic growth, was significantly affected by the economic crisis. The extent of the crisis and the severe contraction of industrial output, particularly in manufacturing, were worsened by distortionary industrial policies that among other things, served to restrict competition, favored large firms, promoted rent seeking, increased costs, and impeded the growth of SMEs. This led to noncompetitive and highly concentrated industrial structures. The adverse effects of these policies were more pronounced for SMEs, which had fewer resources to address the high transaction costs resulting from the complex regulatory framework. The Program aimed to support recovery from the crisis through reforms to support development of a more competitive and resilient industry sector.

5. The final subtranche of \$50 million was canceled in December 2004 due to delays in the enactment of the investment law, the key outstanding condition. The law was subsequently passed in April 2007.

## **B. Program Outputs**

6. Program outputs can be grouped in three broad areas: (i) strengthening competition, (ii) promoting investment and facilitating trade, and (iii) rationalizing assistance to SMEs. The first tranche of \$100 million comprised 30 policy actions carried out prior to program approval; the incentive subtranche of \$50 million had six tranche release conditions and 10 policy actions and the final subtranche of \$50 million had five tranche release conditions and 12 policy actions. All conditions for the release of the first two tranches were complied with. However, only three of the five conditions for the final tranche were fully met prior to program closure in December 2004. Aside from the pending issuance of the investment law, the other unmet condition involved the conversion of all import licenses (other than those required for environmental, moral, safety, security, and public health reasons) into either general licenses or duties. By January 2004, while most specific import licenses were changed, some licenses remained. A summary of program outputs follows.

### **1. Strengthening Competition**

7. To strengthen the competitive environment, the Government undertook the following:

- (i) **Supported tariff reductions.** This included the reduction in (a) the maximum tariff rate on automotive components from 200% to 80%, (b) tariff rates by 5 percentage points for all goods with rates of 15%—25% (excluding motor vehicles and alcohol), and (c) tariff rates by 5 percentage points for nonfood agriculture products. Overall, as of 1999, only 74 of the 7,274 tariff lines exceeded the 30% tariff rate, while most (5,249 tariff lines) had tariff rates of up to 10%.
- (ii) **Removed nontariff barriers.** This included (a) eliminating the import monopoly of the Agency for National Logistics (BULOG); (b) abolishing local content requirements for dairy products and the automotive industry; and (c) abolishing nontariff barriers on imports of used ships, and liberalized restrictive import licensing requirements on about 120 of 190 items as of December 1999.
- (iii) **Issued the Competition Law.** The 1999 law, in accordance with international best practices, focuses on fair market conduct, applies to state-owned

enterprises and private enterprises, and provides for an independent commission to prevent anticompetitive practices.

- (iv) **Established and operationalized the Commission for the Supervision of Business Competition (KPPU).** This was the first independent regulatory agency to identify anticompetitive policies and practices across industry, and develop effective public policy to promote competition through transparent enforcement of the competition law.<sup>4</sup> To shield it from political pressures, KPPU, by law, was made independent from other branches of the government and it works to make effective use of its independence through its actions. Through either its own initiative or actions based on complaints mostly concerning collusion and procurement, KPPU has consistently followed up on reports of unfair business practices from the public, and brought about a series of notable rulings that include the introduction of price competition to the domestic airline industry and annulment of collusive arrangements in other key sectors including energy, telecommunications, and cement. It has been active in handling market distorting practices of state-owned enterprises. Appendix 2 provides a summary of reports submitted to KPPU.
- (v) **Established the Deregulation and Competition Task Force.** The task force was supported by an ADB TA (footnote 1) that worked with KPPU to review and formulate criteria for the economic evaluation of commercial laws and regulations; completed the review of existing laws, regulations, and decrees for agreed manufacturing subsectors that were in conflict with the Competition Law; and made recommendations to improve or repeal such laws, regulations, and decrees.
- (vi) **Developed a methodological framework and criteria for the evaluation and analysis of commercial laws and regulations.** For example, Indonesia's Regulatory Review Manual outlines principles<sup>5</sup> for regulations under the Deregulation and Competition Task Force. The manual presents cost-benefit analyses of regulatory and nonregulatory alternatives.

## 2. Investment Promotion and Trade Facilitation

8. To facilitate investment and trade, the Government undertook the following:

- (i) **Prepared and announced a new investment policy statement.** Issued in September 2001, the policy promotes a predictable and attractive business environment with equal treatment for domestic and foreign investors and access to impartial resolution of commercial disputes. The policy will serve as the basis for finalizing the investment law. The investment policy supports the promotion of private sector investment to achieve sustainable economic growth, employment creation, and transfer and implementation of technology. To promote a stable, predictable, and attractive business environment, the investment policy advocates the following: (a) rationalizing foreign investment policy; (b) ensuring

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<sup>4</sup> KPPU is currently fully operational and has made notable progress in increasing competition in a number of key sectors, i.e., domestic airline industry and the retail sector.

<sup>5</sup> These refer to principles of minimum effective regulation, competitive neutrality and transparency, and participation.

ready availability of land for industrial and commercial use; (c) rationalizing investment incentives; and (d) developing industrial sites.

- (ii) **Lifted restrictions on foreign direct investment.** The Government reduced the number of sectors closed to foreign investors from 9 to 6; eliminated the restriction to foreign direct investment to rescue and restore firms in financial difficulty; and allows investment in all firms, subject to a negative list of sectors where foreign direct investment is not allowed.
- (iii) **Reduced the number of business fields reserved for SMEs.** The number of fields was reduced from 33 to 19, and the number of sectors in forced partnerships from 26 to 16.
- (iv) **Improved import procedures.** The Government improved the transparency of procedures for importing capital goods and raw materials; unified procedures for import licenses and investment; and expanded the integration of importers, banks, and shipping companies.
- (v) **Strengthened investment services.** It promoted the role of the Board of Investments by changing the organization structure of the Investment Coordination Board (BKPM) to reflect its new role as a “market-driven servicing agency.” This action was reinforced by the issuance of a presidential decree (29/2004)-making BKPM a one-stop agency responsible for obtaining necessary documents and licenses on behalf of investors.
- (vi) **Formed the Investment Service Center.** The center, in BKPM, is equipped with an investment information system to provide information to investors.
- (vii) **Created a national investment team.** The team is to help solve problems arising in investment; and recognize and reinforce the need to simplify the regulatory framework for industry as evidenced by the review and revocation by the Ministry of Home Affairs of regulations (with anti-investment provisions) issued by local governments during the advent of decentralization in 2001. This action was complemented by the introduction of a regulatory impact analysis as a methodology to allow for systematic assessment of economic and other effects of regulations.

### 3. Rationalizing Assistance to SMEs

9. To promote SMEs, stressing the need for a sustainable financial policy framework, the Government accomplished the following:

- (i) **Collapsed subsidized SME credit lines.**<sup>6</sup> These had burdened the Government and the banking system with subsidies and nonperforming loan portfolios.
- (ii) **Consolidated five agriculture-related programs.** These were placed under one credit program, Kredit Ketahanan Program (KKP) or Food Stability Credit Funding, mainly for cooperatives;

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<sup>6</sup> According to the Ministry of Finance, no new loans under past SME credit schemes would be subsidized under the budget.

- (iii) **Reviewed and eliminated directed credit to SMEs by commercial banks.** The Bank Indonesia requirement forcing commercial banks to provide directed credit to SMEs, which created distortions in credit allocation, was eliminated.
- (iv) **Formed the SME Task Force.** The task force formulated a Government-wide, medium-term action plan (MTAP), with ADB support (footnote 2) and in consultation with local governments and funding agencies, to articulate a sustainable strategy to overcome financial and nonfinancial constraints faced by SMEs. The MTAP was disseminated in several regions to SME stakeholders, including the private sector. Its main features are the development of a conducive business environment for SMEs, SME finance, business development services, and entrepreneurship and competitive SMEs.
- (v) **Promoted commercial orientation of technical and business support programs for SMEs.**
- (vi) **Established an interagency task force.** The task force is to improve policy coordination among the many agencies with mandates related to SME development.
- (vii) **Revoked subsidized and directed credit schemes.** These schemes for SMEs were replaced with more market-oriented tools to support lending (e.g., establishing a credit information bureau and facilitating collateral-based lending).
- (viii) **Provided business development services.** Services were reviewed and streamlined, and divestment and commercialization of government-sponsored business development services were initiated where appropriate.

### C. Program Costs

10. The Program was supported by a loan of \$200 million from ADB's ordinary capital resources. Complementing the Program were two associated technical assistance (TA) grants with a combined total of \$3.5 million financed by the Asian Currency Crisis Support Fund, which provided support for the promotion of deregulation, competition, and SME development (paras. 19–21).

### D. Disbursements

11. The first tranche of \$100 million was released on 29 March 2000 upon loan effectiveness. The incentive and final subtranches of \$50 million each comprised the second tranche, and were planned to be released in December 2000 and September 2001. The incentive subtranche was released on 19 February 2002—a delay of more than 2 years from the projected disbursement date because of the delayed compliance of 2 out of the 6 core conditions (para. 13). The final subtranche was not disbursed as the Government did not request an extension beyond 31 December 2004 because of continued difficulty in reaching a consensus on the investment law.

## **E. Program Schedule**

12. The planned program period was 2 years, with a closing date of 31 March 2002. Because of delays in compliance with covenants for both the incentive and final subtranches, the Government requested four extensions of the Program. The Program was closed on 31 December 2004—4 years and 9 months after program approval—with the cancellation of the final subtranche of \$50 million.

13. The first tranche, with 30 policy actions completed prior to program loan approval, was released upon loan effectiveness, as planned. Within 2 years of program implementation, all incentive subtranche conditions were completed with a delay of more than 2 years. This was because of the delay in fulfillment of 2 out of 6 core conditions for incentive tranche release: (i) the announcement of the Investment Policy Statement by the Investment Board and (ii) the issuance of new presidential decree to reduce sectors reserved for SMEs and sectors with obligatory partnership between large firms and SMEs. During that time, difficulties in complying with the conditions related to the final subtranche were apparent. In particular the issuance of the investment law was problematic, partly because of the change in Government administration and the advent of decentralization in 2001.

14. The new Government held extensive dialogue on broader issues of improving Indonesia's investment climate. However, the draft investment law underwent several revisions as a result of extensive political deliberations in the House of Representatives before its final approval. Decentralization delegated authority and responsibility to local governments that covered a wide range of administrative and public service functions thereby leading to a proliferation of relevant regulatory authorities as well as local regulations. About 400 local authorities were involved in the simplification and liberalization of the regulatory framework for investment. In the commercialization of business development services, local governments, not the central Government, had the authority; hence, compliance with conditions was delayed. This inevitably complicated efforts to simplify and liberalize the legal and regulatory framework for trade and industry—a core objective of the Program—which made the timing and progress of conditions unpredictable. The investment law was eventually enacted in April 2007, more than 2 years after the Program was closed.

## **F. Implementation Arrangements**

15. As the Executing Agency, the Ministry of Finance (MOF) was responsible for overall supervision of program implementation. It was assisted by a program steering committee (PSC) for interagency consultation and coordination. The Coordinating Ministry for Economic Affairs (EKUIN) chaired the PSC comprising senior officials from the National Development Planning Agency (BAPPENAS), MOF, Ministry of Industry and Trade, Board of Investments, and State Ministry of Cooperatives and Small and Medium Enterprises. To support the functioning of the PSC, a program implementation unit (PIU) was established within BAPPENAS to monitor implementation by regularly obtaining updates from concerned agencies regarding the status of compliance with covenants. Minutes of the regular meetings were provided to ADB during the early stages of implementation. To ensure close monitoring of the Program, the Government and ADB agreed to follow a comprehensive review of progress made, wherein BAPPENAS met with ADB during review missions and provided ADB with quarterly progress reports. This arrangement was satisfactory: it was adequate and proved effective in regularly updating ADB on the progress of meeting the remaining subtranche conditions and on constraints and problems encountered during program implementation.

16. While BAPPENAS had direct staff contacts at the PSC member agencies, it encountered difficulties in obtaining updates on compliance with covenants because some agency counterparts had no official authority to report the status of compliance and required time to get authorization from their respective supervisors. Nevertheless, BAPPENAS was able to fulfill its part on a regular basis although with some delays.

17. ADB conducted about 15 review missions (10 were related to the review of compliance with the conditions for the release of the final tranche) to be updated on compliance with covenants (Basic Data). In the process, ADB was able to hold extensive discussions with key agencies, concerned officers from BAPPENAS, the PSC chairman, and the consultants of the two associated TA projects.

## **G. Conditions and Covenants**

18. Appendix 3 provides the status of compliance with conditions under the Program. During implementation, the Government complied with all tranche release conditions except for the two (para. 6) that resulted in cancellation of the final subtranche. In addition to the release conditions, the Government successfully carried out all 10 monitorable actions under the incentive subtranche and 12 under the final subtranche. No covenant was altered, suspended, or waived. In addition to program-related conditions, the loan agreement specified covenants that included implementation and coordination arrangements and reporting requirements. The Government satisfactorily complied with all these.

## **H. Related Technical Assistance**

19. Two associated TA grants were integral parts of the Program. The TA to promote deregulation and competition (footnote 1) aimed to provide institutional and analytical support to the Government in reviewing and rationalizing the industrial regulatory system based on consistent economic criteria to assess net benefits and policy interventions. This TA was rated “partly successful” because while it met its objectives of supporting the Deregulation and Competition Task Force within budget and helped raise awareness about the benefits and costs of deregulation, the TA fell short of any significant elimination of regulations on trade and industry in Indonesia. The onset of decentralization and the changes in Government administration during TA implementation made improvements in regulations difficult to achieve. Therefore, while the TA was successful in increasing awareness about the need for a better regulatory environment, the Government’s political and administrative environment did not allow for this. The TA completion report (TCR) was circulated on 31 May 2004.

20. The TA to support SME development (footnote 2) was to assist the SME Task Force in formulating and implementing the MTAP by providing background research on specific topics to provide guidelines for future Government interventions in the field of SME development. The TA was rated “satisfactory” as it achieved its objectives within budget and in an innovative manner through advocacy work that emphasized public policy dialogue through workshops, publications, and other media publicity. However, the start of decentralization, together with the change in administration in 2001, caused uncertainty in an already complex and fragmented institutional setup for SME policy, reducing the Government’s ability to deliver effective decision-making. This reduced the impact of the TA on the SME policy environment. The TCR was circulated on 7 November 2003.

21. Another TA approved in 2002 was to support implementation of the Program.<sup>7</sup> It was designed to provide necessary support to the Government for implementation of key MTAP recommendations. The objective was to promote the growth and development of SMEs by (i) strengthening their capacities through business development services, (ii) improving business facilitation by simplifying regulations, and (iii) easing SME access to credit by making credit information more widely available. The TA was rated “successful.” Despite some delays in implementation, it made some concrete contributions to help develop SME competitiveness, which was the goal of the TA. The TCR was circulated on 22 October 2005.

## **I. Consultant Recruitment and Procurement**

22. The two associated TA projects engaged a combined total of two firms and nine individual consultants. No problems were encountered with consultant recruitment or engagement. The completion date of the deregulation and competition TA was extended to allow for the engagement of an individual consultant for one additional person-month to update Indonesia’s Regulatory Review Manual and 20 person-days to provide advice on the investment regulatory environment. The SME development TA was extended to undertake complementary actions under the MTAP for SMEs, such as analytical work on value chain analysis for selected industries.

23. Four of the 11 consultants were rated “satisfactory” and 1 was rated “excellent.” Of the 6 who were not rated, one contract was canceled and the remaining 5 were not rated because the project officer who handled the TA projects left ADB within the 12-month evaluation period.

## **J. Performance of Consultants, Contractors, and Suppliers**

24. The TCR for the deregulation and competition TA rated the consultants’ performance “satisfactory.”<sup>8</sup> The consultants’ outputs were of good quality and timely (para. 19). The TCR for the SME development TA rated the performance of consultants “highly satisfactory.”<sup>9</sup> The Government appreciated their efficient performance and good relationship with the counterpart agencies.

## **K. Performance of the Borrower and the Executing Agency**

25. Overall, the Government’s performance is rated as satisfactory. MOF as the Executing Agency, ECUIN as the PSC, and BAPPENAS as the PIU, were committed to ensuring that reforms under the Program were undertaken. As the coordinating ministry, ECUIN had the mandate and formal authority to undertake this role and did not have any difficulty carrying out its responsibilities. The PSC (paras. 15–17) in MOF held regular meetings to discuss the status of compliance with covenants. One product of these discussions was the quarterly progress report on the status of remaining subtranche conditions, which BAPPENAS submitted to ADB on a regular basis. Submissions had been delayed because of internal approvals needed to release relevant information. BAPPENAS demonstrated commitment to its task and was quite accessible and accommodating when ADB sought clarifications on submissions.

<sup>7</sup> ADB. 2002. *Technical Assistance to the Republic of Indonesia for Strengthening Business Development Services for Small and Medium Enterprises*. Manila (\$1.5 million, from the Asian Currency Crisis Support Facility).

<sup>8</sup> ADB. 2002. *Technical Assistance Completion Report on Promoting Deregulation and Competition in Indonesia*. Manila.

<sup>9</sup> ADB. 2002. *Technical Assistance Completion Report on Small and Medium Enterprise Development in Indonesia*. Manila.

## **L. Performance of the Asian Development Bank**

26. ADB's overall performance is rated "satisfactory." ADB was able to process and immediately release the first tranche and the incentive subtranche of the second tranche after all conditions were met. For the final subtranche release, ADB staff closely monitored program implementation through frequent review missions to follow up on progress of the remaining unmet conditions and to meet with PSC members, BAPPENAS, and TA consultants assisting in loan implementation. At the time of ongoing Government deliberations on the investment law, ADB worked with two well-known multilaterals in the field of investment: Foreign Investment Advisory Services, and Multilateral Investment Guarantee Agency to support policy dialogue on investment. The goal was to engage development partners, the private sector, and local governments more actively into the discussion on the need for a simple and transparent investment law and regulations.

27. The project implementation staff in BAPPENAS noted that they often did not get immediate feedback from ADB after their submission of quarterly progress reports. This delayed their ability to address issues raised in the progress reports, particularly those concerning ADB's interpretation of proposed actions with respect to compliance with program conditions. However, the frequent review missions fielded by ADB, and supported by ADB's Indonesia Resident Mission, to follow up on the actions provided opportunities for BAPPENAS and ADB to hold more in-depth discussions and consultations regarding progress on unmet conditions.

## **III. EVALUATION OF PERFORMANCE**

### **A. Relevance**

28. The Program is assessed "relevant." Its objective of encouraging more diversified and efficient industrial structure and rationalizing assistance to SMEs was consistent with Indonesia's development priorities and ADB's country and sector strategies. The industry sector, which had been a main contributor to the country's growth, suffered heavily during the crisis. The industrial slowdown occurred against the backdrop of existing constraints and issues such as inadequate commercial law and competition framework, anticompetition policies, trade protection, high regulatory and licensing costs, distortions in investment policy and trade facilitation, and inefficient SME policies. Formulated in the aftermath of the 1997–1998 crisis, the Program called for the revival of the real sector through deregulation of industry, trade, and investment; and SME development. The Program was relevant at that time and remained relevant, appropriate, and timely throughout its implementation. Areas supported under the Program continue to be key Government priorities as evidenced by their inclusion in the Government's financial sector and investment policy packages.

### **B. Effectiveness in Achieving Outcome**

29. The Program is assessed "effective" in achieving its outcome. Significant progress was made in strengthening the regulatory and institutional framework for competition. This includes the establishment and operationalization of KPPU, the division of operating and regulatory roles of the state-owned oil and gas monopoly (PT Pertamina) into distinct entities, and the introduction of private sector competition in production and distribution. Government support for SME development has likewise become more market-oriented in terms of access to credit and provision of business development services, while industrial competitiveness in general has

been supported by Indonesia's continued strong progress in trade liberalization in line with program objectives despite regression in some sensitive product categories.

30. Although the new Investment Law was not issued during program implementation due to administrative and political constraints during that time, the essential features of the Investment Law passed in 2007 were developed under the Program. The Program signaled the Government's genuine commitment to reforms that helped ease the country through the crisis years.

31. Currently, BKPM is setting out the details for implementing the Investment Law. Implementing rules and regulations are being developed, leaving its overall immediate practical effect not yet perceptible. The new law allows for equal treatment of domestic and foreign investment, simple registration of investor approvals; and wholly foreign-owned enterprises in most sectors. It has repositioned BKPM's role from an agency with a key role in review and approval of investments to one that has a coordination and facilitation function focused on investment promotion. Because of the lack of progress with respect to the issuance of the draft investment law during program implementation, the Government issued a presidential decree in April 2004 making BKPM a one-stop agency responsible for obtaining necessary documents and licenses on behalf of investors, as well as mandating that investment proposals be submitted to BKPM to allow for effective monitoring. However, while this simplified the procedure for investors as to the number of agencies that they need to deal directly with, the process was time-consuming, with approval of investment taking months instead of the 10-day time frame set by BKPM.

32. The associated TA projects were vital in achieving intended outputs and outcomes, and in the process were effective at providing insights to the technical staff with whom they worked. The consulting firms engaged under the associated TA projects played an important role in program implementation. They not only supported the Government in carrying out reviews and provided recommendations in areas of deregulation and SME development, but also successfully engaged other agencies through active dissemination and discussions about the program objectives.

33. To improve the business environment, KPPU, the commission established under the Program (para. 7), has demonstrated notable independence and made progress in increasing competition in a number of key sectors since its establishment. Performing two key functions, namely, the enforcement of the Competition Law and analysis of weakly performing sectors to determine the causes, KPPU has conducted policy assessments and given recommendations to the Government. It has played a key role in providing advice on separating the Government's role as regulator and operator in key sectors such as railways, ports and airports, oil and gas, and transport. Since its establishment, it has issued about 50 policy recommendations. While these are not binding, they have in cases led to subsequent Government action and significant changes within certain sectors (i.e., the prices for domestic airline industry tickets have fallen by 50% due to the introduction of competition into the sector). For KPPU to maintain its effectiveness in carrying out its mandate, it must work closely with the legal system, practice fairness, and ensure transparency in enforcing the law.

34. Given the outputs discussed in para. 9, the Government has emphasized a market-friendly approach to SME promotion, focusing on a sustainable financial policy framework for SMEs. The MTAP for SMEs developed under the Program with TA support introduced the need for commercial rather than subsidized lending, and the need to establish a credit information bureau/SME support unit and streamline business registration. The credit information bureau

(launched by Bank Indonesia in 2006) assists banks in lending and risk management by making information available on borrowers that financial institutions can access electronically, including borrowers' names, identification numbers, amount borrowed, and collateral. The bureau, which is currently under the Bank Licensing and Banking Information Directorate of Bank Indonesia, is expected to help banks better manage their lending risks and thus reduce their nonperforming loans. The related TA supporting the Program (footnote 7) supported local government efforts to establish a one-stop shop for business licenses. The introduction of a one-stop shop in late 2002 in Sragen, Central Java, proved to be a success with the number of business licenses processed per month increasing by 60%. The number of processing days for a complicated construction permit was reduced to 7–15 days compared with about 35 days for neighboring areas.

35. Overall, the SME sector continues to dominate economic activity in Indonesia. Its output accounted for about 57% of gross domestic product in 2007. According to the latest available data from the Ministry of Cooperatives and Small and Medium-Sized Enterprises, the number of registered SMEs increased by about 23% during 2000–2006 and only about 7,200 of total business establishments (48.9 million) were considered big companies. During the same period, employment by SMEs expanded by 17% from 72.7 million to 85.4 million. Overall, SMEs absorbed more than 96% of employed workers in 2006. In terms of sectoral distribution, a large proportion of SME employment (over 60%) is generated by agriculture and fishery.

**Selected SME Indicators  
2000-2006**

	2000	2006	2000-2006 Growth
<b>A. Number of Establishments SMEs</b>	39,784,036	48,929,636	23%
of which:	39,705,204	48,822,925	23%
Small Enterprises	78,832	106,711	35%
Medium Enterprises	5,675	7,204	27%
<b>Large Enterprises</b>			
<b>Total</b>	<b>39,789,711</b>	<b>48,936,840</b>	23%
<b>B. Number of Employed SMEs</b>	72,704,416	85,416,493	17 %
of which:	68,791,152	80,933,384	
Small Enterprises	3,913,264	4,483,109	18%
Medium Enterprises	2,695,766	3,388,462	15%
<b>Large Enterprises</b>			26%
<b>Total</b>	<b>75,400,182</b>	<b>88,804,955</b>	<b>18%</b>
<b>C. Contribution to total no. of Employed SMEs</b>	96%	96%	
of which:			
Small Enterprises	91%	91%	
Medium Enterprises	5%	5%	
<b>Large Enterprises</b>	4%	4%	

Source: Ministry of Cooperatives and SMEs 2007, *Database of Micro, SME and Cooperatives for 2006*.

### **C. Efficiency in Achieving Outcome and Outputs**

36. The Program is assessed “inefficient” in achieving its outcome and outputs. All but two of the reforms envisaged under the Program were implemented, but delays in compliance with the incentive and final subtranche release conditions proved to be resource and time intensive in terms of ADB and Government coordination. Despite great efforts invested by ADB and the Government to meet the conditions and four loan extensions, two conditions were not fulfilled at the time the Government realized a high degree of uncertainty as to when the investment law would be issued. In 2004, the Government allowed the loan closing date to elapse without the release of the final subtranche of \$50 million.

37. The regular monitoring of compliance with tranche conditions both by ADB and the PSC was a practical step in obtaining timely updates on the achievement of policy actions. The establishment of a PIU in BAPPENAS was necessary because it served as the link between ADB and several concerned agencies involved in the Program. The progress reports that BAPPENAS staff submitted to ADB were well prepared and complete. Although at times ADB did not provide immediate feedback to government counterparts on progress reports, the several review missions that were fielded provided opportunities for more comprehensive feedback and immediate information exchanges between the Government and ADB regarding compliance with covenants.

38. However, progress in implementing the Program was much slower than anticipated, largely because of its vulnerability to the impacts of fundamental and far-reaching political and administrative changes during program implementation, over which ADB and the Government had no control. Enactment of the investment law was significantly delayed due to resistance to reforms by some ministries and regional governments, and the emergence of a more assertive and independent Parliament, which was beyond the Government’s control. In the draft law, BKPM’s increased authority to approve investments was resisted by some ministries that viewed this as an encroachment on their own mandates and authority. It was also opposed by regional governments that wanted to protect their recently acquired power of approval of investments by virtue of the Decentralization Law of 2001. The conversion of all import licenses to general licenses or duties was slowed by the altered conditions in the industry sector, which were much different than those during loan formulation. Gathering and monitoring of import data had been difficult especially after the advent of decentralization that the MOIT still considered maintaining import licenses on some products.

### **D. Preliminary Assessment of Sustainability**

39. The Program’s sustainability is assessed “likely.” The reforms undertaken under the Program set the foundation for facilitating investment and trade, strengthening competition, and promoting SME development. The Government has shown commitment to continue reforms even after cancellation of the final subtranche of the Program in 2004. The measures introduced by the Government to liberalize investment in 1997 and 1998, including allowing foreign firms to operate retail outlets and shortening the negative list of sectors closed to foreign investment, remained in force despite economic and political difficulties. This underscores the Government’s recognition of the primary importance of maintaining a relatively open investment regime.

40. The Government’s commitment to reforms is evidenced by the issuance and enactment of the Investment Law in April 2007, a key outstanding condition under the Program, over 2 years after program closure. BKPM is now developing the implementing rules and regulations in consultation with concerned agencies. The tariff team in BKPM has been working to

synchronize tariff reductions. Bank Indonesia continues its support to SMEs by providing information through the credit information bureau, training, and research assistance to help in the development of SMEs. That the Government has maintained these measures to date despite changes in government administration, is an indication of its recognition of the fundamental importance of maintaining a relatively open investment regime for the economy's recovery and long-term growth.

41. With the many high profile cases it has handled, KPPU is recognized for its important role as a regulation supervisor. Given this, the Government will likely maintain budget support to KPPU to finance its operations to cover salaries, completing infrastructure including office building, case handling and investigation, data gathering and analyses, and information dissemination. Because of KPPU's position as an independent regulation supervisor institution, KPPU's budget will likely have to be separated from that of other government departments.<sup>10</sup>

## **E. Impact**

42. The Program was classified as environment category C; it had no significant direct or indirect environmental impact. KPPU's operations had a significant institutional impact since it separated the Government's roles as regulator and operator of sectors such as railways, ports, and airports. Responsible for enforcing the Competition Law, KPPU is, by law, independent from the main branches of government to insulate it from political pressure. The public has increasingly become aware of KPPU and are supporting it as an institution by reporting cases of unfair business practices, which KPPU can look into. The economic impact of the development of the SME sector could have been more significant if decentralization had not been implemented in 2001. Decentralization reduced the Government's ability to deliver effective decision-making, thus moderating its impact in terms of changing the SME policy environment.

## **IV. OVERALL ASSESSMENT AND RECOMMENDATIONS**

### **A. Overall Assessment**

43. The implementation of the Program is rated "partly successful" overall. Not all conditions were met and the loan was not fully disbursed. This, and the cumulative extension of the loan closing date by more than 2.5 years from the original closing date, showed that the Program was not implemented as conceived and the time frame for implementation was unrealistic. Recognizing the administrative (the advent of decentralization in 2001) and political (deliberations in Congress on the investment law and the national elections in 2004) challenges that caused delays with compliance of conditions, ADB extended the loan closing date four times upon the request of the Government. The identified causes of the delays were not foreseen as major risks in the achievement of the program goal, and neither ADB nor the Government had control over these events. Nevertheless, the Government's continuing efforts to achieve reforms (e.g., continued support for KPPU, continuous tariff reductions, enactment of the Investment Law) underscores the relevance and importance of the Program.

### **B. Lessons**

44. Lessons from the Program and the associated TA projects include the following:

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<sup>10</sup> Commission for the Supervision of Business Competition. Undated. *The KPPU's Five Year Plan 2000-2005*. Jakarta.

(i) Linking tranche releases with conditions involving legislation such as the issuance of laws and presidential decrees (i.e., investment law) is subject to a great degree of uncertainty given that ADB and the Government have no control over actions of Parliament or Congress, hence, the time required to meet conditions can easily be underestimated.

(ii) Newly enacted national laws during program implementation can pose new risks for program implementation. The advent of decentralization in 2001 produced new risks that delayed fulfillment of some reforms under the Program. The Decentralization Law of 2001 devolved to local governments the authority and responsibility for a wide range of administrative and public service functions. During program design, awareness of potential risks involving possible laws and future legislation that could emerge during implementation is important.

(iii) Different conditions facing the industry sector during program formulation as compared with that during program implementation did not allow for the conversion of all import licenses other than those required for environmental, moral, safety, and public health reasons to either (a) a general class of import license or (b) import duty. The Ministry of Industry and Trade indicated that licenses were still to be required for chemical raw materials and farming tools because import regulation in these industries is one of the Government's policy instruments to protect domestic industries. The industry was still competitive at the time of program design but during implementation the situation changed.

(iv) For program monitoring, some agency counterparts who attended the regular PSC meetings did not have official authority to report the status of compliance of their assigned conditionality. For the PIU to obtain timely updates, agency officials attending the PSC meetings must be those given the official authority to disclose official information to the PSC meetings to save time and effort for the PIU's compilation of program updates.

## C. Recommendations

### 1. Program Related

45. **Future Monitoring.** ADB should continue monitoring the progress of Government efforts to strengthen competition, liberalize trade and investments, and develop SMEs. During the Project Completion Review Mission, KPPU indicated that it faced the challenge of pushing for full regulatory reform and noted that the need for a comprehensive approach to attain this. As a first step, KPPU recently proposed to ECUIN that all regulations and laws that go against the Competition Law must be reviewed, and that in the future KPPU must be involved in the drafting of related laws to ensure they are in agreement with the Competition Law. Future discussions in relation to these are worth monitoring. ADB should also continue monitoring reform measures related to the reduction of tariffs, implementation of the Investment Law, support to SMEs in terms of providing business development services and market-oriented credit schemes, and effect of decentralization on these. Assistance from BAPPENAS, as the Program's PIU, and BKPM are essential in looking into recent progress.

46. **Covenants.** If possible, covenants relating to issuing legislation should be minimized, if not removed. Linking tranche releases with conditions relating to legislation leaves the timing of compliance open to a great degree of uncertainty (para. 44[i]). Also, the waiver of a covenant

should be requested if current conditions during program design totally differ from that during program implementation making compliance impossible at the current stage. In the case of the condition on the conversion of all import licenses to general licenses or duties, the Government partially complied with this condition as it substantially reduced the number of products subject to import licensing from 1,112 product lines in 1990 to only 141 in 2004, with many of these related to products that have environmental, moral, safety, security, or public health concerns. The seeking of a waiver (of full compliance) is recommended because of this marked decrease and the recognition that the changed economic conditions hindered full compliance. However, this option of seeking a waiver should be taken on a case-by-case basis and only after other forms of assistance to industries experiencing difficulties have been considered.

47. **Timing of the Program Performance Evaluation Report.** To further assess the impact of program reforms, conduct of a program performance audit report is recommended before the end of 2009.

## 2. General

48. To have a more realistic time frame for program implementation, it would be desirable at the design stage, to be aware of future laws and regulations that are expected to be passed during project implementation. With a broader view of the possible setting that the program would face, policy actions can be accordingly designed, further major risks can be identified, and more realistic assumptions can be made. These constitute ideal circumstances, and while much can be done toward attaining them, the rapidity and magnitude of decentralization reforms in Indonesia proved difficult to anticipate. For more efficient administration of program loans, close coordination between ADB and the executing agency in monitoring and reporting program progress should be thoroughly done from the start of implementation to identify, as early as possible, conditions that are difficult to meet. Then appropriate actions can be made early during implementation.

49. For this type of program loan where evolving conditions from the design to the implementation stage could be a hindrance to the compliance with covenants, a program cluster approach can be used as it combines a long-term approach that allows for covering a wide range of reforms with flexibility to adjust to changing circumstances.

## PROGRAM FRAMEWORK

Design Summary	Measurable Indicators / Targets	Monitoring Mechanisms	Major Risks / Assumption
<b>Goal</b>			
<ul style="list-style-type: none"> <li>• To support economic recovery and achieve higher and sustained growth               <ul style="list-style-type: none"> <li>i. Improved efficiency of resource allocation</li> <li>ii. Increased market competition and outward orientation</li> <li>iii. Promotion of efficient growth of the small and medium-sized enterprise (SME) sector</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Rise in real gross domestic product (GDP) growth underpinned with               <ul style="list-style-type: none"> <li>i. Resumption and increasing flow of domestic and foreign investments                   <ul style="list-style-type: none"> <li>- Investment/GDP ratio = 17.5% (1998)</li> <li>- Foreign direct investment (FDI) = -\$356 million (1998)</li> </ul> </li> <li>ii. Growth industrial output                   <ul style="list-style-type: none"> <li>- Growth rate 1998 = -12%</li> <li>- Growth rate 1999= +1.9%</li> </ul> </li> <li>iii. Reduced concentration in industrial sectors                   <ul style="list-style-type: none"> <li>- Concentration ratio = 54%</li> </ul> </li> <li>iv. Export expansion                   <ul style="list-style-type: none"> <li>- Export : \$41 billion (1998–1999)</li> </ul> </li> <li>v. Expansion in output and employment of SME sector                   <ul style="list-style-type: none"> <li>- Manufacturing employment: 2.5 million (1996)</li> </ul> </li> </ul> </li> </ul>	<p>Regular publications of macroeconomic and real sector indicators by the central statistics bureau and by sector ministries</p> <p>Special review and studies to be conducted by the Asian Development Bank and other funding agencies</p>	<p>Political and social stability is a prerequisite for the economy to gain the renewed confidence of foreign investors and lenders</p> <p>Commitment is in place for macroeconomic stabilization and to actively pursue structural reforms concurrently taking place.</p> <p>Supply response of real sectors to the policy reforms and institutional changes may vary depending on sector-specific rigidity and/or flexibility, and on regional recovery and growth prospects.</p>
<b>Purpose</b>			
<ul style="list-style-type: none"> <li>• To achieve economic recovery by introducing a more diversified and efficient industrial structure through deregulation and adoption of policies that promote greater competition and outward orientation, and provide a more equal access and opportunities for all enterprises including SMEs</li> </ul>	<ul style="list-style-type: none"> <li>• Transparent and predictable market conduct sanctioned by the Competition Policy in line with international best practices</li> <li>• Reduced rent-seeking behavior</li> <li>• Facilitation of market-based closure and emergence of business entities based on their financial viability</li> <li>• Expanded opportunities for private sector participation in domestic trading activities</li> <li>• More competition in industry and trade</li> <li>• Reduced distribution costs</li> <li>• Greater participation of SMEs in economic sectors</li> <li>• Improved world price transmission into the domestic economy through reduction of tariff-induced distortions and antiexport bias</li> </ul>	<p>Ministry of Finance (MOF), National Development Planning Agency (BAPPENAS), Ministry of Industry and Trade (MOIT), and other agencies concerned to monitor and evaluate program implementation progress under guidance by a program steering committee (PSC) and with ADB's technical assistance (TA) support in select areas</p> <p>Sector studies Government reports</p>	<p>The policy reforms and structural adjustments envisaged under the Program will lead to reconfiguration in terms of economic rent sharing, particularly in the short term, and thus political resistance to the reforms is possible. Forging broad-based support is a major challenge for the Government to persevere with the reforms; effective interagency coordination and collaboration will also be essential.</p>

	<ul style="list-style-type: none"> <li>• Increase flow of exports and imports to facilitate greater competition and technology adoption through trade</li> </ul>		
<b>Outputs</b>			
<b>1. Strengthening Competition</b>			
1.1. Strengthen commercial and legal environment to promote entry, exit, and resource mobility	<ul style="list-style-type: none"> <li>• Enactment of Competition Law</li> <li>• An independent commission selected and confirmed by Parliament</li> <li>• Commission staffed, budgeted, trained, and operationalized</li> </ul>	<p>Ministry of Justice and MOIT to monitor implementation and enforcement of the legal framework</p> <p>MOIT to revise and amend relevant ministry decrees in coordination with the other concerned agencies</p> <p>MOIT to monitor and evaluate the compliance of the agreed measures during the program period</p>	<p>Enforcement of the legal framework may be difficult and costly due to capacity concerns of the sectoral line departments</p> <p>TA and Government commitment to public benefit review is adequate.</p>
1.2. Simplify the regulatory framework	<ul style="list-style-type: none"> <li>• Criteria developed for public benefits review of legislation</li> <li>• Review completed</li> <li>• Recommendations implemented</li> </ul>		
1.3. Promote domestic competition	<ul style="list-style-type: none"> <li>• Marketing restraints on plywood and paper removed</li> <li>• Elimination of administered prices for cement</li> <li>• Abolition of fertilizer subsidies and price controls</li> <li>• Distribution of fertilizer opened up to competition</li> <li>• Elimination of restraints to foreign direct investment (FDI) in distribution sector</li> <li>• Buying and selling monopoly eliminated for cloves</li> <li>• Distribution of oil products liberalized</li> </ul>	<p>MOIT and MOF in coordination with other concerned agencies to provide details regarding progress in reforms to be verified through review missions, etc.</p>	<p>Industries and firms that have been protected through restricted policies will see the threat of greater competition.</p> <p>Segments and levels of government may also see themselves losing control and thereby rents.</p>
1.4. Rationalize the tariff structure	<ul style="list-style-type: none"> <li>• Tariff reduction under the ASEAN Free Trade Agreement (AFTA) fast tracked</li> <li>• Tariffs on goods with rates of 15%–25% reduced by 5% age points</li> <li>• Import duty eliminated on automotive products</li> <li>• Average unweighted tariff reduced to less than 8%</li> </ul>		<p>Tariff rationalization results in fiscal revenue losses and reduction in protection that will lead to industrial restructuring. Such adjustments may create difficulties in the short term.</p>
1.5. Eliminate nontariff barriers	<ul style="list-style-type: none"> <li>• Local content requirements on dairy products, autos eliminated</li> <li>• Agency for National Logistics BULOG's import monopoly abolished</li> </ul>		<p>Commitment to reforms</p>

	Remaining restrictive licenses on 120 items liberalized except for environmental, health, safety, and security reasons.		is maintained.
<b>2. Investment Promotion and Trade Facilitation</b>			
2.1. Restructure foreign investment regulatory agency to enhance its service orientation	<ul style="list-style-type: none"> <li>Investment regulatory body to be reoriented to provision of market-friendly services for investment promotion</li> </ul>	MOF and Investment Board to study the rationale and effectiveness of investment regime and to develop action plan to reorient the agency's service direction	Traditional sectional interest may attempt to retain an approach that seeks to regulate and control rather than promote investment.
2.2. Adopt new foreign investment policy	<ul style="list-style-type: none"> <li>Sectors restricted to foreign direct investment to be reduced</li> <li>Sectors reserved for SMEs to be reduced</li> <li>Uniform treatment of domestic and foreign investors</li> <li>Issuance of new, unified investment law</li> </ul>	Investment Board to draft the new investment law for Cabinet review and for submission to the Parliament	New Parliament and Government support agenda draft law.
2.3. Streamline other investment incentives such as duty drawback procedures and tax holidays	<ul style="list-style-type: none"> <li>Effectiveness of the new investment law enhanced by removing the ad hoc incentive measures and ensuring policy consistency on trade and investment services</li> <li>Tax holidays for foreign direct investment converted to accelerated depreciation allowances</li> <li>Reduced customs interventions and discretion of customs officials</li> </ul>	MOF and BPM-PBUMN in coordination with other concerned agencies to review and revise the investment and trade-related policies to ensure their consistency	
2.4. Improved customs procedures and operations	<ul style="list-style-type: none"> <li>Customs examination ratio no more than 10% of imports</li> <li>Imports released within 4 hours if not red-channelled</li> <li>Red-channelled imports released within 12 hours</li> <li>Computerized inspection system</li> </ul>	MOF to issue new decrees on customs operation procedures and standards Customs weekly reports	Government will implement anticorruption policies and continue with civil service reforms.
<b>3. Promotion of Efficient Growth of Small and Medium-Sized Enterprises</b>			
3.1. Improve policy making and implementation, and broaden civil society participation in the process	<ul style="list-style-type: none"> <li>Policy formulation consolidated into ministries of Industry and Trade and Cooperatives and SMEs</li> <li>SME entrepreneurs, including women's groups, represented in SME task Force</li> </ul>	An interagency working group including MOIT, State Ministry of Cooperatives and Small and Medium Enterprise, Bank Indonesia (Bank Indonesia), MOF, and BAPPENAS to conduct	interdepartmental coordination Aid participation and support through TA and policy discussions.

<p>3.2. Reduce SME's regulatory burdens</p>	<ul style="list-style-type: none"> <li>• A medium-term SME development strategy formulated and subjected to public review</li> <li>• Burden of compliance with laws and regulations for SMEs reduced and simplified to increase their active participation in economic activities: compliance costs reduced.</li> <li>• SME-related policy environment subject to continuing and institutionalized monitoring and evaluation to ensure nondiscrimination for SME development</li> </ul>	<p>regular consultation with representatives of the SME sector and to develop SME strategy</p> <p>MOIT and State Ministry of Cooperatives and Small and Medium Enterprise to review and amend the existing laws and regulations with the support of the Deregulation Competition Team</p>	<p>Assumes that sectoral agency staff will demonstrate commitment to reform the program and/or be subject to goals set by Government agencies. Coordination with the Deregulation Task Force.</p>
<p>3.3. Improve the efficiency of financial services provision to SMEs</p>	<ul style="list-style-type: none"> <li>• Bank Indonesia liquidity support for directed credit eliminated</li> <li>• Directed and/or subsidized credits schemes reduced to no more than two programs</li> <li>• Interest rate variations on directed schemes streamlined</li> <li>• Agreed methodology for estimating subsidies</li> <li>• Successful SME financial institutions and mechanisms expanded to enable greater access for SMEs on the grounds of financial soundness. Bank Rakyat Indonesia restructured</li> </ul>	<p>MOF and Bank Indonesia to provide details in regarding the agreed SME finance-related reform measures</p>	<p>Government is committed to promoting rationalized provision of financial service.</p> <p>Technical support is provided by funding agencies including World Bank and ADB.</p>
<p>3.4. Promote commercial orientation of technical and business support for SMEs</p>	<ul style="list-style-type: none"> <li>• Evaluation criteria and monitoring methodology developed for business support programs.</li> <li>• Government-sponsored programs reviewed and rationalized to streamline their operations</li> <li>• All commercially feasible support services fully commercialized</li> <li>• Emerging private sector service centers reviewed and expanded</li> </ul>	<p>MOIT and State Ministry of Cooperatives and Small and Medium Enterprise to provide details on the progress of the reform actions agreed</p>	<p>Technical support is available from Government and funding agencies including ADB.</p>

**SUMMARY OF INCOMING REPORTS  
FROM THE COMMISSION FOR COMPETITION SUPERVISION (KPPU), 2000–2005**

<b>Classification of Reports</b>	<b>No. of Reports</b>	<b>Business Sectors</b>
Oligopoly anticipation	1	Book printing
Price discrimination anticipation	1	Tenancy
Cartel anticipation	4	Ranch, agriculture, cement, manufacturer, battery industry
Allegation of vertical integration	4	Retail, ranch, air transport, food industry
Allegation of closed agreement	3	Battery industry, ranch, salt distribution
Allegation of monopoly	2	Transportation, information system
Allegation of domination of market	3	Drinking water company, hologram ink supply
Selling and loss of practice	3	Food industry, parking service, telecommunications
Allegation of tender conspiracy	104	Government institution (infrastructure, forestry, health, levying of appliance, vehicles), electricity, oil and gas, agriculture, illegal sugar, security service, information technology
Allegation of abuse of dominant position	7	Cinema service, telecommunication service
Reports related to policy on anticorruption released by the Government	24	Oil and gas, retail, Perda, drinking water, auction regulations, schoolbooks, insurance
Reports outside the jurisdiction of KPPU	28	Franchise, telecommunication, plastic industry, building management, outsourcing, human resource and development
Nonreport (incomplete reports)	40	
<b>Total</b>	<b>224</b>	

## POLICY MATRIX

Program Goal: To promote higher and sustained economic growth based on more efficient resource allocation  
 Program Objective: To achieve economic recovery by encouraging a more diversified and efficient industrial structure through deregulation and adoption of policies that promote competition and provide a level playing field for all enterprises including small and medium enterprises (SMEs). This is to be achieved through:

- I. Strengthening Competition
- II. Investment Promotion and Trade Facilitation
- III. Rationalizing Assistance to SMEs

Objectives	Actions Planned	Actions completed prior to Board consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
<b>I. Strengthening Competition</b>				
A. Strengthen commercial legal and regulatory environment to promote entry, exit, and resource mobility	1. Issue a competition law laying down a policy framework consistent with international best practices: law to be based on market conduct principles that apply to private and state enterprises, and provide for establishment of an independent Commission for Competition Supervision.	Done (February 1999)	<b>Complied with</b>	
	2. Issue a Presidential decree establishing an independent Commission for Competition Supervision to implement the competition law.	Done (July 1999)		
	3. Provide Commission for Competition Supervision with adequate budget and staff.			
	4. Issue all implementation regulations required to operationalize Commission for Competition Supervision.			
	5. Issue a bankruptcy law and establish a	Done		

Objectives	Actions Planned	Actions completed prior to Board consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
	<p>Commercial Court for the implementation of bankruptcy and commercial cases and take steps to start bankruptcy hearings.</p> <p>6. Issue regulations for establishment of Jakarta Initiative to promote voluntary restructuring and debt resolution.</p>	<p>(August 1998)</p> <p>Done (September 1998)</p>		

Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
<p>B. Simply and improve the regulatory framework across the industrial sector</p>	<ol style="list-style-type: none"> <li>1. Establish a Deregulation and Competition Task Force to rationalize and simplify the regulatory regime, promote competition across sectors, and create a level playing field for public and private sector.</li> <li>2. Deregulation and Competition Task Force with support of ADB TA<sup>a</sup> to:               <ol style="list-style-type: none"> <li>(i) Initiate review and devise criteria for the economic evaluation of commercial laws and regulations from the perspective of net public benefit;</li> <li>(ii) Complete review of existing laws, regulations, and decrees for agreed manufacturing sub-sectors that are inconsistent with the Competition</li> </ol> </li> </ol>	<p>Done (September 1999)</p>	<p>Done</p>	<p>Partially accomplished. Of the more than 5,000 existing</p>

<sup>a</sup> Proposed Technical Assistance to INO for Promoting Deregulation and Competition.

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	<p>Law with a view to determining their cost and benefit to the public and to making recommendations for improving or repealing such laws, regulations, and decrees;</p> <p>(iii) Identify existing licenses, approvals, a and permits that impose high compliance costs on SMEs, and develop proposals for eliminating or replacing them; and</p> <p>(iv) Task Force to publish a report on its findings and recommendations.</p> <p>3. The Government to further simplify the regulatory framework in the light of the Task Force's recommendations.</p>			<p>laws, regulations and decrees, only a few were identified and reviewed under the TA.</p> <p>Done</p> <p><b>Complied with</b></p> <p>Partially accomplished. The limited number of regulations reviewed could not realistically cover the more than 5,000 pieces of regulations affecting the operation of businesses in Indonesia.</p>
C. Promote domestic competition by removing	1. Eliminate producer subsidies and improve efficiency of fertilizer supply and distribution	Done (January 1999)		

<sup>b</sup> Investment Coordination Board (BKPM) decrees 11/SK/1998 and 12/SK/1998 issues on 30 April 1998.

Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
price and entry barriers to domestic trade and distribution	<p>to farmers:</p> <ul style="list-style-type: none"> <li>(i) Remove price controls;</li> <li>(ii) Remove subsidies to fertilizer production; and</li> <li>(iii) Open the distribution of fertilizer to competition by removing the monopoly of PT Pusri and co-operatives.</li> </ul> <p>2. Revoke the decrees issued in April 1998 that restrict foreign investment in selected sectors, equity, and location.<sup>b</sup></p> <p>3. Eliminate buying and selling monopoly for cloves</p> <p>4. Remove marketing restraints on paper and plywood.</p> <p>5. Eliminate administered prices and restraints to the distribution of cement.</p> <p>6. Develop an action plan to remove the monopoly in the wholesale and retail distribution of oil products and gasoline.</p>	<p>Done (November 1998)</p> <p>Done (September 1998)</p> <p>Done (August 1998)</p> <p>Done (August 1998)</p>		<p>Done</p>
D. Strengthen international competition by reducing tariff and non-tariff barriers	<p>1. Increase international competition and improve efficiency in the trade and industrial sectors by reducing distortions and the anti-export bias due to high and variable import tariffs:</p> <ul style="list-style-type: none"> <li>(i) Reduce tariff rates by 5 percentage points for goods with rates of 15-25% (excludes motor vehicles and</li> </ul>	<p>Done (April 1998)</p>		

Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
	<p>alcohol)</p> <p>(ii) Tariffs on food; nonfood agriculture products, chemical products, and steel/metal products to be reduced by 5 percentage points.</p> <p>(iii) Reduce to 0% final rate of tariff on basic materials for the production of automotive components; and goods and materials for the production of components, accessories and coachwork of special motor vehicles.</p> <p>(iv) Exempt from tariff imports of goods and materials from bonded warehouse to be processed, assembled or installed in other goods for manufacturing motor vehicles destined for exports.</p> <p>2. Abolish import monopoly of the Agency for National Logistics' (BULOG's) by allowing all importers to freely import any commodity.</p> <p>3. Reduce the list of products requiring importer-producer (IP) and importer-trader (IT) licenses.</p> <p>4. All license approvals and permits required of IP and IT other than those required for environmental, moral, safety, security, or public health reasons will be liberalized into a system of transparent and non-discriminatory instruments involving either (i) conversion into the general class of</p>	<p>Done (April 1998)</p> <p>Done (June 1999)</p> <p>Done (June 1999)</p> <p>Done (September 1998)</p> <p>Done (December 1999)</p>		<p><b>Not complied with</b></p>



Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
	<p>investments up to \$100 million and 20 working days for investments of more than \$100 million;</p> <p>(ii) Unify procedures for access to import privileges for capital goods and raw materials for both new and expansion projects;</p> <p>(iii) Strengthen the role of the Investment Board of BPMPBUMN as a resource center and as an investment promotion and facilitation body;</p> <p>(iv) Remove restrictions<sup>3</sup> that foreign direct investment (FDI) can only be made in existing firms to “rescue and restore” these firms;</p> <p>(v) Relax the requirement that foreign direct investment be located in designated industrial estates or zones;</p> <p>(vi) Transfer investment approvals below \$100 million from the President to BKPM; and</p> <p>(vii) Transfer approvals below Rp10 billion from BKPM to regional authorities.</p> <p>(viii) Eliminate the requirement of Presidential approvals for foreign investment and allow investors to seek approval of investment proposals, regardless of the amount, from regional investment coordination boards, Indonesian Embassies, and the Investment Board.</p>	<p>Done (July 1999)</p> <p>Done (July 1999)</p> <p>Done (July 1999)</p> <p>Done (November 1999)</p>	<p>Done</p> <p>Complied with</p>	<p>Complied with</p>

Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
	<ol style="list-style-type: none"> <li>5. Prepare a draft investment policy statement and law outlining approach to be taken to rationalizing the promotion, facilitation, and administration of domestic and foreign investment in accordance with best practices.</li> <li>6. Announce the Investment Policy Statement</li> <li>7. Issue the Investment Law.</li> </ol>	<p>Done (January 2000)</p>	<p><b>Complied with</b></p>	<p><b>Not complied with</b></p>
<p>B. Streamline duty drawback procedures and improve transparency</p>	<ol style="list-style-type: none"> <li>1. Complete a review of the duty drawback facility with a view to improving its effectiveness and treatment and access of SMEs and indirect exporters.</li> <li>2. Implement recommendations of the review.</li> </ol>			<p>Done</p> <p>Done</p>
<p>C. Facilitate trade through improved customs procedures</p>	<ol style="list-style-type: none"> <li>1. Promote greater transparency and efficiency by:               <ol style="list-style-type: none"> <li>(i) Upgrading the existing electronic data interchange program; and</li> <li>(ii) Devising and implementing a strategy for expanding integration with importers, shipping companies, banks, etc.</li> </ol> </li> <li>2. Reduce Customs intervention on trade and limit the discretion of Customs officials and adopt a maximum of 10% of import shipments for examination based on intelligence data targeting analyses and random selections.</li> <li>3. Customs to set performance standards:</li> </ol>	<p>Done (May 1999)</p> <p>Done (May 1999)</p>	<p>Done</p> <p>Done</p>	

Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
	<ul style="list-style-type: none"> <li>(i) Publish a weekly report on the examination ration for shipments to ensure it does not exceed 10% of imports;</li> <li>(ii) Customs to automatically issue the release order for imports within four (4) working hours if the data has been accepted by the system as complete, unless is has been red channeled; and</li> <li>(iii) Importations processed through red channel should be examined within twelve (12) working hours of lodgment of the information with Customs, provided the importer complies with Customs requirements. Reports on performance to be prepared on a weekly basis.</li> </ul>			
<b>III. Rationalizing Assistance to SMEs</b>				
A. Broaden participation of SMEs in policy making and implementation and improve interagency coordination and ensure effective policy and institutional framework.	<ol style="list-style-type: none"> <li>1. Government to establish an SME Task Force to review interagency coordination for developing SMEs, policy and regulatory framework, commercial lending policies, and the provision of technical and business services support on an efficient basis.</li> <li>2. Task Force to complete a medium-term strategy for review and comments.</li> <li>3. Rationalize the responsibilities and mandate of respective line agencies with regard to SME-related policies.</li> </ol>	Done (September 1999)	Done	Done

Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
	4. Ensure continuing public review during strategy implementation.		Ongoing	Ongoing
B. Improve efficiency of financial intermediation	<ol style="list-style-type: none"> <li data-bbox="638 407 1163 651">1. For SME credit programs funded by Bank Indonesia liquidity credit provide appropriate benchmark interest rate for cost of funds and ensure that interest rate subsidies on all SME credit programs are reflected in the bud get based on a defined methodology for the calculation of subsidies.</li> <li data-bbox="638 683 1163 894">2. Issue decrees and regulations eliminating liquidity support for SME credit programs, and defining the transition administrative arrangements for the subsidized credit programs once they are transferred from Bank Indonesia.</li> <li data-bbox="638 911 1163 1122">3. Evaluate the costs and benefits of SME credit programs (formerly financed by Bank Indonesia liquidity) and with a view to their rationalization through consolidation of schemes, provision of risk assessment by intermediating bank, etc.</li> <li data-bbox="638 1154 1163 1338">4. Rationalize SME credit program by consolidating<sup>c</sup> schemes for farm cooperatives, plantations and SMEs previously financed by Bank Indonesia liquidity credit into no more than 2 schemes for: (a) cooperatives, and (b)</li> </ol>	<p data-bbox="1247 407 1394 472">Done (April 1998)</p> <p data-bbox="1215 683 1425 748">Done (November 1999)</p>	<p data-bbox="1507 894 1612 927">Ongoing</p> <p data-bbox="1465 1105 1654 1138"><b>Complied with</b></p>	<p data-bbox="1759 894 1864 927">Ongoing</p>

<sup>c</sup> Except for credit schemes for low cost housing, farm production (KUT), Primary Credit Cooperatives



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	and Indonesian experience			
C. Promote commercially oriented technical and business support	<p>SME Task Force, supported by ADB TA,<sup>5</sup> inter alia to</p> <ol style="list-style-type: none"> <li>1. review existing government</li> <li>2. prepare an action plan identifying opportunities for market-based provision of services and private sector participation;</li> <li>3. consolidate and streamline technical and business support programs; and</li> <li>4. initiate implementation of commercialization and divestment of technical and business support programs in accordance with targets in action plan.</li> </ol>			<p style="text-align: center;">Done</p> <p style="text-align: center;">Done</p> <p style="text-align: center;"><b>Complied with</b></p> <p>Partially accomplished. With decentralization, some divestment and commercialization of services has been started. The SME Task Force provided a broad time frame for implementing the 2002 MTAP for SMEs, including the time frame for commercialization</p>

Objectives	Actions Planned	Actions completed prior to Board Consideration	Release Conditions of Incentive Subtranche	Release Conditions of Final Subtranche
				and divestment-related activities contained in the 2002–2004 MTAP-business development services.