SUMMARY OF INDONESIA’S PRIVATE SECTOR DEVELOPMENT ASSESSMENT

Lazeena Rahman

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PRIVATE SECTOR DEVELOPMENT ASSESSMENT (SUMMARY)

1. Indonesia boasts the largest economy in the Association of Southeast Asian Nations (ASEAN), and the 16th largest worldwide. The country has recorded strong economic growth over the past 6 years, and has made significant strides in reducing the incidence of poverty. The new government has pledged to enhance the country’s competitiveness by accelerating infrastructure development, improving human resource development, and implementing bureaucratic reforms.¹

2. The Private Sector. Indonesia’s formal sector is generally engaged in commodities², retail³, and property. Thirty-nine companies were listed as having more than $1 billion in revenue generated in Indonesia by Globe-Asia in August 2012. The formal private sector consists of large business groups, state-owned enterprises and foreign investors. It is estimated that 54% of the private sector enterprises, mainly micro and small enterprises, operate in the informal sector.⁴ The presence of a large informal sector, over time, weakens productivity growth and eventually reduces the country’s global competitiveness. In addition, many new local government owned state enterprises have been established.⁵

3. The Business Setting. According to the World Bank Groups worldwide competitiveness ranking, Doing Business 2015, Indonesia’s rank in the overall ease of doing business improved to 114 in 2015 from 128 in 2009.⁶ While this represents progress, Indonesia’s overall ease of doing business still ranks unfavorably compared to its regional peer—Thailand (26), Malaysia (18), PRC (90), and Viet Nam (78). The World Economic Forum Global Competitiveness Report 2014–2015 notes even greater progress ranking Indonesia the 34th most competitive country globally compared to 50th in 2012–2013.⁷ Improvements in perception of government bureaucracy, labor regulations and infrastructure supply are also positive outcomes.

4. While progress is being made, effective implementation of the policies aimed at improving the private sector enabling environment are taking longer than anticipated. The local investment climate is also uncertain because of inconsistent and often arbitrary regulations imposed by local Governments. The poor quality of Indonesia’s infrastructure, corruption, legal system weaknesses⁸, regulatory uncertainty, taxes⁹, skill shortages¹⁰, and labor market issues

¹ ADB, Indonesia Fact Sheet
² Oil, gas, coal, nickel, copper and palm oil.
³ Automotive, cigarettes and services
⁴ The Central Statistics Bureau estimated in 2012 that over 118 million workers were employed in the informal sector which represents a significant drop from previous surveys due in part to economic growth since the 1999 Monetary Crisis. However the informal sector remains a significant.
⁵ These locally owned businesses include a number of regions that have been split into two or more regencies with a resulting number of SOE, in water supply, sanitation, solid waste removal and extractive industries.
⁸ See the most recent Jakarta Intercultural School decision and statement from the United States Ambassador Robert O. Blake Jr. Also DB 2015 notes that Indonesia is 172 out of 189 countries in enforcing contracts.
⁹ Particularly a proliferation of local taxes
¹⁰ More than two-thirds of Indonesia’s workers have not completed secondary school.
continue to be perceived as major impediments to doing business. Increasingly, business community perception surveys suggest that infrastructure—i.e. transport, electricity and telecommunications—have become the most serious obstacles to doing business. Foreign investors identify additional impediments, which include: (i) red-tape and high start-up costs; (ii) clarity of the regulatory framework; and (iii) labor market rigidities.

5. **Infrastructure.** While Indonesia has prudently spent resources on fiscal consolidation and improving debt accumulated during the Asian Financial Crisis, there has also been limited spending on public infrastructure. The 2015 World Economic Forum report ranked Indonesia 72nd among 144 countries for its infrastructure spending despite an overall increase in infrastructure supply.

6. **Transport.** Among the key infrastructure subsectors, investors consider poor transport networks one of the most critical impediments to investment and productivity. Indonesia’s road density is among the lowest in ASEAN, whether measured in length per 100 people or average transport speed. Of the road network 36% is classified was either damaged or severely damaged at the end of 2007, the vast majority of which falls under the supervision of district governments.

7. **Ports.** Tanjung Priok is the country’s largest container terminal but is less competitive in the length and number of bureaucratic processes for clearance, waiting time, and port access. When compared to regional competitors Indonesia compares unfavorably to Malaysia, (25th), Thailand (35th), and Vietnam (48th). A major overhaul of the port’s infrastructure is expected to bring significant improvements. The performance of smaller ports, mainly catering to inter-island cargo, is also poor, due to a lack of equipment, inefficient work methods and limited berth lengths.

8. **Communications.** Latest forecasts project a four-fold increase in smartphone ownership for Indonesia (as measured by penetration of total population) in the period to 2018. This means that there will be around 110 million smartphone users by 2018, with this customer segment growing at 30% per year. Estimated penetration will increase from 2014 estimates of 21% to 43% by 2018. With economic growth increasing at between 5% and 6% annually personal spending is rising 10% annually.

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11 DB15 ranks Indonesia in the world’s bottom 20% in (i) starting a business; (ii) getting construction permits; (iii) paying taxes; and (iv) enforcing contracts
12 World Economic Forum (WEF) Global Competitiveness Reports 2014–2015 notes that Indonesia is 72nd overall (out of 144 countries) in infrastructure quality with road (72nd), ports (77th), fixed telephone lines (71st) and electricity (84th) being the most egregious.
14 Redwing Asia edwing-asia.com/page/2/
9. **Logistics Costs.** Poor distribution systems have resulted in very high logistics costs. On average, logistics costs in Indonesia accounted for 23.6% of the country’s current gross domestic product (GDP). This is far higher than other countries such Japan with 10.6% and South Korea with 16.3%.15

10. **Power Supply.** Although Indonesia’s electricity generating capacity has increased by more than 25% in the past decade, the country has a low electrification rate compared to countries with similar income levels. Per capita electricity consumption in Indonesia was about 629 kWh in 2014 and ranks 151st among 220 countries. This compares to 3,780 kWh in Malaysia (72nd), 1,125 in Vietnam (133rd), and 2,511 kWh in Thailand (91st).16 System transmission and distribution losses of 9% in 2011 were still among the highest of major ASEAN economies. Indonesia’s residential and industrial power tariffs remain among the lowest in ASEAN. Low power tariffs limit PLN’s ability to invest in and expand generation capacity, and serves as a strong disincentive to private investment in energy infrastructure.

11. **Regional Infrastructure Disparity.** There is large disparity in the availability of infrastructure and infrastructure services between Indonesia’s islands and provinces. Electricity access varies from 30% in Papua to 94% in Jakarta, and access to asphalt roads averaged 58% across the country but varies from region to region from 40% to 72% of villages within individual provinces. Disparities in infrastructure access translate directly into vast differences in investment patterns. For example, Java received over 60% of the foreign direct investment (FDI) in 2013 and 56% in 2014 Sumatera accounted for just 12% of the FDI in 2013 and about 14% in 2014. Eastern Indonesia, where infrastructure lags far behind, has seen dramatic increases in FDI receiving some 27% in 2014.17

12. **Private Sector Participation in Infrastructure.** Each subsequent 5 year development plan (RPJMN) has called for private sector investment of upwards of 30% of the total planned infrastructure investment. Realizing the benefits of private sector investment in public infrastructure has been difficult. Structural impediments including land acquisition, poorly structured candidate projects, limited capacity in government, local private sector and the financial markets have hampered the delivery of credible projects for investment. The previous public-private partnership (PPP) policy framework has also contributed to the lack of investment.

11. Indonesia has embarked on addressing these structural weaknesses with several legislative initiatives. Presidential Regulation (Perpres) 75 of 2014 was issued to create a new agency under the Coordinating Ministry of Economic Affairs (CMEA) to accelerate delivery of priority infrastructure projects. Ministry of Finance will assume the role as the PPP Centre and will be responsible for tendering all PPP ready projects. Perpres 38 of 2015 codifies cooperation agreements between government and private sector for infrastructure provision and replaces the previous PPP legislation.18

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15 High logistics costs still harming RI competitiveness, Nadya Natahadibrata, The Jakarta Post, Jakarta, March 18 2014,
16 [http://www.photius.com/rankings/energy/electricity_consumption_per_capita_2014_0.html](http://www.photius.com/rankings/energy/electricity_consumption_per_capita_2014_0.html)
17 Eastern Indonesia includes, Kalimantan, Sulawesi, Maluku and Papua which makes up approximately 2/3 of the Indonesia land mass.
18 Specifically it replaces Perpres 67 of 2005 and subsequent amendments with the last amendment Perpres 66 of 2013.
13. **Land Acquisition.** Acquiring land is notoriously difficult in Indonesia. The government is addressing this issue comprehensively by strengthening the process for the government purchase land including for PPPs. In addition, a 2012 law provides for involuntary conversion by eminent domain through a fair and transparent process.

14. **Shallow Financial Sector.** Indonesia’s financial sector is small in relation to GDP, representing just over 70% of GDP, substantially below other large Asian economies. Thailand, for example, has a financial sector of 210% of GDP, India 300% of GDP, Malaysia 383% of GDP and PRC at 500% of GDP. The financial sector is one of the least efficient in the region, and there is a lack of financial depth, as evidenced by limited product offerings and services. As of end–2012, the stock market capitalization was just 49% of GDP (compared to 160% in Malaysia), and outstanding debt securities equivalent to 15% of GDP (compared to 120% of GDP in Malaysia). Both the money market and the foreign exchange market are thin, with limited use of swaps and options.

15. **Cost of Finance.** Indonesia’s cost of finance is high, compared to other parts of Southeast Asia. Since the 1997 Asian Financial Crisis, Indonesia’s real lending rate has remained higher than the rates of the region’s other major economies. In November 2014, Indonesia’s real domestic lending rate stood at 11.8%, compared with 3.8% in Malaysia, 3.8% in the Philippines, 6.1% in Singapore and 2.3% in Thailand. High lending rates are related to a low level of domestic savings and inefficient financial intermediation.

16. **Project Finance.** Project finance is a long–term financing vehicle for infrastructure projects based upon the projected cash flow rather than the balance sheets of its sponsors. Indonesia has, since 2007, been providing long-term project finance in syndication by SOE banks principally to SOE infrastructure projects in key sectors. Lending terms are up to 15 years with grace periods of 2 years or more based on project cash flows under agreement with government. Expanding such offerings to private entities remains limited. Notwithstanding, Indonesia is addressing the shortage of project finance through two institutions, PT IIF and PT SMI, who were created to catalyze project financing through both debt and equity infusions.

17. **Contract Enforcement.** Doing Business 2015 ranks Indonesia 172nd out of 189 countries in enforcing contracts. Transparency International’s Global Perception Index 2013 ranks Indonesia’s legal system and the courts as the third most corrupt institution in the country. Still, outmoded laws, regulations and the heavy weight of administration oriented instructions combined with a badly paid, and increasingly fragmented polity and civil service has increased the scope for bureaucratic discretion.

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19 Behind the police 91% and parliament 89%. 86% of respondents felt the judiciary was corrupt or extremely corrupt.