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Investing in Indonesia Institutions for Inclusive and Sustainable Development

The World Bank in Indonesia

Trade

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FOSTERING COMPETITIVENESS TO INCREASE INVESTMENT, TRADE AND GOOD JOBS

Indonesia has made steady progress in implementing trade reforms in recent years and this has been one of several factors helping formal sector employment to expand, reducing poverty levels and expanding the ranks of Indonesia's middle class. In addition, Indonesia has been more fortunate than its neighbors in coming through the global financial crisis relatively unscathed.

This has given Indonesia a unique opportunity in the wake of the crisis to increase both its global market share and domestic sales. In order to seize this opportunity fully, Indonesia needs to push ahead with trade reforms and avoid protectionism that would stifle efficiency and innovation. Together with Indonesia, by late 2010 only China and Hong Kong had succeeded in bringing their international trade back to their respective absolute pre-global financial crisis values. .

However, despite the rapid growth in exports of resource-based commodities, Indonesia has made limited progress in increasing exports in manufactured and processed products. Indonesian producers have raised concerns about their ability to compete against low-cost producers, both at home and in foreign markets. Declining growth in manufacturing and a shrinking share of manufacturing sector exports have also raised questions concerning the competitiveness of Indonesia's manufacturing sector.

One area that undermines trade by making Indonesian products less competitive than foreign imports is the country's low levels of connectivity that are a consequence of its poor logistics system. Connectivity is an issue that poses different challenges depending on whether the bottlenecks are affecting international, inter-island or intra-island trade. The high cost of transporting high quality goods such as shrimp from eastern Indonesia to processing centers in Java makes them too expensive to export, or similarly it is cheaper to import oranges from China than ship them from Kalimantan to Java. These are examples of inefficiencies in inter-island trade. Examples of high intra-island logistics costs include severe road congestion on Java, especially in the greater Jakarta area, together with the poor road quality outside Java, both of which make trucking costs higher in Indonesia than the average for Asia. Finally, the poor performance of Indonesia's main ports in Jakarta and Surabaya, due to low port productivity and the only partial implementation of the National Single Window (NSW), reduce international connectivity.

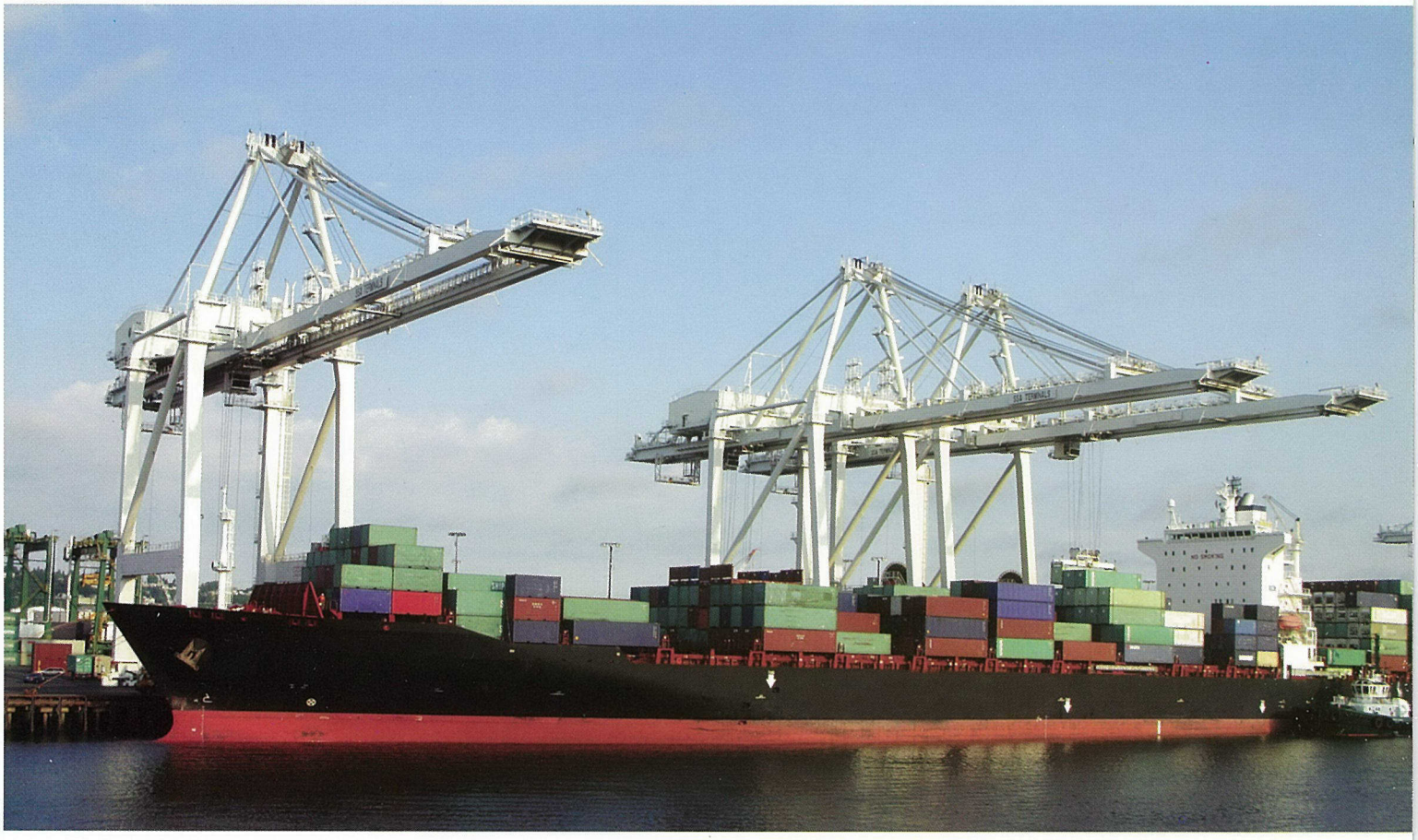
The high cost and uncertainty of domestic transportation channels also prevent Indonesia from being more integrated into just-in-time production networks of higher value-added products. Licensing and government-regulated pricing reduce incentives to invest in better services and restrict competition between domestic land and sea freight companies. Restrictions on foreign investment in logistics only worsen the situation by restricting access to new technology.

While Indonesia has made progress in raising port and customs efficiency levels, further improvements are still needed. The average import container dwell time in the main container terminal is five days compared with less than three days in major regional ports. Imports of empty containers clear in less than half the time needed for full containers, showing that most of the delay is caused by border control and inspection procedures as opposed to inadequate infrastructure. Burdensome and unclear administrative procedures contribute to import delays and invite corruption, undermining the competitiveness of industries that use imported components. Also, although Indonesia has a very open economy in terms of tariffs, its non-tariff barriers (NTBs) remain significant and there has been a worrying increase in NTBs recently.

Key Issues

Going forward, an aggressive push on trade reform designed to achieve higher growth would help to increase employment opportunities in higher-value industries, while also increasing international and domestic trade. A number of ongoing efforts are designed to streamline and simplify trade-related procedures, but require a greater effort to yield results. For example, despite the recent creation of a single window for trade (NSW) to replace a manual system with an online system, traders are still required to visit each agency individually. Also, electronic systems appear to have been added on top of existing manual systems resulting in double submissions and double checking. High-priority action is required in the following areas.

1. Create a Regulatory Reform Commission. International experience suggests that a coordinated top-down approach based on a strong legal foundation is often the only way to overcome bureaucratic resistance to reform. The Government could consider forming a Regulatory Reform Commission. Such a commission could be composed of teams focusing on different topics, such as a future possible connectivity council.
2. Push ahead with the National Single Window (NSW). Eliminate the requirement to submit paper copies of trade documents and create a functioning NSW as agreed with ASEAN, using a single administrative document, single submission, single and synchronous processing and single approval. If such a NSW is to achieve its full potential, strong leadership will be needed to push the core agencies to change their back-office procedures and cooperate in simplifying trade systems.
3. Promote innovation and export diversification. Indonesia should consider promoting public-private R&D partnerships for new product development and align fiscal incentives for the private sector to move into downstream processes. Other practical action would be to support the efforts of the Export Import Financing Agency (LPEI) and related agencies to develop financing and guarantee instruments to support exports of new products or exports to new markets.



HOW **THE WORLD BANK** WORKS IN REAL TERMS

The World Bank is working closely with the Coordinating Ministry for Economic Affairs (CMEA), the Ministry of Trade and the Indonesian Chamber of Commerce and Industry (Kadin) to facilitate trade in to, out of, and inside Indonesia. The World Bank is supporting the Government to improve connectivity and also enhance the policy formulation process and support trade facilitation measures, such as the Indonesia National Single Window and the development of a National Logistics Blueprint. Its advisory work on trade includes the following:

1. Advising on best practice in setting up institutions and processing regulatory reform in trade facilitation.
2. Training in risk management for government agencies participating in the NSW.
3. Strengthening institutional capacity of the Ministry of Trade to take informed policy decisions.
4. Supporting the Ministry of Trade to build capacity to better understand the nature and impact of Non-Tariff Barriers (NTBs).
5. Strengthening the capacity of public institutions and private sector organizations to conduct dialogues on services and connectivity.

Investing in Indonesia Institutions
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