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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
PROGRAM DOCUMENT
ON A PROPOSED LOAN

IN THE AMOUNT OF US\$400 MILLION
TO THE
REPUBLIC OF INDONESIA

FOR A
FIRST INDONESIA LOGISTICS REFORM
DEVELOPMENT POLICY LOAN

September 29, 2016

Trade & Competitiveness

East Asia and the Pacific

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REPUBLIC OF INDONESIA-GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of September 28, 2016)

Currency Unit	Rupiah (IDR)
US\$ 1.00 =	IDR 12,935

ABBREVIATIONS AND ACRONYMS

3PL	Third Party Logistics Provider	KfW	German Development Bank
ALFI	Indonesian Logistics and Forwarder Association	LARTAS	<i>Larangan Terbatas</i> (imports and exports of prohibited and restricted goods)
AMDAL	<i>Analisis Dampak Lingkungan</i> (Environmental Impact Analysis)	LGST	Luxury Goods Sales Tax
ASPERINDO	<i>Asosiasi Perusahaan Jasa Pengiriman Ekspres Indonesia</i> (The Association of Indonesian Express Delivery Services)	LPI	Logistics Performance Indicators
ATM	Automatic Transfer Machine	LSGT	Luxury Goods Sales Tax
BI	Bank Indonesia	MBU	Minister of State-Owned Enterprise letter
BOT	Built-Operate Transfer	MoF	Ministry of Finance
BPK	<i>Badan Pemeriksa Keuangan</i> (State Audit Agency)	NPL	Non-Performing Loan
BPKP	<i>Badan Pengawasan Keuangan dan Pembangunan Indonesia</i> (Development Finance Controller of Indonesia)	NTM	Non-Tariff Measures
BPOM	Indonesian Food and Drug Agency	PEFA	Public Expenditure and Financial Accountability
BPS	Badan Pusat Statistik (Central Bureau of Statistics)	PELINDO	<i>Pelabuhan Indonesia</i> (Indonesia Port Corporation)
CEIC	Euromoney Institutional Investor Company	PDO	Project Development Objectives
CEQ	Commitment to Equity	PFM	Public Financial Management
CMEA	Coordinating Ministry of Economic Affairs	PIB	<i>Pemberitahuan Ekspor Barang</i> (Export Declaration)
CPF	Country Partnership Framework	PM	Ministry of Transport / Communication and Information Regulation
CPI	Consumer Price Index	PMK	Ministry of Finance Regulation
DAG	Ministry of Trade Regulation	PP	<i>Peraturan Pemerintah</i> (Government Regulation)
DG	Directorate General	PPIAF	Public Private Infrastructure Advisory Facility
DNI	Negative Investment List	RAS	Reimbursable Advisory Services
DPL	Development Policy Loan	RER	Real Exchange Rate
EDC	Electronic Data Capture	RPJMN	<i>Rencana Pembangunan Jangka Menengah Nasional</i> (National Medium Term Development Plan)
ESIA	Environmental and Social Impact Assessment	SCD	Systemic Country Diagnostics
FDI	Foreign Direct Investment	SISLOGNAS	Sistem Logistik Nasional (National Logistics System)
FY	Fiscal Year	SIUPAL	<i>Surat Ijin Usaha Perusahaan Angkatan Laut</i> (Marine Transport License)
GDP	Gross Domestic Product	SKI	<i>Surat Keterangan Impor</i> (Import Declaration Letter)
GIZ	German Development Cooperation	SOE	State-Owned Enterprise
GOI	Government of Indonesia	SORT	Systematic Operations Risk Rating
GRS	Grievance Redress Service	STRI	Services Trade Restrictiveness Index
IBRD	International Bank for Reconstruction and Development	SUKK	<i>Surat Usaha Keagenan Kapal</i> (Shipping Agent Licenses)
ICT	Information and Communications Technology	SUSENAS	<i>Survei Sosial dan Ekonomi Nasional</i> (National Socio-economic Survey)
IDR	Indonesian Rupiah	UKL	<i>Usaha Pengelolaan Lingkungan Hidup</i> (Environmental Managing Effort)
INAPORT	Indonesia Port system	UPL	<i>Usaha Pemantauan Lingkungan Hidup</i> (Environmental Monitoring Efforts)
INSW	Indonesia National Single Window	USD	United States Dollar
INTR	Indonesian National Trade Repository	VAT	Value Added Tax
IP	<i>Importir Produsen</i> (Producer Importer License)	WB	World Bank
IT	<i>Importir Terdaftar</i> (Registered Importer)	WBG	World Bank Group
JICT	Jakarta International Container Terminal	WTO	World Trade Organization

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THE REPUBLIC OF INDONESIA
FIRST INDONESIA LOGISTICS REFORM DEVELOPMENT POLICY LOAN
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**SUMMARY OF PROPOSED LOAN AND PROGRAM
REPUBLIC OF INDONESIA
FIRST INDONESIA LOGISTICS REFORM DEVELOPMENT POLICY LOAN**

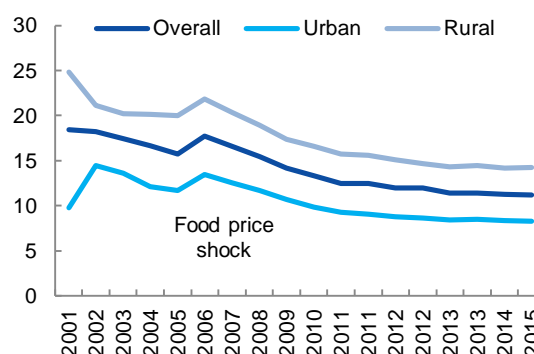
Borrower	The Republic of Indonesia
Implementation Agency	Coordinating Ministry of Economic Affairs
Financing Data	IBRD Loan Terms: [TBD]; Front end fee: [TBD]; Amount: USD [400 million].
Operation Type	Programmatic (1st of 2), single-tranche
Pillars of the Operation And Program Development Objectives	<p>The PDO for the programmatic DPL series is to reduce the costs and improve the reliability of the logistics chain in Indonesia. It comprises of three pillars with the following PDOs:</p> <ul style="list-style-type: none"> • Pillar A: Enhancing ports' performance. PDO: Strengthening port's governance and operations. • Pillar B: Improving logistics services. PDO: Enabling a competitive business environment for logistics service providers. • Pillar C: Strengthening trade processing. PDO: Making trade processing more efficient and transparent.
Result Indicators	<p>A1: Increase in the number of Pelindos' ports and terminals with internationally certified management systems</p> <p>A2: Increase in the number of approved applications for BOT scheme for sea-ports development</p> <p>A3: Reduction in the minimum and maximum ships' waiting times in Tanjung Priok and Makassar sea-ports</p> <p>B1: Increase in the number of new foreign licenses for freight forwarders, warehousing and cold storage service providers</p> <p>B2: Increase in the number of new shipping agents' licenses (SUKK) and foreign maritime cargo handling licenses</p> <p>B3: Increase in the number of operational logistics bonded centres</p> <p>C1: Reduction in pre-clearance time in Tanjung Priok</p> <p>C2: Increase in the share of relevant regulations included in the Indonesia National Trade Repository</p> <p>C3: Reduction in dwelling time in the 2 main ports (Tanjung Priok and Tanjung Perak)</p> <p>C4: Reduction in pre-clearance time for food and drugs imports in Tanjung Priok</p> <p>C5: Decrease in the share of import shipments classified as red channel in Tanjung Priok</p>
Overall Risk	Substantial
Operation ID	P158140

IBRD PROGRAM DOCUMENT FOR A PROPOSED FIRST INDONESIA LOGISTICS REFORM DEVELOPMENT POLICY LOAN (DPL) TO THE REPUBLIC OF INDONESIA

1. INTRODUCTION AND COUNTRY CONTEXT (INC. POVERTY DEVELOPMENTS)

- This program document presents a proposed DPL to support the Government of the Republic of Indonesia's priorities for improving the movements of goods within and across the country's borders to further its medium-term economic development and poverty reduction goals.** The proposed operation, in the amount of US\$ 400 million, is the first in a planned programmatic series of two single-tranche operations supporting critical policy and institutional reforms to address bottlenecks at various points of the supply chain by: A) strengthening port's governance and operations; B) enabling a competitive business environment for logistics service providers; and C) making trade processing more efficient and transparent.
- Over the past decade Indonesia has seen strong growth and job creation, supporting poverty reduction; the end of the commodity boom, nonetheless, has exposed structural weaknesses.** Following the recovery from the Asian financial crisis, annual growth averaged 5.6 percent over 2001-12. As the external tailwinds of commodity prices and demand, along with global financing conditions, have turned to headwinds, other sectors have not been able to take up the slack of commodity exports. As a result growth has slowed, down to 4.8 percent in 2015 and projected at 5.1 percent in 2016. This has translated into a slowing down of the rate of poverty reduction, with a near zero decline in 2015 (Figure 1). In addition the number of vulnerable in 2015 (i.e., those between the poverty line and 1.5 times the line) remains high, at 24 percent of the population, mainly due to a lack of productive employment and vulnerability to shocks¹.
- The need for efficient logistics has become vital to boost competitiveness in tradable sectors, and to reverse the slowing down of poverty reduction, especially in more remote regions of the country.** The Indonesian economy needs to rebalance away from commodity production where prices are declining, and to move towards manufacturing and modern services. Efficient logistics is a vital tool to achieving that end as it can reliably and cost-effectively bring products from the source to those who use them, whether producers or final consumers. Logistics is all the more important in an archipelago nation such as Indonesia where the sea can become a means of cohesion or a source of fragmentation and isolation.

Figure 1: National poverty rate (percent)

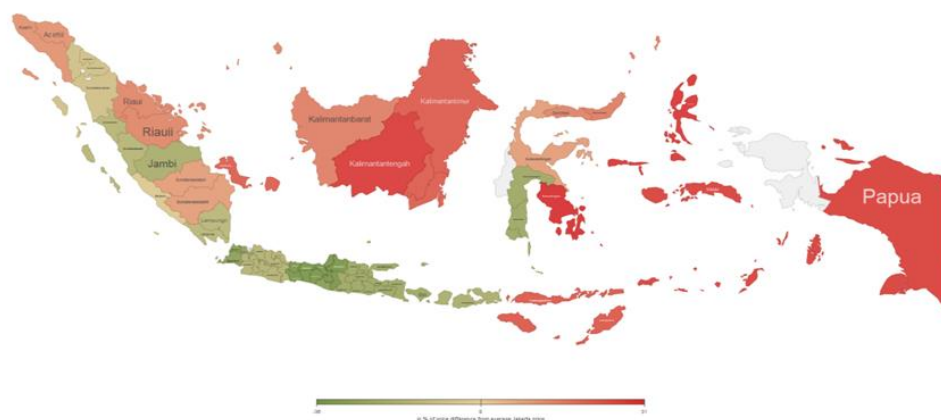


Source: Statistics Indonesia, BPS

¹ World Bank staff calculation using the National Socioeconomic Survey (Susenas) for 2015.

Efficient logistics could reduce the large price premia incurred in less connected regions – where poverty is more concentrated - vis-à-vis the country’s economic core of Java (Figure 2). As poverty is relatively higher in remote regions, especially in Eastern Indonesia, lowering prices there would have a particularly important poverty reduction effect. The importance of logistics is underscored by its relevance in the Indonesian economy: the most recent estimate suggests the sector represents one fourth of the economy.²

Figure 2: Prices compared with Jakarta: Higher prices in remote areas



Note: Principal component analysis of regional prices compared with Jakarta
Source: World Bank staff estimates.

4. **Large inefficiencies still plague the logistics sector in Indonesia, which acts as both a drag on growth and a contributor to inequality.** Logistics costs (transport, warehousing and inventory) are higher in Indonesia (25 percent of manufacturing sales) than in neighboring countries including Thailand (15 percent) and Malaysia (13 percent).³ A large share of these costs are associated with the need to carry high inventory levels due to a lack of predictability and unreliability of the logistics chain.⁴ Almost two thirds of Indonesian manufacturers have in-house, as opposed to outsourced logistics activities, a clear signal of the lack of trust in the capability of local logistics service providers.⁵ Traders who wish to have their freight sent from Java or Sumatra to other islands are likely to be confronted with long supply chains, uncertainties in delivery time, and high costs needed to compensate for at least 70 percent empty volume on the return voyage (backhaul). Indeed it is cheaper to ship a container of Chinese mandarin oranges from Shanghai to Jakarta than to send similar freight from Jakarta to Padang in West Sumatra, despite the distance between the former cities being six times further than the latter.
5. **In a relatively remote archipelago such as Indonesia the logistics supply chain is typically long and fragmented; the DPL tries to address the main choke-points along**

² Bahagia, I.; Sandee, H. and R. Meeuws (2013). “*State of logistics Indonesia 2013*” Washington DC; World Bank.

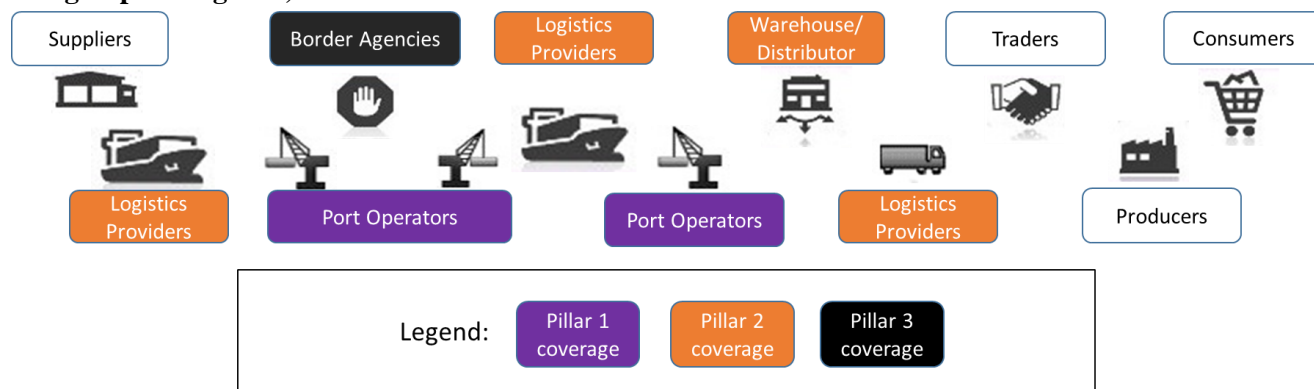
³ These figures are based on various surveys of manufacturing firms administered or gathered by World Bank (2015a). “Improving Indonesia’s Freight logistics a plan for action.” Jakarta: The World Bank.

⁴ Inventory costs are 31% of logistics costs in Indonesia vis-à-vis 22% in Thailand and 14% in Vietnam.

⁵ On average, 19 out of 100 orders will either be late or some units will be missing, a higher share than most countries at similar level of income. See World Bank (2015a). “Improving Indonesia’s Freight logistics a plan for action.” Jakarta: The World Bank.

the chain—including at the port of entry by facilitating more efficient investments and port services; at the border through improved clearance procedures; and before and beyond the border towards the final destination of goods through better logistics services. Consider for example imported inputs used by a manufacturer in South Sulawesi (Figure 3). Inputs produced in a third country are first shipped to an Indonesian international port, often Jakarta. The shipment is typically managed by a logistics service provider (e.g. a freight forwarder), who is responsible for contracting the shipping service via a shipping agent. The shipment has to be off-loaded at the port and go through trade processing, which verifies its compliance with Indonesian regulations. This may involve as many as 12 ministries/agencies and multiple inspections for one product. Once the goods are cleared they may be loaded on another vessel for carriage to the port of Makassar. The container is then off-loaded and loaded on to a truck inside the port, which may deliver it to a warehouse from which the consignment to the final destination would be arranged. Again, the delivery process may be organized by a third party logistics service provider arranging the services of various other providers. Bottlenecks in this chain, whether in terms of inefficient port operations, restrictions on core logistics services or delays in trade facilitation, have a particularly negative impact on manufacturing productivity both internationally⁶ and within Indonesia.⁷ The three pillars in this DPL series cover various choke-points along this supply chain (Figure 3).

Figure 3: The DPL coverage in the long logistics chain in Indonesia (example: producer in Sulawesi using imported goods)



Source: Elaboration of World Bank staff

6. **Inefficient port operations, uncompetitive logistics services markets and lengthy trade procedures are at the core of the country’s inefficient logistics.** Ports are often a bottleneck in the Indonesian logistics chain, hampered chiefly by inadequate infrastructure, although burdensome regulations – related to trade processing and investments - and low

⁶ See Arnold, J., B. Javorcik, M. Lipscomb and A. Mattoo (2014). “Services reform and manufacturing performance: evidence from India”, *Economic Journal*, 126: 1-39; and Salsavski, D. and B. Shepherd (2012). “Facilitating International Production Networks: The Role of Trade Logistics”, Policy Research Working Paper 6224, World Bank.

⁷ Duggan, V., S. Rahardja and G. Varela (2015) “Revealing the Impact of Relaxing Service Sector FDI Restrictions on Productivity in Indonesian Manufacturing”, Policy Note no. 5, World Bank.

labor productivity also play a role.⁸ The quality of ports' infrastructure across the country is a weak factor in the overall country's competitiveness and detailed work on 18 ports throughout Indonesia by the World Bank has confirmed critical infrastructure gaps.⁹ A key reason behind under-investment in the country's port infrastructure is the lack of clarity on the role of the port landlord and the port operator, which generates ambiguity as to who should take the lead in infrastructure development. Restrictions to competition in logistics service markets are another important hindrance to the logistics sector. Indonesia is the most restrictive among the 42 countries surveyed by the OECD in several logistics services, including freight forwarding, maritime transport and distribution.¹⁰ Restrictions include limits to foreign ownership as reflected in the negative investment list (DNI), excessive minimum capital requirements, restrictions on the location of operations and cumbersome licensing requirements. Finally, cumbersome regulatory requirements and inefficient procedures make trade processing a further weak link in the logistics chain. Indonesia ranks 105 out of 189 economies in the Doing Business "Trading across borders" indicators, behind most South East Asian comparators. Documentary compliance for imports in Jakarta takes 144 hours in Jakarta vis-à-vis 10 hours in Malaysia and 4 hours in Thailand. These constraints contribute to the poor global rank of Indonesia in terms of the World Bank's *Logistics Performance Indicators* (LPI), particularly for international shipments, where Indonesia ranks 71 out of 160 countries, well behind Malaysia, Philippines, Thailand, Vietnam and Cambodia.

7. **The Government has recognized the importance of improving logistics and has made it one of its priority objectives.** The Government's Medium-term Development Plan for 2015-2019 (Rencana Pembangunan Jangka Menengah Nasional, or RPJMN 2015-2019) includes efficient logistics as one of the priorities of its economic development strategy. The effort is guided by two high level strategies, i.e. the national logistics blueprint (SISLOGNAS), and the implementation of the Indonesian National Single Window (INSW). The renewed momentum is reflected in an accelerated pace of key logistics reforms by the Government, for example implementing the Shipping Law and increasing competition in logistics service providers' markets.
8. **This DPL series forms an integral part of the Indonesia Country Partnership Framework (CPF) *Maritime Economy and Connectivity* engagement - which aims to support the Government's efforts to improve connectivity; and the *Leveraging the Private Sector* supporting beam - which aims to improve the business climate and markets.**¹¹ The proposed DPL series aims to address key policy and institutional bottlenecks in support of the Government's logistics and trade reforms to improve the efficiency of ports, enhance competition in logistics services, and streamline trade processing.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

⁸ World Bank (2015a). "Improving Indonesia's Freight logistics a plan for action." Jakarta: The World Bank

⁹ World Bank (2015b) "RAS Port Development Priority Project and Financing Strategy", mimeo. See section 4 for more details on this.

¹⁰ OECD Services Trade Restrictiveness Index 2015.

¹¹ *Country Partnership Framework For The Republic Of Indonesia (Fy16 – Fy20)*, World Bank, 2015

9. **Indonesia's economy has slowed since 2012 as a result of the commodities downturn and policy response, with recent headwinds coming from renewed financial market volatility.** Real GDP growth averaged 5.0 percent year-on-year (yoy) in the first half (H1) 2016, slightly up from 4.8 percent in 2015, but still considerably below its 6.4 percent peak in 2010. The main cause of the growth moderation in recent years has been slower investment growth. Weaker job creation and significant Rupiah depreciation have also weighed on household consumption growth. In line with weak domestic demand, import volumes contracted significantly in 2015-H1 2016, after growing by around 2 percent in 2013-2014. Exports have also declined in yoy terms since Q4 2014. The public sector supported GDP growth in H2 2015 and, after a slow start to 2016, in Q2 2016, as expenditure disbursement, including on infrastructure development, accelerated. In 2015, capital expenditure by the government increased by 42 percent yoy in nominal terms.
10. **Weaker global commodity prices and demand have put exports under pressure.** Export revenues contracted in each of the last four years, with the decline reaching 14.4 percent yoy in 2015. Export volume declined in the first half of 2016 too, but by less than in previous quarters. Sharp fall in commodity prices have driven much of the decline in commodity export revenues, which account for approximately 60 percent of total exports.¹² Commodity export volumes have declined by about a quarter over the same period. The commodities downturn has reduced potential GDP growth - now estimated at below 5.5 percent - and exposed structural challenges, including the low quantity and quality of public investment, the quality of the investment climate and skills shortages.
11. **In line with the global slowdown, Indonesia's manufacturing exports also declined in 2015 – by 8.1 percent relative to 2014.** Despite a 30-percent nominal depreciation since mid-2013, the Rupiah has depreciated only by about 7 percent in real terms over the same period. One reason for the limited real depreciation has been persistently high domestic inflation in 2014 and 2015. An additional factor is the increase in distribution costs in Indonesia (vis-à-vis the main regional peers) since the second half of 2014. The rise in the distribution wedge over 2014-15 may partly reflect the restrictions on foreign investment in warehouse and distribution services imposed in 2014, the increasing use of trade restrictive measures in 2014 and the first half of 2015, including the hike in tariffs on many consumer goods, and the rise in domestic fuel prices due to the elimination of fuel subsidies in 2014. Export competitiveness, thus, remains a major challenge.¹³
12. **The current account balance weakened as global commodity prices declined, but the deficit remains moderate relative to GDP.** After recording generally small surpluses over the 2000s, the current account swung into deficit in the final quarter of 2011, reaching -3.0 percent of GDP in 2014. The deficit opened up mainly due to a sharp contraction in the goods trade surplus since 2012, resulting from weaker net commodity exports and a large oil and emerging gas deficit. Import compression on the back of more moderate domestic demand growth helped the goods trade surplus rise in 2014 and a further contraction in imports,

¹² The net weighted price index for Indonesia's six major export commodities (coal, natural gas, crude oil, palm oil, rubber and copper) was about 60 percent lower at end-2015 than its February 2011 peak.

¹³ Cali, M. and M. Nedeljkovic (2016) "RER competitiveness and distribution wedges: The case of Indonesia", mimeo, World Bank.

especially due to lower oil prices, has brought down the deficit to around 2.1 percent of GDP since 2015. There are large structural deficits in the services trade and income sub-accounts.

Table 1: Key Macroeconomic Indicators

	2012	2013	2014	2015	2016f	2017f	2018f
Real Economy	<i>Annual percentage change, unless otherwise indicated</i>						
Real GDP	6.0	5.6	5.0	4.8	5.1	5.3	5.5
Per Capita GDI (USD Atlas Method)	3,599	3,759	3,654	3,515	3,514	3,662	3,998
Contributions to GDP growth (ppt):							
Consumption	3.5	3.6	3.0	3.1	3.2	3.4	3.3
Investment	2.9	1.6	1.5	1.6	1.5	1.7	1.9
Net exports	-1.5	0.6	-0.3	0.9	0.2	0.2	0.0
Imports (real growth)	8.0	1.9	2.2	-5.8	-2.3	2.7	6.2
Exports (real growth)	1.6	4.2	1.0	-2.0	-1.1	3.4	5.9
Unemployment rate (ILO definition)	6.3	6.1	5.9	5.8	..	..	..
GDP deflator (avg.)	3.8	5.0	5.4	4.2	2.8	4	4.5
CPI (avg.)	4.0	6.4	6.4	6.4	3.9	4.5	4.6
Fiscal accounts*	<i>Percentage of GDP</i>						
Expenditure	17.2	17.3	16.9	15.7	14.9	15.3	16.3
Revenue	15.4	15.1	14.7	13.1	12.1	12.5	13.5
General Government Balance	-1.8	-2.2	-2.2	-2.6	-2.8	-2.8	-2.8
General Government Debt	23.0	24.9	24.7	27.4	29.3	29.5	30.1
Selected Monetary Accounts	<i>Annual percentage change</i>						
Base Money (M2)	18.5	13.8	11.5	12.8	..	..	..
Credit to non-government (eop)	22.4	22.1	14.2	..	..	..	..
Interest (key policy interest rate), eop	5.8	7.5	7.8	7.5	..	..	..
Balance of Payments	<i>Percentage of GDP, unless otherwise indicated</i>						
Current Account Balance	-2.7	-3.2	-3.1	-2.1	-2.1	-2.3	-2.5
Imports	23.2	23.2	22.7	19.2	17.3	17.2	16.8
Exports	23.0	22.5	22.3	19.8	17.3	17.2	16.8
Direct Investment (net, US\$ billion)	13.7	12.2	14.8	9.3	10.3	15.9	19.6
Gross Reserves (US\$ billion, eop)	112.8	99.4	111.9	105.9	1110	114.0	117.0
Months' import cover (goods)	7.6	6.8	8.0	7.7	8.5	8.2	7.9
As % of short-term external debt	206.4	176.6	188.8	185.5	178.8	175	182.4
External Debt	27.5	29.2	33.1	35.6	36.0	36.0	35.0
Term of Trade (index 2008=100)	94	81	92.4	96.6	..	..	..
Exchange Rate (average) IDR/US\$	9,387	10,461	11,865	13458	..	..	..
Memo items							
GDP nominal in (in billion US\$)	918	910	889	858	937	1,030	1,133

Note: Using revised and 2010-rebased GDP. *Fiscal accounts for 2016-2018 are World Bank staff projections.

Source: BPS; Ministry of Finance; BI; World Bank staff projections for 2016-2018

13. Despite the narrowing current account deficit, external financing vulnerabilities remain, including significant private external debt rollover requirements. FDI, which

has declined substantially in levels, has covered about 50 percent of the current account deficit since 2014. Consequently, financing of the current account deficit has continued to rely on potentially volatile portfolio investment. Gross external financing needs have also increased due to rising private non-financial sector external debt: US\$134 billion or around 14 percent of GDP in May 2016, up from US\$82 billion in December 2011. Short-term total private sector external debt (by remaining maturity) stood at US\$48 billion in May 2016, more than twice its level at end-2009, but still well-covered by reserves.

14. **The overall financial system position remains solid but corporate and SOE sectors are showing signs of strain.** Banks are well-capitalized, with a capital adequacy ratio of 22.6 percent in June 2016. However, as growth has slowed and funding costs have risen, non-performing loans (NPLs) have increased from 1.8 percent of total loans at the end of 2013 to 3.1 percent in June 2016. The recent rise in NPLs has been driven by non-financial corporate debt (including SOEs), which stood at around 32 percent of GDP in June 2016. Mining sector NPLs rose to 6.6 percent in June from very low levels during the commodities boom, driving the overall deterioration in bank asset quality.
15. **Monetary policy has anchored inflation expectations and prioritized reducing external imbalances.** Bank Indonesia (BI) held its policy rate at 7.5 percent between February and December 2015 in response to sticky inflation and elevated exchange rate pressures, despite weakening domestic demand. Headline inflation, averaged 6.4 percent in 2015, above the target of 4 +/-1 percent on account of the November 2014 fuel price increase¹⁴ and persistently high food prices. Mainly owing to base effects, inflation declined to an average of 3.8 percent yoy between January and July 2016. Weaker price pressures, coupled with a relatively stable currency in recent months, allowed BI to cut its key interest rates by a total of 100 bps so far this year. Nevertheless, on account of weaker demand credit growth has remained low, declining from 23 percent yoy in September 2013 to 8.9 percent yoy in June 2016.
16. **Flexible exchange rate management since mid-2013 has contributed to macroeconomic stability, but continued depreciation pressures require vigilance.** The Rupiah has fallen by around 30 percent against the US Dollar since July 2013. After an initially sharp adjustment in Q3 2013, the depreciation has been generally orderly as BI foreign exchange interventions have limited volatility. The flexible exchange rate has helped to cushion the trade shock which began in 2011 and strengthened currency market liquidity (which, however, remains very shallow). The gradual currency adjustment appears to have been manageable for the corporate sector to date. BI has also taken steps to encourage more hedging and penalize high levels of external leverage. Nevertheless, there are risks that some businesses (e.g., in mining or manufacturing) may face external debt repayment difficulties.
17. **Fiscal management has been generally prudent and there has been a significant energy subsidy reform.** The general government deficit is capped by law since 2003 at 3 percent of GDP and this has been adhered to. The threshold for each level of government is determined each year in a MoF regulation; the 2015 and 2016 maximum threshold for the sub-national government has been set at 0.3 percent and for the central government at 2.7 percent of GDP. The fiscal stance has been mildly expansionary, with the primary balance moving to a deficit

¹⁴ Subsidized gasoline and diesel prices were raised by an average of 33 percent in June 2013 and 34 percent in November 2014, each increasing the consumer price index by 3-3.5 percent.

of around 1.0 percent of GDP in 2013 and 2014 to 1.2 percent in 2015. This was driven initially by expenditure pressures, notably on energy subsidies, mainly for fuels, which swelled to an average of 3.4 percent of GDP over 2012-2014 (30 percent of central government expenditures). In a major policy shift, effective January 1, 2015, the Government introduced a new regulated fuel pricing system with semi-automatic monthly price adjustments based on economic costs, removal of the explicit subsidy for gasoline, and introduction of a fixed per liter subsidy for diesel. This reduced fuel subsidy costs from 2.3 percent of GDP in 2014 to 0.5 percent of GDP in 2015 and provided space for higher spending on infrastructure and social programs. Although, the implementation of the new fuel pricing system has been uneven so far, the 2016 and 2017 budgets have sustained the 2015 reforms. With energy commodity prices expected to remain moderate through the medium-term, the risk of policy reversal is considered low. Electricity subsidies have declined from 1.0 percent of GDP in 2014 to 0.5 percent of GDP in 2015 due to increases in tariffs for selected large businesses. Further reductions in electricity subsidies for certain poor households are proposed in the draft 2017 Budget.

18. **Although the energy subsidy reform reduced the impact of oil prices on spending, state revenues remain sensitive to the global commodity price cycle.** In 2008, oil and gas income taxes and oil, gas and mining royalties (called non-tax revenues) equaled 5.6 percent of GDP and represented one-third of total revenues. Between 2009 and 2014, these natural resource-based revenues averaged 3.4 percent of GDP and one quarter of total revenues. The high energy commodity prices between 2011 and 2013 failed to boost revenues as they were offset by a structural decline in domestic oil and gas production, which continues until today. The sharp decline in commodity prices reduced resource revenues to 1.3 percent of GDP or 10 percent of total revenues in 2015.
19. **Weak revenue performance has emerged as a major fiscal challenge amid a challenging macroeconomic environment.** Since 2012, the revenue-to-GDP ratio has been declining, falling from 15.4 percent in 2012 to 14.7 percent in 2014 and 13.1 percent in 2015. Underpinning this was the decline in natural resource-based revenues coupled with no increase (as a share of GDP) in total other revenues. The slowdown in nominal GDP growth, imports and steep decline in commodity prices resulted in a shortfall equivalent to 2 percent of GDP relative to the revenue target set in the revised 2015 Budget and a nominal decline of 3 percent yoy in total revenue collection. The decline in natural resource revenues (by 58 percent yoy) far outweighed the improvement in non-oil and gas income taxes, which increased by 21 percent yoy as a result of initiatives such as the asset reevaluation program¹⁵.
20. **Despite the revenue shortfall in 2015, government expenditure was maintained in nominal terms with a significant shift in allocation of spending from subsidies to capital.** Capital spending was prioritized over other expenditures, increasing by 42 percent yoy, supported by strong political commitment to infrastructure development and improved budget execution in the second half of the year. To preserve capital spending given the revenue shortfall, the Government raised the fiscal deficit from 1.9 percent of GDP (budget

¹⁵ The fixed asset revaluation facility, which allows individuals and companies to apply for revaluation of their fixed assets, where the increase in fixed assets resulting from the revaluation is subject to a reduced rate of “final income tax” ranging from 3 to 6 percent. Between October 15, 2015 (i.e. issuance of the regulation PMK-191/2015) and December 31, 2015, total tax collection from asset revaluation was IDR 20.1 trillion.

target) to 2.5 percent of GDP, lowered energy subsidy spending and non-tax revenue (from natural resources) sharing to sub-national governments¹⁶, and carried out measures to control other expenditures.

Table 2: Key Fiscal Indicators

<i>Percentage of GDP</i>	2012	2013	2014	2015	2016f	2017f	2018f	2019f	2020f	
	Actual				GoI	WB Baseline Projections				
Overall balance	-1.8	-2.2	-2.2	-2.5	-2.2	-2.8	-2.8	-2.8	-2.8	-2.8
Primary balance	-0.6	-1.0	-0.9	-1.2	-0.7	-1.3	-1.2	-1.2	-1.3	-1.2
Revenues: 1+2	15.4	15.1	14.7	13.1	14.1	12.1	12.4	13.5	13.8	13.8
1. Tax Revenues	11.4	11.3	10.9	10.8	12.2	10.5	10.8	11.9	12.2	12.2
Domestic tax	10.8	10.8	10.5	10.5	11.9	10.2	10.5	11.6	11.9	12.0
Income tax	5.4	5.3	5.2	5.2	6.8	5.3	5.5	5.8	6.2	6.3
Non-oil and gas	4.4	4.4	4.4	4.8	6.5	5.1	5.4	5.7	6.0	6.2
Oil and gas	1.0	0.9	0.8	0.4	0.3	0.2	0.2	0.2	0.1	0.1
VAT (inc. LSGT)	3.9	4.0	3.9	3.7	3.8	3.7	3.7	4.2	4.2	4.0
Excises	1.1	1.1	1.1	1.3	1.2	1.1	1.1	1.4	1.4	1.4
International trade tax	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
2. Non-tax revenues	4.0	3.7	3.8	2.2	1.9	1.6	1.6	1.6	1.6	1.6
Oil, gas & mining	2.6	2.4	2.3	0.9	0.7	0.4	0.4	0.4	0.3	0.3
Expenditures: 1+2+3	17.2	17.3	16.9	15.6	16.5	14.9	15.3	16.3	16.6	16.6
1. Central govt. spending	11.6	11.9	11.4	10.2	10.3	9.3	9.6	9.6	9.5	9.4
Personnel	2.3	2.3	2.3	2.4	2.7	2.5	2.5	2.5	2.5	2.5
Goods and services	1.6	1.8	1.7	2.0	2.2	1.8	1.8	1.8	1.8	1.8
Capital*	1.6	1.9	1.4	1.8	1.8	1.6	1.6	1.6	1.6	1.6
Interest payments	1.2	1.2	1.3	1.4	1.5	1.5	1.6	1.7	1.6	1.6
Subsidies, of which:	4.0	3.7	3.7	1.6	1.4	1.4	1.6	1.6	1.5	1.5
Energy	3.6	3.3	3.2	1.0	0.7	0.9	1.0	1.0	1.0	1.0
Fuels	2.5	2.2	2.3	0.5	0.3	0.4	0.4	0.4	0.3	0.3
Electricity	1.1	1.0	1.0	0.5	0.4	0.5	0.6	0.6	0.6	0.6
Non energy	0.5	0.5	0.5	0.6	0.7	0.5	0.6	0.6	0.6	0.6
Social expenditures	0.9	1.0	0.9	0.8	0.4	0.4	0.4	0.4	0.5	0.4
Other expenditures	0.0	0.0	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0
2. Transfers to regions	5.6	5.4	5.4	5.4	6.1	5.6	5.4	5.6	5.7	5.7

¹⁶ Through the issuance of Ministry of Finance regulation (PMK 249/2015 – December 29 and PMK 259/2015 on December 31). No information is currently available on whether some part of the reduction in payments will be treated as postponed, i.e. arrears with an obligation to pay in the future. Local service delivery disruption from the delayed revenue-sharing transfers to sub-national governments is not expected, as most of these governments are running fiscal surpluses.

3. *Additional Spending (likely to increase capital expenditures)	0.0	0.2	1.2	1.5	1.5
Selected sector spending					
<i>As share of actual govt. spending</i>					
Infrastructure	12.1	11.7	10.6		
Health	3.9	3.9	4.7		
Social assistance	2.9	2.7	2.6		
<i>As share of budgeted central govt. spending</i>					
Infrastructure	13.6	12.5	10.8	19.0	19.5
Health	3.7	3.8	4.5	5.0	7.2
Social assistance	2.9	2.7	2.5	3.2	3.6
Net Financing	2.0	2.5	2.5	2.8	2.1
Domestic (net)	2.3	2.6	2.6	2.7	2.1
of which bonds (net)	1.9	2.4	2.6	3.1	2.6
Foreign (net)	-0.3	-0.1	-0.1	0.1	0.0
Disbursement	0.4	0.6	0.5	0.7	0.6
Amortization	-0.6	-0.6	-0.6	-0.6	-0.5

Source: 2012-2015 Actual and 2016 State Budget from Ministry of Finance, 2016-2020 World Bank projections

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

21. **In the baseline scenario, GDP growth is expected to pick up to 5.1 percent and 5.3 percent in 2016 and 2017, respectively.** Indonesia is transitioning to a new level of trend growth, roughly 1–1.5 percentage points lower than during the commodities boom. Domestic demand growth is projected at 5.1 percent in 2016, supported by higher public spending but hampered by still subdued private sector investment. This scenario is predicated on the government prioritizing infrastructure spending and reforms to improve the business environment.¹⁷ Both import and export volumes are expected to decline for a second year as global trade remains weak and domestic demand moderate..
22. **Risks to the growth outlook are to the downside.** External risks stem from volatile global financial conditions and the possibility of a further weakening in commodity and external demand, including as a consequence of China's economic rebalancing and slowdown. Despite the significant decline in exports to China – which in 2015 were at two-thirds of their 2011 level – the country remains one of Indonesia's largest trading partners with a 10-percent share in total exports (three quarters of which comprise commodities). Domestic risks include slower and more modest reform implementation, lower public investment due to a higher than expected revenue shortfall, and relatively tight profit margins continuing to weigh on private spending.

¹⁷ The Government started a significant effort of regulatory reform with twelve (so far) economic policy packages announced between September 2015 and April 2016. The announced reforms go beyond regulatory simplification and fiscal stimuli, and include structural reforms. The Government's intent is fourfold: to increase investments, revitalize domestic industry, facilitate trade and improve logistics, and ease the procurement of raw materials, particularly in such sectors as agriculture, marine affairs and fisheries, and mining products. However, the effectiveness of the packages will depend on the government's implementation capacity.

23. **The significant decline in inflation has opened some room for monetary easing, but BI will have to balance this against the risk of continued nominal currency depreciation pressures.** The current account deficit is projected at 2.0 percent of GDP in 2016. The expectation of only modest global trade growth with no upswing in commodity prices weighs on the outlook for exports. Consequently, BI, with its focus on limiting external pressures, is likely to move cautiously in easing monetary policy.
24. **The World Bank 2016 fiscal baseline projects a significant revenue shortfall (Table 2).** Revenue is projected at IDR 1,509 tln, almost unchanged from 2015 and IDR 277 tln lower than the revised 2016 Budget target of IDR 1,786 tln¹⁸ and a decline in the revenue-to-GDP ratio to 12.1 percent. The baseline forecast accounts for the sharp fall in international oil and gas prices, lower oil production, and continuing moderate rates of growth in nominal GDP, import and private consumption expected in 2016. The baseline includes about IDR 40 tln from intensified tax enforcement efforts and tax administration reforms which were implemented in 2014-2015 (and are prior actions in the First Indonesia Fiscal Reform DPL approved by the Board on July 5, 2016), including the roll-out of electronic VAT invoicing, expansion of electronic tax filing, establishment of a unique taxpayer ID system, and improvement in access to land asset data for audit purposes. However, there is a risk that these measures result in a smaller than expected increase in tax revenues.¹⁹ An upside risk to the baseline is the impact of the tax amnesty program, which is not included in the projection.
25. **The Government is expected to adjust expenditure and expand the fiscal deficit to 2.8 percent of GDP if revenue collection is below target.** In July, the Finance Ministry announced spending cuts of 1.2 percent of GDP (beyond the small cuts in the revised 2016 Budget) and an expansion of the fiscal deficit to 2.5 percent of GDP. Given the commitment to increasing infrastructure spending and the concrete measures that have already been taken, such as early procurement by line ministries for capital projects, it is expected that the Government will, as it did in 2015, preserve capital spending by adjusting non-priority expenditures, namely material and other (contingency) spending, and allow the fiscal deficit to expand to 2.8 percent of GDP.
26. **As in the past, fiscal financing risks in 2016 are being mitigated through frontloading securities issuance.** A larger than targeted fiscal deficit may be associated with higher financing risks and costs. Although global financial markets have recently favored Indonesia, with local currency sovereign yields down by about 194 basis points year to date for the 10-year bond, financial conditions remain volatile. However, the government has proactively taken measures to manage such risks, frontloading its market financing strategy. As of August 10, the government has secured IDR 511 trillion from securities issuance out of estimated gross financing needs of IDR 711 trillion (based on fiscal deficit of 2.8 percent of GDP) in 2016.
27. **In the medium-term, revenue reforms – both administration and policy - are essential to create the fiscal space for spending on development priorities.**²⁰ The World Bank

¹⁸ The treatment of the tax amnesty is the main reason for the difference between the World Bank revenue forecast and the revised 2016 Budget target.

¹⁹ Table 3 in the First Indonesia Fiscal Reform DPL (approved by the Board on July 5, 2016) PD shows detailed fiscal projections for a scenario of no revenue reform.

²⁰ The Indonesia Fiscal Reform DPL (see footnote 18) can help bring revenue and expenditure closer to 2014 levels by 2019-2020.

baseline revenue projection (Table 2) includes the expected positive impact of tax administration and policy reforms of the collection of non-oil and gas income tax, VAT and excise taxes over the medium-term. The improvements in VAT administration, income tax e-filing, unique taxpayer ID and access to third-party data for audit is expected to improve VAT and non-oil and gas income tax compliance rates moderately from 53% in 2015 to 60% by 2020, leading to an additional 1.1 percent of GDP in tax by 2020. The reforms of VAT and LGST policy (reductions in exemptions and replacement of vehicle LGST with a vehicle excise tax) and income tax policy (anti-tax base erosion measures) are expected to increase the tax base for VAT, excise and non-oil and gas income tax, leading to an additional 1.3 percent of GDP in tax by 2020.

28. Government debt sustainability is strong.

Following a decade-long steep and sustained decline on the back of small fiscal deficits and solid GDP growth, government debt-to-GDP fell to 23 percent in 2012. The debt-to-GDP ratio remains moderate under a range of economic scenarios. Under the baseline fiscal deficit of 2.8 percent of GDP during 2016-2020, the debt-to-GDP is projected to rise to 29.3 percent in 2016 and then gradually to 30.4 percent by 2020. In scenarios with a one-time, permanent one standard deviation shocks to either real GDP growth or the exchange rate in 2015, government debt stays below 32 percent of GDP in the medium term. Only when a

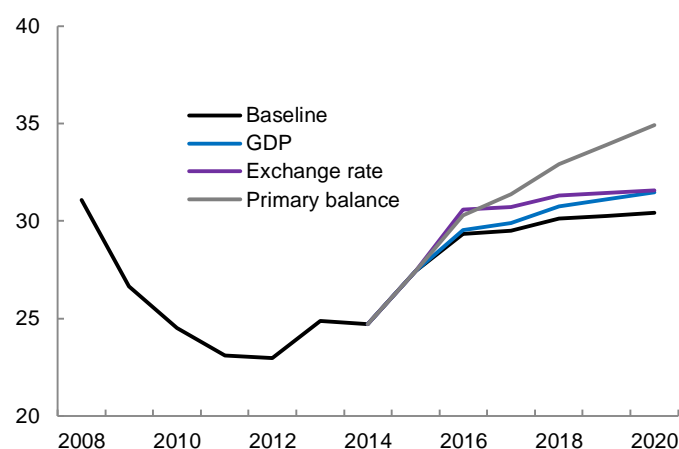
similar shock (equivalent to 1.0 percentage points of GDP) is applied to the primary balance does the debt-to-GDP ratio increase to 35 percent by 2020. In addition to a moderate debt level, the risk profile of the government debt stock is solid, although non-resident holdings of domestic bonds are relatively high at 39 percent. The average time to maturity is relatively long, at 9.3 years. 12.3 percent of the debt is variable rate. Currency exposure is significant, with 43 percent of total debt denominated in foreign currency.²¹ In order to mitigate this risk, Indonesia's debt management strategy continues to focus on domestic bond issuance and financing from multilateral and bilateral partners. Finally, fiscal risks arising from expanding balance sheets of key state-owned enterprises need to be monitored closely.

29. The macroeconomic policy framework is considered adequate for the proposed operation.

Indonesia's economy has weathered a significant deterioration in external demand and its terms of trade and, in mid-2013 and mid-2015, in financial market conditions. This resilience in part reflects a comparatively large domestic demand base and strong structural growth forces, including demographics and rapid urbanization, but also a policy framework that has proved itself responsive to the risk of macroeconomic imbalances. The

Figure 4: In the baseline trajectory government debt-to-GDP remains at 30 percent

(government debt-to-GDP, percent, under baseline and -1 standard deviation shocks to key variables)



Source: Ministry of Finance; World Bank projections

²¹ All debt profile figures are preliminary as of August, 2016 (Source: Ministry of Finance).

Government has also made sizeable progress in strengthening crisis preparedness and management protocols.

3. THE GOVERNMENT'S PROGRAM

30. **The Jokowi administration has set out a series of ambitious development goals, including boosting competitiveness and the maritime economy, partly building on the reforms of the previous administration.** The revised RPJMN sets out national development goals and the main directions of policy for the period. Central to this strategy are the strengthening of national connectivity, the enhancement of national trading capacity and the development of the maritime economy, including maritime transport. To achieve those goals the Jokowi government has sought to partly build on the logistics reform program of the previous administration of President Susilo Bambang Yudhoyono (see Box 1), accelerating the pace of their implementation, including of the 2008 Shipping Law and of the INSW. At the same time the government has changed the governance structure of the logistics sector inherited by the previous government (Box 1).

Box 1 – The pre-Jokowi institutional landscape on logistics

The first cabinet of President Susilo Bambang Yudhoyono (SBY) (2004-2009) enacted a series of new laws governing key transport modalities, including Railways (2007), Shipping (2008), Aviation (2009), Traffic and Road Transportation (2009). These new laws replaced laws passed in the early 90's whereby one reoccurring theme is the higher level of participation of the private sector by ending the legal monopoly of SOE's. Regulator and operator roles were separated whereby the SOE's continued as operators in competition with private sector participants.

The implementation of these laws however proceeded slowly in many areas. In particular SOE's managed to largely resist the reform process and still play a major role in the logistics sector in Indonesia, an industry generally operated by private companies rather than state owned. SOE's are dominant in sea-port, airport, railway, ferry and shipping operations, have a stronghold in airfreight services and some are even active in 3rd Party Logistics (3PL). In addition there is an increasing trend of SOE modality operators to have subsidiaries branch out into a wider range of logistics services (warehousing, trucking, freight forwarding).

Other significant impediments to the implementation of the SBY administration's regulatory reforms have included poor inter-agency coordination and weak institutional capacities. Under SBY, the Coordinating Ministry of Economic Affairs (CMEA) was charged with coordinating 17 ministries, including all those responsible for logistics activities, such as transport, courier services, SOEs and several other key agencies whose activities directly impact logistics performance (e.g. Ministry of Finance, responsible for DG Customs & Excise - DGCE). The current administration has reduced CMEA's span of control to try to make its coordination more effective by creating a new Coordinating Ministry of Maritime Affairs (CMMA). However that has split the logistics responsibilities across different coordinating ministries as Ministry of Transport now falls under the CMMA's purview.

31. **The efforts towards achieving these targets are guided by two high level government policies: the national logistics blueprint, and the implementation of the INSW.** The former is coordinated by the CMEA and is integrated in various key line ministries, including

Ministry of Transport, Ministry of Trade and Ministry of Finance.²² Its strategy includes upgrading transport infrastructure, implementing reforms to lower logistics costs, and raising logistics service providers' competitiveness. The INSW aims to facilitate trade in and out of the country and its implementation has been accelerated with the establishment in 2015 of a Task-force under the Ministry of Finance.²³ Over the past years the government has made considerable progress in the implementation of the two policies, which are embedded in the RPJMN 2015-2019. The government has been ramping up the efforts in these areas also through a series of twelve reform packages since mid-September 2015, encompassing a wide range of policy areas including logistics reforms (see Annex 1).

32. **The government has made major progress towards improving the governance structure of ports as well as their efficiency of operations that bodes well for reviving port infrastructure development.** For the first time the government has started clarifying the conflicting roles of port authorities and port operators Pelabuhan Indonesia (Pelindo's) by stipulating concession agreements between the two parties. The lack of clarity on their roles had arguably constrained Pelindos' investments. They have been reluctant to make major investments in existing port infrastructure because (i) this is part of the mandate of the Port authorities (ii) the Ministry of Transport may take over these fixed assets in line with the spirit of the Shipping Law. The government is also planning to address another key challenge in port infrastructure development, i.e. the overlapping ownership claims over port premises between port authorities and the Pelindo's.²⁴ The government's efforts on port infrastructure development have mainly focused on the small ports over the last years. On the other hand the development of secondary (mid-sized) ports' infrastructure has lagged behind due to a combination of relatively larger costs of upgrading and development and the uncertainty in the demand for services in these ports. The government has sought to address this constraint by providing the 'availability payment option' to the development of infrastructure, including ports, which would help the port's developer absorb the demand risk. In addition the new terminals were developed in larger ports, including Kalibaru (Tanjung Priok) and Teluk Lamong (Tanjung Perak). At the same time the government has started to streamline port operations by introducing single payment and single billing systems and by starting the synchronization of port and trade processing IT systems.²⁵
33. **Important reforms have also focused on increasing competition in logistics services providers with plans to further build on these policies.** The government has relaxed important restrictions affecting these providers, who collectively manage the logistics chain, including freight forwarders, storage and distribution service providers, transport service providers, and auxiliary shipping service providers, such as shipping agents and maritime cargo handlers. The government has already reduced or proposed to reduce barriers to entry for various such providers, including by relaxing the requirements associated with issuing

²² The SISLOGNAS strategy is devised following the Presidential Instruction No. 5/2008.

²³ The INSW was instituted through the Presidential Decree Perpres 10/2008.

²⁴ This should include an evaluation of the assets by the Development Finance Controller (BPKP) and a decision on the assets transfer by the State's Auditor General (BPK).

²⁵ Minister of State-Owned Enterprises Letter No. 169/MBU/03/2016 instructs the Directors of Pelindos to implement single billing in ports; Minister of Transport Regulation No. PM 192/2015 instructs on the implementation of Inaportnet for Shipping and Goods Services in Ports.

licenses for shipping agencies²⁶ and for courier services and by proposed increases in maximum foreign equity limits for a host of logistics service operators, including also freight forwarders, distribution, wholesale and cold storage facility providers, maritime cargo handlers, shipping lines and land transport operators.²⁷

34. **The economic policy packages have provided a renewed momentum to the reform of regulations relating to the costs and time associated with trade processing.** This is another reform agenda where the government has considerably stepped up efforts, especially on simplifications of trade regulatory requirements, on the strengthening of the INSW as the single gateway for traders and on procedural improvements.²⁸ In addition the government has introduced inland tax-free logistics bonded centers as a way to reduce inventory costs – which at 7.5% of manufacturing sales are very high in Indonesia - especially for users of certain raw materials such as cotton. These reforms have strengthened an incipient trade liberalization agenda, which consists in large part of reducing non-tariff measures (NTMs), after several years during which Indonesia has been among the world’s top users of restrictive trade barriers.²⁹ This reform momentum provides an opportunity to significantly improve the country’s efficiency to move goods across its borders, which has been one of the President’s expressed objectives.³⁰ To that end the government is planning to improve inter-agency coordination amongst border management agencies, including through the implementation of an integrated risk management regime, which should reduce container inspection rates further, and through the implementation of the single submission of regulatory requirements via the INSW, which will eliminate the need to submit the same data to multiple government agencies.³¹ This will also help the traders comply with the trade processing requirements thus reducing trade costs.
35. **The government has started to address other areas related to logistics costs, including the road and rail sectors.** The quality of the national road network has improved with 94% of roads in good and fair conditions in 2015 (from 87% in 2010). 175 km of new toll roads have been added between 2012 and 2015. In addition, new rail links to the Tanjung Priok port in Jakarta, the dry port of Cikarangi and the Kualanamu airport have recently started to operate and a rail link to the Tanjung Perak port in Surabaya has been reopened. On the

²⁶ The Minister of Transport Regulation No. PM 11/2016 for the first time introduces the shipping agency license as separate from that of the shipping line. The key implication of this is the elimination of the requirement of ship ownership for obtaining shipping agents’ licenses.

²⁷ Logistics is one of the sectors with the most far reaching reduction in foreign ownership restrictions in the proposed revised negative investment list regulation (DNI).

²⁸ In particular, the Ministry of Trade has eliminated several requirements for imports and exports of various products; in addition the Ministry of Finance has made it compulsory for all agencies to post all of their trade related measures on the INSW portal and a pilot has started for the implementation of the single submission of documentary requirements by traders through the INSW system. Finally, the food and drug agency (BPOM) and the Quarantine agencies have moved the submission of documents by traders online.

²⁹ According to Global Trade Alert data Indonesia’s world ranking in terms of restrictive measures has dropped for three consecutive quarters (from number 3 to number 8 in the last quarter) and while the opposite happened to its ranking in terms of liberalizing measures (from number 12 to number 6).

³⁰ CNN Indonesia, “Target Dwelling Time Tak Tercapai, Jokowi Ngamuk di Pelabuhan”, 17 June 2015 <http://www.cnnindonesia.com/ekonomi/20150617134814-92-60576/target-dwelling-time-tak-tercapai-jokowi-ngamuk-di-pelabuhan/>

³¹ These policies were announced in the 11th economic package in March 2016.

institutional side, in early 2016 the control of heavy vehicle overloading, which damages road pavements, increases accidents and slows down traffic, has been centralized within the Ministry of Transport to ensure uniformity of treatment and improved enforcement. New road pavement standards were introduced in 2013, which will increase the longevity of roads, enhance traffic speeds and improve road safety. The Directorate General of Highways is currently preparing a project to pilot a new approach, which will specifically focus on improving port accesses in the Northern Part of Sumatra.

36. **While the overall outlook is promising, the reform process has not moved smoothly across the board.** For example, the Ministry of Transport has been raising minimum capital requirements in the sector at very high levels by international standards even for logistics providers whose activities are not capital intensive, such as freight forwarders and shipping agencies.³² The objective of such measures are to ensure the quality of service providers. However, they are not likely to be effective as the quality of providers is only loosely associated with the available finances. On the other hand, the high minimum capital requirements are bound to restrict competition, thus potentially pushing up the cost and undermining the quality of services in the market. These changes are also at odds with the general orientation of the government, which has plans to eliminate minimum capital requirements altogether at least for limited liability companies. The second phase of this DPL series will support the government in reforming these measures.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

37. **The proposed DPL series supports the Government's overall objective to reduce the costs and improve the reliability of the logistics chain in Indonesia.** It does so by supporting the relevant institutional and policy reforms being undertaken by the Government. In doing so the operation has been selective on which government initiatives and reforms to support through the DPL – namely those that are expected to contribute significantly to the overall objectives through the medium-term. The DPL complements other ongoing and future work by the WBG, as detailed in section 4.3.
38. **The proposed DPL series is structured around the following three pillars, set of objectives and government program reform areas:**
- **Pillar A: Enhancing ports' performance.** Strengthening port's governance and operations by (i) improving the governance of ports by clarifying the role of Port authorities vis-à-vis port operators; (ii) facilitating the entry of port services operators; and (iii) enhancing coordination of documentary and container examination in ports.
 - **Pillar B: Improving logistics services.** Enabling a competitive business environment for logistics service providers by increasing competition in: (i) freight forwarding services, storage and distribution services; (ii) auxiliary shipping services; and (iii) reducing inventory costs of imported materials for producers.

³² In the case of freight forwarders for instance, the Ministry of Transport regulation PM No. 74/2015 (and the subsequent revision PM No. 78/2015) sets the minimum capital requirement at \$1.8 million for domestic and at \$10 million for foreign freight forwarders, several orders of magnitude above international practices.

- **Pillar C: Strengthening trade processing.** Making trade processing more efficient and transparent by (i) reducing licensing requirements for imports; (ii) facilitating traders' compliance with trade regulatory requirements; (iii) expediting the submission of trade documentation; and (iv) improving risk management of border agencies.

39. **The design of the operation builds on some of the reforms supported by the previous connectivity DPLs in Indonesia while taking on a more focused approach.**³³ In line with the new Energy and Fiscal DPL series, this series takes a focused sectoral approach, which aims to obtain stronger government ownership and deeper reach within the logistics sector. This approach is also consistent with the lessons from the previous connectivity DPL series (see Box 2). The previous DPL series' coverage of several areas limited the ability of the actions to induce substantial changes in each of them.³⁴ This Logistics Reform DPL series has a deeper but targeted focus while it builds on some of the actions in trade facilitation and port development from the earlier DPL. It includes new areas, in particular port governance and logistics service providers' markets. The current operation has also tried to carefully incorporate other lessons from the previous Connectivity DPL series (see Box 2).

Box 2 – Lessons from the 2012-13 Connectivity DPL Series

The previous Connectivity DPL Series provide some important lessons which have been internalized to ensure the effectiveness of the current proposed operations. Firstly, there is a need to balance the trade-off between supporting reforms in narrow areas with less risk, but more sectoral focus, versus a cross-cutting DPL supporting broader reforms with less focus. The ICR suggested a more concentrated program in which policy reforms would be delivered in greater depth and which may have higher chances of success. Secondly, lack of understanding about the mechanisms of a DPL contributed to a lack of buy-in and coordination among the implementing agencies in the previous Connectivity DPL series. This is partly addressed by repeatedly briefing the Government counterpart and the main line Ministries on the mechanisms of the DPL, but more importantly, by structuring the DPL prior actions around the Government's own strategic agenda on logistics reforms. Thirdly, the effectiveness of the connectivity DPL series was hindered by the limited capacity of the counterpart in government, which could not effectively support and follow up the implementation of the DPL reforms. To address these capacity issues the current DPL series is using a dedicated TA to improve the effective implementation of the DPL (see Box 3).

Fourthly, the previous DPL series had a committed counterpart, but one that lacked convening power. In the CMEA, the current DPL has now have a strong counterpart with high-level of ownership and an authority to convene the implementing ministries/agencies. Fifthly, although the current DPL series do not face the risk of an electoral cycle, there remains multiple layers of institutional obstacles during implementation, especially those relating to bureaucratic, administrative, and legal issues. While many of these are outside the control of the Bank, as much as possible, the team has taken into account the uncertainty inherent in those challenges and retain the flexibility needed to adjust prior actions and triggers in order to respond to those issues. Continuous discussions are held with the counterpart on how to adjust the relevant prior

³³ Indonesia DPL Connectivity Series 2012 and 2014; and World Bank (2015a). Improving Indonesia's Freight Logistics System: A Plan of Action.

³⁴ World Bank (2014). ICR Report: Indonesia Connectivity DPL Series.

actions. Finally, a DPL should be seen as one instrument, among others, to improve the chances of structural reforms and the required institutional development, including improved coordination, regulatory reforms, and governance. Specific prior actions in this DPL explicitly aim at these improvements.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

40. **The design of the proposed DPL is a result of an extensive ongoing dialogue and collaboration between the Government, in particular the CMEA, the INSW Portal Administrator, and the World Bank.** The operation builds upon the long-term collaboration on logistics and trade facilitation between the Bank and various government ministries and agencies particularly the CMEA. This collaboration includes support in the drafting of the Indonesia's logistics blueprint and the preparation to introduce the INSW. It is underpinned by substantial other advisory and analytical work (past, ongoing and planned) by the Bank and other development partners, including Australia and Japan. Additional TA has been initiated to support the government to design and implement the triggers for the second operation (see Box 3).
41. **The level of government's ownership of the operation is high.** The government has seen the DPL as a clear opportunity to further galvanize ministries and agencies around an ambitious reform programme on logistics, including on core logistics services and on the further strengthening of the INSW. The CMEA has presented the Bank with a range of policy proposals based on the logistics blueprint and the recent economic policy packages (see Annex 1). Multiple interactions between the CMEA and the Bank and among line Ministries and the Bank have fine-tuned the actions and triggers of the final document.
42. **The first DPL series consists of 11 prior actions, all of which have been completed.** These actions are summarized in Table 3 below. In the majority of reform areas, there is an indicative trigger which builds on the prior action (Annex 2). We expect all the indicative triggers to be completed by end of October 2017 and the result indicators reflect the expected timing of the two operations. However, given the long-standing structural challenges, especially in port governance, there may still be other actions which could be supported through further operations, such as the strengthening of the port authorities.

Box 3 – Bank's support to the government on the DPL implementation

Since the start of this DPL series, the World Bank has been developing a substantial programme of technical assistance to the government to accompany the operation. The programme consists of general support to promote further logistics reform in Indonesia and specific technical support geared to the successful implementation of specific triggers. The former is being carried out specifically with the Ministry of Trade and provides further analysis on topics that have been identified as of crucial importance to promote better logistics in Indonesia. Topics include the strengthening of warehouse policies, costs and benefits of introducing a CIF export regime, the support to Indonesia's trade strategy in logistics services, strategies to reduce domestic shipping costs. These studies will also feed into the general framework of the second logistics DPL series that will be prepared for 2017.

In addition, the World Bank will provide technical support to CMEA for the socialization of the DPL prior actions and to CMEA and other agencies for the implementation of the triggers. The latter will focus partly on triggers related to the strengthening of the INSW including the

operations of INAPORT and its integration with the INSW, the strengthening of risk management systems in non-custom agencies, the implementation of the INSW single submission and more generally the enhancement of the capacity of the INSW staff. Further technical assistance targets other specific triggers in pillars 1 and 2 by providing legal and economic analyses of the triggers, which inform the CMEA in its dialogue with the relevant line ministries and agencies.

Table 3 Prior actions, current status and analytical underpinnings

Objective	Policy	Status	Analytical underpinnings
<i>Improving port efficiency and governance</i>			
Improve the governance of ports by clarifying the roles of Port authorities vis-à-vis port operators	The Port Authorities have granted concessions to operate ports in a hundred and seven (107) locations in Indonesia to Pelindos, as evidenced through DG Sea Transportation Letter No. HK.107/3/15/DJPL-16.	Completed	WB (2015b) RAS Ports; WB (2013) Port Reform Toolkit; WB policy note on Indonesian port development
Facilitate the entry of cargo terminal operators	The Borrower has established the Availability Payment Mechanism, which enables the Borrower to pay companies for providing transportation infrastructure services, including port terminals construction, management and maintenance, as evidenced through Presidential Regulations 38 of 2015 and Minister of Finance Regulation 190 of 2015.	Completed	
Reduce delays in ports due to uncoordinated documentary and container examination	The Minister of Transportation has improved ports efficiency by enabling: (a) the integration of the internet-based single-service system for port services (INAPORTNET) into the INSW; and (b) the rolling out INAPORTNET in sixteen (16) ports, as evidenced through Minister of Transportation Regulations 157 of 2015 and 192 of 2015.	Completed	WB (2015a) RAS on logistics; OECD (2012) Reviews Competition in Ports, Rail and Shipping (2012); WB (2014) study on dwell time; Cubillos (2013).
<i>Enabling a competitive business environment for logistics service providers</i>			
Improve competition in freight forwarding, storage and distribution services	The Borrower has increased the maximum foreign equity limits for freight forwarding, warehousing and general distribution services to 67% and cold storage and producer-affiliated distribution services to 100%, as	Completed	WB (2015a) RAS on logistics; WB analyses based on OECD STRI data; WB (2016) policy note on Logistics

	evidenced through the Presidential Regulation 44 of 2016.		Services Providers; WB (2013) on capital requirements; Duggan et al. (2015)
Improve competition in auxiliary shipping services	The Borrower has: (a) established specific requirements to become a Shipping Agent, which excludes ship ownership, and (b) increased the maximum foreign equity limits for maritime cargo handling services to 67%, as evidenced through the Minister of Transport Regulation 11 of 2016 and the Presidential Regulation 44 of 2016.	Completed	
Reduce inventory costs of imported materials for producers	The Borrower has established tax-free Bonded Logistics Centers, as evidenced through Government Regulation 85 of 2015, Minister of Finance Regulation 272 of 2015 and DGCE Regulations 2 of 2016.	Completed	WB (2015a) RAS on freight logistics
<i>Making trade processing more efficient and transparent</i>			
Reduce licensing requirements for imports	The Minister of Trade has eliminated Registered Importer and Producer Importer licenses for eight (8) categories of products, which accounted for 10.6% of non-oil imports in 2015, as evidenced through various Minister of Trade Regulations.	Completed	Nurridzki (2013); Rahardja (2015); Sandee et al. (2015); WB (2015a) on freight logistics; ongoing WB TA supporting the
Facilitate traders' compliance with trade regulatory requirements	The Minister of Finance has standardized administrative compliance for imports and exports of prohibited and restricted goods by requiring technical government agencies to post all trade-related regulations in a single repository on the INSW after submitting them for administrative-compliance review to DGCE, as evidenced through Minister of Finance Regulation 224 of 2015.	Completed	INSW; WB (2016) Trading Across Borders Indicators
	The Borrower has allowed the single submission of data and information through the INSW and commenced pilot testing with four user agencies (DGCE, BPOM, Agriculture Quarantine Agency and Fish Quarantine Agency), as evidenced through the Presidential Regulation 76 of 2014, the Minister of Finance Regulation 138 of 2015 and	Completed	

	Head of INSW Letter No. S-91/INSW/2016.		
Expedite submission of required trade documentation	BPOM has required the application of Import Declaration Letter for food and drugs to be submitted electronically, as evidenced through Head of BPOM Regulations 12 and 13 of 2015.	Completed	
Improve risk management systems of border agencies	(a) The Coordinating Minister of Economic Affairs has instructed the INSW participating agencies to implement a single-risk management system; and (b) the INSW Portal Administrator has developed a prototype system and commenced a pilot to facilitate the sharing of risk management related data through the INSW, as evidenced through CMEA Letter No. S-88/M.EKON/4.2016 and Head of INSW Letter No. S-95/INSW/2016.	Completed	

PILLAR A — ENHANCING PORTS' PERFORMANCE

Improve the governance of ports by clarifying the role of Port Authorities vis-à-vis port operators

43. **Rationale:** Ports are key nodes of the logistics chain in an archipelago like Indonesia. However the quality of their infrastructure across the country is a weak factor in the overall country's competitiveness.³⁵ Detailed work on 18 ports throughout Indonesia by the World Bank has confirmed relevant infrastructure gaps, which slow down port operations and/or make ports ill-equipped to face the expected demand in the immediate future.³⁶ A key constraint to the development of port infrastructure in Indonesia is the lack of clarity between the role of the de jure port regulator (the newly created port authorities under the Ministry of Transport) and the de jure port operators of all the commercial public ports, the state-owned enterprises Pelindo I, II, III and IV. In line with international best practices³⁷, the Shipping

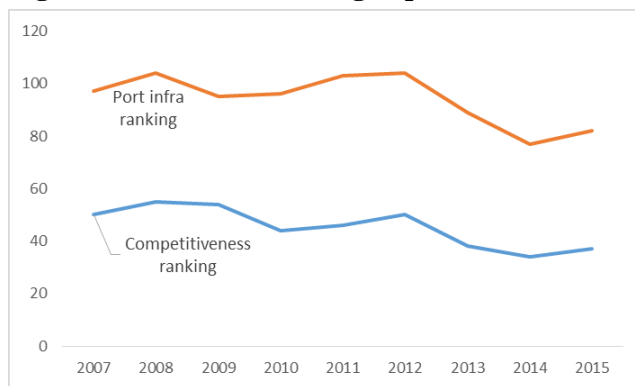
³⁵ According to the World Economic Forum's global competitiveness rankings, Indonesia fares much worse globally in terms of the quality of port infrastructure than in terms of overall competitiveness (Figure 5). The low quality of port infrastructure is partly reflected in the low level of UNCTAD's Liner Shipping Connectivity index that uses amongst others ship size and number of international services as indicators.

³⁶ World Bank (2015b) "RAS Port Development Priority Project and Financing Strategy", mimeo. The main finding of the study is that port infrastructure is oriented towards general cargo, characterized by narrow and weak berths that are not suitable to install cargo handling cranes and therefore the operational concept is based on ships gear that results in slow turnaround of vessels. Our estimates also suggest that when infrastructure expansion does happen, such as in the case of the recent berth extension in the port of Jayapura, then turn-around time is reduced and logistics costs are reduced.

³⁷ World Bank (2013). Port Reform PPIAF Toolkit, Washington DC: The World Bank.

Law 17 of 2008 ruled the separation of these roles, which until then had been jointly held by the Pelindos.³⁸ Construction of port infrastructure is part of the overall mandate of the Port Authorities through the use of the annual budget, but that is insufficient to rapidly close the infrastructure gap. As the port operator each Pelindo retains the revenues from the operations. However they have been reluctant to make major investments in existing port infrastructure because (i) this is part of the mandate of the Port authorities (ii) the Ministry of Transport may take over these fixed assets in line with the spirit of the Shipping Law. Besides the unrealized gains from the full implementation of the Shipping Law, this disconnect between the law and reality has led to conflicting claims which can hinder future investments in infrastructure and even current operations. The recent dispute in Tanjung Priok in 2014 is a case in point. When Pelindo II extended the concession to its own joint venture with Hutchinson for the operation of Indonesia's largest container terminal – the Jakarta International Container Terminal (JICT) - for another 20 years, the Ministry of Transport argued that the asset should be returned to the Port authorities after the existing concession comes to an end in 2019. This has led to a period of uncertainty over the fate of the terminal. While the extension of the concession has been since signed by the Ministry of State Owned Enterprises, the legal uncertainty that continues to surround the case does not provide the right incentives for efficient port operations and durable port investments.

Figure 5: Indonesia rankings - port infrastructure vs. overall competitiveness



Source: World Economic Forum

44. **Prior action #1 and indicative trigger #1:** Eight years since the passing of the Shipping Law the transfer of the port regulator role to the Port authorities has finally started to take shape. At the end of 2015 the four main Port Authorities have signed one concession agreement with each of the four Pelindo's for ports in 107 locations managed by them (prior action #1). These ports comprise of vast majority of shipping volumes in Indonesia. The agreements concession out the existing infrastructure to the Pelindo's for a period of 30 years (except for Pelindo II for which 50 years are granted). The concession agreements allow the Pelindo's to work together with other parties in port business activities and make investments in expanding and maintaining existing port superstructure. The concession agreements also oblige the Port authorities to provide and maintain basic infrastructure including breakwaters,

³⁸ The Port authorities should regulate prices, supervise access to basic port infrastructure and implement the port master-plan and the port operator should provide services as cargo handling, passenger facilities and mooring.

access channels and navigational aid. While the length of the agreements is considerable, the port authorities can in principle discontinue them if ports' performance is poor, which should ensure against the risks of slippage in the performance of the port operators. The clarification of roles should be accompanied by a clarification over the ports' asset ownership. In the absence of that, the concessionaire could make it de facto impossible for the port authorities to exert their right to publicly tender the concession of the port once the concession lapses. To that end the government should take an inventory of the existing port infrastructure and superstructure and decide on the assignment to the parties (indicative trigger #1). The government has tasked the Development Finance Controller (BPKP) to undertake this formal asset inventorization, on the basis of which the Government would eventually determine the modalities of the transfer process.

45. **Expected results:** The concession agreements help provide certainty to the operations of ports. They also generate an additional revenue stream for the port authorities to fulfill its mandate. The agreements define the mandate of the port authorities as that of providing infrastructure only, which is within the capacity of this relatively new organization. By more clearly defining the roles of each organization, the agreements should help improve their internal governance. In addition the prerogative of the port authorities to monitor the operators' performance should further incentivize the Pelindo's to strengthen their corporate governance. The data allows the DPL to develop a result indicator monitoring such governance through the achievement of internationally certified management systems. The concession agreements formally allow the Pelindo's to cooperate with other parties and to invest in expanding existing port superstructure. This would enable potential additional investments whereby Pelindo could utilize its revenues to invest predominantly in immovable assets (port infrastructure) while other parties make investments in movable assets (equipment). While these measures are necessary to improve port governance and investments, they are by no means sufficient. In particular the port authorities would need to be considerably strengthened to efficiently perform its functions, including port master planning, tendering infrastructure development and monitoring ports' performance. In addition a competitive supply of terminal operators should materialize beyond the Pelindo's that may eventually transform more into a port superstructure managing company than a cargo handling operator.³⁹ These requirements call for the continued support of the World Bank and other institutions accompanying the DPL series.

Facilitating the entry of cargo terminal operators

46. **Rationale:** Due to decades of state monopoly, competition between cargo terminal operators is de facto absent in Indonesia unlike in many other large countries. For example, the port of Long Beach in the United States handles container volumes equal to Indonesia's largest port Tanjung Priok on five competing container terminals while all four container terminals in Tanjung Priok are operated fully or in joint venture with state owned port operator Pelindo II. Shipping lines have no alternative if Pelindo's operations are inefficient due to the absence of intra-port competition. One constraint to the entry of new cargo terminal operators is the absence of an adequate legal framework for the private sector to develop/redevelop new commercial port terminals. Until recently this development was a prerogative only of the

³⁹ This strengthening could also be helped by the increased port authorities' revenues from the concession agreements, which are currently set at 2.5% of the revenues from the port operations.

Ministry of Transport. Presidential regulation 67 of 2005 allowed also the private sector to develop ports through the Build-Operate-Transfer (BOT) mechanism. However this mechanism has not been successful to spur the private sector involvement also due to the uncertainty surrounding future demand, especially in secondary ports, where the relatively large upfront investments are not matched by a clear large enough demand for port services. A further obstacle was created by the recent increase in minimum capital requirement to obtain the Port Business license for a main port, set by the Ministry of Transport at Rp. 1 Trillion (around USD 75 million). The lack of new port terminals developed and operated by the private sector has also contributed to the Indonesian port infrastructure gap referred to in prior action 1. Thus private investments could be an important complement to public port investments to fill the infrastructure gap.⁴⁰

47. **Prior action #2 and indicative trigger #2:** The government has improved the Public Private Partnership (PPP) framework through the BOT mechanism in ports for the private sector by introducing the availability payment scheme (prior action #2). This scheme is a periodic payment through which the state ensures the availability of an infrastructure by bridging the initial gap in the demand for the services of that infrastructure, which ensures a minimum level of revenues.⁴¹ While the demand risk would be borne by the port authorities, the cost and time overruns are borne by the BOT contract recipient. The port authorities would have to set the rates and the payment structure in agreement with the contract recipient. Notwithstanding addressing this demand risk, market access is still partly hampered by the burdensome minimum capital requirements to obtain the Port Business License, which is necessary for BOT concession. The minimum capital requirement needs to be deposited as long as the license is valid (5 years) as there are no articles that clarify the return of the deposit. Such capital requirements negatively affect cash flows, and in the smaller main ports they may even make the entire investment unviable altogether. Instead the policy of proof of financial ability as under the regulation for special- terminals and terminals-for-own-use (indicative trigger #2) should further remove barriers to new entrants.
48. **Expected results:** The prior action reduces demand risks for private sector investment in port services. This should increase port service providers' confidence to invest through the BOT scheme in container terminals, including in secondary ports. This increased involvement of port operators may also generate an added level of competition, consistently with the spirit of the Shipping Law of 2008 that has put emphasis on introducing competition in the port sector. Specifically we expect at least three applications for BOT schemes for the development of new ports within two years from the completion of the actions including at least one request for availability payment in the port sector. After the BOT concession has expired the port infrastructure asset would be transferred to the Port authorities thereby further deepening the reform under action #1. As in prior action #1, the weak capacity of the port authorities is an important constraint that would need to be addressed for the efficacy of this reform.

⁴⁰ The Minister of Transport confirmed this observation during the recent seminar 'Private Investment Opportunities in the Development of Maritime Transport Infrastructure' (March 29th 2016).

⁴¹ For port infrastructure this risk applies in particular to secondary ports where initial throughput is low in comparison to the port infrastructure investments that need to be made to adhere to shipping industry standards.

Enhancing coordination of documentary and container examination in ports

49. **Rationale:** Waiting time for ships to enter the port is a major issue in many Indonesian terminals.⁴² In major domestic and international gateways, such as Tanjung Priok and Tanjung Perak, delays in and around ports are often caused by lack of coordination between operators, including trucks, terminals and control agencies.⁴³ Exchange of information between these operators is not efficient due to the absence of a common electronic platform through which to exchange data. As a result agencies lack the information to make timely decisions from whether to allow ships into the port to whether to release cargo into free circulation. For example vessels and port services do not coordinate arrivals and departures (domestic trans-shipment) and the movement of cargo in most ports is not well monitored due to the absence of proper systems linking the physical movements of cargos and the progress on the documentary compliance associated to the cargo.
50. **Prior action and indicative trigger #3:** One solution to this problem is to finalize the implementation of the electronic system that regulates the movement of containers in ports - the proprietor port community system INAPORT - and then link it to the INSW system, which should connect all of the border agencies responsible for checking documentary requirements of the shipments (see below). When fully implemented⁴⁴ INAPORT should allow for real time tracking of movement of goods including through a vessel management system, domestic manifest, SmartCargo and Cargo Management System. The Ministry of Transport has recently issued a regulation (No. PM 192/2015) mandating the integration of the INAPORT system into the INSW system and the roll out of INAPORT in 16 main ports (prior action #3). This regulation is followed by the indicative trigger #3, which includes the actual implementation of the integrated system between INAPORT and INSW in at least 2 ports which have already started with the piloting of both systems (Tanjung Priok and Makassar).
51. **Expected results:** Implementing INAPORT would allow cargo vessels, freight forwarders and land transport operators to exchange data through electronic platform. This is expected to improve certainty in scheduling of shipment, cargo pick-up increasing the accuracy of berthing windows. More accurate berth windows lead to better berth planning and hence lower berthing time. As a result the synchronization in maritime supply chains should improve. Its integration with INSW will enable tracking and tracing of vessels and cargo within the port and port area by government agencies and other stakeholders based on single submission of data and information through integrated systems. As a result waiting times and idle times of ships in the port should be reduced.

⁴² OECD Reviews of Regulatory Reform, Indonesia, Regulatory and Competition Issues in Ports, Rail and Shipping (2012).

⁴³ World Bank (2015a). Improving Indonesia's Freight Logistics System: A Plan of Action.

⁴⁴ Currently the Vessel Management System has been fully implemented, while other elements are nearly completed, except for the Domestic Manifest for which no standardization of data elements is in place yet.

PILLAR B - IMPROVING LOGISTICS SERVICES

Improving competition in freight forwarding, storage and distribution services

52. **Rationale:** Freight forwarders, storage and distribution services are key determinants of supply chain efficiency. These services - *Auxiliary to All Modes of Transport* in WTO's terminology - are often provided in bundle by third-party logistics (3PL) providers.⁴⁵ The bundling of these services has provided manufacturers with a much-sought logistics efficiency. Indeed, foreign investments in manufacturing are typically linked to the presence of world class freight forwarders. At the same time, third-party logistics providers, especially international ones, have the potential to bring global best practices to local manufacturers.⁴⁶ Therefore limiting foreign investors to minority shareholding in freight forwarding, storage and distribution services, as Indonesia has been doing for years through the DNI, tends to harm not only the quality of these services but also the global competitiveness of the downstream goods' producers, particularly manufacturing.⁴⁷ This is especially the case in a period when several countries – including Indonesia's direct competitors such as Vietnam - are removing restrictions on FDI.
53. As a result in Indonesia these services are often considered below international standards of efficiency, quality and safety, due to a lack of quality or security control, ICT capabilities, and skilled workers.⁴⁸ The negative effect of the foreign equity limits on these auxiliary services, introduced in the 2014 DNI, is consistent with a substantial increase in storage and distribution prices in 2015 in Indonesia vis-à-vis regional comparators highlighted in section 2. These restrictions are among the highest among the countries surveyed by OECD (Figure 6 and Figure 7). They risk to constrain investments in capital intensive services, such as warehousing and cold storage.⁴⁹ In addition entry to freight forwarders markets is further hampered by hugely excessive capital requirements, especially for foreign companies (USD 10 million, of which 25% of capital needs to be put in reserve), but also for domestic ones (USD 1.8 million). These restrictions appear grossly out of line with the international experience. For example this minimum capital requirement is 10 times higher than in China for foreign investment in freight forwarding. Other countries apply non-discriminatory and much lower minimum capital requirements, such as Thailand (around USD 66,000) and Singapore (around USD 80,000). These requirements are not justified by the nature of the business. Freight forwarding is typically non-asset based, with low capital needs, and its efficiency depends on skilled professionals and on operational software. These huge capital

⁴⁵ As these services are often performed by the same type of company, the WTO bundles them together in its classification (CPC 742), in Indonesia, these services are split into three categories: (1) warehouse and storage, (2) distribution and (3) cold storage.

⁴⁶ The World Bank. Freight Transport For Development toolkit: Integrated Logistics Services

⁴⁷ Duggan et al. (2015) show that in Indonesia restrictions to foreign investments in transport and logistics services are the most harmful for manufacturing productivity among all restrictions in services.

⁴⁸ Source: Supply Chain Magazine (2015) "Logistics market up but unevenly distributed in Indonesia". Article on April 9th, <http://supplychains.com/logistics-in-line-logistics-market-up-but-unevenly-distributed/>. The weak performance of storage services was also confirmed in a recent audit report of the Global Fund to fight Tuberculosis, HIV, and Malaria (Office the Inspector General (2015). "Audit Report. Global Fund Grands to the Republic of Indonesia", The Global Fund).

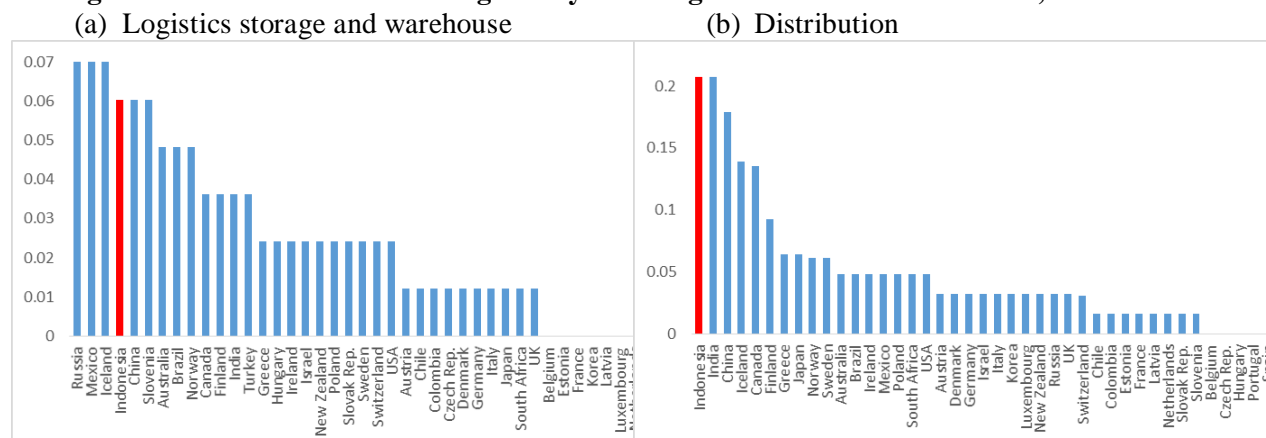
⁴⁹ For example the capacity of cold storage facilities would need to be doubled to handle the current level of catch (based on Indonesia Cold Storage Association (ARPI) data, www.thejakartapost.com/news/2016/01/02/lack-cold-storage-hampers-fish-processing-industry.html).

requirements are unlikely to protect consumers and creditors from hastily established and potentially insolvent firms.⁵⁰ In fact they may even be counterproductive, as they would tie up precious scarce capital that could be used to enhance the skills of freight forwarding professionals. Very few existing domestic freight forwarding firms would be able to fulfill these requirements. In addition freight forwarding foreign operations are limited to 4 main ports and 5 main airports, with the obligation to close existing ones in other locations. Not only do these barriers prevent market entry, market operations outside of limited areas, but they may also lead to market exit, with incumbent companies potentially rejected the right of license renewal if the requirements are not satisfied.

54. **Prior action #4 and indicative trigger #4:** The government has recently reviewed the foreign equity limits for freight forwarders and storage and distribution services. Specifically the Presidential Regulation 44 of 2016 increased maximum foreign equity limits for freight forwarders from 49% to 67%; and for various storage and distribution services: a) for warehousing from 33% to 67%, b) for general distributor from 33% to 67%, for producer-affiliated distributor from 33% to 100%, c) for cold storage from 33% to 100% (prior action #4). The indicative trigger #4 would build on this action and aim to eliminate the other most egregious restrictions to foreign entry and competition introduced by the recent regulations. Specifically it entails: (a) the elimination of minimum capital requirement for both domestic and foreign freight forwarders; and (b) the elimination of location restrictions for foreign freight forwarders.
55. **Expected results:** Such increases in foreign equity limit should encourage foreign investments in all four services, thus raising the rate of foreign entry in the sectors. Importantly, the foreign equity limits have all been raised from below to above the critical 50% threshold, thus making the extent of foreign investors' increased control of the Indonesian firm meaningful. The entry of foreign investors would foster competition in all these services, thus increasing their availability and reducing their prices. It would also help upgrade the quality of warehousing services in Indonesia, with international players bringing global know-how. In addition relaxing market entry requirements for warehouse-related service providers may help attract industries where supply chain management activities are outsourced to third party logistics providers (3PLs), with international manufacturers and traders requiring warehouse-related functions to be handled by a globally contracted 3PL. The trigger also aims to have the direct effects of increasing the number of new freight forwarding licenses (inducing entry) as well as of reducing the share of licenses which are not renewed (preventing exit). These actions should also help Indonesia to abandon the ranks of one of the most restrictive countries in warehouse, storage and freight forwarding services in the OECD STRI database.

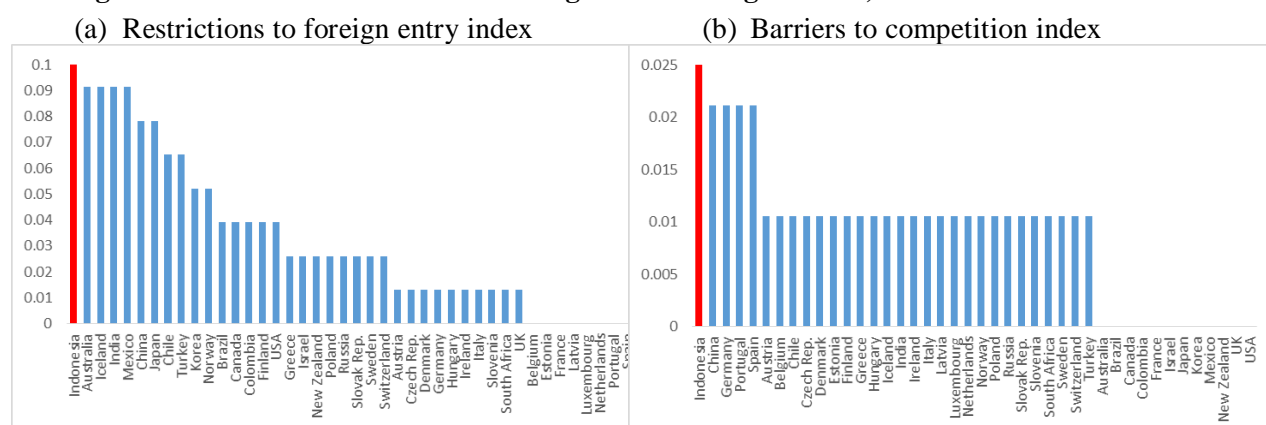
⁵⁰ World Bank (2013). Why are minimum capital requirements a concern for entrepreneurs?, in *Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises*, Washington DC: The World Bank.

Figure 6: Restrictiveness to foreign entry in storage and distribution services, 2015



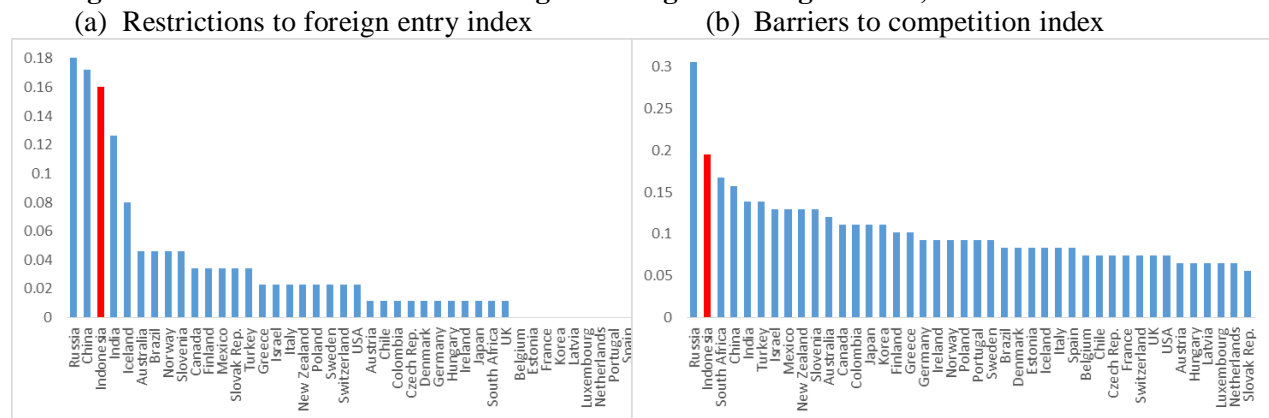
Source: OECD Services Trade Restrictiveness Index (STRI) Database

Figure 7: Restrictiveness indices in freight forwarding services, 2015



eligible, companies need to own a vessel – whose market price is in excess of USD 200,000⁵¹ - and provide high capital requirements of USD 440,000, with 25% paid-up. These requirements de facto rules out the presence of independent pure shipping agencies.⁵² In addition the DNI restricts foreign ownership to 49% for shipping lines, which implies that even large international shipping lines have to operate a shipping agency through a joint venture. This combination of restrictions is unique to Indonesia. To the best of our knowledge no country has a vessel ownership obligation for shipping agents, very few countries restrict foreign equity of shipping agencies, and no capital requirements are as high as Indonesia's.⁵³

Figure 8: Restrictiveness indices in logistics cargo handling services, 2015



Source: OECD Services Trade Restrictiveness Index (STRI) Database

57. Maritime Cargo Handling Services are vital for getting goods off the ship out of the port and visa-versa. Shipping lines depend on local maritime cargo handling firms to execute these vital services. Outside of the main ports the quality of maritime cargo handling services is low and the cargo-handling equipment used is often substandard while labor is unskilled.⁵⁴ These factors contribute to the slow turnaround of vessels and the higher risk of cargo damage especially in smaller ports. Part of the reason for the unsatisfactory quality of capital equipment is due to the restrictions to investments in maritime cargo handling services. Among the countries surveyed by the OECD, Indonesia imposes some of the highest degree of restrictions to both foreign entry and competition (Figure 8). These include maximum foreign ownership share of 49% and higher minimum capital requirements for foreign than domestic firms (USD 750.000 with 50% paid up and USD 300.000 with 25% respectively).

58. Prior action #5 and indicative trigger #5: The Ministry of Transport has acknowledged the unique restriction on shipping agencies and through PM11/2016 has introduced the shipping agent license SIUKK, which eliminates the requirement of vessel ownership to operate as a

⁵¹ This is based on our own research among second hand vessels in Indonesia.

⁵² Our analysis of a sample of shipping lines and their representatives in 7 major Indonesian ports highlights that agency services are dominated by domestic shipping lines' own agencies, followed by joint-venture with domestic shipping lines, and only a handful independent shipping lines operating as independent agents.

⁵³ Examples of capital requirements are Malaysia with 12,900 USD (RM 50,000), Singapore USD 37,200 USD (SGD 50,000), and zero for China.

⁵⁴ World Bank (2015b) "RAS Port Development Priority Project and Financing Strategy", mimeo and Putrahardja, J.S. (2012). "Labour at Indonesia's Ports: The Role of Cooperatives", Prakarsa: Journal of the Indonesian Infrastructure Initiative, Issue 10.

shipping agency (prior action #5). Furthermore the government has acknowledged the obstacles in foreign ownership and has increased maximum foreign equity limit for maritime cargo handling services from 49% to 67% (prior action #5). The regulation however keeps the existing high capital requirement unaffected (at USD 300,000 for domestic firms and USD 750,000 for foreign joint ventures). The indicative trigger #7 entails the elimination of this capital requirement and the alignment of the foreign restriction on maritime cargo handling services to that in the DNI that highlights no additional restrictions besides ownership.

59. **Expected results:** These actions combined are expected to increase the number of independent shipping agencies as well as the number of partly foreign owned shipping agencies and partly owned foreign maritime cargo handling companies. This in turn should increase the efficiency of shipping line services, including also the timeliness of domestic trans-shipment, and thereby reducing maritime transport costs.⁵⁵

Reducing inventory costs of imported materials for producers

60. **Rationale:** A substantial share of the inputs imported by Indonesian industries as well as of the products exported by Indonesia are stored in warehouses in neighboring countries, including Singapore and Malaysia.⁵⁶ In a world of ‘just in time’ production, sourcing inputs stored in other countries can be costly especially when import procedures and transport and logistics services are not always efficient. Indeed, inventory costs (as a share of manufacturing sales) are much higher in Indonesia than in other competitors in the region.⁵⁷ This has led to increasing demand for in-country temporary storage facilities by Indonesian producers, especially those using imported inputs in the production of items for later export, such as textiles, apparel, food processing and automotive parts and manufacturing. While the supply of such facilities potentially existed, until this year the trade regulatory environment was not conducive to their establishment, as there was no provision for tax-free storage services. The exception is the Free Trade Zones, which required securing the sale of the temporarily stored goods before importing them. As such, goods could only be stored for a limited amount of time and could not be re-exported without further processing.
61. **Prior action #6:** The government has prepared the regulatory environment for the establishment and operations of bonded logistics centers through the issuance of: (a) Government Regulation No. 85/2015, revising No. 32/2009; (b) Ministry of Finance Regulation no. 272/PMK 04/2015; and (c) DGCE Regulation PER-02/BC/2016 (prior action #6). These regulations now provide for goods to be imported into logistics bonded centers free of import and other duties. The goods can now be stored for a period of up to 3 years (extendable for another 3 years), within which time they can also be re-exported free of taxes should they not be sold on the domestic market. The regulations allow full control by the private sector over the ownership and operations of the centers and also allow majority foreign ownership.

⁵⁵ Bertho, F., I. Borchert and A. Mattoo (2014) “The Trade-Reducing Effects of Restrictions on Liner Shipping”, World Bank Policy Research Working Paper 6921.

⁵⁶ Singapore is the largest source of imports for Indonesia with over 50% of those being re-exported goods that have been temporarily stored in the country.

⁵⁷ World Bank (2015a). Improving Indonesia’s Freight logistics a plan for action.

62. **Expected results:** The success of the initiative is already apparent with eleven bonded logistics centers now operational across Indonesia, only three months after the issuance of the current legal framework. The zones specialize in the temporary storage of a variety of goods, including among others, cotton, fuel, milk powder, wheat and auto parts, confirming that the zones fulfill the need of manufacturers for faster and cheaper access to imported inputs. It is expected that at least 30 such zones will become operational by mid-2017, mainly focusing on manufacturing inputs. These zones should induce gains in terms of time and cost savings and increased reliability of inputs. If the scale of the operations become sufficiently large, they may also increase negotiating power for Indonesian buyers of certain imported products, thus further reducing the costs of supply.

PILLAR C - STRENGTHENING TRADE PROCESSING

Reducing licensing requirements for imports

63. **Rationale:** Documentary compliance in Indonesian international ports takes considerably longer than in neighboring countries, which contributes to long overall clearance times. As per 2013, between 50 and 60 percent of the dwell time - the time a cargo spends within port limits - in Tanjung Priok port was due time spent from discharge to submission of customs declaration, which was mainly associated with the processing of import licenses not obtained prior to cargo arrival. Import licenses include importer identification number, product-specific import licenses, and shipment-specific import approvals. In addition, imports of restricted goods also carry further requirements, including pre-shipment verifications in the country of export, technical recommendations by the relevant ministries, and, for some agricultural products, recommendations by local governments. All these are part of the extensive list of Non-Tariff Measures (NTMs) that Indonesia maintains. This list now covers 62 percent of about 10,000 tariff lines at the Harmonized System 10-digit level.⁵⁸ While the main purpose of NTMs is to ensure the health and safety of the users, not all of them are administered in the most effective and least trade restrictive manner and frequently impose unnecessary and burdensome requirements on traders. This suggests potentially large returns from a rationalization in the number of such regulations or reform of the way they are administered. A survey among priority importers suggested that the two most important reasons for the delay in submitting the import declaration to customs (PIB) were related to recommendation letters and import licensing. This suggests potentially large returns from a rationalization of such regulations.
64. **Prior action #7:** The Ministry of Trade is one the ministries most responsible for NTMs and in the context of the reform packages it has started this rationalization process. Specifically it has revised or repealed 8 regulations eliminating Registered Importer (IT) and/or Producer Importer (IP) licenses for 8 categories of restricted products spanning several sectors: horticulture products, tires, compact discs and related machinery, textile, wood products, certain types of finished products, color photocopiers, animal products (prior action #7). These licenses require various types of documents to be presented (from 4 different documents for cloves' IT license to 11 for tires' IP license). The revised or repealed

⁵⁸ This data is based on a comprehensive list recently compiled by the Economic Research Institute for ASEAN, which has identified 200 government regulations, generating 638 individual NTMs.

regulations cover products that comprise about 10.6 percent of total non-oil and gas import value in 2015 and 19 percent of tariff lines at the 10 digit HS-code level.

65. **Expected results:** The immediate impact of this simplification should be a reduction in the time and cost of complying with import requirements for those products. In particular the elimination of technical recommendations by Ministries, such as the Ministry of Industry (for products like cooling systems and textiles) or the Ministry of Forestry (for wood forestry products), is expected to yield some gains in trade transaction costs as these recommendations can be slow to obtain. Indeed initial interviews with private sector firms shows that the time to process import licenses has now decreased, with the amount of time improvement differing across sectors. Ultimately, these reforms are expected to reduce the overall time and cost associated with meeting regulatory requirements associated with trade. To the extent that the elasticity of imports with respect to trade costs is positive, this reduction in cost may also translate in some increase in imports. At a higher level such a trade deregulation is a central element of the incipient change in policy direction from a formerly more trade protective policy to a more liberalized regime.⁵⁹ To the extent that this change acts a signaling device for international markets, it may also help raise Indonesian attractiveness for foreign investors.

Facilitating traders' compliance with trade regulatory requirements

66. **Rationale:** The establishment of the INSW has been a major step towards the rationalization of trade procedures in Indonesia. The institution was set up during the SBY administration also through World Bank's support, and in the last two years its implementation has accelerated (Box 4). One of the key advantages of the INSW is that it facilitates traders' compliance with the multiple regulatory requirements especially for controlled or restricted goods by centralizing the information into one publicly available and easily accessible list for each product (the Indonesian National Trade Repository - INTR). This repository also keeps traders up to date about regulatory changes, which is key to avoid unnecessary delays in import and export processes. To that end, line ministries should inform the INSW Portal Administrator about new regulations or changes in existing regulations in a timely manner, preferably before they enter into force. In practice, however, the INTR is not always up to date and information holdings are in some cases incomplete. In addition there is also no provision ensuring that regulations that are no longer valid are deleted in a timely manner from the INTR and no standard check exists to ensure the administrative-compliance of the new regulations. The lack of this compliance can result in delays as border agencies encounter difficulties in identifying the appropriate regulations that apply if the product is not well classified by the agency/ministry issuing the regulation.

Box 4 – The Indonesian National Single Window

In keeping with international good practice, one of the key measures Indonesia has taken to reduce trade costs has been the establishment of the INSW. This system allows traders to submit all import, export, and transit information required by regulatory agencies via a single electronic gateway, instead of submitting and processing the same information numerous times to different government entities, including some that are automated and others that still rely on paper.

⁵⁹ World Bank (2016). Indonesia Economic Quarterly, June.

The INSW provides access to the electronic licensing systems of key line agencies including the Ministry of Trade, the Food and Drug agency, and the Fish and Agriculture Quarantine Agencies and connects all parties to the Customs electronic declaration processing and clearance system. The INSW is currently operating in 14 ports around the country and involves 18 agencies (although the level of integration varies). A National Trade Repository that lists trade related regulatory requirements has also been developed in line with ASEAN commitments and is now operational although it is not complete and is not as user friendly as required, possessing only rudimentary search facilities.

The World Bank supported the establishment and development of the INSW through technical assistance and through the previous DPL series on connectivity. This engagement spurred the inclusion of key agencies to the INSW portal and the establishment of a separate Portal Administrator in 2014 to further the development of the INSW. The Portal Administrator – with around 15 full time staff -moved in 2015 under the purview of the Ministry of Finance being previously hosted under the Coordinating Ministry for Economic Affairs.

67. The trade repository underpins the ultimate role of the INSW as the single entry point for traders, which is at the core of the Portal Administrator's objective of facilitating trade. The INSW has made progress towards this objective by implementing the single sign-on system, which allows traders to log into the INSW website once, which then directs to the websites of the relevant Ministries and Agencies responsible for the approvals without the need to again log into the various agency systems.⁶⁰ However the trader still has to apply for various licenses and approvals via the individual IT systems maintained by regulatory agencies with various levels of procedural automation. In addition, the current approach is sequential as some ministries and agencies only provide clearances after others have provided theirs and Customs will only review the Customs declaration (PIB) once *all* clearances of the other relevant ministries and agencies have been obtained. To overcome these problems, the INSW and participating agencies have started moving towards the implementation of a single submission system. The system will allow all agencies to use the same master data set and allow simultaneous processing by all relevant agencies. Agencies will in turn extract the relevant data necessary for their regulatory requirements. This will eliminate duplication in data entry, reduce errors and speed up trade processing as agencies will no longer have to wait for other processes and approvals to be obtained prior to their own clearance processes commencing. As it is predicated on data sharing between participating ministries and agencies, this could also relieve the constraint of sequential approvals, including by Customs, which will be able to process import declarations even before all other agencies have cleared the goods. Again the portal administrator status of the INSW and its dependence on the Ministry of Finance's internal procedures appears to constrain its ability to galvanize the 18 participating agencies and ministries around the single submission objective.⁶¹ Moreover, the lack of a strong institutional form prevents it from issuing regulations and administrative directions necessary to direct the management and further development of the INSW.

⁶⁰ The introduction of this system was part of the previous DPL connectivity series.

⁶¹ The delay in the budget allocation from the Ministry of Finance and consequently some activities scheduled for early 2016 had to be postponed. This delay causes also that the Taskforce encounters difficulties in paying for staff that other ministries promised to make available.

68. **Prior action #8 and indicative trigger #6:** In 2015, Indonesia standardized the administrative compliance for the imports and exports of prohibited and restricted goods (LARTAS), including the specification of the HS codes of the products. With Ministry of Finance regulation 224/PMK.04/2015, the government requires line ministries/agencies to: (a) submit trade-related regulations for administrative-compliance review by DGCE, prior to being posted on the INTR by the INSW; (b) use a standard template for the submission; and (c) report to the INSW Taskforce about any goods that need to be removed from the list of prohibited and restricted goods (prior action #8). DGCE will carry out an administrative check and provides a recommendation to the INSW Taskforce whether the regulations can be posted on the INTR. The effectiveness of the INSW so far to streamline trade procedures and facilitate compliance to regulatory requirements has been constrained by its relatively low status as a Portal Administrator under the Ministry of Finance. One option currently being canvassed is for the Portal Administrator, which this DPL series supports, to have its status elevated to become a higher level echelon agency reporting to the Ministry of Finance (indicative trigger # 6). This change in status could also enable the INSW to review the extensive stock of NTMs maintained by Indonesia to streamline and rationalize their use, an activity with high returns.⁶² Elevating the INSW status would require the revision of Minister of Finance Regulation 138/PMK.01/2015 on Organization Structure and Governance of the INSW Portal Administrator and Governance of the INSW Portal Administrator. This is something that the INSW agency as well as the CMEA have been discussing extensively with the Ministry of Finance without any resolution as yet. The World Bank is also supporting the achievement of this trigger through ongoing technical assistance to the INSW.
69. **Prior action #9 and indicative trigger #7:** The Customs Agency and the INSW Taskforce are preparing for the implementation of the single submission system by running a partial single submission pilot with five large firms.⁶³ Participating agencies into the pilot include Customs, Quarantine Agencies and the Food and Drug Agency (BPOM). The completion of the pilot (prior action # 9) allows these key agencies to identify the solutions to some of the possible technical and legal problems arising from the wider implementation. The next step would be the extension of single submission implementation for the above mentioned agencies to a wider selection of firms and a wider set of INSW participating agencies in the four main ports of Tanjung Priok, Tanjung Perak, Medan and Makassar (indicative trigger # 7). The World Bank is also supporting this effort through the provision of ongoing technical assistance to support the operation of the INSW. The completion of this step would also require the issuance of new decrees by the participating agencies to facilitate the sharing of data between agencies. Ultimately, this would lead to the expansion of single submission to the entire universe of traders and to all 18 border agencies/ministries.
70. **Expected results:** Regulation 224/PMK.04/2015 streamlines the procedures to post new regulations by line ministries and agencies on the INSW. As a result we would expect a more timely and complete update of trade related regulations in the INTR as measured by the increased share of relevant regulations that are reported in the INTR. In addition the new administrative checking procedure by Customs, supported by the INSW Taskforce, should ensure that trade processing is not hindered by unnecessary administrative errors and unclear

⁶² Cadot, O., M. Malouche and S. Saez (2012). “*Streamlining NTMs: A toolkit for policy-makers*”, Washington: The World Bank.

⁶³ These firms have all the priority lane status granted by Customs to low risk high frequency importers and have given the agreement to the sharing of their data across agencies/ministries participating into the pilot.

postings on the INTR. We expect the single submission actions to complement these benefits for traders in their compliance with regulatory requirements. Specifically the time taken for the clearance process would be reduced through less unintentional errors. Finally, elevating the status of the taskforce would enable the INSW to play a more active role in screening the contents newly proposed regulations and to facilitate the further expansion of the single submission system.

Expediting the submission of required trade documentation

71. **Rationale:** Potential gains in pre-clearance time are constrained by the fact that until recently several agencies and ministries still require the submission of the hard copy of certain trade documents, which slows down the approval process. This contributes to the slowness in compliance with documentary requirements in Indonesia relative to more competitive countries in the region.⁶⁴ Electronic processing of trade documentation has indeed been shown to yield significant reductions in processing time and even to increases in number of exporters and export volumes.⁶⁵ Making the submission and processing of these documents electronic should also facilitate the full implementation of the single window environment. This requires the development and interconnectivity of the IT infrastructure and administrative processing of the relevant line ministries and agencies as well as the setting up of the appropriate legal framework, to facilitate, for example, acceptance of electronic signatures.
72. **Prior action #10:** The government has made progress on the electronic submission and processing in key border agencies. Ministries and agencies, including Customs, the Ministry of Trade and the Food and Drugs Agency (BPOM) have developed their own electronic systems to process declarations and import/export-related licenses. BPOM has recently issued two regulations that automate the process for applying for an Import Declaration Letter (SKI) for both food and drug products and inputs (prior action #10). The BPOM regulations cover food and drug products and materials that comprise 6 percent of total non-oil and gas import value in 2015 and that have typically higher processing times than average.
73. **Expected results:** Electronic processing of import documentation through this action is expected to reduce both pre-customs and customs clearance time. Initial interviews with food and cosmetics companies suggest that BPOM still faces technical issues, thus resulting in the BPOM system not yet being fully operational. Once the technical problems are fully resolved, we would expect a substantial reduction in the processing time and costs for BPOM related permits, which would also likely be reflected in improvement in the overall processing time and costs. The empirical evidence suggests that these time and cost reductions would also translate into increased imports and exports, leading to overall gains for the economy.⁶⁶ In addition, the complementarities of trade processing between ministries/agencies imply that the full realization of the gains will occur once all of the trade processing will be electronic.

⁶⁴ According to the latest World Bank's Doing Business Indicators, documentary compliance for imports in Jakarta port takes 144 hours, more than double the East Asia Pacific average, and much higher than the 4 hours in Thailand.

⁶⁵ Carballo, J., G. Schaur and C. Volpe Martincus (2015). "The Border Labyrinth: Information Technologies and Trade in the Presence of Multiple Agencies", Inter-American Development Bank, mimeo.

⁶⁶ See for instance Djankov et al. (2010), "Trading on time" Review of Economics and Statistics; Carballo, J., G. Schaur and C. Volpe Martincus (2015). "The Border Labyrinth: Information Technologies and Trade in the Presence of Multiple Agencies", Inter-American Development Bank, mimeo.

Improving risk management systems of border agencies

74. **Rationale:** Properly assessing the risks of incoming shipments is one of the most important determinants of a successful trade processing. This allows regulatory agencies to limit the use of time consuming inspections and testing while still ensuring the safety and admissibility of imported goods. International evidence confirms the high returns associated with improving risk assessment systems to speed up the processing of imports and exports, eventually resulting in higher trade volumes.⁶⁷ Customs is the institution that has been leading the improvement in risk management in Indonesia achieving substantial reductions in inspection rates over the past two years, which have helped reduce dwelling time, at least in Tanjung Priok. However, risk management is not yet fully coordinated and other agencies, including the Quarantine Agencies and BPOM, still apply their own risk management processes at borders. Risk profiling among agencies differ and compliance data about firms is not shared thus making less use of precious information that can be used to inform risk profiling. Several goods that have a priority lane status with Customs may still be subject to controls and inspections performed by other agencies. This can neutralize the positive effects of Customs priority lane status which, under normal circumstances, should leave the port area without any inspections. This lack of coordination leads to time- and cost consuming sequential inspection of goods, reflected in the high border compliance time in Indonesia relative to neighboring countries.⁶⁸ Indeed, in many cases inspections are performed before the declaration is even submitted negating the capacity of the INSW system to electronically assess and assign risk ratings.
75. **Prior action #11 and indicative trigger #8:** In an effort to improve risk management systems the government has launched a program of risk management integration across border agencies/ministries, commencing initially with trader information holdings. To formalize these efforts, the Minister of Coordinating Economic Affairs: (a) included the introduction of single risk management in the Government's Economic Package no. 11; and (b) as the head of the INSW board of supervisors he sent a letter to the relevant line ministers and agencies urging them to take the necessary steps for the introduction of single risk management under Customs leadership (prior action # 11). Customs, Quarantine Agencies and the Food and Drugs Agency have recently started exchanging information on their risk profiles and have piloted the approach. Customs envisages that the single risk management process between Customs, Quarantine, and Food and Drug Agencies will be fully implemented by August 2017 (indicative trigger # 8). There are two main challenges to the successful implementation of this trigger. First regulations of participating agencies need to be amended to allow them to share importers' data. Second, the risk management capabilities of individual participating agencies/ministries will need to be improved as poor risk management practices by one institution will negatively impact the entire system. To that end the World Bank is supporting this effort through technical assistance on risk management to INSW participating agencies focusing initially on the two Quarantine agencies.

⁶⁷ Fernandes, A.M. R. Hillberry and Alcántara, A.M. (2015). "Trade Effects of Customs Reform: Evidence from Albania", Policy Research Working Papers 7210, The World Bank; Carballo, J., C. Volpe Martincus and A. Graziano (2015). "Customs", *Journal of International Economics*, 96.

⁶⁸ According to the latest World Bank's Doing Business Indicators, border compliance for imports in Jakarta port takes 80 hours, almost 40% higher than the East Asia Pacific average.

76. **Expected results:** Successful implementation of single risk management approach will improve the cargo targeting and reduce the need for excessive levels of physical inspection. Thus risk inspection rates per consignment should fall.⁶⁹ In addition, inspections that are still required by more than one agency will be carried out simultaneously, thus leading to shorter inspection times. These efforts should also ultimately reduce the overall dwell time in ports, and consistent with international evidence, they should translate into economic gains through higher volumes of imports and exports.

4.3 LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

77. **The DPL is central to achieving the objectives under the CPF *Maritime Economy and Connectivity* engagement area.** Efficient connectivity has been identified in the SCD as a vital instrument to increase competitiveness and decrease poverty and inequality. The CPF reflects this through the *Maritime Economy and Connectivity* engagement. In particular the PDOs of the DPL are consistent with and contribute to the development outcomes of the engagement in terms of reducing container handling time in selected international and domestic terminals and reducing travel time for selected links to the ports. In addition some of the reforms contained in the *Enhancing ports' performance* and *Improving logistics services* pillars can also help to increase private sector investment in infrastructure (including ports, storage and distribution infrastructure), which is one of the development outcomes of the *Leveraging the Private Sector* supporting beam.
78. **The DPL is complementary to other ongoing and potential engagements of the WBG in this area.** The WBG is also engaged in programs supporting other aspects of the logistics problem. World Bank and IFC interventions target the 'hardware' (i.e. the infrastructure) gap in logistics, including the IFC's loan support the Jakarta International Container Terminal and the WBG investment lending in port-hinterland connectivity in Sumatra, which is in the pre-pipeline phase. These interventions complement the DPL focus on the 'soft' constraints in terms of policy and institutional actions/reforms. The DPL reforms can pave the way for greater investments in port infrastructure by all stakeholders, including the private sector and the World Bank Group, in line with investment plans in Eastern Indonesia highlighted in the CPF. Finally, this DPL series also complements other analytical support by the Bank to the government including on ease of doing business (to CMEA and BKPM), particularly in the trading across borders and starting a business areas, and on logistics-related issues (to the Ministry of Trade).

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

79. **The Government's overall objectives for the logistics sector have been discussed with key external stakeholders.** This includes, for example, discussions on the National Medium-term Development Plan (RPJMN) for 2015-2019. Individual policy measures supported in this operation have been separately consulted upon, in particular logistics services providers reforms and streamlining of trade processing have been discussed with industry, including both associations and individual companies.

⁶⁹ On the other hand the effect of improved risk management on hit rates, i.e. the percentage of inspections that lead to discovery of fraudulent shipments, is ambiguous as it will depend on whether the behavior of traders will change as well.

80. **A number of development partners also support the Logistics and Trade agenda through activities complementary to this DPL series.** The Asian Development Bank (ADB) is supporting a broader investment climate DPL which may have some connectivity and logistics components. Both the German Bank for Development (KfW) and Agence Française de Développement (AFD) have both expressed interest in co-financing this proposed DPL series. Other development agencies are involved in connectivity infrastructure development or trade-related reforms. The Dutch Government, through a private sector consulting firm, is exploring increased investment in Indonesian ports, especially in Ambon. The Australian-funded Indonesia Infrastructure Initiative (IndII) has a program component on road transport infrastructure development, covering issues related to policy, planning, and sustainability. In addition the European Union Trade Cooperation Facility (EU TCF) provides capacity development support to the Ministry of Trade in the area of regional maritime connectivity, focusing on the impact of the Chinese-led maritime Silk Road initiative. The Australian-Indonesia Partnership for Economic Growth (AIPEG) has also provided research support on logistics services negotiations to the Ministry of Trade, even though that has now largely phased out.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

81. **While evaluating ex-ante the poverty and inequality impact of logistics improvement is difficult, the evidence suggests that improved logistics can have significant impacts on poverty, through channels of increased growth and lower prices.** Both theory and international evidence suggest that the reduction in trade and transport costs tends to create larger market allowing for greater specialization, increased productivity and incomes.⁷⁰ In addition better logistics performance reduces, prices for consumer goods, especially for food, and increased access to services.
82. **This international evidence of improving logistics performance bodes well for an archipelago like Indonesia** (see Table A1 in Annex 4). First more efficient logistics would allow greater domestic market integration, which would reduce the large price gaps between Indonesian regions especially between the more remote regions and Java (Figure 2).⁷¹ As poverty is relatively higher in remote regions, especially in Eastern Indonesia, lowering prices there would have a particularly important poverty reduction effect. Second, costly and unreliable logistics is one of the key constraints to Indonesian competitiveness, as argued above. Addressing this bottleneck is likely to increase production and exports, thus boosting economic growth, which the evidence suggests is the most important determinant of poverty reduction. Manufacturing and agriculture are the sectors likely to benefit the most from

⁷⁰ See for instance Donaldson, D. (forthcoming) Railroads of the Raj: Estimating the Impact of Transportation Infrastructure *American Economic Review*; Berg, C., Deichmann, U., Liu, Y. and Selod, H. (2015) Transport Policies and Development, World Bank policy Research Working Paper 7366; Varela, G, Cali, M, U. Pape and E. Rojas (2016), Market integration and poverty: Evidence from South Sudan, World Bank Policy Research Working Paper 7564.

⁷¹ This is in line with Varela, G., E. Aldaz-Carroll and L. Iacovone (2013) “Determinants of Market Integration and Price Transmission in Indonesia”, *Journal of Southeast Asian Economies*, 30(1): pp. 19–4, which shows that more distant provinces have larger price differentials vis-à-vis Jakarta but the effect of distance is attenuated by good transport infrastructure.

improved logistics and given their labor intensity, this should provide a further boost in poverty reduction.

83. **While improved logistics is likely to generate net poverty and social gains in Indonesia, it may also have adverse effects in terms of job losses.** For example the increased competition in goods markets that better logistics services can bring about may undermine the rents of producers and traders in net importing regions. As with any trade shocks, this could generate losers among the incumbent firms and workers in those sectors. This could translate into job losses, which can induce some people to fall into poverty especially when they involve low-skilled workers. Recent evidence from the US suggests that local labor market adjustment to trade shocks can be remarkably slow, with wages and labor-force participation rates remaining depressed and unemployment rates remaining elevated for a long time period. Workers made redundant can suffer significant permanent earnings losses and some categories of workers – notably the less-educated – are likely to suffer disproportionately.⁷² Hence the targeted use of policy instruments like social assistance should be an important complement to the logistics reforms. The recent government's reforms of the social assistance framework, including the establishment of a Unified Database for targeting all major social assistance programs, are a positive development in this respect. While implementation challenges remain, such a process would help those who lose their jobs due to improved logistics to apply to be covered by social assistance or retraining programs. At the same time, the government has been expanding key social assistance programs (CCT, scholarships, health insurance) so that greater coverage is possible. The government has also requested TA from the Bank on establishing skills training programs, which could be targeted in part to displaced workers.
84. **Most reform areas in this DPL series have likely indirect impacts on poverty.** Reforms in all areas, port performance, competition in logistics services markets and trade processing, are expected to affect poverty through two channels. First, by raising the efficiency of the logistics chain, they could reduce the prices and expand the variety of the goods that households consume.⁷³ Poorer households should particularly benefit from it given the relatively higher shares of goods in their consumption basket. Second, improvements in logistics would increase producers' competitiveness by reducing their costs of accessing markets as well as their costs of sourcing supplies for production. Given the nature of the reforms many of these reductions are expected to be particularly important for international goods trade. In addition the import simplification reforms are expected to reduce the costs of importing and - subject to a positive pass-through on prices – directly reduce prices of final goods.

5.2 ENVIRONMENTAL ASPECTS

85. **The logistics reform actions supported by the DPL are unlikely to have any direct negative adverse environmental impacts and, insofar as they promote infrastructure improvements in the ports, may have positive impacts overall** (see Table A1 in Annex 5). While all of the actions are likely to carry little environmental impact, the reforms in the port

⁷² Autor, D., Dorn, D. and G. Hanson (2016). The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade, CEPR Discussion Paper 11054.

⁷³ This is conditional on the assumption that at least part of the gains in logistics efficiency would be passed on to final prices.

sectors may have indirect environmental impact as they may facilitate port infrastructure investments. These investments can have positive environmental impact for example as they may reduce traffic congestion (both of vessels and of trucks) outside of ports, induce the use of less energy consuming equipment and allow the use of more modern and efficient vessels. However if not assessed and managed properly these port infrastructure investments can also have adverse environmental impacts such as on marine ecology from land reclamation and dredging and on fishing communities that may lose space to moor their boats. In addition increased vessels' traffic may heighten the risk of oil spills and other marine pollution incidents and may generate greater volumes of ship waste to be managed by port operating companies and local waste processing and disposal facilities.

86. **Indonesia has a well-established system for managing such impacts.** Its cornerstone is a set of provisions in Law 32/2009 on Environmental Protection and Management that declare as criminal offenses: (a) the operation of a business or activity that could adversely affect the environment without the required environmental permit; (b) the issuance of an environmental permit when the necessary environmental assessment has not been completed and approved; and (c) the issuance of a business license or activity without the environmental permit. The AMDAL process applies to projects with substantial potential adverse impacts and produces a full ESIA with management and monitoring plans. Projects with lesser but still adverse potential impacts must prepare a UKL and UPL, which are environmental management and monitoring plans, respectively. This system is well designed and, when properly followed, conforms to international standards.
87. **While there are areas of weaknesses in its implementation, there is evidence that the system undertakes serious scrutiny to port infrastructure projects.** First AMDAL and UKL/UPL review and environmental permitting are normally managed at the *Kabupaten* (district) level, and this results in some inconsistency in document quality due to differences in capacity across districts. Second, capacity and commitment to carry out AMDAL and UKL/UPL mitigation measures is not always inadequate in construction and operation of ports. Third, monitoring and enforcement of the environmental and social management and health and safety requirements is generally weak. Nonetheless the recent construction projects in the ports of Bungkotoko, Kalibaru and Cilamaya, which have either been delayed or cancelled altogether due to environmental impact concerns raised by the system, show that the environmental protection system in Indonesia ensures serious scrutiny of and can provide a hard constraint to the projects.
88. **Mitigation of the weaknesses in the country system will require improvements that will need to be accomplished incrementally, as they cannot all be accommodated in this DPL.** These would include: designating individuals to serve as environmental, social, health and safety (ESHS) focal-points in Port Authorities; providing ESHS training and other resources to those individuals; and providing training on environmental impact assessment and management in port development and operation to relevant regional environmental agencies and to consultants that prepare AMDAL and UKL/UPL for port projects. This DPL series aims to support a number of port authorities by providing at least part of this capacity building in the short term. A joint World Bank – Asian Development Bank activity separate from this DPL is examining the feasibility of establishing a Learning Center for Environmental and Social Safeguards in Indonesia to strengthen Country Safeguard Systems. There are as yet no specific details about the Learning Center's programs, but it could serve as a medium-long term source of the capacity-building described above. In addition the reforms supported through prior action #1 and trigger #1 may enhance the Port Authorities'

ability to fulfill their core mandate including also the protection of the environment, supervision of land and water use.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

89. **The overall fiduciary risk to this operation arising from Indonesia's public financial management (PFM) system, the use of budget resources and its foreign exchange environment as controlled by the Central Bank is assessed to be moderate.** The country PFM system and the government's commitment to reform are adequate to support the operation.
90. **Steady progress has been made in recent years in the way Indonesia's public finances are managed and in increasing transparency and independent oversight.** A repeat assessment of the Public Expenditure and Financial Accountability (PEFA) was conducted in 2012, following a first assessment in 2007. The results showed that Indonesia has made positive steps in strengthening the quality of its PFM systems; fourteen of the twenty six indicators registered an improvement (while two declined). More recently the Integrated Financial Management Information System was rolled out in 2014 and operational guidelines to implement full accrual accounting have been agreed and are being used since the start of 2015. Since 2009 GOI financial statements have received a qualified audit opinion, as opposed to a disclaimer before, with 71.3 and 65 percent of ministries and agencies achieving unqualified audit opinions in 2014 and 2015 respectively. The decrease in the percentage of unqualified opinion in 2015 could be attributed to the first year of implementation of accrual accounting and the related challenges. The Government publishes the annual budget in a timely manner, through the MoF website. Further improvements are required in several areas and are supported by a multi-donor trust fund managed by the Bank.
91. **The foreign exchange control environment is assessed to be generally satisfactory.** Bank Indonesia (BI) was last subject to the transitional procedures under the Fund's safeguards assessment policy in 2002. That assessment recommended remedial action to address a number of vulnerabilities in the audit arrangements of BI. The main recommendations have been implemented. Audited financial statements for BI for 2014 and 2015 have been reviewed and the audit report issued by BPK (the Supreme Audit Institution) contained an unqualified opinion.
92. **The borrower is the Republic of Indonesia and this operation is a single-tranche IBRD loan of US\$ 400 million.** The loan will be made available upon loan effectiveness, provided that the Bank is satisfied with the progress achieved by the Borrower in carrying out the Program and with the adequacy of the Borrower's macroeconomic policy framework. The Government has confirmed that Indonesia will borrow this amount as an IBRD Flexible Loan with Variable Spread in US dollar currency with an annuity repayment schedule linked to commitments.
93. **The loan disbursement will follow the standard Bank procedures for DPLs.** The loan amount will be disbursed into a foreign currency account of the borrower at Bank Indonesia that forms part of Indonesia's official foreign exchange reserves. The equivalent rupiah amount will immediately be transferred to the General Operational Treasury account of the borrower that is used to finance budget expenditures, as the loan is intended to be used to support the general Government budget. This arrangement has been followed for the previous DPLs. The borrower, within 30 days, will provide to the Bank a written confirmation that this transfer has been completed, and provide to the Bank any other relevant information

relating to these matters, including the exchange rate of the conversion from US dollars to rupiah, that the Bank may reasonably request. Disbursements of the loan will not be linked to any specific purchases and no procurement requirements have to be satisfied, except that the borrower is required to comply with the standard negative list of excluded items that may not be financed with Bank loan proceeds, as defined in Schedule 1 to the loan agreement. If any portion of the loan is used to finance ineligible expenditures as so defined in the loan agreement, the Bank has the right to require the Government to promptly, upon notice from IBRD, refund the amount equal to such payment to the Bank. Amounts refunded to the Bank will be cancelled from the loan.

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

94. **The development policy operation, including the development of the program objectives and results indicators, has been prepared through intensive policy dialogue with the Government.** The main counterpart is the Coordinating Ministry of Economic Affairs, with active engagements with the relevant line Ministries/Agencies, including the INSW, Ministry of Finance, Ministry of Transport and Ministry of Trade. Monitoring of progress on indicative triggers and result indicators will be done on a regular, quarterly basis and be coordinated by the CMEA and INSW for the trade processing side. We plan to use the Bank's technical assistance programme to the INSW to help gather the relevant data and set up the reporting system. It is expected that the indicative triggers will be completed by Q1 of 2018 and the second operation will go to the Board in Q1 of 2018 or Q2 of 2018 with a closing date of Q4 of 2018, which means the ICR completion by late 2019-early 2020. We also plan to complement the secondary data available with specific data collection through surveys among logistics service providers.
95. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

96. **The overall risk rating of this operation is substantial.** Major risks are the following: (a) political economy and governance challenges, (b) sector strategies and policies; (c) stakeholders risk and (d) the weak institutional and implementation capacity. These risks, if materialized, could negatively impact the Government's willingness and ability to implement the indicative triggers, and the achievement of the intended positive results (even if the prior actions and triggers are completed). Furthermore, these risks could affect the achievement of

the PDOs as the reforms contained in the DPL are important but not sufficient conditions for achieving the PDOs.

97. **Political and Governance:** While improving port efficiency, a better business environment for logistics service providers and making trade processing more transparent and efficient are all priorities for the government, there is not a government-wide consensus on how to achieve these objectives. There are two Coordinating Ministries respectively for Economic Affairs and Maritime Affairs that do not always have a coherent view and do not always propose sets of coherent strategies to address high logistics costs in Indonesia. The Ministry of Transport is an example of a line ministry that operates outside the realm of the Execution Agency of the DPL Logistics as its reporting lines are primarily to the Coordinating Ministry of Maritime Affairs. Nevertheless, many of the proposed actions have also been included in the Economic Policy Packages that the government commenced launching since 2015 and that have received wide support within the public and private sector. Logistics reform receives substantial support from President's and Vice-President's Office that support the Coordinating Ministry for Economic Affairs in coordinating its efforts to implement further logistics reform through the implementation of the triggers. Even with that, the political and governance risks remain substantial as not all ministries included are within the control of the Coordinating Ministry of Economic Affairs and the launch of recent Economic Packages shows that some line ministries tend to ignore the directives of the Economic Packages.
98. **Sector Strategies:** Indonesia's logistics blueprint represents the country's overall strategy on logistics backed by the public and private sector. Line ministries have been allocated budget during 2012-2016 for the implementation of specific tasks that were assigned. Various line ministries have however also issued their own blueprints, strategic documents and action plans that are not always fully coherent with the Logistics Blueprint. The risk is that this may constrain the timely implementation of some actions and the achievement of the triggers. The recently issued Economic Packages by the Government have provided a coherent view on what the government intends to do to boost competitiveness and a more efficient distribution of goods domestically. There is the risk however that the high frequency of the issuance of new economic reform packages will lead to a certain fatigue within the government to implement reform including proposed DPL triggers. To partially address some of these risks, the World Bank is providing technical assistance to the Government, for example on improving the business environment for logistics service providers and making trading across borders more efficient.
99. **Stakeholders' risks:** Given their so far dominant role in the port sector, the Pelindo's are a key stakeholder in the ports' reform area. While some of the reforms are likely beneficial to Pelindo's operations, such as those in actions #1 and #3, action #2 and trigger #2 may explicitly threaten some of the dominant position of Pelindo's in the sector. This could cause some resistance to the implementation of the reforms. However the formal acknowledgement that the regulatory powers lie with the Port Authorities should help reduce this risk. In addition the Ministry of Transport plays a central role in several proposed triggers but the Ministry has in recent years signaled the intention of protecting the incumbent (domestic) service providers. This poses some risks to the achievement of the triggers. While the Bank has had limited direct dialogue exists with the Ministry, our counterpart in CMEA has good working relations with it. The Bank team is also intensifying its communications with the Ministry and the recent change of Minister may be a positive development in that respect.

100. **Macroeconomic risks:** The Government is expected to face significant fiscal pressures in 2016 arising from a shortfall of revenues, mainly due to lower commodity prices. As in 2015, the government has mitigated financing risks through pre-financing. However, substantial expenditure cuts in response to the revenue shortfall in 2016 could have a small negative impact on growth. Furthermore, the overall macro policy framework is responsive to risks of imbalances, and a range of contingency financing and crisis protocols are in place. As imports are projected to decline in 2016, the risk of near-term import growth acceleration of such a magnitude as to jeopardize the implementation of the pillar on making trade processing more efficient and transparent is very low.⁷⁴
101. **Institutional capacity for implementation and sustainability:** While the Executing Agency for the implementation of the DPL logistics – the CMEA – has a strong track record in managing and coordinating the implementation of logistics reform, the capacity of other agencies and ministries may constrain the implementation of the reforms. In particular, the weakness of the Port Authorities may undermine the success of the reforms in the port sector as highlighted above. To that end the Bank is planning to help strengthen these institutions through a TA programme focusing on the regulator function of the Port Authorities linked to the DPL as well as through a programme beyond the DPL (described in section 5). In addition the implementation of many of the reforms in Pillar C hinges on the coordination of various agencies and ministries, which have relatively limited capacity. This role should be played by the INSW. However there are concerns as to the ability of the INSW to act as an effective coordinator, although its capacity has grown substantially over the last two years, also thanks to the help of DGCE, which has seconded a dozen officers to the port administrator. To mitigate this risk further the World Bank has been developing a substantial technical assistance programme to support the INSW and some of the INSW participating agencies in their efforts to successfully implement the relevant triggers. In addition the DPL2 will support the enhancement of the INSW institutional ability to convene the various agencies/ministries through trigger #6.

Table 4: Systematic Operations Risk Rating (SORT)

Category	Risk	Rating (H, S, M or L)
1	Political and governance	S
2	Macroeconomic	M
3	Sector strategies and policies	S
4	Technical design of project or program	L
5	Institutional capacity for implementation and sustainability	S
6	Fiduciary	M
7	Environment and social	S
8	Stakeholders	S
9	Other	n/a
	Overall	S

Source: World Bank staff.

⁷⁴ As explained above the reduction in imports has been one of the determinants of the reduction in dwell time across Indonesian main ports over the past years.

ANNEX 1: THE POLITICAL ECONOMY CONTEXT AND THE ECONOMIC PACKAGES

The programme of logistics reforms supported by this DPL is one of the most far-reaching of Indonesia in recent times. It comes on the heels of increasing government focus on reducing logistics costs, culminated in a number of high profile visits by the President to major ports across the country. Despite the importance on the government's agenda, logistics is a hard area to reform because it requires the coordination of several ministries and agencies and because of the need to address powerful domestic vested interests.

Embedding much of the logistics reforms agenda into the series of (so far) thirteen economic policy packages has arguably helped to address these challenges. On one hand the packages hinge on a tight coordination by the CMEA, which first identifies the measures to be included in the packages. Coordination implies meetings with relevant line ministries and representatives of the private sector. In some cases, regional stakeholders are consulted as well before the issuance of packages. Then, the line ministries propose adjustments to regulations or the Presidential Office prepares new draft Presidential Decrees as necessary. These are subsequently submitted to the Ministry of Law and Human Affairs for review. After approval, the line ministries prepare the implementing regulations that clearly specify the responsibilities and roadmap of how the new measures will actually need to change.

On the other hand the packages benefit from the direct endorsement of the President, which may help overcome political economy constraints to reforming areas dominated by vested interests, often reflected in the resistance to reforming of the line ministries' themselves. Cases in point are various categories of logistics service providers, including warehouses, distributors, freight forwarders and shipping agents, whose rents are threatened by the reduction in foreign equity limits and in other barriers to entry.

The economic package approach has helped achieve an important level of ambition in logistics reforms, a number of which have been supported in this DPL series, including prior action #3, #4, part of #5, #6, #7, #9, #10 and #11. Indeed the majority of the prior actions have been part of an economic package.

At the same time, the government has been resolute to start addressing major bottlenecks in the port sector, again an area difficult to reform due to powerful vested interests. The main one is represented by the large State Owned Enterprises Pelindo's which have dominated the sector for decades. In fact until mid-2015 the largest of these SOEs, Pelindo II, seemed set to lead major new port infrastructure developments in Eastern Indonesia, thus consolidating the role of the port operators as de facto port regulators as well. However the ousting of the President director of Pelindo II due to corruption charges at the end of 2015 halted these investment plans and the signing of the concession agreements further moved the port regulator responsibilities away from the Pelindo's, a momentous change in the sector.

ANNEX 2: POLICY AND RESULTS MATRIX

Prior actions and Triggers		Results Indicators
Prior Actions under DPL 1	Indicative Triggers for DPL 2	
<i>Improving port efficiency and governance</i>		
Prior Action #1. The Port Authorities have granted concessions to operate ports in a hundred and seven (107) locations in Indonesia to Pelindos, as evidenced through DG Sea Transportation Letter No. HK.107/3/15/DJPL-16.	(Indicative) Trigger #1. The asset inventorization report for the main ports is completed by the Government's Development Finance Controller (Badan Pengawasan Keuangan dan Pembangunan / BPKP) and the government will undertake the necessary steps towards the division of assets between the Pelindo's and the Port Authorities.	Result indicator A1: Increase in the number of Pelindos' ports and terminals with internationally certified management systems (Quality Management Systems – ISO 9000 series). <ul style="list-style-type: none"> • Baseline (2014): 46 • Target (2018): 60
Prior Action #2. The Borrower has established the Availability Payment Mechanism, which enables the Borrower to pay companies for providing transportation infrastructure services, including port terminals construction, management and maintenance, as evidenced through Presidential Regulations 38 of 2015 and Minister of Finance Regulation 190 of 2015.	(Indicative) Trigger #2. The Ministry of Transport revises minimum capital requirements for Port Business Licence (Permenhub 45/205) to conform with article 32, Law No. 40/2007.	Result indicator A2: Increase in the number of approved applications for BOT sea-ports development. <ul style="list-style-type: none"> • Baseline (2015): 0 • Target (2019): at least 2 (cumulative between 2015 and 2018)
Prior Action #3. The Minister of Transportation has improved ports efficiency by enabling: (a) the integration of the internet-based single-service system for port services (INAPORTNET) into the INSW; and (b) the rolling out INAPORTNET in sixteen (16) ports, as evidenced through	(Indicative) Trigger #3. The Borrower fully integrates the INAPORT system with the INSW system in at least 2 ports (Tanjung Priok and Makassar).	Result indicator A3: Reduction in the minimum and maximum ships' waiting times in ports: <ul style="list-style-type: none"> • Baseline: <ul style="list-style-type: none"> ○ Tanjung Priok (2014): min. 1 hour – max. 24 hours ○ Makassar (2014): min. 0.5 hours – max. 6 hours

Minister of Transportation Regulations 157 of 2015 and 192 of 2015.		<ul style="list-style-type: none"> • Target: <ul style="list-style-type: none"> ○ Tanjung Priok (2018): min. 0.8 hours – max. 12 hours ○ Makassar (2018): min. 0.4 hours – max. 4 hours
<i>Enabling a competitive business environment for logistics service providers</i>		
Prior Action #4. The Borrower has increased the maximum foreign equity limits for freight forwarding, warehousing and general distribution services to 67% and cold storage and producer-affiliated distribution services to 100%, as evidenced through the Presidential Regulation 44 of 2016.	(Indicative) Trigger #4. The Minister of Transport revises the Decree on Licensing for Freight Forwarders, PM No. 74/2015 (revised by PM No. 78/2015, PM No. 146/2015, PM No. 12/2016) to be in accordance with the negative investment list thus eliminating the minimum capital requirement and the location restrictions for foreign service providers from the Decree.	<p>Result indicator B1: Increase in the number of new foreign licenses for freight forwarders warehousing, and cold storage service providers.</p> <ul style="list-style-type: none"> • Baseline (2015): <ul style="list-style-type: none"> ○ New foreign licenses for freight forwarders: 1 ○ New foreign licenses for warehousing and cold storage: 7 • Target (2018) <ul style="list-style-type: none"> ○ New foreign licenses for freight forwarders: at least 5 ○ New foreign licences warehousing and cold storage: 15
Prior Action #5. The Borrower has: (a) established specific requirements to become a Shipping Agent, which excludes ship ownership, and (b) increased the maximum foreign equity limits for maritime cargo handling services to 67%, as evidenced through the Minister of Transport Regulation 11 of 2016 and the Presidential Regulation 44 of 2016.	(Indicative) Trigger #5. The Minister of Transport revises Regulation PM No. 60/2014 to be in accordance with the negative investment list eliminating the minimum capital requirement for Cargo Handling Operation from the regulation.	<p>Result indicator B2: Increase in the number of new shipping agents' licenses (SUKK) and foreign maritime cargo handling licenses</p> <ul style="list-style-type: none"> • Baseline: <ul style="list-style-type: none"> ○ SUKK licenses up to 2015: 0 ○ New Maritime cargo handling licenses (2015): 1 • Target: <ul style="list-style-type: none"> ○ New SUKK licenses (2016-18): at least 5 ○ New Maritime cargo handling licenses (2018): at least 3

Prior Action #6. The Borrower has established tax-free Bonded Logistics Centers, as evidenced through Government Regulation 85 of 2015, Minister of Finance Regulation 272 of 2015 and DGCE Regulations 2 of 2016.		Result indicator B3: Increase in the number of operational logistics bonded centres. <ul style="list-style-type: none"> • Baseline (2015): <ul style="list-style-type: none"> ○ LBCs: 0 • Target (2018): <ul style="list-style-type: none"> ○ LBCs: at least 30
<i>Making trade processing more efficient and transparent</i>		
Prior Action #7. The Minister of Trade has eliminated Registered Importer and Producer Importer licenses for eight (8) categories of products, which accounted for 10.6% of non-oil imports in 2015, as evidenced through various Minister of Trade Regulations.		Result indicator C1: Reduction in pre-clearance time in Tanjung Priok <ul style="list-style-type: none"> • Baseline (June 2015): 3.6 days • Target (June 2018): less than 2 days
Prior Action #8. The Minister of Finance has standardized administrative compliance for imports and exports of prohibited and restricted goods by requiring technical government agencies to post all trade-related regulations in a single repository on the INSW after submitting them for administrative-compliance review to DGCE, as evidenced through Minister of Finance Regulation 224 of 2015.	(Indicative) Trigger #6. The Borrower changes the Organizational Structure and Governance of the INSW Portal Administrator to elevate the status of the INSW Portal Administrator.	Result indicator C2: Increase in the share of relevant regulations included in the INTR <ul style="list-style-type: none"> • Baseline (2015): 90% • Target (2018): 100%
Prior Action #9. The Borrower has allowed the single submission of data and information through the INSW and commenced pilot testing with four user agencies (DGCE, BPOM, Agriculture Quarantine Agency and Fish Quarantine Agency), as evidenced through the Presidential Regulation 76 of 2014, the Minister of Finance Regulation 138 of 2015 and Head of INSW Letter No. S-91/INSW/2016.	(Indicative) Trigger #7. The Borrower implements the single submission system in at least four main INSW participating agencies (Customs, Agriculture and Fish Quarantine agencies and BPOM) for all importers rated as low risk by Customs.	Result indicator C3: Reduction in dwelling time in the 2 main ports (Tanjung Priok and Tanjung Perak) <ul style="list-style-type: none"> • Baseline (Tanjung Priok, June 2015: 5.5 days; Tanjung Perak, June 2015: 6.3 days) • Target (Tanjung Priok, June 2018: 4 days; Tanjung Perak, June 2018: 4 days)

Prior Action #10. BPOM has required the application of Import Declaration Letter for food and drugs to be submitted electronically, as evidenced through Head of BPOM Regulations 12 and 13 of 2015.		Result indicator C4: Reduction in pre-clearance time for food and drugs imports in Tanjung Priok: <ul style="list-style-type: none"> • Baseline (Average 2015): min. 3 - max 6 days • Target (Average 2017): min. 2 – max. 4 days
Prior Action #11. (a) The Coordinating Minister of Economic Affairs has instructed the INSW participating agencies to implement a single-risk management system; and (b) the INSW Portal Administrator has developed a prototype system and commenced a pilot to facilitate the sharing of risk management related data through the INSW, as evidenced through CMEA Letter No. S-88/M.EKON/4.2016 and Head of INSW Letter No. S-95/INSW/2016.	(Indicative) Trigger #8. The Borrower implements the single risk management process at least in the Agriculture and Fish Quarantine agencies, BPOM and Customs in the four main ports.	Result indicator C5: Decrease in the share of import shipments classified as red channel in Tanjung Priok: <ul style="list-style-type: none"> • Baseline (2014): 6% • Target (2018): 4%

ANNEX 3: LETTER OF DEVELOPMENT POLICY



MINISTER OF FINANCE
OF THE REPUBLIC OF INDONESIA

LETTER OF DEVELOPMENT POLICY

MINISTRY OF FINANCE

Jakarta, 26 September 2016

No.: 5-817 /MK.08/2016

Mr. Jim Yong Kim
President
World Bank

Dear Mr. President

1. Since taking office in October 2014, the Government of Indonesia has placed a particular emphasis on infrastructure development, recognizing its crucial link with the country's economic and broader development performance. The purpose of this Development Policy Letter is to provide an overview of the Government's medium term reform agenda with regard to enhancing ports' performance, improving logistics services, strengthening trade processing and to provide an update on recent progress towards implementing the reforms.
2. On behalf of the Government of Indonesia, we would like to express our appreciation for the technical assistance provided by International Bank for Reconstruction/World Bank to logistics reforms in Indonesia over the recent and longer term. We would also like to request the support of the International Bank for Reconstruction/World Bank in the form of the First Indonesia Logistics Reform Development Policy Loan.

Indonesia's Economic and Logistics Situation

3. Following the recovery from the Asian financial crisis, Indonesia saw strong economic growth, at an average of 5.6 percent over 2001-12. However, real GDP growth has decelerated gradually since peaking at 6.5% in 2011, down to 4.8 percent in 2015 and projected at 5.1 percent in 2016. This decline has been spurred by the commodities downturn, declining exports and weakening of investment growth. The slowdown in growth and decline in commodity-related revenues increased fiscal pressures significantly in 2015 and is expected to continue to do so in 2016. Indonesia has made significant progress on reducing poverty with the national poverty rate falling from 24 percent in 1999 to 11 percent in 2015. However, the pace of poverty reduction has slowed down and nearly a quarter of the population lie slightly above the poverty line and are vulnerable to shocks. Moreover, while poverty has fallen, inequality has been rising in Indonesia.

4. Efficient logistics is vital to boost the country's competitiveness and to reduce the large price premia incurred in less connected regions – where poverty is more concentrated - vis-à-vis the country's economic core of Java. To that end the main choke-points of the fragmented logistics supply chain in Indonesia need to be addressed including at the port of entry by facilitating more efficient investments and port services; at the border through improved clearance procedures; and before and beyond the border towards the final destination of goods through better logistics services.
5. Indonesia has to improve its regulatory framework to invest in ports' infrastructure, which recent World Bank work suggests to suffer from critical gaps. While the Shipping Law has mandated the port regulator to lead the development of port infrastructure, its implementation has lagged behind. The government has also to address various restrictions to competition in logistics service markets, including freight forwarding, maritime transport and warehouse and distribution. Finally, Indonesia has to streamline regulatory requirements and improve border procedures that make trade processing cumbersome and expensive, as highlighted by the World Bank's Doing Business "Trading across borders" and *Logistics Performance Indicators* (LPI).

Government Response and the Medium-Term Reform Agenda

6. Since taking office in October 2014, President Joko Widodo has embarked on a significant reform program. The President's electoral platform – the "Nawa Cita" – has been reflected in the National Medium-term Development Plan (RPJMN) for 2015-2019, which sets out national development goals and the main directions of policy for the period. The Government's growth strategy is based on a big infrastructure push and accelerating structural reforms, with a series of economic policy packages being rolled out since mid-September 2015. The program of logistic reforms to support the national development goals of the RPJMN and the Government's growth strategy is outlined below.

Enhancing ports' performance

7. *Enabling port infrastructure investment by clarifying the role of Port Authority vis-à-vis port operators:* In line with international best practices, the Shipping Law of 2008 ruled the separation of the port regulator and port operator roles, which until then had been de facto jointly held by the State Owned Enterprises Pelindo I, II, III and IV. The government has started to clarify these roles acknowledging the Port Authorities as the port regulators through four agreements through which the main Port Authorities have concessioned out to the Pelindo's the existing infrastructure of 87 out of the 96 public ports managed by them. The concession agreement allows a Pelindo to work together with other parties in port business activities and make investments in expanding and maintaining existing port superstructure. The concession agreement also obliges the Port Authorities to provide and maintain basic infrastructure including breakwaters, access channels and navigational aid.
8. *Facilitating the entry of cargo terminal operators:* Increased port performance will also hinge on the entry of new operators bringing fresh capital and competition to the sector. The Government is creating an enabling environment for private sector investment and public-private partnerships, including issuance of regulations in 2015 to allow port authorities to engage in a wider range of contract types with the private sector, including Availability Payment Contracts that are often used in large infrastructure projects. The government believes that this scheme would incentivize the participation of the private into port investment projects by insuring the investors against the demand risk. For port infrastructure this risk applies in particular to secondary ports where initial throughput is low in comparison to the port infrastructure investments that need to be made to adhere

to shipping industry standards. Reducing this demand risk is a first step to addressing the needs of the private sector in port development and providing port services.

9. *Enhancing coordination of documentary and container examination in ports:* The government has started the implementation the electronic system that regulates the movement of containers in ports - INAPORT - and linked it to the INSW system, which should connect all of the border agencies responsible for checking documentary requirements of the shipments. Implementing INAPORT would allow cargo vessels, freight forwarders and land transport operators to exchange data through electronic platform, improving certainty in scheduling of shipment, cargo pick-up increasing the accuracy of berthing windows.

Improving logistics services

10. Improving the contestability of logistics service markets is a key step to ensure that the entire logistics supply chain runs smoothly in Indonesia. To that end the government has *improved competition in freight forwarding, storage and distribution services* by raising the foreign equity limits for these service providers. Such increases should encourage foreign investments in all four services, thus raising the rate of foreign entry in the sectors. Importantly, the foreign equity limits have all been raised from below to above the critical 50% threshold, thus making the extent of foreign investors' increased control of the Indonesian firm meaningful. The entry of foreign investors would foster competition in all these services, thus increasing their availability and reducing their prices.
11. *Improving competition in auxiliary shipping services:* The government has reduced the barriers to entry in two important services auxiliary to shipping services, i.e. shipping agents and maritime cargo handling services. The Ministry of Transportation has introduced the shipping agent license SIUKK, which eliminates the requirement of vessel ownership to operate as a shipping agency. At the same time the government has increased maximum foreign equity limit for maritime cargo handling services from 49% to 67%.
12. A substantial share of the inputs imported by Indonesian industries as well as of the products exported by Indonesia are stored in warehouses in neighboring countries, including Singapore and Malaysia. Inventory costs (as a share of manufacturing sales) are particularly high in Indonesia relative to other competitors in the region. The government has sought to *reduce inventory costs of imported materials for producers* through the establishment of bonded logistics centers, which allow for the temporary storage of imports free of duties. The goods can now be stored for a period of up to 3 years (extendable for another 3 years), within which time they can also be re-exported free of taxes should they not be sold on the domestic market. The regulations allow full control by the private sector over the ownership and operations of the centers and also allow majority foreign ownership.

Strengthening trade processing

13. *Reducing licensing requirements for imports:* The Ministry of Trade has eliminated Registered Importer (IT) and/or Producer Importer (IP) licenses for 8 categories of restricted products comprising over 10% of non oil imports. These licenses require various types of documents to be presented (from 4 different documents for cloves' IT license to 11 for tires' IP license). This simplification should reduce substantially the time and costs of documentary compliance in Indonesian international ports, which currently takes considerably longer than in neighboring countries.

14. *Facilitating traders' compliance with trade regulatory requirements:* At the end of 2015 Indonesia has standardized the administrative compliance for the imports and exports of prohibited and restricted goods (LARTAS), including the specification of the HS codes of the products. The government now requires line ministries/agencies to: (a) submit trade-related regulations for administrative-compliance review by DG Customs, prior to being posted on the Indonesia National Trade Repository by the Indonesia National Single Window (INSW); (b) use a standard template for the submission; and (c) report to the INSW Taskforce about any goods that need to be removed from the list of prohibited and restricted goods. This streamlines the procedures to post new regulations by line ministries and agencies on the INSW. As a result we would expect a more timely and complete update of trade related regulations in the INTR. In addition the new administrative checking procedure by Customs, supported by the INSW Taskforce, should ensure that trade processing is not hindered by unnecessary administrative errors and unclear postings on the INTR.
15. In addition the government has sped up the implementation of the single submission system. This will enable traders to submit all the necessary trade documentations to comply with the necessary requirements from multiple border agencies only once via the INSW. Customs Agency and the INSW Taskforce are preparing for its implementation by running a partial single submission pilot with five large firms. Participating agencies into the pilot include Customs, Quarantine Agencies and the Food and Drug Agency (BPOM). This pilot has allowed these key agencies to identify the solutions to some of the possible technical and legal problems arising from the wider implementation.
16. *Expediting the submission of required trade documentation:* The government has also made progress on the electronic submission and processing in key border agencies, which has the potential to reduce the pre-clearance time. The Food and Drugs Agency (BPOM) and the Customs have developed their own electronic systems to process declarations and import/export-related licenses. BPOM has recently issued two regulations that automate the process for applying for an Import Declaration Letter (SKI) for both food and drug products and inputs. The BPOM regulations cover food and drug products and materials that comprise 6 percent of total non-oil and gas import value in 2015 and that have typically higher processing times than average.
17. In an effort to improve risk management systems for border agencies – which is key to minimize unnecessary inspections at the border - the government has launched a program of risk management integration across border agencies/ministries. To formalize these efforts, the Minister of Coordinating Economic Affairs: (a) included the introduction of single risk management in the Government's Economic Package no. 11; and (b) as the head of the INSW board of supervisors he sent a letter to the relevant line ministers and agencies urging them to take the necessary steps for the introduction of single risk management under Customs leadership. Customs, Quarantine Agencies and BPOM have recently started exchanging information on their risk profiles and have piloted the approach.

Conclusions

18. In summary, the Government is firmly committed to the program of logistics reforms set out above in order to enhance ports' performance, improve logistics services and strengthen trade processing, which in turn can help to reduce poverty and contribute to broad-based economic growth.
19. The Government greatly values the support provided by the International Bank for Reconstruction/World Bank over the years to help finance Indonesia's development priorities and the provision of technical assistance that is helping us to identify issues and develop a comprehensive and well-coordinated logistics reform program. We look forward to your continued engagement and support in the coming years.

Minister of Finance
Republic of Indonesia


Sri Mulyani Indrawati

Cc:

1. Coordinating Minister for Economic Affairs
2. Director General of Budget Financing and Risk Management, Ministry of Finance
3. Director General of Customs and Excise, Ministry of Finance
4. Deputy Minister for Industry and Trade, Coordinating Ministry for Economic Affairs.

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects (yes/no/to be determined)	Significant poverty, social or distributional effects positive or negative (yes/no/to be determined)
<i>Pillar 1: Improving port efficiency and governance</i>		
Prior Action #1. The Port Authorities have granted concessions to operate a hundred and seven (107) ports in Indonesia to Pelindos, as evidenced through DG Sea Transportation Letter No. HK.107/3/15/DJPL-16.	<p>No significant direct effects.</p> <p>To the extent that it creates the conditions for more port infrastructure investments, the action may have indirect environmental effects if investments are not assessed and managed properly.</p> <p>These investments can also have positive environmental impact as they may reduce traffic congestion (both of vessels and of trucks) outside of ports, induce the use of less energy consuming equipment and allow the use of more modern and efficient vessels</p> <p>By strengthening the role of the Port Authorities as the port regulator, the action may help them focus on their core mandate and enhance their financial capacity to fulfill their roles.</p>	<p>No significant direct effects.</p> <p>To the extent that they stimulate port infrastructure development, these actions could overall benefit consumers and producers across Indonesian islands.</p> <p>By reducing transport and logistics costs port development could help reduce the large price gaps between Indonesian regions especially between the more the remote regions, where prices and poverty rates are higher, and Java.</p> <p>Port development can also have adverse effects on incumbent firms and workers in those sectors, which can induce some people to fall into poverty if not tackled in a timely fashion.</p>
Prior Action #2. The Borrower has established the Availability Payment Mechanism, which enables the Borrower to pay companies for providing transportation infrastructure services, including port terminals construction, management and maintenance, as evidenced through Presidential Regulations 38 of 2015 and Minister of Finance Regulation 190 of 2015.	<p>No significant direct effects.</p> <p>To the extent that it creates the conditions for more port infrastructure investments, the action may have indirect environmental effects if investments are not assessed and managed properly.</p> <p>These investments can also have positive environmental impact as they may reduce traffic congestion (both of vessels and of trucks) outside of ports, induce the use of less energy consuming equipment and allow the use of more modern and efficient vessels</p> <p>By facilitating the entry of large investors into the construction of new ports, the action may allow the introduction of modern technologies for construction which may limit the adverse environmental impact.</p>	<p>No significant direct effects.</p> <p>To the extent that they stimulate port infrastructure development, these actions could overall benefit consumers and producers across Indonesian islands.</p> <p>By reducing transport and logistics costs port development could help reduce the large price gaps between Indonesian regions especially between the more the remote regions, where prices and poverty rates are higher, and Java.</p> <p>Port development can also have adverse effects on incumbent firms and workers in those sectors, which can induce some people to fall into poverty if not tackled in a timely fashion.</p>
Prior Action #3. The Minister of Transportation has improved ports efficiency by enabling: (a) the integration of the internet-based single-service system for port services (INAPORTNET) into the INSW; and (b) the roll out INAPORTNET in sixteen (16) ports, as evidenced through Minister of Transportation Regulations 157 of 2015 and 192 of 2015.	<p>No significant direct effects.</p> <p>By improving the efficiency of ports, it may reduce congestion inside and outside the ports with associated environmental benefits.</p>	No significant effects.
<i>Pillar 2: Enabling a competitive business environment for logistics service providers</i>		

Prior Action #4. The Borrower has increased the maximum foreign equity limits for freight forwarding, warehousing and general distribution services to 67% and cold storage and producer-affiliated distribution services to 100%, as evidenced through the Presidential Regulation 44 of 2016.	No significant direct effects. Increasing foreign equity maximum limits for cold storage facilities is intended to stimulate investments, and it will be important that any such investment not violate Indonesia’s regulations banning import of ozone-depleting refrigerants and systems that use them. ⁷⁵	No significant direct effects. Improvement in logistics services could overall benefit consumers and producers across Indonesia by reducing prices and improving the competitiveness of the productive sector, thus reducing poverty rate. By better connecting markets improved logistics could also penalize incumbent firms and workers in certain markets through higher competition.
Prior Action #5. The Borrower has: (a) established specific requirements to become a Shipping Agent, which excludes ship ownership, and (b) increased the maximum foreign equity limits for maritime cargo handling services to 67%, as evidenced through the Minister of Transport Regulation 11 of 2016 and the Presidential Regulation 44 of 2016.	No significant effects.	
Prior Action #6. The Borrower has established tax-free Bonded Logistics Centers, as evidenced through Government Regulation 85 of 2015, Minister of Finance Regulation 272 of 2015 and DGCE Regulations 2 of 2016.	No significant effects.	
Pillar 3: Making trade processing more efficient and transparent		
Prior Action #7. The Minister of Trade has eliminated Registered Importer and Producer Importer licenses for eight (8) categories of products, which accounted for 10.6% of non-oil imports in 2015, as evidenced through various Minister of Trade Regulations.	No significant effects.	No significant direct effects. To the extent that these actions facilitate trade and reduce its costs, they could reduce the domestic prices of imported goods. This could diminish poverty overall by reducing the costs faced by households and firms. At the same time some incumbent firms and workers may be adversely affected by increased import competition.
Prior Action #8. The Minister of Finance has standardized administrative compliance for imports and exports of prohibited and restricted goods by requiring technical government agencies to post all trade-related regulations in a single repository on the INSW after submitting them for administrative-compliance review to DGCE, as evidenced through Minister of Finance Regulation 224 of 2015.	No significant effects.	
Prior Action #9. The Borrower has allowed the single submission of data and information through the INSW and commenced pilot testing with four user agencies (DGCE, BPOM, Agriculture Quarantine Agency and Fish Quarantine Agency), as evidenced through the Presidential Regulation 76 of 2014, the	No significant effects.	

⁷⁵ Ministry of Trade Regulation No. 83/M-DAG/PER/10/2015 Regarding Stipulations on Import of Ozone-Depleting Substances, and Regulation No. 84/M-DAG/PER/10/2015 Regarding Stipulations on Import of Materials for Cooling Systems.

Minister of Finance Regulation 138 of 2015 and Head of INSW Letter No. S-91/INSW/2016.		
Prior Action #10. BPOM has required the application of Import Declaration Letter for food and drugs to be submitted electronically, as evidenced through Head of BPOM Regulations 12 and 13 of 2015.	No significant effects.	
Prior Action #11. (a) The Coordinating Minister of Economic Affairs has instructed the INSW participating agencies to implement a single-risk management system; and (b) the INSW Portal Administrator has developed a prototype system and commenced a pilot to facilitate the sharing of risk management related data through the INSW, as evidenced through CMEA Letter No. S-88/M.EKON/4.2016 and Head of INSW Letter No. S-95/INSW/2016.	No significant direct effects. To the extent that better risk management translates into a higher probability of detecting illicit hazardous and other environmentally harmful imports, this action can lead to positive effects.	