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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

ON A PROPOSED LOAN

IN THE AMOUNT OF US$300 MILLION

TO THE

REPUBLIC OF INDONESIA

FOR THE

SECOND INDONESIA LOGISTICS REFORM

DEVELOPMENT POLICY LOAN

May 31, 2018

Macro, Trade and Investment Global Practice

East Asia and the Pacific Region

**REPUBLIC OF INDONESIA-GOVERNMENT FISCAL YEAR**

January 1 – December 31

**CURRENCY EQUIVALENTS**

(Exchange Rate Effective as of 31 May, 2018)

| | |
|---|---|
| Currency Unit | Rupiah (IDR) |
| US$ 1.00 = | IDR 13,889 |

## ABBREVIATIONS AND ACRONYMS

| | | | |
|---|---|---|---|
| 3PL | Third Party Logistics Provider | LGST | Luxury Goods Sales Tax |
| AfD | Agence Française de Développement | LPI | Logistics Performance Indicators |
| ALFI | Indonesian Logistics and Forwarder Association | LSGT | Luxury Goods Sales Tax |
| AMDAL | *Analisis Dampak Lingkungan* (Environmental Impact Analysis) | MoF | Ministry of Finance |
| BI | Bank Indonesia | MFD | Maximizing Finance for Development |
| BLC | Bonded Logistic Center | NDC | Nationally Determined Contributions |
| BOT | Build-Operate Transfer | NPL | Non-Performing Loan |
| BPK | *Badan Pemeriksa Keuangan* (State Audit Agency) | NTM | Non-Tariff Measures |
| BPKP | *Badan Pengawasan Keuangan dan Pembangunan Indonesia* (Development Finance Controller of Indonesia) | PA | Prior Action |
| BPOM | Indonesian Food and Drug Agency | PEFA | Public Expenditure and Financial Accountability |
| BPS | Badan Pusat Statistik (Central Bureau of Statistics) | PELINDO | *PT. Pelabuhan Indonesia* (Indonesia Port Corporation) |
| CMEA | Coordinating Ministry of Economic Affairs | PDO | Project Development Objectives |
| CPF | Country Partnership Framework | PFM | Public Financial Management |
| CPI | Consumer Price Index | PIB | *Pemberitahuan Ekspor Barang* (Export Declaration) |
| DAG | Ministry of Trade Regulation | PM | Ministry of Transport / Communication and Information Regulation |
| DG | Directorate General | PMK | Ministry of Finance Regulation |
| DNI | Negative Investment List | PP | *Peraturan Pemerintah* (Government Regulation) |
| DPL | Development Policy Loan | RAS | Reimbursable Advisory Services |
| ESIA | Environmental and Social Impact Assessment | RPJMN | *Rencana Pembangunan Jangka Menengah Nasional* (National Medium Term Development Plan) |
| FDI | Foreign Direct Investment | SCD | Systemic Country Diagnostics |
| FY | Fiscal Year | SISLOGNAS | Sistem Logistik Nasional (National Logistics System) |
| GDP | Gross Domestic Product | SIUPAL | *Surat Ijin Usaha Perusahaan Angkatan Laut* (Marine Transport License) |
| GOI | Government of Indonesia | SOE | State-Owned Enterprise |
| GRS | Grievance Redress Service | SORT | Systematic Operations Risk Rating |
| IBRD | International Bank for Reconstruction and Development | STRI | Services Trade Restrictiveness Index |
| ICT | Information and Communications Technology | SUKK | *Surat Usaha Keagenan Kapal* (Shipping Agent Licenses) |
| IDR | Indonesian Rupiah | SUSENAS | *Survei Sosial dan Ekonomi Nasional* (National Socio-economic Survey) |
| INAPORT | Indonesia Port system | UKL | *Usaha Pengelolaan Lingkungan Hidup* (Environmental Managing Effort) |
| INSW | Indonesia National Single Window | UPL | *Usaha Pemantauan Lingkungan Hidup* (Environmental Monitoring Effort) |
| INTR | Indonesian National Trade Repository | USD | United States Dollar |
| IP | *Importir Produsen* (Producer Importer License) | VAT | Value Added Tax |
| IT | *Importir Terdaftar* (Registered Importer) | WB | World Bank |
| JICT | Jakarta International Container Terminal | WBG | World Bank Group |
| KfW | German Development Bank | WTO | World Trade Organization |

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**THE REPUBLIC OF INDONESIA**

**SECOND INDONESIA LOGISTICS REFORM DEVELOPMENT POLICY LOAN**

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

| | |
|---|---|
| **Borrower** | The Republic of Indonesia |
| **Implementation Agency** | Coordinating Ministry of Economic Affairs |
| **Financing Data** | IBRD Loan Terms: IBRD Flexible Loan with fixed spread; Front end fee: 0.25%; Amount: USD 300 million. |
| **Operation Type** | Programmatic (2nd of 2), single-tranche |
| **Pillars of the Operation And Program Development Objectives** | 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:<br>• **Pillar A: Enhancing ports' performance**. PDO: Strengthening port's governance and operations.<br>• **Pillar B: Improving logistics services**. PDO: Enabling a competitive business environment for logistics service providers.<br>• **Pillar C: Strengthening trade processing.** PDO*:* Making trade processing more efficient and transparent. |
| **Result Indicators** | A1a: Increase in the number of Pelindos' ports and terminals with internationally certified management systems; A1b: Increase in the number of container handling equipment in the 10 largest secondary container ports; A1c: Increase in the number of ports handling more than 2000 TEU vessels in the 10 largest secondary container ports |
| | A2a: Increase in the number of approved applications for Build-Operate-Transfer (BOT) for public seaports development; A2b: Increase in the number of feasibility studies for BOT concessions received by Ministry of Transport. |
| | A3: Reduction in the minimum and maximum ships' waiting times in Tanjung Priok and Makassar sea-ports |
| | B1: Increase in the number of new foreign licenses for freight forwarders, warehousing and cold storage service providers |
| | B2: Increase in the number of new shipping agents' licenses (SUKK) and foreign maritime cargo handling licenses |
| | B3: Increase in the number of operational logistics bonded centers as well as of centers handling trans-shipment operations |
| | C1: Increase in the share of relevant regulations included in the Indonesia National Trade Repository |
| | C2: Reduction in dwelling time in the 2 main ports (Tanjung Priok and Tanjung Perak) |
| | C3: Decrease in the share of import shipments classified as red channel in Tanjung Priok |
| **Overall Risk** | Moderate |
| **Operation ID** | P163973 |

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

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

1. **This program document presents a proposed second 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$ 300 million, is the second in a 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.

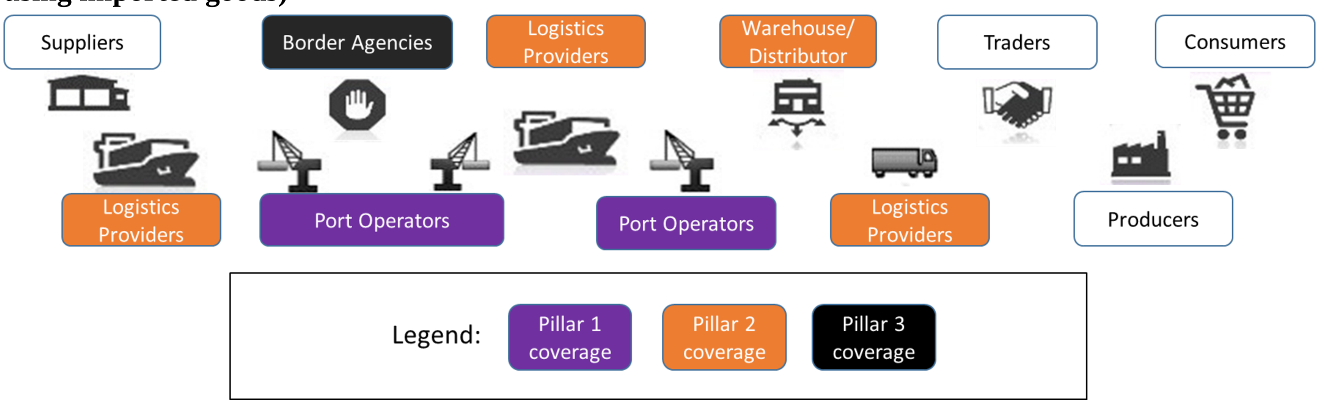
2. **Over the past decade Indonesia has seen strong growth and job creation, supporting poverty reduction; the end of the commodity boom, nonetheless, has exposed structural weaknesses**. Following the recovery from the Asian financial crisis, annual growth averaged 5.6 percent over 2001-12. As the external 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 since 2012, and it is down to 5.0 percent in 2016 and 5.2 percent in 2017. This has translated into a slowing down of the rate of poverty reduction, with a near zero decline in 2015 and a 0.4 percentage point decline between September 2015 and September 2016 to 10.7 percent. However, this decline is still lower than the rates of poverty reduction achieved between 2007 and 2011, which averaged 1.1 percentage points annually.

3. **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. It could also 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. As poverty is relatively higher in remote regions, especially in Eastern Indonesia, lowering prices there would have a particularly important poverty reduction effect.

4. **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 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 outside of Jawa and Sumatra (Figure 1).

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 in the secondary island. 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 internationally[1] and within Indonesia.[2] The three pillars in this DPL series cover various choke-points along this supply chain (Figure 1).

**Figure 1: The DPL coverage in the long logistics chain in Indonesia (example: producer in Sulawesi using imported goods)**




*Source: Elaboration of World Bank staff*

5. **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 by inadequate infrastructure, burdensome regulations – related to trade processing and investments - and low labor productivity also play a role.[3] 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

[1] 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.
[2] 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.
[3] World Bank (2015a). "Improving Indonesia's Freight Logistics. A plan for action." Jakarta: The World Bank

Indonesia by the World Bank has confirmed critical infrastructure gaps.[4] The Government has started to address some of the factors behind under-investment in port infrastructure, such as by strengthening the distinction between the roles of port landlord and port operator, but other areas such as port assets ownership, remain ambiguous and can stifle investments. Restrictions to competition in logistics service markets are another important hindrance to the logistics sector. Indonesia is the most restrictive among the 44 countries surveyed by the OECD in several logistics services, including freight forwarding and maritime transport.[5] The first operation supported a relaxation of restrictions to foreign ownership, but other barriers such as excessive minimum capital requirements, restrictions on the location of operations and cumbersome licensing requirements, stifle competition into these markets. Finally, cumbersome regulatory requirements and inefficient procedures make trade processing a further weak link in the logistics chain. Despite some recent improvement, Indonesian still ranks 108 out of 189 economies in the Doing Business "Trading Across Borders" indicators, behind most South East Asian comparators. Documentary compliance for imports takes 132 hours in Jakarta vis-à-vis 10 hours in Kuala Lumpur and 50 hours in Bangkok. These constraints contribute to the poor global rank of Indonesia in terms of the World Bank's *Logistics Performance Index* (LPI), particularly for international shipments, where Indonesia ranks 71 out of 160 countries, behind Malaysia, Philippines, Thailand, Vietnam and Cambodia.

6. **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 Menegah 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.

7. **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.**[6] This operation builds on the reforms supported by the first DPL and 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.

8. **This DPL series is aligned with the *Maximizing Finance for Development* (MFD) approach and is an MFD-enabling project**. Many of the reforms in the DPL series aim to

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[4] World Bank (2015b) "RAS Port Development Priority Project and Financing Strategy", mimeo. See section 4 for more details on this.
[5] OECD Services Trade Restrictiveness Index 2016.
[6] World Bank (2015c) *Country Partnership Framework For The Republic Of Indonesia (Fy16 – Fy20).*

crowd in private investments in logistics and trade sectors, for example by removing key bottlenecks to private sector participation into port development and by lowering barriers to entry in logistics markets (see Box 1). The early results of the reforms – reported in section 4.2 - already suggest promising increases in private sector investments in new port development along with increased entry of private operators in logistics services markets.

9. **The reforms supported in this series will also generate climate change co-benefits in line with Indonesia's response to the Paris Climate Agreement highlighted in the First Nationally Determined Contributions (NDC), as well as with the global need to reduce contribution from international shipping industry to climate change**. Through the NDC, the Government has set climate policy objectives for both climate change mitigation and adaptation. For mitigation, Indonesia aims for an unconditional emission reduction target of 29% and a conditional reduction target up to 41 % of the business as usual scenario by 2030. This DPL will support this mitigation policy objective through: 1) promoting gains in terms of better ports management and improved efficiency in overall supply chain management that will generate decreases in energy intensity; and 2) promoting, through construction of new port infrastructure, a modal shift in freight transport from road to waterways (i.e. ferry services), thus reducing greenhouse gas (GHG) emissions in port and logistics activities. As international shipping currently contributes approximately 2.4% of GHG emissions and its share is expected to increase in the future[7], these measures supported by this DPL are in line with key actions needed to reduce the sector's contribution to climate change.[8] For adaptation, the country's medium-term strategy is to reduce risks from climate change on all development sectors, including public service and infrastructure, by 2030.[9] As an archipelagic country with extensive coastlines, Indonesia is highly vulnerable to the long-term impacts of climate change, such as sea level rise and changing weather patterns.[10] In particular, a large number of Indonesia ports are located in Sumatra, Java, Kalimantan, and Sulawesi, which are ranked as facing high to very high risks for climate-related coastal inundation and floods, and also in many Eastern Islands that face high risk of coastal inundation.[11] These increasing climate-related disasters have caused both direct damage to Indonesian ports' infrastructure, equipment, and stocks in warehouses, and indirect damage from operation interruptions caused by access roads to ports being blocked by floods. The reforms supported by this DPL series will contribute to the adaptation policy objective by facilitating investments that increase climate resilience of the port infrastructure and related logistic operations in these locations.

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[7] International Maritime Organization (2014), Third IMO GHG study 2014 (2014) London, UK.
[8] See more information in World Bank Task Team (2018) "Background Study on Potential Greenhouse Gas Emission Reductions from the Second Indonesia Logistics Reform Development Policy Loan". Jakarta and Washington DC.
[9] Indonesia's First Nationally Determined Contributions, November 2016.
[10] GFDRR (2016) Country Profile: Indonesia. The Global Facility for Disaster Reduction and Recovery(GFDRR).
[11] ~~Government~~Government of Indonesia (2013), National Action Plan for Climate Change Adaptation (RAN-API)

***Box 1 – The MFD-enabling nature of the DPL reforms***

This logistics DPL series support reforms which have the potential to crowd in private sector investments for growth and sustainable development, thus enhancing the catalytic role of the operation. Each of the pillars in the operation contains reforms aimed at directly or indirectly easing the entry of private investors in the logistics and trade sector.

The enhanced division of roles between port operator and regulator achieved through the operations' prior actions (PAs) #1 enables the Port Authorities to involve other operators beyond the Pelindo's – which used to operate de facto as both port operator and regulator - in the development of new ports. At the same time the concession agreements also allow the Pelindos to cooperate with other parties including in expanding existing port superstructure. This enables 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). Consistently with the expected outcomes of these reforms, the Pelindos have accelerated investments in super- and infra-structure expansion, which improve the efficiency of port operations, including in ports that lagged behind such as the 10 largest secondary ports.[12] In these ports the number of container handling equipment has increased by 50% between 2015 and 2017 (with a port like Ambon installing its first ship-to-shore crane last year); moreover since 2015, five of these ports have upgraded their infrastructure, which for the first time have enabled Indonesian secondary ports to receive larger vessels (more than 2000 TEU).

The introduction of the availability payment scheme (PA #2 in DPL I) and the elimination of high minimum capital requirement for port businesses (PA #2 in DPL II) further enhance the ability of third operators, including private, to invest in ports' infrastructure and superstructure. This is confirmed by the early results of the operation, which show an increased participation of private investors in new port developments. Since 2016 six new BOT concessions have been granted by the Ministry of Transport for an estimated USD 3 billion investments, with half of them involving full or joint private sector participation. This is an unprecedented expansion in an environment historically dominated by Pelindos' monopoly. A further 11 new port projects have reached the pre-approval stage with feasibility plans already submitted to the Ministry of Transport, which is expected to grant concessions to many of them over the next months.

Similarly reforms in Pillar 2 of the DPL series pave the way to enhanced participation of private operators in logistics markets by considerably reducing barriers to entry. Foreign equity limits have been increased to above 50% and a new license (SUKK) has been created allowing for the development of independent shipping agencies (PAs #4 and #5 in DPL I). In addition minimum capital requirements and other restrictions have been reduced or eliminated for the main categories of logistics providers (PAs #4 and #5 in DPL II). These reforms have already spurred increased entry by foreign and domestic operators in these markets. In the first 18 months since the SUKK was introduced, a total of 110 companies have already received a shipping agency license, thus substantially expanding the supply of shipping agency services, which was controlled by a handful of shipping lines before the reforms. The reduction in barriers to entry for other logistics operators has also led to an increase in the entry of foreign freight forwarders

[12] These ports are Pontianak and Teluk Bayur (managed by Indonesia Port Cooperation (IPC)); Tanjung Emas and Banjarmasin (managed by Pelindo III); Balikpapan, Bitung, Ambon, Jayapura, Ternate and Kendari (managed by Pelindo IV).

and warehousing and storage providers. In the first half of 2017 new foreign freight forwarding licenses are almost equal to the number for the entire 2015 (16 vs. 19), and new foreign warehousing licenses are already almost 5 times larger than in 2015 (14 vs. 3). The introduction of BLCs in mid-2016 and its further strengthening the following year (PAs #6 in DPL I and II) have led to the opening of 58 BLCs (as of July 2017). These are operated by 43 new private companies - mostly logistics service providers - allowing producers to reduce the costs of their inputs.

Finally, by reducing the costs of trading, the reforms in pillar C increase the competitiveness of trading firms as well as of firms using imported inputs and of those exporting part of their outputs. This in turn enhances the expected returns to investors across a wide range of sectors in the economy, thus having the potential to enhance private investments in the economy. The removal of importer and producer licenses (IP/IT) (PA #7, DPL I) and the implementation of the electronic application to BPOM (PA #10, DPL I) have contributed to a decrease pre-clearance time in the main international port, Tanjung Priok: average pre-clearance time has already been slashed by more than a third across all goods and by two third for food and drugs, which are targeted by the BPOM reforms. The Word Bank analytical work confirms these results, estimating that these reforms have reduced import prices of goods subject to the IP/IT reforms by 6.7% and for food and drugs by 8.4%.[13] Similarly the push towards the use of the INSW system as single gateway for traders (PA #8, DPL I) and the acceleration in the granting of the Customs partner status to traders (PA #9, DPL II) have already helped reduce substantially dwelling time in Indonesia's largest ports. In addition, the enabling of single risk management through the exchange of importers' risk profile data between the 4 main border agencies (plus DG Tax) has made risk management more effective resulting in a decrease of physical inspection from 6% in 2015 to 4.78% in the early 2017.

## 2. MACROECONOMIC POLICY FRAMEWORK

### 2.1 RECENT ECONOMIC DEVELOPMENTS

10. **Indonesia's economic performance in 2017 was characterized by an uptick in growth driven by robust investment growth and supported by a pickup in domestic demand**. Real GDP growth accelerated from 5.1 percent yoy in Q3 to 5.2 percent in Q4 due to a larger increase in domestic demand, comprising of stronger investment, as well as stronger private and Government consumption; compensating the contraction on inventory stocking. In Q4, investment growth rose to its highest rate in more than 4 years. Bank Indonesia's (BI) series of policy interest rate cuts and the gradual recovery in commodity process and the pick-up in infrastructure investment, all contributed to the improved performance of investment. Both export and import growth slowed from Q3; but imports grew faster than exports, which led

[13] These estimates are obtained by running a difference-in-difference analysis comparing the change in the value of imports of products subject to the IP/IT (BPOM) reform in the quarters before and after the introduction of the reform to the same changes for the other products. The import price effect is then estimated by combining the import elasticity thus computed with the price elasticity of imports for the relevant HS-6 digit products (available from Kee et al. (2009) "Estimating trade restrictiveness indices", Economic Journal 119: 172—199). The full details and results of this analysis are available in Cali (2017). "Have the economic policy packages reduced import costs in Indonesia? A quantitative assessment of two sets of measures", mimeo, World Bank.

to a drag from net export growth. The moderation in export growth (8.5 percent in Q4 from 17.0 percent in Q3) was partly due to weaker non-oil and gas exports growth, in particular coal exports. The reduction in import growth (11.8 percent in Q4 from 15.5 percent in Q3) was also driven by lower non-oil and gas imports growth, especially of raw materials and capital goods, despite still growing double digits in nominal terms.

11. **Monetary policy continues to be accommodative and the financial sector remains stable.** Headline inflation eased to an average of 3.5 percent yoy in Q4, as food price inflation continued to ease and the effect of administered price hikes in the first half of the year began to wane. Benign prices in most non-food categories also contributed to lower inflation. Combined with a manageable current account deficit, easing inflation opened the door for more accommodative monetary policy to support growth. Bank Indonesia cut its benchmark policy rate, the 7-day reverse repo, twice by 25 basis points in August and September 2017. Combined with 2016's series of six policy rate cuts, the benchmark rate eased a total of 200 basis points over 2016-17. Non-performing loans (NPLs) are plateauing at around 3 percent and the capital adequacy ratio remains well above the Basel III threshold.

12. **Current account deficit widened substantially and financial account surplus shrank.** The current account deficit widened from 1.7 percent of GDP in Q3 to 2.2 percent of GDP in Q4, led by a much-lower goods trade balance surplus, as imports grew faster than exports, in line with the strong investment in Q4. In annual terms the current account deficit in 2017 narrowed to 1.7 percent of GDP from 1.8 percent in 2016. Meanwhile, the financial account surplus nearly halved from 4.1 percent of GDP in Q3 to 2.5 percent of GDP in Q4 as both direct investment and portfolio investment surplus narrowed following outflows in FDI in oil and gas sector as well as outflows in foreign capital, particularly in Rupiah-denominated securities.

13. **Gross financing needs have declined.** Gross external financing needs have declined in recent years to 7.4 percent of GDP in 2016 down from 9.5 percent in 2014. Gross external short-term debt stood at US$48.9 billion in Q4 2017, an increase from US$38.7 billion in Q4 2015.

**Table 1: Key Macroeconomic Indicators**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018f | 2019f | 2020f |
|---|---|---|---|---|---|---|---|---|---|
| **Real Economy** | *Annual percentage change, unless otherwise indicated* | | | | | | | | |
| Real GDP | 6.0 | 5.6 | 5.0 | 4.9 | 5.0 | 5.1 | 5.3 | 5.3 | 5.4 |
| Per Capita GNI (USD Atlas Method) | 3,599 | 3,759 | 3,654 | 3,515 | 3,514 | .. | .. | .. | .. |
| Contributions to GDP growth (ppt): | | | | | | | | | |
| Consumption | 3.1 | 3.0 | 2.9 | 2.7 | 2.8 | 2.8 | 2.8 | 2.9 | 2.9 |
| Investment | 2.9 | 1.6 | 1.4 | 1.6 | 1.4 | 2.0 | 2.0 | 1.9 | 2.1 |
| Net exports | -1.5 | 0.6 | -0.2 | 0.9 | 0.2 | 0.3 | 0.1 | 0.1 | -0.1 |
| Imports (real growth) | 8.0 | 1.9 | 2.1 | -6.2 | -2.4 | 8.1 | 7.0 | 6.0 | 5.5 |
| Exports (real growth) | 1.6 | 4.2 | 1.1 | -2.1 | -1.6 | 9.1 | 7.0 | 6.0 | 6.5 |
| Unemployment rate (ILO definition) | 6.1 | 5.9 | 5.5 | 3.6 | 4.1 | 4.1 | 4.2 | 4.4 | 4.4 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| GDP deflator (avg.) | 3.8 | 5.0 | 5.4 | 4.0 | 2.5 | 4.2 | 3.6 | 3.7 | 3.8 |
| CPI (avg.) | 4.0 | 6.4 | 6.4 | 6.4 | 3.5 | 3.8 | 3.5 | 3.7 | 3.7 |
| **Fiscal accounts** | *Percentage of GDP* | | | | | | | | |
| Expenditure | 17.3 | 17.3 | 16.8 | 15.7 | 15.0 | 14.6 | 14.5 | 15.0 | 15.8 |
| Revenue | 15.5 | 15.1 | 14.7 | 13.1 | 12.5 | 12.2 | 12.2 | 12.7 | 13.6 |
| General Government Balance | -1.8 | -2.2 | -2.1 | -2.6 | -2.5 | -2.4 | -2.3 | -2.3 | -2.2 |
| General Government Debt | 23.0 | 24.9 | 24.7 | 27.5 | 28.3 | 25.5 | 28.9 | 29.2 | 29.2 |
| **Selected Monetary Accounts** | *Annual percentage change* | | | | | | | | |
| Base Money (M2) | 15.0 | 12.8 | 11.9 | 9.0 | 10.0 | 4.5 | 6.9 | 8.5 | 8.9 |
| Credit to non-Government (eop) | 22.4 | 22.1 | 14.2 | .. | .. | .. | .. | .. | .. |
| Interest (key policy interest rate), eop[1] | 5.8 | 7.5 | 7.8 | 7.5 | 4.6 | 3.3 | 2.5 | 2.0 | 1.7 |
| **Balance of Payments** | *Percentage of GDP, unless otherwise indicated* | | | | | | | | |
| Current Account Balance | -2.7 | -3.2 | -3.1 | -2.0 | -1.8 | -1.7 | -1.9 | -2.1 | -2.3 |
| Imports | 23.2 | 23.2 | 22.7 | 19.3 | 17.1 | 18.0 | 18.7 | 19.4 | 20.1 |
| Exports | 23.0 | 22.5 | 22.3 | 19.9 | 18.0 | 19.1 | 20.0 | 20.7 | 21.4 |
| Direct Investment (net, US$ billion) | 13.7 | 12.2 | 14.7 | 10.7 | 16.1 | 20.2 | 30.6 | 37.4 | 45.2 |
| Gross Reserves (US$ million, eop) | 112.8 | 99.4 | 111.9 | 105.9 | 116.4 | 122.4 | 136.1 | 149.6 | 162.5 |
| Months' import cover (goods) | 7.7 | 7.1 | 9.9 | 9.8 | 9.3 | 9.1 | 8.5 | 8.4 | .. |
| As % of short-term external debt | 206.4 | 176.6 | 188.8 | 190.9 | 212.7 | 237.8 | .. | .. | .. |
| External Debt | 27.5 | 29.1 | 32.9 | 36.1 | 34.3 | 34.8 | .. | .. | .. |
| Terms of Trade (index 2015=100) | 107.8 | 102.1 | 98.2 | 99.4 | 100.0 | 101.6 | 102.5 | 103.0 | 103.3 |
| Exchange Rate (average) IDR/US$ | 9,387 | 10,461 | 11,865 | 13,389 | 13,308 | 13,381 | 13,550 | 13,750 | 13,950 |
| | | | | | | | | | |
| **Memo items** | | | | | | | | | |
| GDP nominal in (in billion US$) | 918 | 913 | 891 | 861 | 932 | 1,016 | 1,094 | 1,177 | 1,269 |

*Source:* BPS; Ministry of Finance; BI; World Bank staff projections for 2018-2020
*Note:* Using revised and 2010-rebased GDP. * Fiscal accounts for 2018-2020 are World Bank staff projections. [1]Bank Indonesia strengthened monetary operations by introducing a new policy rate known as the BI 7-Day (Reverse) Repo Rate, effective from 19th August 2016.

**Table 2: Indonesia: BoP Financing requirements and sources FY16-FY20**

| BoP financing requirements and sources | FY16 | FY17 | FY18 | FY19 | FY20 |
|---|---|---|---|---|---|
| | Act. | Act. | Est. | Est. | Est. |
| **Financing Requirements (US$ millions)** | | | | | |
| Current account deficit | 16,952 | 17,293 | 21,185 | 25,039 | 29,309 |
| Debt amortizations | 20,075 | 21,869 | 23,551 | 25,344 | 27,320 |
| Other short-term capital outflows | 30,415 | 31,205 | 57,649 | 60,532 | 34,318 |
| | | | | | |
| **Financing sources (US$ millions)** | | | | | |
| FDI and portfolio investments (net) | 35,132 | 40,813 | 63,277 | 70,159 | 77,974 |
| Capital grants | 0 | 0 | 0 | 0 | 0 |
| Debt disbursements | 21,869 | 23,551 | 25,344 | 27,320 | - |
| Change in reserves | 10,441 | 6,003 | 13,764 | 13,436 | 12,973 |

*Source:* BPS; Ministry of Finance; BI; World Bank staff projections for 2018-2020
*Note:* Using revised and 2010-rebased GDP. * Fiscal accounts for 2018-2020 are World Bank staff projections. [1]Bank Indonesia strengthened monetary operations by introducing a new policy rate known as the BI 7-Day (Reverse) Repo Rate, effective from 19th August 2016.

14. **2017 saw some improvements in tax collection and spending execution, and a lower fiscal deficit.** Due to a combination of higher global oil prices and efforts to improve tax compliance, Indonesia's revenues grew at the fastest pace in the last six years to 12.2 percent of GDP, excluding revenues from the Tax Amnesty Program (2016: 11.7 percent of GDP). Higher revenues supported the fastest nominal growth in total Government spending in the last three years, driven by capital, material, and social spending. Overall, the fiscal deficit stood at 2.4 percent of GDP in 2017, lower than the 2016 deficit of 2.5 percent. Given the fiscal rule to keep the deficit below a cap of 3 percent of GDP[14], and given constraints to rapidly increasing revenue, increasing the overall *level* of public expenditure is not possible, at least in the medium-term. As such, the Government has been improving the *quality* of its public expenditure in order to achieve its development goals. In 2017, higher capital and social spending drove growth of total expenditures, growing by 21.1 and 10.9 percent respectively from over a year ago, although in the case of capital spending this was due to the low base from expenditure cuts in 2016. Infrastructure continues to be a priority in the 2018 budget, with the Government allocating IDR 410.7 trillion[15] or 18.5 percent of total expenditures to infrastructure. Social spending was also maintained, increasing by 7.4 percent[16] relative to the 2017 Revised Budget. However, increasing spending in priority

[14] The general Government deficit is capped by law at 3 percent of GDP. 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.
[15] This figure follows the Government definition of infrastructure spending, which comprises: line ministry spending (Ministry of Transport, Ministry of Public Works & Housing), transfers to subnational Governments (*Dana Alokasi Khusus*, DAK), and capital injections.
[16] This calculation excludes rice subsidies (*Rastra*), which have been reclassified from non-energy subsidies to social spending in the 2018 Budget in view of program modifications (see footnote below).

sectors will not contribute to development goals if the delivery of the spending is ineffective. Continuous improvements in budget planning and execution at central and sub-national levels are needed to ensure that increases in budget allocations for key sectors translate into improved outcomes.

15. **Despite a small improvement in the tax-to-GDP ratio excluding Tax Amnesty revenues in 2017, weak revenue performance remains a major fiscal challenge**. Excluding tax amnesty redemption fees, the tax ratio improved slightly to 9.8 percent from 9.5 percent in 2016[17]. This small increase in the tax ratio points to the impact of higher oil prices and some early results from the Government's efforts to ease the burden of paying taxes and enhance compliance management. However, overall revenue collection remains weak at 12.2 percent of GDP[18] compared to 27.8 percent of GDP for the average emerging economy. Moreover, higher oil prices in 2017 led oil and gas-related revenues to play a substantial role in overall revenue growth, contributing 3.6 percentage points to total revenue growth.

16. **Upward and downward fiscal risks persist in 2018.** A significant share of revenues in 2018 will remain closely correlated with global oil price, exposing the Government to upside and downside risks from oil price fluctuations. Without continuing the reforms that broaden the tax base and tax the existing tax base more efficiently and equitably, the Government's medium-term fiscal position will be compromised. On the spending side, the Government has announced that it will keep the regulated fuel and electricity prices unchanged until the end of 2019 amid higher global fuel prices, potentially leading to an increase in fuel subsidies. This policy increases fiscal risks from potential losses by Pertamina and higher expenditure through payments on arrears to Pertamina and PLN, leading to even higher energy subsidy outlays. If downside risks from revenue collections materialize and expenditures are maintained, a wider fiscal deficit could emerge in 2018. Overall, sustaining the reform momentum in revenue administration, tax policy, and quality of spending, will potentially be more challenging given upcoming regional and Presidential elections in 2018-2019.

**Table 3: Key Fiscal Indicators**

| **Percentage of GDP** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018f** | **2019f** | **2020f** |
|---|---|---|---|---|---|---|---|---|---|
| **Overall balance** | -1.8 | -2.2 | -2.2 | -2.6 | -2.5 | -2.4 | -2.3 | -2.3 | -2.2 |
| Primary balance | -0.6 | -1.0 | -0.9 | -1.2 | -1.0 | -0.8 | -0.7 | -0.6 | -0.5 |
| **Total Revenues (and grants)** | 15.4 | 15.1 | 14.7 | 13.1 | 12.5 | 12.2 | 12.2 | 12.7 | 13.6 |
| Tax Revenues | 11.4 | 11.3 | 10.9 | 10.8 | 10.3 | 9.9 | 10.2 | 10.8 | 11.8 |
| Domestic tax | 10.8 | 10.8 | 10.5 | 10.5 | 10.1 | 9.6 | 9.9 | 10.5 | 11.6 |
| Income tax | 5.4 | 5.3 | 5.2 | 5.2 | 5.4 | 4.8 | 5.1 | 5.3 | 5.6 |

[17] Including redemption fees, the tax-to-GDP ratio declined from 10.4 percent of GDP in 2016 to 9.9 percent of GDP in 2017, continuing the downward trend since 2012.
[18] Excluding tax amnesty revenues.

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Oil and gas | 1.0 | 0.9 | 0.8 | 0.4 | 0.3 | 0.4 | 0.3 | 0.3 | 0.3 |
| Non-oil and gas | 4.4 | 4.4 | 4.4 | 4.8 | 5.1 | 4.4 | 4.8 | 5.0 | 5.3 |
| Value added taxes | 3.9 | 4.0 | 3.9 | 3.7 | 3.3 | 3.5 | 3.5 | 4.0 | 4.4 |
| LGST | 0.2 | 0.2 | 0.1 | n.a | n.a | n.a | n.a | n.a | n.a |
| Excises | 1.1 | 1.1 | 1.1 | 1.3 | 1.2 | 1.1 | 1.1 | 1.1 | 1.4 |
| International trade tax | 0.6 | 0.5 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Non-tax revenues | 4.0 | 3.7 | 3.8 | 2.2 | 2.1 | 2.3 | 2.0 | 1.9 | 1.8 |
| Grants | 0.0 | 0.1 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Expenditures** | 17.2 | 17.3 | 16.9 | 15.7 | 15.0 | 14.6 | 14.5 | 15.0 | 15.8 |
| Central govt. expenditure | 11.6 | 11.9 | 11.4 | 10.3 | 9.3 | 9.2 | 9.4 | 10.0 | 10.3 |
| Wages&compensation | 2.3 | 2.3 | 2.3 | 2.4 | 2.5 | 2.3 | 2.2 | 2.2 | 2.2 |
| Goods and services | 1.6 | 1.8 | 1.7 | 2.0 | 2.1 | 2.1 | 2.4 | 2.8 | 2.8 |
| Capital expenditures | 1.6 | 1.9 | 1.4 | 1.9 | 1.3 | 1.5 | 1.4 | 1.3 | 1.7 |
| Interest payments | 1.2 | 1.2 | 1.3 | 1.3 | 1.5 | 1.6 | 1.6 | 1.7 | 1.7 |
| Subsidies, of which: | 4.0 | 3.7 | 3.7 | 1.6 | 1.4 | 1.2 | 1.2 | 1.2 | 1.1 |
| Energy | 3.6 | 3.3 | 3.2 | 1.0 | 0.9 | 0.7 | 0.8 | 0.9 | 0.9 |
| Fuels | 2.5 | 2.2 | 2.3 | 0.5 | 0.4 | 0.3 | 0.4 | 0.5 | 0.5 |
| Electricity | 1.1 | 1.0 | 1.0 | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 |
| Non-energy | 0.5 | 0.5 | 0.5 | 0.6 | 0.5 | 0.5 | 0.3 | 0.2 | 0.2 |
| Social expenditures | 0.9 | 1.0 | 0.9 | 0.8 | 0.4 | 0.4 | 0.5 | 0.7 | 0.7 |
| Other expenditures | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Transfers to regions | 5.6 | 5.4 | 5.4 | 5.4 | 5.7 | 5.5 | 5.0 | 5.0 | 5.5 |
| **Selected priority sectors** | | | | | | | | | |
| Infrastructure | 1.4 | 1.4 | 1.1 | 1.9 | 1.6 | 1.4 | 1.4 | | |
| Health | 0.4 | 0.4 | 0.5 | 0.5 | 0.6 | 0.5 | 0.5 | | |
| Social assistance | 0.3 | 0.3 | 0.3 | 0.5 | 0.4 | 0.4 | 0.4 | | |
| **Net Financing** | 1.5 | 2.4 | 1.9 | 3.5 | 2.7 | 2.7 | 2.2 | | |
| Domestic (net) | 2.3 | 2.6 | 2.6 | 2.7 | 2.7 | 2.8 | 2.3 | | |
| of which bonds (net) | 1.9 | 2.4 | 2.6 | 3.1 | 3.3 | 3.3 | 2.8 | | |
| Foreign (net) | -0.3 | -0.1 | -0.1 | 0.1 | -0.1 | -0.1 | -0.1 | | |
| Disbursement | 0.4 | 0.6 | 0.5 | 0.7 | 0.5 | 0.4 | 0.4 | | |
| Amortization | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -0.5 | -0.5 | | |

*Notes:* Using revised and 2010-rebased GDP. All sectoral spending is only at central Government level; approved budget figures are used for infrastructure and social assistance spending in 2017 and 2018, while 2017 actual and 2018 approved budget figures are used for health. Infrastructure spending includes expenditures of the Ministry of Public Works and Housing, Ministry of Transport, Ministry of Energy and Mineral Resources, and Ministry of Agriculture; and capital injections into state-owned enterprises (SOEs) and public services delivery units (BLUs). Health spending includes expenditures by the Ministry of Health and the Medicine Control Agency. Social assistance follows the World Bank definition and excludes the health insurance subsidy for the poor, which is included in health spending, and the temporary compensation for fuel price increases. *Source:* Ministry of Finance.

## 2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

17. **The outlook continues to be favorable as the conducive external environment persists and domestic conditions become more positive.** Real GDP growth is estimated to increase

up to 5.3 percent in 2018 and 2019 (Table 1), driven by a continuation of strong investment growth and a modest, but continued recovery in consumption, lifted by the upcoming regional and presidential elections. Higher consumption growth will be supported by firm commodity prices, low inflation, strong labor markets and easing borrowing costs. Partly due to the credit rating upgrades, stronger foreign direct investment inflows and public capital expenditures, particularly in 2017, are forecast to buttress investment expenditures by the private sector.

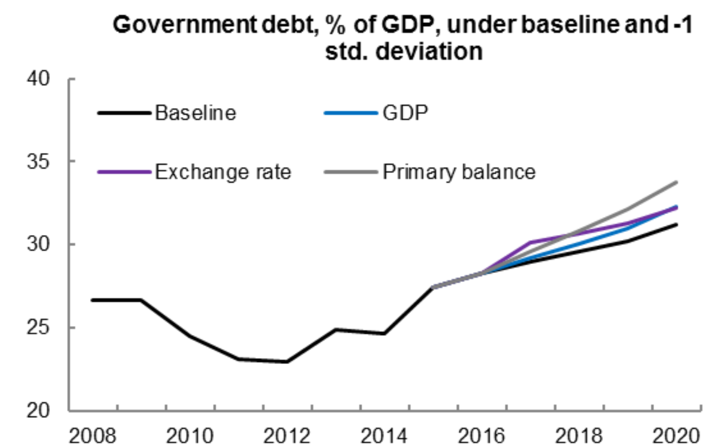
18. **Most components of aggregate demand are expected to be robust.** Private consumption is forecast to advance on continued moderate inflation, a stable Rupiah, stronger consumer confidence and lower consumer lending rates. The double-digit increase in real wages observed in 2016 is also expected to have carry over effects for consumption growth in 2017. Finally, lower commercial lending rates will be supporting investment, further buttressed by strong foreign direct investment.

19. **The Government's debt sustainability is strong.** Following a decade-long steep and sustained decline on the back of small fiscal deficits (strictly adhering to the 3 percent fiscal deficit to GDP limit) and solid GDP growth, Government debt-to-GDP reached 29.0 percent in 2017. The debt-to-GDP ratio remains moderate under a range of economic scenarios. Under the baseline, assuming fiscal deficit as a share of GDP is 2.4 in 2017, 2.3 percent in 2018, 2.3 percent in 2019 and 2.2 percent in 2020, the debt-to-GDP is projected to rise only slightly from the 2017 level of 29.0 percent to approximately 29.1 percent through 2019. In scenarios with one-time, permanent one standard deviation shocks to either real GDP growth or the exchange rate in 2016, Government debt remains below 32 percent of GDP in the medium term. Only when a similar shock (equivalent to 0.6 percentage points of GDP) is applied to the primary balance does the debt-to-GDP ratio go above 32 percent in 2019-20. In addition to a moderate debt level, the risk profile of the Government debt stock is strong, although non-resident holdings of domestic bonds are relatively high at 39 percent. The average time to maturity is relatively long, at 8.9. years. Less than 11 percent of the debt is variable rate. Currency exposure is significant, with 42 percent of total debt denominated in foreign currency.[19] 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.

[19] All debt profile figures are as of April 2017 (Source: Ministry of Finance).

**Figure 2: In the baseline trajectory Government debt-to-GDP remains below 30 percent**

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




*Source*: Ministry of Finance; World Bank projections

20. **The Government remains committed to structural reforms required to enhance potential growth and become less commodity reliant.** These include ongoing reforms to lift tax revenues and to improve the business environment to enhance attractiveness to investors and further reduce reliance on commodity exports. In particular, the Government has rolled out 16 reform packages to improve the regulatory environment since September 2015. The measures announced to date have, for example, led to a simplification of approvals and procurement procedures for large-scale infrastructure projects and faster approval of business licenses. These reforms have partially contributed to Indonesia's improvement in the 2017 Doing Business rankings. Other important reforms, such as the reduction of Indonesia's negative investment list (DNI) has led to fewer restrictions to foreign direct investment, which has been associated with higher FDI inflows over time.

21. **Increased international trade protectionism and unexpected changes in U.S. monetary policy and possible financial volatility tilt the risks to Indonesia's economic growth outlook to the downside**. Global policy uncertainty, including increased international trade protectionism, continues to pose substantial downside risks to the nascent recovery in global trade and global economic growth. Meanwhile, as the U.S. Federal Reserve proceeds with its monetary tightening cycle and normalization of its balance sheets, unexpected hikes in the U.S. federal funds policy rate could spark volatility in global financial and capital markets, leading to capital outflows from emerging market economies, including Indonesia. Such outflows could cause a rapid tightening of domestic financial conditions and induce volatility in the Rupiah, which would weigh on both domestic private consumption and investment.

22. **Domestic risks include adverse political economy effects.** Regional elections will be held in 2018 and legislative and presidential elections will be held in 2019. As the 2019 general election draws closer, the Government will face difficult and occasionally unpopular fiscal structural policy choices that may affect Indonesia's ability to achieve higher rates of economic growth. Increased political uncertainty may also discourage investment, in particular foreign investment.

23. **The macroeconomic policy framework is considered adequate for the proposed operation.** Strong economic management has helped improve Indonesia's economic fundamentals with stable and strong real GDP growth, low inflation, a conservative current account deficit and fiscal deficit, plus enhanced fiscal credibility, recognized in the S&P and Fitch rating upgrades. The policy mix has been consistent with macroeconomic stability and the management of risk that may arise. Monetary policy continues to be credible and responsive to inflation and external risk pressures. Similarly, the Rupiah has been stable despite recent appreciation pressures thereby decreasing exchange rate uncertainty in the immediate and medium-term. In terms of fiscal policy, the fiscal rule, the low level of debt and ongoing fiscal reforms will contribute to maintaining a conducive and stable fiscal framework.

## 3. GOVERNMENT'S PROGRAM

24. **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, accelerating the pace of their implementation, including of the 2008 Shipping Law and of the INSW. The overall coordination of logistics policy is still responsibility of the Coordinating Ministry of Economic Affairs (CMEA) although the Ministry of Transport now falls under the purview of the newly created Coordinating Ministry of Maritime Affairs (CMMA).

25. **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.[20] 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.[21] Over the past years the Government has made

[20] The SISLOGNAS strategy is devised following the Presidential Regulation No. 5/2008.
[21] The INSW was instituted through the Presidential Decree (Perpres) 10/2008.

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 sixteen reform packages since mid-September 2015, encompassing a wide range of policy areas including logistics reforms.

26. **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 (Pelindos) 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, and (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 Pelindos.[22] 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).

27. **Important reforms have also focused on increasing competition in logistics services providers with the recent economic policy package Nr. 15 focusing exclusively on improving logistics services**. 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. These include for example relaxing the requirements associated with issuing licenses for shipping agencies[23] and for courier services, increasing maximum foreign equity limits and reducing or eliminating minimum capital requirements and other barriers to entry for a host of logistics service operators. The latter reforms were included in the policy package Nr. 15 on logistics, which was announced in June 2017 and which was the first policy package entirely dedicated to a specific sector.

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[22] 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).

[23] 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.

28. **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.[24] 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.[25] 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.[26] 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.[27]

# 4. PROPOSED OPERATION

## 4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

29. **This second operation in the DPL series builds on the first operation to support 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 work by the World Bank Group (WBG), as detailed in section 4.3.

30. **The DPL is structured around the following three pillars, set of objectives and Government program reform areas**:

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[24] 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.

[25] 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).

[26] 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/

[27] These policies were announced in the 11th economic package in March 2016.

- **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; (ii) shipping and auxiliary shipping services; and (iii) reducing inventory costs of imported materials for producers.
- **Pillar C: Strengthening trade processing.** Making trade processing more efficient and transparent by (i) facilitating traders' compliance with trade regulatory requirements; and (ii) improving risk management of border agencies.

31. **The second operation in the DPL series builds on the achievements of the first one; its design has benefited from an extensive collaboration between the Government, in particular the CMEA, the INSW Portal Administrator, the Ministry of Transport, and the Ministry of Finance, 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 National Logistics Blueprint and the preparation to introduce the INSW. It is underpinned by other advisory and analytical work (past, ongoing and planned) by the Bank and other development partners, particularly Australia and Japan.

32. **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 program 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 National Logistics Blueprint and the recent economic policy packages. 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.

33. **The Government of Germany, through the German Bank for Development (KfW) and the Government of France, through the Agence Française de Dévelopement (AFD), are also providing policy loans in support of the Government's program, within this DPL series.** AFD signed a EUR 150 million credit facility agreement with the Ministry of Finance in March 2017 and KfW signed a similar agreement for EUR 200 million in August 2017 following World Bank Board approval of the first operation in November 2016. Strong collaboration in preparation of the remaining loans in the series continues with both institutions.

34. **The early results of the DPL series are encouraging, with significant progress across the three main pillars**. The World Bank monitoring work suggests that the reforms supported by the DPL have already started to make an impact in a number of areas, including an acceleration of new port projects with additional private participation, increased entry of operators – including foreign - in various logistics markets port investments and the reduction of time and costs of trade processing (see Box 1).

35. **Despite these promising results, the Indonesian logistics reform agenda is still far from completed and the WBG will continue to assist the Government in furthering this agenda beyond the DPL series**. The unfinished agenda encompasses all of the areas of the supply chain. For example, the full implementation of the port concession framework requires strong Port Authorities which can effectively lead infrastructure investments, monitor operational efficiency in ports and ensure environmental protection. Similarly, the ownership of assets within ports still needs to be clarified, and the mechanism to set port tariffs is cumbersome and leads to inefficiently low tariffs, especially for domestic services, reducing the attractiveness. Further reforms are needed across the other pillars as well, such as the further reduction of minimum capital requirements for freight forwarders and the implementation of the single submission and single sign-on for traders through the INSW. The WBG is committed to support the Government in this important agenda well beyond the span of this DPL series. To that end it aims to extend additional TA initiated to support the Government in implementing the DPL reforms to help addressing the remaining regulatory bottlenecks beyond the DPL series (see Box 2).

***Box 2 – WBG's support to the Government on the DPL implementation and beyond***

Since the start of this DPL series, the WBG has been developing a substantial program of technical assistance to the Government to accompany the operation. The program consists of support to strengthen the capacity of the Port Authorities to fulfill their ambitious mandate both through trainings and through TA to the Ministry of Transport to develop an effective curriculum for Port Authority staff. Given the longer time horizon for this type of TA to bear fruits, this support extends beyond the DPL series and is part of the overall WBG effort to help the Indonesian Government in improving the efficiency and the sustainability of the port sector. Other TA in this context includes support to the Ministry of Transport and CMEA for reforming port tariffs setting, improving further the port concession agreement framework and support to port operators and Port Authorities in accelerating the adoption of environmental policies in ports, starting from ship waste management, which is largely undeveloped in Indonesian ports.

In addition, the World Bank has been providing technical support to CMEA for the socialization of a number of logistics actions including prior actions in this DPL series and to CMEA and other agencies for the implementation of the prior action in this operation. In particular the World Bank has helped inform the design of prior actions in pillars A and B by providing legal and economic analyses of the actions, which inform both CMEA and the relevant line ministries including Ministry of Transport and Ministry of Finance. The TA program has also assisted the INSW in strengthening the risk management systems in non-custom agencies, developing service level agreements between the INSW and related agencies and more generally enhancing the capacity of the INSW staff. These TA programs would also continue beyond the DPL series, with a focus on the remaining barriers to entry in logistics markets, including in freight forwarding and the foreign ownership limits in various logistics markets, and on helping the INSW and related agencies implement the single submission and rationalize NTMs.

## 4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

36. **The second operation in the DPL series consists of 9 prior actions, all of which have been completed.** These actions are summarized in Table 4 below. Seven of the prior actions in this operation are identical or slightly modified versions of the triggers in the first operation; two prior actions are additional but build on prior actions in the first operation, and one trigger in DPL I was dropped due to the slow progress in implementation. Table A1 in Annex 1 details the changes between the DPL I's triggers and DPL II's prior actions. The result indicators reflect the combined outcome of the prior actions across the two operations and the time-frame for their targets taking into account the completion of all the actions in this operation. The full policy matrix across operations along with the result indicators is provided in Table A2 in Annex 2.

**Table 4 Prior actions, current status and analytical underpinnings**

| Objective | Policy | Status | Analytical underpinnings |
|---|---|---|---|
| ***Pillar A: Improving port efficiency and governance*** | | | |
| Improve the governance of ports by clarifying the roles of Port Authorities vis-à-vis port operators | BPKP has completed the asset inventory report for the ports managed by the Pelindos and the Auditor General of BPK has used the report to provide an independent assessment of the port concession agreements between Port Authorities and the Pelindos, as evidenced through BPKP letter dated June 10, 2016, the asset inventory report dated June 3, 2016 and BPK letter dated October 23, 2017. | Completed (October 2017) | WB (2015b) "RAS Port Development Priority Project and Financing Strategy"; World Bank (2013) "Port Reform Toolkit"; van Tuijll, D. (2017) "How to improve Indonesian port development", WB Policy Note |
| Facilitate the entry of cargo terminal operators | The Minister of Transportation has eliminated the minimum capital requirement to obtain a port business license, as evidenced through the Minister of Transportation Regulation No. PM 24/2017. | Completed (March 2017) | |
| Enhancing coordination of documentary and container examination in ports | The Borrower has integrated information from the Port Operators on the flows of documents and containers at the ports with the INSW system in Jakarta, Surabaya, Medan, Makassar and Semarang ports, as evidenced through the Head of INSW Portal Administrator letter No. S-19/INSW/2018 dated January 19, 2018. | Completed (October 2017) | WB (2015b) "RAS Port Development Priority Project and Financing Strategy"; OECD (2012) "Reviews Competition in Ports, Rail and Shipping"; Cubillos (2014), "Unlocking Indonesia's Potential International Connectivity: How to |

| Objective | Policy | Status | Analytical underpinnings |
| --- | --- | --- | --- |
| | | | Reduce Dwell Time in Tanjung Priok” |
| ***Pillar B: Enabling a competitive business environment for logistics service providers*** | | | |
| Improving competition in freight forwarding, storage and distribution services | The Minister of Transportation has simplified the licensing requirements of freight forwarders by: (a) reducing the minimum capital requirement for both domestic and foreign freight forwarders; (b) eliminating the location restrictions for foreign service providers; and (c) removing the requirement to obtain a recommendation by the freight forwarding association, as evidenced through the Minister of Transportation Regulation No. PM 49/2017. | Completed (July 2017) | WB (2015a) “Improving Indonesia’s Freight Logistics: A Plan of Action.”; WB analyses based on OECD STRI data; WB (2016) policy note on Logistics Services Providers; WB (2013) “Why are minimum capital requirements a concern for entrepreneurs”; Duggan et al. (2013) Service Sector Reform and Manufacturing Productivity : Evidence from Indonesia. WB Policy Research Working Paper 6349. |
| Improving competition in shipping and auxiliary shipping services | The Minister of Transportation has eliminated the minimum capital requirement for cargo handling operators, shipping agencies and maritime transport providers, as evidenced through the Minister of Transportation Regulation No. PM 24/2017. | Completed (March 2017) | |
| Reducing inventory costs of imported materials for producers | The Borrower has enabled Bonded Logistics Centers to carry out trans-shipment operations for all types of goods, as evidenced through the Director General of Customs and Excise Regulation No. PER-10/BC/2017. | Completed (June 2017) | WB (2015a) “Improving Indonesia’s Freight Logistics: A Plan of Action.” |
| ***Pillar C: Strengthening Trade Processing*** | | | |
| Facilitating traders' compliance with trade regulatory requirements | The Borrower has improved the organizational structure and governance of the INSW Portal Administrator by elevating the status of the INSW Portal Administrator as evidenced by the Presidential Regulation dated 31 May 2018. | Completed (May 2018) | Cubillos (2014), “Unlocking Indonesia’s Potential International Connectivity: How to Reduce Dwell Time in Tanjung Priok”; Nurridzki (2013), |

| Objective | Policy | Status | Analytical underpinnings |
|---|---|---|---|
| Facilitating traders' compliance with trade regulatory requirements | The Borrower has expedited import procedures for qualified importers by: (a) introducing the Customs Partner Status; and (b) creating clear rules and user-friendly procedures for qualified importers to obtain the Customs Partner Status, as evidenced through the Minister of Finance Regulation 229/PMK.04/2015, the Minister of Finance Regulation 211/PMK.04/2016 and the Director General of Customs and Excise Regulation No. PER-11/BC/2017. | Completed (June 2017) | "Analysis of pre-clearance: Case of selected products"; Rahardja (2015), "Openness in trade and investment: Putting the debate in Indonesia's development context"; WB (2015a) "Improving Indonesia's Freight logistics a plan for action"; ongoing WB TA supporting the INSW; WB (2017) Trading Across Borders Indicators |
| Improving risk management systems of border agencies | The Borrower has implemented the integrated risk management system by exchanging – through the INSW portal – information on the importers' risk profiles and tax compliance across four key border agencies, i.e. BARANTAN, BKIPM, BPOM and DGCE, and the Ministry of Health, as evidenced through the Head of INSW Portal Administrator Letter No. S-19/INSW/2018 dated January 19, 2018. | Completed (August 2017) | |

***PILLAR A - ENHANCING PORTS' PERFORMANCE***

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

37. **Rationale for prior action #1**: The first lending operation supported the signing of the concession agreements between the Port Authorities and the Pelindos, which has formalized the relationship between regulator and operator in the ports operated (and regulated) by the Pelindos (Annex 6 provides a summary of the concession agreements). The concession agreements have been instrumental in removing uncertainties related to the existing cooperation between the Pelindos and third parties. For example, the agreements have facilitated the extension of Indonesia's largest container terminal – the Jakarta International Container Terminal (JICT) - in Tanjung Priok for 20 years, resolving a critical dispute over the fate of the terminal between the Ministry of Transport and IPC. This increased certainty to investors bodes well to fill the large existing investment gap in ports.[28] In addition, the

[28] 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 (source: World Bank (2015b) "RAS Port Development Priority Project and Financing Strategy", mimeo).

concession agreements have provided the port regulator with a substantial and predictable stream of revenues that can strengthen its ability to lead infrastructure development.

38. Despite their important role, the terms of the concession agreements need to be further refined for two main reasons. First, at the time of the signing in 2015 there was still incomplete information on the existing fixed and movable assets present in each of the concession areas, which hampered the definition of what exactly was being concessioned out and of the price of the concession. Second, the concession agreements stipulate an exchange of services (by the concession provider) for fees and performance (by the concessionaire), which would have to be monitored in the course of the agreement.

39. **Prior action #1:** The Government has recently tried to tackle both issues with a view to improving the transparency, legitimacy and effectiveness of the concession agreements through two related actions (prior action #1). First, upon instruction of the Ministry of Transport, the Government Internal Audit Body (BPKP) has undertaken an asset inventory that details the assets present in the port working areas under the concession agreements which was completed in June 2016. Second, the External Audit Body (BPK) has used the inventory report as one of the bases to evaluate the terms of the concession agreements including the adequacy of the concession fee (currently set at 2.5% of gross revenues from the port operation) in relation to the services' commitments of both parties. The audit by the External Audit Body (BPK) is expected to be completed later this year.

40. **Expected results:** by providing an independent and authoritative assessment of the concession agreements this action should increase their legitimacy and accuracy. This should enhance their effectiveness in providing certainty to the port operations and generating additional revenues for the Port Authorities to fulfill their mandate. In addition, the monitoring by the Port Authorities of the operators' performance and its evaluation by BPK should further incentivize the Pelindos to improve the efficiency of their operations as recognized also through international certification of management systems. The strengthening of the concession agreements should also provide certainty to the Pelindos in their cooperation with other parties and, by freeing up more capital for the Pelindos, would enable additional investments whereby Pelindo could utilize its revenues to invest predominantly in immovable assets (port infrastructure), including by making them more resilient to risks from climate change, while other parties make investments in movable assets (equipment). Such investment in port improvements that also strengthen the infrastructure's climate resilience was evident in the case of IPC, which, following the concession agreements, revitalized the Bengkulu Port in 2016 by reinforcing and increasing the height of its berths, making them more operationally effective as well as more resilient to extreme rainfalls and raising sea levels. In addition, investments in port upgrades can also cater to alternative forms of shipping, including long-haul ferry services that replace freight transport by trucks. As an example, the current construction of the new port in Lombok (Lembar)

More recent estimates by the World Bank team 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.

includes design features to cater to large ferry vessels that provide these alternative shipping services. Once operational, these new ports will enable cargos to reduce distance traveled by roads (e.g. 350 km of road haul removed in the case of a RORO service between Surabaya-Bali[29]) and shift to maritime transport earlier. This could enhance operational efficiency of freight transport while substantially reducing its contribution to GHG emissions. At the same time, investment in equipment is vital to increase performance to optimally use existing port infrastructure. This is expected to be reflected in higher utilization rates which requires installation of more dedicated container handling equipment and deployment of larger vessels.

41. Two indicators are used to measure the expected results. The first is the increase in container handling equipment in the 10 largest secondary container ports (the largest ports outside the four main ports)[30], growing from 15 Ship-to-Shore Cranes (STS) and 34 Rubber Tire Gantry Cranes (RTG) in 2015 to 29 STS and 53 RTG by 2018/2019. The second indicator is the increase of the size of vessel deployed, where in 2015 only one of the 10 secondary ports received vessels larger than 2.000 TEU it is expected by 2018/2019 to increase to 7 ports. The first indicator measures the outcome of investments in berths to support STS cranes (newly constructed or strengthened) and the second indicator measures the outcome of dredging of access channels and basins.

42. In addition to the main result, this prior action may also have additional benefits in terms of helping to kick-start the discussion on the division of assets between Pelindos and the Port Authorities. The BPK evaluation will likely contain an opinion on the ownership of the assets listed in BPKP asset inventory. As BPK is bound by law to present its evaluations to parliament this will likely trigger the Government to discuss feasible actions towards the transfer of certain assets from the Pelindos to the Ministry of Transport thus complying with the spirit of the 2008 port reform and paving the way for more private sector participation.

***Facilitating the entry of cargo terminal operators***

43. **Rationale for prior action #2:** 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 limited alternatives if Pelindos' operations are inefficient as all port terminal operators are Pelindo-majority owned thus limiting the extent of intra-port competition. As argued in the first DPL Logistics project document, the introduction of the BOT mechanism along with the development of the

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[29] **Roll-on/roll-off** (**RORO** or **ro-ro**) ships are vessels designed to carry wheeled cargo, such as cars, trucks, semi-trailer trucks, trailers, and railroad cars, that are driven on and off the ship on their own wheels or using a platform vehicle.

[30] 10 ports are: Balikpapan, Bitung, Ambon, Tanjung Emas, Banjarmasin, Pontianak, Teluk Bayur, Jayapura, Ternate and Kendari, the 4 main ports are; Tanjung Priok, Tanjung Perak, Belawan and Makassar.

concession framework and the introduction of the availability payment scheme have facilitated the involvement of new players in the development and management of new ports and terminals. A case in point is the ongoing development of a green field port terminal in Muaro Jambi based on a BOT type concession agreement given by the Ministry of Transport to the private company PT. Wahyu Samudera Indah in October 2016. Despite this progress an important entry barrier to the sector was still the high level of minimum capital requirement to obtain the Port Business license, which up to 2016 was set by the Ministry of Transport at Rp. 1 Trillion (around USD 75 million) for main ports, Rp. 200 billion for collector ports and Rp. 25 billion for feeder ports. The regulation also establishes that 25% of this capital has to be paid up. 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. These requirements act as important barriers to entry in the port sector as they negatively affect cash flows, and may even make the entire investment unviable altogether. That is particularly the case given the relatively small size of ports in Indonesia. The paid up capital required can outstrip the infrastructure investments required to upgrade most Indonesian main ports, and to increase their operational efficiency. In addition to acting as a barrier to trade, inefficient ports and terminals lead to higher contribution of ports to climate change through redundant and lengthy port procedures that lead to high energy consumption (fuel, electricity etc.) from both stationery sources (such as port-own buildings etc.), and mobile sources (such as employee commute vehicles, ships, trucks, cargo handling equipment, harbor craft etc.), thus generating larger amounts of greenhouse gas emissions.[31]

44. **Prior action #2:** The Government has reduced barriers to entry in the port sector by eliminating the burdensome minimum capital requirements to obtain the Port Business License for all categories of ports. Hence funds do not have to be deposited as paid up capital, and the freed up funds can be used by port investors to expand their investments. This action can also help expand the use of BOT concessions and the related availability payment scheme supported by the first operation.

45. **Expected results:** Along with the related prior action in the first operation this action should increase port service providers' ability to invest through the BOT scheme in container terminals, including particularly in secondary ports. This could also help private investments to become an important complement to public port investments in filling the infrastructure gap, thus also contributing to the new WBG's *MFD* approach. The development of new ports by new operators would put competitive pressure on Pelindos' operations, especially as they – unlike Pelindos - are not burdened by the requirement of cross-subsidizing commercially non-viable ports, which reduces the ability to invest in commercial ports. The pro-competitive effects of additional port investors may materialize even sooner than the team expected at the beginning of the DPL series, when the result indicator's target was at least 3 BOT concessions granted for new port development within two years from the completion of the actions. This target has already been surpassed at the time of writing with 6 concessions granted for new ports and terminals for estimated investments of USD 3 billion. Compared to the older-generation port infrastructure, these new ports and terminals developed by the

[31] International Association of Ports and Harbors (IAPH). IAPH toolbox for ports clean air program (2008)

private sector are expected to represent significant infrastructure upgrade for the port sector– especially from the improved environmental sustainability and climate-resilience perspectives-- as they will need to comply with the environmental impact assessment process (AMDAL) that requires construction of new docks and berths to consider all potential changes from siltation, hydrological systems and ecosystems, including from climate risks, and encourages the developers to address these risks through design and management plans.[32] After the expiration of the BOT concession 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 and the accompanying technical assistance described above is an important complement for the efficacy of this reform.

46. The increased competitive pressure from the additional port operators – including private companies – is also likely to generate positive environmental spillovers in two ways. First, construction of new private terminals should expand the existing port infrastructure, which currently constrains the development of ferry services for freight as an alternative to road transport.[33] By replacing trucks, these alternative ferry services are less GHG emissions intensive. For example, since mid-2017 the ferry service between Jakarta and Surabaya has allowed to take 160 full length trucks per day off the coastal road of Java, substantially reducing GHG emissions from freight transport. Second, the DPL is also expected to improve operational efficiency and reduce GHG emissions from cargo handling equipment. In particular the need to achieve operational efficiency would help shift port operations from on-ship cranes, which are currently used in the majority of Indonesian ports, to more efficient dedicated shore cranes. The latter can make on average 25-30 moves per hour compared to the 10-15 moves per hour of ship cranes leading to a sizeable reduction in emission per container $m^3$/tons when using shore cranes.

***Enhancing coordination of documentary and container examination in ports***

47. **Rationale for prior action #3:** Waiting time for ships to enter the port is a major issue in many Indonesian terminals.[34] In major domestic and international gateways, such as Tanjung Priok and Tanjung Perak, delays in and around ports are partly caused by lack of coordination between operators, including trucks, terminals and control agencies.[35] 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, the movement of cargo in most ports is not

[32] Ministerial regulation from the State Secretary no 05/2012 (Para F, section 4. a).
[33] In the last two years, service providers have emerged to cater to this demand by providing long haul ferry services such as between Jakarta – Surabaya, Jakarta – Lampung (Sumatra) and Surabaya – Lembar (Lombok), substituting land transport over long distances. Several new routes are being contemplated such as Jakarta – Pontianak, Surabaya – Bali and Surabaya – Banjarmasin.
[34] OECD Reviews of Regulatory Reform, Indonesia, Regulatory and Competition Issues in Ports, Rail and Shipping (2012).
[35] World Bank (2015a). Improving Indonesia’s Freight Logistics System: A Plan of Action.

well monitored by all relevant agencies due to the absence of proper systems linking the physical movements of cargos and the progress on the documentary compliance associated to the cargo. This leads to delays in moving the cargo through the various stages of the Customs clearance process within the port. Congestion of port access roads are a common outcome of such delays, leading to high levels of fuel consumption by trucks and other vehicles accessing the ports and therefore of GHG emissions.

**Prior action #3:** The first DPL supported a Government action that started addressing this issue by mandating the roll out of the proprietor port community system INAPORT – composed of both vessel management and cargo tracking modules - in 16 main ports and its link to the INSW system. This integration between the INAPORT and the INSW should connect all of the border agencies responsible for checking documentary requirements of the shipments. While the vessel module has been fully implemented by the Ministry of Transport in all main ports, INAPORT cargo module is still under development. Hence instead of using the INAPORT cargo module, the Government has integrated the information on cargo movement from the port operators with that on the documentary compliance process through the INSW portal in the four main ports (Tanjung Priok, Tanjung Perak, Belawan, Makassar) as well as Semarang (prior action #3). This integration allows all of the INSW participating agencies to track in real time at what point of the physical and documentary process the cargo is within the port (i.e. discharge, stacking, receipt of custom application, issuance of Customs' permit, issuance of each of the other agencies' permits).

48. **Expected results:** The implementation of the cargo module of INAPORT allows to improve certainty in scheduling of shipment, cargo pick-up from ports thus reducing GHG emissions generated by high fuel consumption from trucks' congestion, and 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. In addition, the integration of the cargo movement information with INSW enables tracking and tracing of 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.

### *PILLAR B - IMPROVING LOGISTICS SERVICES*

#### *Improving competition in freight forwarding, storage and distribution services*

49. **Rationale for prior action #4:** Freight forwarders, storage and distribution services a play key role in determining 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.[36] These providers, especially international ones, have the potential to bring global best practices to local manufacturers.[37] Therefore the increase in the maximum foreign equity

[36] 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.
[37] The World Bank. Freight Transport For Development toolkit: Integrated Logistics Services

limits in these services supported by the first DPL has addressed an important constraint to the development of these providers. Despite these improvements entry to freight forwarders markets is hampered by other significant barriers. The first type of barriers includes 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).

50. 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 requirements are unlikely to protect consumers and creditors from hastily established and potentially insolvent firms.[38] 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. Secondly, foreign freight forwarders' 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. Finally, the issuance of the freight forwarders' license requires the recommendation from the Indonesian Freight Forwarding Association (ALFI) about the fitness of the new entrant. This requirement effectively gives the association representing the incumbent businesses the power of restricting the entry to potential competitors thus creating a prominent (and unusual) barrier to entry.[39] It also directly increases the costs of a license as the recommendation is costly (USD 1,200 for domestic and USD 2,900 for foreign freight forwarders).[40] These requirements contribute to make Indonesia the most restrictive on freight forwarding services among the countries surveyed by OECD, both overall and in terms of barriers to competition (Figure 3).

51. **Prior action #4:** The Government has recently substantially reduced the barriers to entry into freight forwarding markets by: (a) reducing significantly the minimum capital requirements for foreign (from USD 10 to 4 million) and domestic companies (from around USD 1.8 million to USD 150,000)[41]; (b) removing the location restrictions to foreign equity

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[38] 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.

[39] It also gives the association further powers of scrutiny vis-à-vis the new entrants, such as the right to check the applicant's strategy and financial situation, with a request to have an end of month account balance of at least a minimum of USD 88,889 (IDR 1.2 billion), and the right to request evidence of the minimum capital deposit required by the regulation.

[40] These amounts include membership base fee, 6 month of membership monthly fee, and the administrative recommendation fee.

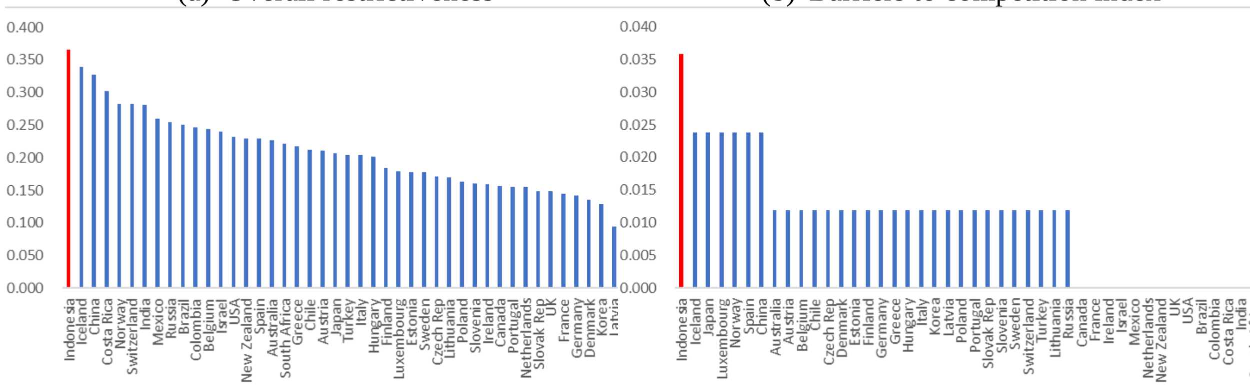
[41] The exact amount in the previous regulation was IDR 25 billion which was then eventually reduced to IDR 2 billion.

firms, and (c) eliminating the compulsory recommendation from ALFI to obtain the freight forwarding license (prior action #4).

52. **Expected results:** Combined with the increase of foreign equity limits in 2016, this prior action would lead to increased competition in freight forwarding including also by encouraging foreign investments in the sector. While minimum capital requirements for foreign freight forwarders are relatively still high by international standards, their reduction appears to be meaningful and can be seen as a stepping stone to further reductions in the near future. When considered together with the accompanying elimination of other licensing requirements, these reforms make for a substantial reduction in barriers to entry for both foreign and domestic freight forwarding companies. The expected direct effect is to increase the number of new freight forwarding licenses (inducing entry) as well as to reduce the share of licenses which are not renewed (preventing exit).[42] This in turn would foster competition hence reducing prices and/or increasing the quality of these key logistics services. This action should also help Indonesia to abandon the ranks of the most restrictive country in freight forwarding services in the OECD STRI database.

**Figure 3: Restrictiveness indices in freight forwarding services, 2016**

(a) Overall restrictiveness (b) Barriers to competition index




*Note: values vary between 0 (minimum level of restrictions) and 1 (maximum level of restrictions) for STRI and between 0 and 0.250 for the barriers to competition index.*
*Source: OECD Services Trade Restrictiveness Index (STRI) Database*

### *Improving competition in shipping and auxiliary shipping services*

53. **Rationale for prior action #5:** Shipping agents, maritime cargo handling companies and shipping lines provide the bulk of maritime shipping services. Shipping agents act as intermediaries between the ship owner and the port stakeholders and between ship owner and the customers. In addition, they also promote ship owner's services. Maritime cargo handling companies are responsible for loading and discharging activities of the ship, including safely

[42] Indeed some of the reduction in entry barriers have already been associated with an increase in new foreign licenses from 7 in the first 6 months of 2016 to 16 in the same period in 2017, which is a significant share of foreign freight forwarders currently operating in Indonesia (note that that is an appropriate comparison period especially for the capital requirement reduction, which occurred in October 2016).

securing the cargo on board, discharging and loading of cargo, delivering and picking up cargo at the warehouse. Finally shipping lines carry out the maritime transport service and they depend on local maritime cargo handling firms to execute these vital services. Until recently these services were subject to a host of high barriers to entry including also restrictions to foreign investments. These in turn limited competition in these services markets contributing to the relatively low quality of services especially outside of the main ports and the outdated capital equipment used by the providers.[43] These factors contribute to the slow turnaround of vessels and the higher risk of cargo damage especially in smaller ports. Inefficiencies generated by shipping lines and cargo handling companies can also contribute to climate change by increasing direct GHG emissions from ships due to longer waiting time at each stage of the turnaround time, and indirect emissions due high energy consuming- low productivity cargo handling equipment.

54. The first operation supported actions aimed to reduce barriers to entry into these markets, including eliminating the requirement for ship ownership for shipping agencies – hence fostering the development of independent pure shipping agencies - and increasing maximum foreign equity limits for maritime cargo handling companies. However, until this year high minimum capital requirements still restricted entry into these sectors (Table 5). For example, maritime transport companies must have had a capital of at least USD 450,000 (as shipping agencies) if domestic and USD 750,000 if in a joint venture. Given that at least 25% of this capital had to be paid upfront, this effectively reduced the resources available to invest in much needed new capital equipment in capital intensive services as maritime transport and cargo handling services. These requirements may be even less justified for shipping agencies as their operations entail a relatively low level of investments. Such requirements helped make Indonesia one of the countries with the highest restrictions to competition among those surveyed by the OECD in 2016 (Figure 4).

**Table 5: Minimum capital requirements for selected maritime logistics providers up to Dec. 2016**

| | **Minimum capital requirements** | | **Paid up deposit** | |
|---|---|---|---|---|
| | IDR (mln) | **USD** | IDR (mln) | **USD** |
| ***Maritime transport companies*** | | | | |
| Domestic | 6,000 | 444,444 | 1,500 | 111,111 |
| Joint-Venture | 10,000 | 740,741 | 2,500 | 185,185 |
| ***Shipping agencies*** | 6,000 | 444,444 | 1,500 | 111,111 |
| ***Maritime Cargo handling companies*** | | | | |
| Domestic (Main port) | 4,000 | 296,296 | 1,000 | 74,074 |
| Domestic (Collector port) | 2,000 | 148,148 | 500 | 37,037 |
| Domestic (Feeder port) | 1,000 | 74,074 | 250 | 18,519 |

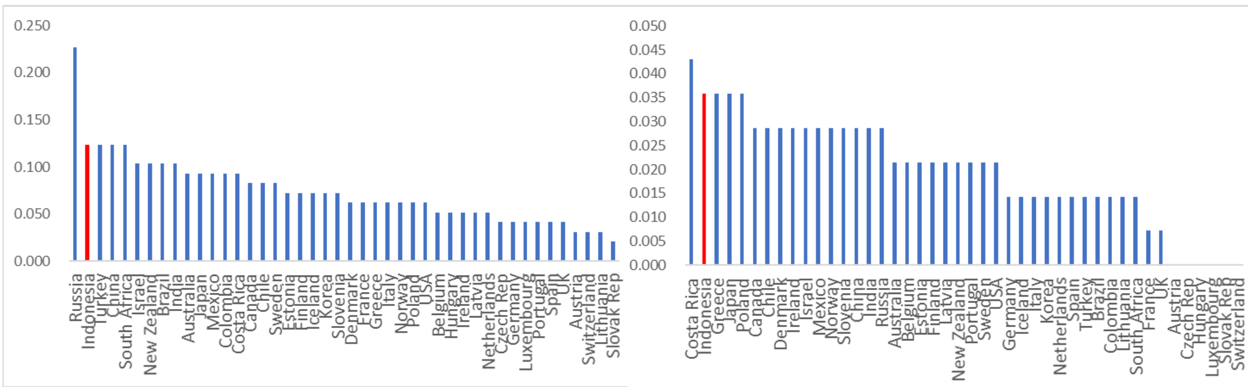
[43] World Bank (2015b) "RAS Port Development Priority Project and Financing Strategy", mimeo and Putrahardja, J.S. (2012). "Labour at Indonesia's Ports: The Role of Cooperatives", Prakarsa: Journal of the Indonesian Infrastructure Initiative, Issue 10.

| | | | | |
|---|---|---|---|---|
| Joint-Venture | 10,000 | 740,741 | 5,000 | 370,370 |

*Note: exchange rate applied is USD 1 = IDR 13,500.*
*Source: Ministry of Transport PM93/2013; PM 60/ 2014 and PM 11/2016.*

**Figure 4: Barriers to competition in logistics cargo handling and maritime transport services, 2016**

(a) Logistics cargo handling (b) Maritime transport




*Note: values vary between 0 (minimum level of restrictions) and 0.250 (maximum level of restrictions)*
*Source: OECD Services Trade Restrictiveness Index (STRI) Database*

55. **Prior action #5:** The Ministry of Transport has acknowledged the obstacles that these high minimum capital requirements entail to enter the sectors and has eliminated the capital requirements on maritime cargo handling, shipping agency and maritime transport services. This change also eliminates the discrimination in barriers to entry between domestic and foreign providers, which was in contradiction with the DNI, thus reducing the uncertainty in the application of the regulatory framework.

56. **Expected results:** Combined with the reduction in the restrictions to foreign investments and to the operations of shipping agencies, these actions are expected to increase the number of independent shipping agencies, the number of maritime transport companies and maritime cargo handling companies, both domestic and foreign owned. This in turn should increase the efficiency and/or decrease the price of these services, including also the timeliness of domestic trans-shipment, and thereby reducing maritime transport costs.[44] Furthermore, shorter vessel turnaround time would help reduce direct emissions in Indonesian ports, whereas freed-up capital could encourage maritime cargo handling companies to invest in more energy efficient equipment, thus reducing indirect GHG emissions.

***Reducing inventory costs of imported materials for producers***

57. **Rationale for prior action #6:** A substantial share of the inputs imported by Indonesian industries as well as of the products exported by Indonesia have been stored until recently in

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

warehouses in neighboring countries, including Singapore and Malaysia.[45] 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 higher in Indonesia than in other competitors in the region.[46] The recent introduction of bonded logistics centers (BLC) - supported by the first operation - has partly addressed this problem by providing Indonesian producers with a facility where they could temporarily store at arms' length imported inputs used in the production of items for later export, such as textiles, apparel, food processing and automotive parts and manufacturing. Climate change is also believed to increase the risk for hydro-meteorological disasters, such as floods and droughts, which make up to 80% of disaster occurrences in Indonesia[47]. In the event of these climate-induced disasters, availability of food and construction-related commodities is paramount, and BLCs could also be used to provide quick relief for disaster and post-disaster recovery, by drawing on the stock of goods stored in there. While these facilities have filled an important gap in the logistics operations of Indonesian producers, the BLCs initially catered only to imported inputs for use of domestic producers without appropriate regulations for smooth re-export of those goods and without the possibility of using the BLCs for final goods. This has been an important gap given that trans-shipment – especially of final goods - can help develop efficient logistics services, as that has been the case for instance for Singapore and Hong Kong.

58. **Prior action #6:** Building on the introduction of the BLCs, the Government has enabled the BLCs to carry out trans-shipment operations for all types of goods (prior action #6). This regulation effectively allows the use of BLCs as international logistics hubs by facilitating the re-export of raw materials, semi-finished and finished goods through BLCs. The goods can be imported into the BLCs also in the absence of a final destination and there they can be stored for a period of 3 years (renewable for another 3 years), thus providing flexibility for the trans-shipment operations. This is also the first attempt to provide a legal framework to regulate trans-shipment in Indonesia.

59. **Expected results:** The success of the BLCs is already apparent and in July 2017, just over a year from the issuance of the regulating framework, 43 companies were running 58 BLCs operating across Java, Sumatera, Kalimantan and Bali. Interviews with users suggest that these zones have induced gains in terms of time and cost savings and increased reliability of inputs. The expansion of the BLCs' scope to include trans-shipment of all goods can further promote gains in domestic logistics operations through two channels. First, the opportunity of trans-shipment can lure more logistics providers that may use Indonesia as a logistics hub

[45] 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.
[46] World Bank (2015a). Improving Indonesia's Freight logistics: A Plan of Action.
[47] Indonesia's Intended Nationally Determined Contributions

alternative to more expensive options in the region.[48] This increased entry could lead to efficiency gains in logistics services thus lowering costs and/or increasing quality of the services. Second, to the extent that the trans-shipment business could expand the scale of the BLCs operations in Indonesia, this may also increase negotiating power for Indonesian buyers of certain imported products, thus further reducing the costs of supply. In addition, expanded BLC operations would also contribute to long term climate risk management of supply chains in Indonesia by building in geographical variation and redundancy, moving away from concentration of supply chain facilities in only few hazard-prone locations.[49] Additional volumes stored in BLCs would also enable quick response to climate and non-climate induced disasters.

### *PILLAR C - STRENGTHENING TRADE PROCESSING*

#### *Facilitating traders' compliance with trade regulatory requirements*

60. **Rationale for prior action #7:** 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 it is supposed to act 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, and then get directed to the websites of the relevant Ministries and Agencies responsible for the approvals without the need to again log into the various agency systems. 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.

61. To overcome these problems, the INSW and participating agencies have started moving towards the implementation of a single submission system. The system should allow all agencies to use the same master data set and allow simultaneous processing by all relevant agencies. Agencies would in turn extract the relevant data necessary for their regulatory requirements. This would eliminate duplication in data entry, reduce errors and speed up trade processing as agencies would 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. Moreover, the lack of a strong institutional

[48] Anecdotal evidence collected by the World Bank team suggests that at least one third party logistics service provider, has already moved its Asean transshipment hubs from Singapore and Tanjung Pelepas to Bali as a result of the new regulation.

[49] Mckinsey (2015). "How companies can adapt to climate change?" (https://www.mckinsey.com/business-functions/sustainability-and-resource-productivity/our-insights/how-companies-can-adapt-to-climate-change)

form prevents it from issuing regulations and administrative directions necessary to direct the management and further development of the INSW.

62. **Prior action #7:** 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. To overcome this problem the President has improved the INSW Portal Administrator's organizational structure and governance by elevating the status of the INSW to become an echelon-level agency with regulatory powers reporting to the Minister of Finance (prior action #7). This change in status also enables the INSW to review the extensive stock of NTMs maintained by Indonesia to streamline and rationalize their use, an activity with high returns.[50] The World Bank has also been supporting the achievement of this action through extensive technical assistance to the INSW.

63. **Expected results:** This upgrade reinforces the prior action supported in the first DPL to achieve a more timely and complete update of trade related regulations in the Indonesian national trade repository, which underpins the ultimate role of the INSW as the single entry point for traders. In addition, elevating the status of the taskforce would enable the INSW to play a more active role in screening the contents newly proposed trade regulations and to facilitate the full implementation of the single submission system through a more effective coordination of the participating agencies. This would also include the ability of the INSW to issue regulations that would allow for instance the exchange of information between each agency and the ISNW, which currently hampers the single submission implementation.

64. **Rationale for prior action #8:** Pre-clearance and Customs clearance are responsible for almost the entirety of dwelling time – the time between the arrival of the ship in port to the exit of the cargo out of the port's gate - in Indonesian international ports.[51] The pre-clearance stage refers to all activities between the arrival of the ship and submission of the import declaration form (PIB) to Customs. During this time all of the supporting documents must be presented by the trader to the Customs. These may include certificates of origin, import permits and licenses, payment of fees and for certain restricted goods such as foodstuffs or pharmaceuticals, other documents may be required, such as specific import license, a phyto-sanitary certificate, or a proof of fumigation from the country of origin to obtain a preferential duty rate. For each new import declaration PIB, Customs reconcile payment information of import duty in the PIB with information from the bank system. Gathering all of these documents and checking them is time consuming and often lead to delays in the PIB submission. In addition, Customs has to check the completeness and validity of the submitted documents before providing clearance, which further lengthens the process. These multiple procedures contribute to much lengthier border documentary checks in Indonesia than in countries as Thailand and Malaysia, as measured by the Doing Business Indicators.

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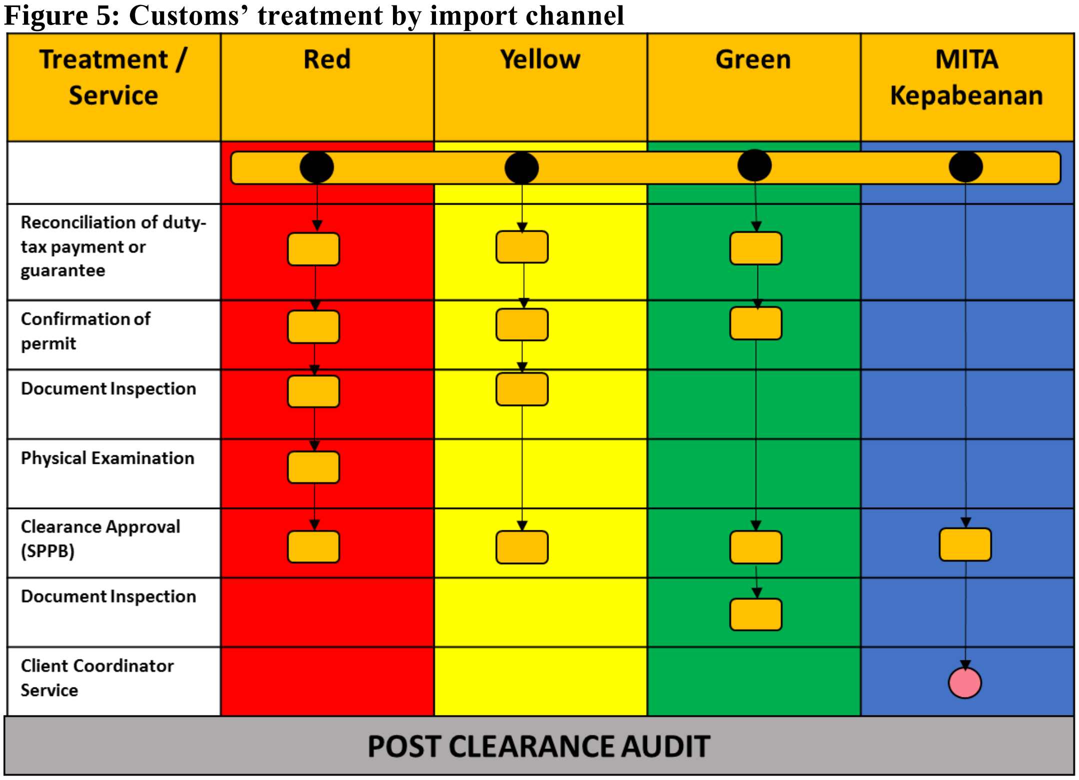
[50] Cadot, O., M. Malouche and S. Saez (2012). "*Streamlining NTMs: A toolkit for policy-makers*", Washington: The World Bank.
[51] See Cubillos (2014) and Nurridzki (2013).

65. **Prior action #8:** Recognizing the importance of facilitating documentary submission and checking the Government had created special channels for pre-approved importers, including MITA prioritas and non prioritas, relieving them of much of the burden of documentary checking. These importers comply with a specific set of Customs requirements, including exemplary tax history records, minimum capital limits, and recurrent import of goods, among others. Recently DG Customs consolidated these special channels under a Customs partner status with an even easier documentary compliance (Mitra Kepabean Utama, the new MITA) and created clear rules and user-friendly procedures to expand the granting of this status to qualified importers (prior action #8). These Customs partner importers benefit from deferred payment of import duties and taxes that they pay on a monthly rather than on a transactional basis as the other importers. They are also not subject to the verification by Customs that the permits included in the PIB application match those posted by relevant agencies into the INSW, as they are instead screened and audited by Customs on a periodic basis (

66. Figure ). Because of these exemptions MITA importers are the only ones allowed to complete the pre-clearance procedures before the arrival of the shipment in port. They are also exempted from submitting the original Certificate of Origin after Customs' clearance for those shipments covered by a free trade agreement.[52] Finally, they are the only importers not subject to any physical inspections during the clearance process.

**Figure 5: Customs' treatment by import channel**




*Source: World Bank's elaboration on DG Customs information*

[52] For MITA importers, the submission of the original Certificate of Origin is due before the 10th of the following month.

67. **Expected results:** The recent introduction of the Customs' partner status and the related simplified procedures to gain the status have allowed DG Customs to expand to 264 (from the previous 170 MITA Prioritas) the universe of beneficiary importers in a few months. This expansion in MITA importers allows to cover already more than a quarter of imports in the main port (Tanjung Priok)[53] and it should lead to a significant decrease in dwelling time in international ports as MITA importers enjoy much shorter dwelling time relative to the next most privileged importer channel – i.e. the green channel.[54]

***Improving risk management systems of border agencies***

68. **Rationale for prior action #9:** 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.[55] 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 Indonesia's food and drug agency 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 enable the shipment to 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.[56] A further effect of long dwelling time of cargo in ports leads to additional GHG emissions, due to higher fuel consumption to handle cargo between inspection and storage facilities, and additional energy consumption for temperature-controlled cargo requiring refrigeration facilities (reefer plug).

69. **Prior action #9:** In an effort to improve risk management systems the Government has launched a program of risk management integration through the sharing of information on

[53] The combination of Customs partner importers with the 46 Authorized Economic Operators, which benefit from the same treatment, covers 27% of import volume and 30% of taxes and import duties in Tanjung Priok in February 2017 (source: DG Customs).
[54] Using Indonesian Customs data from 2014, Cubillos (2014) estimates that MITA Prioritas importers experienced on average a 25% shorter dwelling time than green channel importers. As the import procedures for the new MITA importers have further simplified it is plausible to assume that this could be a lower bound estimate of the current reduction in dwelling time when moving from green lane to the Customs' partner status.
[55] 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.
[56] 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.

importers across border agencies/ministries. This integration process was kick-started also with the support of the first DPL, with the Minister of Coordinating Economic Affairs instructing the agencies to introduce the single risk management under Customs leadership. After a successful pilot to test the concept Customs, the Fish Quarantine Agency, the Agriculture and Plant Quarantine Agencies, the Food and Drug Agency and the Ministry of Health have recently started exchanging information on the risk profiles of importers, which can be accessed through the INSW portal along with information on the importers' tax compliance from DG Tax (prior action #9).

70. **Expected results:** The availability of the risk profile information across the four key INSW agencies and DG Tax should improve their accuracy in assessing the risk of importers by relying on a larger amount of information than previously available. In fact, to the best of our knowledge Indonesia is one of the first countries to implement systematically such risk information sharing while also adding tax compliance. This integration of risk profiles should improve the cargo targeting and reduce the need for excessive levels of physical inspection. Thus, risk inspection rates per consignment should fall.[57] These efforts should also ultimately reduce the overall dwell time in ports, and consistent with international evidence, they should translate into decrease in fuel and energy consumption, and as a result GHG emissions, and into economic gains through higher volumes of imports and exports. The outcomes of this initiative also critically rely on the risk management capabilities of individual participating agencies/ministries. To that end the World Bank has been supporting this effort through technical assistance on risk management to these border agencies except Customs, whose risk management capabilities are deemed well developed. This assistance has for instance helped establish the first dedicated risk management team in the Fish Quarantine Agency.[58]

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

71. **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.

72. **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

[57] 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.
[58] This was established in November 2016 through Fish Quarantine Agency Regulation No. 85/KEP-BKIPM/2016.

problem. IFC interventions target the ‘hardware’ (i.e. the infrastructure) gap in logistics, including the IFC’s loan to support the Jakarta International Container Terminal. This intervention complements 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. In this sense, the DPL series contributes to the new WBG’s *MFD* approach. 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 Transport and Ministry of Trade).

## 5. OTHER DESIGN AND APPRAISAL ISSUES

### 5.1 POVERTY AND SOCIAL IMPACT

73. **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.[59] In addition better logistics performance reduces prices for consumer goods in net importing areas, especially for food, and increased access to services.[60]

74. **This international evidence of improving logistics performance bodes well for an archipelago like Indonesia** (see Table A3 in Annex 5)**.** 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.[61] 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 improved logistics and given their labor intensity, this should provide a further boost in poverty reduction. Furthermore, by implementing trade facilitation measures such as

[59] 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.

[60] See for instance Varela, G, Calì, M, U. Pape and E. Rojas (2016), Market integration and poverty: Evidence from South Sudan, World Bank Policy Research Working Paper 7564.

[61] 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.

enhancing transparency through the INSW, the DPL could also help foster the development of trading companies owned or managed by women, thus contributing to women's economic empowerment.[62] That is because lack of information of border and trade regulations is usually more common among female than male traders.[63]

75. **Simulation results confirm that some of the reforms implemented in this DPL series have a significant net poverty reducing impact.** World Bank estimates – presented in Box 1 above - suggest that the elimination of the IP/IT requirements for importers (PA # 7, DPL I) and the electronic submission for BPOM import permit (PA # 10, DPL I) have reduced import prices of the affected products by 6.7% and 8.4% respectively. Matching these reductions in prices with households' consumption data, the World Bank estimates that these two reforms generate a reduction in poverty rate of 0.63 percentage points as households' consumption baskets become less expensive.[64] This is equivalent to around 1.6 million individuals lifted out of poverty mainly as a result of the IP/IT reform, which affects almost a quarter of the food consumption of the bottom quintile. Recent work show that significant poverty effects are expected also from port infrastructure upgrading of the type facilitated by the DPL reforms in Pillar A. In particular since 2004 upgrading of secondary ports in Eastern Indonesia, such as berth extensions and equipment modernization, are shown to significantly reduce local inflation as well as its volatility.[65] This reduction in inflation is estimated to reduce the poverty rate at the provincial level by 1.5 percentage points by 2022.[66]

76. **While improved logistics is likely to generate net poverty and social gains in Indonesia, it may also have small 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 or climate-induced 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.[67] Hence the targeted use of policy instruments like social

[62] The share of traders in Indonesia, where women are either shareholders or top managers are 26.4% and 38.2% respectively (source: Indonesia World Bank Enterprise Survey 2015).
[63] Higgins, K. (2012) "The Gender Dimensions of Trade Facilitation and Logistics", Report for World Bank, April, Washington DC: World Bank.
[64] The computations are based on the March wave of the Indonesian household survey (SUSENAS) which includes approximately 70,000 households. The estimation is performed by calculating the change in real expenditures needed to maintain the same level of utility of the households given the reduction in prices of the relevant goods due to the DPL reforms. The estimation incorporates also substitution effects between goods as a result of the price changes. More details are available from the team leader upon request.
[65] Serhalawan, P. (2017). "Assessment of the Benefits of Improving Ports in Eastern Indonesia", Jakarta: The World Bank.
[66] Lain, J. (2018). Port Upgrading: Forecasting Poverty Effects, mimeo, Jakarta: The World Bank.
[67] 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.

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.

77. **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.[68] 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

78. **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 A3 in Annex 5). While all of the actions are likely to carry little environmental impact, the reforms in the port sectors may have indirect environmental impact as they may facilitate port infrastructure investments, and build resilience to natural disasters. 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.

79. **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

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

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.

80. **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.

81. **Mitigation of the weaknesses in the country system will require improvements that will need to be accomplished incrementally, some of which can be started in this DPL.** These improvements 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 is supporting a number of Port Authorities by providing at least part of this capacity building in the short term. In addition, these series are providing technical assistance to IPC (Pelindo II) and to the Port Authority in Tanjung Priok to design and implement a functioning Ship Waste Management system (SWM) thus addressing an important gap in the current port system. Once operational in Tanjung Priok, the SWM could be used as a model for other Indonesian ports.

### 5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

82. **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**.

83. **Steady progress has been made in recent years in Indonesia's public finance management system, including increased transparency and independent oversight**. The last successive assessment of the Public Expenditure and Financial Accountability (PEFA) was conducted in 2012, following a first assessment in 2007. An assessment using the new PEFA 2016 framework is underway and is expected to be issued during this year. The results of the 2012 report 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). The implementation of the Treasury Single Account for revenue and expenditure since 2010 significantly improved the cash management, accounting and reporting systems. 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. The 2016 GOI financial statements have received a clean opinion as opposed to qualified opinion since 2009 and a disclaimer before. In FY 2016, 74 out of 88 central agencies (84%) had unqualified opinion. 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. On completion of the 2016 PEFA assessment, the Bank and GoI will work together to develop a new PFM reform roadmap to improve the low PEFA scores.

84. **The foreign exchange control environment is assessed to be generally satisfactory**. BPK expressed an unqualified opinion (again) on Bank of Indonesia (BI) financial reports for FY2016. 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.

85. **The borrower is the Republic of Indonesia and this operation is a single-tranche IBRD loan of US$ 300 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 terms of the loan is an IBRD Flexible Loan with Fixed Spread with a grace period of five years and total repayment period of 20 years, in US Dollars.

86. **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 60 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 the General Conditions for IBRD

Financing: Development Policy Financing (2017) (General Conditions). If any portion of the loan is used to finance ineligible expenditures as so defined in the General Conditions, 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

87. **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 and Ministry of Transport. Monitoring of progress on indicative triggers and result indicators have been done on a regular, quarterly basis and coordinated by the CMEA and INSW for the trade processing side. We have been using the Bank's technical assistance program to the INSW to help gather the relevant data and set up the reporting system. It is expected that all the prior actions will be completed by Q1 of 2018 and the operation will go to the Board in Q2 of 2018 with a closing date of Q4 of 2018, which means the ICR completion by late 2019-early 2020. The team has also been complementing the secondary data available with specific data collection through a survey among manufacturers of their logistics operations.

88. **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.[69]

## 6. SUMMARY OF RISKS AND MITIGATION

89. **The overall risk rating of this operation is moderate.** Main risks are the following: (a) political economy and governance challenges, (b) stakeholders risk and (c) the weak institutional and implementation capacity. These risks, if materialized, could negatively impact the Government's willingness and ability to achieve the intended positive results of the DPL series (even if all of the prior actions are completed). Furthermore, these risks could

[69] 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.

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

90. **Political and Governance:** Improving port efficiency, strengthening the business environment for logistics service providers and making trade processing more transparent and efficient are all priorities for the Government. However, there is no Government-wide consensus on how to achieve these objectives. There are two Coordinating Ministries respectively for Economic Affairs and Maritime Affairs that are responsible for various parts of the logistics agenda but do not always propose the same strategies to address high logistics costs in Indonesia. This may matter in this context. For example, the Ministry of Transport is a key line ministry to this reform agenda, which operates outside the realm of the Execution Agency of the DPL Logistics as it falls under the Coordinating Ministry of Maritime Affairs. In addition, the coordinating role of these Ministries face challenges as line Ministries are not bound to the coordinating Ministries' decisions. This poses risks to achieving the results of the reform program to the extent that the DPL reforms are discussed with and owned only by CMEA. There are three factors that mitigate this risk. First, many of the proposed actions have also been included in the Economic Policy Packages coordinated by the office of the DPL main counterpart in CMEA. This provides greater legitimacy to the reform agenda making it more difficult to reverse it, at least during the current Presidency. Second, the team has sought to extend the DPL policy discussions as much as possible beyond CMEA, discussing the proposed reforms with the responsible line ministries and agencies (including Ministry of Transport, Coordinating Ministry of Maritime Affairs, Ministry of Finance and INSW). In particular the team has strengthened the cooperation with the new DG Sea Transport to assist in the implementation of the reforms in pillars A and B, as well as with the DG Customs and INSW team on the implementation of Pillar C reforms. This cooperation includes the expansion of the Bank's technical assistance to these agencies both in terms of advisory services and capacity building.

91. **Stakeholders' risks:** Given their so far dominant role in the port sector, the Pelindos 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 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.

92. **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 relative weakness of the Port Authorities may undermine the success of the reforms in the port sector as highlighted above. To that end the Bank has been working with the Ministry of Transport and the AfD to help strengthen these institutions through a TA program focusing on the regulator function of the Port Authorities linked to the DPL. 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 portal administrator. To mitigate this risk further the World Bank has been implementing a substantial technical assistance program to support the INSW and some of the INSW participating agencies in their efforts to ensure the successful implementation of the reform program.

**Table 6: 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 | M |
| 4 | Technical design of project or program | L |
| 5 | Institutional capacity for implementation and sustainability | S |
| 6 | Fiduciary | M |
| 7 | Environment and social | M |
| 8 | Stakeholders | S |
| 9 | Other | n/a |
| | Overall | M |

*Source:* World Bank staff.

## ANNEX 1: CHANGES TO TRIGGERS IN DPL I RELATIVE TO PRIOR ACTIONS IN DPL II

| **Table A1: Status of DPL 2 Triggers and Proposed Changes** | | |
|---|---|---|
| **Trigger for DPL 2 at Board approval of DPL 1** | **Changes to trigger, if any, and potential impact on result, if any** | **Prior Action for DPL 2** |
| ***Pillar A: Improving port efficiency and governance*** | | |
| **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 Pelindos and the Port Authorities. | **Trigger was partially retained but revised to reflect changes in Government's reform timeline.** Trigger#1 (a) was retained in the matrix as Prior Action#1 (a). Trigger#1 (b) was amended to reflect the Government's priority of providing an independent evaluation of the concession agreements. While this evaluation could also provide some momentum to the port assets division (as explained above), it falls short of achieving that target. On the other hand the BPK opinion would strengthen the certainty of the concession agreement thus boding well for infrastructure investments. As a result it is hard to predict to what extent this change may affect the achievement of the results in the series of action. | **Prior action #1.** BPKP has completed the asset inventory report for the ports managed by the Pelindos and the Auditor General of BPK has used the report to provide an independent assessment of the port concession agreements between Port Authorities and the Pelindos, as evidenced through BPKP letter dated June 10, 2016, the asset inventory report dated June 3, 2016 and BPK letter dated October 23, 2017. |
| **Trigger #2.** The Ministry of Transport revises minimum capital requirements for Port Business License (PM No. 45/2015) to conform with article 32, Law No. 40/2007. | **Trigger was retained and strengthened**. The wording of the trigger was slightly changed to reflect the elimination of rather than the simple reduction in minimum capital requirement. | **Prior action #2.** The Minister of Transport has eliminated the minimum capital requirement to obtain a port business license, as evidenced through the Minister of Transport Regulation No. PM 24/2017. |
| **Trigger #3.** The Borrower fully integrates the INAPORT system with the INSW system in at least 2 ports (Tanjung Priok and Makassar). | **Trigger was partially retained but revised to reflect changes in Government's reform timeline.** The integration of INAPORT with the INSW will take longer due to additional constraints, such as the lack of common standards among ports regulated by the Ministry of Transport and other Government agencies. Nonetheless, the relevant agencies have implemented a different solution to achieve the same objective of maintaining the momentum of better coordination of documentary and cargo flow among ports and control agencies, by implementing a real-time data flow from international terminals to the INSW, through their port operators PELINDOs. | **Prior action #3.** The Borrower has integrated information from the Port Operators on the flows of documents and containers at the ports with the INSW system in Jakarta, Surabaya, Medan, Makassar and Semarang ports. |

| | | |
|---|---|---|
| ***Pillar B: Enabling a competitive business environment for logistics service providers*** | | |
| **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. | **Trigger was revised to better reflect the nature of the reform program.**<br>The actual prior action substantially reduced the minimum capital requirement (from USD 1.8 million to 148,000 for domestic and USD 10 to 4 million for foreign freight forwarders), even though it does not eliminate it. At the same time it retained the elimination of location restrictions and it added a third component which arguably strengthens the policy action, as a key barrier to freight forwarders' entry – the recommendation of freight forwarders' association - was removed.<br>On balance the team expects the impact of the action would remain the same as a result of these changes. Indeed some of the reduction in entry barriers have already been associated with an increase in new foreign licenses from 7 in the first 6 months of 2016 to 16 in the same period in 2017, which is a significant share of foreign freight forwarders currently operating in Indonesia (note that that is an appropriate comparison period especially for the capital requirement reduction, which occurred in October 2016). | **Prior action #4.** The Minister of Transport has simplified the licensing requirements of freight forwarders by: (a) reducing the minimum capital requirement for both domestic and foreign freight forwarders; (b) eliminating the location restrictions for foreign service providers; and (c) removing the requirement to obtain a recommendation by the freight forwarding association, as evidenced through the Minister of Transport Regulation No. PM 49/2017. |
| **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. | **Trigger was retained and strengthened.** The policy on cargo handling operation has been retained and the Government has extended this measure to support other key players of the maritime supply chain, including maritime transport companies and, shipping agencies, whose position was strengthened through the first DPL. | **Prior action #5.** The Minister of Transport has eliminated the minimum capital requirement for cargo handling operators, shipping agencies and maritime transport providers, as evidenced through the Minister of Transportation Regulation No. PM 24/2017. |
| | **A new prior action was introduced.** The action reflects the willingness of the Government to invest in the success of Bonded Logistics Centers, which were supported in the first operation. It does so with an important expansion of the scope of their work, which is also the first attempt to provide a legal framework to regulate trans-shipment operations in Indonesia. | **Prior action #6.** The Borrower has enabled Bonded Logistics Centers to carry out trans-shipment operations for all types of goods, as evidenced through the Director General of Customs and Excise Regulation No. PER- 10/BC/2017. |
| ***Pillar C: Making trade processing more efficient and transparent*** | | |

| | | |
|---|---|---|
| **Trigger #6.** The Borrower changes the Organizational Structure and Governance of the INSW Portal Administrator to elevate the status of the INSW Portal Administrator. | **Trigger was retained.** | **Prior action #7.** The Borrower has improved the organizational structure and governance of the INSW Portal Administrator by elevating the status of the INSW Portal Administrator as evidenced by the Presidential Regulation dated 31 May 2018. |
| **Trigger #7.** The Borrower implements the single submission system in (a) at least four main INSW participating agencies (Customs, Agriculture and Fish Quarantine agencies and Food and Drug Agency - BPOM) for (b) all importers rated as low risk by Customs. | **Trigger was replaced.** The trigger #7 on single submission was replaced as the single submission has met several operational and legal hurdles – including the inability of agencies to share information on the importers' application through the INSW - and is unlikely to be completed within the timeframe initially envisaged. This trigger has been replaced with an action which aims to achieve the same objective of facilitating traders' compliance with the trade regulatory requirements, i.e. the introduction of a special importers' status that unifies importers which used to qualify for various special channels under one umbrella and creates user-friendly procedures to expand the granting of such status among qualified importers. As these special status importers benefit from much simplified compliance with trade regulations, this measure may be particularly effective at reducing the overall burden of complying with import procedures.<br>The team believes that the expected result of the action would not be much affected given that the action is aiming to the same objective as the previous trigger and its potential impact is of a similar order of magnitude. | **Prior action #8.** The Borrower has expedited import procedures for qualified importers by: (a) introducing the Customs Partner Status; and (b) creating clear rules and user-friendly procedures for qualified importers to obtain the Customs Partner Status, as evidenced through the Minister of Finance Regulation 229/PMK.04/2015, the Minister of Finance Regulation 211/PMK.04/2016 and the Director General of Customs and Excise Regulation No. PER- 11/BC/2017. |
| **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. | **Trigger was retained and slightly revised to better reflect the nature of the reform program.**<br>The language of the action has been made more precise to highlight the key element of the integrated risk management, i.e. the sharing of risk profiles' data on traders among the four key INSW participating agencies. The action has also added an improvement as the border agencies' data on importers has been matched with that on tax compliance from the Directorate General of Taxation to provide for an even more enhanced evaluation of risk. | **Prior action #9.** The Borrower has implemented the integrated risk management system by exchanging – through the INSW portal – information on the importers' risk profiles and tax compliance across four key border agencies, i.e. BARANTAN, BKIPM, BPOM and DGCE, and the Ministry of Health. |

## ANNEX 2: POLICY AND RESULTS MATRIX ACROSS THE DPL SERIES

**Table A2: Prior Actions and results indicators across DPL I and II**

| **Prior actions** | | **Results Indicators*** |
|---|---|---|
| **Prior Actions under DPL 1** | **Prior Actions under DPL 2** | |
| ***Improving port efficiency and governance*** | | |
| 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. | Prior Action #1. BPKP has completed the asset inventory report for the ports managed by the Pelindos and the Auditor General of BPK has used the report to provide an independent assessment of the port concession agreements between Port Authorities and the Pelindos, as evidenced through BPKP letter dated June 10, 2016, the asset inventory report dated June 3, 2016 and BPK letter dated October 23, 2017. | Result indicator A1:<br>(a) Increase in the number of Pelindos' ports and terminals with internationally certified management systems (Quality Management Systems – ISO 9000 series).<br><br>Baseline (2015): 46<br>Target (2018): 60<br>Latest (2016): 52<br><br>(b) Increase in the number of container handling equipment in the 10 largest secondary container ports.<br><br>Baseline (2015): 49<br>Target (2018): At least 80<br>Latest (2017): 75<br><br>(c) Increase in the number of ports handling more than 2000 TEU vessels in the 10 largest secondary container ports.<br><br>Baseline 2015: 1<br>Target (2018): At least 5<br>Latest (2017): 5 |
| Prior Action #2. The Borrower has established the Availability Payment Mechanism, which enables the Borrower to pay companies for providing transportation infrastructure | Prior Action #2. The Minister of Transportation has eliminated the minimum capital requirement to obtain a port business license, as evidenced | Result indicator A2:<br><br>(a) Increase in the number of approved applications for BOT public seaports development |

| Prior actions | | Results Indicators* |
|---|---|---|
| **Prior Actions under DPL 1** | **Prior Actions under DPL 2** | |
| services, including port terminals construction, management and maintenance, as evidenced through Presidential Regulations 38 of 2015 and Minister of Finance Regulation 190 of 2015. | through the Minister of Transportation Regulation No. PM 24/2017. | Baseline (2015): 0 (cumulative between 2011 and 2015)<br>Target (2018): at least 2 (cumulative between 2015 and 2018)<br>Latest (2017): 6<br><br>(b) Increase in the number of feasibility studies for BOT concessions received by M.O.T.<br><br>Baseline 2015: 4<br>Target (2018): at least 10 cumulated<br>Latest (up to 2017): 11 |
| Prior Action #3. The Minister of Transport 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 Transport Regulations 157 of 2015 and 192 of 2015. | Prior Action #3. The Borrower has integrated information from the Port Operators on the flows of documents and containers at the ports with the INSW system in Jakarta, Surabaya, Medan, Makassar and Semarang ports, as evidenced through the Head of INSW Portal Administrator letter No. S-19/INSW/2018 dated January 19, 2018. | Result indicator A3: Reduction in the minimum and maximum ships' waiting times in ports.<br><br>Baseline:<br>• Tanjung Priok (2014): min. 1 hour – max. 24 hours<br>• Makassar (2014): min. 0.5 hours – max. 6 hours<br>Target:<br>• Tanjung Priok (2018): min. 0.8 hours – max. 12 hours<br>• Makassar (2018): min. 0.4 hours – max. 4 hours |
| ***Enabling a competitive business environment for logistics service providers*** | | |
| 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 | Prior Action #4. The Minister of Transport has simplified the licensing requirements of freight forwarders by: (a) reducing the minimum capital requirement for both domestic and foreign freight forwarders; (b) eliminating the location restrictions for | Result indicator B1: Increase in the number of new foreign licenses for freight forwarders warehousing, and cold storage service providers.<br><br>Baseline (2015):<br>• New foreign licenses for freight forwarders: 20 |

| Prior actions | | Results Indicators* |
|---|---|---|
| **Prior Actions under DPL 1** | **Prior Actions under DPL 2** | |
| to 100%, as evidenced through the Presidential Regulation 44 of 2016. | foreign service providers; and (c) removing the requirement to obtain a recommendation by the freight forwarding association, as evidenced through the Minister of Transport Regulation No. PM 49/2017. | • New foreign licenses for warehousing and cold storage: 3<br>Target (2018)<br>• New foreign licenses for freight forwarders: at least 25<br>• New foreign licenses for warehousing and cold storage: at least 10<br>Latest (2017 Q1-Q3 only)<br>• New foreign licenses for freight forwarders: 20<br>• New foreign licenses for warehousing and cold storage: 18 |
| 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. | Prior Action #5. The Minister of Transport has eliminated the minimum capital requirement for cargo handling operators, shipping agencies and maritime transport providers, as evidenced through the Minister of Transport Regulation No. PM 24/2017. | Result indicator B2: Increase in the number of new shipping agents' licenses (SUKK) and foreign maritime cargo handling licenses.<br><br>Baseline:<br>• SUKK licenses up to 2015: 0<br>• New foreign licenses for Maritime cargo handling (2015): 3<br>Target:<br>• New SUKK licenses (2016-18): at least 5<br>• New foreign licenses for Maritime cargo handling (2018): at least 3<br>Latest (2017):<br>• New foreign licenses for Maritime cargo handling: 2 (Q1-Q3) |
| 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. | Prior Action #6. The Borrower has enabled Bonded Logistics Centers to carry out trans-shipment operations for all types of goods, as evidenced through the Director General of Customs and Excise Regulation No. PER-10/BC/2017. | Result indicator B3: Increase in the number of operational bonded logistics centres and of those specialized in trans-shipment operations.<br><br>Baseline (2015):<br>• BLCs: 0<br>• BLCs handling trans-shipment: 0 |

| Prior actions | | Results Indicators* |
|---|---|---|
| **Prior Actions under DPL 1** | **Prior Actions under DPL 2** | |
| | | Target (2018):<br>• BLCs: at least 30 licenses<br>• BLCs handling trans-shipment: at least 3<br>Latest (July 2017):<br>• BLCs: 43 licenses in 58 locations<br>• BLCs handling trans-shipment: 0 |
| ***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. | | Result indicator C1: Reduction in pre-clearance time in Tanjung Priok.<br><br>Baseline (1st semester 2015): 3.37 days<br>Target (1st semester 2018): less than 2 days<br>Latest (1st semester 2017): 2.35 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. | Prior Action #7. The Borrower has improved the organizational structure and governance of the INSW Portal Administrator by elevating the status of the INSW Portal Administrator as evidenced by the Presidential Regulation dated 31 May 2018. | Result indicator C2: Increase in the share of relevant regulations included in the Indonesian National Trade Repository.<br><br>Baseline (2015): 90%<br>Target (2018): 100%<br>Latest (2017): 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 | Prior Action #8. The Borrower has expedited import procedures for qualified importers by: (a) introducing the Customs Partner Status; and (b) creating clear rules and user-friendly procedures for qualified importers to obtain the Customs Partner Status, as evidenced through the Minister of | Result indicator C3:<br><br>(a) Reduction in dwelling time in the main port of Tanjung Priok:<br><br>Baseline (1st semester 2015): 5.68 days<br>Target (1st semester 2018): 4 days |

| Prior actions | | Results Indicators* |
|---|---|---|
| **Prior Actions under DPL 1** | **Prior Actions under DPL 2** | |
| Minister of Finance Regulation 138 of 2015 and Head of INSW Letter No. S-91/INSW/2016. | Finance Regulation 229/PMK.04/2015, the Minister of Finance Regulation 211/PMK.04/2016 and the Director General of Customs and Excise Regulation No. PER- 11/BC/2017. | Latest (1st semester 2017): 3.96 days<br><br>(b) Reduction in dwelling time in the main port of Tanjung Perak:<br><br>Baseline (1st semester 2015): 6.13 days<br>Target (1st semester 2018): 4 days<br>Latest (1st semester 2017): 4.15 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.<br><br>Baseline (Average 2015): min. 2 - max 5 days<br>Target (Average 2017): min. 2 – max. 4 days<br>Latest (Average 2017): min. 1 – max. 2 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. | Prior Action #9. The Borrower has implemented the integrated risk management system by exchanging – through the INSW portal – information on the importers' risk profiles and tax compliance across four key border agencies, i.e. BARANTAN, BKIPM, BPOM and DGCE, and the Ministry of Health, as evidenced through the Head of INSW Portal Administrator letter No. S-19/INSW/2018 dated January 19, 2018. | Result indicator C5: Decrease in the share of import shipments classified as red channel in Tanjung Priok.<br><br>Baseline (2015): 6%<br>Target (2018): 4%<br>Latest (March 2017): 4.78% |

** Note: the latest values (as of the time of writing this document) are not available for all indicators. Source: various Government and private sector's sources collected by the World Bank team (see "DPL Logistics: Results indicators" document for more details).*

## ANNEX 3: LETTER OF DEVELOPMENT POLICY

MINISTER OF FINANCE
OF THE REPUBLIC OF INDONESIA

### LETTER OF DEVELOPMENT POLICY

**MINISTRY OF FINANCE**

Jakarta, 27 February 2018

No.: ..157...../MK..08/2018

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 fiscal reforms, 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 and Development/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 and Development /World Bank in the form of the Second Indonesia Logistics Reform Development Policy Loan.

**Indonesia's Economic and Fiscal 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 5.0 percent in 2016 and projected at 5.2 percent in 2017. 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 in the past years. Indonesia has made significant progress on reducing poverty with the national poverty rate falling from 24 percent in 1999 to 10.7 percent in 2016. 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.

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 Fiscal 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. In order to ensure the transparency and effectiveness of these agreements, the Government Internal Audit Body (BPKP) has undertaken an asset inventory of the assets in the port working areas under the concession agreements, which is now used by the External Audit Body (BPK) as one of the bases to evaluate the terms of the concession agreements.

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 by eliminating the burdensome minimum capital requirements to obtain the Port Business License for all categories of ports. This would allow to free up funds which do not have to be deposited as paid up capital, and which can be used by port investors to expand their investments. The government believes that this reform can also help expand the use of Built-Operate-Transfer concessions.

9. *Enhancing coordination of documentary and container examination in ports:* The government has integrated the information on cargo movement from the port operators with that on the

documentary compliance process through the Indonesia National Single Window (INSW) portal in the four main ports (Tanjung Priok, Tanjung Perak, Belawan, Makassar) and in Semarang. This integration allows all of the INSW participating agencies to track in real time at what point of the physical and documentary process the cargo is within the port (i.e. discharge, stacking, receipt of custom application, issuance of customs' permit, issuance of each of the other agencies' permits).

***Improving logistics services***

10. Improving the contestability of freight forwarding service markets is a key step to ensure that the entire logistics supply chain runs smoothly in Indonesia. To that end the government has *reduced the barriers to entry in freight forwarding services* by: (a) reducing significantly the minimum capital requirements for foreign (from USD 10 to 4 million) and domestic companies (from around USD 1.8 million to USD 150,000); (b) removing the location restrictions to foreign equity firms, and (c) eliminating the compulsory recommendation from the ALFI to obtain the freight forwarding license. These measures should foster competition hence reducing prices and/or increasing the quality of these key logistics services.

11. *Improving competition in shipping and auxiliary shipping services*: The Government has also improved competition in other important maritime logistics service markets by eliminating the capital requirements on maritime cargo handling, shipping agency and maritime transport services. This change also eliminates the discrimination in barriers to entry between domestic and foreign providers, thus reducing the uncertainty in the application of the regulatory framework.

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 (BLCs), which allow for the temporary storage of imports free of duties. The government has now also enabled *the BLCs to carry out trans-shipment operations for all types of goods*, effectively allowing the use of BLCs as international logistics hubs by facilitating the re-export of raw materials, semi-finished and finished goods through BLCs.

***Strengthening trade processing***

13. *Facilitating traders' compliance with trade regulatory requirements*: The Government aims to increase the effectiveness of the INSW to streamline trade procedures and facilitate compliance to regulatory requirements by elevating the status of the INSW to become an echelon-level agency with regulatory powers. This upgrade would enable the INSW to play a more active role in screening the contents newly proposed trade regulations and to facilitate the full implementation of the single submission system through a more effective coordination of the participating agencies.

14. Recognizing the importance of facilitating documentary submission and checking the Government had created special channels for pre-approved importers, including MITA prioritas and non prioritas, relieving them of much of the burden of documentary checking. These importers complied with a specific set of customs requirements, including exemplary tax history records, minimum capital limits, and recurrent import of goods, among others.

Recently DG Customs *consolidated these special channels under a Customs partner status with an even easier documentary compliance* (Mitra Kepabean Utama, the new MITA) and created clear rules and user-friendly procedures to expand the granting of this status to qualified importers. The exemptions associated with the MITA status allow importers to complete the pre-clearance procedures before the arrival of the shipment in port thus saving precious time at the border and leading to a significant decrease in dwelling time in international ports.

15. 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. After a successful pilot to test the concept the Customs, Fish Quarantine Agency, Agriculture and Plant Quarantine Agencies, the Food and Drugs Agency and the Ministry of Health have recently started exchanging information on the risk profiles of importers, which can be accessed through the INSW portal along with information on the importers' tax compliance from DG Tax. The availability of the risk profile information across the four key INSW agencies and DG Tax should improve their accuracy in assessing the risk of importers by relying on a larger amount of information than previously available.

**Conclusions**

16. 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.

17. 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

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# ANNEX 4: IMF ARTICLE IV PRESS RELEASE

Press Release No. 18/36
FOR IMMEDIATE RELEASE
February 6, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

**IMF Executive Board Concludes 2017 Article IV Consultation with Indonesia**

On January 10, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Indonesia.

The Indonesian economy has continued to perform well. Real GDP growth accelerated slightly to 5.1 percent in Q3:2017 from 5 percent in 2016 and H1:2017, led by robust exports and fixed investment. The output gap is estimated at –0.5 percent of GDP. Inflation fell to 3.3 percent in November, at the lower half of the official target band (4±1 percent), due to the slightly negative output gap and stable food prices, which more than offset the increase in electricity prices earlier in the year due to improved targeting of subsidies. Core inflation has remained stable at around 3 percent. The current account deficit declined to 1.5 percent of GDP in Q1-Q3:2017 due to higher exports. However, credit growth remains slow reflecting both weak demand and banks' tight lending standards.

The economic outlook is positive. Real GDP growth is projected at 5.1 percent in 2017, rising gradually to 5.6 percent over the medium term, led by robust domestic demand. Inflation is projected to remain around 3.5 percent, within the official target range, due to stable food and administered prices, and well anchored inflation expectations. The current account deficit is expected to remain contained at near 2 percent of GDP due to firm commodity prices and robust exports. Risks to the outlook remain tilted to the downside, including spikes in global financial volatility, uncertainty around U.S. economic policies, lower growth in China, and geopolitical tensions. Global growth and commodity prices could surprise on the upside. Domestic risks include tax revenue shortfalls and larger fiscal financing needs due to higher interest rates.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

**Executive Board Assessment**[2]

Executive Directors commended the authorities for the sound economic performance, including stable economic growth, moderate inflation, and a modest current account deficit, which have contained systemic risks. They noted that the economic outlook is favorable, but encouraged the authorities to stay vigilant against risks, including from volatile capital flows. Directors stressed that achieving higher potential growth would help create jobs for the young and growing labor force. The priority should be on a self-reinforcing and well-sequenced fiscal-structural reform package that mobilizes revenues to finance development spending and supports structural reforms in the product, labor, and financial markets.

Directors welcomed the focus of the near-term policy mix on supporting growth while preserving stability. They noted that fiscal adjustment in 2018 should be gradual to protect growth while rebuilding fiscal buffers. They agreed that the current stance of monetary policy is appropriate for targeting price stability and supporting growth, and recommended further enhancing monetary transmission. Directors welcomed the authorities' commitment to maintain exchange rate flexibility and to limit foreign exchange intervention to preventing disorderly market conditions.

Directors commended the authorities' efforts to rebalance public expenditure toward priority sectors. They encouraged early implementation of a medium-term revenue strategy to finance growth-enhancing priority spending and structural reforms, as well as reduce the heavy reliance on external financing. This strategy should include frontloaded tax policy and administration reforms. Short-term measures to arrest the fall in the tax ratio should also be considered.

Directors welcomed the progress achieved in boosting infrastructure investment. They stressed that the pace of infrastructure development should be aligned with available financing and the economy's absorptive capacity. Priority should be given to financing infrastructure with domestic revenue, as well as greater private sector participation, including foreign direct investment. This would limit the buildup of corporate external debt and contingent liabilities from state-owned enterprises (SOEs). Financial deepening through developing a national strategy for capital market development would also support infrastructure investment.

Directors commended the authorities' efforts to streamline regulations. They noted that future efforts should target areas with the largest potential gains for the economy, such as reducing state control, rationalizing the role of SOEs, and greater coordination of regulations among ministries and regional governments.

Directors emphasized that improving education and easing labor market regulations would support employment. They underscored the need to raise the level and quality of education spending, streamline job protection regulations, and improve vocational training and job placement services. Enhancing female labor participation would also be important.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors took positive note of the authorities' efforts to strengthen financial oversight and crisis management. Going forward, they encouraged greater focus on the areas identified by the FSAP where further improvement is needed, including clarification of institutional mandates, improving supervision of financial institutions and financial conglomerates, adopting a more rigorous approach to credit risk, and continuing to strengthen the crisis management framework. Continuing to monitor foreign exchange and external debt vulnerabilities of corporates will also be important.

## Indonesia: Selected Economic Indicators

| | 2013 | 2014 | 2015 | 2016 | 2017 Prel. | 2017 Latest outturn | | 2018 Proj. |
|---|---|---|---|---|---|---|---|---|
| Real GDP (percent change) | 5.6 | 5.0 | 4.9 | 5.0 | 5.1 | 5.0 | Q1-Q3 | 5.3 |
| Domestic demand | 4.7 | 5.0 | 4.2 | 4.6 | 4.7 | 4.5 | Q1-Q3 | 5.1 |
| *Of which:* | | | | | | | | |
| Private consumption 1/ | 5.5 | 5.3 | 4.8 | 5.0 | 5.0 | 5.0 | Q1-Q3 | 5.0 |
| Government consumption | 6.7 | 1.2 | 5.3 | -0.1 | 2.1 | 1.3 | Q1-Q3 | 2.0 |
| Gross fixed investment | 5.0 | 4.4 | 5.0 | 4.5 | 6.0 | 5.8 | Q1-Q3 | 6.2 |
| Change in stocks 2/ | -0.6 | 0.5 | -0.6 | 0.3 | -0.2 | -0.3 | Q1-Q3 | 0.0 |
| Net exports 2/ | 0.6 | -0.2 | 1.0 | 0.1 | 0.7 | 0.8 | Q1-Q3 | 0.3 |
| Saving and investment (in percent of GDP) | | | | | | | | |
| Gross investment 3/ | 33.8 | 34.6 | 34.2 | 34.3 | 34.0 | ... | ... | 34.1 |
| Gross national saving | 30.7 | 31.5 | 32.1 | 32.5 | 32.4 | ... | ... | 32.3 |
| Prices (12-month percent change) | | | | | | | | |
| Consumer prices (end period) | 8.1 | 8.4 | 3.4 | 3.0 | 3.3 | 3.3 | Nov. | 3.6 |
| Consumer prices (period average) | 6.4 | 6.4 | 6.4 | 3.5 | 3.8 | 3.8 | Jan.-Nov. | 3.4 |
| Public finances (in percent of GDP) | | | | | | | | |
| Central government revenue | 15.1 | 14.7 | 13.1 | 12.5 | 12.0 | 8.1 | Jan.-Sept. | 12.2 |
| Central government expenditure | 17.3 | 16.8 | 15.7 | 15.0 | 14.7 | 10.1 | Jan.-Sept. | 14.7 |
| *Of which:* Energy subsidies | 3.2 | 3.2 | 1.0 | 0.9 | 0.7 | 0.4 | Jan.-Sept. | 0.7 |
| Central government balance | -2.2 | -2.1 | -2.6 | -2.5 | -2.7 | -2.0 | Jan.-Sept. | -2.5 |
| Primary balance | -1.0 | -0.9 | -1.2 | -1.0 | -1.0 | -0.8 | Jan.-Sept. | -0.9 |
| Central government debt | 24.8 | 24.7 | 27.4 | 28.3 | 29.0 | ... | ... | 29.5 |
| Money and credit (12-month percent change; end of period) | | | | | | | | |
| Rupiah M2 | 9.4 | 13.5 | 9.0 | 11.7 | 12.0 | 9.8 | Jul. | ... |
| Base money | 16.7 | 11.6 | 3.0 | 4.6 | 9.8 | 7.2 | Jul. | ... |
| Private Sector Credit | 20.0 | 11.8 | 10.3 | 7.7 | 8.6 | 7.5 | Sept. | 10.3 |
| One-month interbank rate (period average) | 5.8 | 7.5 | 7.2 | 6.9 | ... | | | ... |
| Balance of payments (US$ billions, unless otherwise indicated) | | | | | | | | |
| Current account balance | -29.1 | -27.5 | -17.5 | -16.8 | -16.9 | -11.5 | Q1-Q3 | -20.4 |
| In percent of GDP | -3.2 | -3.1 | -2.0 | -1.8 | -1.7 | -1.5 | Q1-Q3 | -1.9 |
| Trade balance | 5.8 | 7.0 | 14.0 | 15.4 | 18.4 | 15.8 | Q1-Q3 | 14.8 |
| *Of which:* Oil and gas (net) | -9.7 | -11.8 | -5.7 | -4.8 | -6.9 | -5.0 | Q1-Q3 | -7.6 |
| Inward direct investment | 18.8 | 21.8 | 16.6 | 3.8 | 23.8 | 16.8 | Q1-Q3 | 26.6 |
| Overall balance | -7.3 | 15.2 | -1.1 | 12.1 | 11.3 | 10.6 | Q1-Q3 | 7.3 |
| Terms of trade, percent change (excluding oil) | -2.5 | -3.3 | -14.6 | -0.2 | 6.5 | ... | ... | 2.7 |
| Gross reserves | | | | | | | | |
| In billions of U.S. dollars (end period) | 99.4 | 111.9 | 105.9 | 116.4 | 127.6 | 126.5 | Oct. | 135.0 |
| In months of prospective imports of goods and services | 5.9 | 8.1 | 8.0 | 7.9 | 8.0 | 7.9 | Oct. | 7.9 |
| As a percent of short-term debt 4/ | 177 | 189 | 191 | 213 | 226 | 224 | Oct. | 234 |
| Total external debt 5/ | | | | | | | | |
| In billions of U.S. dollars | 266.1 | 293.3 | 310.7 | 318.8 | 345.4 | 335.4 | Q2 | 359.3 |
| In percent of GDP | 29.0 | 32.9 | 36.1 | 34.2 | 34.0 | 33.0 | Q2 | 32.8 |
| Exchange rate | | | | | | | | |
| Rupiah per U.S. dollar (period average) | 10,414 | 11,862 | 13,391 | 13,306 | ... | 13,382 | Jan.- Dec. | ... |
| Rupiah per U.S. dollar (end of period) | 12,171 | 12,435 | 13,788 | 13,473 | ... | 13,579 | Dec. 18 | ... |
| Memorandum items: | | | | | | | | |
| Jakarta Stock Exchange (12-month percentage change, composite index) | -1.0 | 22.3 | -12.1 | 15.3 | ... | 15.5 | Dec. 18 (ytd) | ... |
| Oil production (thousands of barrels per day) | 830 | 794 | 800 | 820 | 815 | | | 800 |
| Nominal GDP (in trillions of rupiah) | 9,546 | 10,570 | 11,532 | 12,407 | 13,604 | | | 14,852 |

Sources: Data provided by the Indonesian authorities; and IMF staff estimates and projections.

1/ Includes NPISH consumption.
2/ Contribution to GDP growth (percentage points).
3/ Includes changes in stocks.
4/ Short-term debt on a remaining maturity basis.
5/ Public and private external debt.

# ANNEX 5: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

**Table A3: 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)** |
|---|---|---|
| ***Pillar A: Improving port efficiency and governance*** | | |
| Prior Action #1. BPKP has completed the asset inventory report for the ports managed by the Pelindos and the Auditor General of BPK has used the report to provide an independent assessment of the port concession agreements between Port Authorities and the Pelindos, as evidenced through BPKP letter dated June 10, 2016, the asset inventory report dated June 3, 2016 and BPK letter dated October 23, 2017. | No significant direct effects.<br>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.<br>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<br>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. | No significant direct effects.<br>To the extent that they stimulate port infrastructure development, these actions could overall benefit consumers and producers across Indonesian islands.<br>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.<br>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. |
| Prior Action #2. The Minister of Transport has eliminated the minimum capital requirement to obtain a port business license, as evidenced through the Minister of Transportation Regulation No. PM 24/2017. | No significant direct effects.<br>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.<br>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<br>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. | |
| Prior Action #3. The Borrower has integrated information from the Port Operators on the flows of documents and containers at the ports with the INSW system in Jakarta, Surabaya, Medan, Makassar and Semarang ports. | No significant direct effects.<br>By improving the efficiency of ports, it may reduce congestion inside and outside the ports with associated environmental benefits. | No significant effects. |
| ***Pillar B: Enabling a competitive business environment for logistics service providers*** | | |
| Prior Action #4. The Minister of Transport has simplified the licensing requirements of freight forwarders by: (a) reducing the minimum capital requirement for both domestic and foreign freight forwarders; (b) eliminating the location restrictions for foreign service providers; and (c) removing the requirement to obtain a recommendation | No significant effects. | No significant direct effects.<br>Improvement in logistics services could overall benefit consumers and producers across Indonesia by reducing prices and improving the competitiveness of the |

| | | |
|---|---|---|
| by the freight forwarding association, as evidenced through the Minister of Transport Regulation No. PM 49/2017. | | productive sector, thus reducing poverty rate.<br>By better connecting markets improved logistics could also penalize incumbent firms and workers in certain markets through higher competition. |
| Prior Action #5. The Minister of Transport has eliminated the minimum capital requirement for cargo handling operators, shipping agencies and maritime transport providers, as evidenced through the Minister of Transport Regulation No. PM 24/2017. | No significant effects. | |
| Prior Action #6. The Borrower has enabled Bonded Logistics Centers to carry out trans-shipment operations for all types of goods, as evidenced through the Director General of Customs and Excise Regulation No. PER-10/BC/2017. | No significant effects. | |
| ***Pillar C: Making trade processing more efficient and transparent*** | | |
| Prior Action #7. The Borrower has improved the organizational structure and governance of the INSW Portal Administrator by elevating the status of the INSW Portal Administrator as evidenced by the Presidential Regulation dated 31 May 2018. | No significant effects. | No significant direct effects.<br>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 Borrower has expedited import procedures for qualified importers by: (a) introducing the Customs Partner Status; and (b) creating clear rules and user-friendly procedures for qualified importers to obtain the Customs Partner Status, as evidenced through the Minister of Finance Regulation 229/PMK.04/2015, the Minister of Finance Regulation 211/PMK.04/2016 and the Director General of Customs and Excise Regulation No. PER- 11/BC/2017. | No significant effects. | |
| Prior Action #9. The Borrower has implemented the integrated risk management system by exchanging – through the INSW portal – information on the importers' risk profiles and tax compliance across four key border agencies, i.e. BARANTAN, BKIPM, BPOM and DGCE, and the Ministry of Health. | No significant direct effects.<br>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. | |

## ANNEX 6: SUMMARY OF CONCESSION AGREEMENTS

In total four concession agreements have been signed whereby the concessioning party (the Port Authorities) have concessioned out all of the existing working areas of the four Pelindo's to the concessionaires (the port operators). Each concession agreement consists of 24 articles that are listed in below table

| | |
|---|---|
| 1. Legal basis | 13. Disclosure |
| 2. Definitions | 14. Change of law |
| 3. Objective | 15. Circumstance beyond control |
| 4. Scope of the concession agreement | 16. Non-performance |
| 5. Timeframe of the concession agreement | 17. Sanctions |
| 6. Rights and obligations of concession parties | 18. Termination of concession agreements |
| 7. Concession fee | 19. Conflict resolution |
| 8. Terminal developments activities | 20. Independent auditor/surveyor |
| 9. Tariff and tariff adjustments formula | 21. Applicable law |
| 10. Public grievance procedures | 22. Announcements |
| 11. Reporting | 23. Addendum |
| 12. Monitoring and intervention | 24. Other conditions |

The concessions apply for a period of 30 to 50 years against a fee of 2.5% of gross revenue. In return the Port Authority amongst others will provide and maintain access channels, basins, breakwaters, internal roads and aids to navigation. The Port Authority in addition responsible for setting performance standards and evaluation of these standards, these standards are set in separate regulations and can be amended every two years. Non-performance can lead to sanctions that include the termination of the concession agreements.

The concessionaire is responsible for developing, maintaining and operating of port infrastructure according to the set performance standards. The development does need to adhere to the individual port masterplan issued by the Ministry of Transport. In the development and operation, the concessionaire (Pelindo) is allowed to work with 3$^{rd}$ parties after recommendation has been provided by the Port Authority. In the article *other conditions*, it is stated that existing agreements between the Pelindos and 3$^{rd}$ parties will be respected and land status for right of use remains unchanged as a result of the concession agreement.