LETTER OF DEVELOPMENT POLICY
MINISTRY OF FINANCE

Jakarta, 27 February 2018

No.: 15.7.../MK.082018

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 prioritias and non prioritias, 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