

Issue August 2010

Trade Development



Summary of Workshop

Insights from Second Dialogue: Services for Domestic Connectivity¹

Significance:

Indonesia is currently paying the price for poor domestic connectivity. Symptoms are reflected in: differing rates of regional development; disparities in the prices of essential food commodities across regions; and declining competitiveness of domestic products in export and home markets. Improving domestic connectivity requires not only investment in physical infrastructure but also investment in services that link across the supply chain (intra-island, inter-island, international). One way of encouraging higher levels of investment in connectivity services as the Services Dialogue underlines is in developing a coherent domestic regulatory environment that attracts private investment in services.

The Indonesia Services Dialogue held its second half-day forum on 20 July 2010. The forum, which was organized jointly by the Coordinating Board for Investment (BKPM), the Indonesian Chamber of Commerce and Industry (Kadin) and the World Bank, attracted stakeholders from both the public and private sectors. The core program of the forum laid out issues for discussion, such as the importance of efficient services and policy priorities to attract private investment in connectivity services. The forum also offered some lessons learned from the experiences of other countries that have similar geographical characteristics to Indonesia.

Main Findings of the Workshop

The forum helped to place services and domestic connectivity in a broader Indonesian perspective, namely in supporting the strategic importance of: **regional development, poverty reduction, and increased competitiveness.**

- Services play an integral part in shaping domestic connectivity. Domestic connectivity is not just about “being connected” by physical infrastructure. Services are the key ingredient in inter-linking different activities in domestic connectivity. For example, improvements in port services can help to improve efficiency in inter-island shipping; a modern trucking industry can increase efficiency in logistic services; and increasing the frequency of maritime services in the outer islands can increase the demand for transport services. Therefore, efficient services across the whole supply chain will determine the overall level of domestic connectivity.
- Improving services for domestic connectivity increases integration of local manufacturers and links consumers with producers across Indonesia. Better

services for connectivity would provide opportunities for local manufacturers to market or source products locally. Regarding agriculture and mining commodities, better services for connectivity would provide opportunities for producers to connect with individual or industrial consumers located in other parts of the country. Given the daunting challenges that Indonesia faces, the Gol should consider prioritizing efforts to improve domestic connectivity.

- Given Indonesia’s unique geographical characteristics, improving services for connectivity would have a significant impact on regional development. As an archipelago, Indonesia has to confront challenges, such as linking growth poles on different islands, linking urban areas to growth poles within islands, and connecting rural areas with urban growth centers. Improvement in ports and inter-island shipping will strengthen links between growth poles on different islands. Increasing the use of roll-on-roll-off (RoRo) ferry services and combining these with efficient road transport services would dramatically improve economic connectivity among smaller islands off Java. Meanwhile, stronger links within islands would help to spur economic growth gains to the least developed areas by providing hinterland areas access to urban centers and by connecting different urban centers. Efficient end-to-end logistics, railway cargo services, and modern trucking services could significantly improve intra-island connectivity.

Main Recommendations

Several important issues regarding connectivity services were presented in the Dialogue. The World Bank highlighted several areas that require attention from stakeholders, such as:

- **Improving the efficiency of the domestic sea-freight system:** Domestic shipping is key in transporting goods across Indonesia and consists not only of shipping services but also port services. Indonesia needs a more efficient domestic sea-freight system but increasing the use of efficient cargo ships also requires an improvement in port performance. RoRo ferries, combined with road transport, are an efficient means of transporting goods across islands providing that there are ports that allow them to operate efficiently.

► To attract more private investment into port services, the Gol could consider clarifying the 2008 Shipping Law, particularly the ambiguities over port management, the scope of port authorities, and responsibility for providing port infrastructure. The Gol could also reconsider, given the need for major new port facilities, whether limiting foreign equity in port operators to 49 percent is sensible for attracting foreign investors to form joint ventures with Indonesian port operators.

► The Gol could consider emulating the Philippines to connect small islands through a combination of land transport with RoRo shipping. For outer islands, the Gol could consider a scheme for subsidized RoRo shipping.

- **Improving the efficiency and quality of land-transport services:** Improving efficiency in the trucking industry and increasing the frequency of railway cargo services are key issues in improving land-transport services. There are very few large and mid-size trucking companies that can benefit from economies of scale and thereby provide efficient services. The ad-hoc nature of the industry contributes to inefficiencies and congestion, which feed into low profits for truck operators and diminishes their incentive to upgrade their fleets. Indonesia also has relatively higher import tariffs for trucks compared with its

¹ We would like to express our gratitude to the Dutch Government for funding this 2nd Services Dialogue forum.

regional peers, making the upgrading of truck fleets relatively more expensive. For railways, although “above the rail” services have been deregulated, private investors require a regulatory regime that assures fair access to railway track.

▶ *The Gol could consider reducing import tariffs for trucks and work with trucking associations to facilitate consolidation in the trucking industry. Trucking associations could consider working with banks to device financing schemes for upgrading fleets.*

▶ *The Gol could consider establishing fair access to railway tracks for private investors by introducing an implementing regulation for Law No. 43/2007 to separate control over railway tracks from “above the rail” service providers.*

- **Reducing barriers to entry for end-to-end logistics services:** There is growing interest among manufacturers worldwide in using third-party logistics providers (3PLs). However, Indonesia still has many regulations that prohibit the establishment of a single company that can provide an end-to-end logistics service. One private sector operator mentioned that the regulatory regime required it to establish four separate companies, each with separate licenses (trucking, freight forwarder, express delivery, and warehousing) in order to provide full end-to-end services for the manufacturing sector in Indonesia. As a result, logistics costs are raised, making Indonesian products of good quality and reasonable price uncompetitive and out of the reach of many potential customers.

▶ *The Gol could consider streamlining licensing requirements for end-to-end logistics providers and use this as a quick win for policy reform in logistics.*

- **While there is a proliferation of roadmaps and strategies, there is a lack of prioritization and a poor track record in implementation:** There is no deficit of ideas and strategies for improving domestic connectivity in Indonesia. However, the ability to implement those ideas and strategies is constrained by low capacity, fragmented institutional structures, and lack-luster political support from the highest level.

▶ *There is a need to obtain a common understanding on the agenda and priority of services for domestic connectivity. The Gol could consider stepping up coordination and assigning technical agencies clear mandates and time schedules to address the challenges.*

In the Dialogue, the Chairman of BKPM explained a recent initiative to speed up the procedure for public-private partnership (PPP) infrastructure projects in order to reduce bottlenecks in connectivity. Meanwhile, the Minister of Trade provided an update on government efforts to issue a National Logistics Blueprint.

Representatives from the private sector also provided feedback and highlighted issues related to regulations in connectivity services that are having an adverse impact on their businesses.

▼ The current Joint Decree by the Directorates General in the Ministries of Manpower, Transport, and Cooperatives and Microenterprises on stevedores (loading and unloading) has created investment uncertainty. The decree states that stevedores must be sourced from port workers’ cooperatives. The decree is believed to have a significant impact on loading and unloading costs, while severely limiting the incentive for stevedores to improve their performance.

▶ *The regulation grants monopoly power to port workers and may be causing serious inefficiencies in port operations. The Gol could consider revoking the regulation or amending it to allow for more flexibility for ports in sourcing stevedores.*

Better domestic connectivity would integrate domestic industries



Source: World Bank calculation from BPS data.

▼ Lack of effort in verifying Customs documents prior to the arrival of containers contributes to inefficiencies in port operations. Currently, Customs handle documents after ships arrive and therefore have significant impact on clearing times and congestion at major ports such as Tanjung Priok.

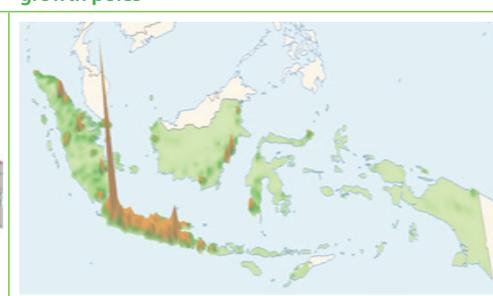
▶ *Customs could consider a pilot project to implement pre-arrival document verification, at least for “Green Line importers” in major ports such as Tanjung Priok.*

▼ Restrictions on trucks carrying multiple export cargos are causing inefficiencies. Lack of coordination in Customs inspections prevents trucks from operating efficiently by carrying export cargos from multiple warehouses.

▶ *Customs could consider taking the initiative in facilitating inspections in multiple warehouses.*

- The forum also concluded that the Services Dialogue needed to engage in a deeper discussion to identify specific regulatory issues and identify reform priorities. Regulatory reform in services should also be part of addressing domestic connectivity. Certainty and coherence in regulations are key in attracting private investment in connectivity services. This is important particularly for investments that require large sunken costs, such as ports and domestic shipping. The next step for the forum is to have smaller working groups consisting of private-sector representatives and think-tank organizations to discuss specific topics on connectivity services and to come up with recommendations to the Gol.

There is a need to connect regions with economic growth poles



Source: World Development Report, World Bank, 2009
Note: Economic activity using sub-national GDP estimates

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