Services in Indonesia – Perspectives from the Private Sector

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The services sector has tremendous potential to drive economic growth.

Services sector plays an increasingly important role in the global economy and the growth and development of countries.

Services sector has contributed as much as 63% to world GDP in 2013.

Indonesia’s services sector annual contribution to GDP grew only 1.2% over the last ten years (from 41% in 2004 to 42.2% in 2014).

Indonesia’s services sector is an important part of the economy, but has seen little growth over the past decade.

Indonesia’s trade in services has shown a deficit of around USD10 billion a year over the last five years.

Indonesia accounts for only 8% of ASEAN’s total exports of services in 2014.

Around 600,000 Indonesians travel abroad annually for medical tourism, spending a total of around USD1.4 billion.
Indonesia’s services sector is smaller than peer ASEAN countries

ASEAN countries services sector – contribution to national GDP in 2014

- Singapore: 75%
- Philippines: 57.3%
- Thailand: 52.7%
- Malaysia: 51.2%
- Vietnam: 43.4%
- Indonesia: 42.2%

Source: World Bank
Indonesia’s operating environment poses significant challenges to the development of Indonesia’s services sector

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<td>Bans and quotas on the imports of certain goods</td>
<td>Weak infrastructure – particularly the lack of trans-Java and trans-Sumatra highways, inadequate power supply and insufficient seaport facilities – creates high logistics costs</td>
<td>High rates of corruption and gov’t leakage reflect slow progress in anti-corruption programs and judicial system reform</td>
<td>Negative investment list restricts foreign investment in key sectors including healthcare, warehousing and distribution, and e-commerce</td>
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<td>Domestic content requirements for retailers and telcos</td>
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<td>Many regulations over past decade distort market prices and raise costs; tight restrictions remain on foreign labor</td>
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<td>Ownership restrictions on retail outlets</td>
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<td>Preferential treatment to SOEs raises prices and crowds out private capital</td>
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<td>Numerous and overlapping import licensing requirements slowing down customs clearance</td>
<td>Gov’t unwillingness to use new rules for land acquisition for public-interest infrastructure</td>
<td>Poor inter-ministerial coordination undermines governance and policymaking</td>
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<td>Mandatory regulated agents system affects exports and airfreight</td>
<td>Infrastructure investment has struggled to reach 3 to 4 percent of GDP</td>
<td>Many local governments lack adequate human resources, organizational and fiscal capacities</td>
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President Jokowi’s issuance of 11 deregulation packages is a step in the right direction, but full implementation will be critical.

- There has been no detailed study of the implementation of the deregulation packages to date, but there are growing signs that implementation is lagging.

- Private sector welcomes the government’s effort to reduce red-tape and bureaucracy, and enhance business certainty. However, investors are looking for tangible results, not more rhetoric.

- Previous administrations have issued high-profile reform packages but failed to improve the business environment because implementation was lacking (e.g. August 2013 Policy Package issued under former Finance Minister Chatib Basri).

- President Jokowi’s administration issued 11 deregulation and economic stimulus packages from September 2015-April 2016.

New policy packages

Details remain unclear

Experienced investors are wary

Investors monitoring implementation closely
The government needs more structured, frequent and effective dialogue with the private sector to build investor confidence and better inform future economic policy.

**Some ideas to consider**

- Increase structured dialogue between cabinet and peak Indonesian business associations such as KADIN and APINDO.
- Create mechanisms to facilitate transparency in regulation drafting process, allowing adequate commentary periods for new regulations to enable input from stakeholders.
- President Jokowi to meet regularly with global business CEOs.
- Government of Indonesia to articulate its commitment to strengthening the services sector, and affirm its role as a facilitator and not merely a regulator.
- Services-restricting regulations (including those developed under the current administration) should be reviewed and amended to be line with regional and international standards.

**Additional Points**

- Existing policy packages should be properly implemented before new packages are rolled out.
- Future policy packages should more specifically address pressing problems for the business community e.g. labor restrictions.
Overall, Indonesia needs to take more proactive measures to improve its services sector or risks losing out to peer countries.

“The services sector is becoming a more important part of the economic equation. It makes up approximately two-thirds of the GDP in the APEC region, and we need to put more emphasis and thought into making this sector even more competitive.”

- President of the Philippines Benigno S. Aquino III, 2015 APEC Summit - November 19, 2015
Case Study 1: Distribution and Logistics

### Overview

- Indonesia’s logistics and distribution sector has expanded in line with economic growth.
- But at 24% of GDP, Indonesia’s logistics costs are higher than most other countries in the region.
- Burdensome regulatory requirements and outdated customs procedures hold back efficiency improvements.

### Examples of Key Regulatory Challenges

1. **Restrictions on Freight Forwarding**
   - PM74/2015 raises the capital requirements for local and foreign operators.
   - Regulation also introduces business permit requirements that are lengthy and complicated.
   - Implementation is still unclear, especially in relation to existing investment laws.

2. **Cumbersome Customs Procedures**
   - Cumbersome customs procedures e.g. physical inspections, and burdensome and duplicative hardcopy paperwork submission requirements.
   - These procedures cause lengthy delays and raise logistics costs e.g. port dwelling time.

3. **Cargo Security**
   - Regulated Agents system at the airports increases logistics costs as screening fees increase ten-fold.
   - The system also fails to meet international civil aviation safety standards, increasing flight safety risk.

### Recommendations

- Develop a regulatory framework that best supports free flow of goods domestically and internationally.
- Adopt efficient and modern customs procedures to better integrate domestic supply chains into global value chains.
### Case Study 2: Financial Services

#### Overview
- Indonesia’s financial services sector is underdeveloped, and financial inclusion is an ongoing challenge.
- The sector is still highly concentrated; the banking sector accounts for about 80% of the sector’s assets.
- Insufficient role played by pensions, insurance and other nonbanking financial institutions.

#### Examples of Key Regulatory Challenges

1. **Regulatory framework struggling to keep up with new financial technology**
   - OJK is moving ahead with implementing data on-shoring requirement (GR82/2012) for the financial sector, even though KOMINFO recognizes it would burden businesses.
   - BI has stopped granting new e-money licenses. Many companies that want to offer new services e.g. mobile money, are unable to enter market.

2. **Uncertainties in the enactment of the new Insurance Law (Law 40/2014).**
   - 18 new OJK regulations and 2 MoF regulations need to be issued by 2017 to implement this Law.
   - Unclear provisions include: new foreign shareholder requirements, moving reinsurance onshore, and a new single presence policy.

#### Recommendations
- Create a regulatory ecosystem that promotes more cost-efficient, secure, and innovative electronic payment services that caters to all segments of society.
- Ensure that the implementation of the 2014 Insurance Law is aligned with private sector priorities to better deepen Indonesia’s developing insurance sector.
Overview

- Indonesia has the potential to become the largest Southeast Asian e-commerce market by value by 2017.
- But Indonesia’s e-commerce sector still lags ASEAN peers, due to limited capital investment, low broadband penetration, etc.
- ICT services sector held back by poor electricity & telecommunications infrastructure.

Examples of Key Regulatory Challenges

1. Local Content Requirements
   - Starting from January 2017, 4G smartphone sold in Indonesia will be required to use at least 30% of local content.
   - GOI is trying to develop new categories that would include software into local content requirements, but actual implementation is still unclear.

2. Restrictive Regulatory Framework
   - KOMINFO developing a new regulation for OTT companies, which may require foreign OTT companies to establish Permanent Commercial Presence in Indonesia, and pay special taxes, in order to provide services in Indonesia.
   - OTT companies may also be required to employ censorship mechanisms, and use Indonesian internet protocol numbers.

Recommendations:

- Apply a light touch to regulation to enable innovation and growth in ICT and e-commerce services.
- Support, rather than restrict, the role of private sector companies, which can contribute to the long-term development of ICT infrastructure and services.
Thank you