

**PRODUCT MARKET REGULATION IN INDONESIA - AN INTERNATIONAL COMPARISON**

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**ABSTRACT/RÉSUMÉ****Product Market Regulation in Indonesia - An International Comparison**

Appropriately designed Product Market Regulation (PMR) is essential to enhance productivity, boost economic growth and increase welfare. Regulation is needed to address market failures and guarantee the health and safety of consumers. However, by limiting the entry and expansion of firms, a too stringent regulatory environment can hinder an efficient allocation of resources both within and across industries. This paper provides a detailed review of PMR in Indonesia and analyses the country's performance in this area relative to OECD countries, other G-20 members and regional peers. To do so, it relies on the OECD's PMR Indicators, which have been recently compiled for Indonesia. These indicators assess the extent to which the regulatory framework of a country is competition-friendly across a range of sectors and regulatory areas. The analysis reveals that PMR in Indonesia is less conducive to competition than in most OECD countries. The scope for improvement is particularly great in areas such as barriers in network sectors, command-and-control regulation, public procurement, the governance of State-owned Enterprises (SOEs) and the extent to which the impact on competition is assessed when designing new regulation. The paper proposes concrete policy measures to align the regulatory environment of Indonesia with that of best performing countries.

JEL codes : D24, D4, K23, K32, L1, L2, L3, L4, L5, L8, L9, H57, O53

Keywords: Regulation, Competition, Product Market Regulation, Productivity, Indonesia, Professional Services, Governance of State-Owned Enterprises, Public Procurement, Network Sectors.

\* \* \* \* \*

**Réglementation des Marchés de Produits en Indonésie - Une Comparaison Internationale**

Une réglementation des marchés de produits (PMR) bien conçue est essentielle pour améliorer la productivité, stimuler la croissance économique et accroître le bien-être. Des réglementations sont nécessaires pour remédier aux défaillances du marché et garantir la santé et la sécurité des consommateurs. Cependant, en limitant l'entrée et l'expansion des entreprises, un environnement réglementaire trop strict peut entraver une allocation efficace des ressources au sein des industries et entre les différents secteurs de l'économie. Ce document fournit une évaluation détaillée de la PMR en Indonésie et analyse la performance du pays dans ce domaine par rapport aux pays de l'OCDE, aux autres membres du G-20 et aux pairs régionaux. Pour ce faire, il utilise les indicateurs PMR de l'OCDE, récemment compilés pour l'Indonésie. Ces indicateurs évaluent dans quelle mesure le cadre réglementaire d'un pays est favorable à la concurrence dans plusieurs secteurs et domaines réglementaires. L'analyse indique que la PMR en Indonésie est moins propice à la concurrence que dans la plupart des pays de l'OCDE. La marge d'amélioration est particulièrement importante dans des domaines tels que les barrières dans les secteurs de réseau, des réglementations de type injonction et contrôle, marchés publics, la gouvernance des entreprises publiques (SOEs) et la mesure dans laquelle l'impact sur la concurrence est pris en compte lors de la conception des nouvelles réglementations. Le document propose des mesures politiques concrètes pour aligner l'environnement réglementaire en Indonésie sur celui des pays les plus avancés dans ce domaine.

JEL codes : D24, D4, K23, K32, L1, L2, L3, L4, L5, L8, L9, H57, O53

Mots clés : Réglementation, Concurrence, Réglementation du marché des produits, Productivité, Indonésie, Services professionnels, Gouvernance des entreprises publiques, marchés publics, Secteurs des réseaux.

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# Product Market Regulation in Indonesia- An International Comparison

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## 1. Introduction

Well-designed product market regulation (PMR) is essential to foster competition, as it facilitates the entry of new competitors and encourage the efficient allocation of resources across firms. Competition allows more efficient firms to gain market share at the expense of less efficient ones. A competitive environment also improves how firms are run, as incumbents face greater incentives to adopt better management practices (Van Reenen, 2011<sup>[1]</sup>). Moreover, lower barriers to entry can facilitate innovation. As firms facing competition cannot earn monopoly rents, they are forced to innovate if they want to retain profits. Furthermore, once innovation takes place, all firms have strong incentives to adopt the most efficient technologies and practices. Indeed, empirical evidence suggests that competition increases both innovation output within firms (Correa and Ornaghi, 2014<sup>[2]</sup>) and technological diffusion across firms (Andrews, Criscuolo and Gal, 2016<sup>[3]</sup>).

By fostering these mechanisms, the adoption of pro-competition PMR regimes can foster productivity and growth. A wide range of firm, industry and country-level studies suggest that regulatory frameworks that lower barriers to entry and encourage a level playing field across firms are associated with gains in multi-factor productivity growth (Buccirosi et al., 2013<sup>[4]</sup>; Demmou and Franco, 2020<sup>[5]</sup>), as well as positive effects on aggregate investment, GDP growth and income per capita (Égert, 2017<sup>[6]</sup>; Égert, 2018<sup>[7]</sup>). These economic benefits accrue both in high-income and emerging economies (Égert, 2016<sup>[8]</sup>). Pro-competition PMR is also associated with higher employment in the long-run (Griffith, Harrison and Macartney, 2007<sup>[9]</sup>),

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<sup>1</sup> Cristiana Vitale, Christine Lewis and Javier Terrero-Davila are members of the OECD Economics Department, Rosamaria Bitetti and Auxentius Andry Yudhianto are expert consultants for the OECD Economics Department. The authors acknowledge valuable comments and inputs received from Andrea Goldstein, Asa Johansson, Fernando Mistura, Paul Davidson, Alexandre de Crombrughe, Federica Maiorano, Sophie Flaherty, Ching-a Park, and Wouter Wills, who are OECD staff in different departments. Paul Yu and Isabelle Wanner (OECD Economics Department) provided key statistical support. Eszter Danitz contributed to the verification of the answers to the PMR questionnaire. Massimo Geloso Grosso and Yulianti Susilo (OECD's Jakarta Office) gave invaluable support from Jakarta. Additionally, the Secretariat thanks the support of government officials of the Republic of Indonesia, particularly Dr. Iskandar Simorangkir (Deputy Minister for Macroeconomic and Financial Coordination, Coordinating Ministry for Economic Affairs), Puji Gunawan (Assistant Deputy for Regional Economy and Real Sector), Ferry Irawan (Assistant Deputy for Monetary and External Sector) and Belinda Laksmi (Economic Analyst). Thanks are extended to the agencies and ministries that participated in this review by filling in the PMR questionnaire and providing feedback during the review. Thanks are also due to Sisse Nielsen and Michelle Ortiz for their editorial support.

particularly among vulnerable groups such as women and young workers (Gal and Theising, 2015<sup>[10]</sup>). This is the result of greater economic output and lower barriers to the creation and expansion of businesses.

To measure the extent to which a country's PMR promotes competition through well-designed and proportionate regulation, the OECD has designed the Product Market Regulation (PMR) indicators. These compile and score information on the regulatory framework in a broad range of cross-sector policy areas, as well as on specific sectors, such as network industries and professional services. They are an essential element of OECD's policy toolkit. They are also widely used by national governments and international organizations to identify areas where countries' regulatory frameworks deviate from international best practices and reforms may be needed.

The PMR indicators were first calculated in 1998 and have been updated regularly since. Initially only OECD member states were included, but at each update the geographic coverage has increased. Indonesia was included in 2013 and again in 2020.

Relying on the most recent PMR indicators for Indonesia, this paper presents a detailed review of product market regulation in the country and compares the main features of its regulatory environment to that of OECD countries, other G-20 economies, and regional peers.

The information used to calculate the PMR indicators was collected in early 2020.<sup>2</sup> Hence, the indicator values reflect regulations in force on 1 January 2020. However, the paper acknowledges major reforms lowering barriers to Foreign Direct Investment (FDI) in 2021 by providing an up-to-date analysis in this area.

The first section of the paper explains the structure of the OECD PMR indicators. The second section presents the results of these indicators for Indonesia. Firstly, it discusses the results related to barriers to competition arising from the state's involvement in firms and markets. Secondly, it discusses the barriers related to domestic and foreign entry. After the results for each area are presented, the paper suggests policy options that could make Indonesia's regulatory environment more conducive to competition. The policy assessment takes into account Indonesia's context as a geographically large, middle-income economy.

## 2. The OECD Product Market Regulation Indicators

The PMR indicators are based on an extensive database that is prepared by the OECD, relying on the answers to the OECD PMR questionnaire. This questionnaire contains over 1200 questions on laws and regulations in force in the country in a range of sectors and areas that are answered by national authorities. The responses are then assessed and validated by OECD experts. The PMR values are derived from scoring of the information in the database against internationally accepted best practices. The scores range from 0 to 6, with 0 representing international best practice. The scoring grid, the specific weights used to calculate all the indicators, together with the underlying database, are available on the OECD PMR website.<sup>3</sup>

A key feature of the PMR database is that it captures the *de jure* policy settings. The answers to the PMR questionnaire are not based on subjective assessments by market participants, but on the laws in force in the countries assessed. This improves the comparability across countries, as the PMR values do not depend on context-specific assessments. It also allows the OECD to verify the precision of the information

<sup>2</sup> These indicators are based on the methodology for the PMR indicators introduced by the OECD in 2018. This methodology is very different from the one used in 2013. Hence, the values based on the 2018 methodology cannot be compared with those obtained based on the 2013 one.

<sup>3</sup> See [www.oecd.org/economy/reform/indicators-of-product-market-regulation/](http://www.oecd.org/economy/reform/indicators-of-product-market-regulation/)

provided. On the other hand, the *de jure* nature of the indicators imply that these do not capture the degree of regulatory enforcement (so-called *de facto*).

The information included in the database is used to build two sets of indicators: an economy-wide indicator, which provides a general quantitative measure of a country's regulatory stance, and a group of sector indicators that focus on regulation at the level of specific network and service sectors. The strong emphasis on network and services sectors stems from the importance of energy, transport, e-communications and professional services as inputs in most other sectors of the economy (OECD, 2014<sup>[11]</sup>). In this regard, empirical research has shown that upstream regulations in network and services sectors curb productivity growth in the manufacturing sector and the economy more broadly (Demmou and Franco, 2020<sup>[5]</sup>; Égert and Wanner, 2016<sup>[12]</sup>; Arnold et al., 2015<sup>[13]</sup>; Bourlès et al., 2013<sup>[14]</sup>; Barone and Cingano, 2011<sup>[15]</sup>).

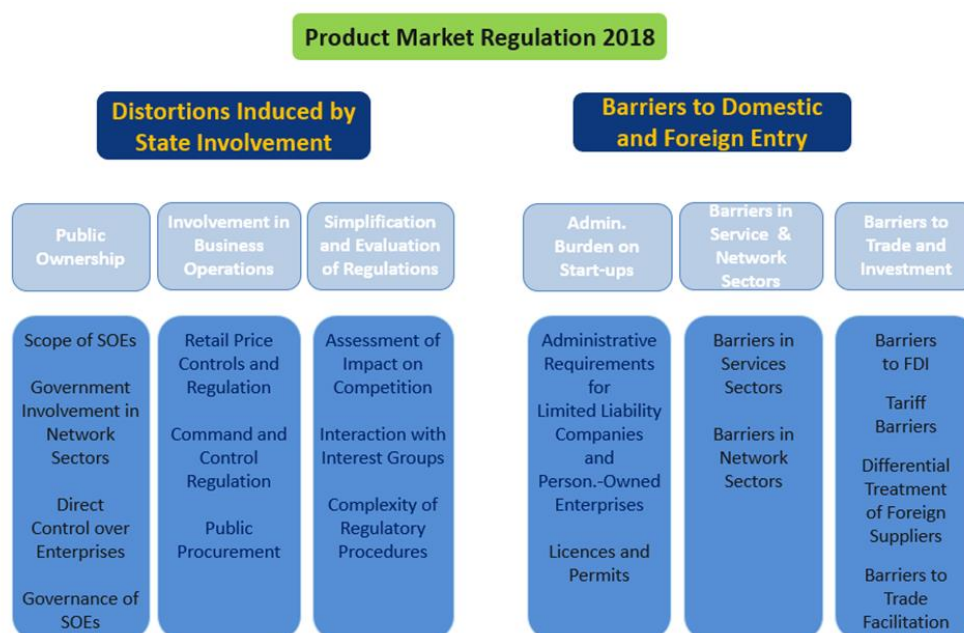
## 2.1 The economy-wide PMR indicator

The economy-wide PMR indicators are constructed from two high-level indicators capturing two potential sources of barriers to competition in the economy:

- i) those that may arise from state involvement in the economy, and
- ii) those that may arise from regulations affecting the entry and expansion of domestic and foreign firms.

Each of these two high-level indicators is composed of three low-level indicators, which are in turn composed of several low-level indicators that refer to specific regulatory domains (Figure 1).

Figure 1. The structure and content of the economy wide PMR indicator



Source : (Vitale, Moiso and Wanner, 2020<sup>[16]</sup>)

### 2.1.1. Indicators of Distortions Induced by State Involvement in the economy

This high-level indicator captures distortions that can be caused by the state's involvement in the economy through the activity of state-owned enterprises (SOEs) and other forms of controls and obligations imposed

by the state on private firms. It covers three key regulatory domains, represented by the three medium level indicators (the light blue boxes on the left-hand side in Figure 1). These are:

1. Presence of state-owned enterprises in the economy and their governance (*Public Ownership*),
2. Controls and obligations imposed on private firms (e.g., price regulation) including the rules regulating public procurement (*Involvement in Business Operations*), and
3. Rules in place to evaluate new and existing regulations in order to minimise negative impacts on competition and efforts to simplify the administrative burden businesses face when interacting with the government (*Simplification and Evaluation of Regulations*).

The ten low-level indicators (i.e., the dark blue boxes on the left of Figure 1) focus each on a specific regulatory area, in particular:

- *Scope of state-owned enterprises (SOEs)*: measures whether the government controls at least one firm in several business sectors, with a higher weight given to the key network sectors on which the PMR exercise focuses.
- *Direct control over business enterprises*: measures the existence of special voting rights by the government in privately owned firms and constraints to the sale of government stakes in publicly controlled firms (based on same sectors and weights as the indicator above).
- *Government involvement in network sectors*: measures the size of the government's stake in the largest firm in key network sectors.
- *Governance of state-owned enterprises*: measures the degree of insulation of state-owned enterprises from market discipline and degree of political interference in the management these firms. This low-level indicator is based on the principles underlying the *2015 OECD Guidelines on Corporate Governance of State Owned Enterprises* (OECD, 2015<sub>[17]</sub>), herein the *2015 OECD Guidelines*.
- *Retail Price Controls*: measures the extent and type of retail price controls in the key network and service sectors.
- *Command and control regulation*: measures the extent to which the government uses command and control regulations, as opposed to incentive-based ones, across key network and service sectors.
- *Public procurement*: measures the degree to which procurement rules ensure a level playing field in access to public contracts for the provision of goods, services and public works.
- *Assessment of Impact on Competition*: measures the level of assessment of the impact of new and existing regulations on competition to ensure minimization of distortions to competition.<sup>4</sup>
- *Interaction with Interest Groups*: measures the existence of rules for engaging stakeholders in the design of new regulation to reduce unnecessary restrictions to competition and for ensuring transparency of lobbying activities.<sup>5</sup>
- *Complexity of regulatory procedures*: measures the government's efforts in reducing and simplifying the administrative burden of interacting with the government.

<sup>4</sup> For OECD countries, half of the information used in calculating this indicator comes from the OECD iREG database, which presents in-depth evidence on countries' regulatory policy and governance practices: [www.oecd.org/gov/regulatory-policy/indicators-regulatory-policy-and-governance.htm](http://www.oecd.org/gov/regulatory-policy/indicators-regulatory-policy-and-governance.htm). Since Indonesia is not included in this database, the information was collected directly from the Indonesian authorities.

<sup>5</sup> As above.



### 2.1.2. Indicators of Barriers to Domestic and Foreign Entry

This high-level indicator captures barriers to firms' entry and expansion across various sectors of the economy. It covers three key regulatory domains represented by the three medium level indicators (the light blue boxes in the right-hand side of Figure 1).

1. The administrative burden that new firms have to face when starting their business (*Administrative Burden on Start-ups*),
2. The qualitative and quantitative barriers firms face to enter and operate in specific key economic sectors (*Barriers in Service and Network Sectors*),
3. The barriers that could limit the access to domestic markets by foreign firms and foreign investors (*Barriers to Trade and Investment*).

The eight low-level indicators (i.e., the dark blue boxes on the right-hand side of Figure 1) focus each on a specific regulatory area, more specifically:

- *Administrative requirements for limited liability companies and personally owned enterprises*: measures the extent of the administrative requirements necessary to set up new enterprises, with a focus on two specific legal forms: limited liability companies and personally owned enterprises.
- *Licences and permits*: measures the existence of initiatives to simplify licensing procedures, such as 'one-stop-shops' for informing business about licences and notifications and for issuing/accepting them, 'silence is consent' rule and programs to review and reduce number of licences.
- *Barriers in services sectors*: measures the extent of the qualitative and quantitative barriers to competition arising from existing incentive-based regulation in key service sectors.<sup>6</sup>
- *Barriers in network sectors*: measures the extent of the qualitative and quantitative barriers to competition arising from existing incentive-based regulation in network sectors.<sup>7</sup>
- *Differential treatment of foreign suppliers*: measures the level of discrimination that foreign firms may experience when participating in public procurement processes, and the barriers to entry that foreign firms may experience sectors relative to domestic firms in key network and service.
- *Barriers to FDI*: measures the restrictiveness of a country's FDI rules in 22 sectors in terms of foreign equity limitations, screening or approval mechanisms, restrictions on the employment of foreigners as key personnel and operational restrictions. This indicator reflects the value of the FDI Regulatory Restrictiveness Index developed by the OECD Directorate for Financial and Enterprise Affairs.<sup>8</sup>
- *Tariff barriers*: reflects the value of a cross-product average of effectively applied tariffs. The source of the relevant information is the UNCTAD Trade Analysis Information System database.<sup>9</sup>
- *Barriers to trade facilitation*: measures the level of complexity of the technical and legal procedures for international trade, ranging from border procedures to the simplification and harmonisation of trade documents. This indicator reflects the value of the average of a subset of the Trade Facilitation Indicators developed by the OECD Trade and Agricultural Department.<sup>10</sup>

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6 This indicator captures the barriers to competition that can exist in service sectors that are related to incentive-based regulation. The low-level indicator Command and Control Regulation measures the barriers created by the government's use of coercive regulations in the same sectors.

7 As above, but with reference to network sectors.

8 More information on the FDI restrictiveness index can be found at [www.oecd.org/investment/fdiindex.htm](http://www.oecd.org/investment/fdiindex.htm).

9 The UNCTAD Trade Analysis Information System database can be accessed at <https://wits.worldbank.org/>

10 More information on the OECD Trade Facilitation Indicators can be found at [www.oecd.org/trade/topics/trade-facilitation/](http://www.oecd.org/trade/topics/trade-facilitation/)

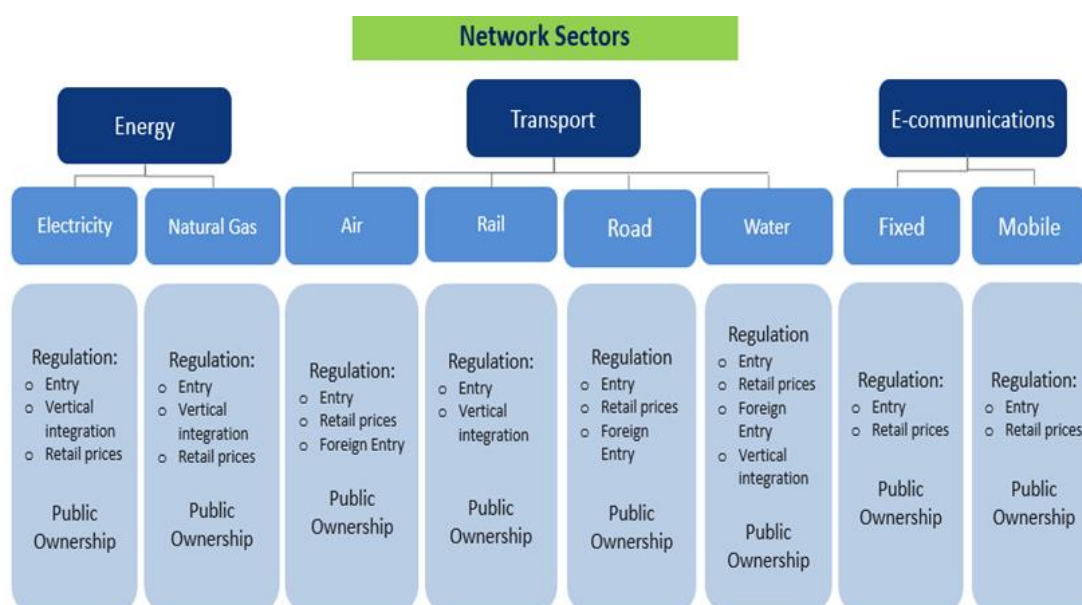
## 2.2 PMR Sector Indicators

The PMR sector indicators summarise information by sector, and not by regulatory domain, as in the economy-wide indicator. These indicators cover three broad sectors: network industries, professional services and retail distribution.

The indicators for network sectors assess eight sectors: electricity, natural gas, air transport, rail transport, road transport, water transport, as well as fixed and mobile e-communications. E-communications are traditionally referred to as telecommunications, but to highlight the relevance of data transmission in the PMR questionnaire and indicators they are referred to as e-communications. Each of these indicators include information on how entry and conduct in the relevant sector is regulated, and on the level of public ownership.

These eight indicators are then aggregated into three indicators, one for each industry (energy, transport and e-communications), and in one single overall indicator covering all network sectors (Figure 2).

Figure 2. Structure of the PMR indicators for network sectors



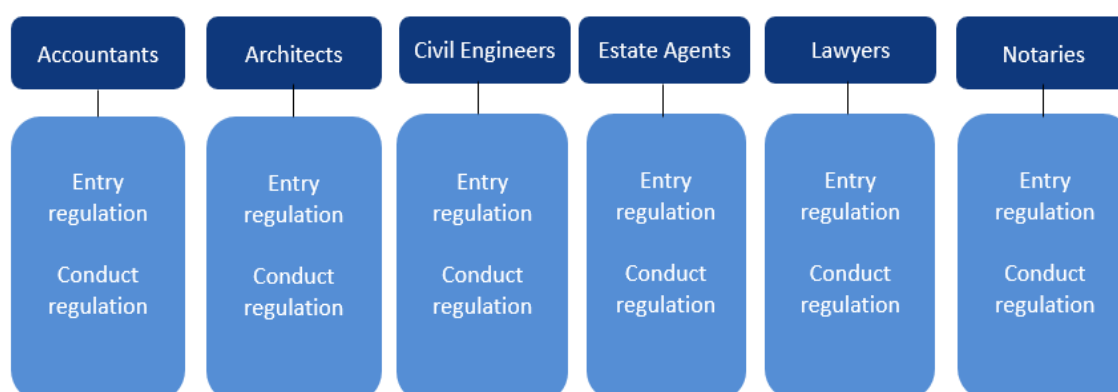
Source: (Vitale, Moiso and Wanner, 2020<sup>[16]</sup>)

The service sector indicators cover six professions (accountants, architects, civil engineers, real estate agents, lawyers, and notaries), as well as general retail distribution and retail sales of medicines.

The professional services indicators include information on entry requirements and conduct constraints (Figure 3), whereas the retail trade indicators cover a broad set of regulatory issues, ranging from shop opening hours to licensing and retail price regulation (Figure 4).

There is no aggregate indicator covering these eight sectors because of the very different nature of the sectors covered. In addition, there is no single indicator on the regulation of all professional services because some professions do not exist in all countries; hence, a single average would distort comparisons.

Figure 3. Structure of the 2018 PMR indicators for professional services



Source: Vitale et al. (2020).

Figure 4. The structure of the PMR indicators for retail trade



Source: (Vitale, Moiso and Wanner, 2020<sub>[16]</sub>)

### 3. Indonesia's results for the PMR Indicators

Tables 1 and 2 below summarise the key take-aways from the results of the 2020 PMR indicators for Indonesia. They show the gap in scores between Indonesia and the average of all OECD countries relative to the standard deviation across OECD countries. The number of asterisks indicates whether the gap is of 1, 2, 3, 4 or 5 or more standard deviations.

The results for the economy-wide PMR indicator suggests that the regulatory setting in Indonesia is less conducive to competition than in most OECD countries (Table 1). The scope for improvement is greater in the area of Distortions Induced by State Involvement in the Economy. Indonesia presents a large presence of State-owned Enterprises (SOEs) across the economy, a high level of government involvement in network sectors, an extensive use of special voting rights as means to influence key decisions in privatised firms, and a tight regulation of retail prices. The corporate governance of SOEs could also be improved. Moreover, the high value of the indicator on Assessing the Impact on Competition indicates that the process for assessing the impact of new laws and regulations could be better aligned with international best practices. On the other hand, Indonesia is relatively more aligned with OECD countries in most areas regarding Barriers to Domestic and Foreign Entry, especially after recent reforms concerning Barriers to Foreign Direct Investments; although here too there is still scope for improvements.

**Table 1. Overview of scope for improvement in economy-wide PMR indicators**

High-level indicators	Medium-level indicators	Low level indicators	Scope for improvement
Distortions Induced by State Involvement	Public Ownership	Scope of State-owned Enterprises (SOEs)	**
		Government Involvement in Network Sectors	**
		Direct Control over Business Enterprises	*****
		Governance of SOEs	*
	Government Involvement in Business Operations	Retail Price Controls and Regulation	****
		Command and Control Regulation	**
		Public Procurement	**
	Simplification and Evaluation of Regulations	Assessment of Impact on Competition	****
		Interaction with Interest Groups	**
		Complexity of Regulatory Procedures	
Barriers to Domestic and Foreign Entry	Administrative Burden on Start-ups	Administrative Requirements for Limited Liability Companies and Personally-Owned Enterprises	-
		Licences and Permits	-
	Barriers in Service & Network Sectors	Barriers in Services Sectors	-
		Barriers in Network Sectors	*****
	Barriers to Trade and Investment	Barriers to Foreign Direct Investment	**** (this could become ** based on the assessment of recent reforms)
		Tariff Barriers	**
		Differential Treatment of Foreign Suppliers	**
		Barriers to Trade Facilitation	*

Note: Scope for improvement is given by size of the gap with the OECD average relative to the standard deviation across OECD countries. The number of asterisks indicates whether the gap is 1, 2, 3, 4 or 5 or more standard deviations.

The PMR sector indicators suggest that regulation in network industries is also less competition-friendly than in OECD countries (Table 2). The sector indicators for network industries comprise two elements: entry regulation and public ownership. In Indonesia, the high level of public ownership contributes to a high indicator value, but regulatory settings are also still far from best practices. Indonesia is more aligned with OECD countries in the regulation of professional services, although this is an area where OECD countries have scope for improvement.

The following sections analyse these results more in detail and provide policy options to make PMR in Indonesia more aligned with international best practices. The OECD average is always shown to provide a reference point. Since OECD countries have undertaken many pro-competition reforms in the last two decades, these countries tend to be closer to international best practice. Hence, throughout the analysis, Indonesia's results are presented alongside its G20 peers (Argentina, Brazil, China, Mexico, Russia, South Africa and Türkiye) and other Asian economies that are currently included in the PMR database (Japan, Korea, and Malaysia), as well as to the average of its G20 peers and the average of all emerging economies currently included in the PMR database, as defined by the International Monetary Fund.<sup>11</sup>

<sup>11</sup> The emerging economies currently in the PMR database includes Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye.

**Table 2. Overview of scope for improvement in the PMR sector indicators**

Broad sector	Low-level indicator	Scope for improvement
<b>Network sectors</b>		
Energy	Electricity	*****
	Natural Gas	**
Transport	by Rail	*
	by Air	**
	by Road	*
	by Water	****
E-Communications	Fixed	*****
	Mobile	*****
<b>Services sectors</b>		
	Lawyers	
	Notaries	
	Accountants	*
	Architects	
	Civil engineers	
	Estate agents	***
	Retail Distribution	*
	Retail Sales of Medicines	

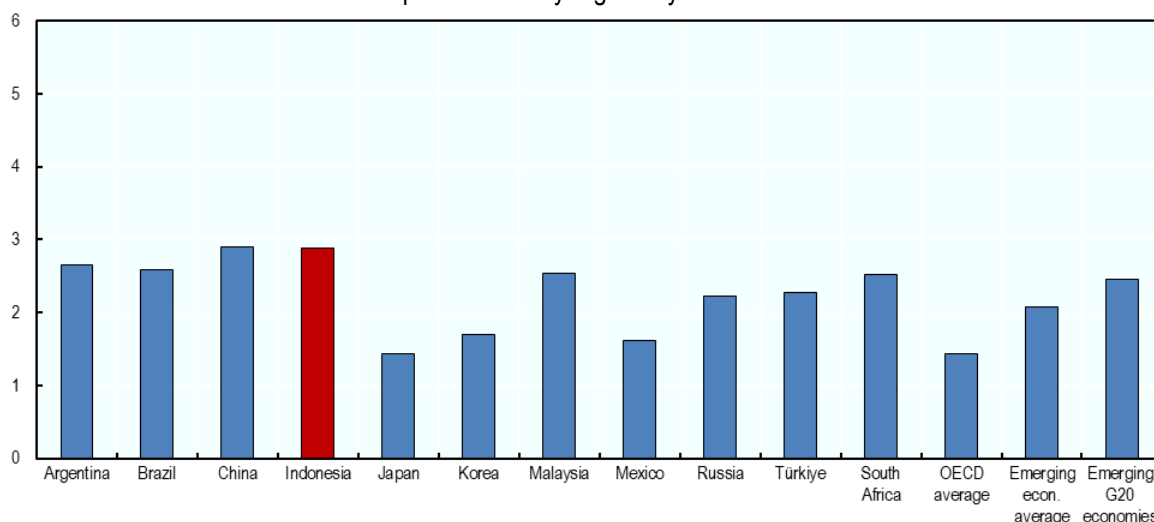
Note: Scope for improvement is given by size of the gap with the OECD average relative to the standard deviation across OECD countries. The number of asterisks indicates whether the gap is 1, 2, 3, 4 or 5 or more standard deviations.

### 3.1. Results for the economy-wide PMR indicator

The 2020 economy-wide PMR indicator suggests that Indonesia's regulatory regime is less pro-competition than that of OECD member countries and other emerging economies, apart from China (Figure 5).

**Figure 5. Economy-wide PMR indicator**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



*Note:* The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019, and for Indonesia, Malaysia and China to 1 January 2020.

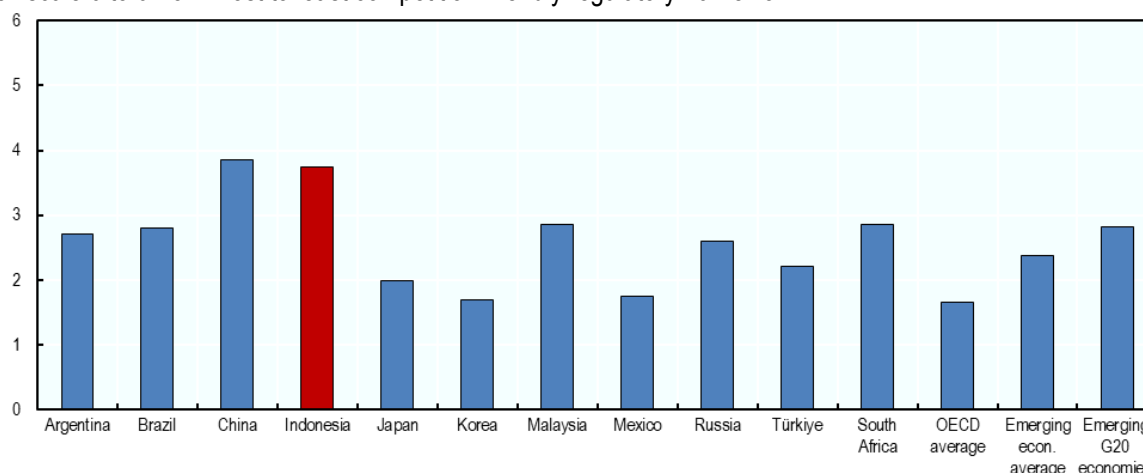
*Source:* OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

### 3.2. Results for Distortions Induced by State Involvement

The result for the economy-wide PMR indicator is driven by the value of the high-level indicator of *Distortions Induced by State Involvement*, which is much higher than for most peer countries (Figure 6). The value of the high-level indicator *Barriers to Domestic and Foreign Entry* (Figure 7) is more aligned with peer countries.

**Figure 6. High-level component: Distortions Induced by State Involvement**

Index scale 0 to 6 from most to least competition-friendly regulatory framework

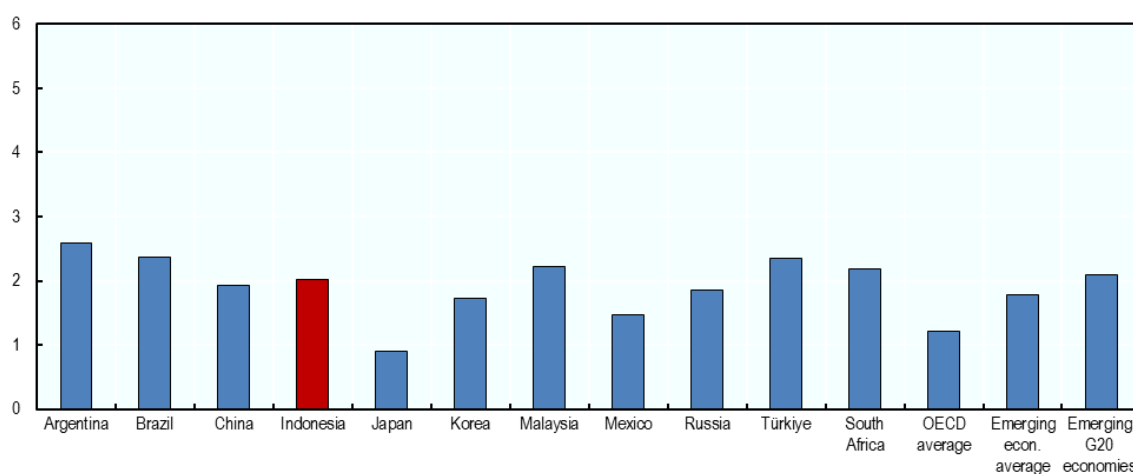


*Note:* The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020.

*Source:* OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

**Figure 7. High-level component: Barriers to Domestic and Foreign Entry**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



*Note:* The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020.

*Source:* OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

### 3.2.1. Public Ownership

The high value of the indicator *Distortions Induced by State Involvement* reflects:

- the wide presence of SOEs across the economy,
- the existence of special voting rights held by the government in privately owned firms,
- the tight constraints on the sale of government stakes in state-controlled firms, and
- a comparatively high level of government involvement in network sectors through its control of incumbent firms.

The PMR indicators capture the level of state presence across the economy in terms of sectors in which the government controls at least one firm and the amount of shares it owns in the largest firms in key network sectors. Extensive state presence warrants that significant attention is paid to how SOEs are organised and managed.

According to data collected through the PMR questionnaire, the **Scope of SOEs** is high in Indonesia, with the central government owning at least one company in 35 of 41 economic sectors covered by the questionnaire (Figure 8, top left panel). Indeed, Indonesia has the highest score for this indicator after China. State ownership of firms is not necessarily a concern *per se* and may be justified based on economic rationale and social objectives. However, risks to competition can arise, for example the private sector could be crowded out or allocative efficiency could be weakened. Hence, when the presence of SOEs in commercial activities is so widespread, it is crucial that the framework governing these SOEs guarantees that these firms compete on a level playing field with privately owned firms, i.e., that it ensures *competitive neutrality* among SOEs and privately owned firms.

On the low-level indicator that measures the quality of the **Governance of SOEs**, Indonesia performs better than several peer countries and its score is a little below the average of emerging G20 economies (Figure 8, bottom right panel). This is noteworthy given the importance of governance rules when state ownership is pervasive across the economy. However, the comparison with the OECD average shows there is room to improve the governance rules and to align them and their implementation to the *2015 OECD Guidelines* (OECD, 2015<sub>[17]</sub>). For instance, there is no broad requirement to separate activities that are, or could be, exercised in competition with private firms from non-competitive ones, thus creating the risk for cross-subsidies between different activities that can distort competition. In addition, the Constitution protects the role of the state in business activities that are deemed to be important for the public and for the state and, as a result, Competition Law 5/1999 includes two provisions that may result in the exemption of SOEs, for instance by allowing SOEs to operate legal monopolies in certain economic activities.<sup>12</sup> Moreover, SOEs have access to finance at privileged conditions compared to private firms, as for some, though quite limited, activities such as infrastructure projects, SOEs can benefit from government guarantees coming from the Guarantee Reserve Fund.<sup>13</sup> Overall, Indonesia could benefit from a comprehensive regulatory framework for ensuring competitive neutrality, which would help the country to bring the governance of its SOEs more in line with OECD standards (see Section 3.2. for more details).

The government is heavily involved in network sectors, as indicated by the value of the indicator on **Government Involvement in Network Sectors** (Figure 8, top right panel). This indicator is higher than in peer countries, apart from China. Indeed, the largest firm in most of the network sectors assessed is fully government owned; that is, in electricity generation and retail supply, in gas production, export, and storage, in freight and passenger rail transport, in freight and passenger water transport and in the operation of water terminal facilities (such as harbours and piers) and airports. In addition, the government

<sup>12</sup> Articles 50 and Article 51 of Law No. 5 of 1999 on Anti-Monopoly and Unfair Competition are discussed in OECD (OECD, 2021<sub>[24]</sub>).

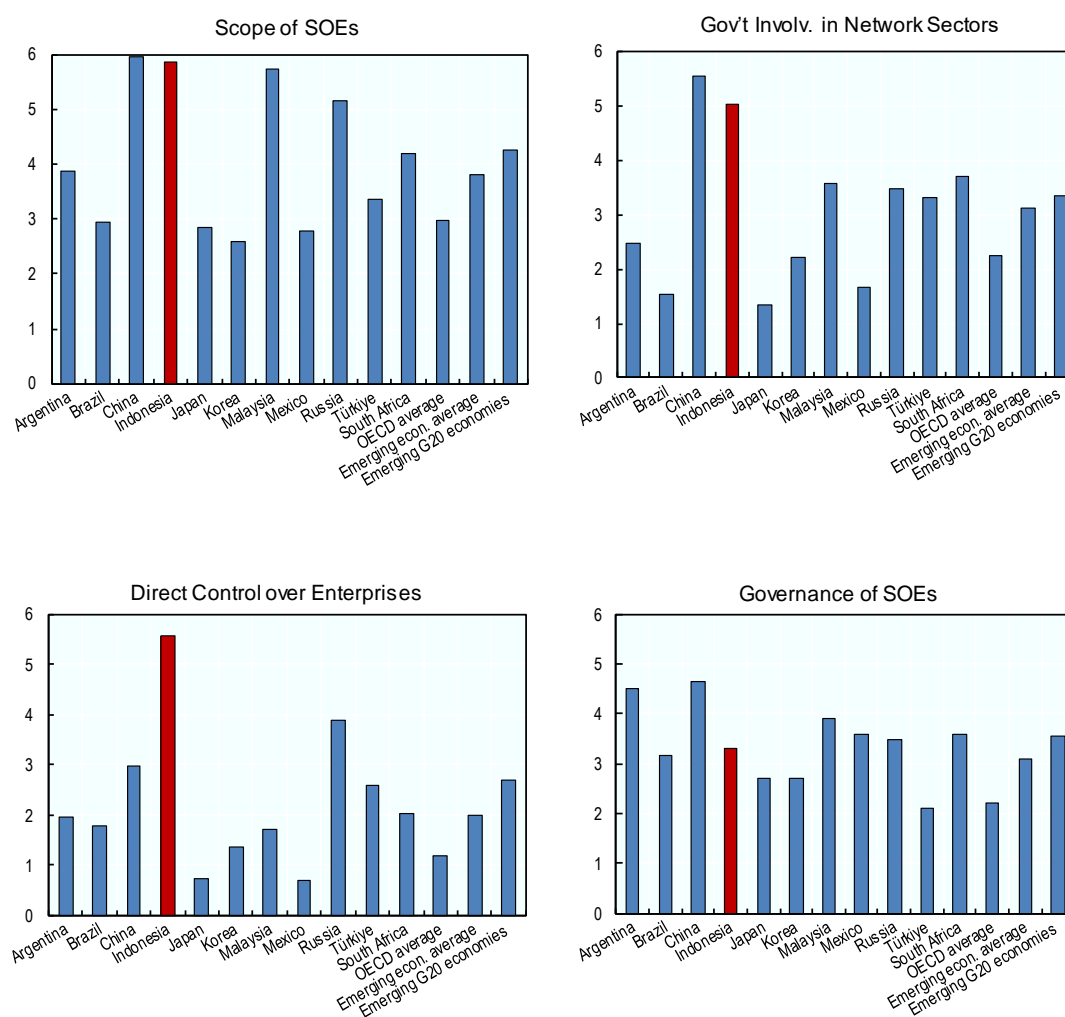
<sup>13</sup> This fund is subject to Ministry of Finance Regulation No. 30/PMK.08/2012



has a majority equity holding in the largest firm in gas retail supply, in fixed e-communications, and in domestic and international air transport. Other peer countries, such as Brazil and South Africa, have lower scores because the largest players in some network sectors are privately owned, and the government has smaller equity stakes in those sectors where there are state-owned incumbents.

**Figure 8. Low-level components on Public Ownership**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



Note: The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020.

Source: OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

The indicator of **Direct Control over Business Enterprises** measures the existence of special voting rights held by the government in privately controlled firms and of constraints to the privatisation of SOEs. Indonesia has a much higher score than other countries (Figure 8, bottom left panel). This indicator also shows the largest gap with the average across G20 emerging economies and the OECD average. The two main drivers of this result are: (i) the 2003 law on SOEs, which requires Parliament to approve the privatisation of any SOE; and (ii) SOEs' articles of association, which provide that the government has to

maintain a golden share (“dwiwarna” share) upon privatisation. The golden share ensures the government retains significant control over a privatised company through veto powers and the ability to nominate candidates to the Board of Directors and Board of Commissioners. In most countries, decisions about maintaining special voting rights are made on a case-by-case basis. For example, in Kazakhstan the government has retained special voting rights in the water sector, whereas in Brazil there are special voting rights for SOEs involved in operating airports, manufacturing basic metals and manufacturing aircraft, but not in other sectors. Likewise, legislative approval for SOEs’ privatisation is a requirement only in some sectors, including non-OECD countries (for example, South Africa and Russia).

### 3.2.2. Government Involvement in Business Operations

The results for this medium-level indicator suggest that the government imposes relatively extensive obligations on firms. In particular, retail price controls are more widespread in Indonesia than in other emerging economies or in OECD countries (Figure 9). Indonesia also makes greater use of command-and-control regulation (i.e., coercive rather than incentive-based regulation) in both network sectors and service sectors and has a less competition-friendly public procurement framework than most peer countries.

The indicator of **Retail Price Controls and Regulation** captures the extent and type of controls and regulation imposed on retail prices in key network and services sectors. Indonesia’s use of this type of controls is considerably more extensive than other countries, not just OECD ones but also other emerging economies (Figure 9, top left panel).

Retail prices of staple goods (rice, sugar, frozen meat, and cooking oil) and household fuels are subject to controls. The Indonesian government imposes them to protect consumers, and in some cases producers. However, there is considerable evidence across countries that price controls distort production and investment decisions, delay market entry, misdirect consumer choices (leading often to over-consumption), and favour the development of parallel black markets. As discussed below (Section 2.2), there are more efficient ways of supporting low-income consumers than through controls on retail prices. Brazil, a country with a high incidence of low-income households, does not regulate fuel prices, nor the prices of staple goods.

In several network sectors (air transport, water transport, road transport, retail supply of natural gas, and fixed and mobile e-communications), retail prices are regulated or, in a few cases, subject to government pricing guidelines, even though these markets are open to competition.<sup>14</sup>

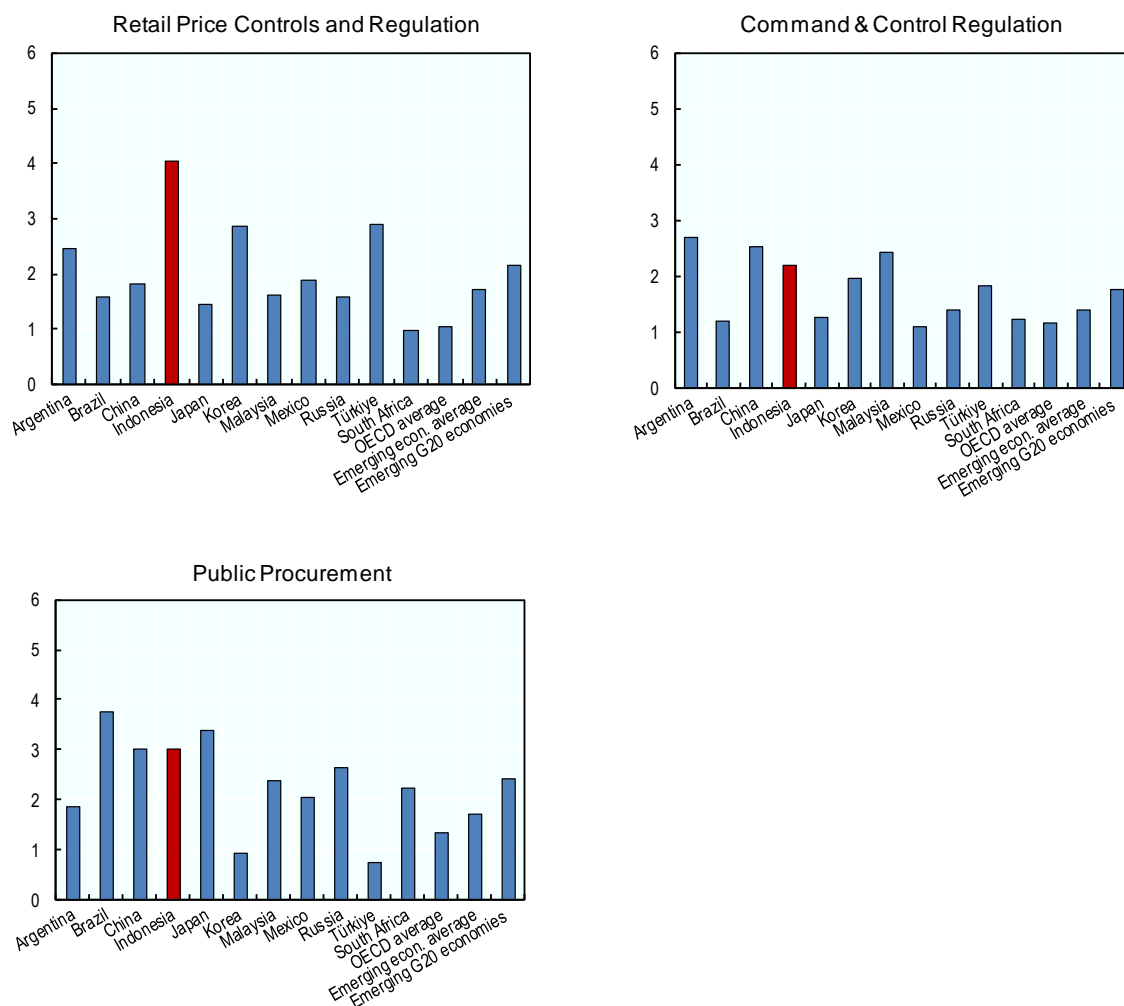
The government uses **command and control regulations** across key network and services sectors more extensively than in most emerging economies, except for Argentina and China (Figure 9, top left panel). For example, there are restrictions on the legal structure of some professional firms or on who can have ownership rights in such firms (for lawyers, notaries, accountants, civil engineers and real estate agents). These types of restrictions limit the ability of firms to obtain financing and to be more innovative.

The result for the indicator on **public procurement** of goods, services and public works suggests that the rules in this area do not guarantee that all firms compete on a level-playing field. Indonesia’s score is higher than other emerging economies, except Brazil, and on a par with China (Figure 9, bottom panel). It should be noted that this is an area where *de jure* and *de facto* realities are often quite different, making comparisons difficult (Vitale et al., 2020<sub>[18]</sub>). Nevertheless, Indonesia lacks some requirements that, if enforced, would ensure greater competition for public contracts.

<sup>14</sup> Retail price controls that are imposed because a market is a monopoly are not considered.

**Figure 9. Low-level indicators on Government Involvement in Business Operations**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



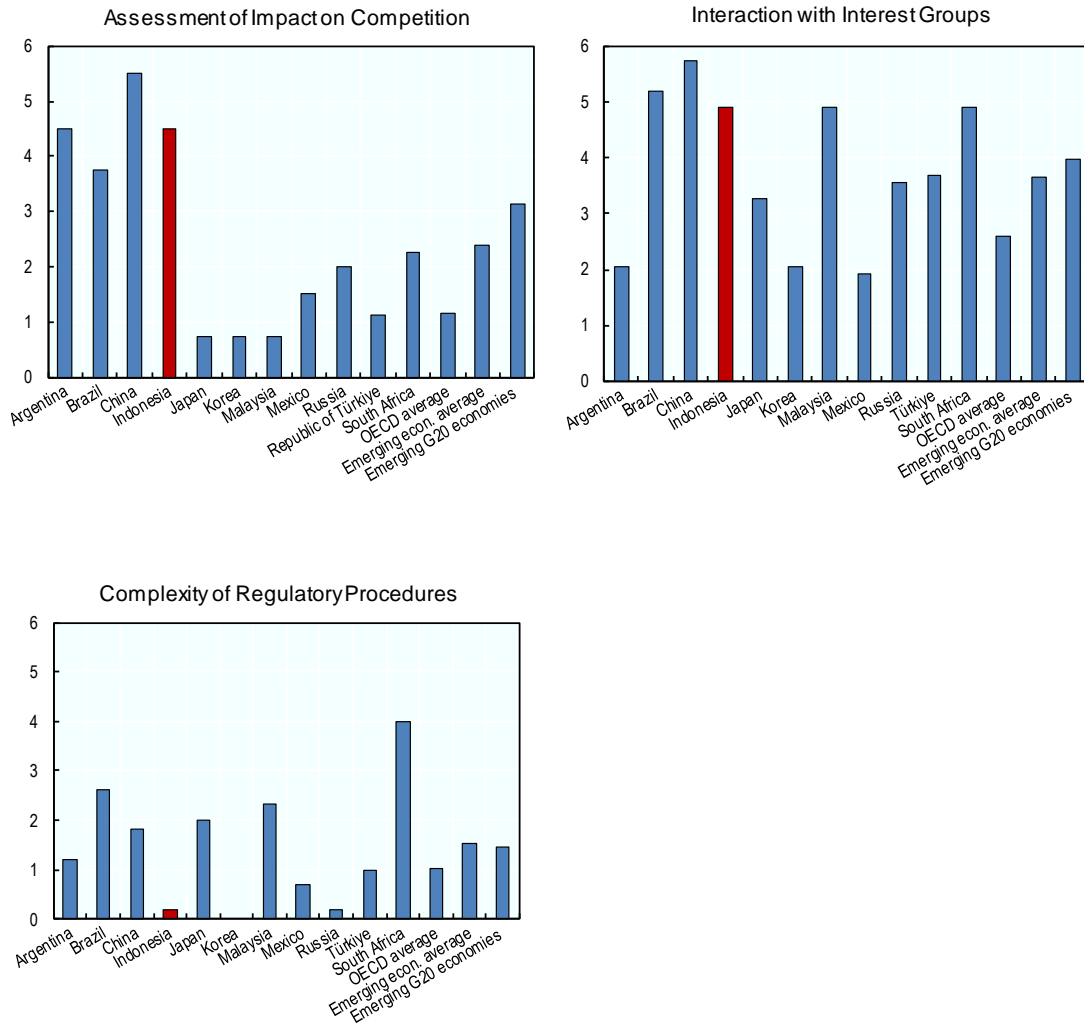
Note: The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020. Source: OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

3.2.3. Efforts to simplify and evaluate of regulations

Indonesia’s performance in the low-level indicators that assess the processes for simplifying and evaluating regulations is mixed (Figure 10).

Figure 10. Low-level indicators on Simplification and Evaluation of Regulations

Index scale 0 to 6 from most to least competition-friendly regulatory framework



Note: The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020. If the bar for a country or for a specific indicator does not appear on the chart, it means that its value is 0.

Source: OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

The indicator that measures the **complexity of regulatory procedures** has a relatively low score (Figure 10, bottom panel). This reflects past and current programs aimed at reducing red tape, which include the 2018 government regulation on Electronic Integrated Business Licencing Services. This regulation required an assessment of existing regulations to identify those that could be removed or simplified. It also asked ministries to co-ordinate amongst themselves to simplify business licences and permits, facilitated by the Coordinating Ministry for Economic Affairs. Another major innovation introduced by this regulation was an online one-stop shop (the Online Single Submission System) covering many licensing requirements at the national and, increasingly, subnational levels. This one-stop shop continues to be improved, as recommended in the 2018 *Economic Survey* (OECD, 2018<sup>[19]</sup>) and in the 2020 *OECD Investment Policy Review* of Indonesia, because it still does not include all the administrative procedures associated with starting a business.<sup>15</sup> The implementation of the Omnibus Law on Job Creation, which centralises more licensing processes, will further increase the coverage of the one-stop shop.

Requirements regarding the communication of regulatory agendas and the use of plain language in the drafting of new laws are also in line with best practice. However, the regulatory regime for assessing the impact of new and existing regulations on competition (**Assessment of Impact on Competition**) could be improved (Figure 10, top left panel). Indonesia's score is high in this indicator, and well above the average of G20 emerging economies. This result is driven by the lack of a clear requirement to perform regulatory impact assessments (RIAs) as part of policy development. Law 12/2011 on the Formation of Legislation requires policymakers to analyse the impact of new laws, but this requirement is not equivalent to the use of a RIA as defined by the OECD (see OECD (2012<sup>[20]</sup>) and OECD (2020<sup>[21]</sup>)). Although a Presidential Instruction (7/2017) promotes the use of RIAs for new regulations, it ranks below the law on Formation of Legislation and is not binding in practice.

A RIA is an exercise that requires policymakers to identify alternative regulatory and non-regulatory solutions to address a specific policy need and to assess their relative costs and benefits, including their impact on the competitive process, in cooperation with stakeholders. These assessments need to be underpinned by robust and reliable data. The RIA helps to identify the most appropriate solution to the policy need and to ensure that stakeholders are appropriately consulted and involved. The use of RIAs enhances the quality of new laws and regulations, and their publication improves transparency around decision-making.

With respect to competition advocacy, the *de jure* situation in Indonesia is similar to most OECD and non-OECD countries: the competition commission (*Komisi Pengawas Persaingan Usaha*, or KPPU) is an independent body with powers to advocate competition. KPPU can carry out market studies, which can be a powerful tool to enhance competition, but its recommendations are non-binding and the government is not required to publicly respond to them. As a result, the KPPU recommendations have limited impact in terms of removing barriers to competition that fall outside the traditional scope of antitrust law.

Having clear rules that regulate the **interaction with interest groups** is important, because they ensure that stakeholders' views are considered when designing regulatory proposals. These views help to identify potential consequences of any eventual regulations and are important to build trust and a sense of shared ownership in any regulatory framework (Lind and Arndt, 2016<sup>[22]</sup>). In addition, such rules guarantee transparency in the interaction between policymakers and interest groups and limit opportunities for distorting the regulatory design process at the expense of new entrants and smaller firms. The high value that this indicator has in Indonesia points to a large gap with OECD countries' practices, as well as with the settings in many G20 peers (Figure 10, top right panel). Although policymakers must consult stakeholders (according to Law 12/2011), there is no standard process for collecting such comments, nor any obligation to publicly respond to them, which ensures that these comments are properly taken into account in policy design. In addition, there are no rules at the national level to ensure transparency and

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<sup>15</sup> OECD (2020<sup>[59]</sup>) can provide useful examples of effective one-stop shops.

accountability in the interactions between public officials, such as legislators, and interest groups. The lack of rules in this area may favour lobbying activities by incumbents and firms with greater resources. In addition, Indonesia does not have national-level regulations concerning conflicts of interest for public officials; rather these are delegated to individual ministries and agencies, which creates the possibility for substantial heterogeneity and complicates their enforcement. Finally, there is no requirement for a cooling-off period for public officials that wish to move to the private sector.

### 3.2.4. Opportunities for improving the terms of state involvement in the economy

This section focusses on ways that Indonesia could bring its regulatory settings towards best practice in those areas where the PMR indicator results have shown the largest gaps. A table summarising policy options for improvement is presented at the end of the section.

#### **Options for reducing distortions caused by the presence of the state in the economy**

The PMR indicators highlight that public ownership is extensive in Indonesia. According to the Ministry for SOEs, there were 114 central government SOEs on 1 January 2020, which in turn had hundreds of subsidiaries that also had subsidiaries. These figures do not include enterprises owned by provincial or local governments, of which there are many more. The value of the indicators also does not reflect those cases where there is more than one SOE in a sector; for example, three of the four largest banks by assets are state-owned. While it might be justified for the government to retain a certain level of participation in specific sectors, a thorough assessment of the rationale for the state's presence in the economy would be useful. Indonesia could improve the regulatory framework for SOEs by designing and publishing a whole-of-government ownership policy that sets out the rationale for state ownership, as recommended in the 2015 *OECD Guidelines* and the 2018 *Economic Survey* (OECD, 2015<sup>[17]</sup>; OECD, 2018<sup>[19]</sup>). This would involve reviewing the rationale for state ownership provided in the 2003 Law on SOEs and provide more details on the justification for such holdings (Box 1). This review could eventually guide possible privatisations (OECD, 2019<sup>[23]</sup>).

Moreover, when state ownership is pervasive there is a greater risk that distortions to competition arise if the corporate governance of SOEs is still distant from best practice. Hence, even though Indonesia is close to the average of emerging G20 economies on the low-level indicator *Governance of SOEs* (Figure 9), it still lacks some of the rules that foster competitive neutrality between SOEs and private firms. The risks of competitive distortions that the lack of these rules can cause are elevated by the level of government's holdings.

The PMR indicator on *Governance of SOEs* shows that in some sectors SOEs do not compete on a level playing field with the private sector, as some of them enjoy several benefits, such as interest rate subsidies, government guarantees, and implicit guarantees. Although some of these policies form part of the government's strategy to use SOEs to help meet infrastructure investment targets, there can be costs in using this approach, in terms of competition distortions and loss of efficiency, that should be carefully evaluated (OECD, 2018<sup>[19]</sup>). Distortions to competition can also arise in markets for public procurement because SOEs can bid alongside private firms, which creates conflicts of interest for the government as procurer and risks deterring private investment (OECD, 2018<sup>[19]</sup>). This can erode value-for-money in procurement processes and hamper the emergence of productivity-enhancing ideas and innovations. Further distortions can arise from the fact that an SOE procuring goods or services may assign the contract to another SOE without running a procurement tender, thus preventing private firms from obtaining such contracts (OECD, 2021<sup>[24]</sup>). Direct awards should be limited to ensure that private firms can also compete for the assignment of public contracts and that contracts are assigned to the most efficient provider.

The 2018 OECD *Economic Survey* of Indonesia (OECD, 2018<sup>[19]</sup>) recommended giving clearer mandates and objectives to public enterprises along with greater independence to deliver them. In principle, monopoly rights should be granted to SOEs only when the relevant market has the characteristics of a

natural monopoly, or when other clearly justified market failures support such an extreme decision. In addition, the 2021 *Economic Survey* of Indonesia recommended ensuring that SOEs are always subject to competition law and held responsible if they abuse their dominant market position (OECD, 2021<sup>[25]</sup>).

Further, SOEs performing both non-competitive activities and activities in which they compete or potentially compete with private firms could be required to separate these activities by implementing accounting, legal or operational separation to avoid cross-subsidies. The choice of the most appropriate form of separation should be guided by an evaluation of the costs and benefits of the various possible options (see OECD (2016<sup>[26]</sup>)). In principle, accounting separation should be implemented as a minimum to avoid cross-subsidies, as these can lead to inefficiencies and competitive distortions.

Allowing the board of SOEs, rather than the Ministry of Finance or Ministry of SOEs, to appoint the top management, especially the CEO, would strengthen independence and accountability. Likewise, publishing the pay scales used to calculate executives' remuneration would introduce greater transparency on the state's policy in this area.

It should be acknowledged that Indonesia has made progress regarding aggregate reporting practices of SOEs, bringing them more in line with the 2015 *OECD Guidelines*. The Ministry of SOEs produces a report called "Government Agency Performance Accountability Report" (*Laporan Akuntabilitas Kinerja Instansi Pemerintah*) on an annual basis. The report covers both financial and non-financial aspects of all SOEs in Indonesia. In addition, there are dedicated websites for each SOE and the links for each SOE are available on the website of the Ministry of SOEs. However, more could be done to enhance disclosure and transparency in this sector to bring it closer to OECD best practices. The most important changes that the OECD has recently recommended are (OECD, 2020<sup>[27]</sup>): i) including the board composition and their remuneration in the annual aggregate report on the SOE sector; ii) introducing a requirement to report any form of financial assistance granted by the state to the SOE, as well as any commitment that the state undertakes on behalf of an SOE; and iii) improving the quality of accounting and auditing standards for unlisted or small SOEs. On top of those, the OECD has also recommended to ensure that the boards of SOEs are sufficiently independent and that direct appointments by the minister are limited to very specific circumstances (OECD, 2021<sup>[24]</sup>).

In terms of obstacles to possible privatisations, the systematic presence of golden shares increases the potential for state intervention and adds to the uncertainty faced by potential investors, thus possibly reducing the sale price of SOEs' shares (OECD, 2019<sup>[23]</sup>). To address this, the blanket rule that the government shall always maintain a golden share could be removed. Golden shares could instead be limited to those sectors where they are strictly necessary to protect essential public interests. The accompanying rights should also be proportionate to the objectives they are meant to achieve (OECD, 2015<sup>[17]</sup>). For example, limiting the duration of golden shares would ensure that the need for maintaining them is regularly reviewed (OECD, 2019<sup>[23]</sup>). Likewise, the requirement for consultation with the parliament before selling all or part of any SOE could be relaxed in non-strategic sectors.

Indonesia is aware of these challenges and indeed reforms are currently being implemented to improve the governance of SOEs<sup>16</sup>.

### Box 1. State ownership policies in practice

An ownership policy for SOEs should ideally be a concise, high-level policy document that outlines the overall rationales for state enterprise ownership and the role and responsibilities of the state. It provides all stakeholders, including the company's board and management, parts of government and employees and labour groups, with a clear understanding of the state's overall objectives and priorities as an owner.

<sup>16</sup> See [Reimagining Indonesia's State-Owned Enterprises - Ahmed M. Saeed and Erick Thohir | Asian Development Bank \(adb.org\)](#)

It also provides predictability for market participants and accountability for the general public, who are the ultimate owners of SOEs. It can also help to identify possible candidates for privatisation, based on when an SOE no longer falls within the rationale for state ownership.

State ownership policies include the following features:

- Set out the state's overall objectives and priorities as an owner and explicit rationales for state ownership. These could include the provision of public services, or strategic goals such as the maintenance of certain industries under national ownership.
- Identify state's role and responsibilities in the governance of SOEs. This includes the mandate of the ownership entity, as well as the main functions, roles and responsibilities of all government entities that exercise state ownership. It should synthesise main elements of relevant policies, laws and regulations as well as any other guidelines that inform how the state exercises ownership rights. If relevant, it should also include information on any privatisation policy and plans.
- Used to define rationales for shareholdings in individual firms. For example, fulfilling public policy functions, for strategic reasons or because they operate in sectors with characteristics of natural monopoly. If individual SOEs or groups of SOEs are required to achieve public policy objectives, these should be clearly mandated and disclosed.
- Reviewed periodically. For example, this could be as part of state budgetary processes, medium-term fiscal plans or with the electoral cycle. Early consultation with stakeholders and the public can increase credibility.

In Korea, the ownership policy for SOEs is determined by legislation and government decree. The ownership entity is required to regularly review and revise its ownership policy. In Norway a whole-of-government state ownership policy is expressed as a white paper that is presented to the Norwegian Parliament but not subject to its approval. A new White Paper is published every four years after each parliamentary election. The White Paper includes the overall objectives for state ownership and for each individual company in which the state is a shareholder and states how the government intends to exercise its ownership. In Germany, the portfolio of SOEs is reviewed every two years and state ownership of each enterprise must be justified or it will be privatised.

Source: OECD (2020<sup>[28]</sup>; 2019<sup>[23]</sup>; 2015<sup>[17]</sup>)

### Options for reducing government involvement in business operations

The PMR results highlight that there could be scope for liberalising retail prices that are currently subsidised or subject to ceilings, such as staple foods and household fuels. The OECD has previously recommended to Indonesia alternative policy approaches to address food security (OECD, 2015<sup>[29]</sup>; 2015<sup>[30]</sup>) and access to fuel (OECD, 2019<sup>[31]</sup>; 2018<sup>[19]</sup>). In particular, the substantial improvements in targeting, coverage and delivery of the social safety net in recent years makes it feasible to undertake further reforms that liberalise prices of household foods and fuels, while relying on targeted income support and vouchers to protect poor households. Cost-reflective pricing would also reduce the fiscal cost of subsidies and encourage efficient levels of consumption (OECD, 2019<sup>[31]</sup>; 2019<sup>[32]</sup>; 2018<sup>[19]</sup>).

In several network sectors (air transport, water transport, road transport, retail supply of natural gas, and fixed and mobile e-communications) retail prices are regulated, even though these markets are open to competition. Where competition is effective such price regulation is unnecessary and distortive (see for example, the analysis of road transport in OECD (2021<sup>[33]</sup>)). In those markets where competition is still developing, such as retail supply of natural gas, retail price regulation may be necessary to protect consumers. However, regulated tariffs are currently not based on the costs of the most efficient supplier. Gas and electricity prices are also held down by requirements for gas and coal producers (along with oil



producers) to sell some production on the domestic market at discounted prices.<sup>17</sup> This means that prices will neither give consumers the right signals to consume efficiently, nor provide the correct incentives for entry by new players, thus hampering the development of effective competition. Additionally, the lack of cost-based retail prices discourages investment in efficiency-enhancing technology and innovation by the incumbent (Restuccia and Rogerson, 2017<sup>[34]</sup>). Ensuring that retail tariffs for network services reflect the cost of the most efficient supplier would strengthen competition, encourage investment and ultimately improve productivity (OECD, 2019<sup>[31]</sup>; 2019<sup>[32]</sup>; 2018<sup>[19]</sup>).

Similarly, retail prices for fixed and mobile e-communications services are regulated because the incumbent operators in both markets (PT Telekomunikasi Indonesia and PT Telekomunikasi Selular) have a very large market share. However, the PMR assessment of the regulatory framework in these markets shows that more could be done to foster the development of competition. Introducing number portability, for example, would remove an important obstacle to consumer switching and could foster competition (see Box 2).

In the service sectors, competition and innovation in professional services would benefit from fees being further liberalised, and from restrictions on the legal and ownership structure being reduced. These restrictions do not provide benefits to consumers, while they limit access to sources of funding and to better management skills for professional firms.

Public procurement policy could be brought closer to that of OECD countries by ensuring greater transparency and creating the conditions for a level playing field for all firms – foreign and domestic, large and small. This would allow the state to benefit from acquiring goods and services at lower prices, while supporting the most efficient firms. Some parts of the public sector already have introduced e-procurement; requiring *all* procurement agencies to make all tender documentation freely available online would increase the openness and transparency of the process and would simplify the acquisition of the information necessary to firms to decide where to bid. Systematically allowing bids to be submitted online, rather than in paper form, would also increase competition by expanding accessibility. Currently, reference prices are published online: this can facilitate collusion amongst bidders by giving a price on which to coordinate. Hence, it would be more appropriate for the procuring authority not to disclose reference prices, but instead to use them only internally to assess value-for-money. Further, tightening exemptions to competitive tenders would generate efficiencies and reduce opportunities for corruption. The 2021 *Economic Survey* recommended limiting direct awards only to satisfy urgent and unforeseeable needs, when there really is only one qualified supplier, and terminate them as soon as possible (OECD, 2021<sup>[25]</sup>). In addition, there should be no differential treatment between domestic firms and foreign firms in the award of tenders for public work, as this only discourages the latter and reduces efficiency.

### Box 2. Success factors for number portability

Number portability allows consumers to keep their number when they switch to another service provider. This regulatory requirement is widely regarded as a fundamental prerequisite for effective competition and choice in telecommunication markets. OECD countries have adopted it, with a positive impact on the level of consumer mobility and, hence, on competition (Cho, Ferreira and Telang, 2013<sup>[35]</sup>). International experience points to some key factors for successful implementation:

- **Application of international experience.** Regulators should use, when possible, well-established processes and technical solutions.

<sup>17</sup> See also the OECD June 2020 Fossil Fuel Support Country Note at <http://stats.oecd.org/wbos/fileview2.aspx?IDFile=52efa13c-bd5d-4493-9dc6-9ba637821ae4>

- **Involvement of operators.** Because the operation of number portability falls on service providers, it is crucial that regulators make sure all service providers work with them to define and implement number portability processes.
- **Porting time.** A shorter porting process is better for competition and consumers. Long porting times discourage users from switching provider and translate into lower numbers of ports. Regulators should require that the shortest possible time is taken to complete number portability. In most countries included in the PMR where number portability is implemented, porting of mobile numbers must be completed within one business day (e.g., European Union member states, Chile and Peru). Regulating the number of days would ensure that consumer switching is not discouraged by long waiting times.
- **Porting fees.** High porting fees hinder porting opportunities. Ideally, no onus should fall on consumers once they have expressed a preference to change provider. If fees do exist, they should fall on the operator that receives the number. Fees should in any case only reflect the costs that an efficient operator would incur to port the number and should be set or approved by the sector regulator to avoid abuses that could discourage customer switching.
- **Simplified processes for consumers.** Number porting should be simple and rapid for consumers. All information on cost and maximum time required to port numbers should be made available in advance to consumers.
- **Consumer awareness.** In some countries, regulators have gone to significant lengths to make consumers aware of number portability, such as through marketing campaigns and publications on their websites and on social media. Service providers should give consumers accurate information on portability before, during and immediately after portability processes.
- **Clear guidance.** Regulators should ensure that service providers are aware of, understand and comply with all obligations relating to national legislation on number portability.

Source: Adapted from OECD (2016a) and BEREC (2010).

### Options to improve the design of new regulations

There is scope to reduce the gap between Indonesia and other countries in terms of the requirements that should be met when addressing novel public policy needs and designing new policies. Aligning with international best practice would contribute to higher quality of laws and regulations over time, enhanced regulatory stability, and increased well-being. The current framework in Indonesia (see section 2.2 above) does not require RIAs to be undertaken systematically. As a result, it is difficult for policymakers to identify the most appropriate solution to address a specific policy need, as well as to ensure that the costs of any government intervention do not exceed its benefits. This risk is further heightened by the fact that the regulatory framework ensuring transparency in the interactions between policymakers and interest groups is comparatively weak, which can make it easier for some interest groups to have an excessive influence over policy design.

The OECD has developed detailed guidelines on RIA (Box 3). Embedding RIAs and stakeholder engagement in the policy development process from the outset would improve the quality of new laws and regulations by helping to avoid potential unintended negative consequences, and would increase the buy-in and trust of stakeholders and citizens. This, in turn, can help to boost compliance and reduce government enforcement costs. Malaysia's experience illustrates how these processes can be improved (Box 3).

Quality of laws and regulations would benefit if ministries were required to perform a RIA whenever a new policy need is identified and well before starting any resultant regulatory drafting process. The practice of institutionalising RIAs is increasingly widespread among OECD and accession countries. RIAs identify and

evaluate all potential alternative solutions for addressing the policy need identified, and select the most appropriate instrument, or mix of instruments, to achieve it. RIAs also include an assessment of all potential economic, social and environmental costs and benefits borne by businesses, citizens or government for the possible alternative options. Costs and benefits are usually assessed in a quantitative manner whenever this is possible. RIAs also consider the impact of the proposed solutions on the competitive process and carefully evaluate any adverse effects that these solutions may have against their claimed benefits. To ensure that new regulatory interventions are effectively needed a “no policy change” option is always examined among the proposed solutions. In addition, stakeholders are involved in the process to help better identify all potential costs and benefits and to foster buy-in and improve trust in government action. Good practice also includes ensuring that an oversight body is responsible for reviewing the quality of the RIAs.

Indonesia could benefit from institutionalising and embedding RIA into its policy making processes. A gradual approach to their introduction could help build a better understanding of the instrument and its use, as well as of the skills necessary to complete them, to avoid the exercise becoming compliance-oriented and bureaucratic.

In a growing number of jurisdictions<sup>18</sup>, detailed RIAs are employed for those regulatory proposals that are expected to have significant impact on the economy, while a simplified format is used for proposals of lesser anticipated impact. These threshold tests help to ensure that RIAs are proportionate to the significance of the potential impact (OECD, 2020<sub>[21]</sub>). Indonesia could follow such an approach, to limit the resources needed to implement RIAs and make sure these are focused on the most important policy proposals.

In addition, appropriate regulation of the interactions between policymakers and interest groups could increase transparency and accountability, reduce the risks of capture and corruption, and enhance the quality of regulation. The lack of such rules may favour lobbying activities by vested interests with greater resources, which can distort the regulatory design process at the expense of new entrants and smaller firms. Transparency could be improved by requiring disclosure of the interest groups consulted in a regulatory process and imposing on policymakers the obligation to make public their calendar of meetings. Bringing regulations on conflict of interest closer to best practices would also reduce the risk of regulatory capture. Moreover, setting these regulations at the central level would ensure these are uniformly applied across all agencies and bodies in the public sector. Further, the requirement to consult stakeholders (in Law 12/2011) could be made more effective by providing policymakers with written guidance on how to conduct stakeholder engagement and by requiring that a summary of all significant issues raised in the comments received and an explanation of how the agency addressed those comments be made public. In the context of tax policy, the 2018 OECD *Economic Survey* highlighted how meaningful public consultation could help reduce policy uncertainty and increase the quality of legislation (OECD, 2018<sub>[19]</sub>).

### Box 3. Best practice in implementing Regulatory Impact Assessments

According to the OECD Best Practice on Regulatory Impact Assessment (OECD, 2020<sub>[21]</sub>), RIAs should:

- Always start at the inception phase of the regulation-making process.
- Be proportionate to the significance of the regulation.
- Clearly identify the specific policy need and the desired goals of the proposal.

<sup>18</sup> Several countries, such as Japan and Korea, have adopted a threshold test to decide whether a detailed RIA or a more simplified one would be justified.

- Identify and evaluate all potential alternative solutions of addressing the policy need identified, both regulatory and non-regulatory ones and select the most appropriate instrument or mix of instruments to achieve policy goals.
- Always attempt to assess all potential economic, social and environmental costs and benefits, both direct (administrative, financial and capital costs) as well as indirect (opportunity costs) whether borne by businesses, citizens or government, including the distributional effects over time.
- Consider the impact on the competitive process and carefully evaluate any adverse effects against the claimed benefits of the regulation, which includes exploring whether the objectives of the regulation cannot be achieved by other less restrictive means.
- Always assess these costs and benefits for the “no action” option.
- When policy proposals are likely to have significant impacts, assess costs, benefits and risks in a quantitative manner whenever possible, and qualitative where no quantification is possible.
- Be developed transparently with stakeholders, and have the results clearly communicated
- Lead to identifying the approach likely to address the policy need while delivering the greatest net benefit to society, including complementary approaches such as through a combination of regulation, education and voluntary standards.
- Be publicly available so they can be scrutinised by stakeholders and the public.
- Have an oversight body that checks the quality of the analysis of all RIAs.

### Two examples of good practice in implementing RIAs

#### **Malaysia**

In 2013, Malaysia launched the National Policy for the Development and Implementation of Regulations to, *inter alia*, improve the overall regulatory process using a people-centred approach. According to this policy, a ministry drafting a new law or regulation must perform a regulatory impact assessment (RIA), consult with the public and prepare a regulatory impact statement (RIS). This includes an assessment of the impact on various policy variables, including competition, of the preferred regulatory approach, a “do nothing” approach and feasible alternatives, such as non-regulatory options. The Malaysia Productivity Corporation and National Development and Planning Committee are responsible for reviewing the RIA and the RIS. If the quality of the RIS is inadequate, this is returned to the relevant ministry for revision before the proposal can advance to the cabinet. The introduction of this policy was gradual and its rollout was accompanied by training and outreach by the Malaysia Productivity Commission, as well as by guidelines to support policymakers. A RIA is not required if the impact of the proposed regulation is minor and it does not significantly change regulatory requirements.

#### **United Kingdom <sup>19</sup>**

In the UK RIA is considered as a key tool in delivering better regulation supporting the government's aim of only regulating when necessary and to do so in a way that is proportionate to the risk addressed.

Before introducing a new regulation, the relevant Ministry has to carry out a RIA, outlining the problem it aims to address and evaluating the costs and benefits of the possible regulatory and non-regulatory solutions to this problem. The RIA must be signed off by the senior departmental analyst and the responsible Government Minister, who is required to confirm that they have read the RIA and that they are satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options. The RIA is then submitted to the Regulatory Policy Committee, an independent advisory non-departmental public body that provides independent scrutiny

<sup>19</sup> For further details see: [www.economy-ni.gov.uk/articles/regulatory-impact-assessment-ria-guidance](http://www.economy-ni.gov.uk/articles/regulatory-impact-assessment-ria-guidance)

on the quality of evidence and analysis for all RIAs. Once this Committee gives the green light, the Reducing Regulation Cabinet sub-committee must give its clearance. This sub-committee provides strategic oversight of the government's regulatory framework and provides the mechanism for clearance and scrutiny of any measure that regulates or deregulates business. Deregulatory measures and low-cost measures (i.e., proposals with a gross cost to business and civil society organisations below GBP 1 million a year) are eligible for a Fast Track "Regulatory Triage Assessment". This fast track ensure that the RIA process focuses on the most significant regulatory changes and that deregulatory proposals are brought forward more quickly.

Source: OECD (2020<sup>[21]</sup>; 2018<sup>[36]</sup>; 2018<sup>[37]</sup>; 2017<sup>[38]</sup>) and OECD (2015<sup>[39]</sup>; 2012<sup>[40]</sup>).

**Table 3. Policy options for improvements in the area of state involvement in the economy**

Area of product market regulation	Options to consider for potential reforms based on the PMR indicators
Direct Control over Business Enterprises	<ul style="list-style-type: none"> <li>• Replace rules that give the government a golden share in all privatised firms with a requirement for a case-by-case assessment of the need for such a golden share.</li> <li>• Review and scale back requirements for the parliament to approve partial or full privatisations of firms in non-strategic sectors.</li> </ul>
Other aspects of the exercise of public ownership	<ul style="list-style-type: none"> <li>• Develop and publish a whole-of-government ownership policy for SOEs and an associated rationale for individual stake-holdings; and use this policy to identify where to scale back state ownership.</li> <li>• Evaluate the feasibility of vertical separation of remaining SOEs' non-competitive activities from potentially competitive activities, and introduce accounting separation in other cases</li> <li>• Expose SOEs to greater market discipline by scaling down favourable finance conditions that are not available to privately owned firms and making them more transparent.</li> <li>• Increase disclosure and transparency to be in line with the 2015 OECD Guidelines, for instance, by including the board composition and their remuneration in the annual report on SOEs</li> <li>• Subject all SOEs to competition law and hold them accountable for any abuse of their dominant market position.</li> </ul>
Retail Price Controls and Regulation	<ul style="list-style-type: none"> <li>• Remove price controls prices in network sectors where competition is effective, and, where regulation is still necessary, ensure that prices are set efficiently to encourage entry and investment.</li> <li>• Gradually liberalise prices for staple foods and household fuels at the same time as increasing the targeting of the social safety net.</li> <li>• Further liberalise tariffs charged by regulated professionals to foster competition.</li> </ul>
Other aspects of government involvement in business operations	<ul style="list-style-type: none"> <li>• Mandate fixed and mobile phone number portability, with clear rules on the costs that can be charged to consumers and operators, and on the maximum time in which the operation must be performed.</li> <li>• Increase the information that must be provided to customers by requiring that energy bills show clear information on usage and pricing.</li> <li>• Relax rules on the legal and ownership structure of professional firms</li> <li>• Require that documents for all public tenders for the procurement of goods, services and public works are made available online.</li> <li>• Systematically requiring procurement agencies to accept online bids</li> </ul>
Assessment of Impact on Competition	<ul style="list-style-type: none"> <li>• Amend legislation to explicitly require ex-ante regulatory impact assessments (RIAs) of all new laws and regulations.</li> <li>• Ensure that these RIAs are aligned with OECD best practices and that public authorities have the relevant skills to undertake them.</li> </ul>
Other aspects of improving the formation of regulation	<ul style="list-style-type: none"> <li>• Increase the transparency and accountability of interactions with interest groups by issuing national regulations to guide the engagement and the sharing of information with the public.</li> <li>• Replace ministry-level regulations on conflicts of interest with national-level regulations and impose a cooling-off period for senior public officials seeking to move to the private sector.</li> </ul>

Note: Most but not all of these reforms would improve Indonesia's PMR score. The areas of product market regulation in the first column are based on the PMR low-level indicators. Low-level indicators are highlighted specifically where the gap between Indonesia's score and the OECD average is more than two standard deviations (across OECD countries) (see Table 1).

### 3.3. Results for Barriers to Domestic and Foreign Entry

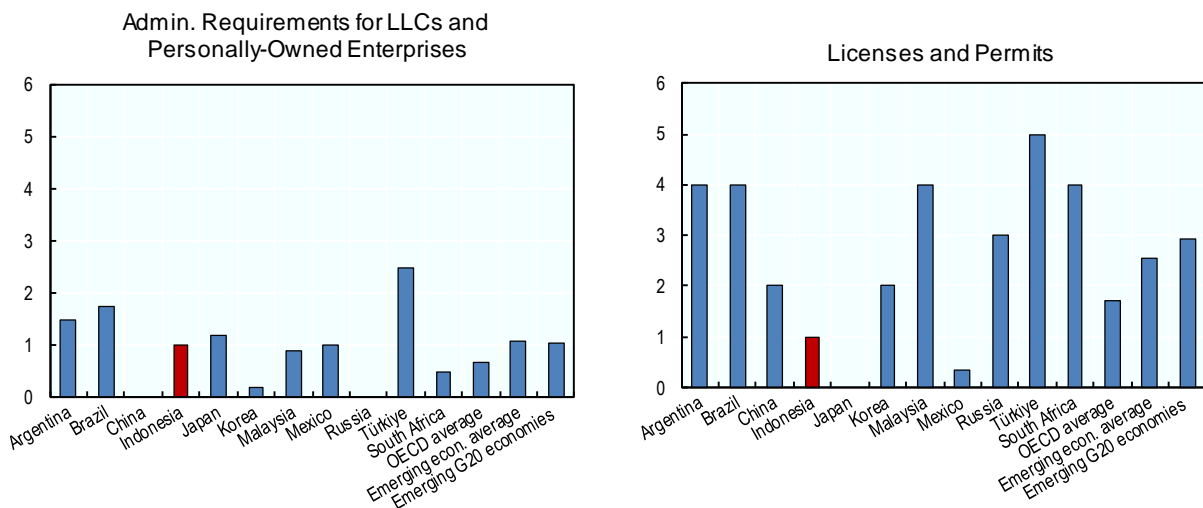
The PMR results on the barriers to both domestic and foreign firms entering and expanding into markets show that the regulatory set-up in this area is more conducive to competition than the regulatory framework concerning the state involvement in the economy (Figures 6 and 7).

#### 3.3.1. Administrative Burden on Start-ups

Indonesia scores well in the two low-level indicators on the administrative burden that new firms must face to start their business (Figure 11). This reflects the government’s focus on reducing administrative costs and cutting red tape since 2014, which lifted Indonesia’s ranking in the *Ease of Doing Business* indicators from 114<sup>th</sup> in the 2015 report to 73<sup>rd</sup> in the 2020 report. However, more can still be done to ease administrative burden on new firms to ensure that the good processes captured by the PMR results generate improvements in practice and that implementation is consistent across the country. Indeed, the *Ease of Doing Business* sub-indicator for *starting a business* has improved by 40% since 2014, but its value is still high.

Figure 11. Low-level indicators on Administrative Burden on Start-ups

Index scale 0 to 6 from most to least competition-friendly regulatory framework



Note: The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020. If the bar for a country does not appear on the chart, it means that its value is 0.

Source: OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

The indicator on **Administrative Requirements for Limited Liability and Personally owned Enterprises** (Figure 11, left panel) captures the amount of administrative requirements necessary to set up a new enterprise, including the number of bodies to be contacted and the associated compliance costs. Regional one-stop shops and various websites, including the online single submission system, facilitate this process. These were established in 2016 and have been improved upon since, as part of a reform agenda to speed up the process for registering a business. As a result of all these efforts, the value of this indicator for Indonesia is quite low and not far from the OECD average. However, the one-stop shop, and online single submission system do not yet cover all bureaucratic steps, which hampers the efficiency of

the system (see also (OECD, 2020<sub>[28]</sub>)). The government is seeking to further streamline the process, and further improvements are expected as a result of recent reforms.

Indonesia also performs well on the measure of the presence of initiatives to simplify licensing procedures (**Licences and Permits**), with a better score than most peers (Figure 11, right panel). Past and ongoing efforts to reduce the burden of licences and permits drive Indonesia's performance. The one-stop shops in the largest cities and online single submission system cover many national and subnational licences, thereby lowering the administrative burden associated with starting a business. Nevertheless, as mentioned earlier, the online single submission system still does not cover all the necessary administrative requirements, though recent reforms are likely to further expand its scope. In addition, the PMR score is based on the *de jure* progress, and it does not assess implementation. Some recent improvements, which fall outside the scope of the PMR questionnaire, could help in this direction. For instance, a 2019 Presidential Instruction (7/2019) delegated responsibility for permits of 22 ministries and institutions to the Indonesia Investment Coordinating Board. In addition, the 2020 Omnibus Bill on Job Creation aims to eliminate overlap (and differences) between national and sub-national licences by centralising licensing responsibilities and then delegating them back to regional governments accompanied by norms and procedures. Its practical effects will depend on how it is implemented, including the interaction with subnational governments and regional one-stop shops, and ensuring that centralisation does not weaken the evaluation of requirements in areas such as Environmental Impact Assessments (OECD, 2021<sub>[25]</sub>; 2021<sub>[33]</sub>).

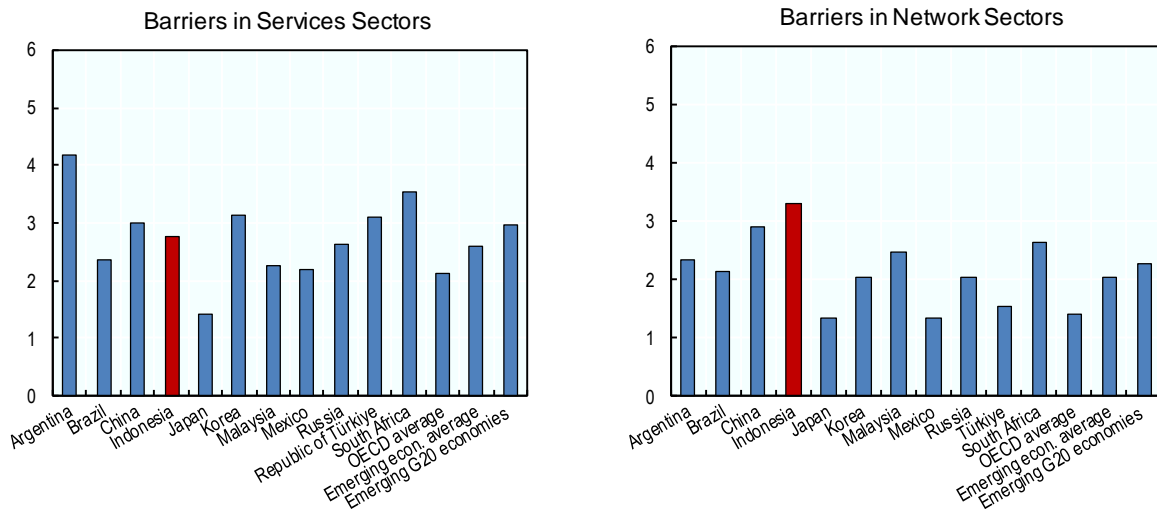
The one improvement to this PMR low-level indicator that Indonesia could still introduce is a “silence is consent” rule, which would further speed up licensing procedures and reduce uncertainty. An increasing number of OECD and non-OECD countries, including, Costa Rica, Kazakhstan, and Mexico, have such a rule.

### 3.3.2. *Barriers to entry and competition in service and network sectors*

The PMR results suggest that barriers to entry in network sectors are more significant than in services sectors (Figure 12). The indicator of **Barriers in Services Sectors** is somewhat higher than the OECD average, but similar to peer countries (left panel). Regulatory **Barriers in Network Sectors**, instead, are significantly higher than in the average OECD country and higher than in peer countries (right panel). The following sections use the sectoral indicators to better understand the nature of these barriers to competition.

**Figure 12. Low-level indicators on Barriers in Service and Network Sectors**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



Note: The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020.

Source: OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

### Insights from sectoral PMR Indicators: services sectors

Indicators of the regulatory framework in **professional services** show a mixed picture (Figure 13). Regulations appear less restrictive than in many other countries, including OECD ones, in some professions and more restrictive in others.

The profession where the stringency of regulation is highest in comparison with other countries is **real estate agents**. This profession is highly regulated in Indonesia, both in terms of barriers to entry and of regulation of the professionals' conduct. For example, real estate agents have the exclusive right to perform activities that are not restricted in many countries, such as obtaining information about properties to be bought and sold and showing properties to interested parties. Professional exams and membership of the professional organisation are also compulsory, unlike many other countries.

The provision of **notarial** services is also very strictly regulated. In this area, Indonesia does not differ from most OECD countries, but still its regulatory regime for this profession is one of the most restrictive ones. Some countries, such as France and the Netherlands, have started deregulating the profession showing that introducing greater competition does not harm consumers (Vitale et al., 2020<sup>[18]</sup>).

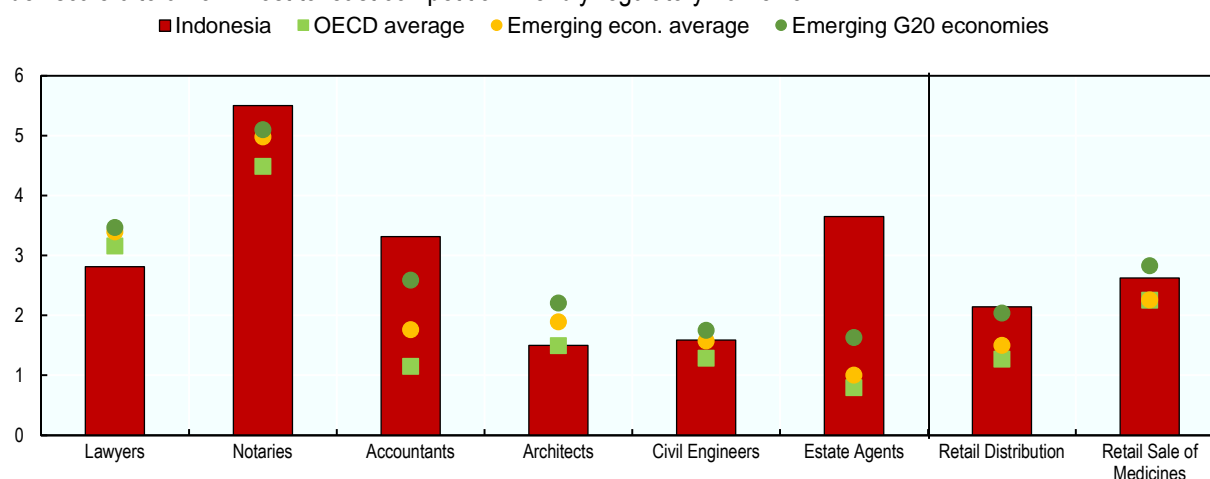
**Accountants** and **lawyers** also face high entry barriers. In both professions, the requirements to pass an entrance exam set by professional bodies and to become a member of the professional association, which may be needed to ensure quality and protect consumers against asymmetric information and adverse selection, must be balanced against the cost of hampering access. In terms of conduct regulation, in Indonesia law partnerships can accept external investors, who benefit from limited liability, while partners cannot benefit from limited liability. This arrangement allows for external sources of funding, but still exposes partners, who make the most important decisions in the firm, to unlimited liability and hence to a high level of risk. Accountants also face restrictive conduct regulation in the form of limits on who can hold ownership interests and voting rights in accounting firms.



Regulations for **architects** and **civil engineers** are less restrictive than for the other professions and comparable to (civil engineers) or better than (architects) in peer countries. However, entry regulations are still a little higher than in the average OECD country.

**Figure 13. Indicators of regulation in service sectors – professions and retail trade - across countries**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



Note: The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia, and China to 1 January 2020.

Source: OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

The stringency of regulation of **retail distribution** is close to that of other large peer countries, but more restrictive than in OECD countries (Figure 13). The indicator captures barriers to entry caused by registration and licensing requirements, as well as limits on shop opening hours. Entry regulations include requirements to obtain an authorisation to open stores larger than 500 sqm (including minimarkets, supermarkets and department stores), as well as a business licence.<sup>20</sup> In addition, a request to establish a retail outlet can be denied based on an economic needs test, which the OECD considers an unnecessary test, since such business decisions are better taken by entrepreneurs, who then face the risk of failure. As already discussed, the prices of some retail goods and services are regulated. In general, direct price regulation should be avoided, as it distorts market mechanisms: if vulnerable consumers need protection, the government should rely on subsidies and other forms of more direct and targeted support. Regulation of shop opening hours, instead, is quite light, leaving outlets rather free to decide their opening schedule.

Entry barriers for selling online have so far been very low, although a separate licence for online sales has been necessary since 13 November 2020 (Minister of Trade Regulation No. 50 of 2020).<sup>21</sup> The introduction of additional administrative steps for online shops, which may place them at a disadvantage with respect to brick and mortar ones, should be carefully considered, as online shopping is an important area of growth, as shown during the COVID-19 pandemic.

<sup>20</sup> The opening of a retail outlet requires a store permit under Presidential Regulation No.112 of 2007 and Minister of Trade Regulation No. 8 of 2020 on Electronically Integrated Business Licensing Services in Trade Sector.

<sup>21</sup> Ministry of Trade Regulation No. 50 of 2020 is implementing Government Regulation No. 80 of 2019.

Regulation of **retail sale of medicines** is as restrictive as the OECD average. Competition is still constrained by limitations on the number of pharmacies that can be opened in a given area and on their specific location. However, there are no restrictions on who can own a pharmacy nor on their opening hours and most non-prescription medicines can also be sold in para-pharmacies and drugstores.

### Insights from sectoral PMR Indicators: network sectors

The overall indicator of regulation in **network sectors** suggests that regulatory settings in network sectors are more restrictive than in other emerging economies included in the PMR dataset (Figure 14, Panel A). These sectoral indicators comprise two elements: entry regulation and public ownership. In Indonesia, the high level of public ownership in these sectors (discussed in section 2.2) contributes to a higher indicator value compared to the other countries, but regulatory settings are also still far from best practice and generally not very conducive to competition. Indonesia performs less well than the average of G20 emerging economies and of OECD countries in each sector, but particularly in electricity, water and rail transport, and fixed and mobile e-communications (Figure 14, Panel B).

Within the energy industry, the **electricity** sector is highly regulated in both absolute and relative terms. This is mostly because PLN - a fully state-owned company that dominates all segments in the sector - is heavily protected from competition at all stages of supply. By contrast, most other countries in the PMR database have opened generation and retail supply to competition. Indonesia's 2009 Electricity Act, which followed the Constitutional Court's 2004 decision to overturn the 2002 electricity law encouraging private participation, still gives PLN priority rights for each element of operations (IEA, 2015<sup>[41]</sup>)(see also Box 4). As a result, PLN dominates all segments of Indonesia's power market, and this is limiting the development of competition in generation and retail distribution (OECD, 2021<sup>[42]</sup>).

Regulation in the **gas** sector restricts competition less than in electricity. Notably, production and retail supply are open to competition, though in the latter market only large and medium non-residential consumers can choose their provider. Still, regulatory barriers to competition are higher than in OECD countries. There is no national wholesale market for gas and, while all retail prices are regulated, including those of consumers that are free to choose their supplier, there is no requirement to ensure that retail price regulation is based on the cost of the most efficient operator.

Within the transport sector, regulatory barriers to competition are highest in **rail transport**, which is also the case for most non-OECD countries and OECD countries. However, at least some form of competition in the market for passenger services is allowed in many OECD and non-OECD countries - often relying on public service contracts. This is not the case in Indonesia.

Regulations in **air transport** and **road transport** are closer to those of peer countries, while regulation of **water transport** is more restrictive. The OECD recently published a report on barriers to competition in the logistics sectors that examines in detail the regulation of freight transport by road and the reforms that would be needed to foster competition (OECD, 2021<sup>[33]</sup>).

The indicators suggest that regulatory settings in **fixed and mobile electronic communications** are not conducive to competition. PMR values in these sectors are considerably higher than in peer countries and in OECD countries.<sup>22</sup> The international best practice consists in requiring that competition is regularly assessed in a forward-looking manner in key wholesale markets<sup>23</sup> to establish if there are no significant or non-transitory barriers to entry and if the market structure tends towards effective competition. The Indonesian regulator (KOMINFO), however, is only required to determine the market shares and to assess

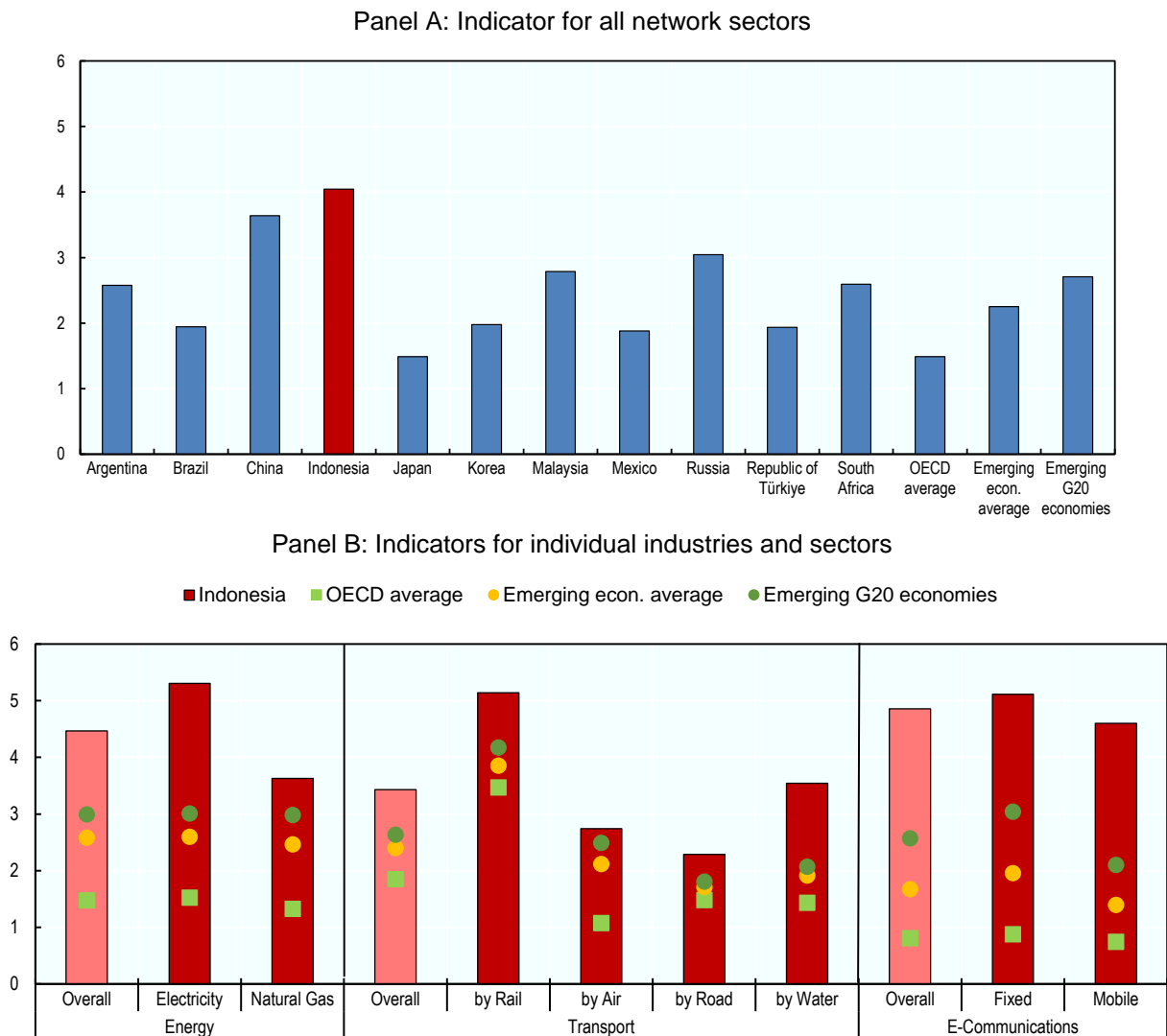
<sup>22</sup> As the PMR indicator reflects regulatory settings on 1 January 2020, it does not capture any changes due to the Ministry of Communications and Information Technology Regulation No. 13/2019 which came into effect in April 2020.

<sup>23</sup> These are wholesale fixed local access, wholesale provision of leased lines, wholesale fixed call origination and termination, and wholesale mobile call origination and termination.

and approve the reference offers issued by operators with shares greater than 25% of total market revenues. The lack of a regulatory approach ensuring that interventions are gauged to the effective level of competition and regularly adapted as competition evolves implies that healthy and long-lasting competitive environment is unlikely to develop.

**Figure 14. Indicators of regulation in network sectors across countries**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



*Note:* The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020.

*Source:* OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

In addition, Presidential Regulation No. 112 of 2020 dissolved the Indonesian Telecommunications Regulatory Agency (BRTI). This raises further concerns on the quality of the regulatory framework in this sector. The OECD considers that independent sector regulators are an important element of a competition-friendly regulatory environment, especially when the state controls the largest firms in the industry.

Further, Indonesia is the only country in the PMR database without the requirement to offer phone number portability both for fixed and mobile telephony services. This limits the ability of consumers to switch providers and disadvantages new entrants (see Box 2).

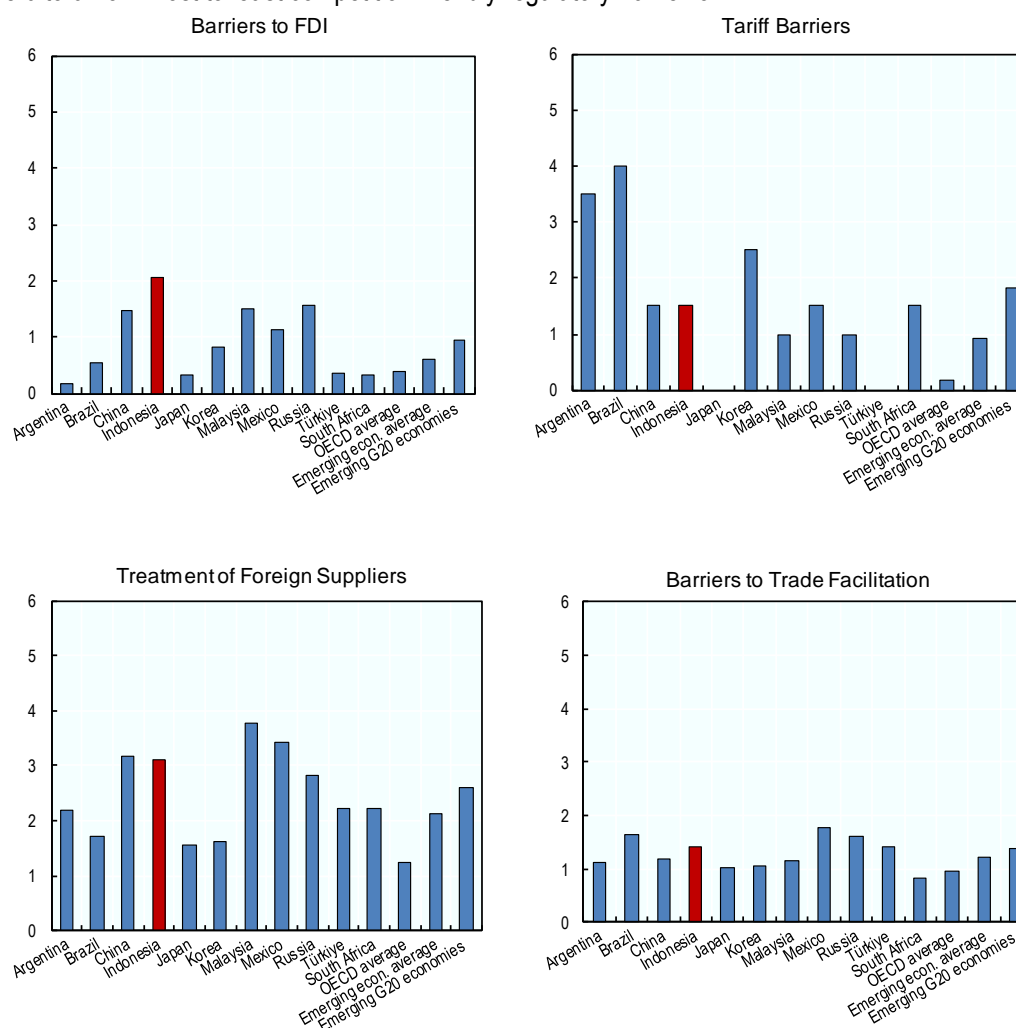
It should be noted that when the information to build the PMR indicators was collected, frequency spectrum could not be traded among operators. However, in 2021, regulations implementing the Omnibus Bill on Job Creation have introduced the possibility for network operators to lease or pool spectrum, subject to approval from the relevant ministry. This reform is likely to have a small impact on PMR sector indicator for mobile e-communications, as it represents a positive step towards a more efficient allocation of a scarce and valuable resource.

### 3.3.3. Barriers to trade and investment

The PMR results indicate that regulatory barriers to trade and investment are low relative to other elements of the PMR indicator but are high relative to other countries (Figure 15).

**Figure 15. Low-level indicators on Barriers to Trade and Investment**

Index scale 0 to 6 from most to least competition-friendly regulatory framework



*Note:* The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020. If the bar for a country or for a specific indicator does not appear on the chart, it means that its value is 0.

*Source:* OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

Regulatory **barriers to FDI** – as measured in the OECD FDI Regulatory Restrictiveness Index that feeds directly into this PMR low-level indicator- were amongst the most restrictive across peer countries at the time of the PMR computation in 2020 (Figure 15, top left panel).<sup>24</sup> This is true of other Southeast Asian countries, such as the Philippines and Thailand, which are not included in the PMR database, but for which the FDI Regulatory Restrictiveness index is calculated. Indonesia’s FDI Regulatory Restrictiveness Index score is driven by extensive restrictions on foreign equity in a range of sectors, as governed by a negative investment list (*Daftar Negative Investasi*) that was in place until February 2021. Under this negative list, restrictions were relatively high in services and primary sectors. In addition, some parts of sectors were reserved for domestic small and medium enterprises (SMEs).

In early 2021, the government approved Presidential Regulation 10/2021, which implemented changes introduced as part of the Omnibus Bill on Job Creation that lowered foreign equity limits in a range of sectors. Particularly large changes were in: fisheries; mining, oil and gas; distribution; transport; and communications. These reforms could not be included in the PMR indicators as the indicators were calculated in late 2020, based on information collected in that year, while the reform was introduced afterwards. However, a preliminary assessment suggests that the overall effect would lower the Barriers to FDI indicator by over one-third and the Barriers to Trade and Investment low-level indicator by almost 10% (Figure 16 Panel A).<sup>25</sup> The Presidential Regulation also includes investment incentives in a number of sectors, but it continues to restrict some sectors fully or partly for investment by domestic SMEs (e.g., some types of constructions, retail trade and services) or by domestic firms (e.g., media, air transport and water transport and traditional manufacturing).

The PMR indicator also captures a range of other policies that hinder foreign investment by imposing different and stricter requirements on foreign companies. These include higher minimum capital requirements for foreign companies,<sup>26</sup> stringent conditions on the employment of foreigners in key management positions, limitations on branching and access to land by foreign legal entities and preferential treatment accorded to Indonesian-owned entities in public procurement. Indonesia also makes extensive use of local content requirements, which add to the hurdles of carrying out foreign investments in Indonesia (OECD, 2020<sub>[27]</sub>).

Overall, after allowing for the most recent reforms, barriers to FDI as measured by the PMR indicators have decreased, but they are still likely to remain above the average of peer countries (Figure 16 Panel B).

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<sup>24</sup> The FDI Regulatory Restrictiveness Index is used to calculate the low-level indicator Barriers to FDI. The value of this low-level indicator is set equal to the value of the FDI index, adjusted to a 0 to 6 scale. For more detail refer to [www.oecd.org/economy/reform/A%20detailed%20explanation%20of%20the%20methodology%20used%20to%20build%20the%20OECD%20PMR%20indicators\\_FINAL.pdf](http://www.oecd.org/economy/reform/A%20detailed%20explanation%20of%20the%20methodology%20used%20to%20build%20the%20OECD%20PMR%20indicators_FINAL.pdf)

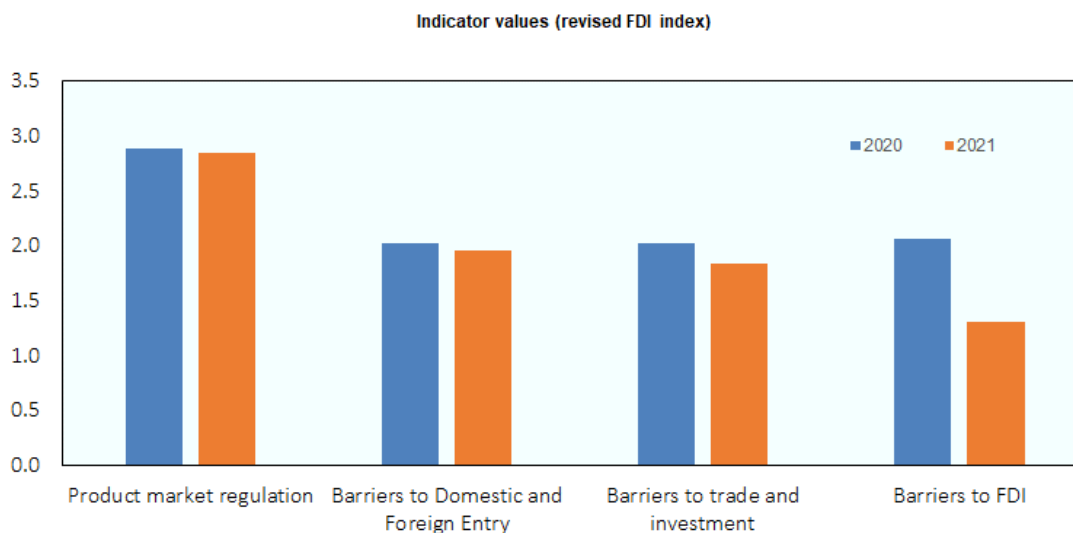
<sup>25</sup> The FDI Regulatory Restrictiveness Index for 2021 has not been published at the time of publication, so this assessment was carried out ad-hoc based on the existing 2020 methodology and the policy measures contained in Presidential Regulation 10/2021.

<sup>26</sup> In Indonesia, businesses are classified according to several sizes. Only for large-scale businesses, the regulations are the same for direct investment and FDI (minimum capital of 10 billion rupiah).

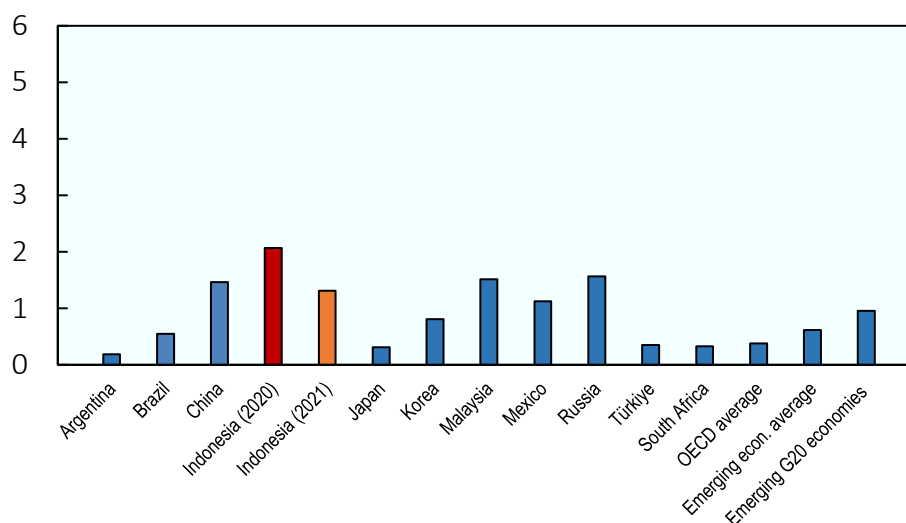
**Figure 16. Preliminary assessment of expected effects of recent reforms lowering barriers to foreign investment**

Index scale 0 to 6 from most to least competition-friendly regulatory framework

Panel A: Expected impact on PMR indicators



Panel B: Expected impact on cross-country comparison for the indicator Barriers to FDI



Note: The OECD average includes Costa Rica, which has become a member of the OECD in May 2021. Emerging economies average is the average of all emerging economies, as defined by the IMF, which are currently in the PMR databases (Albania, Argentina, Brazil, Bulgaria, China, Chile, Colombia, Costa Rica, Croatia, Hungary, Indonesia, Kazakhstan, Malaysia, Mexico, Poland, Romania, Russia, Serbia, South Africa and Türkiye). Emerging G20 economies is the average of Argentina, Brazil, China, Indonesia, Mexico, Russia, South Africa and Türkiye. For most countries the indicators are based on laws and regulation in force on 1 January 2018, but for Bulgaria, Costa Rica Croatia, Estonia, Romania and the US the information refers to 1 January 2019 and for Indonesia, Malaysia and China to 1 January 2020.

Source: OECD 2018 PMR database; and OECD-World Bank Group 2018 PMR Database.

**Tariff Barriers** to trade – as indicated by effectively applied tariffs – are around the average of G20 peers (Figure 15, top right panel). This reflects past tariff reduction programmes as well as trade patterns: Indonesia was a founding signatory to the ASEAN Free Trade Area agreement, which eliminates tariff barriers on almost all goods and services, but only between ASEAN members. Still, tariff barriers in Indonesia are higher than in almost all OECD countries and several emerging economies. Tariffs on

consumer goods are highest: in 2018, effectively applied tariffs averaged 4.4% for consumer goods, compared to 0.8-1.9% for upstream goods.

Regulations create relatively high barriers for foreign firms participating in public procurement processes or trying to operate in key network and service sectors (*Differential Treatment of Foreign Suppliers*) (Figure 16, bottom left panel). Indonesia's result is one of the highest in the PMR database, comparable with China, Mexico, and Kazakhstan. The gap with the OECD average is quite large.

When it comes to public procurement, in Indonesia only some tenders are open to international firms<sup>27</sup>, thus implying that a share of public contracts is reserved for domestic firms. In addition, foreign firms may only participate in tenders for public works through a joint venture with a domestic firm, and there are local content rules. As highlighted above and in OECD (2020<sup>[43]</sup>), it is unusual to limit the ability of resident firms to participate in public tenders, even if these are foreign owned.

Restrictive cabotage regimes in air and sea transport prevent foreign planes and ships from operating internal routes. At the time when the information for calculating the PMR indicators was collected, there was a limited exemption allowing foreign vessels to carry out specific activities (such as drilling or dredging), but only if no domestic vessel was available and a permit was obtained, which lasted for a limited period of time. The subsequent Omnibus Bill on Job Creation has opened up some activities in the shipping sector by allowing specialised foreign-owned ships to operate, which is welcome, but it does not include passenger or freight services. As a result, this reform does not affect the PMR results.

Accountants and lawyers are protected from competition from foreign professionals, since Indonesian citizenship is required to practice. This restriction is not in place for architects and civil engineers, where a transparent system of assessment of recognition of foreign titles is in place.

The indicator of *Barriers to Trade Facilitation* reflects the degree of complexity of the technical and legal procedures for international trade (based on the OECD Trade Facilitation indicators, which aim to mirror the key provisions of the World Trade Organisation's Trade Facilitation Agreement<sup>28</sup>). The indicator for Indonesia is similar to other large economies, such as Brazil, and only a little above the OECD average (Figure 15, bottom right panel). As in other domains, Indonesia has lowered barriers by streamlining procedures and making information more accessible in recent years. However, there are gaps with best practice in areas such as consultations with the trade community and the degree of automated processing.

### 3.3.4. Opportunities for improving Barriers to Domestic and Foreign Entry

This section discusses existing barriers to entry in network sectors and barriers to trade and investment. Potential policy options for fostering competition in these areas are summarised at the end of the section (Table 4).

#### Lowering entry barriers in network sectors

OECD research drawing on the sectoral indicators has shown that the effects of competition-friendly regulation in upstream sectors cascade through the economy improving productivity (Égert and Wanner, 2016<sup>[12]</sup>; Boursès et al., 2013<sup>[14]</sup>). Liberalisation of entry in potentially competitive network sectors has been associated with higher productivity and may have a larger effect when countries are further from the technology frontier (Nicoletti et al., 2003<sup>[44]</sup>). The PMR indicator results for Indonesia reveal substantial scope for pro-competition reforms in the energy industry, particularly in electricity, as well as in water transport and in fixed and mobile e-communications.

<sup>27</sup> These are tenders above IDR 50 billion, or IDR 1 trillion for construction works (around USD 3 million and USD 64 million, respectively).

<sup>28</sup> For more information, see <https://www.oecd.org/trade/topics/trade-facilitation/>.



The importance of energy for economic activity, investment, competitiveness, and welfare suggests there could be sizeable benefits from exploring all margins within the Constitution for introducing competitive forces to the sector. In 2015, the Constitutional Court issued guidance that electricity services cannot be unbundled, if it would result in the State having less control over the sector (Karim and Karim, 2020<sup>[45]</sup>). Nevertheless, the omnibus law has opened the possibility of greater private sector participation in different aspects of electricity supply. It is not yet clear how it will be implemented given the constraints that have been repeatedly imposed by the Constitutional Court (see Box 4), but some interpretations do suggest that private-sector involvement could be possible (Butt and Lindsey, 2012<sup>[46]</sup>). Introducing some vertical separation by requiring accounting separation between the various activities would increase transparency, thus limiting, or at least exposing, cross-subsidies and fostering more cost-reflective pricing at all levels of the value chain. This could be a precursor to introducing greater competition in some parts of the sector. An independent regulator could help balance cost, availability and reliability and improve investor confidence (IEA, 2015<sup>[41]</sup>). Nevertheless, some activities currently undertaken by PLN, such as ensuring that households in remote regions have access to electricity, are unlikely to be profitable and measures such as transparent subsidies for supplying these households will be needed.

In **natural gas**, more vertical separation could be introduced, including some form of separation of gas storage from transmission and distribution. Having an independent regulator would support the process (Indonesia's sector regulators are generally less independent than in OECD countries (OECD, 2012<sup>[47]</sup>)). The creation of an integrated national wholesale market is hampered by Indonesia's geography and infrastructure, so any attempt to create one would need to be preceded by reform of wholesale prices and form part of a comprehensive longer-term plan, as proposed in IEA (2015<sup>[41]</sup>). A RIA could evaluate the costs and benefits of such a reform with a view to establishing a path.

#### Box 4. Constraints imposed by Article 33 of the Constitution and the Constitutional Court's interpretation

Article 33 of the 1945 Constitution of Indonesia sets out the provisions on 'economic rights' in 4 paragraphs:

1. Art 33(1) provides that "the economy shall be organised as a collective endeavour based on the family principle". This has been interpreted by the Constitutional Court to mean that production activities are conducted 'by all and for all' under the ownership of the members of society and that cooperative and private ownership is only possible in companies that are not controlling 'the people's necessities of life'.
2. Art 33(2) provides that "branches of production that are important to the state, and that affect the people's necessities of life, are to be controlled by the state." The Constitution does not provide clarity on which branches of production are considered as 'important' and affect the 'people's necessities of life'. However, the Constitutional Court considers electricity as one of them.
3. Art 33(3) provides that "earth, water and other natural resources contained within shall be controlled by the state and utilised for the maximum prosperity of the people".
4. Art 33(4), which was added in 2002, provides that "the national economy is to be run on the basis of economic democracy, and the principles of togetherness, just efficiency, sustainability, environmentalism, and independence, maintaining a balance between advancement and national unity." Many local commentators argue that this was included to give the government greater flexibility in managing the economy.

The Constitutional Court is responsible for ensuring that the state respects the Constitution and has the authority to hear judicial reviews on whether the substantive content of any law meets the provisions of the Constitution and, if the law is inconsistent with these provisions, to declare it void of legal force.

The Constitutional Court's interpretation of Art 33 with respect to the electricity sector, which has emerged through a number of reviews concerning various elements of the 2003 and 2009 Electricity Act, can be summarised as follows:

- Article 33 is not against the free competition and market principles, but requires the state to maintain control on the important branches of production that affect 'the people's necessities of life', like electricity.
- Control over these sectors cannot be realised only through regulatory and supervisory functions, but must be exercised through SOEs; as only in this manner the state can ensure sufficient supply, equitable distribution, and affordability of important resources, such as electricity, to all the Indonesian people.
- The state does not have to be the majority owner of these SOEs. Hence, partial privatisation is possible, but only in so far as the state maintains control over their decision-making process.
- SOEs must be given priority in strategic sectors like electricity, and private companies can only operate in those shares of the market that the SOEs cannot satisfy.
- The state cannot unbundle the electricity sector in separate generation, transmission, distribution and retail sales activities.
- The state should control retail prices of essential services like electricity.

Source: Adapted from Yudhianto (2021)<sup>[48]</sup>

Given Indonesia's geography, the price and availability of **water transport** services for passengers and freight has substantial knock-on effects to households and firms alike. Encouraging more competition, even in parts of the sector, would benefit economic activity and firms' competitiveness. Lowering regulatory barriers to entry by domestic and foreign firms and relaxing price controls would bring Indonesia's regulatory settings closer to those of other emerging economies. Liberalising prices and relaxing barriers to foreign entry are discussed in sections 2.2 and below. Repealing the government's ability to limit industry capacity would increase the attractiveness of investing in the sector for investors; Indonesia is one of a handful of countries to retain such an ability. Although licensing is common, requiring new firms to notify the regulator, rather than obtain a licence, would ease entry. This is the case in other island nations like New Zealand and Greece. Such reforms could be introduced as part of the shift to risk-based licensing envisaged by the 2020 Omnibus Bill on Job Creation. The OECD *Competition Assessment Review* of the logistics industry includes more detailed suggestions on how to increase competition in some of the transport sectors (OECD, 2021<sup>[33]</sup>).

Lowering barriers to entry in **e-communications** could increase competitive pressures in a sector that is increasingly important given the digital transformation currently underway around the world. Even though the number of firms operating in the sector has increased in recent years, the majority government-owned Telkom still has an 80% share of the fixed line market and its subsidiary Telkomsel has the largest revenue share in the mobile market. Indonesia could improve the regulatory framework in this sector by tasking an independent regulator to regularly undertake market studies to assess the state of competition in the key fixed and mobile e-communications markets in a forward-looking manner and considering a variety of indicators (not just market shares) and regulating the sector accordingly.<sup>29</sup> In addition, the regular repetition of this exercise, e.g. every four to five years, ensures that as competition develops unnecessary regulatory obligations are lifted or reduced. In most OECD countries such assessments are used to determine what type of *ex-ante* regulation is necessary and on which player(s) (see Box 5).

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<sup>29</sup> Key markets to assess should be wholesale fixed local access, wholesale leased lines, wholesale fixed call origination and termination, and wholesale mobile call origination and termination, as these represent potential bottlenecks for the development of healthy competition.

### Box 5. Assessing the state of competition to set ex ante regulation in the ecommunications sector: the European Union

The European Union is an example of best practice in setting up ex-ante access regulation in the e-communications sector. In broad terms, this requires independent sector regulators establishing whether competition is effective in key retail and wholesale markets and, if not, imposing ex-ante remedies to foster its development.

Under this approach, a market warrants *ex-ante* regulation if it satisfies three criteria:

- (i) There are high and non-transitory barriers to entry, whether structural, legal or regulatory;
- (ii) There is no trend towards effective competition within a relevant time horizon; and
- (iii) General competition law is insufficient.

The regulators should then impose remedies to address the competition problem. These remedies must be proportionate to the objectives. Wholesale markets should be regulated first and retail markets only as a last resort. The regulators should review each market periodically until competition is effectively working in order to ensure that appropriate regulation is adopted where necessary to foster the development of competition, and adapted or rolled back as competition becomes effective.

Good practices include:

- Making the market analysis methodology and rules for imposing ex-ante obligations transparent.
- Identifying the markets to be assessed in advance.
- Reviewing each market periodically to ensure that regulation is reflecting the developments in state of competition.
- Using a variety of qualitative and quantitative indicators to assess the level of competition in each market and how this is likely to develop in the near future
- Using geographical segmentation of markets if competition differs greatly.
- Avoiding subjecting new and innovative services to regulatory obligations.
- Subjecting preliminary conclusions of market analysis and proposed regulatory interventions to public consultations.
- Ensuring adequate experts and resources to undertake these analyses

Source: Adapted from OECD (2014<sup>[49]</sup>), OECD and IDB (2016<sup>[50]</sup>) and European Commission (2020<sup>[51]</sup>).

### Lowering barriers to foreign investment and trade

Reforms to attract foreign investment form part of Indonesia's overall plan to improve its business environment. The significant reforms implemented in February 2021 contribute to such an objective and will generate a more growth- and competition-friendly regulatory environment. Nonetheless, the PMR indicators point to further scope for improving Indonesia's openness to FDI by reducing regulatory restrictions. The stock of inward FDI in Indonesia was equivalent to 21% of GDP in 2019, only a little over half the ratio in Brazil and South Africa. FDI in services sectors is particularly low (OECD, 2020<sup>[43]</sup>).

In addition to constraining investment, restrictions on foreign investment limit the transfer of new technologies and skills such as managerial and technical skills. Scaling back restrictions on investment, especially in services sectors, could lift trade and innovation, thereby raising productivity and growth (Nicoletti et al., 2003<sup>[44]</sup>). Cross-country research and studies of Indonesia show that by raising the quality and quantity of services, FDI in services sectors can boost services sector productivity as well as contribute to a more competitive manufacturing sector (since manufacturing firms use services sectors) (Duggan,

Sjamsu and Gonzalo J., 2013<sup>[52]</sup>). Restrictions on FDI in services sectors may be contributing to Indonesia's low level of participation in global value chains (OECD, 2020<sup>[43]</sup>).

The 2021 reform has clearly removed some of these restrictions and made regulatory settings friendlier for foreign investors. However, with other restrictions still in place, further reforms could yield additional economic gains. The 2020 *OECD Investment Policy Review of Indonesia* shows that a reform equivalent to removing **all** foreign equity restrictions would lower the FDI Restrictiveness Index to the average of non-OECD countries and would likely translate into a massive increase in FDI in services and manufacturing (OECD, 2020<sup>[43]</sup>). The government could determine priorities for future reforms by assessing the costs and benefits of lifting the remaining restrictions, such as high minimum capital requirements still imposed on foreign investors and the reservation of some activities to domestic SMEs.

The PMR results also point to significant scope to boost competition by granting foreign suppliers of goods and services greater access to Indonesian procurement markets and to its services markets. Although other countries favour resident firms in public procurement, Indonesia is particularly unusual in favouring only local resident companies (as opposed to foreign-owned resident companies) (OECD, 2020<sup>[43]</sup>). Levelling the playing field would increase competition and increase value for money for the taxpayer. Local content requirements in procurement may aim to develop local markets for goods and services but the impact will depend on market power and the potential for foreign contestability (Stone et al., 2014). These requirements also create inefficiencies by increasing costs, lowering quality, or constraining options. Thus, the effect of these requirements should be evaluated with a view to removing them, if the costs outweigh the likely benefits.

Given Indonesia's geography and the importance of connectivity for consumers and firms alike, opening up air and sea transport routes to foreign operators could lower costs and increase productivity. Relaxing cabotage rules could help develop the coastal shipping industry as it would make Indonesian ports more attractive for global shipping companies designing their routes (ITF, 2017<sup>[53]</sup>). The OECD *Competition Assessment Review of the logistics sector* suggests several alternative reforms (OECD, 2021<sup>[33]</sup>).

**Table 4. Policy options for improvements related to Barriers to Domestic and Foreign Entry**

Area of product market regulation	Options to consider for potential reforms based on the PMR indicators
Barriers in Network Sectors	<ul style="list-style-type: none"> <li>• Introduce some form of vertical separation of business activities in the electricity sector, as a minimum accounting separation, and strengthen separation in the gas sector.</li> <li>• Explore ways of liberalising the electricity sector within the provisions of the Constitution.</li> <li>• Evaluate the costs and benefits of a wholesale gas market, including the impact on competition and consumers.</li> <li>• Replace the obligation for new firms in road and water transport to obtain a licence by a simple notification to the relevant authorities.</li> <li>• Task an independent regulator for the e-communications sector with the responsibility to regularly assess the state of competition in fixed and mobile electronic communications markets, relying on a variety of indicators, and to use the outcome to determine appropriate and proportionate ex-ante regulation that can foster the development of competition.</li> </ul>
Other barriers to trade and investment	<ul style="list-style-type: none"> <li>• Evaluate the costs and benefits of remaining barriers to FDI, such as reserving some activities to domestic SMEs.</li> <li>• Level the playing field between foreign-owned and domestic companies.</li> <li>• Lift restrictions on foreigners holding key management positions.</li> <li>• Relax restrictions on foreign suppliers' participation in public procurement tenders, particularly resident companies.</li> <li>• Evaluate the effectiveness of local content requirements in public procurement.</li> <li>• Lower trade tariffs, particularly on consumer goods.</li> </ul>

Note: Most but not all of these policy options if implemented would improve Indonesia's PMR score. The areas of product market regulation are based on the low-level PMR indicators. Low-level indicators are highlighted specifically where the gap between Indonesia's score and the OECD average is more than two standard deviations (across OECD countries) (see Table 1).

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