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TRADE AND INVESTMENT PROJECT

(PROJECT IDENTIFICATION DOCUMENT)

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT NO. 497-0363

SEPTEMBER 5, 1989

AGENCY FOR INTERNATIONAL DEVELOPMENT
PROJECT IDENTIFICATION DOCUMENT
FACESHEET (PID)

1. TRANSACTION CODE
Revision No. _____
 A = Add
 C = Change
 D = Delete

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2. COUNTRY/ENTITY
Indonesia

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497-0363

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B. Code

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Trade and Investment Project

6. ESTIMATED FY OF AUTHORIZATION/OBLIGATION/COMPLETION
A. Initial FY 9|0|
B. Final FY 9|6|
C. PACD 9|5|

7. ESTIMATED COSTS (\$000 OR EQUIVALENT, \$1 =)
FUNDING SOURCE LIFE OF PROJECT
A. AID 20,000
B. Other U.S. 1.
2.
C. Host Country 6,700
D. Other Donor(s)
TOTAL 26,700

8. PROPOSED BUDGET AID FUNDS (\$000)							
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE		D. 1ST FY		E. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) SDA	730	720		2,700	-	2,700	-
(2) DP	730			-	-	17,300	-
(3)							
(4)							
TOTALS						20,000	

9. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

10. SECONDARY PURPOSE CODE

11. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)
A Code
B. Amount

12. PROJECT PURPOSE (maximum 480 characters)

a) To help the government more effectively implement the recent trade and investment policy reforms -- by shifting the operational role of the targeted government agencies away from regulating business and toward providing services that support business activity and private-sector development; and b) to help several private-sector intermediary organizations provide services that enhance the responsiveness of the private sector to the policy reforms.

13. RESOURCES REQUIRED FOR PROJECT DEVELOPMENT

Staff: USAID/Jakarta : Project Committee (5 USDH, 3 contractors)
Outside consultants : Trade economist, contracts/admin. specialist, institutional analyst

Funds FY '89 PD&S - \$50,000
FY '90 PD&S - \$50,000

14. ORIGINATING OFFICE CLEARANCE
Signature: David Merrill
Title: Director
USAID/Jakarta
Date Signed: MM DD YY
09 07 89

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16. PROJECT DOCUMENT ACTION TAKEN
 S = Suspended CA = Conditionally Approved
 A = Approved DD = Decision Deferred
 D = Disapproved

17. COMMENTS

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PROJECT IDENTIFICATION DOCUMENT
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GLOSSARY

AMCHAM	Indonesian American Chamber of Commerce
BKPM	Capital Investment Coordinating Board, which is responsible for licensing and promoting investments in Indonesia
BPPT	Board for the Assessment and Application of Technology
COCOM	An international Agreement to control the export of high-technology goods within non-Communist countries
DFI	Direct foreign investment
EKUIIN	Coordinating Minister for Economics, Finance, Industry and Development Control
ESB	Export Support Board -- A quasi-independent export development board established under the Ministry of Trade
FCS	The Foreign Commercial Service of the U.S. Department of Commerce
GATT	The U.N.-sponsored General Agreement on Trade and Tariffs
GOI	The Government of the Republic of Indonesia
GSP	Generalized System of Preferences, a U.S. trade arrangement allowing tariff relief to selected countries
IESC	The International Executive Service Corps, comprised of volunteer retired executives of U.S. corporations
IPR	Intellectual property rights, or patent, copyright and trademark protection
ITPC	International Trade Promotion Centers, which are overseas promotion offices of the Ministry of Trade
JIC	Joint Investment Committee, headed by the Indonesian Embassy in Washington, D.C. to promote U.S. investment in Indonesia
KADIN	Indonesian Chamber of Commerce and Industry
NAFED	The National Export Development Agency under the Ministry of Trade
PASA	An internal U.S. Government contract between government agencies
PID	Project Identification Document, a preliminary AID project proposal used to raise project issues and design requirements for the final project document, the Project Paper
T&I	Trade and Investment
USAID	The Agency for International Development Mission in Jakarta, Indonesia

EXECUTIVE SUMMARY

A. Introduction and the Project Context

More than ever before, the Indonesian private sector is expected to lead economic growth. A strong private sector requires an efficient and dynamic business environment; an environment that enhances the productivity of Indonesian producers and traders. The Indonesian government, through an on-going series of deregulation packages initiated five years ago, has acted convincingly toward establishing market-oriented policies more conducive to efficient economic growth.

Private and public sector institutional development, however, has lagged behind the policy reform, perpetuating implementation obstacles that curb significantly the potential benefits of economic reform. In the public sector, this is particularly evident where government institutions whose primary function traditionally has been to regulate business decisions are now expected to promote market-driven business initiatives. Even when government policy implementation is effective, the Indonesian private sector -- especially for smaller firms -- still suffers from information and managerial handicaps that limit their trade and investment performance. Weak intermediary private institutions, such as trade and producer organizations, rarely are capable of providing needed assistance and representation for these firms and workers.

B. Project Description

1. Project Objectives

The Trade and Investment Project is a six-year effort with life-of-project AID funding of \$20 million (grant). The purpose of the project is to help develop Indonesia's institutional and human resources, both in the private and public sectors, to take full advantage of its newly deregulated trade and investment environment. More specifically, the project aims: a) to help the government more effectively implement the recent trade and investment policy reforms -- by shifting the operational role of the targeted government agencies away from regulating business and toward providing services that support business activity and private-sector development; and b) to help several private-sector intermediary organizations provide services that enhance the responsiveness of the private sector to the policy reforms.

2. Project Strategy

The top priority of the project is to stimulate trade in Indonesia, including both foreign exports and imports, and internal trade among provinces. An inefficient trading system is widely held to be a primary contributor to Indonesia's high-cost economy. Also, expanding trade opportunities encourage investment and technology transfer, since marketing prospects help determine the profit incentives that drive businesses' investment and technology decisions. At the same time, once

domestic production capacity is fully employed, as is the case now in many manufacturing sectors in Indonesia, growth in trade cannot occur without new investment. The project, therefore, also focuses on promoting investment in Indonesia, from both domestic and foreign sources. These two highly interdependent economic activities -- trade and investment -- are key elements in the GOI deregulation effort and contribute vitally to achievement of top GOI economic development priorities, especially increasing non-oil export, employment and income growth.

A key element of the recent reform packages has been to curtail the use of restrictive trade and investment licenses. This has forced the Department of Trade and the Investment Coordinating Board (BKPM), the two government agencies responsible for such licenses, to shift away from an emphasis on licensing operations toward becoming more service and promotion oriented. About two-thirds of the resources of this project will be used to help these two government institutions, through the intermediation of the high-level Economic Coordinating Ministry (EKUIN), to minimize their licensing function and develop the capability to provide useful services to the business community. In conjunction with this effort, the remaining project funds will be dedicated to helping develop several key private sector intermediary organizations. Such intermediary organizations play a key role in helping firms take advantage of the deregulated economic environment. In all parts of this project, possible gains from contracting out services to private firms will be explored.

3. Project Implementation

Project implementation is influenced importantly by two factors. First, government administration of trade and investment policies is dispersed among a number of ministries and agencies, affecting a wide array of private sector operations. A key project objective is to systematically improve the trade and investment business climate, rather than taking a piecemeal approach -- since piecemeal approaches have not proven effective in Indonesia in the past. Secondly, institutional reform is inherently a political process, requiring a pro-active and flexible approach that allows the GOI and the project team to both initiate activities and respond constructively as conditions change over time.

To accommodate these project demands, while at the same time attempting to minimize the AID management burden, one contract will be used to provide project services. This contract will provide long and short-term technical assistance, training, workshops and commodities (primarily computer equipment and software). Grants for private sector institutional development are the other important aspect of this project.

EKUIN will be the project leader. EKUIN is chosen both because it plays the natural role of coordinating government agencies affecting trade and investment flows and because of the high-quality and accessibility of its staff. Although EKUIN does not have direct operational control over the technical departments, it does commonly play a leadership role in tackling difficult problems -- such as those addressed in this project -- that confront the economic departments. As well, EKUIN plays a key role in determining the broad trade and investment policy framework that underpins this project.

Under EKUIN leadership, the Department of Trade, and then BKPM, are expected to receive the bulk of project resources directed to government operations. Recipients of private sector grants (e.g. IESC, several dynamic regional KADINDAs and trade associations) will be a limited number of intermediary organizations determined on the basis of performance-based proposals.

C. Outputs

This project generates three broad outputs:

- developing the institutional capacity of key public and private sector organizations to implement effectively the pro-trade and investment policy reforms enacted by the GOI, including where necessary full-scale reorganization and training programs;
- increasing private sector involvement and promoting a transparent public-private dialogue in the formation of trade and investment policies and in implementing trade and investment functions and programs, including increasing the use of the private sector to actually carry out various activities such as certain trade and investment promotion efforts;
- improving the capability to conduct effective trade and investment policy analysis and to upgrade promotion efforts, including the development of a high-quality, compatible trade and investment data and information base that is widely available throughout the government and private sector.

D. Expected Accomplishments

The expected accomplishment of the project in broad terms is a more stimulative, pro-trade and pro-investment business environment -- supported by facilitating government services and policies; and, by dynamic and representative private sector intermediary institutions. A more dynamic business climate leads directly to achieving the project goal of increasing Indonesian employment and income levels. Although there is no explicit, contingent policy agenda for this project, its outputs and expected accomplishments are designed to bolster the current deregulation effort and to provide a sustained institutional foundation of support for a continuation of reform efforts.

E. USAID Staffing and Budget Requirements

The USAID Private Sector Development (PSD) Office will manage this project, with assistance from the Economic Policy Support Office (EPSO). Management responsibilities are anticipated to require: one USDH from PSD as project manager; part-time of a trade economist (PSC) in EPSO to assist in project development; and an Indonesian FSN to assist in project management.

We also expect to leverage additional AID resources for this project through coordination with the ASEAN Representative Office's Private Investment and Trade Opportunities Project and by maintaining close cooperation with the ANE Bureau Private Sector Office.

The estimated budget for AID funding is as follows:

1.	<u>Long-term Technical Assistance</u>		
	EKUIIN Team Leader	5 p/y	
	Deputy Team Leader/Admin. Manager	5 p/y	
	Trade Advisor	5 p/y	
	BKPM Investment Advisor	5 p/y	
	Private Sector Advisor	5 p/y	
		<u>25 p/y @ \$260,000</u>	\$ 6,500,000
2.	<u>Short-term Technical Assistance</u>		
	11 p/y (132 p/m) @ \$250,000		\$ 2,750,000
3.	<u>Private Sector Grants</u> 5 yrs @ \$1,000,000		\$ 5,000,000
4.	<u>Special Studies/Workshops</u> 5 yrs @ \$200,000		\$ 1,000,000
5.	<u>Training Fund</u> 5 yrs @ \$500,000		\$ 2,500,000
6.	<u>Commodities</u>		\$ 750,000
7.	<u>Contingency/Evaluation</u>		\$ 1,500,000
			<u>\$ 20,000,000</u>

Host country contributions will total \$6,700,000, with allocation of these funds determined during the PP design. The technical assistance contract, and private sector grants, will follow direct AID contract and grant award procedures. Special studies, training, and commodities will be managed and funded under the TA contract.

A summary of key issues to be considered during PP design are included in Section IV.L.

I. THE PROJECT CONTEXT

A. The Development Context

Current Indonesian economic policy is dominated by two problems: the need to replace the oil and gas sector as the primary source of foreign exchange and government tax revenues; and the need to cope with an influx of about 2 million new entrants a year into an already saturated labor market.

Without the windfall benefits of high oil prices (which effectively allowed Indonesia to tax foreign oil consumers to finance Indonesian development), Indonesian economic growth now must be generated by efficiently mobilizing domestic (both private and public) resources, and attracting foreign investment (and foreign aid) and technology from abroad. This shifts the focus of a successful and sustainable development strategy for Indonesia toward implementation of policies and practices that raise factor productivity, especially the productivity of Indonesia's large (and underemployed) labor force.

Developing countries have pursued a wide range of policies toward this end, but the most successful policies seem to be those that have encouraged domestic market forces to operate in tandem with world markets. Encouraging the freer flow of trade both in internal and external markets, combined with the deregulation of business activity, generates strong incentives for economic efficiency and productivity gains throughout the system. In particular, outward-looking growth strategies, emphasizing growth in exports and imports, have proven quite successful in encouraging the foreign and domestic trade and investment, and transfer of technology, that are vital to raising labor productivity (and employment and income levels) in an economy.

For Indonesia, a country rich in natural resources and unskilled labor, the key resource constraints to economic growth are shortages in skilled labor, physical capital, and appropriate technology. Overcoming shortages in these key resources will involve increasing investment in both human and physical capital, and technology. Such investment, however, must be funded either from domestic savings or by tapping into international trade and financial markets. Thus, limitations in domestic savings and foreign exchange are major barriers to growth in Indonesia.

Equally as important, economic growth is constrained by government policies that introduce inefficiencies into the economy, reducing the output that can be generated from Indonesia's endowment of resources.

Indonesia has attempted to overcome these constraints to growth by implementing an on-going series of deregulation reforms, including:

- financial sector deregulation designed to encourage domestic savings and net financial capital inflows;

- a tax reform to increase government revenues;
- cancellation of a number of government projects, restraining government spending;
- streamlining the investment licensing system in order to attract foreign investment; and,
- liberalizing trade policies to increase non-oil exports and imports of key investment and technology goods and services.

These reforms not only help ameliorate macroeconomic constraints to growth, but they also help improve the allocation of resources within the domestic economy. Trade and investment policies that encourage export-oriented industries will shift resources toward efficient sectors that must compete on world markets and away from import substitution sectors where inefficiency is protected by import barriers to trade. This tends to stimulate both exports and imports. Similar and often equally important gains from deregulated internal trade are possible. Also, given Indonesia's comparative advantage in labor-intensive production -- where firms take advantage of Indonesia's abundance of low-wage labor -- export-led growth tends to have high employment multipliers that help provide jobs for the ever-expanding labor force.

The on-going deregulation effort represents a strong GOI commitment to "free up" business decisions. For these reforms to yield maximum benefits, however, they must be effectively implemented by government authorities, and the capacity for the private sector to respond to the reforms must be improved. Additional information on Indonesia's recent trade and investment performance is found at Appendix C. Also included is a synopsis of the key constraints affecting trade and investment in Indonesia.

B. Conformity with Indonesia's Strategy and Programs

Perhaps the best measure of the GOI's development strategy is the Repelita V, which covers the 1989-94 period. The following illustrations from the summary of Repelita V, entitled "The Main Aim and Objectives of Development," highlight the key medium-term development goals of the GOI.

- The annual economic growth rate target is 5 percent, with an anticipated 10 percent per year growth in the non-oil manufacturing sector leading the way. The manufacturing sector is expected to increase from 14.4 to 16.9 percent of gross domestic product while agriculture drops from 23.2 to 21.6 percent.
- Export targets imply a growth rate of about 16 percent per year for non-oil exports, and investment is planned to increase by Rp. 239.1 trillion (\$136.5 billion), of which about 55 percent is expected to come from the private sector.

-- "In Repelita V, the government will take steps to revitalize and improve the institutions in all fields to enable them to increasingly meet the demands of the development. These measures include deregulation and debureaucratization, which will be continued and intensified."

-- "In Repelita V, balanced development of overseas and domestic markets constitutes one of the [top] objectives of government policy. The promotion of foreign capital investment is to be particularly directed to sectors which produce or support the marketing of goods and services for export, encourage the development of new products, new methods of working and the transfer of technology."

From the above broad objectives and the more detailed plans throughout the Repelita V, and from discussions with a number of public and private sector Indonesian officials who have contributed over the past two years to the conceptualization of this project design, we can conclude that the GOI has, and will continue, to take the lead in implementing the strategies and actions presented in this PID.

C. Relationship to AID Strategic Concerns

Developing a more open trade and investment environment is a key element in USAID's first CDSS sub-goal, "to support a more open, less regulated market and trade-oriented economy, both internally and externally". Within this sub-goal, the CDSS states the following:

1. "The open market trade objectives are the center piece of our private sector dialogue with the GOI. This dialogue, which is consistent with the GOI commitment to a more open economy, will be augmented by substantial AID support for follow-on policy implementation requirements" (p. 32). We see this Project as a direct fulfillment of this objective to help implement new GOI trade and investment policies.

2. "These trade and enterprise development efforts will build on the program base already established with numerous technical ministries in support of specific programs." As noted specifically in Section III.E of this PID, this project pulls together and continues many important initiatives started in trade and investment under the PSD Office, and builds a more cohesive and long-term focus for future trade and investment initiatives.

3. "Trade, industry and investment deregulation is a relatively new focus for USAID, and is predicated on substantial changes already enacted or contemplated by the GOI. Many of these actions have involved close cooperation with and substantial program support by the World Bank. We will therefore take a flexible, cooperative approach that is mutually supportive with the Bank, targeting those areas of opportunity which are most consistent with our own program" (p. 33). Our proposed coordination with the World Bank (see Section III.F) and our desire to maintain flexibility in this Project are directly responsive to the proposed approach in the CDSS. In addition, the design of this project has taken

into account fully the "impact potential" and "management effectiveness" concerns set forth in the CDSS. We believe this Project scores very high marks on all aspects of impact potential. While management effectiveness for such a large program is obviously a concern, the concepts of maximum use of GOI leadership, project-funded management and leverage of other donor assistance have been integrated into the project design so that management inputs are reasonable, well-defined, and justifiably based on probable impact.

Finally, seen from the perspective of broader USG strategic concerns, encouraging the efficient implementation of open-market policies in developing countries also is a prominent U.S. trade policy goal, both in terms of the U.S. Omnibus Trade and Competitiveness Bill of 1987 and for the Uruguay Round of GATT Negotiations. This project's purpose is to make the trade and investment environment work more efficiently by reducing government restrictions and by strengthening the capacity of the private sector to respond to free-market incentives. During project design, U.S. regulations concerning assistance for export promotion -- such as the Bumpers and Lautenberg Statutes -- will be enforced.

II. PROJECT DESCRIPTION

A. Statement of the Problem

The continuing series of GOI deregulation packages -- including major reforms in trade and investment policy -- has demonstrated clearly a commitment to rectifying many of the key causes of the high-cost economy. Efforts to implement these policy changes, however, are seriously thwarted by the lack of appropriate public and private institutional and human resources. In addition, many efforts to promote trade and investment still are structured around a government-controlled, sectoral approach rather than a functional approach that stresses supporting and responding to the private sector's needs.

In the public sector, the primary mission of both the Department of Trade and BKPM has been traditionally to regulate trade and investment licenses. The current organization of the Department of Trade involves a staff of about 12,000 people stationed predominantly in regional and local offices throughout Indonesia. 1/ The capacity of the Department of Trade to do trade policy analysis and to coordinate export promotion programs is weak, so much so that the Department of Trade often does not play a major role in trade policy formulation and export development.

1/ A relatively small proportion of all Department of Trade staff is stationed in the central office and in attache positions in Indonesian Embassies abroad. In addition, State Trading Companies, who also employ a large number of workers, are under the jurisdiction of the Department of Trade.

Furthermore, trade and investment promotion activities are scattered broadly among organizations, and performance incentives are lacking. Results are, therefore, minimal. Even though data for policy analysis and trade promotion exist, it can rarely be used effectively because data sources are dispersed among organizations who have little communication between each other or with the private sector. No one Department is responsible for coordinating and disseminating most trade and investment data.

The "natural" roles or focus for the Department of Trade in a deregulated environment include: trade and private sector promotion; information dissemination; trade policy analysis; and international negotiations. In addition, since the Department of Trade shares trade-related (and less directly investment-related) functions with a number of other departments, the Department of Trade can make an important contribution by improving policy and data coordination among these government organizations, and the private sector.

BKPM must address some of the same problems as the Department of Trade, in particular the need to shift away from licensing and toward investment promotion. Since promotion involves an entirely different approach than licensing, the provision of effective promotion services by BKPM will require a range of training and technical assistance, including the possibility of some institutional restructuring and contracting out of services.

In the private sector, KADIN -- the Indonesian Chamber of Commerce -- is the major national organization. Yet KADIN appointments are often more political than commercial in nature, and there is little bottom-up representation. Nevertheless there are encouraging signs that local KADINDAs are becoming a stronger voice for the private sector. Likewise trade associations, although presently weak and not a pro-active force for marketing and trade, can potentially play a much greater role in strengthening private sector operations and representation.

This Project, therefore, is targetted at the following needs:

1. To assist in the development of key institutions, both public and private, responsible for trade and investment policy and promotion;
2. To further engage Indonesian public and private institutions and businesses in sustainable, long-term relationships that will strengthen trade and investment to and within Indonesia and increase the voice of the private sector;
3. To allow the GOI to more systematically address, analyze and implement trade and investment policies and to a lesser extent related commercial laws.

B. Project Goal and Purpose

The Trade and Investment Project is a proposed six-year effort with life-of-project AID funding of \$20 million (grant). The project's goal is to generate sustained increases in employment and income levels by increasing the productivity, and thus the competitiveness, of Indonesian producers and traders. The purpose of the project is to help develop Indonesia's institutional and human resources, both in the private and public sectors, to take full advantage of its newly deregulated trade and investment environment. More specifically, the project aims:

- a) to help the government more effectively implement the recent trade and investment policy reforms -- by shifting the operational role of the targeted government agencies away from regulating business and toward providing services that support business activity and private-sector development; and
- b) to help several private-sector intermediary organizations provide services that enhance the responsiveness of the private sector to the policy reforms.

C. Outputs

This project involves most fundamentally reworking the organizational structures of key public and private institutions to operate more effectively in the new deregulated environment. Institutional reorganization, and the development of human resources and information channels go hand-in-hand. While building human resources are clearly important, appropriate organizational structures are also critical to provide adequate performance incentives and to increase the voice of the private sector in decision-making processes.

As a theme to guide institutional development, the project aims to improve the productivity of Indonesian producers and traders within an open-market trade and investment policy framework. As Indonesian firms become more productive, they naturally become more competitive on world markets. Institutional development stresses shifting the function of government operations away from control and regulation toward providing services that facilitate business activity, while concurrently upgrading the receptiveness of the private sector to respond to government reforms.

Institutions, both public and private, can provide better services not only by improving their internal operations, but also in many cases by contracting out some of their activities to private firms. The potential benefits from such contracting out of services will be explored thoroughly during Project-Paper development, not only for government services such as export and investment promotion, but also for relevant activities in KADIN and the producer associations. Initial conceptual interest to this idea has been expressed by various government officials, but the discussion has yet to address concrete proposals. The use of various privatization schemes is also in line with the June state enterprise reform package, although this package was stated in such broad terms that its operational impact is unclear as yet.

Project Outputs

Within this overall policy framework, the Project proposes to achieve the following outputs:

1. Institutional development. The project proposes to help develop a rationalized institutional structure with an increased capacity for trade and investment development, both internationally and within Indonesia. Public sector institutional reforms will focus specifically on staff development and reorganization in the Department of Trade and its related organizations at the international, national and regional levels, including NAFED, Commercial Attaches and International Trade Promotion Centers, the State Trading Companies, and its regional offices (Kanwils). The Department is expected to focus future development around the core areas of trade promotion, international negotiations, trade information dissemination, standards development, and trade policy coordination.

The project also proposes to help BKPM develop a more effective investment promotion and policy program in general, and in particular, to promote US-Indonesian investment (and investment-related trade) ties. Included here will be staff training, program development (including improving linkages between the national and regional operations) and other types of assistance designed to upgrade BKPM's investment promotion operations. The common theme of all programs will be improving productivity through facilitated trade and investment.

2. Increased private sector involvement. A strong priority of the Project is to increase the role of the private sector in trade and investment policy formulation, and in implementing trade and investment functions and programs. As the government relies increasingly on the private sector to generate economic growth, it becomes more and more important that the private sector has active forums to represent itself and take action. This Project proposes both to help strengthen information channels between the private and public sectors, and to help better develop the capacity of the private sector to participate actively and productively in this process. This will be accomplished by strengthening organizations such as trade associations, regional, and possibly the national Indonesian Chamber of Commerce (KADIN), and the IESC. Institutional development for these private-sector intermediary organizations will stress increasing bottom-up representation, improving marketing programs, increasing policy input into government decisions, improving information dissemination, and providing better service to small business clientele.

3. Improved trade and investment policy analysis and promotion. A key goal of this project is to help upgrade the policy analysis capabilities of the GOI and the private sector, to improve both the quality and availability of trade-related government data bases, and when focussing on institutional development, to develop an institutional structure and incentive system conducive to the achievement of the above. The project

will also work to increase communication and coordination among divisions within Departments, among key Departments, and between the GOI and the private sector. This includes the possibility of improving trade and investment policy formulation procedures. Improving the economic analytical capabilities of these institutions provides a basis for continued deregulation efforts.

Strengthening trade and investment promotion requires many of the same outputs as stated above for policy, including improving organizational structure and incentives, developing quality and easily accessible information systems, providing a wide range of applied training, and working toward better coordination within and among Departments. Promotion differs most fundamentally in requiring the government to provide active consulting services to private sector "clients". A distinct output for trade promotion, then, is to encourage GOI promotion services to be demand-led by the needs of businesses. The GOI will be encouraged to contract out part of its trade and investment promotion activities to private firms.

D. Inputs

Two key considerations in planning project inputs will be to maintain flexibility in programming, and to have the GOI take the lead role in directing the Project's institutional focus as the Project proceeds. Flexibility is necessary not only because the proposed restructuring process requires the GOI to determine its pace and direction, but also because USAID is a relatively new player in the trade sector. USAID experience in the finance sector has clearly demonstrated the high payback of flexible programming in the early stages of project activity, for example demonstrated by the Private Sector Project (0329) Special Studies Component.

The major categories of inputs will be technical assistance, training, private sector institutional development grants, funding for special studies, and limited commodities. Flexibility will be maintained by keeping a substantial portion of the technical assistance as un earmarked short-term assistance, and through the special studies and contingency funds. In particular, funds will be made available to help initiate various "contracting out" programs. Inputs are described in more detail below:

1. Technical Assistance -- A technical assistance team will be formed under the leadership of EKUIN, which will then assist in implementing programs primarily with the Department of Trade and BKPM, and to a lesser extent when needed with the Department of Finance. The common theme of facilitating trade and investment, and their role in increasing productivity, will be reflected in each advisor's scope of work. The proposed long-term team would provide a total of 25 person-years of assistance, and would consist of the following positions:

- The team leader will serve as the principal policy and institutional development specialist working with EKUIN. He/she will coordinate work among all advisors, and will work with the Departments of Finance (co-located with EKUIN) and Trade, and BKPM on trade and investment issues.
- The deputy team leader/administrative manager will also reside in EKUIN, but will be actively involved in developing short-term assistance inputs, workshop and seminars, and training programs to support the team as a whole. He/she also will work on contract administration.
- The trade advisor will advise the Department of Trade on policy analysis, institutional restructuring, developing and managing training programs, managing short-term experts and other project resources targeted at the Department, and coordinating institutional support carried out under other donor programs.
- The BKPM investment advisor will support U.S. investors in Indonesia, work with BKPM to improve investment promotion programs and assist in developing investment information networks that can serve public and private sector needs. Depending upon developments, this advisor also may be expected to assist BKPM to develop an institutional reorganization and training program.
- The private sector advisor will work with private-sector organizations selected to receive grants, helping them to design and implement effective programs. This advisor will assist technical experts paid by the grantees themselves, and will also be available to assist in establishing management and financial accountability for grant recipients.

Up to 132 person-months of short-term expertise in such areas as trade negotiations, trade promotion and policy analysis, data and information systems development, investment promotion, and commercial law development will be provided, with most of this time available for quick-response, flexible programming. Emphasis will be placed on assisting the targeted institutions to establish "contracting-out to private firms" programs.

2. Private Sector Grants -- Grants funds will be made available to qualified Indonesian national and provincial organizations, both public and private, and to U.S. organizations who are involved in trade and investment promotion. Solicitations of interest will be requested using an invitation for application process that advertises the availability of grant funds for a stated purpose and invites interested parties to submit an application. Each application will be evaluated against a clearly defined criteria that will include qualification and responsibility factors as well as evaluation of goals and objectives of the responding organizations.

Organizations successfully evaluated on the basis of this criteria for potential grant recipients will be required to submit a fully defined grant proposal detailing how grant funds will be applied to obtain specific developmental objectives. Such proposals may include counterpart pairings with U.S. organizations or obtaining specific technical assistance from qualified sources to assist in organizational development. The grant selection criteria will stress helping private-sector organizations better represent their interests in the government policy debate and to improve their ability to provide informational and technical services to their members. The number of grant recipients will be limited to probably no more than five. On the basis of our on-going analysis of private-sector intermediary institutions, the most likely candidates now include several regional KADINDAs, the IESC and several trade associations.

Although grants appear to be the most effective way to achieve the private sector goals of this project, the PP design team will examine the relative merits of using a technical assistance package for this purpose.

3. Special Studies and Workshops -- Funds will be provided for trade and investment studies and workshops that contribute to project objectives. These monies will be managed by EKUIN and the technical assistance team, in conjunction with USAID. In addition to inputs needed for public and private institutional development initiatives, specific targets of interest include studies on commercial and trade law reform, GATT and GSP workshops, support for participation in international commodity agreements, assistance for Indonesian conformity to COCOM standards, and studies leading to greater private sector involvement in trade and investment activities.

4. Training -- A substantial amount of long and short-term training, both U.S. and local, for trade and investment-related studies will be provided. Both public and private participants will be targeted. Training will be managed by EKUIN and the technical assistance team. The deputy team leader/administrative manager will help the GOI develop an overall training plan for the government agencies based on a training-needs assessment. The private sector advisor will be available to assist grant recipients in developing training plans. Both overseas and Indonesian training resources will be employed. Whether GPT II Project funds can be used effectively for this type of training will be examined during PP design.

5. Commodities -- Purchase of certain commodities will be required to help the targeted institutions achieve their institutional development goals. These are likely to include: computer hardware and software; various types of data, including data from international organizations about world market conditions and foreign trade and investment barriers; and, information management technology. Commodity purchases will be procured under the contract.

E. Expected Accomplishments

The expected accomplishment of the project in broad terms is a more stimulative, pro-trade and pro-investment business environment -- supported by facilitating government services and policies; and, by dynamic and representative private sector intermediary institutions. Whereas it is impossible to precisely calibrate the benefits of a robust business climate, a vigorous business sector clearly will result in tangible and significant increases over time in a number of key economic variables, including employment and income levels, non-oil exports and imports, and investment. Although there is no explicit, contingent policy agenda for this project (see Issues Section III.L, para 2), its outputs and expected accomplishments are designed to bolster the current deregulation effort and to provide a sustained institutional foundation of support for a continuation of reform efforts.

EKUIN, as project leader, and the Department of Trade have stressed the need to set clear, scheduled benchmarks for institutional reform and training. Combining these quantitative gauges with qualitative assessment will form the core of the evaluation procedures for this project. Grant proposals for the private sector will include well-defined evaluation criteria. An important issue for PP design will be to clarify further this evaluation process. Part of the PP design, already in progress, will be a thorough description of the institutions targeted by this project. This will set a baseline by which progress can be measured over the life of the project. An evaluation of progress by the GOI and the project team will be performed quarterly. USAID will evaluate the project one year after installment of the team, and then every two years thereafter.

The detailed accomplishments of the project can be separated into two categories: a) direct institutional development; and b) broad economic gains resulting from the more effective implementation of the policy reforms. Included in the following list is a brief discussion of how each accomplishment can be measured.

Potential direct institutional development accomplishments, for both the public and private sector include:

-- A full organizational restructuring of the Department of Trade, with an expected concentration on seven functions: export promotion; domestic trade promotion; international negotiations; operation of overseas commercial attaches and promotional offices; trade policy analysis and coordination among public and private groups; development and coordination of information (data) sources and dissemination; and, standards and quality control. Such a restructuring will be transparent and easily measured. Its success, however, might be measured by increases in export promotion contacts and sales, by fuller participation in the Uruguay Round of GATT negotiations, by the establishment of a more effective system of product standards, and so on.

-- A full-scale training program at the Department of Trade targeted at three areas of human resource development: the establishment of "elite" cadres of professionals in each of the seven key functional divisions; development of computer and informational specialists; and, basic retraining for the thousands of Department employees scattered throughout the provinces. On-the-job training and specialized in-country training sessions will be stressed as a vital complement to increasing the academic skills of Department staff -- reflecting the demonstrated weakness in transferring academic training to practical, operational capacity throughout the Indonesian system. The accomplishment here is two fold -- developing a viable training approach that can be sustained once the project concludes; and, increasing the operational skills of all Department staff over the term of the project. Both of these accomplishments lend themselves to quantitative measurement, including number of people trained and the existence of a viable training program and staff.

-- Restructuring and training programs for BKPM, on a more limited basis than for the Department of Trade, combined with technical assistance and funding for various promotional activities. Included here is an improvement in the information channels between the largely independent regional BKPMs and the national BKPM. Activity here might be measured in terms of increased investment approvals, higher investment implementation rates, and number of people trained.

-- A strengthened capacity for several private-sector intermediaries -- centered most likely around several dynamic regional KADINDAs and producer associations -- to represent private-sector interests in policy debate and to provide practical services to their members. Accomplishment might be measured by increased membership in these organizations, by greater sales and investment by members, by the quantity and quality of technical services provided and informational seminars conducted, and by the number of staff trained.

-- Establishing sustainable channels of communication among government agencies dealing with trade and investment issues, and between the private sector and the government. This includes helping to improve current trade-policy formulation procedures. All institutions targeted in this project have expressed the need for this output, but the best way to effect this communication will be analyzed during PP design and later by the GOI and the project team. A proposed inter-ministerial coordinating body for national export policy may provide a good vehicle to achieve this task. The establishment of operational channels of communication between these groups would be monitored, and the number of meetings could be used as a gauge of activity.

-- Development of a data management system that coordinates the trade and investment data capabilities in various government agencies, resulting in a core data and information center where a comprehensive, current and compatible data set is made available to all government and private-sector users. To facilitate this process, a national trade and

investment data committee should be established -- consisting of key government, private sector, and academic representatives -- to guide these activities. Evaluation of this accomplishment will focus on the tangible output of this center and committee.

-- Setting the stage for commercial law reform in Indonesia through a series of investigative studies analyzing both deficiencies in legal statues and in the implementation of law.

-- Developing the human resource and analytical capacity of Indonesia to become more active in ASEAN, GATT and other international economic organizations. This accomplishment can be evaluated by noting advances in Department of Trade international negotiating capacity, and advances in the inter-departmental GATT coordinating committee. Also, another key benchmark might be a formal presentation of an Indonesian proposal for GATT action in the Uruguay Round, something that few developing countries will be able to do effectively.

-- The development of an effective set of commodity and product standards and quality controls, possibly leading to an organization similar to the U.S. Bureau of Standards.

In a longer-term sense, these institutional development accomplishments can be expected to lead to gains in a number of key economic targets, which include:

-- Success in the project's accomplishments should contribute significantly toward achieving a number of key economic targets. Although it is impossible to precisely quantify the impact of institutional development on these variables, given how closely integrated this project is to the overall GOI developmental effort over the next 5 years, it seems reasonable to gauge success by the achievement of the following targets: 15 percent growth in non-oil exports per year; at least \$10 billion of new private sector investment, both domestic and foreign, per year; at least 1 million new jobs per year; at least a 5 percent increase in real per capita income per year. Achievement of those targets, of course, depends on steady growth in the world economy.

-- Increased trade and investment by small and medium firms, both domestic and foreign owned. The institutional barriers to trade and investment that this project aims to reduce, and the new services provided, will benefit small and medium firms disproportionately. Thus, an expected measurable outcome is a substantial increase in trade and investment by small and medium firms in Indonesia.

-- Increased regional diversification of trade and investment, since again the current system tends to discriminate against trade and investment outside the large, established market centers. A measurable outcome here is an increase in the relative share of trade and investment in regions other than Jakarta, Surabaya and Medan.

-- Increased transfer of "appropriate" technology based on Indonesian comparative advantage, and closely related, encouraging labor-intensive production. This can be measured by comparing the industrial structure and production techniques of key traded-good sectors.

-- Increased implementation rate of BKPM-approved investments, especially off Java. This can be measured by comparing current and post-project implementation rates.

F. Project Implementation and Management

In order to facilitate the implementation and management of this project, a single contract will be awarded competitively to a firm which will be responsible for: recruiting and backstopping both the long and short-term technical assistance personnel; identifying training requirements and backstopping participants; developing workshops and special studies; purchasing commodities to support hardware and software needs; and developing a project management system that can be used by the Contractor, EKIIN and USAID in monitoring the management of the Project. Selection criteria will emphasize the evaluation of the capabilities of the interested firms to respond to the diverse requirements of this contract.

Award and management of the private sector grants will fall outside the TA contract, but the process will be designed to minimize USAID management requirements. Use of the invitation for application process will screen out unsuitable recipients. Management of the grants after award will follow the standard USAID procedures of quarterly progress reports and periodic evaluations. In addition, the TA team private sector specialist will have specific responsibilities to provide technical assistance to grant recipients. Such assistance could include proposal preparation as well as development of specific grant management techniques. During PP design, opportunities for Gray Amendment contractors will be fully explored and identified, and opportunities to use AID/Washington "buy-in" technical assistance resources will be evaluated.

a) A Strategic Framework of Action -- Institutional development is a painstaking, but potentially quite rewarding, task. It mixes many technical issues with fundamentally political decisions. Even once an organization's leadership commits to change, many barriers often stand in the way. Each government and private institution addressed in this project must operate within the constraints of general national rules and regulations. ^{2/} They in most cases do not have unilateral authority to make serious organizational and personnel changes.

^{2/} For example, government "civil service" rules rigidly: define organizational structure at Echelon I levels; set salary and promotion standards; regulate hiring and firing activities; and so on. As well, major structural change in any one organization generally affects other organizations, and must be approved at the Presidential level. Kadin and the trade associations are also under various degrees of control by the government, such that changes in these organizations also must take into account outside interests.

Given these political realities, and building from the recent successes gained by GOI policy reformers operating under many of the same constraints, USAID's broad strategy in addressing institutional development issues in this area emphasizes the following points. First, momentum for change must be maintained within the targeted institutions. Second, a steady and prolonged effort must be made to prepare the organization to take advantage of political windows of opportunity. It is the task of effective managers to be prepared to step forward with well-designed plans for action when such opportunities arise.^{3/} Third, a systematic approach, fully supported by all key players, must be developed at the beginning, identifying first a clear vision of how the institution can be most effective in 5 to 10 years, and then setting a path, with clear priorities, toward achieving that vision. Fourth, considerable flexibility must be available to accommodate shifts in political and economic conditions -- including both adjusting plans in progress and establishing new plans as conditions change. Fifth, within this broad framework, specialized technical assistance will be provided on a continual basis, mixing long and short-term consultants, to identify and solve problems. Sixth, this whole process must be done discretely following GOI and private-sector leadership, since they must make the political commitment. Lastly, USAID must help the GOI coordinate actions from other donors in order to most effectively use the pool of resources available to the GOI to address these problems.

In many regards, USAID has a comparative advantage in providing assistance for institutional development, as expressed by GOI interest in USAID help. By providing a mix of long and short-term consultants, combined with training, seminar and operational support over a number of years, this project stresses operational results that can become self-sustaining. It is this potential for delivering results, rather than yet another critical study with a long list of recommendations, that is the most attractive element of the project to the Indonesians.

b) Expected Project Evolution -- Project implementation is envisioned to evolve through two stages over its six-year life. Specific benchmarks will be developed in much greater detail during PP design to guide program activities, and to determine how to monitor GOI support for the project over time.

^{3/} For example, with regard to the comprehensive tax reform initiated by the Department of Finance in 1983, forward-thinking Department leadership first began preparing for the tax reform packages in the late 1970s, well before economic conditions made domestic tax revenue mobilization a top priority in the Mid-1980s. Without this preparation, sub-standard reforms, or maybe no reforms at all, might have occurred.

Stage I: During the first stage, the technical assistance team will be fully staffed and the private sector support grants initiated. Major tasks will be: to help forge mutually agreeable institutional goals related to trade and investment; to perform training needs analysis and train core groups of experts in policy analysis, international negotiations and trade promotion in the Department of Trade, and in investment promotion in BKPM; to coordinate actions with the World Bank and with the UNDP and other likely donors to the targeted institutions; to inventory all trade (and related economic) data bases, identify the multiple uses of the data, and then to develop a comprehensive data development and dissemination program; and, to evaluate initial results from the private grants. Special studies would focus on specific concerns such as GATT, COCOM, commercial law (including IPR issues) and key commodity negotiations. During this period the Department of Trade would seek GOI consensus on appropriate scope and timing of actions for its long-term reorganization plan.

Stage II: At this stage we anticipate the Department of Trade should have trained a number of key staff, developed organizational plans and obtained approval to begin reorganization. This may involve: the dissolution of some existing regulatory groups; the creation of a new unit for trade policy and international negotiations in the Department of Trade; and the consolidation and perhaps partial privatization of trade promotion functions and/or their local and overseas branches. At this point World Bank funds, along with this Project's resources, would be made available under flexible arrangements to help absorb GOI costs of reorganization and contracting out to private firms.

The timing of the actual implementation of reorganization plans depends importantly on political events related to the determination of a new cabinet in 1992 -- which will occur approximately midway in the life of the project. The current leadership of this project's targeted institutions have set the end of the Repelita V (1993) as the deadline for accomplishing most of the institutional development supported by this project. Whether this cabinet or the next cabinet formally implements these programs, this project will lay firmly the groundwork for such a change.

III. FACTORS AFFECTING PROJECT SELECTION AND FURTHER DEVELOPMENT

A. Project Selection and Design Rationale

The project design has evolved through a series of stages. Stimulating international and domestic trade has been the centerpiece of the project from the beginning, given its vital contribution to economic growth in Indonesia and in line with the Mission's CDSS. As project development progressed, it became increasingly clear that trade is a systematic issue, spanning a wide array of government policies and institutions and being related integrally to growth in the private sector. Expanding trade opportunities is also highly interrelated with investment and technology transfer. To approach the issue systematically, and yet to form the project into a manageable proposition, facilitating trade and investment was chosen as the project purpose.

How best to encourage trade and investment was shaped profoundly by the surge in deregulation reforms enacted over the last several years. Policy reform progressed at a much faster pace than did institutional development, focusing attention on the need for improving policy implementation. It became clear that a systematic problem had developed, something requiring a broader approach than the more standard and narrowly defined funding of promotion tours and trade fairs, and sending in specialized TA teams. The GOI and USAID came to the conclusion that the overall institutional structure of both public and private organizations -- including functional tasks, incentives, human resource development, and so on -- had to be addressed in a systematic manner before specialized technical assistance could be fully effective.

The Department of Trade approached USAID for a range of technical assistance needs within this context of systematic institutional development. BKPM had a range of similar, although less commanding, problems. EKUIN, a small but highly influential coordinating department whose responsibility spans the trade and investment issues, also stressed the need for institutional improvements and offered to coordinate and provide objective leadership for the project. These three departments have become the focus of the project in terms of governmental institutional development, even though other departments also are involved with trade and investment. Centering on these three departments evolved because of their commitment to meaningful actions (and thus the increased likelihood of project success), the important role that they are likely to play over the next decade, and because of the necessity to focus the project on a manageable task.

Helping government organizations to promote business activity is just one side of the coin; the private sector must also be encouraged to take advantage of the new deregulated environment. Private sector intermediaries -- such as Chambers of Commerce, and producer and trade associations -- have played a key role in many countries by promoting business interests, both in terms of political lobbying for business interests and in the provision of technical and informational services to their members. Currently in Indonesia such intermediaries generally are not very effective at serving these functions.

Precise selection criteria for choosing private-sector aid recipients and the type of funding vehicle employed will be developed in PP design. At this stage, based on lessons learned in the Private Sector Development Project, grants will be used to channel assistance to private sector intermediaries.

B. Negotiating Status

This project is developing within the context of a broader dialogue between USAID and the institutions involved. USAID is working currently on a weekly basis with the Department of Trade to help them begin the process of institutional reform. USAID has funded a study comparing

Indonesian export promotion facilities with promotional efforts in other Asian countries, and is funding a study of constraints faced by Indonesian exporters and the feasibility of a quasi-private trading company. USAID also funded a quite effective Department of Trade Workshop that effectively became a strategic planning session where USAID and USAID-funded consultants helped the Department of Trade analyze their strengths and weaknesses, and helped them grapple with how best to improve the effectiveness of their operations. Building upon this momentum, USAID will fund a consultant for at least one year, starting in late 1989, who will concentrate on providing on-the-job training for a group of young professionals who will form the core of future leadership in the Department of Trade. As well, several short-term experts will be available to provide specialized training to this group, and to advise the Department in their area of specialty. Therefore, by the time this project is authorized, a considerable foundation for institutional development will have been laid in the Department of Trade.

EKUIN has been consulted on a regular basis in the development of this project, making numerous substantive contributions to the final draft of this PID. E KUIN has stressed project management and implementation issues, noting that the problems are reasonably well-known to the GOI and USAID. E KUIN, being action oriented, is expected to play a major role in designing a management system that can overcome the political and bureaucratic inertia that tends to stifle institutional reform. E KUIN will provide strategic and political leadership to the project, while at the same time shifting much of the day-to-day administrative responsibilities of the project to the contract team. This conforms with the Mission's desire to have as much of the project funds administered by the contractor as possible. In combination with the proposed development of a computerized project-management system for USAID, most of the administrative burden of the project will be borne by the project team. As a consequence, one long-term TA position in the team will be dedicated to administrative responsibilities.

Negotiations are less advanced with BKPM, the KADINDAs and other private-sector groups. Initial indications of support have been received, but a well-defined game plan has yet to be developed. From September to November, 1989, USAID plans to initiate a series of studies, seminars, and interviews to determine more clearly how best USAID support can be used to assist these organizations. A consultant has been hired for three months to do a thorough study of the organizational structure of these groups, to determine strengths and weaknesses, and to recommend which private-sector institutions might be able to use most beneficially USAID assistance.

C. Socio-Cultural Effects

This project aims to raise the productivity of all Indonesian traders and producers by reducing government constraints to business activity and by increasing government services that support economic growth. However, since the current system is biased against the growth

of smaller firms in outlying regions, an expected side effect of this project is to disproportionately benefit smaller firms off-Java and smaller foreign investors. The current system of bureaucratic restrictions favors larger firms who have the capacity to side-step cumbersome government procedures. Smaller firms who do not have special access or influence outside normal channels are constrained by the rigidities and expense of operating in the formal system. Similarly, this project will support policies that encourage labor-intensive production using appropriate technology, which will increase demand for low-skilled labor during a time of rapid increases in the supply of low-skilled workers into the labor force.

The income distribution consequences of this project's actions, and more importantly of the overall deregulation effort, can have a decisive political impact over the next decade. By helping to raise the public's perception of the integrity of government services and by helping to achieve key economic growth targets, political and economic friction can be reduced. Nevertheless, although many gain from deregulation, others lose; and often the most prominent beneficiaries are the already wealthy. It is beyond the scope of this project to conduct a full study of the effects of deregulation on income distribution and other political economy issues, but it will likely be possible to incorporate the results of several other proposed studies on this topic (most notably at BAPPENAS) into the development and evaluation of this project.

Although there is little solid empirical evidence concerning the role of women in industry, anecdotal evidence shows that women make up a substantial proportion of employment in many light-manufacturing activities, the very activities that are most likely to gain from deregulation and from this project. Most of the women employed in these firms, however, work for low wages in low-skilled jobs; few women appear to hold managerial and other high-paying positions. Part of the PP preparation will include gathering information about the impact on women of small and medium business development. In addition staff training programs will include priorities for increased women's participation within targeted institutions.

D. Economic Considerations

This project is expected to have a significant economic impact -- causing a number of key economic variables to grow faster than would be the case without the project. It is quite difficult, if not impossible, however, to accurately measure the macroeconomic effects of institutional development. Several problems arise: institutional development occurs over time, with often long-lasting benefits, making it difficult to quantify impact in any one period; and, over this period, many other factors affect the macro variables, making it difficult to isolate the "true" effect of the institutional changes.

It is possible, though, to measure the economic effect of a number of specific activities, such as policy changes, improvements in licensing operations and promotion efforts, and so on. For these types of accomplishments, cost-benefit analysis can be done to estimate economic returns. As well, such analysis can be used in a planning sense -- project priorities can be judged by ranking prospective project activities according to those with the highest rates of return.

The PP design team will research the types of methodologies used to measure the economic impact of similar projects in an attempt to determine the most suitable technique for this project.

E. Relevant Experience with Similar Projects

AID (worldwide) is a relative newcomer to trade and investment programs, with most prior experience being in joint venture or trade-linkage brokering programs. Nevertheless USAID/Jakarta has helped initiate several experimental T&I programs, particularly through the BKPM Investment Promotion contracts (Private Sector Project 0329, 1985-89) that targeted U.S.-Indonesian joint venture promotion; the Central Java Enterprise Development Project (Private Sector Project 0329, 1984-88), an effort to promote export opportunities for small businesses; the Development Studies Project, Phase II, with its focus on trade and industrial policy (Project 0340, 1987-present); and the Agriculture and Rural Sector Support Program and its focus on agricultural trade issues (Program 0357, 1987-present). USAID has also been a key actor in the recent Congressionally-sponsored Agricultural Trade Development Mission (ATDM). In addition, USAID actively supports the Cooperative Business International (CBI) trade initiative, locally known as the Indonesian Enterprise and Trade Development Foundation. Lastly, this project builds directly on a one-year training project in the Department of Trade.

While the scope of this Project is considerably broader than any previous USAID project in this area, the components -- institution building, training, technical assistance and key studies -- are familiar building blocks in USAID's repertoire. Relationships with key counterpart organizations, including UKUIN, Trade, Finance and BKPM have been developed over a substantial time frame and are good.

F. Relationship to Other Donor Projects

The World Bank has been, and will likely remain, the major financial donor in the trade and investment sector. In addition, the Bank plays the leading role in analytical work supporting trade and investment policy reforms, which recently has focused on shifting non-tariff barriers to tariffs. USAID has consulted closely with the World Bank in preparing this PID, and we anticipate that World Bank trade projects will be cooperatively designed with the GOI to support the programs outlined in this PID.

The UNDP, and its sister organizations UNCTAD and ITC, have funded several projects related to the Indonesian trade sector, especially with the Department of Trade over the last six years, and are considering a multi-year, \$3 million follow-on to assist Trade. USAID has also developed a dialogue with UNDP to ensure our efforts are coordinated and not duplicative. It is anticipated that UNDP will fund several short-term advisors at the Department of Trade to work along side the AID advisor, and that the excellent resources of the ITC will contribute significantly to project training and promotion objectives.

The ADB, to the best of our knowledge, is not planning to be involved directly in the trade sector.

Other bilateral donors have various programs aimed at bilateral trade and investment promotion, but none take a sectoral approach. JICA has recently built a large export training center for Indonesia. We do not anticipate that any bilateral programs will work directly in the trade sector as defined in this Project.

G. Proposed Implementing Agencies

EKUIN, the Coordinating Department for Economics, Finance, Industry and Development Control, is the proposed implementing agency. EKUIN is selected because it plays a strong coordinating role for trade and investment policy and implementation issues, which is particularly important given the systematic approach of this project. EKUIN as a coordinating department can provide objective leadership to the sometimes sensitive task of institutional development across several government and private organizations. Both the EKUIN Assistant Minister for Industry, Mines and Energy, and the Assistant for Infrastructure and Services would assume key project management functions.

In the Department of Trade, the Secretary General would oversee project implementation, while the Vice-Chairman is expected to be the main counterpart for BKPM. BAPPENAS, through its Bureau Chief for Trade, would be an active participant in GOI discussions on trade coordination and organizational structures, as would the Minister of Administrative Reforms (MENPAN) and many other key political actors. Specific private-sector involvement will be determined through the competitive grant process. EKUIN would take the lead in coordinating project activities.

H. AID Support Requirements and Capability

The USAID Private Sector Development (PSD) Office will manage this project, with assistance from the Economic Policy Support Office (EPSO). Management responsibilities are anticipated to require: one USDH employee from PSD to act as project manager; part-time of the trade economist (PSC) in EPSO to assist in project development and monitor technical inputs from the TA team; and an Indonesian FSN to assist in project management.

We also expect to leverage additional AID resources for this project through coordination with the ASEAN Representative Office's Private Investment and Trade Opportunities Project and by maintaining close cooperation with the ANE Bureau private sector officer for trade development.

I. Estimated Costs and Methods of Financing

The estimated budget for AID funding is as follows:

1.	<u>Long-term Technical Assistance</u>		
	EKUIN Team Leader	5 p/y	
	Deputy Team Leader/Admin. Manager	5 p/y	
	Trade Advisor	5 p/y	
	BKPM Investment Advisor	5 p/y	
	Private Sector Advisor	5 p/y	
		25 p/y @ \$260,000	\$ 6,500,000
2.	<u>Short-term Technical Assistance</u>		
	11 p/y (132 p/m) @ \$250,000		\$ 2,750,000
3.	<u>Private Sector Grants</u> 5 yrs @ \$1,000,000		\$ 5,000,000
4.	<u>Special Studies/Workshops</u> 5 yrs @ \$200,000		\$ 1,000,000
5.	<u>Training Fund</u> 5 yrs @ \$500,000		\$ 2,500,000
6.	<u>Commodities</u>		\$ 750,000
7.	<u>Contingency/Evaluation</u>		\$ 1,500,000
			<u>\$ 20,000,000</u>

Host country contributions will total \$6,700,000, with allocation of these funds determined during the PP design. A significant portion of this contribution is expected to be in cash, as well as in-kind contributions. The technical assistance contract, and private sector grants, will follow direct AID contract and grant award procedures. Special studies, training, and commodities will be managed and funded under the TA contract. During the PP design, alternative funding amounts will be examined for their feasibility, impact, and fit with overall mission budgetary resources.

J. Design Strategy

As explained in Section III.B. of this document, this project is being designed within the context of an on-going policy dialogue and technical assistance relationship between USAID and the Indonesian government and private sector. Mission staff have continued a weekly dialogue, at times supplemented by short-term consultants, with each of the institutions targeted by this project. The goal is to have developed by the end of CY 1989 a "consensus" framework for institutional and human resource development in the Department of Trade and BKPM, in conjunction with EKUIN.

During this period of discussion, a PP team will generate the Project Paper, targeted for completion by February 1990. The PP team will rely heavily on Mission expertise for substantive guidance and writing of the PP. In addition, the team will require one experienced PP design consultant, an investment and/or trade promotion expert, an institutional specialist, and possibly selected other short-term specialists. Preparatory field work has already begun and will be further focused upon completion of the AID/W review, expected in late-September. PP preparation will require an additional \$50,000 from PD&S funds.

A proposed project design and implementation schedule follows:

<u>Action</u>	<u>Completion Date</u>
PID Approval from AID/W	10/89
PP Drafting	10/89 - 2/89
Draft private sector grants	3/90
PP Approval/Obligation	3/90
Advertise for technical assistance	4/90
Private sector grants awarded	6/90
Technical assistance contracts signed	9/90
Project training plan approved/initiated	12/90
First project evaluation	7/92

We anticipate obligation and initiation of this Project by March 1990. We request authority for PP approval in the Mission.

K. Environmental Statement

A categorical exclusion for this Project is included as Appendix A to this PID. It has been determined that the activities proposed for this project meet the criteria for categorical exclusion in accordance with Regulation 16, Section 216.2(c), and are therefore excluded because they fall within the class of actions described in Section 216.2(c)(2)(i) and (iii). A further discussion is included in Appendix A.

L. Project Paper Issues

Several issues have been identified that will require significant attention during Project Paper preparation. A summary of these issues follows:

1. Project Focus. The PID proposes a variety of activities aimed toward stimulating Indonesian trade and investment. Expected achievements are broad and encompass both the institutional and human resource developments necessary to help move existing public and private organizations in appropriate directions. To accomplish these objectives, an equally complex array of inputs are proposed, which would generate change across several institutions. While the PID has attempted to

demonstrate how inputs and outputs will be coordinated to provide a central "theme" for the project, more work remains to be done in this area. The PP design team will assess how to best focus and streamline project activities in order to provide targetted inputs which will systematically help to improve Indonesia's trade and investment environment. Particular attention will be paid to clarify project activity related to BKPM and private-sector organizations.

2. The Role of Policy in the Project. The mandate for the institutional development in the project is linked integrally with the broad GOI deregulation efforts, especially the call for debureaucratization. Although further policy reforms will likely be needed to achieve fully all GOI developmental goals, enough reform has occurred to merit a substantial commitment to help the GOI more effectively implement the impressive list of deregulation packages already in place. This project, therefore, does not have an explicit policy agenda. Nevertheless, the technical assistance team is expected to be actively involved with encouraging multi-faceted policy debate and raising the analytical level of policy research -- both key aspects of institutional development. As well, the project will have the capability of helping the GOI improve their trade and investment policy procedures. Thus, the project is designed not only to bolster the positive effects of the current deregulation efforts, but also to develop a sustained institutional foundation that supports a continuation of reform efforts.

The Project Paper team will need to more clearly define the nature and depth of project involvement in the policy arena, which could include attention to the following:

Macroeconomic policies -- This project could provide resources which support the continuation of the current "responsible" macroeconomic policy approach.

Regulatory policies -- The project could help support the improved implementation of those policy reforms already achieved, as well as supporting further policy reforms in the following areas: limiting non-tariff barriers to trade; reducing and rationalizing tariff rates; continuing improvements in the licensing and legal environment; improving intellectual property right protection; decreasing barriers to inter-provincial trade; and, increasing the competitiveness of the state enterprises.

3. Project Management/Administration. A management process has been described in the PID which relies heavily on a single technical assistance contractor. In addition, USAID proposes to assign a USDH project officer and one FSN project manager. The need for these resources will be re-evaluated as part of the PP design process. Particular emphasis will be placed on requiring a computerized management system that covers both contract and financial management. Evaluation criteria that emphasizes the ability of the contractor to backstop management as well as provide required technical assistance will be designed. The objective will be to reduce the administrative burden on USAID while still providing strong USAID oversight and direction for all aspects of the project.

4. Private Sector Grants. The PID envisions the award of a series of grants to Indonesian organizations, both public and private, and US counterpart organizations. A pre-qualification system will be designed during PP preparation to select grant recipients. Emphasis will be placed on identifying selection criteria and studying the current status of potential recipients to determine better the type of grant aid needed. In addition, the role of the private sector advisor on the TA team will be more fully defined to clarify assistance to private sector grant recipients. Although grants appear to be the most effective vehicle for achieving the private sector objectives of this project, the PP team will examine the relative merits of using a technical assistance package for this purpose, especially judged in terms of the relative labor intensity to the Mission of the two approaches.

5. Choice of Counterpart. The PID proposes that EKUIN serve as principal project counterpart, and that the team leader be based in this organization. EKUIN is a small group tasked with the difficult issues of inter-departmental coordination, and it is an entity with which USAID/Jakarta has had no prior counterpart relationships. The feasibility of using EKUIN, and the alternative use of other counterparts, will be further analyzed during project preparation.

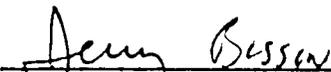
6. Contracting Out Services to Private Firms. In many cases, both public and private services can be provided more efficiently by contracting out activities to private firms. Contracting out various trade and investment promotion activities is being done in several other countries, most notably Costa Rica. The Project Paper will study thoroughly the potential for such "privatization" plans in all areas of the project.

Initial Environmental Examination

- (A) PROGRAM COUNTRY : Indonesia
(B) ACTIVITY : Trade and Investment Project (497-0363)
(C) FUNDING : \$20.0 million
(D) PERIOD OF FUNDING : FY 90 - FY 95

(E) STATEMENT PREPARED BY: 
John R. Rogers
Office of Private Sector Development
USAID/Indonesia

(F) ENVIRONMENTAL ACTION RECOMMENDED: Categorical Exclusion in accordance with Regulation 16, Section 216.2(c)(1). Activities fall within the class of actions described in Section 216.2(c)(2)(i) and (iii).

(G) ENVIRONMENTAL OFFICER CLEARANCE:  Sept. 1, 1989
Jerry Bisson
Mission Environmental Officer
USAID/Indonesia

(H) DECISION OF USAID/INDONESIA DIRECTOR
Approved: 
Disapproved: _____
Date: 9/7/89

(I) DECISION OF ANE ENVIRONMENTAL OFFICER
Approved: _____
Disapproved: _____
Date: _____

EXAMINATION OF THE NATURE, SCOPE AND MAGNITUDE OF THE ENVIRONMENTAL IMPACT

A. Description of the Program:

The Trade and Investment Project (497-0363) is a six year, \$20.0 million initiative with the purpose of a) helping the government more effectively implement the recent trade and investment policy reforms -- by shifting the operational role of the targeted government agencies away from regulating business and toward providing services that support business activity and private-sector development; and, b) to help several private-sector intermediary organizations provide services that enhance the responsiveness of the private sector to the policy reforms. This will be accomplished through providing technical assistance to several GOI entities, providing grants for trade and investment promotion, supporting institutional reorganization in the Ministry of Trade, and funding studies, workshops, training and commodities which will contribute to project objectives.

B. Recommended Environmental Action:

Activities funded by this project fall within the class of actions described in Section 216.2(c)(2)(i) and (iii) and will have no direct impact on the physical environment. Any indirect environmental effects are likely to be slight. Further environmental review does not appear to be possible or necessary. On this basis, it is recommended that this project be categorically excluded from further environmental review pursuant to A.I.D. Regulation 16, Section 216.2(c)(1).

APPENDIX B

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Project Title and Number: Indonesia - Trade and Investment Project (497-0363)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Program Goal: The broader objective to which project contributes:</p> <p>Generate sustained increases in Indonesian employment and income levels by increasing the productivity, and thus, the competitiveness, of Indonesian producers and traders.</p>	<p>Measures of goal achievement:</p> <ul style="list-style-type: none"> - Number of new jobs - Per capita income increase - Increased trade and investment flow 	<ul style="list-style-type: none"> - GOI statistics - Other donor studies 	<p>Assumptions for achieving goal targets:</p> <ul style="list-style-type: none"> - Economic and political stability - GOI commitment to implementation of the current Repelita - Continued deregulation measures implemented by GOI - Continued openness of GOI to sound advice for decision making, problem solving. - Strong world markets conditions
<p>Project Purpose:</p> <p>a) To help the government more effectively implement the recent trade and investment policy reforms -- by shifting the operational role of the targeted government agencies away from regulating business and toward providing services that support business activity and private-sector development; and, b) to help several private-sector intermediary organizations provide services that enhance the responsiveness of the private sector to the policy reforms.</p>	<p>Conditions that will indicate that purpose has been achieved by the end of project (to be refined during the PP design):</p> <p>a) - a reduction in the "informal" barriers to trade that can be traced to the targeted government agencies, for example reductions in the time and expense required to receive trade and investment licenses and other types of approvals;</p> <p>- an increase in verifiable and effective services provided by the targeted government agencies to the business community</p> <p>- a continuation of policy reforms supported by effective implementation procedures;</p> <p>b) - a strong private-sector voice in determining government policies and effective member services provided by the targeted private-sector groups, stimulating generally greater business activity for members of these groups;</p> <p>a,b) - improved communication and cooperation among various government departments, and between the public and private sector, especially with regard to setting and implementing economic policies</p>	<ul style="list-style-type: none"> - comparison of estimates of informal non-tariff barriers at the end of the project; - qualitative evaluations of improved performance of targeted government agencies and private-sector groups; - project monitoring of key institutional data versus baseline information established in PP; - analyzing growth in trade and investment data over life of project; - monitoring of new trade and investment policy reforms; 	<p>Assumptions for achieving purpose:</p> <ul style="list-style-type: none"> - GOI remains receptive to analysis, advice of donor financed TA - Climate of economic reform continues - GOI institutions sustain the will for change - Existence and development of a pool of talented GOI individuals to spearhead the restructuring of key institutions - Foreign investors respond to an improved Indonesian investment climate

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS																											
<p>Outputs:</p> <p>a) human resource and institutional development for targeted organizations;</p> <p>b) increased private sector involvement in the policy decision making process, in implementing policies, and in strengthening private-sector capability to respond to the policy reforms</p> <p>c) improved trade and investment policy analysis, policy formulation procedures, and promotion</p>	<p>a) - operational and sustainable reorganization and training programs for each targeted government institution;</p> <p>- an increased capacity for Indonesia to participate in international negotiations;</p> <p>- development of an effective set of commodity and product standards and quality control;</p> <p>- completion of studies on commercial law reform;</p> <p>b) - operational and sustainable reorganization and training programs for each targeted private-sector intermediary;</p> <p>b,c) - the establishment of transparent communication channels and better coordination of actions among government agencies, and between the public and private sectors;</p> <p>c) - improved trade and investment policy analysis, and promotion efforts, with some promotion efforts contracted out to private firms;</p> <p>- development of a trade and investment data system;</p>	<p>- Project evaluations</p> <p>- Project monitoring of key institutional data versus baseline information established in PP</p> <p>- Progress reports prepared by TA team</p> <p>- Export and investment statistics</p>	<p>Assumptions for achieving outputs:</p> <p>- Newly developed human resources are utilized in an appropriate capacity</p> <p>- Current balance of power/influence among GOI institutions is not significantly altered</p> <p>- Private sector responds to opportunities to influence policy</p> <p>- The will for change in GOI institutions is genuine and able to endure power/personality shifts</p>																											
<p>Inputs:</p>	<p>Implementation Target:</p> <table border="1"> <thead> <tr> <th data-bbox="475 1190 545 1216"><u>USAID</u></th> <th data-bbox="602 1212 685 1238">(\$000)</th> <th data-bbox="751 1190 801 1216"><u>GOI</u></th> </tr> </thead> <tbody> <tr> <td data-bbox="74 1262 404 1288">Technical Assistance - L/T</td> <td data-bbox="487 1262 553 1288">6,250</td> <td></td> </tr> <tr> <td data-bbox="74 1290 404 1316">Technical Assistance - S/T</td> <td data-bbox="487 1290 553 1316">2,800</td> <td></td> </tr> <tr> <td data-bbox="74 1319 338 1345">Private Sector Grants</td> <td data-bbox="487 1319 553 1345">5,000</td> <td></td> </tr> <tr> <td data-bbox="74 1347 289 1373">Studies/Workshops</td> <td data-bbox="487 1347 553 1373">1,000</td> <td></td> </tr> <tr> <td data-bbox="74 1375 173 1402">Training</td> <td data-bbox="487 1375 553 1402">2,500</td> <td></td> </tr> <tr> <td data-bbox="74 1404 223 1430">Commodities</td> <td data-bbox="512 1404 553 1430">750</td> <td></td> </tr> <tr> <td data-bbox="74 1432 437 1472">Other - including contingency and evaluations</td> <td data-bbox="487 1454 553 1480"><u>1,700</u></td> <td></td> </tr> <tr> <td></td> <td data-bbox="475 1502 553 1528">20,000</td> <td data-bbox="743 1502 801 1528"><u>6,700</u></td> </tr> </tbody> </table>	<u>USAID</u>	(\$000)	<u>GOI</u>	Technical Assistance - L/T	6,250		Technical Assistance - S/T	2,800		Private Sector Grants	5,000		Studies/Workshops	1,000		Training	2,500		Commodities	750		Other - including contingency and evaluations	<u>1,700</u>			20,000	<u>6,700</u>	<p>- Project documentation</p> <p>- Monitoring of counterpart contributions</p>	<p>Assumptions for providing inputs:</p> <p>- Counterpart budget forthcoming</p> <p>- Private sector grantees meet funding criteria</p> <p>- Qualified and acceptable TA available</p>
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APPENDIX C

RECENT INDONESIAN TRADE AND INVESTMENT PERFORMANCE

Indonesia has experienced a non-oil export boom over the last three years. In value terms, non-oil exports increased by almost 50 percent from 1985 to 1987, and preliminary data for 1988 show a continuation of this rapid growth. Oil and gas exports have declined by a greater amount over this period, however, causing total merchandise exports to fall. For the first time in almost two decades, non-oil exports exceeded oil and gas exports in 1987 and 1988. Imports have also been growing rapidly over the last two years -- to an significant degree, many think (no empirical evidence is available), because of the trade policy liberalization that has allowed imported inputs into the production of exports to enter into the economy duty free and without any special import license arrangement. The overall trade balance has remained in surplus throughout the 1980s, although the level of the surplus has declined significantly since 1980 as growth in non-oil exports has not been able to offset the fall in oil and gas export values.

The recent growth in non-oil exports has been broad based. Improvements in world commodity markets helped buoy Indonesian commodity exports, which still account for the majority of non-oil exports. For many primary commodities, domestic supply constraints, and expanding domestic demand, limit growth in exports. As well, however, Indonesia now exports a wide range of manufactured products. Much of the surge in non-oil exports over the last several years has resulted from large increases in these manufactured exports (including processed agricultural products such as plywood). And, most of the future growth in non-oil exports expected over the next 5 years -- the engine of growth for the new 5-year Repelita plan -- is predicted to come from industry.

The non-oil export boom resulted in large part from a shift in Indonesian policy toward a broad-based export incentive strategy, a distinct shift from previous policies dominated by a sectoral, import-substitution approach. Three key policy changes -- the 31% devaluation of the Rupiah in 1986; the decision to allow all imported inputs into exported products to enter duty free and without licensing restrictions; and the opening of most export-oriented sectors to unlimited domestic and foreign investment -- combined to provide strong market incentives to invest in and export from Indonesia. Essentially now, a number of manufacturing industries operate in a sectoral, free trade environment -- and the success of these industries makes a strong case for expanding these arrangements throughout the economy. ^{1/} Another key element to this strategy, and again a shift from previous policy, was the overwhelming reliance on the private sector to propagate this export growth.

^{1/} This is not to say, however, that these sectors are not affected by trade policy. Even though trade and industrial policy may not directly distort incentives in a sector, the impact of protection in other sectors does affect resource pulls throughout the economy.

With respect to investment performance, output growth can come from utilizing more fully domestic productive capacity, or by investing in new capacity. It is widely believed now that most growth in Indonesian exports must come from investments in additional production capacity.

Largely in response to the new export-oriented policy environment, both private domestic and foreign investment has surged over the last several years. Between 1986 and 1988, domestic investment increased three-fold, and foreign investment also tripled from just 1987 to 1988. ^{2/} Much of this investment is geared to the export market. As well, the trend reflects the key role of the private sector as the driving force behind the export growth strategy of the GOI -- about 55 percent, or \$77 billion, of the \$140 billion of total investment that is needed to support the 5 percent real GDP growth in the Repelita V is predicted to come from private sources.

Investment has increased in many sectors, especially in manufacturing sectors. Both domestic and foreign investment growth has been led by large increases in textiles and apparel, chemicals, paper products and shrimp. These investment trends should increase even further, both in magnitude and diversity, in response to the new shift in investment regulation from a positive list of acceptable investments to only a negative list. There is little evidence, however, that government promotion efforts have contributed significantly to this growth.

Policy Constraints

1. Active Government T&I interventions include the following:

-- Investment is restricted by a negative list of sectors closed to domestic and/or foreign investment. The negative list replaces the Investment Priority List, which designated only sectors open to investment. The negative list is relatively short and considered more transparent than the Priority List, which should encourage investment.

-- Divestiture rules are in place that require foreign partners to divest ownership in Indonesian companies to below 50 percent within 15 years (20 years in certain special cases) of the initial investment. Recently, this regulation has been relaxed for joint ventures that export most of their production.

^{2/} Investment here is measured as the value of investment projects approved by BKPM. Historically, about three-quarters of all approved investment plans actually are realized (about one-half in value terms), although some after a considerable time lag. Also, these trends are quite sensitive to large investment projects. For example, two large investment approvals in paper production (one by Scott Paper and another by a Taiwanese firm) contributed a large proportion of the recent increase in foreign investment.

-- Land ownership is not open to foreigners. This is of particular importance to agribusiness, but much less so for industry, since foreigners can lease land.

-- Investment and industrial licensing requirements consist primarily of investment licenses (BKPM) and industrial licenses (Department of Industry) at the national level, while additional regulations often are enforced at the provincial and local levels. Investment licensing procedures have been streamlined considerably over the last five years, but little progress has been made in ameliorating local restrictions, which affect most adversely smaller firms.

-- Export and import licenses are used to control and restrict trade, although the importance of trade licenses have declined substantially as the result of recent trade policy reforms. General trade licensing requirements have been greatly simplified, and the number of products using restricted import licenses have been reduced substantially; often, however, replaced by high tariffs. Trade licenses, nevertheless, are still used to control a substantial amount of trade, for both imports and exports. In fact, while import licensing restrictions have been liberalized, export restrictions for natural resource exports have expanded considerably. ^{3/} The GOI, with analytical assistance from the World Bank, is committed to further reductions in import licenses and to continued progress in simplifying export licenses for manufactured goods, although GOI policy toward export licensing of natural resource exports appears to be moving toward greater regulation.

-- Import tariffs are being used increasingly to enforce import policy, while export taxes are being phased out. A key aspect of the recent trade policy reforms has been to replace import quotas and bans with import tariff surcharges. This shifts the focus of import policy toward phasing out these surcharges and, more generally, toward lowering and rationalizing the overall tariff schedule over time. Current import tariff levels are quite high for a number of product categories.

^{3/} Import and export quotas (including bans or zero quotas) are administered in Indonesia through trade licenses. Anyone wanting to trade a product must have a general import or export license. In addition, however, the trade of certain products are limited to firms with special licenses. Quotas are enforced by manipulating the use of these special licenses. For example, most import bans have been administered by granting import licenses only to State Trading Companies, who then import goods only when authorized by the Department of Trade. Non-zero import quotas generally are implemented by restricting import licenses to some type of para-statal operation, who again import only the quantity levels authorized by Trade. Export bans are applied by not granting to anyone the right to export a certain product.

-- Local content and labor laws generally promote the use of Indonesian inputs and manpower. Local content requirements (the deletion program) restrict imports by mandating levels of domestically-sourced inputs to production, and labor laws limit the use of foreign workers.

-- Licensing and other regulations for services restrict opportunities for foreign firms to participate in many service sectors, although recent reforms have freed up some foreign activity in this area, including banking and wholesale (but not retail) distribution.

2. Passive Government Interventions include the following:

-- Intellectual property rights have been an issue of discussion for over a decade. Indonesia now has a draft patent law that soon will be enacted, and an amended copyright law was enacted in 1987. On March 22, 1989, the GOI signed a copyright agreement (effective August 1, 1989) that provides for enforcement of copyright laws over a number of products, including video and audio cassettes and computer software. Efforts to enforce laws in these areas will depend importantly on training Indonesian lawyers in IPR skills.

-- Legal protection provided to investors, contractors and creditors under Indonesian law is minimal and based on outdated Dutch commercial law. Momentum for improving the rule of law is building, but any major reform will take considerable time to complete.

-- Financial constraints to investment, although not a major focus of this project, include most importantly the local unavailability of long-term investment capital, and persistently high (20-25%) interest rates. The GOI is taking steps to solve these problems, especially in terms of encouraging local capital markets and stabilizing the value of the Rupiah, although results will be gradual in coming.

-- Market information is quite limited, both in terms of inadequate data about domestic and foreign business opportunities, and in terms of the lack of transparency for many key government policies. For example, the lack of an effective trade and promotion capacity for smaller firms limit their abilities to trade on domestic and international markets. Poor information about investment opportunities throughout Indonesia hinders broad-based regional development.

-- Business transactions and linkages are hampered by the lack of reliable legal, financial and business standards and consulting services; inadequate T&I promotion, facilitation and support; and the lack of qualified local partners for potential foreign joint ventures.

-- A lack of private sector institutions that represent business and labor interests inhibit the formulation of effective policies, especially at the implementation stage. When the actors who are most affected by policy changes have little input into policy design, policy often overlooks many practical implications that may subvert the original intent of those changes.

In sum, through the issuance of a series of deregulation packages during the last five years, the trade and investment climate has on paper become substantially more open. Even further changes affecting state enterprises, banking and pensions, and agriculture are under consideration. Yet the real world of dealing with the government bureaucracy and investing in an underdeveloped private sector represent still formidable challenges for reform. Overcoming these implementation challenges are top priorities for the GOI and the Indonesian private sector.