

**USAID/INDONESIA
ECONOMIC GROWTH STAKEHOLDER WORKSHOP
JULY 8-10, 2008**

FINAL WORKSHOP REPORT

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I. EXECUTIVE SUMMARY

Background

As part of the process to develop a new five-year (2009-2014) strategy for Indonesia, the Economic Growth Office (EGO) of USAID/Indonesia sponsored a workshop July 8-10, 2008 for the purpose of gathering key stakeholders to discuss emerging economic issues in Indonesia and develop a set of recommendations for USAID to consider under its new strategy. Over 100 stakeholders, from the Government of Indonesia (GOI), private sector, donor community, civil society, USAID implementing partners, and other U.S. Embassy sections, participated in the workshop.

Given the sheer number of participants and diverse organizations they represented, USAID decided to structure the breakout sessions of the workshop in the following broad sectors:

- Agriculture
- Business development
- Financial markets
- Trade and investment
- Cross-cutting issues

Each breakout session consisted of approximately 25 participants. The purpose of the breakout sessions was to: a) discuss emerging issues, challenges, and/or opportunities in that particular sector, b) outline GOI plans and priorities in that particular sector, and c) offer recommendations to USAID for interventions in that sector under the 2009-2014 strategy for Indonesia.

Key Presentations

The workshop was opened by Walter North, USAID/Indonesia Mission Director, who highlighted some of USAID's recent accomplishments in the economic growth area and asked for continued collaboration with key stakeholders as USAID develops its new strategy. Mr. North was followed by remarks from Pak Sidqy Suyitno, Director of Financial Service and Monetary Analysis at BAPPENAS, who discussed thanked USAID for support in the economic growth arena and highlighted some of the GOI's plans in this arena.

Two keynote speakers also made remarks. Dr. Gus Papanek, President of the Boston Institute for Developing Economies (BIDE), made a presentation on "The Indonesian Economy and USAID's Comparative Advantage." During his presentation, Dr. Papanek argued that while Indonesia has recovered from its 1997 financial crisis and been steadily growing ever since, its type of growth is risky as it has been heavily reliant on commodity exports when Indonesia is not a resource-rich country and almost 2/3 of the value of Indonesian commodity exports have been based upon rapid price increases for Indonesia's major export earners. Consequently, according to Dr. Papanek, commodity

exports do not create sufficient jobs. In fact, he claimed that since the 1997 crisis, 20 million workers have been added to the labor force but only three million real jobs have been created—hence, recent Indonesian growth can be hailed as “no jobs growth.” In order to combat this situation, Dr. Papanek recommended that policies and programs be developed to expand labor demand and that USAID should continue focusing on institutional capacity building, in coordination with BAPPENAS and the Coordinating Ministry for Economic Affairs, as well as focus on policies and programs that help to reduce poverty, especially in relation to rice price policy.

Dr. Papanek’s presentation was followed by a discussion on “Economic Policy Priorities for Indonesia” by Dr. M. Chatib Basri of the University of Indonesia’s Institute for Social and Economic Research. In his presentation, Dr. Basri gave an overview of how recent developments in the global economy—related to the spreading global financial crisis, spillover effects of slow growth within advanced economies, surge in food and oil prices—are impacting developing economies such as Indonesia. He also discussed GOI priorities in the areas of trade and investment, labor, infrastructure, fiscal and monetary policy, and job creation and poverty alleviation, and concluded his presentation by recommending that USAID develop programs that address the issues related to energy and food price increases, local government support, trade and services, and trade logistics.

Overall Findings

During the presentations of each breakout session, a consensus began to emerge as to the key issues facing Indonesia’s economy:

- Poor state of transportation infrastructure (e.g., roads and ports)
- Lack of sufficient access to electrification, especially in rural areas, and alternative sources of energy
- Inadequate capacity and skill levels within critical private sector and government partner organizations
- Lack of access to financial services, especially for small farmers and micro-entrepreneurs
- Insufficient attention paid to the potential role of Non-Bank Financial Institutions (NBFIs)
- Lack of transparency and continued corruption in several areas including the government procurement process
- Insufficient levels of foreign investment flows into Indonesia due to poor transportation networks, labor policies, and corruption

As mentioned above, the sections that follow provide a detailed summary of a) these key issues, opportunities, and/or constraints; b) GOI priorities; and c) recommendations for USAID intervention under the 2009-2014 strategy. It should also be mentioned that these sections offer a summary of issues discussed by a broad range of participants from a myriad of organizations and with varied viewpoints. Therefore, what follows describes the consensus reached by these participants in their particular sections and should not necessarily be accepted as statements of fact.

II. AGRICULTURE

Issues, Opportunities, and/or Constraints

According to the *Central Statistics Agency (BPS)*, 63% of the 37.2 million Indonesians defined as poor work in the agricultural sector. Other organizations, such as the World Bank, claim that 57% of the poor work in rural areas. Therefore, based on the data, focusing upon the agricultural sector is necessary in order to address the issue of poverty.

In the breakout session, the discussion was centered upon the agricultural sector in general and not on specific sub-sectors. Several issues were raised in relation to how the agricultural sector can generate economic growth and help to alleviate poverty. In the short-term, the agricultural sector is seen as a sector that can hardly create new employment or erase poverty quickly. However, in the long-term, it has the potential to boost the Indonesian economy if all aspects of the sector—from government policy to infrastructure to supply to market—are improved. In addition, GOI agriculture development programs to date have not sufficiently reached those small farmers who are also becoming the majority of Indonesian farmers.

The issue of *agricultural technology* surfaced in the discussion. Today, the majority of Indonesian farmers still use conventional/traditional technology in cultivating their farming fields. On the other hand, farmers in countries where the agricultural sector has developed more successfully use modern technology. The limited use of modern technology can be caused by several factors such as the lack of information, government support for field research, and access to finance. The U.S. experience shows how government support for agricultural research spurs the development and use of modern technologies. This can be seen with the establishment of a land grant university, an institution focusing on agricultural research. Such an institution has produced many new technologies that are regularly used by U.S. farmers.

Infrastructure was another issue raised in the discussion. There are a lot of poor roads and irrigation systems throughout rural areas. The poor state of rural infrastructure hinders production, marketing, and sales. According to a World Bank study, 72% of rural roads are in “poor” condition and only 19% are in “good” condition. The study reveals that poor infrastructure creates high transaction costs. As a result, farmers only get 25-30% of the gross value of their high-value products¹. According to GOI representatives in the breakout session, 80% of irrigation systems in Indonesia are damaged and need government attention². Furthermore, although local governments have mechanisms to involve the local community, including farmers, in designing local infrastructure development plans, these mechanisms have yet to effectively improve agricultural infrastructure because the farmer’s bargaining position is low compared to the government representative at the village level.

¹ <http://siteresources.worldbank.org/INTINDONESIA/Resources/Publication/280016-1106130305439/617331-1110769011447/810296-1110769073153/agriculture.pdf>

² GOI prediction on the irrigation condition in Indonesia

The role of *private sector participation* in agriculture in Indonesia is still low in contrast with the U.S. agricultural sector which is dominated by private sector participation, leading to a good bargaining position in agricultural policymaking. According to the BPS, private sector contribution to agriculture is only 12.5%. Hence, the government needs to implement policies that support private participation in agriculture such as tax incentives, licensing facilities, adequate infrastructure, and access to credit.

Supply side dynamics, particularly related to crop seed prices and fertilizer, are another issue. The government subsidy for seeds, especially rice seeds, is has not reached the farmers. Farmers are generally unable to secure subsidized fertilizer. Although the price of agricultural products, especially rice, is high in the international market, Indonesian farmers do not enjoy the benefits of increased prices.

Indonesian *farmer organizations* are considered weak due to the lack of capacity to manage such organizations and the high number of people from non-agricultural sectors active in these organizations for political purposes or other interests. U.S. experience shows that farmer organizations have the potential to influence government policy in agriculture. In addition, they can also provide technical services, management and marketing support for their members. Hence, it is critical for all parties, including the government, to improve the capacity of Indonesian farmer organizations.

Access to credit is another key issue. The main obstacle to accessing credit is the physical guarantee required, although credit insurance and warehouse receipts are being developed as alternatives to the guarantee. In 1998-99, the government launched an agricultural credit program (called *kredit usaha tani*) that involved formal banks. However, the program failed because loans were disbursed without proper due diligence since the loan funds were provided by the government but disbursed through participating banks. As a result, the banks had no incentive to conduct proper checks on creditworthiness of potential borrowers. Later, in October 2006, the government launched an agricultural credit scheme called *SP3* that provided a guarantee of 225 billion rph. to five banks. However, this program also failed to reach small farmers because participating banks risk aversion. Hence, there is a need for assisting the government to create financing schemes that can be enjoyed by all farmers, including small ones, such as the establishment of farmer banks, improving the capacity of banks to conduct proper credit assessments of potential borrowers, improving the availability of credit risk information, and the further development and empowerment of micro-finance institutions.

The limited capacity of rural infrastructure, especially roads, is a major obstacle to marketing and sale of agricultural goods. In addition, marketing channels, such as agribusiness sub-terminals, have not effectively given added value to the marketed agricultural products. Sub-terminals widely constructed today mostly function as the pooling places of agricultural products not as the points for added value. Furthermore, the role of agro-industry in Indonesia is still limited. Other country experience shows that agro-industry can produce benefits such as: (1) creating added value to domestic agricultural products, (2) creating employment, especially switching the workers from the agricultural sector to agro-industry sectors, (3) increasing foreign exchange earnings

through agro-industry exports, (4) improving the income share for farmers, and (5) increasing development of agricultural fields.

In terms of *agricultural policy* issue, government representatives admitted there is no clear roadmap. Although the GOI has an agriculture development program for 2005 – 2025, it has no practical regulatory instruments that can help achieve targets identified in the program. Many developed countries, especially in Europe, have agricultural roadmaps in place through 2020. Indonesia, by contrast, implements roadmaps for only periods of five years at a time and the government is often not consistent because it often amends the roadmaps. Existing policies today are more for addressing short-term crises such as the increase in rice prices and other basic commodity price hikes. The government is also prone to offering subsidies without making any improvements to the overall agriculture sector. In this decentralization era, where the role of local government is quite substantial in all development sectors in their regions, many local governments do not realize that developing agricultural sector will also increase the economic growth of their regions. This attitude makes many local governments to not have effective agricultural policies in place. As a matter of fact, in this decentralization era, local governments should play a very significant role in developing the agricultural sector.

International dynamics also influence the agricultural sector in Indonesia. Market liberation and unfair trade practices challenge the development of agricultural sector. The revolutionary changes in international agricultural production management also challenge the Indonesian agricultural sector to compete with agricultural products from other countries in the global market. International food scarcity and bio-energy issues are two international aspects influencing the agricultural sector in Indonesia. The information technology revolution in this sector also demands that the agricultural sector in Indonesia be managed professionally.

Based on the discussion above, there are eight areas in which the Indonesian agricultural sector can develop: (1) effective government agriculture policies, (2) increased power and influence of farmer organizations, (3) clear information systems, (4) availability of adequate infrastructure, (5) easier access to financial services, (6) availability of R&D services, (7) agro-industry development which is integrated with the development of agricultural sector in rural areas, (8) policymaking that includes private/public dialogue with farmers and agribusinesses, and (9) good governance at all government levels.

Government of Indonesia (GOI) Priorities

The GOI's 2005-2025 agriculture development program focuses on the following areas: (1) agriculture development based on rural industrial development; (2) food security based on food estate; (3) job creation; and (4) poverty eradication with farmer income reaching U.S. \$2500 per capita per year. To achieve these goals, the GOI developed a midterm (2005-09) program focusing on: (1) increasing production to more than 90% of domestic demand, especially in rice, corn, and sugar exports; (2) food and energy diversification; (3) availability of protein resources; (4) increasing value added and

competitiveness; (5) enhancing production and export of products including horticultural goods.

In 2008-2009, the government will also launch a rural agribusiness development program, targeting the development of agribusiness in 11 thousand poor villages nationwide. With this program, every village will receive 100 million rph. through farmer groups. With associate supervisors, management of farmer groups and extension workers, the target of this program includes “on-farm” (e.g, food crop, horticulture, animal husbandry and plantation) as well as “off-farm” (e.g., home industry, micro-scale marketing of products).

The government now is also faced with food security as an agricultural issue and is trying to boost rice production to secure the existing food stock. It is also required to keep the prices stable by providing enough basic food stock, especially rice. Private sector participation should be taken into account to draw new investments into the agriculture sector, especially into rice production.

Recommendations for USAID

1. Assist the GOI in policy/regulatory reform and advocacy for farmers and agribusinesses, resulting in institutional reform on extension and research services.
2. Establishing and strengthening professionalism of farmer organizations or associations by capacity building programs and best practices case studies.
3. Improving value added for agriculture products which have market value through technical assistance on processing, packaging, certification, and branding.
4. Promoting rural infrastructure (e.g, irrigation, rural road, water, electricity and communication) development with local governments through advocacy and effective lobby by farmer associations.
5. Improving access to financial services.

III. BUSINESS DEVELOPMENT

Issues, Opportunities, and/or Constraints

Indonesia's overall macroeconomic picture is stable and improving as it has made remarkable economic progress since the financial crisis by recapitalizing the banking sector, improving oversight of capital markets, and taking steps to stimulate growth and investment. GDP growth has steadily risen this decade from 5.4% in 2000 to 6.3% in 2007. By 2004, real GDP per capita returned to pre-financial crisis levels. Poverty levels (i.e., those living on less than \$1 per day) have reduced in recent years from 17.8 to 16.6% and unemployment has decreased from 10.3 to 9.1%.³

However, much remains to be done. Despite President Yudhoyono and his economic ministers' repeated intention to improve the climate for private sector investment in order to raise the level of GDP growth and reduce unemployment, corruption and legal uncertainty remain. A number of the factors often mentioned for reducing Indonesia's competitiveness include: corrupt and inefficient customs services; non-transparent and arbitrary tax administration; inflexible labor markets that have reduced Indonesia's advantage in labor-intensive manufacturing; increasing infrastructure bottlenecks; and uncompetitive investment laws and regulations. A new policy package announced in 2007 to improve the investment climate in Indonesia for both domestic and foreign investors has not been fully implemented.

According to a 2006 ADB study on private sector development policies in Indonesia, there are an estimated 40 million small-and medium-sized enterprises (SMEs) in operation, employing approximately 73 million people. However, most of these enterprises are micro or cottage enterprises rather than SMEs in the strict sense of the word and the largest percentage are in the agricultural sector. According to a 2006 World Bank rural investment climate survey, there are nearly 16 million micro- and small-enterprises that employ more than 50% of all non-farm workers in Indonesia.

Five major issues were identified by the group of participants in the breakout session: human resources, energy, transportation infrastructure, microfinance, and the environment. Three cross-cutting issues were also raised: land, local private sector initiatives, and corruption related to the procurement process.

Human resources – The group agreed that existing models of training programs run largely by governments are driven by what is budgeted rather than what is needed. Such programs are not sustainable. There is little linkage between what training there is and what the industry needs and consequently, such programs are considered a government subsidy with no obligation to pay back.

Energy – The group agreed that the major concern for businesses at the moment is the cost of energy and how it's distributed. The cost of electricity has soared following the

³ The World Bank, "Indonesia: Economic and Social Update, April 2008"

global fuel price hikes. This is further exacerbated by lack of transparency in the provision and distribution of electricity.

Transportation infrastructure – The group felt that there are numerous issues with infrastructure but that the most common concern relates to transportation infrastructure, particularly the provision and maintenance of roads and ports. The key challenge to the road issue is to overcome various constraints to new investment/provision.

Access to credit – Donors should move away from traditional direct provision models as there are already over 80,000 microfinance institutions (MFIs) in Indonesia. The group did not recommend any new donor effort on MFIs and instead donors should focus on developing what is already functioning. One of the key regulatory issues is the draft Microfinance Law (RUU LKM) which has been under preparation by the GOI for the past several years. Passage of this bill will allow MFIs to mobilize lower cost funds and hence be able to provide lower cost loans.

Environment – The most pressing issue discussed was to develop measures to translate environmental constraints into business opportunities (eco-business).

Cross-cutting issues – Three areas were noted by the group as critical cross-cutting factors that affect business development in Indonesia: 1) land acquisition, ownership and title, and its overall regulatory framework; 2) community private sector initiatives such as small-scale electricity generation should be encouraged; and 3) public procurement transparency should be encouraged and regulated. Corruption cases, especially at the local and regional levels, should be tried and widely publicized to act as a deterrent.

Government of Indonesia (GOI) Priorities

Given that most of the participants in the breakout session were from the private sector and civil society, there was little discussion on GOI programs and priorities except in relation to transportation infrastructure.

Transportation infrastructure: On the issue of land, special attention is drawn on the new interest that the GOI, through BAPPENAS, is reviewing the possible adoption of some sort of “land market mechanism”. With regard to Ports, with the recent issuance of the new Shipping Law, there have been new opportunities to promote investment and foster greater competition.

Recommendations for USAID

1. *Human resources:* New models of training are required. Donors can assist in building market institutions such as the use of vouchers, link vocational schools with industry, and provide an inventory of both training needs and training programs.
2. *Energy:* The group recommends further development of local energy supply through community-based green initiatives (e.g., utilizing bio-fuels, wind power) and that any

surplus electricity be sold to others in the region or into the main grid. USAID could focus assistance on a number of activities that provide technology and “know-how,” improve local connectivity to the electrical grid, and address institutional and regulatory constraints.

3. *Transportation infrastructure*: The group recommended the following areas of intervention: 1) new mechanisms to assist with land acquisition (*pembebasan tanah*) and to address speculation problems, 2) investment facilitation and exploring Sharia/Sukuk financing; 3) assisting local governments with investment implementation (rather than keeping funds in bank accounts), and 4) addressing congestion in major cities through travel demand management programs (e.g., congestion pricing, public transport etc).

4. *Access to credit*: Key activities to address these issues would include: 1) generating necessary momentum to push through DPR then disseminate it; 2) assisting with prudential regulation and oversight; 3) assisting with ratings of MFIs; and 4) exploring the potential of “angel investors.”

5. *Environment*: Make better use and development of green certifications. Such measures would include: 1) group based volume discounts, 2) land area/zone based certifications, and 3) development of certifier supplier market.

6. *Cross-cutting issues*: Helping to improve land acquisition and related regulatory framework; 2) promotion of small-scale electricity generation activities; and 3) advancement of public procurement transparency.

IV. TRADE & INVESTMENT

Issues, Opportunities, and/or Constraints

Job creation is still a key problem in Indonesia. Indonesia's official unemployment rate, among the highest in Asia, is approximately nine percent in 2007 according to the Indonesia Central Bureau of Statistics. Despite high rates of economic growth over the past five years, Indonesia is still lacking in employment opportunities, particularly in the manufacturing sector. In order to do that, Indonesia needs new investment. However, new investors do not know how to do business in Indonesia. Legal uncertainty remains, along with corruption and lack of adequate infrastructure. Indonesia has a new investment law but some aspects (e.g., related to the "negative list" of sectors not open to investment) are widely considered controversial and some implementing regulations are unclear. The law still overlaps with regulations produced by technical ministries or other local level regulations known as "perda" which sometimes make the investment climate worse in certain areas.

In addition, the *cost of labor* has greatly increased since the 1980s when Indonesia started its current industrialization phase. In addition, most of this labor is not highly skilled. The costs of labor have greatly increased because of increased living costs caused by increases in the gasoline price due to reduced government subsidy. The GOI needs to invest more in education and vocational training to increase skill levels. Worker salaries have increased but GOI investment in worker education and training has not. Also, severance payments in Indonesia are widely considered one of the central deterrents to greater foreign investment.

Regarding *infrastructure*, the problem lays in the fact that Indonesia is unable to provide public goods to its people (in education and access to land) as well as to investors (in skilled labor and physical infrastructure). In addition, the GOI lacks an effective Industrialization Plan or Investment Development Policy and local governments lack effective incentives to attract investment in infrastructure. Inadequate physical infrastructure leads to higher transportation costs which strain domestic trade. There are unresponsive *perda* on trade between provinces and districts. Market infrastructure is inadequate, especially for storage. Access to information is limited in international trade and international best practices and knowledge. There are also technical barriers for export-oriented products and export promotion. Lastly, problems abound in public procurement as well as the competitiveness of Indonesian products.

Government of Indonesia (GOI) Priorities

The Ministry of Trade has been working and/or would like to continue working in the following areas to support domestic and international trade:

1. Implementation of a National Single Window for customs (currently a trial operation)
2. Creation of faster and more transparent licensing procedures

3. Conducting trade and investment promotion including export promotion and development of an import strategy
4. Implementation of ASEAN Economic Cooperation (free trade among ASEAN countries) and Free Trade Agreements with U.S., Japan, India, and Australia
5. Establishment of the Batam-Bintan-Karimun special economic zone
6. Promotion of market expansion / export diversification
7. Development of a blueprint for a creative economy (the idea is for one village to have one specific product that can be traded)
8. Developing capacity for SMEs through training and international exhibitions
9. Conducting bilateral meetings to overcome barriers for export
10. Expansion of market penetration through the opening of trade promotion offices abroad
11. In cooperation with JICA, conducting market intelligence research

BKPM, the GOI's investment promotion organization, is focused upon the following to improve the investment climate:

1. Publishing guidance on investment that is scheduled to be completed in June 2008 and followed by a road map at the end of this year.
2. Finishing the implementing regulations of the 2007 Investment Law.
3. Implementing regulation on One Stop Shops in terms of shifting and delegating authority, due in 2008.
4. Finalizing the draft law on the Special Economic Zone for Batam-Bintan-Karimun.

Participants also think that a roadmap for investment is needed, especially for certain commodities, sectors, and areas. Related to investment, PEPI, the GOI's investment policy coordination entity, thinks that the government needs to clarify which GOI organization should be responsible for which investment activities. This is true especially for inter-agency work and it needs to be made clear as to who should be taking the lead for certain actions.

Recommendations for USAID

1. Assist GOI to synchronize conflicting trade and investment laws and regulations pertaining to such areas as mining and gas, the 2007 Investment Law, the 2007 Corporate Law, and 2003 Labor Law. A mechanism should be developed and put into place to deter conflicting regulations.
2. Capacity building for local government on investment services. Not all local governments are able to provide good public services such as a One Stop Shop.
3. Assistance to reduce transaction costs (e.g., local levies, poor roads) for domestic trade and to exporters to improve their market opportunities and meet international standards.
4. Assist GOI to develop the National Single Window on customs.
5. Assistance in addressing trade logistics
6. Assistance in drafting *perda* conducive to domestic trade

7. Continued capacity building to technical / line ministries
8. Strengthen GOI inter-agency coordination on trade and investment matters.
9. Judicial and legal capacity building
10. Assistance in developing effective competition regulations
11. Assistance in developing an effective infrastructure policy
12. Creation of internet-based export promotion facilities
13. Improving transparency of public procurement system
14. Promoting labor law reform and labor policy reform
15. Further development of Special Economic Zones
16. Improving capacity of local and regional governments on transparency and combating corruption
17. Developing a draft law on land acquisition for public purpose (will need to support a comparative law study)
18. Adoption of ISO to address problems of technical barriers for SMEs
19. Developing alternative energy sources
20. Assisting importers to comply with trade obligations, deal with competition (cartel, exclusive import, and licenses), access financial services, etc.
21. Improving inter-agency coordination (facilitation role and networking)
22. Assistance in analytical-based policy development to better prepare GOI in policy and regulation drafting
23. Improving transparency of public services (e.g. public procurement process, support for local governments to set up OSS, etc.)

V. FINANCIAL MARKETS

Issues, Opportunities, and/or Constraints

Both Banking and Non-Bank Financial Institutions (NBFIs) play important roles in Indonesia today and in future Indonesian development. However, according to BAPEPAM-LK, 80% of all financial sector assets are in the banking sector whereas NBFIs, such as insurance firms, pension funds, mutual funds, leasing and venture capital companies, and capital markets (including equity and bond market) only hold 20% of all financial sector assets. To date, donor support has been heavily concentrated on the banking sector rather than the NBFIs sector.

Based upon this, the majority of the discussion was centered upon the potential role of NBFIs. It was agreed that insufficient attention is being paid by the GOI on the role of NBFIs. As a result, there is lack of incentive for NBFIs and insufficient investment in the financial sector which limits the availability of critically needed long-term financing opportunities. It was also mentioned that the average Indonesian did not fully understand the importance and concept of NBFIs such as insurance and pension funds.

Representatives of various NBFIs stated that reliable and standardized information systems at the Ministerial level are much needed. Access to such information would make the NBFIs better able to provide service to their customers. It is also necessary to have capable human resources both in the Central Bank and in the NBFIs to access and maintain such systems. Moreover, one of the key issues raised, especially in relation to NBFIs, is that they lack sufficiently trained personnel both at the regulatory level as well as within the NBFIs themselves. Hence, effective capacity building and training is necessary.

Lastly, it was also mentioned that access to finance at the local level was still seriously lacking. The local bank, or Bank Pembangunan Daerah (BPD), which is supposed to provide access to financial services to local communities, is playing only a limited role. Such local banks lack capacity to provide and expand access to financial services and access to micro insurance. In addition, Central Bank regulations on microfinance need to be cleared up to improve BPD performance and enhance their capacity to provide financial services to local communities.

Government of Indonesia (GOI) Priorities

Some of the GOI priorities discussed are as follows:

- Developing Financial Sector Architecture (Arsitektur Sektor Keuangan Indonesia – ASKI) to better integrate banks and NBFIs. Currently, the banking sector is controlled by Bank Indonesia while the NBFIs sector is controlled by the Ministry of Finance.

- Another priority is developing a financial sector “Early Warning System.” The system is a database that contains all indicators related to the financial sector and would be used to predict the financial situation a few months in advance.
- Strengthen the weak regulatory system for NBFIs. For the banking sector, the Indonesian Deposit Insurance Agency (LPS – Lembaga Penjamin Simpanan) will guarantee deposits up to 100 million rph in the event of bank failure but no such system is in place if NBFIs, such as insurance companies, were to collapse. As a result, NBFIs are able to operate without sufficient supervision or regulation.

Recommendations for USAID

Based on the discussion, the following five priority areas for USAID consideration were developed:

1. Assist GOI to generate additional capital to maintain financial sustainability
2. Promote the role of NBFIs especially in life insurance, pensions, and venture capital
3. Strengthen the capacity of BAPEPPAM-LK as the financial sector supervisor and regulator
4. Assist in the passage and establishment of the proposed microfinance regulatory framework
5. Support development of other service sectors

Generate Additional Capital to Maintain Financial Sustainability

The 1st priority is to generate additional capital to maintain financial sustainability.

Actions to be taken include:

1. Broaden investor base
2. Encourage financial institutions to provide long-term financing opportunities with incentives related to tax, accounting, or regulations
3. Support regional/city borrowing to facilitate capital markets development (e.g., municipal bonds)
4. Develop borrowing strategies for the regions and cities

Promote the Role of NBFIs

As mentioned, Indonesian society does not fully understand the importance of NBFIs, especially relating to insurance or venture capital. Therefore, the group agreed that introducing the concept of insurance by doing a public awareness campaign, including introducing it in school curriculum, is important. Improvements are also necessary to the insurance industry itself including an assessment of policy holder protection and the role of consumers versus investors. Training is also needed to improve the quality of human resources. It was also suggested to expand the operation of STIMRA, the Indonesian Risk Management Institute, beyond Jakarta. Working more closely with the Indonesian chapter of the International Association of Insurance Supervisors (IAIS) was also raised as a critical point. The IAIS represents insurance regulators and supervisors in more than 130 countries, consisting of 97% of the world’s insurance premiums, includes the world’s

leading insurance companies as observers. The IAIS aims to contribute to improved supervision of the insurance industry in order to maintain efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. Active Indonesian participation in IAIS would demonstrate to the world that Indonesian authorities are committed to improving the working of the insurance industry in Indonesia. On policy issues, in order to address the needs of “ordinary” citizens, new systems to deal with the labor intensive nature of such businesses are needed. Costly investment in that area should be encouraged through incentives. One of the GOI’s plans in the financial sector is to strengthen the weak regulatory body of NBFIs that could address this issue.

Strengthen the Capacity of BAPEPAM-LK

The 3rd priority recommended is to strengthen BAPEPAM-LK and the regulatory environment. This would include:

1. Strengthening the quantity and quality of staff
2. Revisiting the standards structure for oversight within the current laws
3. Consolidating all insurance activities under one roof
4. Enhancing availability of data on markets, earning statements, balance sheets, transactions, etc.
5. Guaranteeing uniform enforcement and supervision
6. Protecting policy holders, investors, and consumers
7. Improving the regulatory environment for microfinance

Establish Microfinance Regulatory Framework

Coordination among GOI entities (Ministry of Home Affairs, BAPPENAS, Ministry of Finance, and Bank Indonesia) and NGOs for development of an effective regulatory framework and standardization is necessary. The group believed that the BPD should be examined as the possible vehicle for delivering financial services at the local level.

Support Other Service Industries

The group agreed that NBFIs should support other service industries such as tourism and health. Both industries are labor-intensive and can contribute to job creation and foreign exchange earnings. Successful tourism and health industries can also attract foreign investment.

Capacity Building

Capacity building was seriously raised several times. The consensus is there is not enough well-trained personnel in middle and upper management. The group agreed that continued training and capacity development are urgently needed and that training facilities be made available outside of Jakarta and in the various regions.

VI. CROSS-CUTTING ISSUES

Issues, Opportunities, and/or Constraints

Three cross-cutting issues were identified in this particular breakout session: infrastructure, labor, and corruption.

Infrastructure

Completion of several major *infrastructure* development projects, including toll roads, irrigation dams, and transmission lines, have been delayed by the GOI due to land acquisition issues. Although new regulations such as Presidential Instructions (Perpres) No. 36/2005 and later Perpres No. 65/2006 were issued, they have not been effective in addressing land acquisition issues.

There are two kinds of infrastructure needed by GOI: soft infrastructure and hard infrastructure. Soft infrastructure refers to sound policies, regulations, strategies and programs to address different economic problems facing the country. Hard infrastructure refers to roads, energy, irrigation systems, and other capital that is necessary for successful economic development at the national and local levels.

However, Indonesia has been experiencing many difficulties in developing and reforming both soft and hard infrastructure. Inconsistency of economic development policy, poor regulations, and legal uncertainty remain key challenges. Indonesia also has insufficient energy supply and increased logistics cost caused by bad transportation infrastructure which inhibit development.

Labor

The population of Indonesia exceeds 230 million and the workforce constitutes approximately 100 million of the total population. Despite an abundance of labor, Indonesia has witnessed tough labor market conditions since the 1997 financial crisis. Many workers are not fully employed because they work less than 35 hours a week. Much of the labor force in Indonesia is experienced in the resource-based economy rather than a knowledge-based economy. According to one of the participants, the majority of Indonesian labor is employed in agriculture rather than the industrial or services sectors.

Corruption

Corruption is one of the biggest challenges facing Indonesia. Although the GOI has taken action to combat corruption through the creation of the Corruption Eradication Commission (KPK) and other measures, corruption persists at both the national and regional levels.

Government of Indonesia (GOI) Priorities

Except for one KPK employee, none of the participants in this breakout session were GOI employees. Rather, they came from the private sector or civil society. Hence, the discussion on GOI priorities was limited to the following:

Infrastructure

In the need for soft infrastructure, the group agreed that the central government should focus its efforts on developing sound policies and regulations and improving coordination with and cooperation among various GOI institutions.

Labor

It was mentioned that the GOI is improving efforts to improve the quality of the labor force through vocational training.

Corruption

Civil service reform was cited as the key GOI priority in combating corruption.

Recommendations for USAID

Overall: Strengthen GOI institutional capacity.

Infrastructure

- Improve legal and regulatory framework for land acquisition
- Develop oversight or regulatory body to address pricing issues for energy
- Promote public-private partnerships to raise capital necessary for building of new or improvement of existing transportation networks
- Promote development of municipal finance
- Pay greater attention to environmental impacts of infrastructure projects
- Assist GOI to establish cost-recovery and cost-structure mechanisms

Labor

- Improve database of skills needed by industry
- Enhance existing educational/training programs and facilities to target and meet industry skill needs
- Provide more vocational training
- Improve enabling environments for micro-, small- and medium-sized enterprises

Corruption

- Strengthen the capacity of existing GOI institutions such as KPK, among others, to combat corruption through human resource development and improvements in information communications technology.

First Draft – for comment

4 July 2008

THE INDONESIAN ECONOMY AND USAID'S COMPARATIVE ADVANTAGE

Gustav F. Papanek

[Preliminary ideas, stated like firm conclusions – so can learn from the workshop participants & revise the paper. “Crash program” – expand in discussion].

PART I: THE INDONESIAN ECONOMY AND ITS KEY PROBLEM

A. BY THE USUAL STANDARDS FOR MACROECONOMIC PERFORMANCE INDONESIA HAS PERFORMED WELL IN THE LAST 3 YEARS [See World Bank reviews; Chatib Basri presentation]

1. Growth in 2007 speeded up to 6.3% despite a slowing world economy
Per capita income reached 15% above pre-Crisis levels
2. Unemployment down to 9.5% from 10.5% and over 2 million fewer “poor”
3. Government debt down to 35% of GDP [from 80% in 2000].
4. Non-oil/gas exports in US\$ increased at 18% a year from 2004-07
5. Investment reached 25% of GDP, an important achievement, which guarantees further growth

B. KEY PROBLEMS: “NO JOBS GROWTH” AND THE RISKS OF A COMMODITY-LED EXPORT STRATEGY

I. A Risky Strategy

1. Growth recently has been heavily dependent on rising earnings from commodity exports – growing at 10% a year since 1997 and 20% a year in last 3 years, accounting for three-quarters of the recent increase in exports. Such commodity booms in the past have never lasted very long, despite predictions that “this one is different” [see Graph 1].

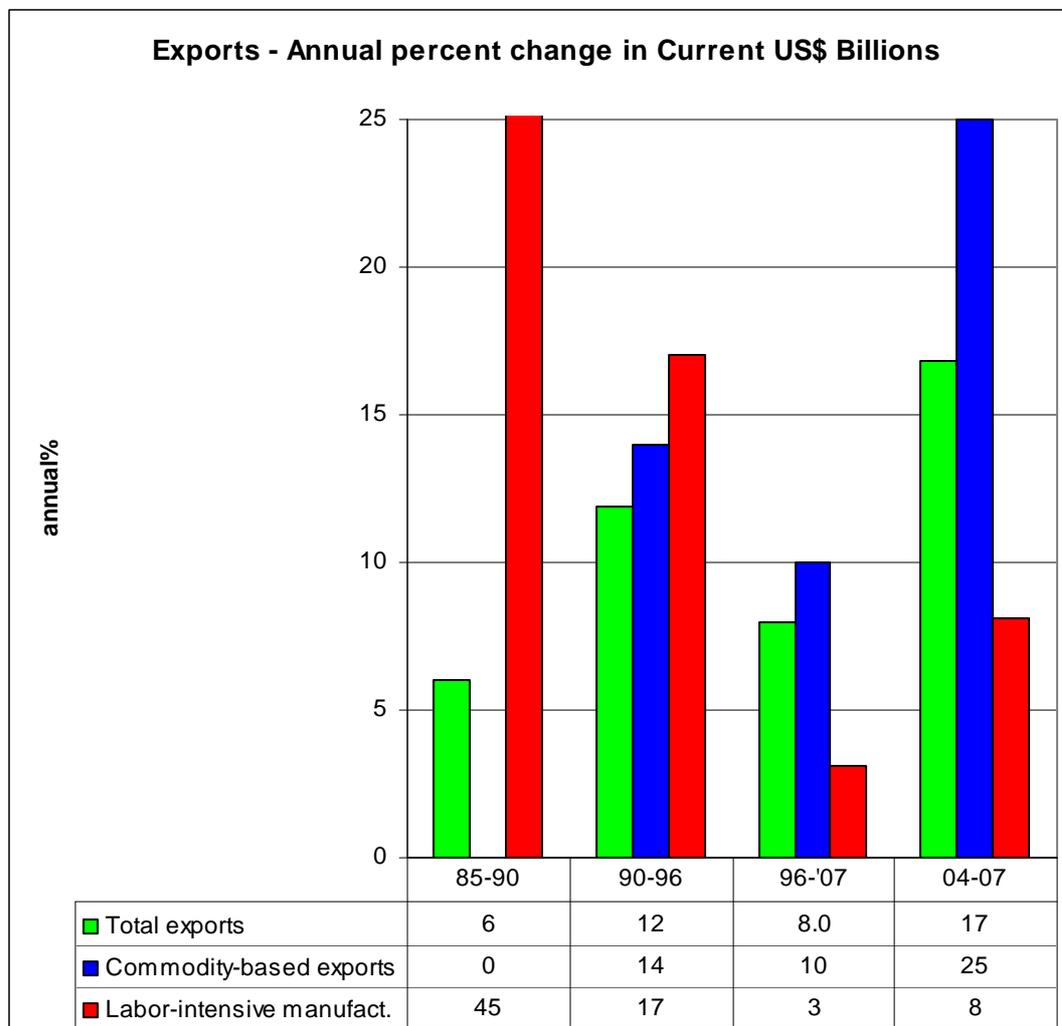
2. Almost 2/3 of the increase in value of exports was due to an incredibly rapid increase in world prices for Indonesia's major export earners: 2001 to 2008 palm oil by 345%; rubber 379%; all metals by 229%; and coal nearly 300%. Both IMF and World Bank predict commodity prices will stop rising and fall 5-15% in the next 2 years. Past experience: could fall much more.

3. Some commodity exports, especially metals, could grow more rapidly with a policy changes and contribute significantly to a higher rate of growth.
4. Reliance on commodity exports as the leading sector is risky because on a per capita basis Indonesia is NOT a resource-rich country [Table 1]. Australia exports almost 15 times the value of commodities that Indonesia does; Malaysia 6 times and even Thailand almost twice as much.

II. Commodity Exports do not Create Jobs for the Additions to the Labor Force

Since the Crisis 20 million workers have been added to the labor force, but only 3 million real jobs have been created. The rest are added to the unemployed or have “crowded-in” to “work- & income sharing” sectors, where they add little to output.

Underused labor is Indonesia’s great potential resource [Table 2, Graph 2].



Calculated from monthly BPS export data

**NOTES: Export data preliminary. Commodity-based: oil/gas; agricultural; mineral; forestry; fertilizer/chemicals, whose primary cost is oil/gas
 Labor-intensive, low-tech manufactures: textiles, garments, footwear, furniture**

Table 1: Per capita commodity exports by Asian Countries

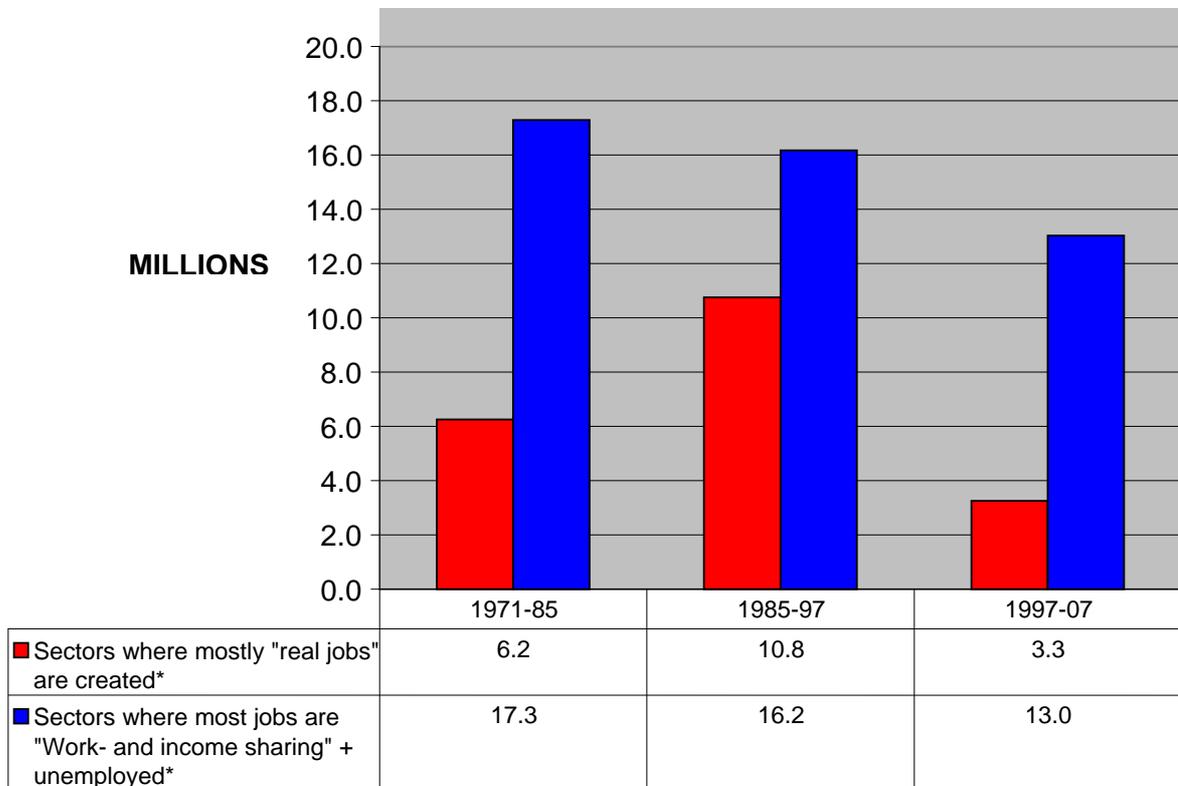
Country	Population (2006) millions	Commodity exports- 2006 \$ billions	Commodity exports in \$ per person	% exports from commodities
Indonesia	223	56.9	0.26	68
Australia	21	83.8	3.99	55
Malaysia	26	40.2	1.54	25
Sri Lanka	20	1.9	0.10	28
Thailand	63	30.1	0.48	23
Vietnam	84	19.8	0.24	50

Source: World Bank, "World Development Indicators - 2008"

Table 2: Sectors that Created the most Jobs before the Crisis and had "Jobless Growth" after the Crisis (millions employed)

	1985	1997	2007	Increase 85-97	Increase 97-07
Manufacturing	5.8	11.2	12.1	5.4	0.9
Construction	2.1	4.2	4.4	2.1	0.2
Transp., Communic., Finance	2.3	4.8	6.9	2.5	2.1
Total	9.9	19.5	22.1	10.0	3.2

Graph 2: INCREASED EMPLOYMENT BY SECTORS
(in millions of jobs added during the period)



2. The key political, social & economic problem of the next 5 years is to provide productive employment for 20 million or more workers. Expanding the demand for labor is the only way to significantly reduce poverty. Income transfer programs, the most important of which is the “Raskin” program of subsidized rice distribution, have problems in all countries and therefore are not large enough to pull the poor out of poverty:

- targeting is poor and only about half of the benefits reach the poor [SMERU report];
- the non-poor do not like programs that tax them to benefit the poor and therefore usually oppose any big expansion;
- the poor do not like “charity”, they want the dignity and regular income of work.

So these programs can help, but they are usually of limited benefit.

Policies that stabilize the price of rice and other basic food are important to the real income of the poor in the short term and discussed a bit below. But the key are policies and programs to increase demand for their labor. That will remain the heart of poverty reduction in the medium-term.

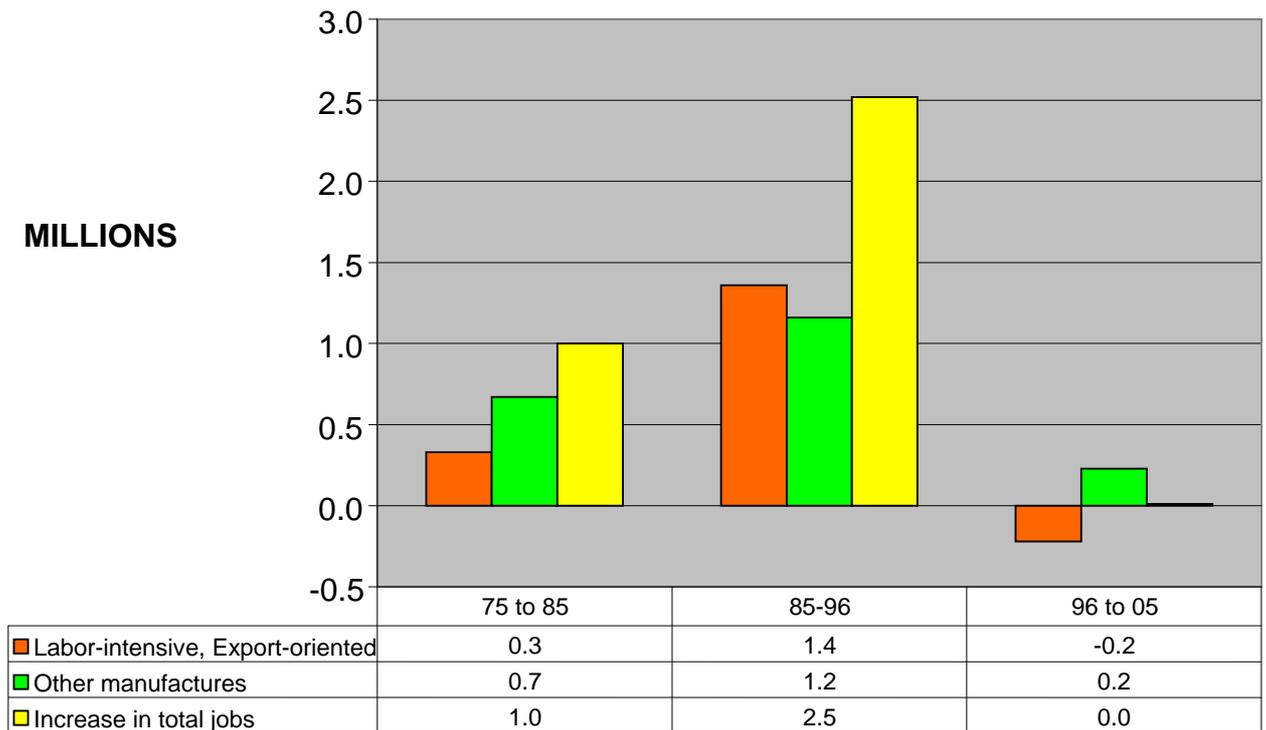
3. A major reason for “Jobless Growth” is the stagnation of 4 labor-intensive industries producing for export. Before the Crisis more than half of the job growth in large-/medium manufacturing was in these industries; there was no increase in jobs in the last 10 years. [See Graph 1 for slow exports; Graph 3 for stagnation in employment and Table 3 for labor-intensity/ job creation in different industries].

Industries like mining, fertilizer and chemical production, and car/ motorcycle/ parts production, whose exports have boomed just do not require much labor to expand output.

Table 3: Labor-intensive and non-intensive Exports

Sector	Period	Increase in Exports in \$ billion	Increase quantity exported [in \$ billion at fixed prices]	Increase in employment in 1,000	Employment for every \$ billion of increased exports in 1,000	
					Value -current prices	Quantity-constant prices
Coal	1995-2006	5.0	4.6	58.5	12	13
Other mining	1995-2006	6.0	1.6	259	43	162
Textiles & Garments	1990-1995	3.3	2.8	800	242	286
Motorcycles and cars	2000-2006	4.7	5.0	171	36	34
Chemicals & fertilizer	1990-1996	1.2	1	60	50	60
	1996-2005	2.4	2.3	20	8	9

Graph 3: INCREASED EMPLOYMENT IN LARGE/MEDIUM FIRMS (in millions of workers)



PART II: THE COMPARATIVE ADVANTAGE OF USAID - WHERE CAN IT BE MOST USEFUL IN 2009-2014.

The Indonesian government, like governments to world over, responds to crises and so do the international and bilateral agencies cooperating with it. The principle followed is: “The urgent always gets priority over the merely important.” This means that emphasis now is on inflation and the budget deficit as a result of rising costs of fuel subsidies. USAID’s comparative advantage therefore lies in assisting with the key medium-term problem of employment and its impact on poverty.

1. AID’s Comparative Advantage: Long-term participation in building institutions, including provision of training.

a. Medium-term commitment. Usefulness of donor participation increasingly requires commitment to an institution for the medium-term [say, 5 years] Short-term consultants take more time than their advice is worth unless they are embedded in a group of Indonesian and foreign experts who can assure they their skills and professional quality are appropriate, brief them and follow up on their recommendations. More generally it requires time to develop the trust, the understanding and the professional relations essential for effective work.

b. Commitment to Indonesian interests: Policy advisers are not acceptable are therefore not useful if there is any doubt that their client is Indonesia not the donor agency [as one high-ranking official said: “We no longer ask for policy advisors from X because we know they will not examine what our needs and problems are, they will give their advice based on X’s ideology”].

c. AID has major comparative advantage in academic training in the US. Despite problems training in the US has unmatched prestige and value. Yes, compared to short workshops in Indonesia it is incredibly expensive per participant. But if well done the benefits greatly outweigh the costs:

[i] The US provides highly relevant training in such fields as business, law, economics and public administration.

[ii] If given at well-known institutions it confers considerable prestige and can therefore the forces of reform. A leading member of civil society said: “If USAID 2-3 young staff members from the corruption eradication commission or the judicial selection commission to one of the leading US law schools for Master’s degrees they would do more to strengthen judicial reform than almost anything else they could do”.

But to be effective participants should:

[i] come from the handful of agencies to which AID has a long-term commitment;

[ii] should be selected after having worked at the agency for some period of time;

[iii] with the participation of advisers to the agency to strengthen the selection process against pressure;

[iv] and placed and advised by the advisory group to assure that the training is relevant and useful and to help them navigate the US academic world [for instance, government economists are unlikely to find appropriate programs in economics departments; the top schools of public policy are likely to be much better].

2. Working with the two agencies concerned with macro-economic policies to address the employment/ poverty problem. Priority to the issues relatively neglected by other cooperating agencies.

a. *The appropriate agencies.* Dealing with the medium-term employment problem requires attack along a broad front: tax, credit and exchange-rate policies; investment climate and incentives; labor regulation and minimum wages; government expenditure policies and investment in infrastructure; education programs and industrial policy. Two agencies are deal with such overall issues: Bappenas and MenKo, the Coordinating Minister for the Economy. Working with them permits addressing all issues relevant to employment/ poverty and can provide a platform to also work with:

Think tanks such as SMERU & LPEM.

Employers, such as KADIN, and labor unions.

The legal profession, the Corruption Eradication Commission and the judicial nominating commission

The Ministries of Industry, Agriculture, Labor and Manpower, Finance, Education Coordinating Ministry for People's Welfare and other relevant agencies.

b. *Neither agency is currently seen as central to the formulation of economic policy but both have great potential to be central again.*

c. *Bappenas & MenKo are currently receiving little support so USAID cooperation could be especially useful.* Some ministries dealing with important aspects of the economy, are overrun with foreign experts, so adding experts there may not give much benefit. Cooperating agencies have neglected Bappenas because it is not a major factor in current urgent policy issues. And MenKo has only a small staff of economic professionals and little real statutory power. Therefore both have had few outside experts provided to them. But Bappenas still has a very strong economic staff and could again play a major role after the election of 2009. MenKo's role too could increase with a new full-time Minister. Providing help as needed to both agencies to work on employment/ poverty issue might give high returns.

d. *The likely effectiveness of cooperation with all ministries depends greatly on the minister, so any final decision is risky if taken before the appointment of new ministers in 2009.*

e. *Work with these 2 agencies needs to focus especially on major factors in the competitiveness of Indonesia's manufactured exports and therefore on the following issues/agencies:*

[i] Infrastructure costs and availability- a major factor why Indonesia can not compete.

Others are dealing with execution and financing problems, but policy issues [pricing; role of foreign investors; priority to exports] need more attention.

[ii] Scarcity of trained personnel is particularly important in Indonesia; successes in dealing with the issue in other countries can be drawn on.

[iii] Labor regulation and minimum-wage setting has been given much attention but the useful initiative by Bappenas in developing a Tri-partite negotiating mechanism could be revived.

[iv] The impact of exchange-rate and interest-rate policies on the competitive position of Indonesia needs more attention than Bank Indonesia is inclined to give it.

3. Related priorities in poverty reduction: Support for PNPM, for Agricultural Policy, especially rice price policy, and the Environmental considerations.

USAID recognizes the great danger in designing a program of spreading efforts among too many agencies, especially since its resources are now quite limited. The result may be little impact. Moreover, at any time some government agencies will not provide a hospitable environment for an AID project, for political reasons or because it is concerned with technical issues and not with economic policies.

Working with Bappenas and MenKo has several advantages in these respects. Both are able to deal with issues that touch on many ministries and other agencies, both governmental and non-governmental. Second, both are mandated to deal with economic policy, not with particular technical issues and are accustomed to working with outside experts provided they are first rate and clearly working for Indonesia.

By focusing its effort on these two ministries USAID can concentrate on the employment/poverty issue –and especially measures to increase labor-intensive exports- which involves to some degree most agencies of government and many non-governmental organizations. Three other aspects are also important for dealing with the employment/ poverty nexus and can be addressed from a base in these 2 agencies.

Finally Bappenas has a strong staff of experienced economists, stronger than any ministry [only Bank Indonesia has a comparable group of economists] while MenKo has a broad mandate and considerable power if it has a strong minister [unlike the Ministry of Finance it does not control a lot of resources and without a strong minister plays very little role]. Cooperating they can have formidable influence.

a. *PNPM, the Community Driven Development program for infrastructure is an important source of employment.* It provides work only for a limited number of days but during the slow season when any work is scarce [World Bank report by Voss]. Its targeting is effective, benefiting almost exclusively the poor and raising their yearly income by 5-10%.

PNPM needs to be an integral and important part of any employment/ poverty reduction strategy, especially effective in providing immediate benefits while policy changes can take longer to be effective. It can also serve as an automatic safety net, expanding during periods of greater need and contracting in boom times.

USAID could provide crucial support by focusing its efforts on neglected areas of this program [to be spelled out].

b. *In the short-term the price of rice and other staple foods is crucial to the poor. In the medium-term growth in agricultural production affects both employment and real income. USAID could fill an important hole by supporting both policy for rice and other staples and policies which affect agricultural production [e.g.: investment in and pricing for fertilizer and pesticides; the development of the cold chain and of supplies to supermarkets; export prices; policy on agricultural subsidies and price guarantees; diversification vs emphasis on rice].* Such policies involve not only the Ministry of Agriculture, but also Trade, Finance, Industry [with respect to inputs and processing, the latter especially weak in Indonesia], and the Agricultural Institute among others. Some of them are also of great political significance [especially rice price and distribution policies]. Previous USAID efforts have sometimes

been housed in Bappenas therefore. Again a base in Bappenas and Menko is therefore quite appropriate.

c. Environmental degradation can have a particularly great impact on the poor who are least able to deal with polluted water, air and unbridled land speculation. And many of the issues are multi-ministerial –e.g. the Ministry of Mines supports mining in protected forest areas; the Ministry of the Environment may be opposed and so may the Forest Ministry. The gains from mining in terms of income and employment must be compared to the environmental costs and the cost of timber income foregone and the employment and tax consequences of either policy. Bappenas has a Deputy dealing with environmental issues and the Minister of Coordination chairs many of the relevant committees, so again this issue can be addressed in the context of poverty reduction from these 2 agencies.

4. A Multi-faceted Strategy for Indonesia?

This paper proposes that USAID focuses its effort on employment/ poverty reduction by emphasizing policies that can achieve a much higher rate of growth of labor-intensive exports of manufactures [and agricultural products]. But the implication is NOT that Indonesia need not adjust policies to increase exports of commodities, the lead sector in the last 10 years and especially in the last 3 years. Indeed there is little doubt that Indonesia could greatly increase its national income and tax revenue by policy reforms to speed the production and export of minerals, other than coal and some other commodities.

But a commodity-led strategy is vulnerable, does not create many jobs and benefits the income primarily of Kalimantan, parts of Sumatra and parts of Sulawesi. It provides few benefits for the areas where underemployment and poverty are concentrated: Java and the Eastern Islands. Moreover the World Bank is doing extensive work on this area. USAID's comparative advantage lies in helping with policies that are focused on neglected issues of employment and consequent poverty in some parts of the country.

Annex 2: Economic Policy Priorities for Indonesia

ECONOMIC POLICY PRIORITIES FOR INDONESIA

M. Chatib Basri

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External situation

Slow down of economic growth

(GDP real growth, %)

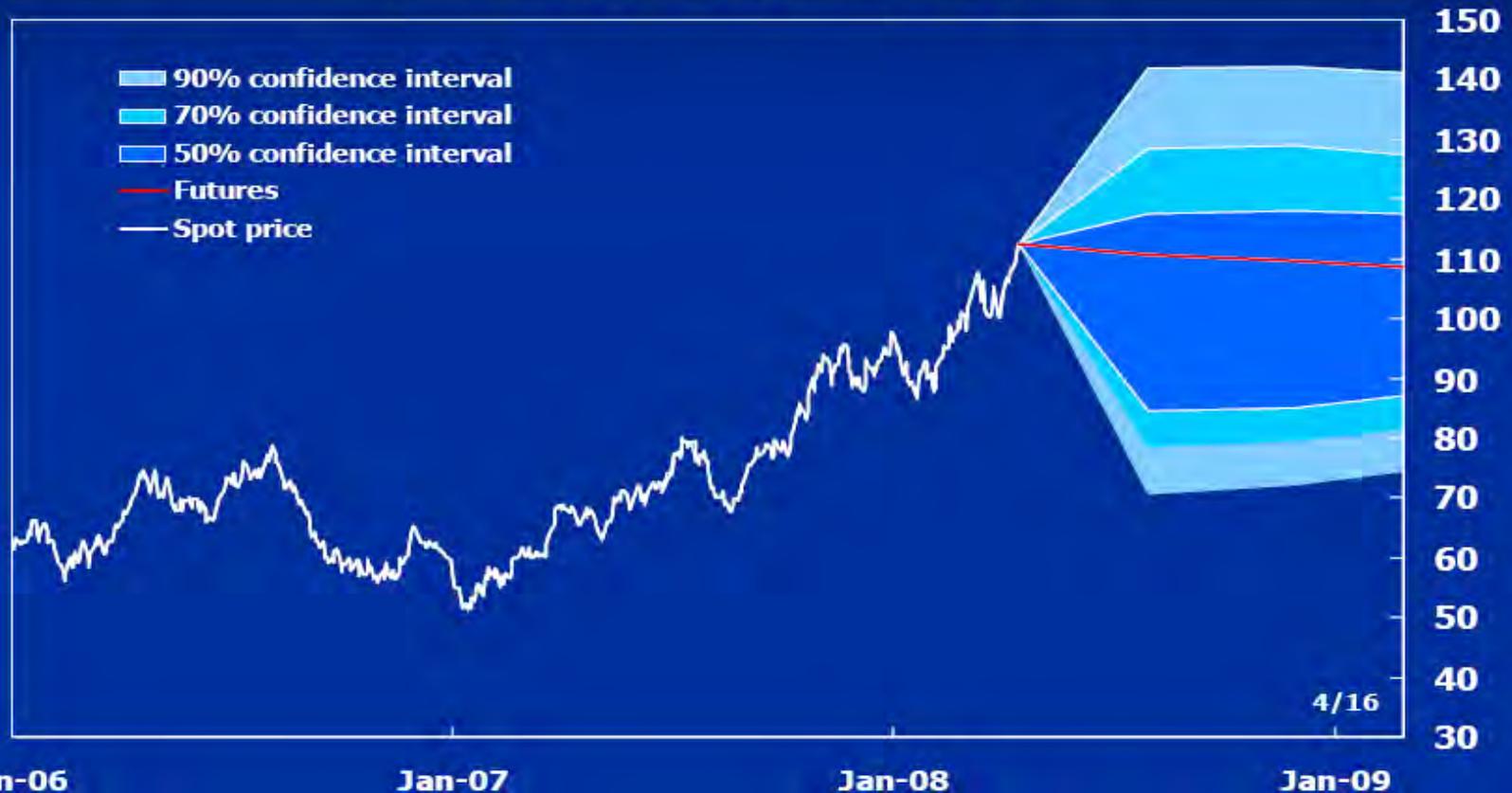
	2006	2007	2008	2009
USA	2.9	2.2	0.5	0.6
European	2.8	2.6	1.3	1.1
Japan	2.4	2.1	1.4	1.5
China	11.1	11.4	9.3	9.5
World	5.0	4.9	3.7	3.7

Source:WEO, March 2008

Oil Prices Have Touched New Highs, Amid Tight Market Conditions

Crude Oil Prices

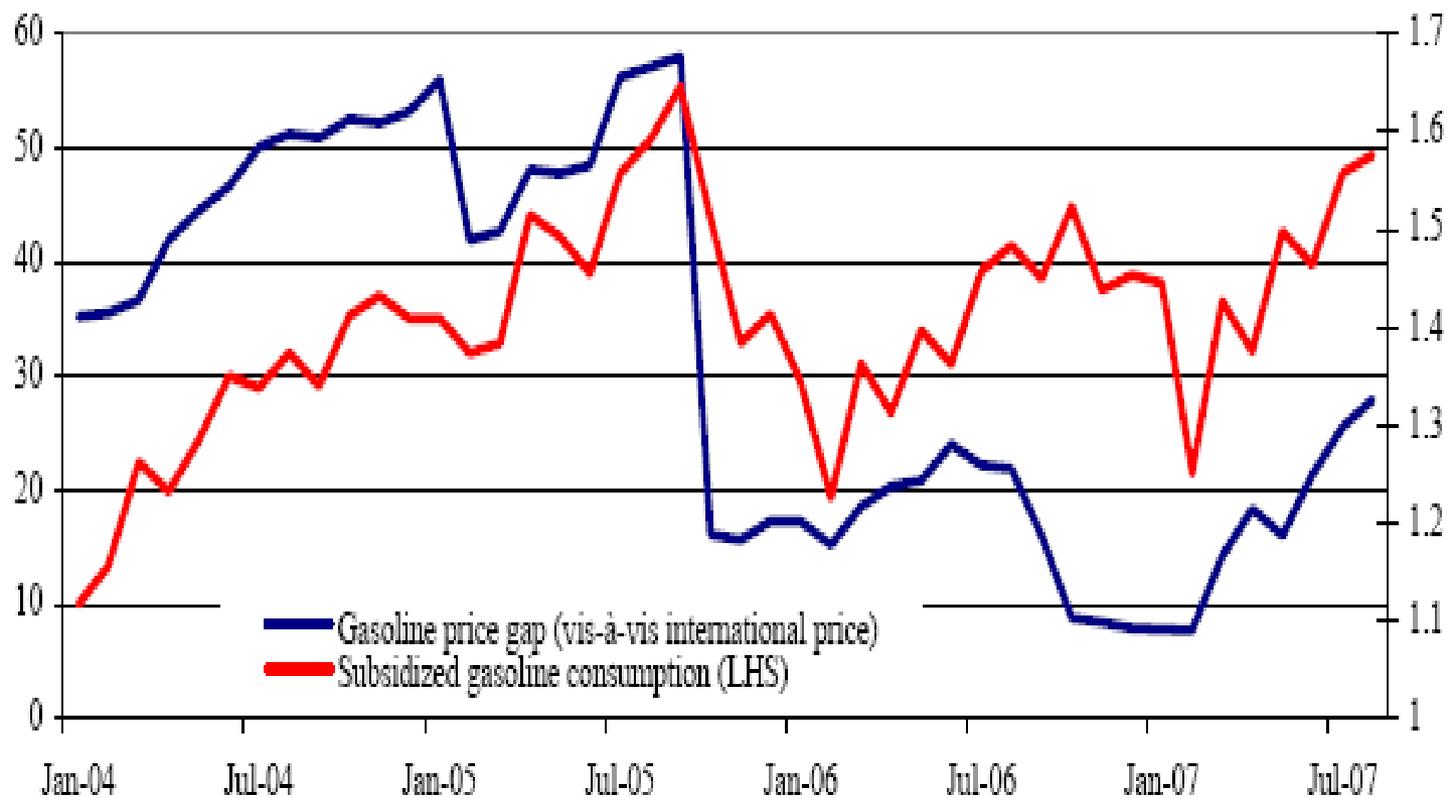
(Brent futures options; U.S. dollars per barrel)



Indonesia: Subsidized Oil Consumption and Price Gap

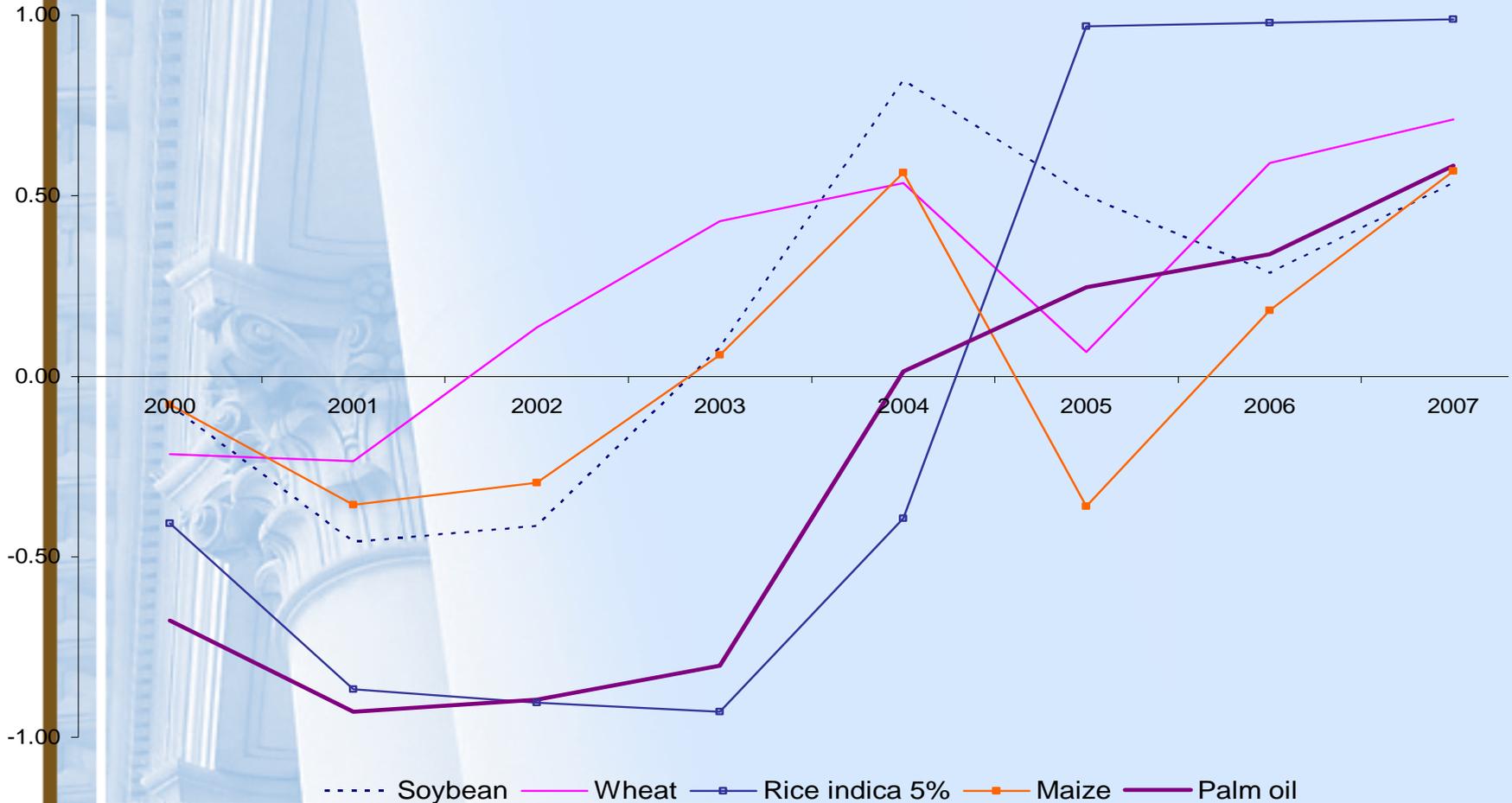
million liters

Percent



Food Prices and Oil Price

Figure2: 5 Years Moving Correlation of Food Prices against Price of Crude Oil

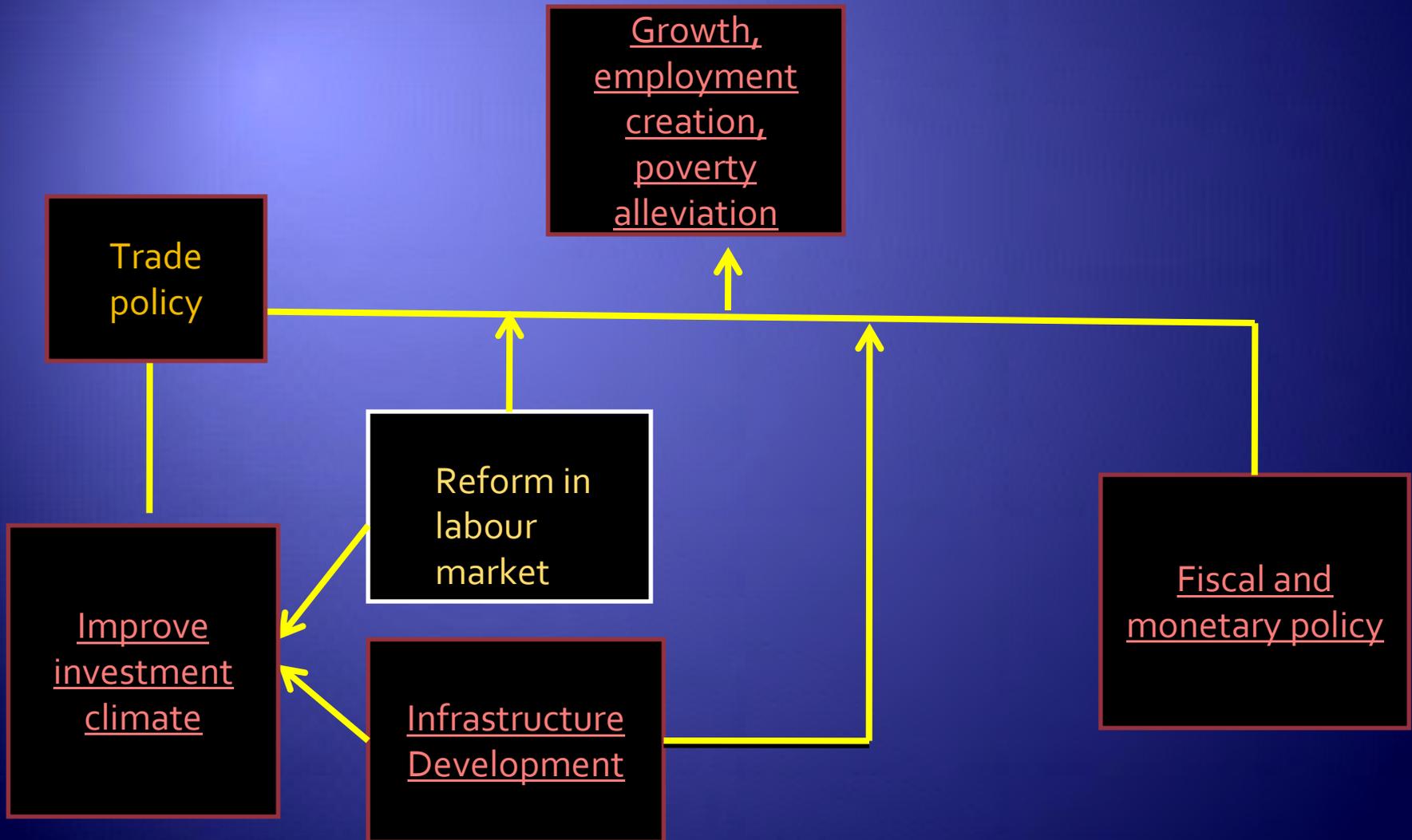


Share food in per capita household expenditure: high commodity prices will certainly affect the poor (decile 1)

Item	Decile 1	Decile 2	Decile 9	Decile 10	Total
Rice	25.4%	21.7%	6.4%	3.6%	14.0%
Sticky rice	0.1%	0.0%	0.0%	0.0%	0.0%
Corn with husk	0.4%	0.2%	0.1%	0.1%	0.1%
Corn kernels/ ground corn	2.3%	0.7%	0.0%	0.0%	0.4%
Rice flour	0.1%	0.1%	0.0%	0.0%	0.1%
Corn flour (maize)	0.0%	0.0%	0.0%	0.0%	0.0%
Wheat flour	0.1%	0.2%	0.2%	0.1%	0.2%
Others	0.1%	0.0%	0.0%	0.0%	0.0%
Total Grains	28.4%	22.9%	6.7%	3.8%	14.9%
Instant noodle	1.08%	1.25%	1.02%	0.67%	1.19%
Wet noodle	0.01%	0.01%	0.01%	0.01%	0.01%
Rice noodle	0.01%	0.01%	0.02%	0.01%	0.01%
macaroni/dried noodle	0.01%	0.02%	0.01%	0.01%	0.01%
Total noodle	1.11%	1.28%	1.05%	0.69%	1.22%

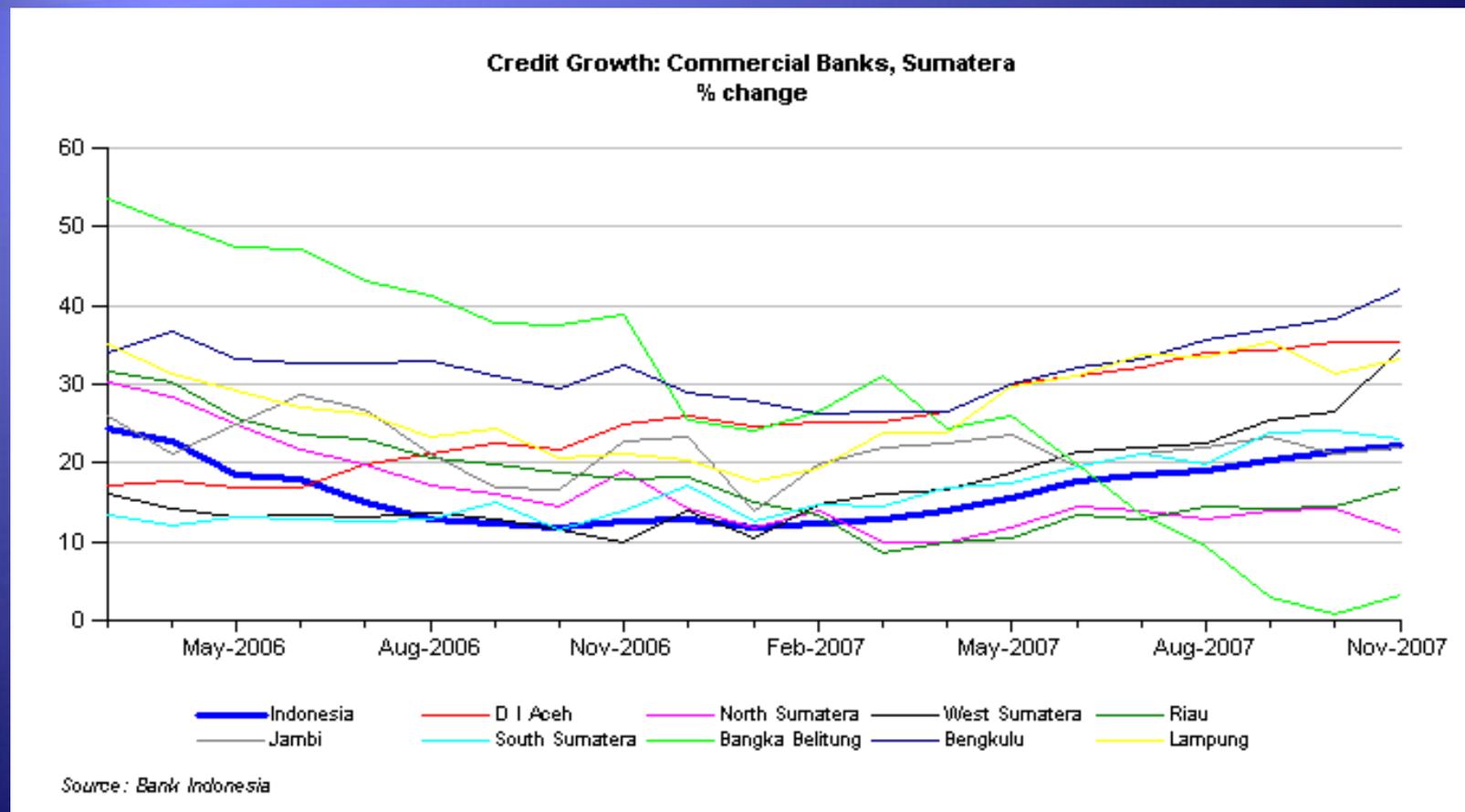
Source: World Bank staff estimate based on 2007 Susenas module

Government Priorities



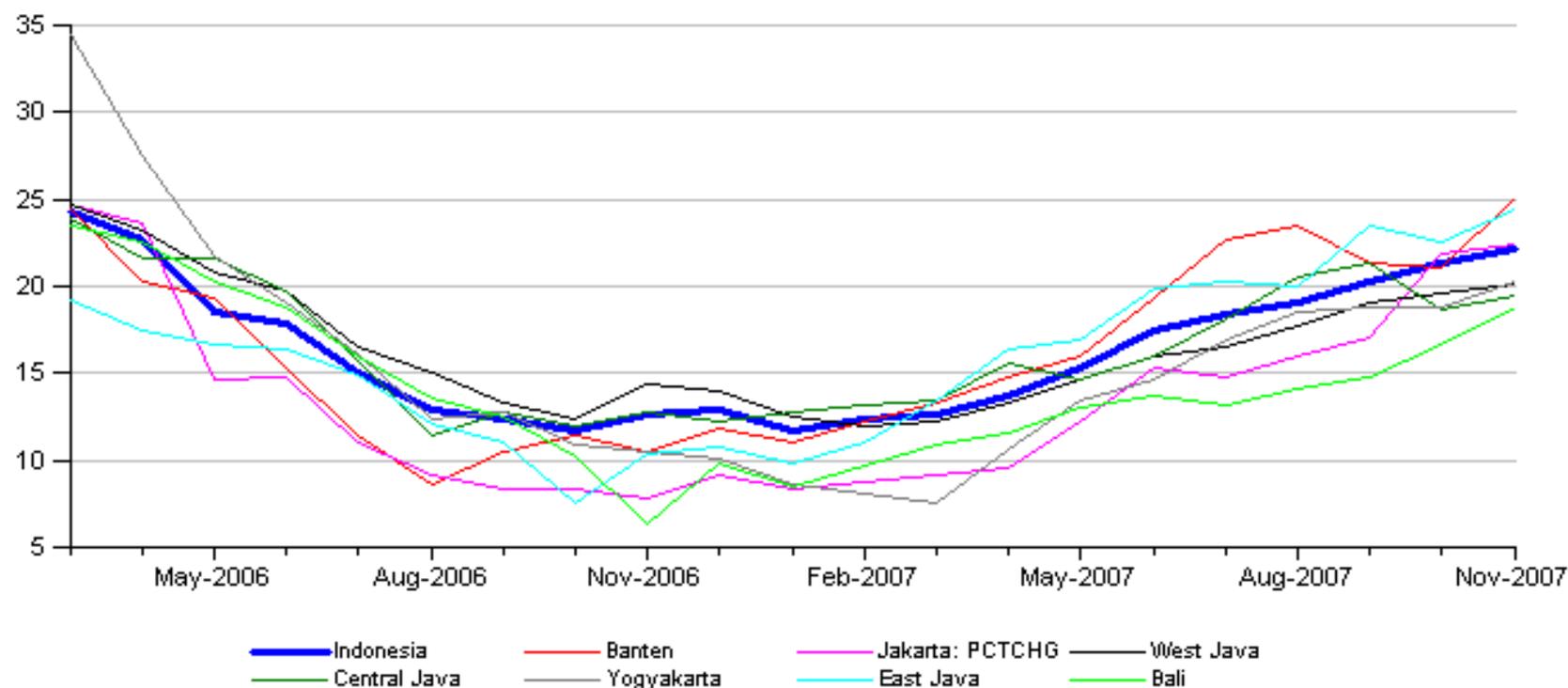
New trend

Rupiah Credit Growth: Commercial Banks, Sumatera: higher than national



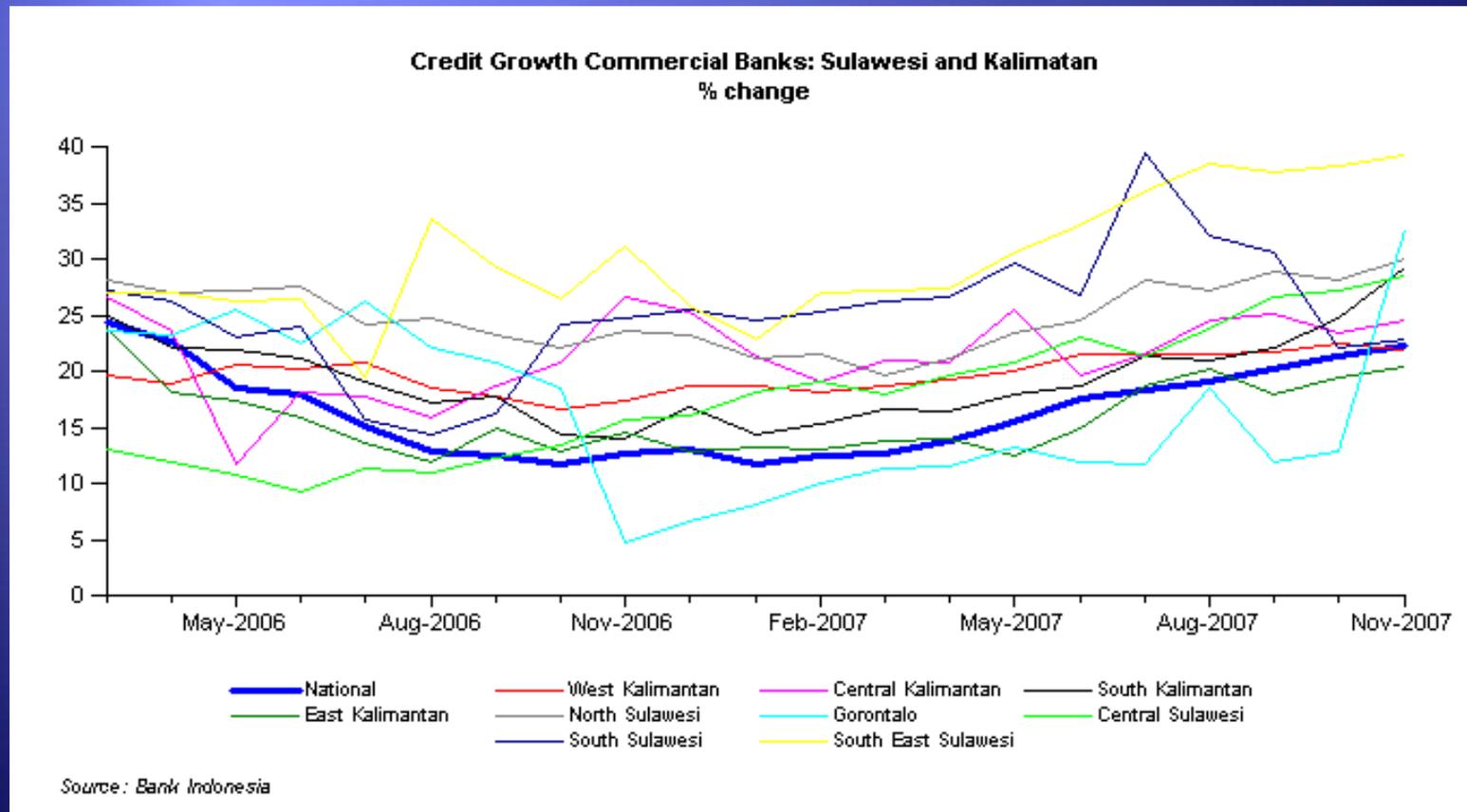
Rupiah Credit growth: commercial banks, Jawa: average national

Credit Growth: Commercial Banks, Jawa
% change



Source: Bank Indonesia

Rupiah Credit growth: commercial banks, Kalimantan, Sulawesi: higher than national

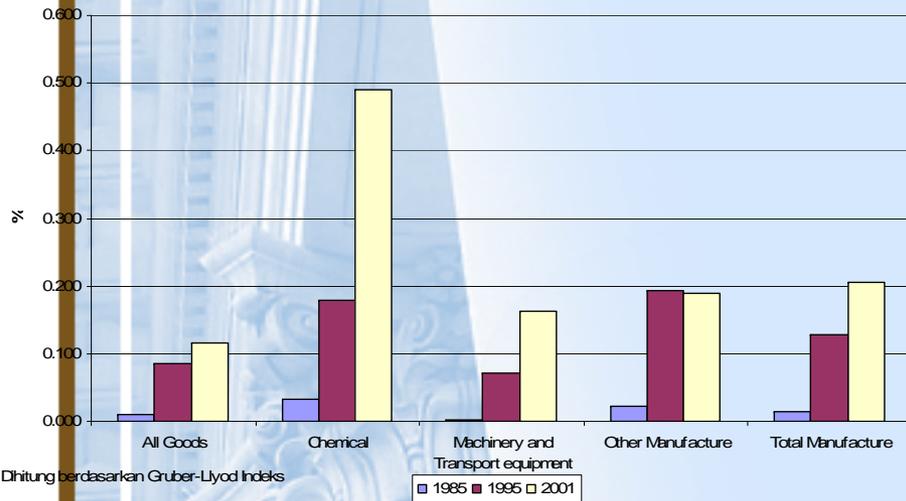


Pattern of future trade

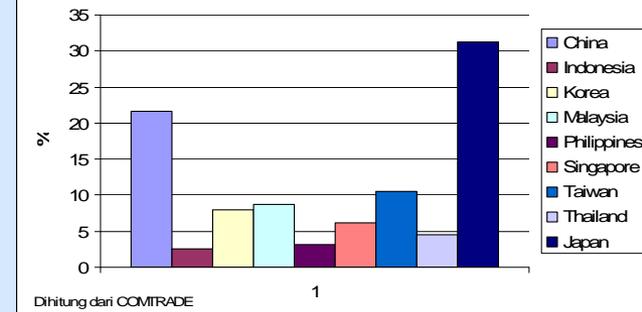
- ◆ Two-third of world trade in East Asia economies
- ◆ One-fifth of East Asia trade is in the form of production network or production sharing
- ◆ In the future, countries in East Asia should take part in the production net-work
- ◆ However.....

Indonesia is left behind in production net-work

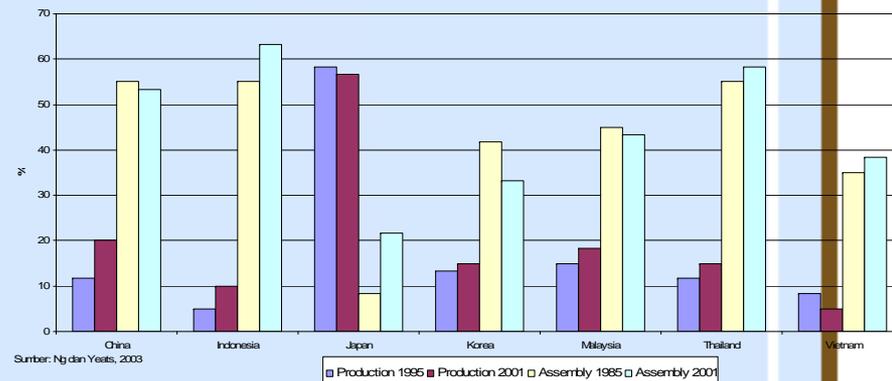
Intra-Industry trade ratio between Indonesia-Japan, 2001



Market Share of Export parts and components 10 Asian countries, 2001



% of parts and components have Comparative advantage



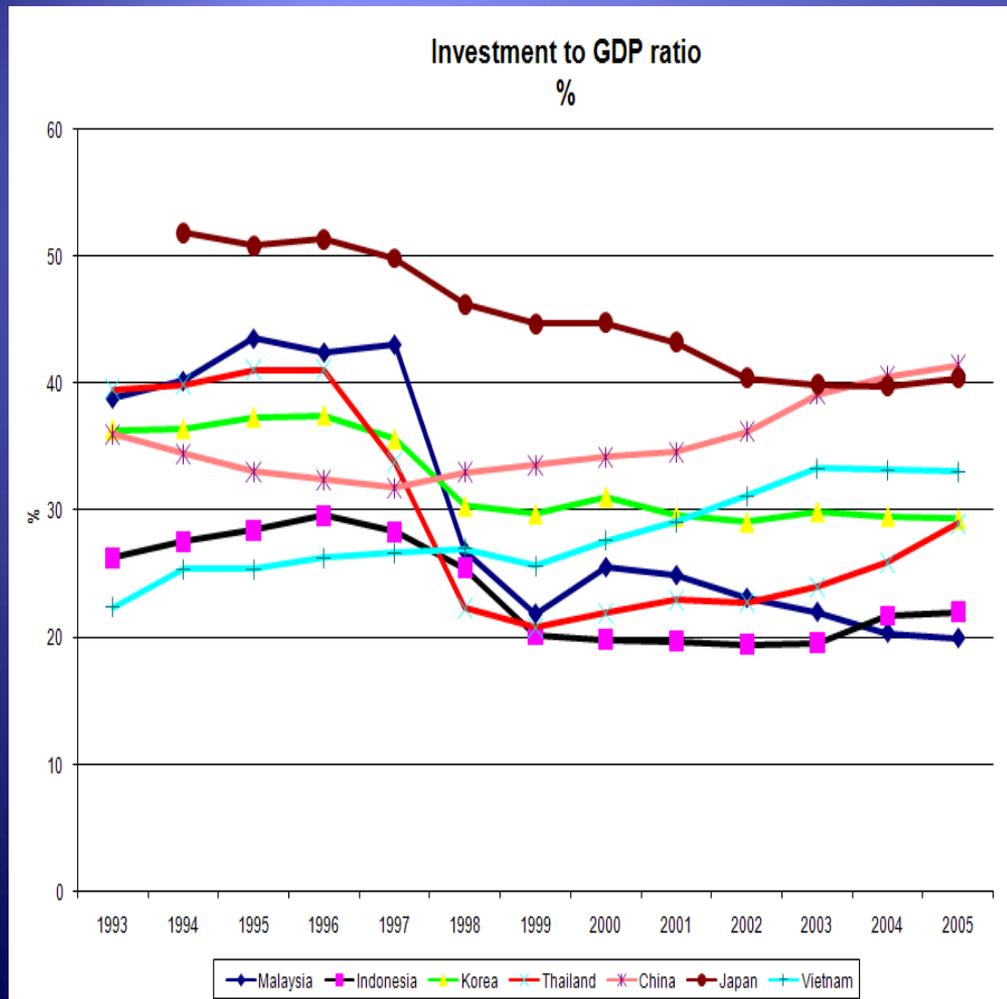
Role for USAID

- ◆ Energy and food issues
- ◆ Local government
- ◆ Trade and services
- ◆ Logistics and production net-work

Important to note: in the short run institution is given

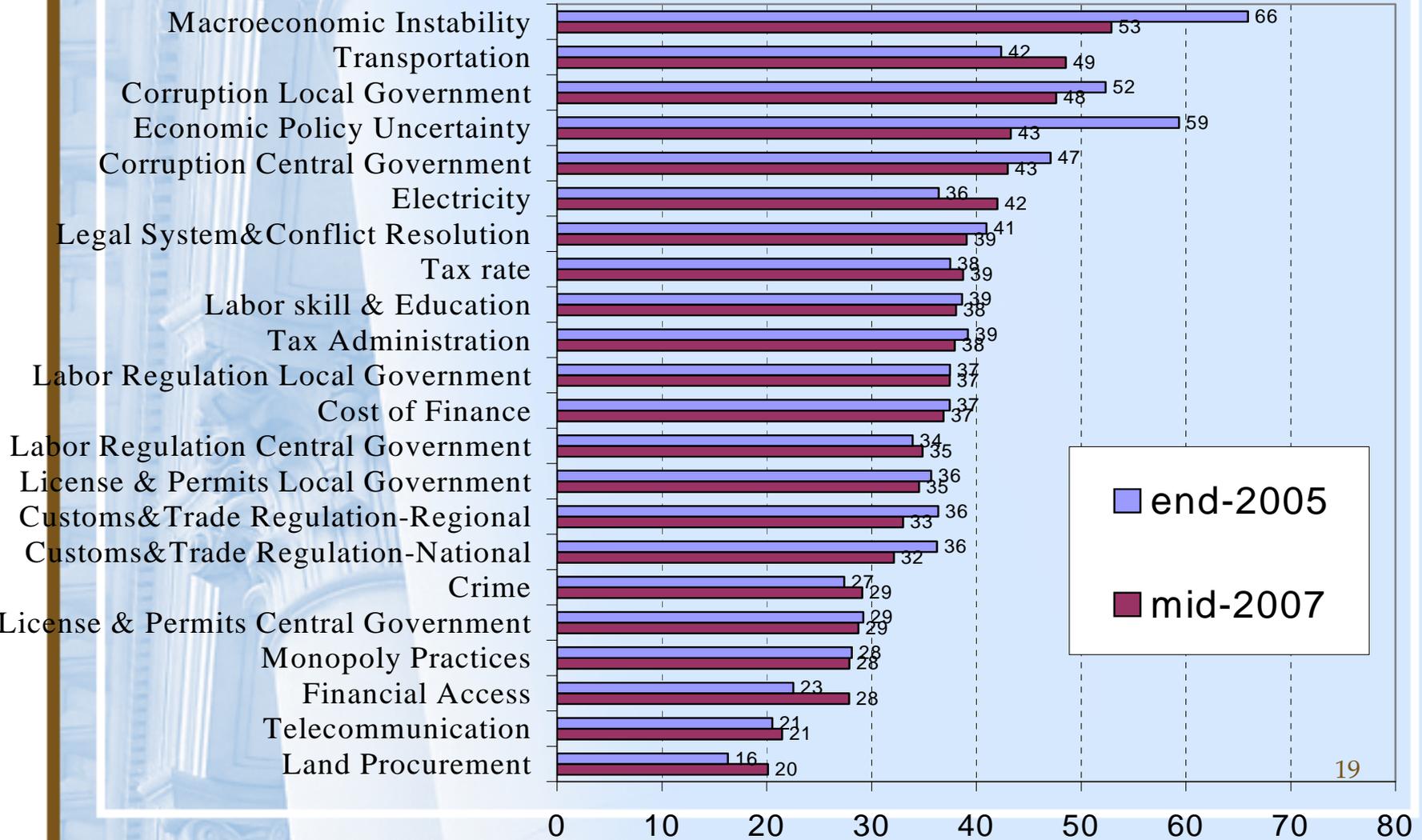
Thank you

Investment/GDP



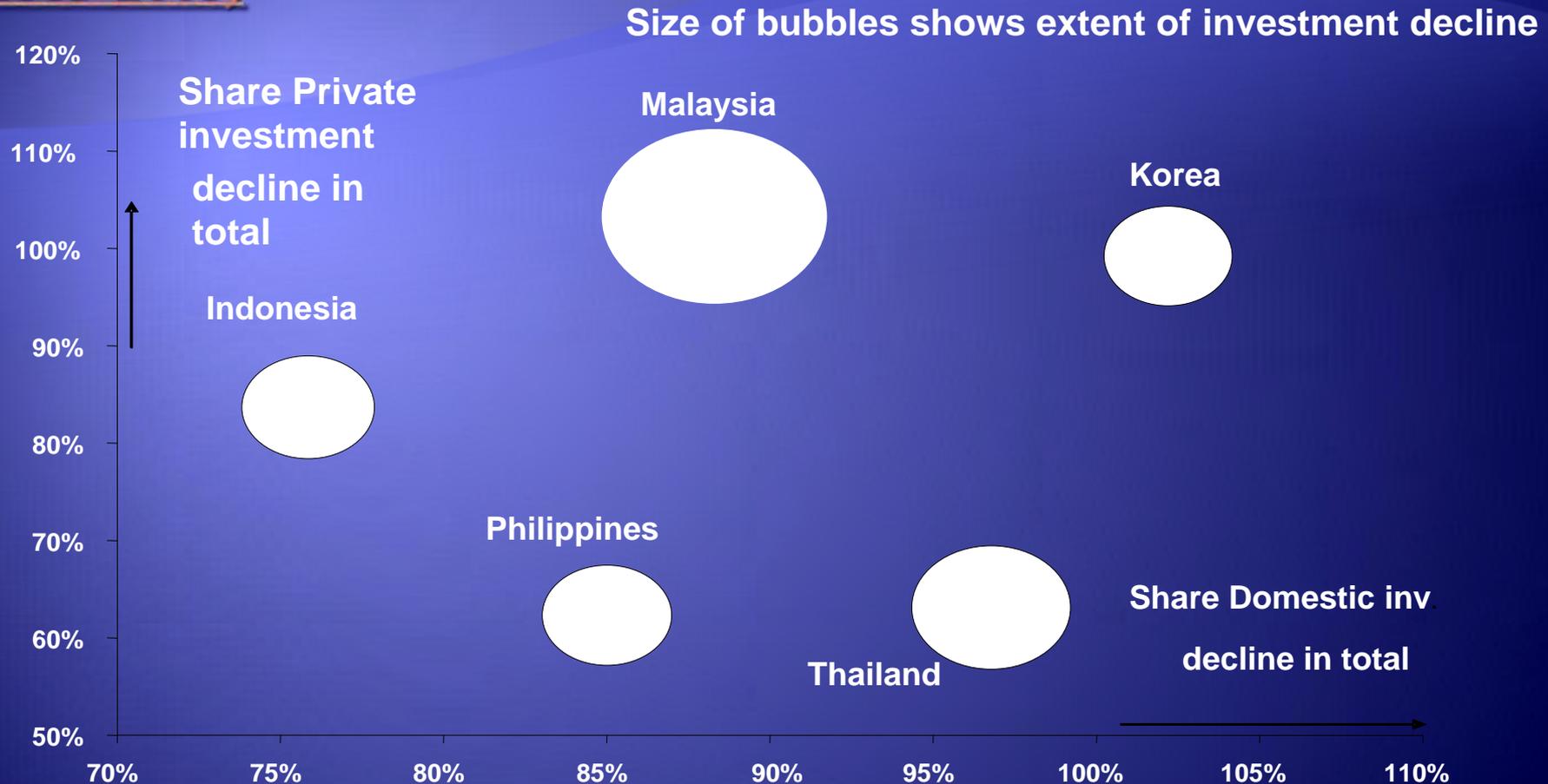
- ◆ Investment/GDP ratio declined in all crisis affected countries
- ◆ Improvement in investment climate, necessary but not sufficient?
- ◆ Possibility of risk averse behaviour
- ◆ Shift towards China, Vietnam and India

Percent of respondents reporting obstacle to be moderate, severe, or very severe



Decomposition of investment decline

(by types of investment, comparison between 1995-97 and 2003-2005)



Note: bubble size shows the extent of investment decline

Source: World Bank

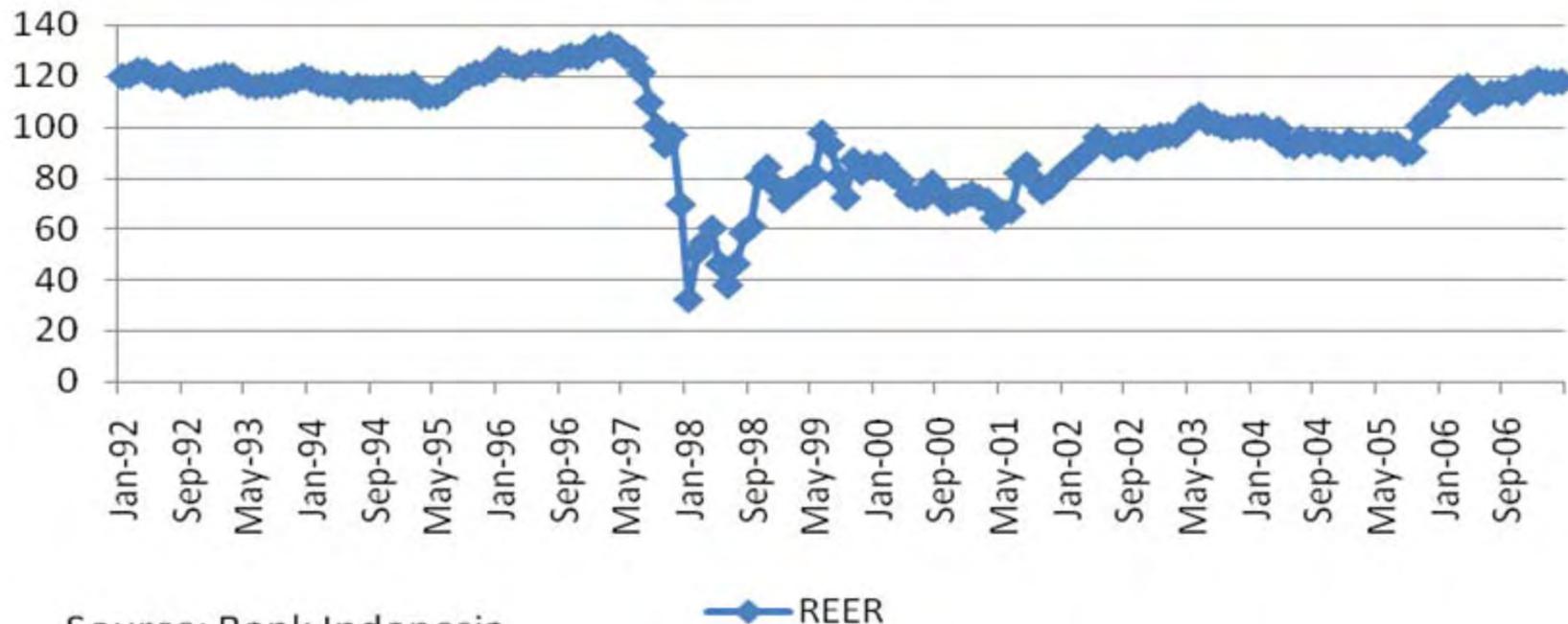
Can Indonesia maintain its open trade regime? Creeping protectionism?

- ❖ Raising wages and rigidity in the labour market
- ❖ High cost economy
- ❖ Appreciation of rupiah
- ❖ Distributive consequences of reform
- ❖ Crisis hypothesis
- ❖ Slow economic growth, high unemployment

Further unilateral trade liberalization more difficult

Appreciation in the RER increase the demand for trade protection

Figure 4
Indonesia's Real Effective Exchange Rate
2003=100



Source: Bank Indonesia

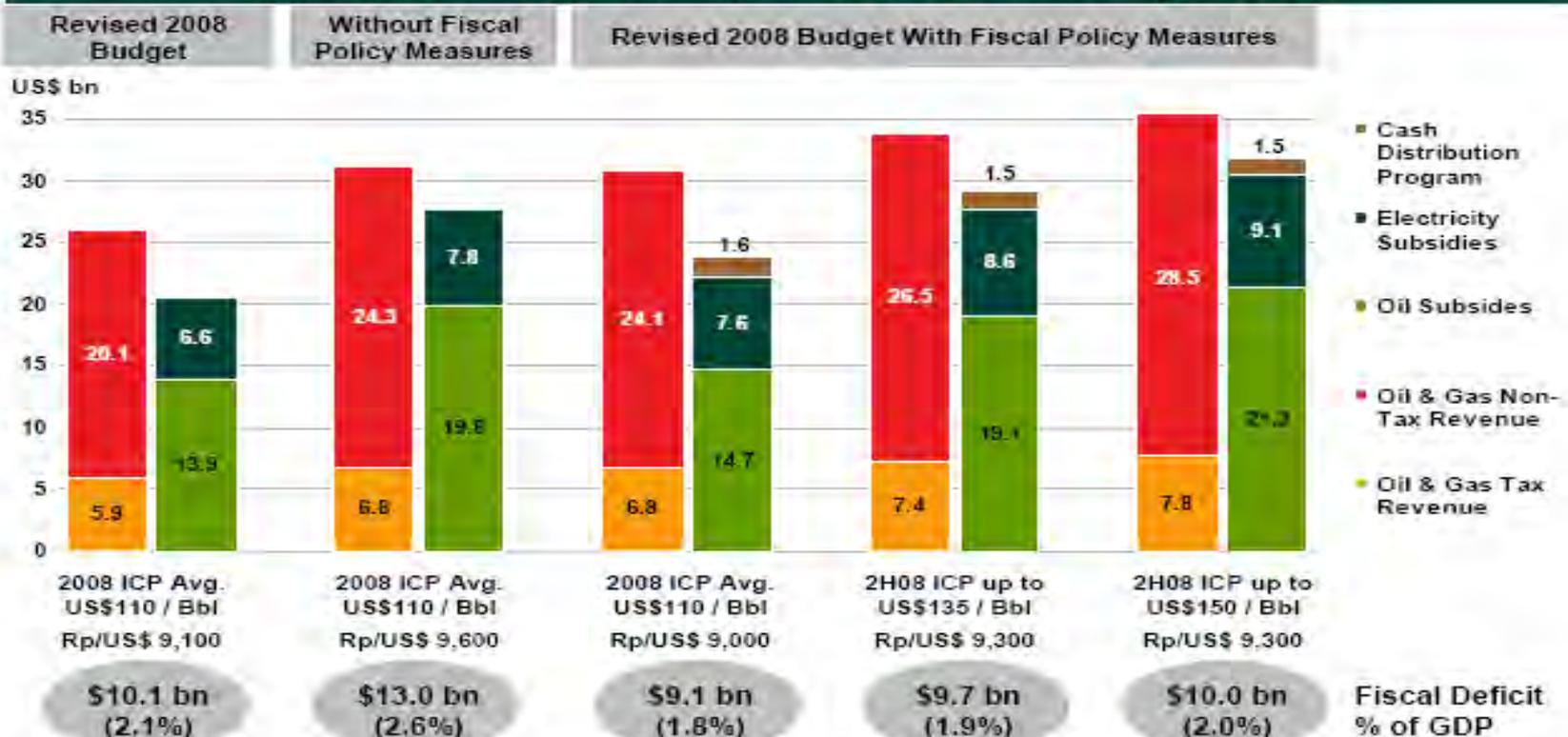
Prospect of trade liberalization: Unilateral, multilateral or FTA?

- ❖ Unilateral: strong pressure for trade protection
- ❖ Multilateral: prospect of WTO and DDA ?
- ❖ FTA: - 2nd best solution for reform?
 - Rule of origin issues?
 - Low rate of utilization
 - Divert the focus from multilateral

Impact of fiscal adjustment on budget

Impact of Fiscal Policy Adjustments on Budget

Impact of Revised ICP Assumption on 2008 Revised Budget Outlook



Tax and Custom Reform

Tax

- Modernize DGT: Expansion of LTO, MTO and HQ
- Service desks at Major Tax Offices
- Speedup of VAT refund to promote export activities
- Improve audit
- Improve data base and link to customs
- Tax incentives for investment

Customs

- Modernize Custom Office
- Streamlined processing time
- Implementation of EDI system to improve efficiency
- Extend Priority and Green Lane
- Improve Compliance

- Establishment of Government Revenue Module which improve efficiency & transparency in government revenue system. The Module is operated based on online system among Customs Office, Tax Office & DG of Treasury

- Draft Tax Law submitted to Parliament.
- Custom law has been approved by the Parliament on October 18, 2006
- Two regulations issued on streamlining of customs processing, revision of remaining regulations ongoing

Budget Policy and Implementation Reform

MOF

- Establishment of FPO
- More Focus on Organization Structure of MOF: FPO, Budget, Debt, Asset, Regional and Treasury
- Leading to performance based budget
- Improve Governance (reward and punishment)

- Implementation of new organization structure of MoF
- Appointed Echelon I and other
- MTEF, 'Hold harmless', Performance Based in 2008 budget

Policy

- Better Fiscal Policy and Coordination; Fiscal-Monetary Fiscal-Financial Sector, Fiscal-Trade and Fiscal Decentralization
- Balance: Fiscal Incentives and Fiscal Sustainability:
 - Incentives to Investment (PP 148)
 - EPA and FTA
- Lower cost of Financing Sources

- Develop an early indicators and anticipate downward trend
- Improve Policy Coordination
- Use fiscal policy tools to support investment and growth
- Exercise Medium Term Fiscal Outlook

Monetary Policy

Response of inflation to shocks (Basri, Damayanti, Sutisna, 2002)

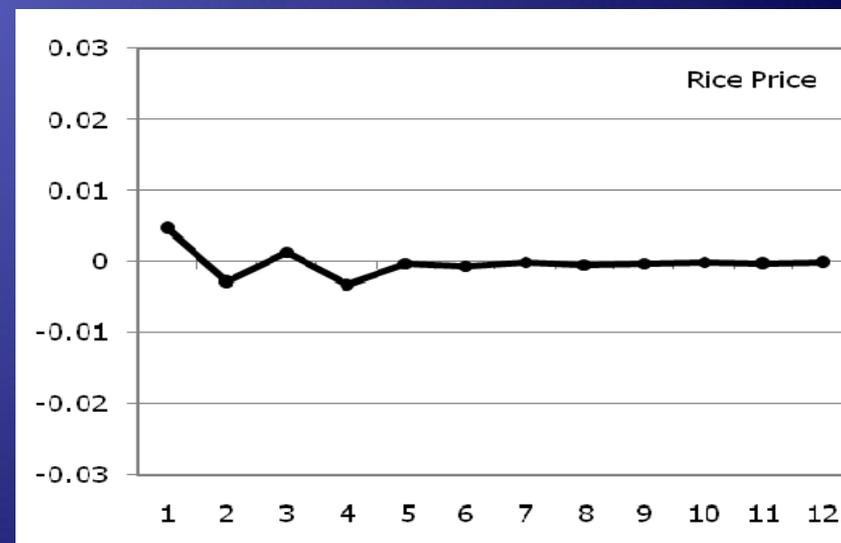
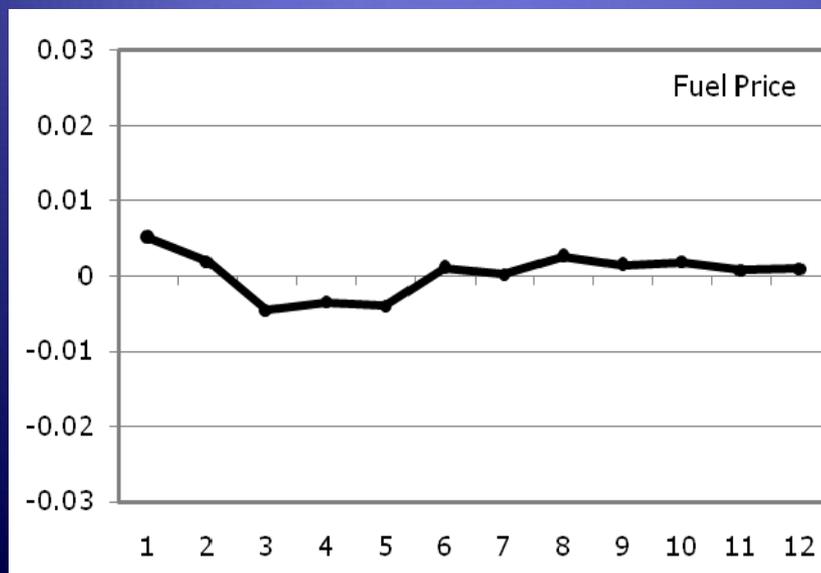
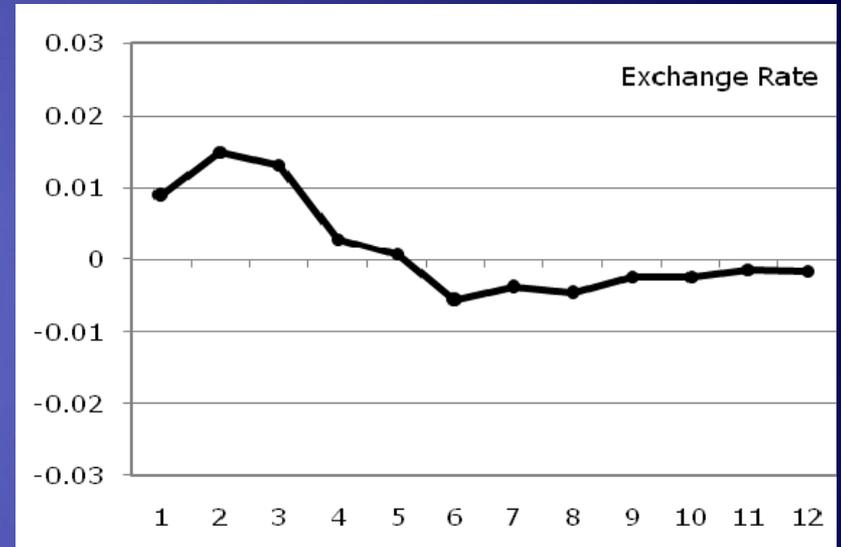
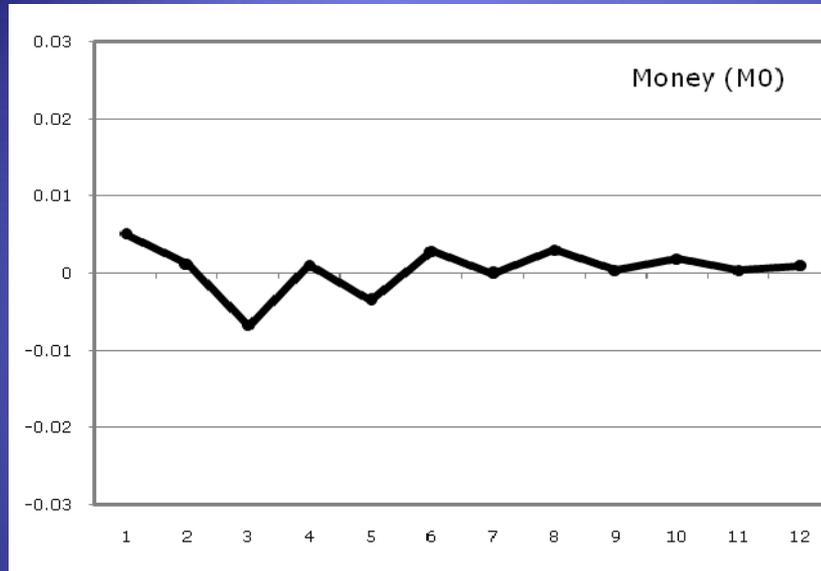
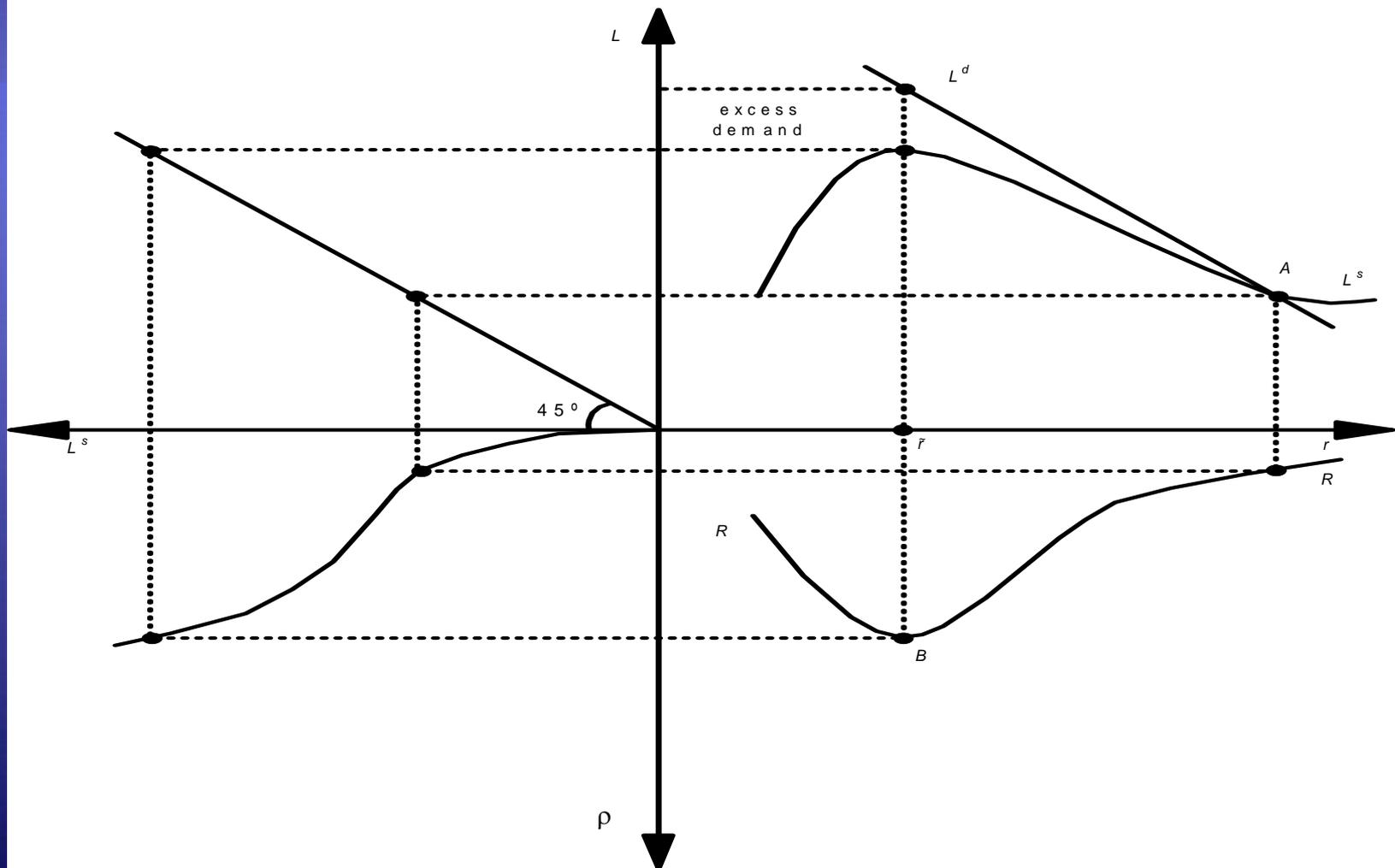


Figure 2.4
Interest Rate Determination
in the Stiglitz-Weiss Credit Rationing Model

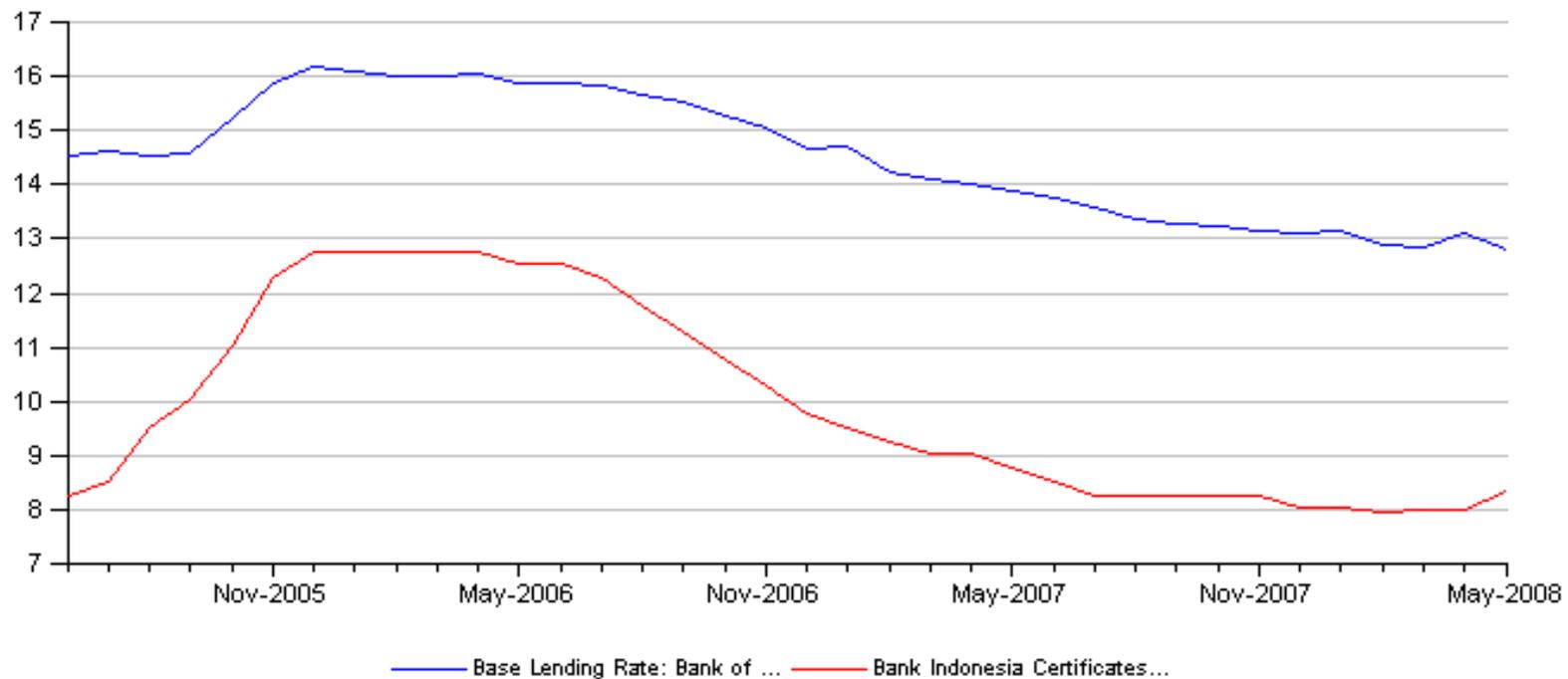


Source: Agenor

Source: Adapted from Stiglitz and Weiss (1981, p. 397).

Although BI rate is declining, lending rate remains high due to risk in real sector

Lending rate and SBI
% pa



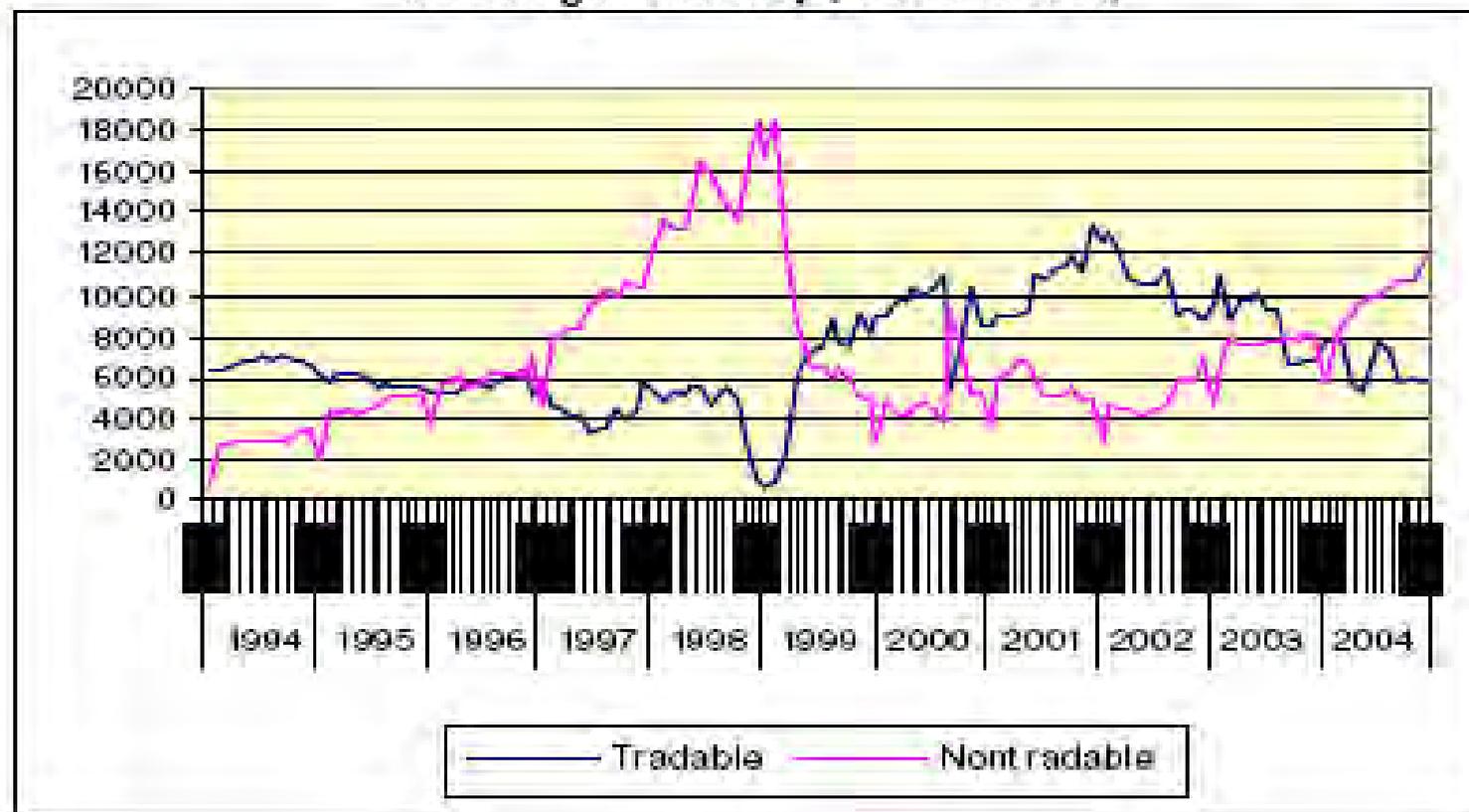
Source: BI

Supply constraints and declining potential output

- ◆ Need to solve asymmetric information between bank and companies
- ◆ Weak infrastructure
- ◆ Relative low potential output due to limited investment
- ◆ Need prudent monetary policy

Credit allocation shift towards non-traded sector since 2003

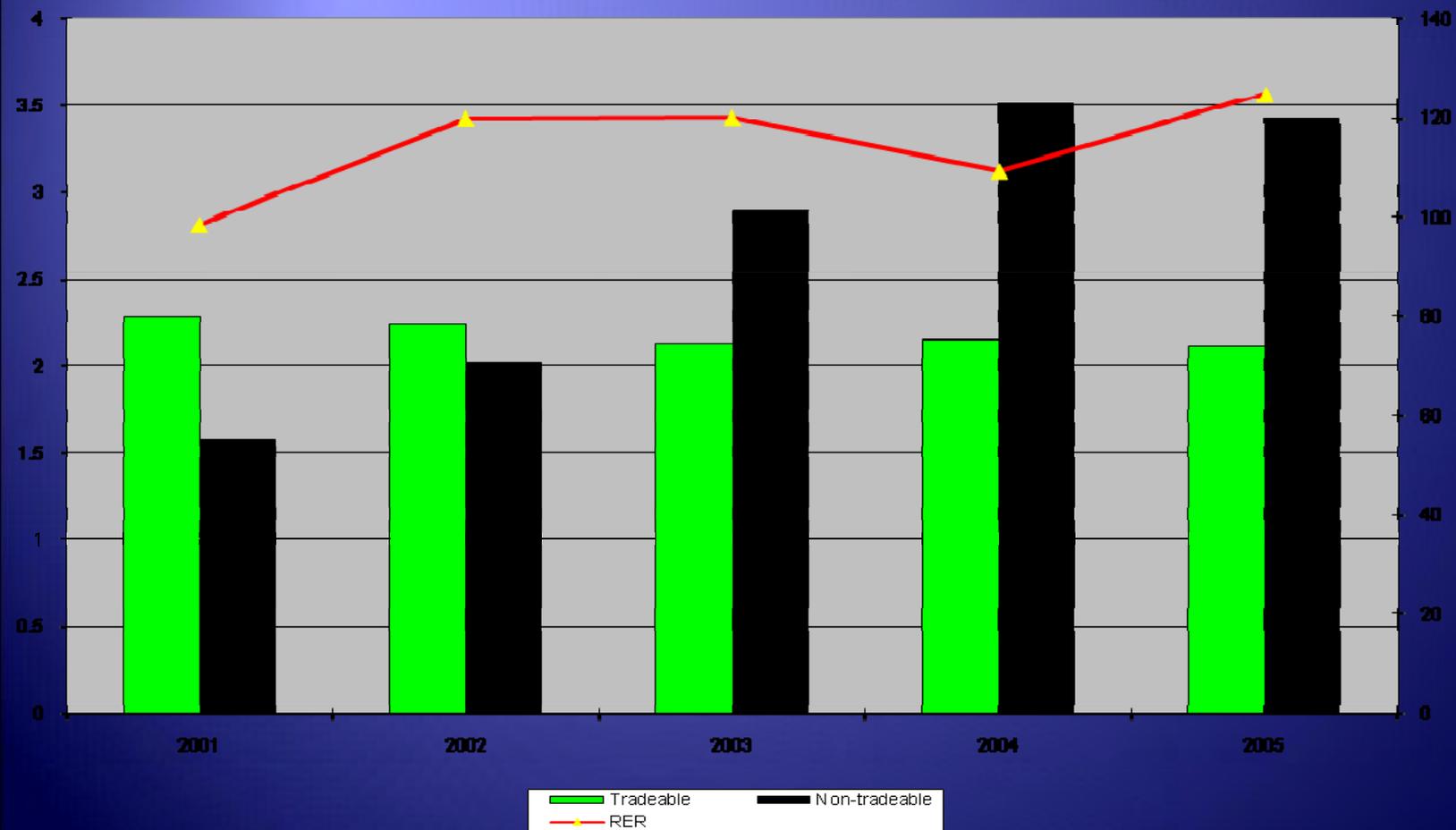
Outstanding of Investment Credit of Commercial Banks
in Foreign Currency (in billion IDR)



Source: Prasetyantoko

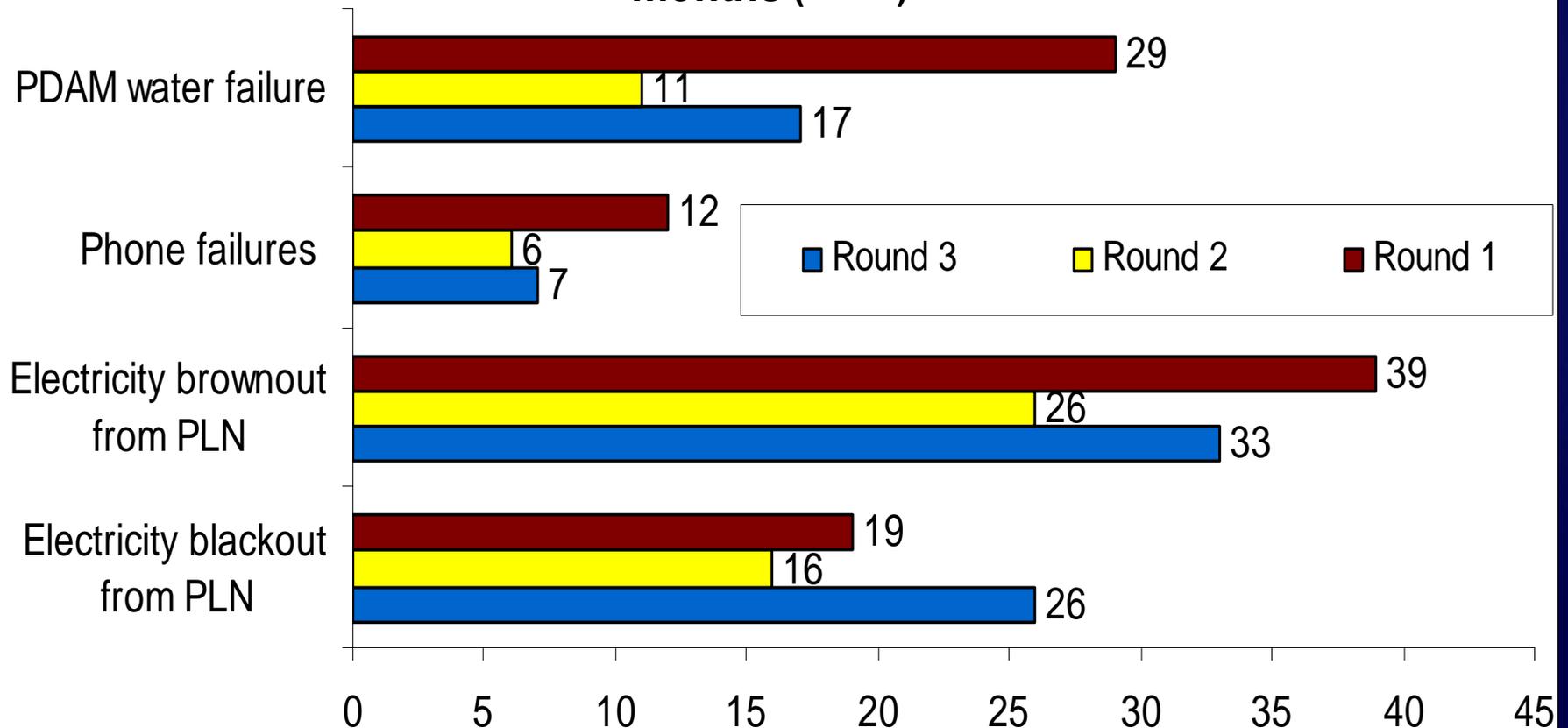
Growth was mainly driven by non-traded sector

Sumber pertumbuhan PDB. traded vs non-traded dan Real Effective Exchange Rate

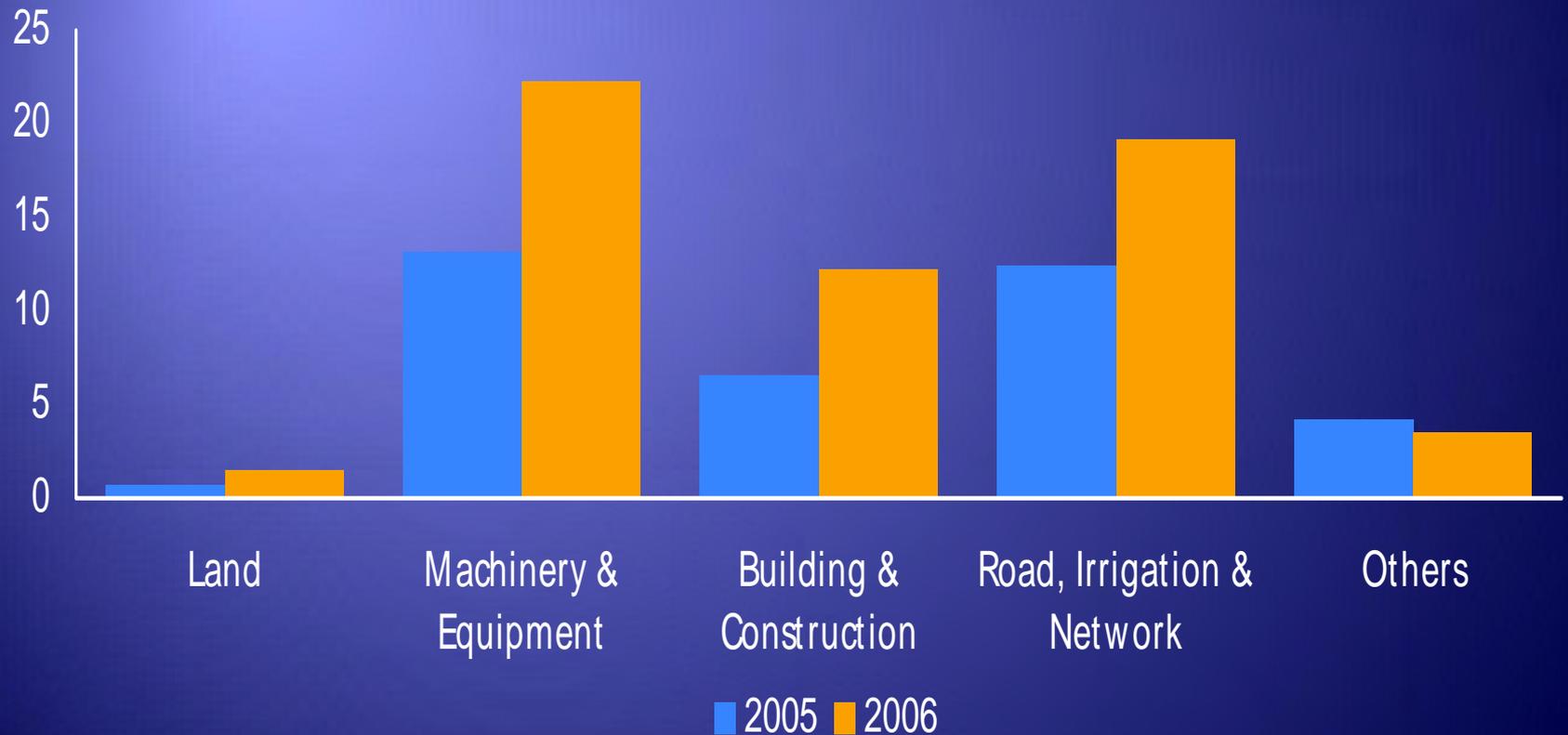


➤ Frequency of problems with public utilities increased between Round 2 (end-2005) and Round 3 (mid-2006). The most frequent problem is PLN electricity brownout.

Public Utilities: Frequency of Problems over the previous 6 months (mean)

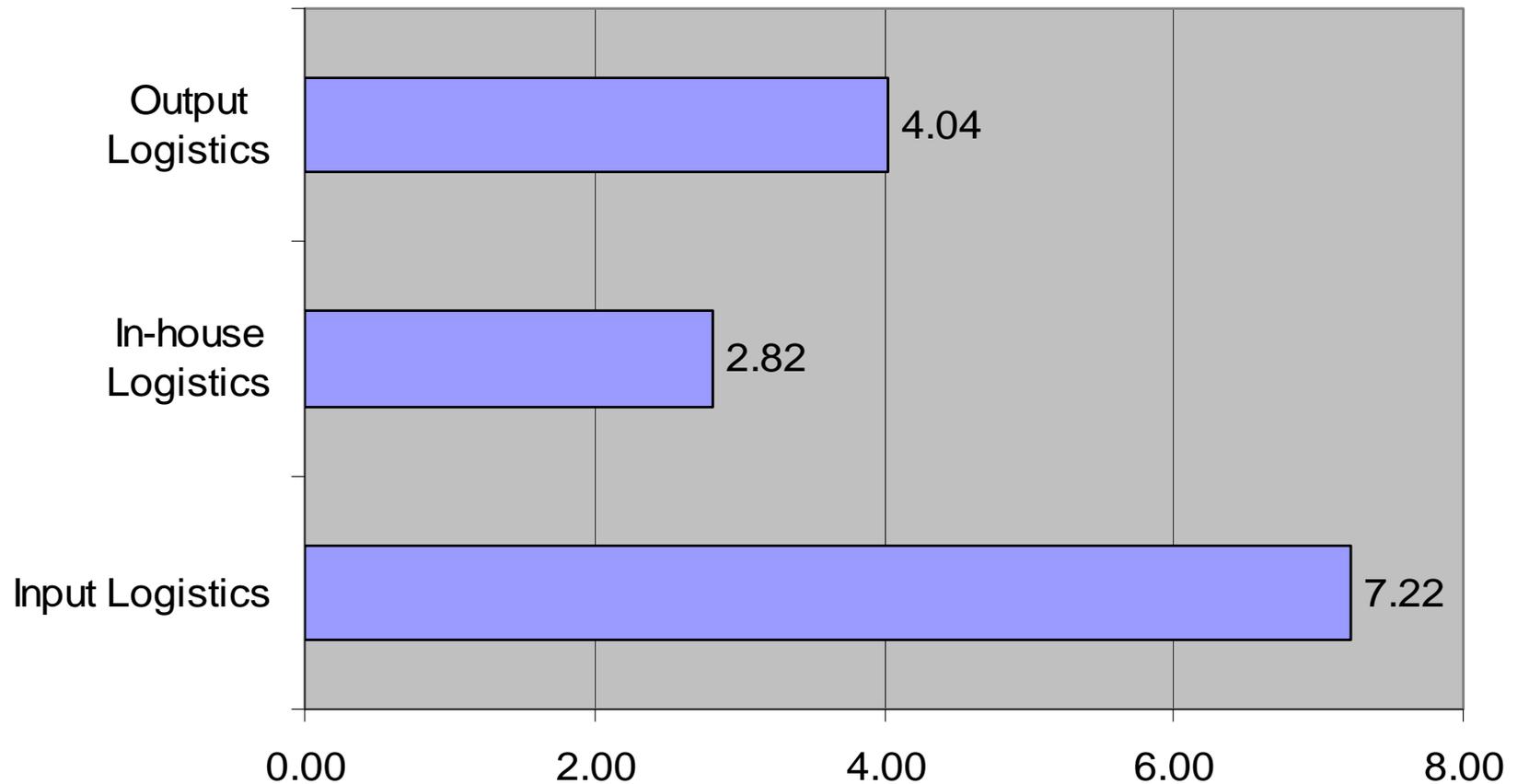


Infrastructure-related activities dominated government expenditure



Source: MOF

Logistics Costs in Indonesia



	Input Logistics	In-house Logistics	Output Logistics
Actual Logistics Cost	7.22	2.82	4.04

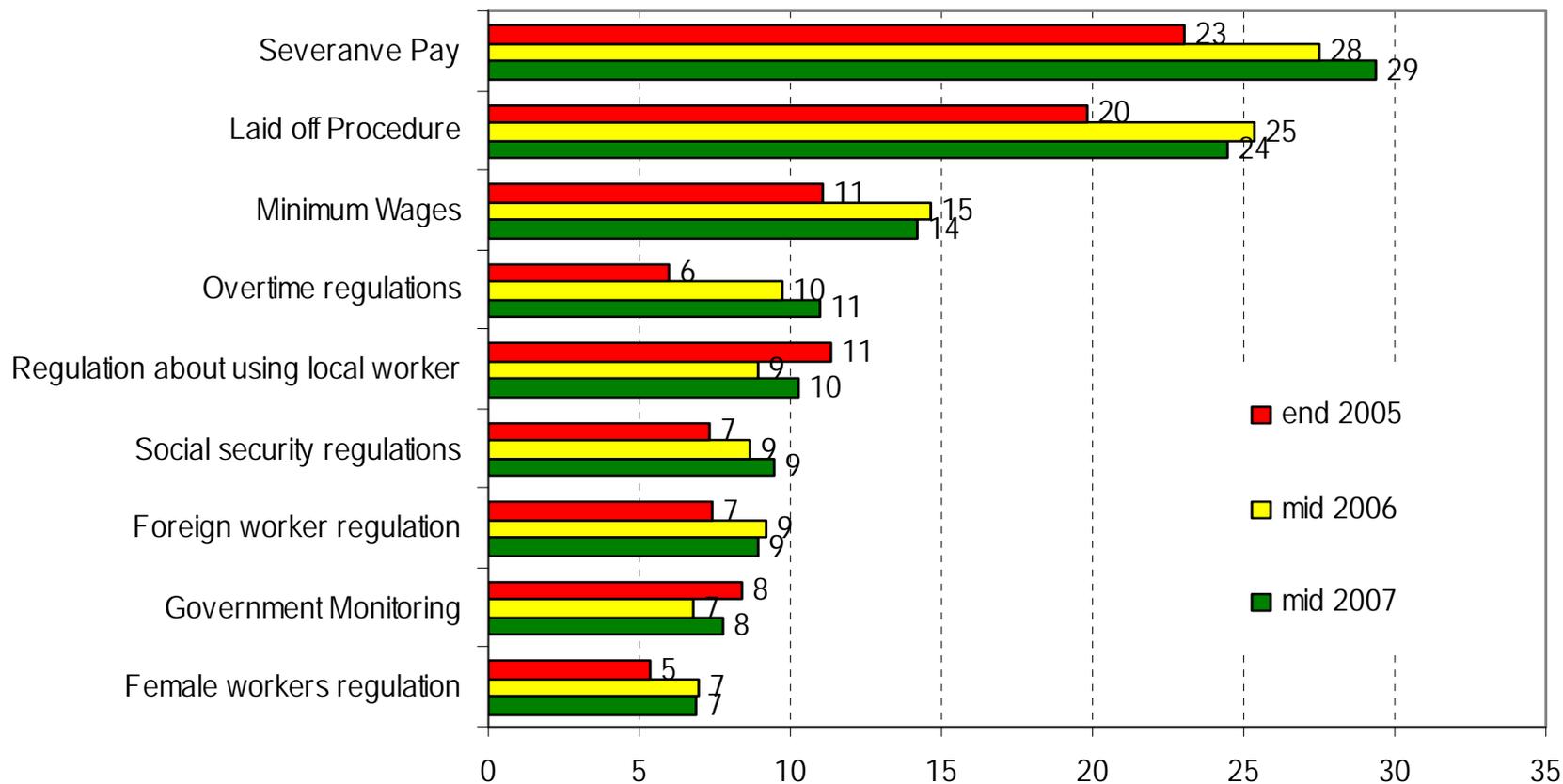
PPP

- ◆ Establishment of Risk Management Unit
- ◆ Risk Sharing Schemes
- ◆ Infrastructure and Land Fund



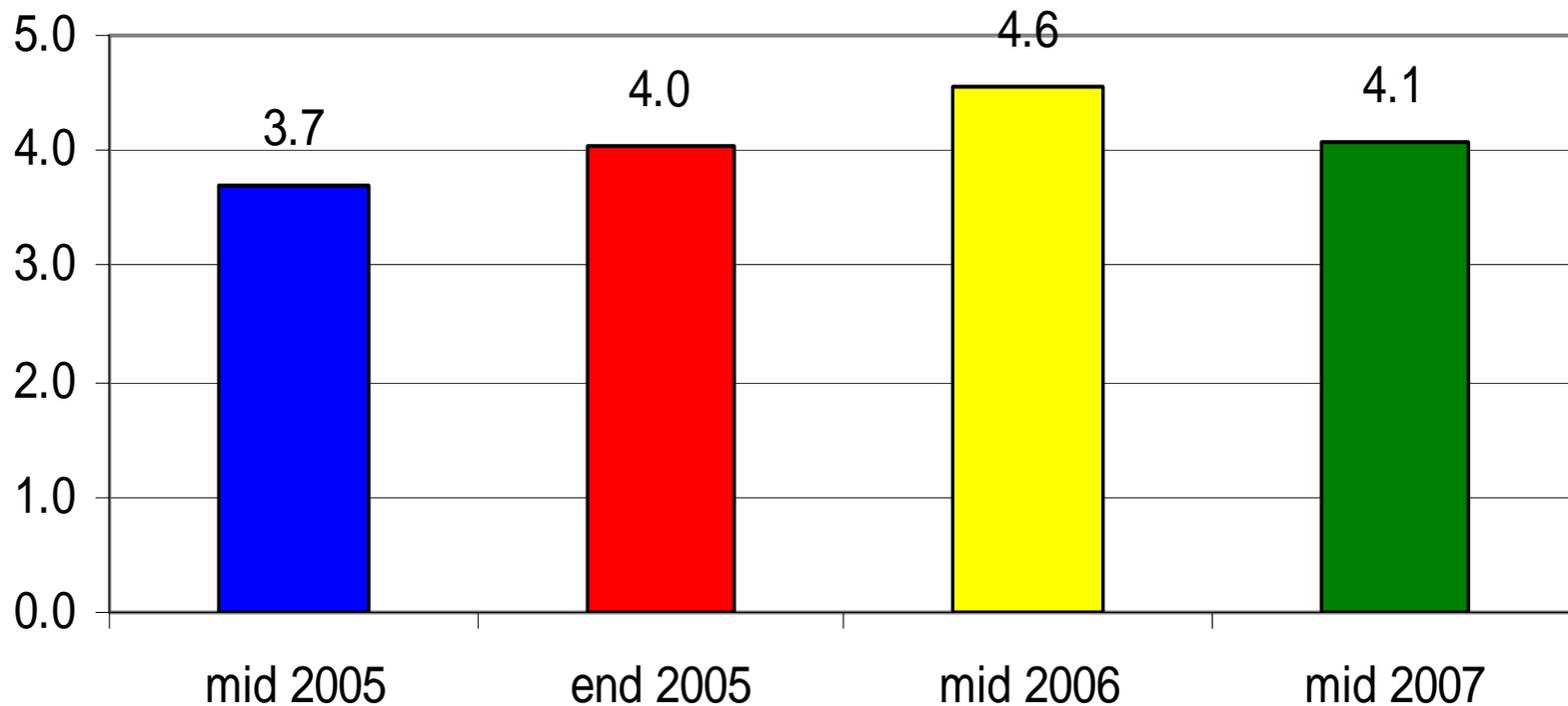
Severance pay and lay-off procedures are still the biggest obstacles

Percentage of respondent reporting labor regulation to be severe and very severe constrains



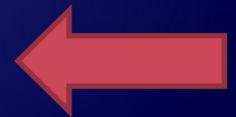
Cost to handle labor problems decreased slightly

Cost to Handle Labor Problem as % of total production cost



Labour market

- ◆ Severance payment acts as hiring tax
- ◆ 2007 is very critical
- ◆ Politically sensitive



AGENDA
ECONOMIC GROWTH STAKEHOLDER'S WORKSHOP
KOTA BUKIT INDAH, PURWAKARTA, JULY 8-10, 2008

Day 1 - OPENING

- 15:00 Leave Jakarta (U.S. Embassy, Jl. Merdeka Selatan) by bus
17:00 Arrive at venue, check in
- 18:30 Dinner: Riung Graha
- 19:25 Introductory Remarks by John Packer, USAID
19:30 Opening Remarks by Walter North, USAID Mission Director
Opening Remarks by Slamet Seno Adji, Deputy for Economic Affairs, Bappenas
- 19:50 Key Note Speech:
Prof. Gustav Papanek on "*Emerging Economic Issues in Indonesia*"
President of the Boston Institute for Developing Economies (BIDE) and
Professor of Economics Emeritus at Boston University
- 20:10 Q & A Session led by Rafael Jabba, USAID

Day 2 – SUBSTANTIVE DISCUSSIONS

PLENARY SESSION

- 08:00 Opening Remarks by John A. Pennell, Economic Growth Director
- 08:10 Q & A Session and Follow-up from Day 1 evening led by Rafael Jabba, USAID

BREAK-OUT SESSIONS (by subject areas)

- 08:30 Session I: Identify key issues & constraints
- 10:30 Morning break
- 10:45 Session II: Discuss Government of Indonesia Plans
- 12:00 Lunch Break
- 13:00 Session III: Develop strategic ideas to address key constraints to Indonesia's development

- 15:00 Afternoon Break
- 15:15 Session IV: Findings, Recommendations, and Write-up
- 18:30 Dinner
- 19:30 Key Note Speech:
Dr. M. Chatib Basri on “*Indonesian Employment and the Policy Issues*”
Director, Institute for Economic and Social Research (LPEM),
Faculty of Economics, University of Indonesia
- 20:00 Q & A

Day 3 – CONCLUSIONS & WRAP-UP

PLENARY SESSION

- 08:30 Opening by Firman Aji, USAID
- 09:00-10:00 Findings from Break-out sessions: Groups 1 - 2
- 10:00-10:15 Morning Break
- 10:15-11:45 Findings from Break-out sessions: Groups 3 - 5
- 11:45 Summary of the Workshop and Closing Remarks by John Pennell, USAID
- 12:00 Lunch
- 13:00 Return to Jakarta

SUBJECT AREAS (Facilitators):

1. Agriculture (Pantjar Simatupang, AMARTA)
2. Business Development (David Ray, SENADA)
3. Financial and Non-Financial Sector (Harry Wheeler, SECID)
4. Trade and Investment (Ardimas Sasdi, ITAP)
5. Cross-cutting Issues (Akhmad Safik, University of Indonesia School of Law)

Annex 4: Presentations by Sector

AGRICULTURE

Enhancing Economic Growth through Agricultural Development

**ECONOMIC GROWTH STAKEHOLDER'S
WORKSHOP**

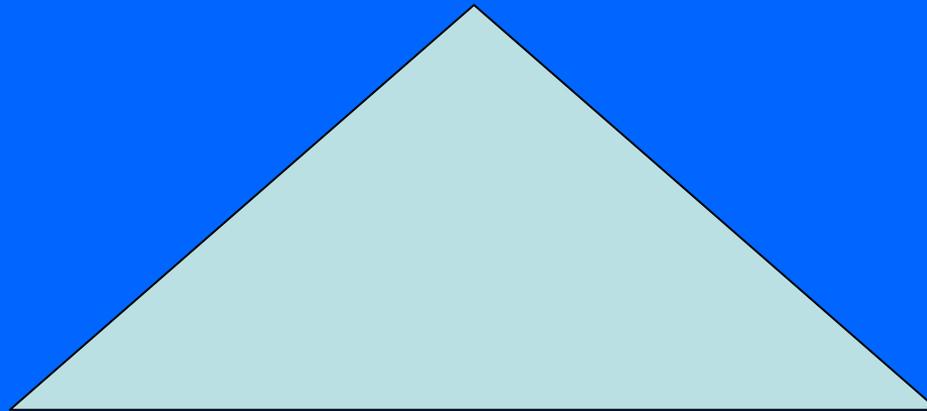
JULY , 8-10, 2008

I. BACKGROUND

✓ Strategic roles of agricultural sector

social roles :

- national resilience
- food security



economic :

- Income
- job creation
- Foreign exchange earning

Environment

- water availability
- biodiversity
- Forest conservation

Background (continued)

- ✓ **Agricultural Strategic Roles proven during multi-crisis: Accelerating growth**
- ✓ **Agricultural sector as a prime mover of Indonesian Economic growth.**
- ✓ **Seemingly declining quality of economic growth. Despite robust economic growth, basic indicator of social welfare remain bleak.**
- ✓ **Growth without job**
- ✓ **Persistent high poverty incidence: 15.42%**
- ✓ **Persistently high unemployment**

Background (continued)

- ✓ Strong Agricultural foundation will create strong economic growth foundation
- ✓ Dynamic international situation influent Indonesian agricultural sector:
 - (1) market liberalization and unfair trade practises ;
 - (2) change in agricultural production management;
 - (3) focus on food (and energy) security and poverty alleviation; and
 - (4) Information technology revolution.

Background (continued)

- ✓ **Dynamic national situation:**
 - (1) Rocketing Food (and Fuel) Prices;**
 - (2) Agricultural Input (water, seed, fertilizer) scarcity and its quality degradation;**
 - (3) decentralization and private sector participation**

TANTANGAN PEMBANGUNAN PERTANIAN

PASAR DAN TATA NIAGA

INFORMASI

KEPEMILIKAN LAHAN

KEBIJAKAN

BIROKRASI DEPTAN

PETANI

**NASIB PETANI
INDONESIA**

MODAL

ORGANISASI TANI

KETERAMPILAN

MENTALITAS

TEKNOLOGI



- ✓ *Long-term agri Development vision
To Perform competitively Sustainable
Agro-industrial system which is able to
guarantee national food security and
farmer welfare.*

Longterm Policy Formulation 2005-2025 :

- (1) Improving Farmer Participation;
- (2) Increasing production capacity and productivity ;
- (3) Realizing qualified agricultural human resources ;
- (4) Realizing Rural Infrastructure;
- (5) Realizing agricultural financial system;

Continued

- (6) Enhancing Farmer Innovation;
- (7) Providing incentive and protection for the farmer;
- (8) Diversification and developing one village on products (OVOP);
- (9) Developing domestic resources based rural agroindustry ;
- (10) Realizing Supply-chain system;
- (11) Implementing Good Agricultural and Manufacturing practises;
- (12) Performing Good Governance Practises.

Government plan on agriculture Development 2005-2025.

Targets:

- (1) Agricultural development based on rural industrial development;**
- (2) Food security based on food estate;**
- (3) Job creation on Agricultural sectors ; and**
- (4) Poverty Eradication in agriculture sector with farmer income achieving US\$ 2500/ cap/year.**

AGRICULTURAL DEVELOPMENT IN THE MID-TERM 2005-2009.

- ✓ OBJECTIVES ;
 - (1) Poverty alleviation;
 - (2) Unemployment Reduction;
 - (3) Increased Competitiveness;
 - (4) Food Security;
 - (5) Rural Development;
 - (6) Reducing Development Gap ;
 - (7) Sustainability of the agricultural development;
 - (8) Environmentally approach

✓ Agricultural Development Agenda (Mid-term):

- (1) Agricultural Revitalization
- (2) Increasing Investment and non-gas & oil export;
- (3) Supporting macro economic stabilization;
- (4) Poverty alleviation;
- (5) Rural Development; and
- (6) Natural Resources and sustainability approach.

✓ Agricultural Revitalization :

- (1) Increased Rice production more than 90 Percent of domestic demand (Indonesia has potency to become rice, corn and sugar exporter);
- (2) Food and energy diversification program;
- (3) Availability of protein resources;
- (4) Increasing value Added and competitiveness;and
- (5) Enhancing production and export of agricultural products including horticultural products.

Lesson learns

- **United States Experiences:**
- Run by Private Sectors (less intervention by government)
- Strong Producer Association
- Effective Lobby to government policy makers
- Strength support through imperative government policies :
- Fiscal Policy to survive farmers
- Agricultural extension services
- Land Grant University for Research and extension
- Market Information Services.
- **European Union:** Priviledge Policy for the farmer

Key issues and constraints

1. Salient features of agricultural enterprises:
53.29% are marginal farmers
2. Slowing growth rate of arable land
3. Declining irrigation infrastructure capacity and growing water scarcity

Key issues and constraints (con)

4. **Seemingly saturated technology innovation and ineffective extension system**
5. **Lacking of agriculture and rural infrastructure: rural road and marketing facilities**
6. **Lacking access to credit**
7. **Poor governance: policy implementation failures, disharmony and lack of synergy and coordination**

Strategic ideas:
strength gov. policy need:

Support needs in the area of:

1. Independent and strong Farmer Organization/Association
2. Market Information system
Infrastructure and processing and marketing facilities
3. Financial Intermediaries

Strategic ideas (continued)

- 4. Research and Extension Services
- 5. Agro-industry development for rural job creation
- 6. Effective and Efficient Policy Formation and Implementation
- 7. Good Governance Practices

Recommendation for USAID

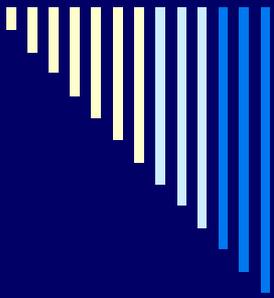
Policy/regulation Reforms and advocacy from farmers to local and central government resulting Institutional Reform on extension and research services.

Establishing/empowering professionally farmer organizations/ associations by capacity building through training program and comparative study to the success areas.

Recommendation for USAID

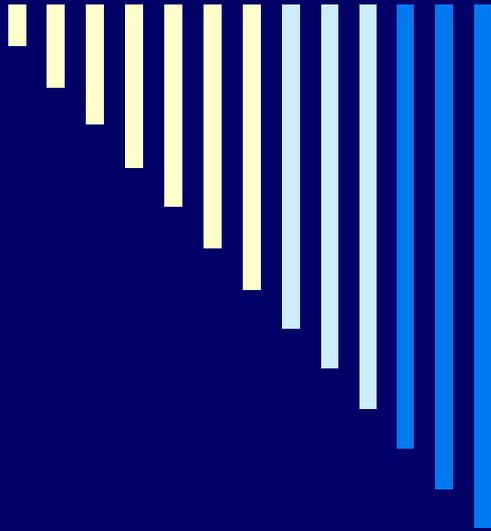
- Improving value added for agricultural products which have market value through technical assistance on processing, packaging, certification and branding.
- Promoting rural infrastructure (irrigation, rural road and telecommunication, electricity) development to local government through advocacy and effective lobby by farmers associations.
- Improved workable access to financial credit for farmers associations.

Terima Kasih



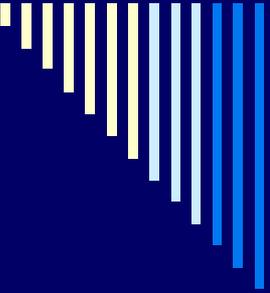
Annex 4: Presentations by Sector

BUSINESS DEVELOPMENT



Business Development

Facilitator:
David Ray, Senada

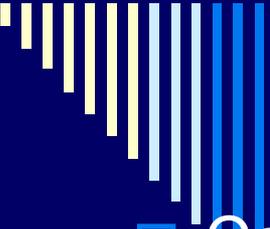


Issues & Constraints

- Human resources
- Energy
- Transportation infrastructure
- Micro - finance
- Environmental issues

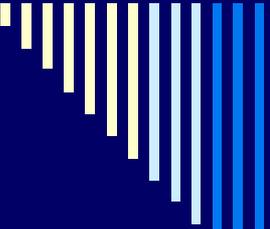
Key cross cutting themes

- land
 - community/local private sector initiatives
 - procurement/corruption concerns
-



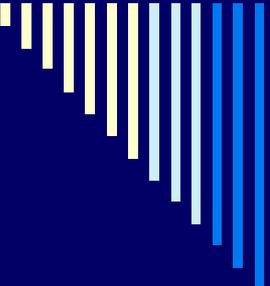
Human Resources

- Concerns about existing models of training
 - government (budget) driven, not demand driven to match with industry needs, poor quality
 - unsustainable – not being carried out on a market basis. Business expect subsidy not prepared to pay.
 - New models of training required
 - Market based – building market institutions. Donor could play catalytic role (not direct provision).
 - Existing programs: Use of vouchers – move from subsidy to market-based provision
 - Others: development of vocational schools, embedded value chain training/knowledge transfer, Database of training programs, inventory of business needs
-



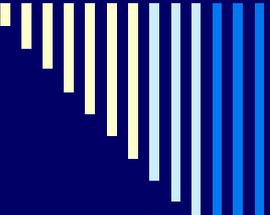
Energy

- Concerns about increasing costs, lack of transparency in the provision and distribution of electricity
 - Encourage the development of local electricity through community based green initiatives (biofuel, wind power), and sell surplus to others in the region or into the main grid. Assistance may focus on
 - Technology/knowhow (reducing costs of conversion)
 - Replication to larger scale
 - Connectivity to grid
 - Institutional/regulatory constraints
 - Assistance with start-up risks
-



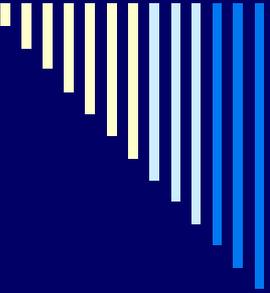
Transport Infrastructure

- 2 primary concerns: roads and ports
 - Roads: key challenge is to overcome various constraints to new investment/provision
 - New mechanisms to assist with land acquisition (*pembebasan tanah*), address speculation problems
 - Investment facilitation, explore Sharia/Sukuk financing
 - Assist local governments with investment implementation (rather than keep funds in bank accounts)
 - Other issues: addressing congestion in major cities through travel demand management programs (congestion pricing, public transport etc)
 - Ports: new opportunities to promote investment and greater competition through the new shipping law
-



Access to (Micro)finance

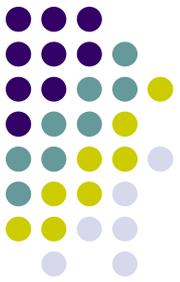
- Move away from traditional direct provision models – already over 80,000 MFIs in Indonesia. No need for me, rather develop/enhance what is there
 - Key regulatory issue is *RUU LKM* -microfinance law, which will allow MFIs to mobilize lower cost funds (hence will be able to provide lower cost loans).
 - Generate necessary momentum to push through parliament, then disseminate
 - Assist with prudential regulation/oversight
 - Assist with ratings of MFIs
 - Angel investors – intermediation, information, build market necessary market infrastructure
-



Environmental Issues

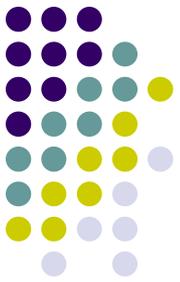
- Measures to translate environmental constraints/issues into business opportunities (eco-business)
 - better use and development of green certifications –
 - group based volume discounts,
 - land area/zone based certifications,
 - development of certifier supplier market
-

Annex 4: Final Presentations by Sector



CROSS-CUTTING ISSUES

****REVISED DRAFT ONLY****



USAID
FROM THE AMERICAN PEOPLE

INDONESIA

CROSSING CUTTING ISSUES: HOW ENERGY MEETS ECONOMIC DEVELOPMENT FOSTERED BY COOPERATION



CROSS CUTTING ISSUES/ PROBLEMS:

INFRASTRUCTURE

- 1. ENERGY**
- 2. AGRICULTURE-food security/issues, irrigation development**
- 3. Land Acquisition**

B. LABOR/HUMAN RESOURCE DEVELOPMENT (vocational training)

C. CORRUPTION, TRANSPARENCY, ACCOUNTABILITY

TIME FRAME:

- SHORT TERM (0 to 5 yrs); AND**
- LONG TERM (5 to 10 yrs+) VIABILITY,National focus- policy, reforms**



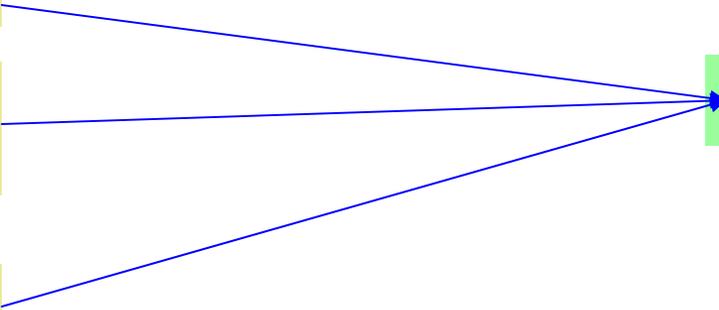
CROSS CUTTING ISSUES/ PROBLEMS:

1. INFRASTRUCTURE

2. LABOR-vocational training

3. CORRUPTION

ENERGY





SUMMARY:

**NEW STRATEGIES: Next Five years-
Where, when, what, and how?**

- Lower the carbon intensity of development path while maintaining acceptable levels of macro, micro, and sectoral growth.
- Estimate the financing needs, and economic impacts of shifting to cleaner carbon energy development paths
- Outline mechanisms for achieving it, Investment, incentives, financial and economic policy initiatives



USAID
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INDONESIA



KEY CONSTRAINTS/ISSUES

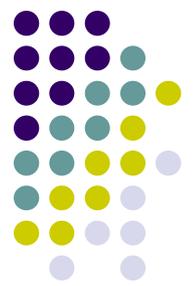
A. NATIONAL LEVEL PROBLEMS —

- a. **Indonesia's Supply and Demand imbalance**, Energy Structures-oil, gas, and coal, and current Government of Indonesia (Ministry of Energy and Mines, and Ministry of Finance Plans)—for Diversifying National energy plan to broaden the need to supply the energy portfolio-addressing climate changes
- b. **Energy Diversification Problem**: Problem with Indonesia's oil dependence
- c. **Bad Governance**--Transparency, Corruption, Accountability complications
- d. **Regulation and deregulation**—current subsidy--pricing, deregulation
- e. **Bureaucracy Complications**
- f. **Electricity Sector Reform and Plans**-Challenges, shortages, and geopolitics

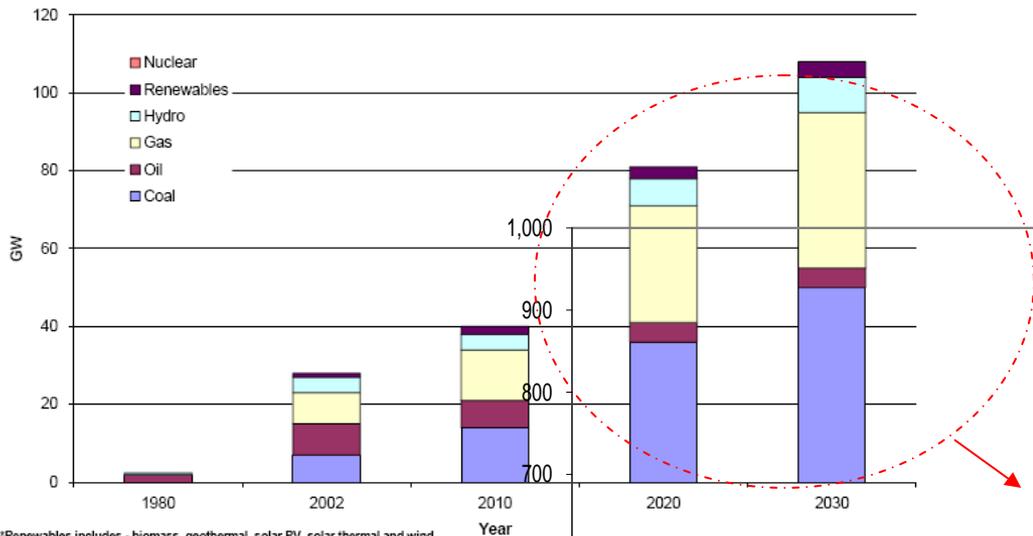
B. LOCAL COMMUNITY LEVEL, CITIZEN PROBLEMS—

- a. Off-grid electricity problems and complications
- b. Local Corruption
- c. Land Acquisition (property) for public energy purposes

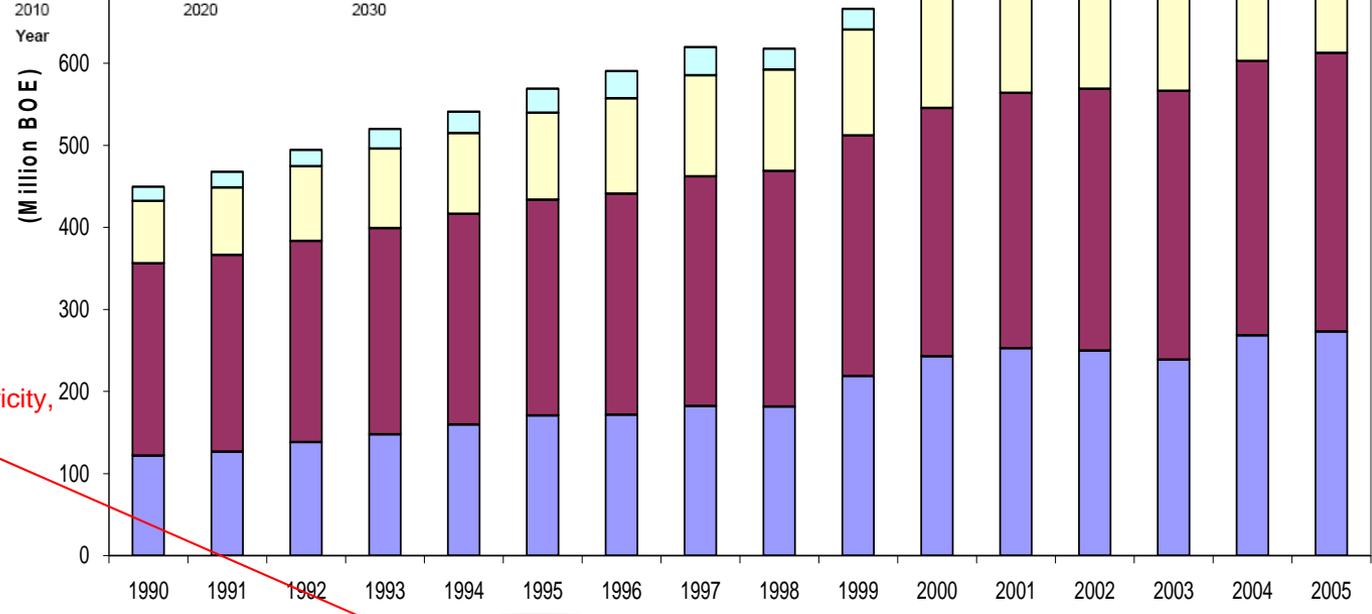
Reason : Indonesia's Electricity Demand



m) Electricity installed generation capacity



*Renewables includes - biomass, geothermal, solar PV, solar thermal and wind



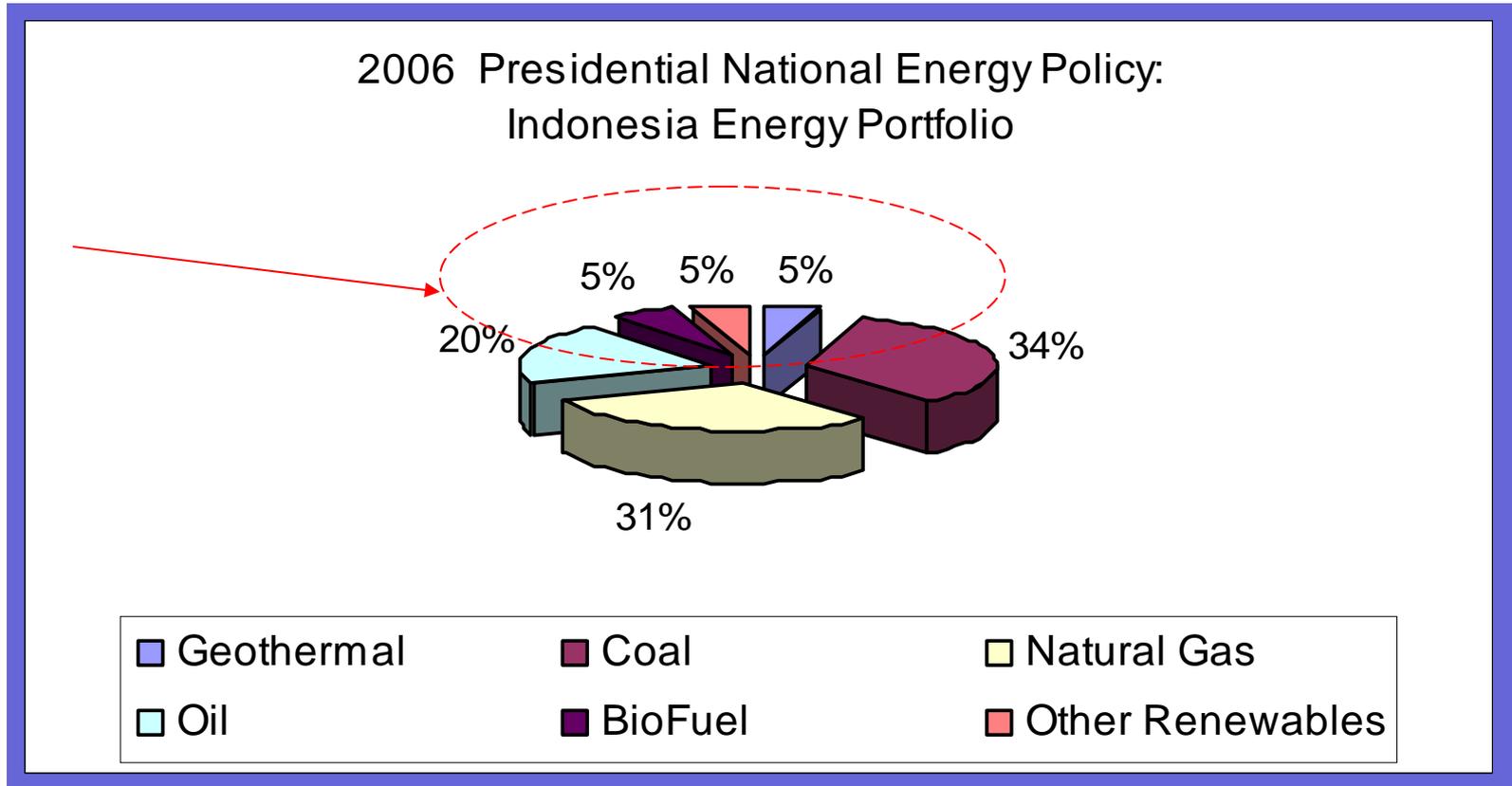
Nearly 70% of use will require input of electricity, meaning natural gas and coal production

Industry Households & Commercial Transportation Others



GOI's Objective:

GOI is willing to listen to Aid agencies for cleaner energy resources now than in the past when oil was abundant and cheap which resulted in our USAID programs to fail on energy reform. Private organizations are willing to invest when necessary regulation and policies are in place for easier and faster way of doing business is available.



D TO FOCUS ON WHERE INDONESIA'S ADVANTAGE

UNCOMMITTED NATURAL GAS RESOURCES [1] SELECTED POTENTIAL EXPORTING COUNTRIES INCLUDES UNCOMMITTED RESERVES, DEFERRED RESERVES AND UNDISCOVERED RESOURCES

TCF

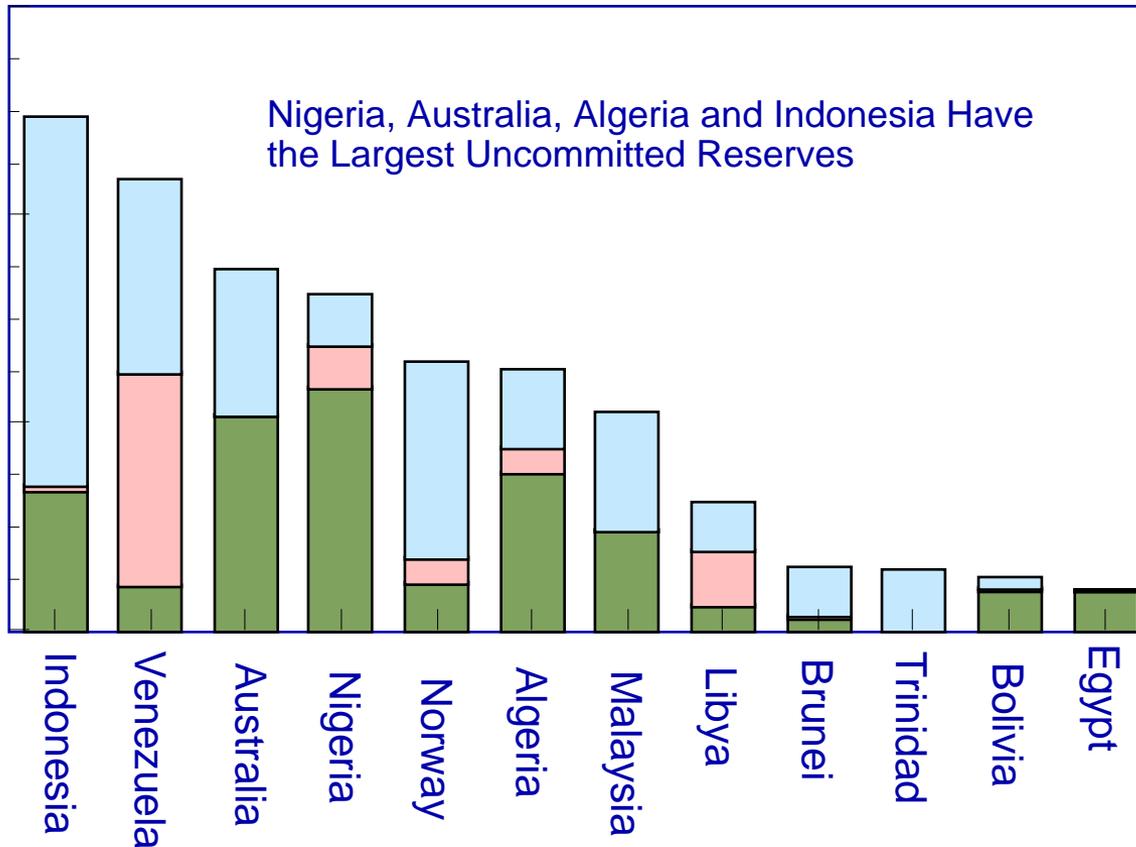
Note: As a unit of volume, 1,728 cubic inches. As applied to water, 7.48 gallons. As applied to natural gas, the volume of gas which, when saturated with water vapor at 60°F and at a pressure of 30 inches of mercury occupies one cubic foot of volume.

300

200

100

0



TRILLION CUBIC FEET AS OF 12/31/2005

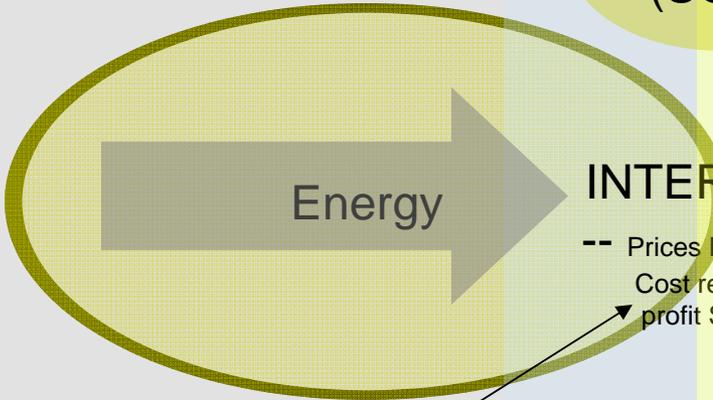


New Short Term Framework: WHERE USAID CAN HELP

PRIVATE to bring in PRACTICE

PUBLIC to implement POLICY

Gov. of Indonesia
(SOEs)



INTERESTS

-- Prices Mechanism,
Cost recovery,
profit Sharing

NGOs,

International
Energy
Companies

US ASSISTANCE: CLEAN
ENERGY RESPONSIBILITY
INITIATIVE



Past USAID Recommendation

1. Energy Sector Policy/Restructuring and Capacity Building
1. Electricity Sector Reform
1. Oil and Gas Sector Restructuring
1. Energy Sector Subsidies Targeting and Price Reform
1. Supply Side Efficiency
2. Demand Side Efficiency
2. Renewable Energy Policy Support
2. Air Quality Improvement Program
3. U.S. Utility Partnership Program

The interventions are divided into two broad areas: (1) Energy Sector Restructuring and Regulatory Reform; and, (2) Urban and Environmental Management. Indicators are discussed for each of these areas.

Source: USAID Indonesia Energy Strategy for Sustainable Growth Report 1999



Recommendations

1. Energy Sector Policy/Restructuring and Capacity Building
1. Electricity Sector Reform
1. ~~Oil and Gas Sector Restructuring~~
1. ~~Energy Sector Subsidies Targeting and Price Reform~~
1. ~~Supply Side Efficiency~~
2. ~~Demand Side Efficiency~~
2. Renewable Energy Policy Support
2. ~~Air Quality Improvement Program~~
3. U.S. Utility Partnership Program

Incorporate Assistance that would enhance more policy dialogues between the GOI and Private Energy corporation while emphasizing the need for CLEAN ENERGY Responsibility Programs that incorporate initiatives and practices

The interventions are divided into two broad areas: (1) Energy Sector Restructuring and Regulatory Reform; and, (2) Urban and Environmental Management. Indicators are discussed for each of these areas.

USAID programs that would increase funding for US-INDONESIA Energy Professional Vocational Training, Experts Dispatch to educate Indonesian energy experts on best practice models, pricing mechanism, better availability of statistics and analysis of data

New Framework: Short Term Approach

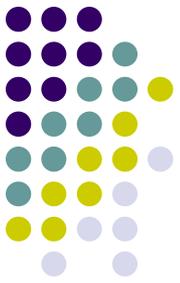


CLEAN ENERGY RESPONSIBILITY INITIATIVE:

THREE COMPONENTS

- 1) National policy level: US Expertise and Technical Transfers--mobilize appropriate energy professionals for consulting, advising, technical transfers of US knowledge to GOI national government on pricing, regulation laws, contracts, bureaucracy, energy conservation, etc.
i.e. Clean Technology Fund
- 2) Regional Level: SMEs Development and Financing for Rural Energy projects/ Communities
- 3) *Community-citizen Level*: efficiency, incandescent light bulbs, clean energy development projects—UNDP on Micro-Hydro spends 20.5 million dollars. Currently, almost estimated 18 million dollars is coming from GOI side to develop these projects.

New Framework: Short Term Approach



Examples:

Public and Private side in Indonesia has trouble in deciding the appropriate Pricing:
Federal Energy Regulatory Commission FERC– to give knowledge sharing, best practice/lessons learned for electricity reform.

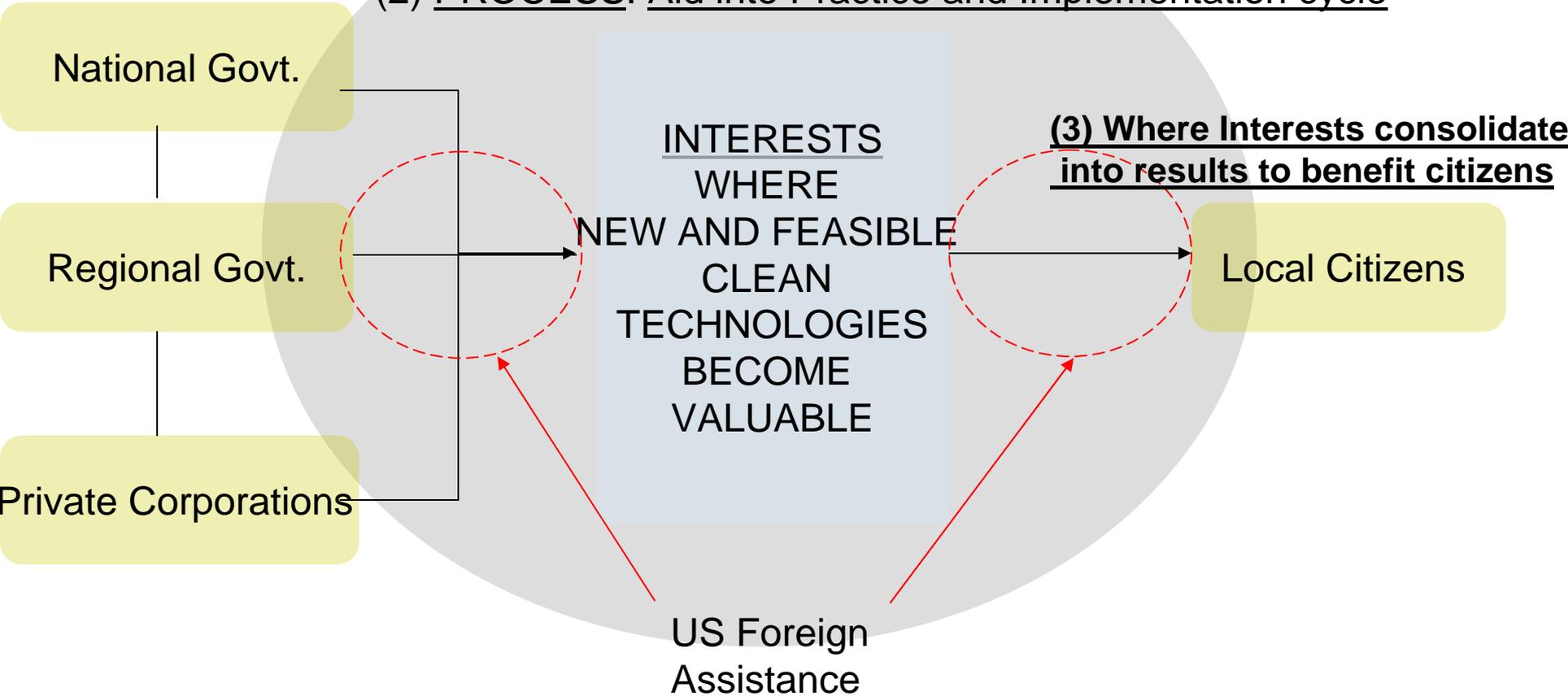
Statistics/data--Energy Information Administration (EIA): energy information statistics is pivotal for transparency, informative on decision-making on all levels of government on energy policy, and accountability. There are no unified strategies for GOI and this is coupled with many discrepancies between the GOI on statistics. Need for clearer and unified system and integration--US knowledge sharing to build and improve GOI role.



SHORT TERM FRAMEWORK USAID CAN HELP

(1) Collaboration

(2) PROCESS: Aid into Practice and Implementation cycle





LONG TERM APPROACH: AID NOT IN DIRECT PROCESS OF SUPPLY, BUT ASSISTING THE PROCESS WHERE THE ENERGY PLAYERS HAVE AGREEABLE INTERESTS TO PURSUE IN DEVELOPING RESPONSIBILITIES TO BRING CLEAN ENERGY TECHNOLOGIES VIABLE FOR ECONOMIC GROWTH AND ENVIRONMENT.

Aid Contribution in three phases:

(1) Collaboration

(2) Aid into Practice and Implementation cycle

(3) Interests of public private would benefit citizen level



**CLEAN ENERGY
RESPONSIBILITY
INITIATIVE**



POINTS SUMMARY: Short and Long Term Approach

USAID SHOULD IMPLEMENT CLEAN ENERGY RESPONSIBILITY PRACTICUM TO SHORT AND LONG TERM APPROACHES AS FOLLOWS:

✓ SHORT TERM APPROACH: STRESS FOR POWER SECTOR REFORM, FACILITATE BETTER UNDERSTANDING PUBLIC-PRIVATE PLAYERS THAT WOULD BENEFIT IN PRO-POOR GROWTH

✓ LONG TERM APPROACH: FACILITATE THE PROCESS IN WHICH INDONESIA'S EFFORT IN ADOPTING AN INFRASTRUCTURE NECESSARY TO DEVELOP AND IMPLEMENT CLEAN TECHNOLOGY OPTIONS:

i.e. clean technology fund, micro-hydro power, geothermal

Annex 4: Presentations by Sector

FINANCIAL & Non-FINANCIAL SECTOR



FINANCIAL & NON-FINANCIAL SECTORS



I. KEY ISSUES/CONSTRAINTS:

1. More investors are needed (broader spectrum investor vehicles)
2. Limited number of buyers (regulation/tax hurdles)
3. Government emphasizes Banking over NBFIs
4. Long term financing needed
5. Disincentives/Lack of Incentives
6. Limited role of local bank (BPD = Bank Pembangunan Daerah)
 - Capacity Building (network/microcredit)
 - Central Bank vs. NBFIs (should be one resources)
 - No regulation – micro/cooperatives
 - Micro – where resides – across the board / freedom

I. KEY ISSUES/CONSTRAINTS:

7. Development Bank
8. Insurance/source/misunderstood/social safety net
9. No 3rd party liability law
10. Information system
 - Lack of business data
 - Standardization
 - Project Management
 - HRD/Training
11. Level playing field

I. KEY ISSUES/CONSTRAINTS:

11. Information availability

- Access/overview
- Sharing of data – financial statement

13. BPD / Big Brother / Rural Bank – only in limited areas in Indonesia

14. Insurance has small penetration of market—market potential is vast

15. HRD/Capacity

- Not enough trained person
- Early warning system

16. Too much regulations

II. GOI PLANS

1. Financial Sector architecture
2. Early warning system (includes practitioners) – 2 years
3. Role of financial sector (NBFIs) on microfinance policy– 2 – 5 years
4. Enforcement of anti money laundering
5. Level playing field in broad market
6. Strengthen the weak regulatory body of NBFIs – 2 – 3 years for regulations that are easier to change
7. Enforcement
8. Political will

III. STRATEGIC IDEAS TO ADDRESS KEY CONSTRAINTS

1. Insurance strengthening programs: (Socialization)

- Study the needs of policyholder protection/consumers/investors
- Introduction concept of insurance at school curriculum
- Public awareness campaign and to give incentive for buyers to buy
- Develop a long term financial instruments (pension fund, insurance firms)
- Examine Incentives for buyers to buy

2. Enhancing staff:

- Attending training of IAIS (International Association of Insurance Supervisors)
- Develop a risk-based provisions (skillsets)

3. Policy issues

- Incentives for industries to develop systems/new product
- Accounting changes – 2 years

III. STRATEGIC IDEAS TO ADDRESS KEY CONSTRAINTS

4. STIMRA to be operated beyond Jakarta

5. BPD:

- Strengthened in countrywide
- Credit info system (for smaller institutions) to be reliable and set standard (3.5 – 5 years)

6. Pension Fund

7. Strengthen Financial Capital Markets

8. Role of Rating Agency

9. Factoring Company (Intermediary) to help with Finance

10. Mindset of people to be changed re Banking and NBFIs

III. IMPORTANT OTHER SERVICES INDUSTRIES IN INDONESIA

1. Tourism

- Eco tourism
- Foreign language
- Promotion
- Job creation
- Security
- Foreign Exchange
- Labor Intensive

2. Health Sector

IV. PRIORITIES

1. Generate capital to maintain financial sustainability
 2. Promote life insurance / pension / venture capital / NBFIs
 3. Strengthen and enforce regulatory environment
 4. Establish micro finance regulatory framework
 5. Support other services sector
 6. Build capacity
- 

PRIORITY 1:

Generate capital to maintain financial sustainability

- a. Broaden investor base
- b. Encourage long term financial institutions with incentives relative to tax / accounting / regulatory
- c. Support regional / city borrowing
- d. Develop borrowing strategies

PRIORITY 2:

Promote life insurance / pension / venture capital / NBFi

- a. Introducing concept of insurance
- b. Public awareness campaign
- c. Study policy holder protection plan/consumers/investors
- d. Qualified staff and distribution to serve public agencies
- e. Consolidate under one roof – general/social/life/etc
- f. Support BAPEPAM – LK (Real time data and actuarial soundness)
- g. Create products to meet the needs of majority of citizens
- h. Provide incentive for purchase
- i. Create intermediary mechanism export / investor

PRIORITY 3:

Strengthen and enforce regulatory environment

- a. Strengthen quantity and quality of regulatory staff
- b. Education on best practices
- c. Revisit the standards structure for oversight within the current laws
- d. Consolidate regulations by sector issues under 1 roof
- e. Enhance data availability – market/earning statement/balance sheet/transaction
- f. Guarantee uniform enforcement and supervision
- g. Protect policy holder/investor/consumer
- h. Create regulatory environment for microfinance

PRIORITY 4:

Establish micro finance regulatory framework

- a. Coordination among ministries and NGOs for standardization and lessons learned
 - Home Affairs
 - Bappenas
 - MoF
 - BI
 - Cooperatives
 - etc
- b. Examine possibility for BPD to enhance microcredit with regions (e.g. BPD as apex bank, standardization system among BPD)

PRIORITY 5:

Other service industry:

- a. Tourism
- b. Health



PRIORITY 6: CAPACITY BUILDING

- a. Early warning system
- b. Not enough trained personnel
 - In middle and upper level
 - To meet legal requirements currently established
 - Best practices of regulator
 - Geographic training facilities

- Annex 4: Presentations by Sector

TRADE & INVESTMENT

A faint, stylized background image of two hands shaking, symbolizing agreement or partnership, set against a teal gradient background.

USAID | Indonesia
“Accelerating Economic Growth in Indonesia”
Economic Growth Office Stakeholders’ Workshop
8 – 10 July 2008

Break-Out Session

TRADE & INVESTMENT

KEY ISSUES ON INVESTMENT

- Legal Uncertainty including local regulation (*PERDA*) which is not conducive to the investment climate.
- Labor Inflexibility.
- Land Acquisition.
- Transparency (Spreading virus of corruption).
- Poor Infrastructure.
- 5-10 years planning to direct investment on food, energy and infrastructure.
- High labor cost but comparatively low skill

KEY ISSUES ON TRADE

- Lack of Capacity Building for SMEs
- Access to information and knowledge among medium size and big firms (market information)
- Technical Barriers for export oriented products
- Logistical Problems for agricultural products, i.e.: providing the cold storage warehouse
- Unsupportive *PERDA* on inter provinces and regencies transportation
- Public Procurement Reform
- Competitiveness of Indonesian Products

Government of Indonesia's Plans on Trade

1. Public Service
 - 1.1. National Single Window (on-trial operation)
 - 1.2. Faster and Transparent Licensing Procedure
 - 1.3. Safeguard on eco-labeling, standardization, illegal transshipment for garment, footwear and shrimps
2. Trade & Investment Promotion
 - 2.1. Small & Medium Enterprise's products
 - 2.2. Priority for certain market
 - 2.3. Market Diversification/Expansion
 - 2.4. Trade Expo
 - 2.5. Capacity Building for SME: training and international exhibition

Continued

3. Developing Blueprint for Creative Economy
4. Free trade among ASEAN countries and FTA with Japan, India, US, and Australia (in the pipeline)
5. Development of economic zones (Batam, Bintan and Karimun)
6. Market penetration (opening of 11 ITPC and trade promotion offices abroad)
7. Trade show with Asmindo and other associations
8. Warehouse receipt system

Government of Indonesia's Plans on Investment

- General Guidance on Investment with focus on investment, promotion and facilities, scheduled to be finished in June 2008 and followed by Road Map at the end of this year.
- Finishing implementing regulation of Investment Law.
- Implementing regulation on one stop shopping due in 2008.
- Special Economic Zone (Batam, Bintan and Karimun), draft law to be submitted to the Parliament on fiscal and non-fiscal. On-line system consist of Information and Licensing.
- Promotion.

Areas for USAID to work for

- Innovative promotion plan
- Development of economic zone
- Staff capacity building for investment services
- Creation of models of incentive system for certain industry.
- Provision of legal assistance with ITAP as model approach

CHALLENGES AHEAD FOR INDONESIA

- Drafting/Reviewing Investment Law, Labor Law and Corporate Law
- Capacity Building to Local Government and National Government on Transparency and Corruption Fighting
- Drafting of Law on Land Acquisition for Public Interest
- Developing Website to create access to information for SMEs to encourage direct export

Continued

- Adoption of ISO components to address the problem of technical barriers for SMEs
- Drafting Law on Public Procurement to comply with WTO
- Addressing issue of alternative energy with declining resource of oil and gas (the government should focus on bio-fuel)

THANK YOU

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