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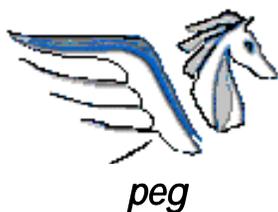
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Technical Report

Summary Report: Survey on Decentralization and the Business Climate

By David Ray



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KEY POINTS AND CONCLUSIONS FROM THE SURVEY¹

- There has been no major degradation of the business climate under decentralization. At the same time we have not seen any significant improvement. The general response from business is that the regulatory environment remains as problematic as it was prior to decentralization.
- The business-licensing environment has more or less remained the same. There appears to be an improvement in processing time required and to a lesser extent, in procedural and cost transparency. However these improvements are offset by higher licensing costs as local governments seek to raise own-source revenues (PAD), most likely through the pricing of licenses/permits (*retribusi izin*) beyond that required for cost-recovery. One salient point regarding licensing is that almost half the respondents report that they are still paying informal facilitation or brokerage fees to officers in the licensing-issuing agency.
- Most small and medium sized respondents perceive substantial increases in formal taxes and charges paid, but no change in the number of exactions, nor the number of exacting agencies. This suggests local governments are extracting greater amounts of funds from existing revenue instruments as opposed to creating new ones (i.e. intensification instead of extensification). Larger firms report increased amounts exacted formally, and also greater number of formal exactions and collecting agencies.
- The burden of informal payments (*pungli*) appears to have slightly eased under decentralization., particularly in East Java, but worsening in North Sumatra and North Sulawesi. Increases in the burden of informal payments are positively correlated with firm size. Larger firms report greater amounts, frequency and number of exacting agencies or individuals. Informal exactions are most commonly imposed during transport and/or distribution. Most respondents prefer to absorb the cost of informal exactions rather than passing it on to suppliers or buyers.
- Given the structure of the sample in favor of small businesses, most respondents report no impact from minimum wage increases nor from severance pay stipulations.
- The business climate has remained the same or shown a slight improvement for all sectors, except for transport. This result is consistent across a number of measures (e.g. licensing, informal exactions, service delivery, impact of local regulations etc).
- There appears to be a slight improvement in business perceptions on the impact of local regulations upon the business climate (under decentralization).

¹ This summary report and the “Key Points” page were prepared by David Ray, Domestic Trade Advisor to the Ministry of Industry and Trade (MOIT), PEG Project, Jakarta, Indonesia, e-mail: dray@pegasus.or.id, Tel: 3483-3813. The original survey was carried out by the Regional Economic Development Institute (REDI) of Surabaya, jointly sponsored by the PEG Project and The Asia Foundation, both funded by the U. S. Agency for International Development (USAID). The views expressed in this report are those of the author and not necessarily those of USAID, the U.S. Government or the Government of Indonesia.

Summary Report: Survey on Decentralization and the Business Climate

Introduction

The objective of the survey of was to gauge changes in business perceptions two years after decentralization as a means to assess whether the business climate had worsened, improved or remained the same.

Survey questions focused on four key elements:

- Licensing and bureaucracy
- Fees and charges – both formal and informal
- Labour and manpower issues
- The direction and orientation of local economic policy

The survey was carried out over two stages:

1. July-August 2002
2. October 2002 – January 2003

Sample

In total 1014 businesses were surveyed from 23 districts (*Kabupaten/Kota*) across 12 provinces.

Table 1 Survey Provinces and Districts

Province	Kabupaten	Kota
Lampung	Lampung Tengah	Bandar Lampung
West Kalimantan	Pontianak	Pontianak
Central Java	Demak	Semarang
Yogyakarta	Bantul	Yogyakarta
Bali	Gianyar	Denpasar
West Nusa Tenggara	West Lombok	Mataram
North Sumatra	Deli Serdang	Medan
West Java	Sumedang	Bandung
East Java	Jember	Surabaya
South Sulawesi	Maros	Makassar
North Sulawesi	Minahasa	Manado
Jakarta	-	-

- One rural and one urban district was chosen from each province. In rural areas agriculture typically accounted for around 15-20% of the regional economy.
- Respondents were drawn from five key sectors in proportions (roughly) consistent with their relative contributions to the regional economy. The overall breakdown of the final sample was:

- Trade 29%;
 - Manufacturing 22%;
 - Agribusiness 15%;
 - Transportation 11%;
 - Services 23%.
- The final sample structure by firm size was 57.4% small, 35.6% medium and 7% large, where size was determined by number of employees and value of non-property assets.

Results

1. Bureaucracy and Licensing

- Most firms surveyed had at least one license relating to their business activities. Only 22% of firms had no license at all. SIUP (*Surat Izin Usaha Perdagangan*) was the most common license, held by 63% of respondents.
- Five criteria were used to assess the efficiency and transparency of the licensing process:

1. speed of processing,
2. transparency in costs,
3. total licensing costs
4. procedural transparency, and
5. required documentation.

- For each of the five elements, responses were quantified as follows:

Much worse	-2
Worse	-1
Same	0
Better	1
Much better	2

Much of the analysis below is based upon simple averages of these scores.

- Of the 1014 businesses surveyed, 932 gave one of these 5 responses listed above, another 82 responded ‘don’t know’ or ‘unsure’.
- Table 2 provides cross-provincial comparisons, based on averages for each of the five elements of the licensing climate. Note that the index in the final column is a simple average of the five elements.

Table 2. Perceptions of the Business Licensing Process: Provincial Performance
Scale: -2 (much worse) ↔ 2 (much better)

	Processing Time	Transparency in costs	Total Cost	Procedural Transparency	Documentation Required	Index
East Java	0.40	0.37	-0.22	0.40	0.14	0.21
Yogyakarta	0.45	0.28	-0.10	0.15	0.10	0.18
Central Java	0.34	0.15	-0.07	0.20	0.07	0.14
South Sulawesi	0.34	0.29	-0.18	-0.01	0.16	0.12
West Nusa Tenggara	0.32	0.20	-0.10	0.20	-0.09	0.10
Bali	0.18	0.19	-0.13	0.17	0.06	0.09
West Java	0.31	0.03	-0.28	0.12	0.09	0.06
North Sulawesi	0.25	-0.01	-0.26	0.10	-0.01	0.01
North Sumatra	0.25	-0.01	-0.26	0.10	-0.01	0.01
Lampung	0.24	0.03	-0.33	-0.03	0.10	0.00
Jakarta	0.03	-0.07	-0.12	0.05	0.07	-0.01
West Kalimantan	0.44	-0.04	-0.36	-0.10	-0.03	-0.02
Average	0.29	0.11	-0.20	0.11	0.05	0.07

▪ **Key results**

- There appears to be a general and relatively strong improvement in licensing processing time required (except for Jakarta).
- Less obvious and less consistent, are the improvements in procedural transparency and in cost transparency.
- The amount of documentation required appears to have remained more or less constant
- Total costs have increased, perhaps reflecting new own-source revenue raising efforts of local governments.
- The summary measure in the final column (a simple average of the 5 elements) suggests that the business-licensing climate has remained the same (i.e. close to 0) or if any, a very slight improvement. This is perhaps better illustrated in Table 3 below.

Table 3. Overall Perceptions of the Business Licensing Climate

	Much better	Better	Same	Worse	Much Worse	Unsure
Time required for processing	5.2%	24.6%	54.3%	6.5%	1.0%	8.4%
Transparency in costs	2.1%	19.5%	58.0%	10.8%	1.2%	8.4%
Total licensing costs	0.5%	11.8%	49.6%	27.7%	2.0%	8.4%
Procedural transparency	1.3%	20.1%	58.3%	10.7%	1.2%	8.4%
Amount of documentation required	1.4%	16.0%	61.4%	11.1%	1.7%	8.4%
Average	2.1%	18.4%	56.3%	13.4%	1.4%	8.4%

Using the same data and approach, this result appears to be consistent for all sectors, with transportation a notable exception with the only negative score.

Table 4. Business Perceptions by sector
Scale: -2 (much worse) ↔ 2 (much better)

Sector	Summary Index
Trade	0.10
Manufacturing	0.08
Agribusiness	0.06
Transportation	-0.01
Other services	0.07
Average	0.07

Other key results regarding licensing and bureaucracy:

- Staff of the local agency (DINAS) issuing permits and licenses continue to play an important ‘facilitation role’ (in return for a fee) in assisting business with their license applications. Less than 46% of respondents sort out licensing matters themselves whilst over 30% pay informal fees to local government officers to facilitate their licensing applications. Other respondents use alternative means such as *Biro Jasa* (service agencies) or other kind of brokers (*calo*).
- Respondents were asked to consider the overall proportions of formal and informal fees in total licensing costs. Many respondents had difficulty answering this question as they were unsure of the precise breakdown of total licensing costs.

Balance of Formal and Informal Fees

More formal than informal fees	43.3%
More informal than formal fees	17.0%
Formal same as informal fees	10.8%
Unsure	28.9%

2. Taxes and Charges

For both formal and informal taxes/charges, respondents were surveyed regarding perceptions of the following:

1. Total exaction amounts
2. Frequency/number of exactions
3. Number of collecting agencies or individuals

using the same method described above (i.e. -2 much worse ↔ 2 much better).

Results are summarized as follows:

Table 5. Business Perceptions of Formal Exactions: Provincial Performance
Scale: -2 (much worse) ↔ 2 (much better)

	Total Amount	Frequency / Intensity	No of Agencies	Index
Bali	-0.24	0.07	-0.07	-0.08
Jakarta	-0.22	0.10	0.12	0.00
West Java	-0.23	0.20	0.17	0.05
Central Java	-0.29	-0.08	-0.01	-0.13
East Java	-0.30	0.20	0.17	0.02
Yogyakarta	-0.52	0.09	0.04	-0.13
West Kalimantan	-1.09	-0.07	-0.09	-0.42
Lampung	-0.46	0.20	0.21	-0.02
West Nusa Tenggara	-0.83	-0.16	0.06	-0.31
South Sulawesi	-0.34	0.05	-0.08	-0.12
North Sulawesi	-0.66	-0.17	-0.36	-0.40
North Sumatra	-0.63	-0.14	-0.31	-0.36
Average	-0.49	0.02	-0.01	-0.16

- **Results:**
 - Respondents in general perceive substantial increases in formal taxes and charges paid, but no change in the number of exactions, nor the number of exacting agencies.
 - Suggests local governments are extracting greater amounts of funds from existing revenue instruments as opposed to creating new ones (intensification as opposed to extensification).
 - West Kalimantan and West Nusa Tenggara are perceived by business to have been particularly aggressive in increasing own source revenues through formal exactions.

Table 6. Perceptions of Formal Exactions: By Firm Size
Scale: -2 (much worse) ↔ 2 (much better)

	Amount	Intensity	No. of Agencies
Small	-0.47	0.07	0.02
Medium	-0.55	-0.10	-0.04
Large	-0.55	-0.16	-0.31
Average	-0.49	0.02	-0.01

- **Results**
 - The (perceived) increasing amounts of formal taxes and charges paid are unrelated to firm size.
 - Large firms on average see themselves paying an increasing number of formal exactions, to a more varied group of agencies.

Table 7. Business Perceptions of Informal Exactions: Provincial Performance
Scale: -2 (much worse) ↔ 2 (much better)

Province	Amount	Frequency	Agencies	Index
Bali	-0.04	0.04	-0.03	-0.01
Jakarta	-0.15	-0.02	-0.02	-0.06
West Java	0.13	0.36	0.13	0.23
Central Java	-0.12	-0.04	-0.14	-0.10
East Java	0.53	0.69	0.80	0.67
Yogyakarta	0.14	0.09	0.00	0.08
West Kalimantan	-0.02	0.16	0.20	0.11
Lampung	0.13	0.34	0.23	0.23
West Nusa Tenggara	-0.11	0.23	0.28	0.13
South Sulawesi	-0.07	0.01	0.12	0.02
North Sulawesi	-0.19	-0.13	-0.22	-0.18
North Sumatra	-0.18	-0.08	-0.21	-0.16
Average	0.02	0.16	0.12	0.10

- Key results:
 - The overall result suggests that the burden of informal payments (represented by perceptions of total amounts exacted, frequency of imposition and the number of collecting agencies) has eased slightly under decentralization.
 - This is driven to a certain extent by a strong improvement in East Java.
 - It is also interesting to note that Lampung (known for its problematic regulatory environment) has also shown improvement.
 - The problem of informal exactions in North Sumatra and North Sulawesi appears to be getting worse.

Table 8. Perceptions of Informal Exactions: By Business Size
Scale: -2 (much worse) ↔ 2 (much better)

Size	Amount	Frequency	Agencies	Index
Small	0.08	0.18	0.21	0.16
Medium	-0.12	-0.01	0.05	-0.03
Large	-0.33	-0.23	-0.17	-0.24
Average	0.02	0.12	0.16	0.10

- Results
 - Under decentralization increases in the burden of informal exactions are positively correlated with size.
 - Larger firms report greater amounts, greater frequency and more exacting agencies/individuals than smaller sized firms.

Table 9. Perceptions of Informal Exactions: By Sector
Scale: -2 (much worse) ↔ 2 (much better)

Sector	Amount	Frequency	Agencies
Trade	-0.06	0.16	0.16
Manufacturing	0.21	0.26	0.18
Agribusiness	0.13	0.19	0.16
Transportation	-0.26	-0.08	-0.11
Services	0.01	0.16	0.10
Average	0.02	0.16	0.12

- The problem of informal exactions appears to be worsening in the transportation sector.

Common Locations for Informal Exactions

Markets and other sales outlets	37%
Main roads	25%
Factories	23%
Ports	4%
Airports	1%
Other	10%

- Informal exactions are commonly imposed during transport and/or distribution.

Other results

- Respondents indicated which agencies or individuals most frequently impose informal exactions upon their businesses. The most commonly mentioned group was village (*desa*) officials (25%) followed by officials from the sub-district (*camat*) level of government (18%). Other groups included police, army, port officials, traffic officers (*DLLAJ*), and political party organizations and youth groups.

Table 10. Who carries the burden of informal exactions?

Strategy	Total	Percentage
Transfer all burden to suppliers	21	2%
Transfer some of the burden to suppliers	39	4%
Fully absorb the loss	577	57%
Transfer some of the burden to buyers/consumers	131	13%
Transfer all of the burden to buyers/consumers	42	4%
Unsure/don't know	201	20%
Grand Total	1011	100%

- Most respondents absorb the cost of informal exactions, rather than passing on the burden to suppliers/producers or consumers/buyers. This result is consistent across sector and across firm size.

Table 11. Overall Business Perceptions of Formal and Informal Exactions

	Much better	Better	Same	Worse	Much Worse	Unsure
Formal exactions (taxes, retribusi etc)						
Total amount (value)	2.3%	6.2%	35.7%	35.0%	9.8%	11.0%
Frequency (times)	3.8%	13.5%	54.0%	15.6%	2.0%	11.0%
No. of different collecting agencies	3.2%	12.7%	53.7%	18.1%	1.2%	11.0%
Informal Exactions (<i>pungli</i>)						
Total amount	8.2%	14.8%	28.5%	21.1%	4.4%	23.0%
Frequency	7.9%	18.9%	31.0%	15.9%	3.4%	23.0%
No. of different collecting agencies	7.4%	15.0%	36.3%	16.1%	2.3%	23.0%

Respondents were also asked to assess whether public services funded by formal taxes and charges (retribusi) had improved, worsened or remained the same.

Table 12. Service Delivery under Decentralization

	Total	Percentage
Much worse	18	2%
Worse	110	11%
Same	583	58%
Better	257	26%
Much better	30	3%
Total	998	100%

Table 13. Perceptions of Service Delivery by Sector

Scale: -2 (much worse) ↔ 2 (much better)

Note: A positive score suggests improvement.

Sector	Score
Trade	0.14
Manufacturing	0.16
Agribusiness	0.29
Transport	0.06
Other services	0.19
Average	0.17

- Results
 - Of the 998 businesses responding to this question, most (58%) perceived service delivery to have remained the same whilst 29% thought that it had improved and only 13% saw it as worsening.
 - The positive average score in Table suggests an overall improvement in service delivery. This is consistent across all sectors, with the transport sector again being the laggard.

Table 14. Perceptions of Service Delivery by Sector

Scale: -2 (much worse) ↔ 2 (much better)

Note: A positive/negative score suggests improvement/deterioration.

Province	Score
Bali	0.35
Jakarta	0.26
West Java	-0.11
Central Java	0.18
East Java	0.38
Yogyakarta	-0.06
West Kalimantan	0.61
Lampung	-0.03
West Nusa Tenggara	0.09
South Sulawesi	0.44
North Sulawesi	-0.11
North Sumatra	-0.09
Average	0.17

- Surprisingly West Kalimantan records the highest score followed by South Sulawesi. Almost two thirds of the businesses surveyed in West Kalimantan responded that services under decentralization were either 'better' or 'much better.'

3. Labour and Manpower issues

Table 15. Impact of Minimum Wage (UMP) Increases upon Firm Productivity in 2002

	Business Size			Total
	Small	Medium	Large	
No impact	57%	38%	31%	52%
Very small	31%	41%	43%	33%
Moderately burdensome	10%	17%	21%	12%
Very burdensome	1%	3%	2%	2%
Positive impact	1%	2%	3%	1%
No. of firms	775	180	58	1013

- **Results**
 - Over half of the respondents reported no real impact, and another third reported only a small impact.
 - Unsurprisingly the impact is positively correlated with size (i.e. smaller firms use casual labour, or are simply unaware of, or do not adhere to minimum wage stipulations).

Businesses were also asked about the impact of the Manpower Ministerial decree KEPMEN 150/2000.

Table 16. Impact of and response to KEPMEN 150/2000

No impact	716	71%
Greater focus on subcontracting	96	9%
Greater focus on casual employment	78	8%
Lay-offs	9	1%
Replace labour with machinery	3	0%
No new recruitment	69	7%
Other	43	4%
Total	1014	100%

- As with minimum regulations, most firms surveyed reported no impact.
- For those firms impacted, there was a move toward subcontracting and casual employment, and less recruitment.

4. The direction and orientation of local economic policy

Firms were asked what they considered to be the primary objective of local policy making under decentralization: the improvement of public services or to increase own-source revenues. Clearly the two should be related, that is an increase in own-source revenue should lead to better service delivery (although evidence from the regions suggests that this is not always the case). In this case our objective was to determine what businesses saw as the primary end of government policy, i.e. what is the government's first priority.

Table 17 Policy Focus: Service Delivery or Own-Source Revenues?

Strong focus on public services	28	2.8%
Focus on public services	93	9.2%
Balanced approach	268	26.4%
Focus on own-source revenues	412	40.6%
Strong focus on own-source revenues	106	10.5%
Unsure	107	10.6%
Total	1014	100%

- Perhaps unsurprisingly, firms see local governments as giving greater priority to revenue raising rather than improving public service delivery.

Table 18: Impact of Tataniaga (non-tariff barriers)

Positive impact	63	6%
No real impact	339	33%
Negative impact	276	27%
Unsure/don't know	336	33%
Total	1014	100%

- Firms were asked about the impact of non-tariff barriers (such as price controls, forced monopsonies, quotas, export controls etc) on the business climate. As expected most firms responded that there was no impact or were unaware of these types of business barriers. Interestingly a third responded that there was an impact (mostly negative), suggesting that non-tariff barriers remain a problem in the regions.

Table 19 Impact of Regional Autonomy upon *Putra Daerah* (local ethnic group)

Less advantage	81	8%
Same	575	57%
More advantage	186	18%
Unsure/don't know	172	17%
Total	1014	100%

- Firms were asked if regional autonomy had resulted in discriminatory treatment in favor of local ethnic group(s) or *putra daerah*. Most responded that putra daerah were treated as before, whilst 18% said that there was various forms of discrimination in favor of local businesses.

Other results

- Firms were also asked if cronyism under regional autonomy was more or less prevalent under regional autonomy (i.e. giving certain business people unfair advantages). Most answered that it remained as before, or were unsure.
- Firms were asked about their participation in the policy formulation and socialization process. Only 10% of firms reported greater participation under decentralization. The majority reported no involvement and only come to know about new policies and/or regulations once they impact upon their businesses.

Table 20 Impact of Local Regulations/Policies upon Business Climate

Much better	23	2%
Better	204	20%
Same	496	49%
Worse	145	14%
Much worse	14	1%
Unsure/Don't know	132	13%
Grand Total	1014	100%

- There appears to be a slight improvement in business perceptions of the impact of local policies, although almost half the respondents report no change.
- The most positive changes by province were in South Sulawesi, West Kalimantan and Bali. Negative changes were reported in North Sumatra, West Nusa Tenggara and Lampung.
- All sectors reported a positive change, except for transport.