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Institutionalizing Regulatory Reform in Indonesia

by

Gary Goodpaster¹

I

The General Need for Indonesian Administrative Law Reform

In all modern economies, governmental administrative agencies perform important regulatory and other governmental functions. In addition to agencies that may provide social benefits, e.g., administer a social security or state pension system, there are numerous agencies that administer and regulate particular sectors of the economy. For example, administrative agencies may deal with taxes, oil and gas, mining, forestry, telecommunications, labor, transportation, highways, and so on. Such agencies usually enact regulations, grant licenses or permits, regulate industries under their supervision, and administratively decide issues arising in cases within jurisdiction.

When one considers the immense scope of agency activity, one quickly realizes that the interactions that most citizens and businesses have with government take place through administrative agencies. In terms of interactions with citizens and range of activities, administrative agencies are actually more important than courts. Because administrative agencies exercise so much governmental power and have a huge regulatory impact on the economy and its various sectors and actors, it is important that agencies operate fairly and efficiently, and transparently and accountably within the law. It is essential to insure that agencies do not abuse their power or discretion and that agency officials do not use their authority to extract bribes from regulated parties. In democracies, it is important that these agencies involve the regulated and

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the public in their work. This openness and participation greatly improve the work of the agencies and makes them responsive and accountable to the people.

All administrative agencies should operate within a framework of law that aims at “regulating the regulators”. In developed countries, there are usually general, framework laws concerning administrative procedures. These laws, often referred to as administrative procedures acts, lay down the procedural rules that all administrative agencies, except those specially exempted, must follow in carrying out their activities. These laws define the specific procedures to be followed when an agency drafts and issues regulations, conducts investigations, holds hearings, and issues decisions. Such laws usually call for public notice of proposed agency action, an opportunity for citizens or regulated parties to be heard before action is taken, fairness in hearings, decision based on a written record, internal agency appeals from adverse decisions, and a review of final agency action, when called for, by a court. The set of common procedures that these laws create work to insure fairness, efficiency, and lawfulness throughout all government bureaucracies.

Because such laws create a set of procedures common to all administrative agencies, they create efficiency, transparency, responsiveness, and accountability in agency operations. They also greatly facilitate citizen and business interaction with agencies, permit greater executive and legislative oversight of agency activities and performance, and enhance coordination between different Ministries.

Indonesia, however, does not have a generally applicable administrative procedures act. This means that each agency can create its own procedures, that there may be little consistency between the operating procedures of various agencies, and that the public may have little knowledge of how agencies operate. In effect, it means that each agency can become a law unto itself and have relatively uncontrolled discretion. This is the antithesis of rule of law. In order to keep administrative agencies operating within the bounds of law and enable them to operate fairly and efficiently, Indonesia should adopt an administrative procedures act.

There is a further important reason for concern about Indonesia’s regulatory agencies. Many Indonesian laws are general and direct agencies to fill out the details of the law through regulations. This is highly problematic where there are no standards or established consultative procedures that must be met for regulations to be valid. Where the law itself is ambiguous or

vague, as is often the case in Indonesia, regulatory agencies have immense and virtually uncontrolled power.

Given the immense regulatory power of Indonesian government agencies, such agencies should, in addition to following open, transparent, and consultative procedures, analyze the potential social and economic costs the regulations impose. This is simply a way to understand the impact of governance on the governed, but this is now not done. It is important that it be done to assure the government and people of Indonesia that the benefits of regulations exceed their costs and to assure that regulation is not simply a means of securing, or transferring, rents. Indonesia should require that its regulatory agencies conduct regulatory reviews and cost-benefit analyses of proposed regulations.

Indonesia's Existing and Proposed Independent Regulatory Commissions

As a part of governmental reforms instituted since the fall of former President Suharto, Indonesia has created, or intends to create, new and independent regulatory bodies. Organizationally, these Commissions reside outside the line Ministries and are not subservient to them. Functionally, they are responsible to the Office of the President, through the State Secretariat, and to the DPR. While instruments of government, these bodies are “independent” in the sense that the Commissioners who run them cannot be discharged at will, but only for some good cause. They are also independent in that they are tasked to carry out specific, often sectoral, functions and act independently of other governmental agencies.

The following is a list of existing and proposed Indonesian independent regulatory commission.

- The Commission for Business Supervision (competition and antimonopoly)
- The Consumer Protection Board
- The Commission for the Investigation of Officeholder Wealth
- The Telcoms Commission
- The Energy Commission
- The Mining Commission

Each of these Commissions will have the authority to the draft rules, regulations and procedures necessary to carry out their statutory mandates. Some, perhaps all, of these Commissions will have additional authorities to investigate complaints, to hold hearings, produce reports, impose sanctions, and to advise the Government and DPR on matter falling under their jurisdiction.

Given the separate creation of each commissions and their independence, there is a strong likelihood that each commission will adopt different administrative procedures. The government, however, has a major opportunity to advance efficiency, transparency, and accountability in government by requiring these bodies to follow a common set of general administrative procedures. The common set of procedures – what is called *administrative due process* – would be those to be followed when an agency drafted and issued regulations, conducted investigations, held hearings, and issued decisions. In general, the procedures would call for public notice of proposed action, an opportunity for persons to be heard before decisions were made, fairness in hearing, decisions based on written record, and provisions for review of agency action.

Creating an overarching system of administrative due process would not interfere with the substantive independence of regulatory agencies, but would concern itself with the formal, decision-making procedures. This would assure that regulations would take into account the concerns of the regulated and greatly improve regulatory quality, consistency, and fairness in application and implementation. Adopting a system of administrative due process through a framework administrative procedures act would be a major governance reform in Indonesia and would change favorably, in democratic, responsible, and responsive ways, the ordinary operations of Indonesia’s administrative agencies and apparatus.

II

Deepening Administrative Reform: Regulatory Reform and Deregulation

Regulation is a pervasive feature of modern states. Indeed, we often refer to the modern state as the “regulatory state” to distinguish it from earlier kinds of rule and to note the immense interventions of the state in the economy and private choice.

In recent decades, we have learned that certain kinds of regulations, even those adopted with the best of intentions, can injure economies, distort entrepreneurial and business decision-making, and add unnecessary costs to doing business. Regulations that reduce competition lead to inefficient and noncompetitive businesses. Competition, by contrast, disciplines firms and impels them to become more efficient and to produce the best products and offer them at the lowest prices. Regulations that unnecessarily increase business costs raise the cost of doing business and make firms less competitive.

Governments are sometimes responsive to the demands or requests of special interest groups. Such groups may seek special privileges, or relief from competition, or make other various proposals that, from the point of view of economic efficiency and firm competitiveness, are injurious. To provide relief, governments sometimes adopt these proposed regulations without considering their broader impact on the economy or the consumer. For example, a special tariff placed upon a particular import to protect a domestic industry from import competition entails increased costs to the consumers of the product. The government, instead of looking at the consequences of the tariff for all affected stakeholders, may look only to the complaining firm. With a tariff, the complaining firm will undoubtedly become more price competitive and may even increase its sales. But the price of its products and the price of the imported products will be higher than they would otherwise have been without the tariff. If the product is an input in a production industry, its costs of production will be greater, and the costs of its products will be greater. If it is a consumer product, the consumer will directly pay more for it. Thus the tariff on the imported product becomes an indirect tax on industries that use the product and ultimately it is a tax the consumer will pay.

In modern states, where a major function of government is to help the economy grow so that all will be better off, regulations that reduce competition, that increase the costs of business or the costs to consumers, or that decrease the competitiveness of firms defeat this aim. Governments, recognizing the problems of over and inappropriate regulation, have therefore sought to deregulate intelligently, that is, to reduce the burden and direction of regulation while yet insuring the achievement of government aims. Governments now realize that regulations have serious and oftentimes damaging unintended consequences and they have come to understand that they should regulate only when it is essential that they do so. They also understand that when they regulate, they should do so only in ways that insure that the bene-

fits of the regulation exceed the costs. Finally, they have decided that it is important to review regulations prior to adoption to insure that their benefits are greater than their costs and that they do not injure competition or competitiveness.

Today, many countries are undertaking this kind of regulatory reform. These efforts include both reducing direct government management of economic actors and establishing a review process for existing and proposed regulations to determine their competitive impact and cost-effectiveness. The countries undertaking regulatory reform and deregulation include those in the former Soviet block – former command and control economies – as well as countries with advanced market economies, such as the United Kingdom, Canada, the United States, Australia, New Zealand and those comprising the European Economic Community.

These governments believe that they should seek the best solutions to problems by considering both nonregulatory and regulatory alternatives and by choosing whichever alternative produces the best results at the least cost. Governments now place the burden of proof on the proposed regulator and require well-considered and careful justifications before adopting any particular regulatory alternative. Today, when these governments address problems, using transparent and open processes, they review and compare different proposed solutions and evaluate them in accordance with well-established procedures and criteria, including cost/benefit analysis.

This process of reviewing regulations is, appropriately enough, called regulatory review, and its principal aim is to optimize policy. It involves particular kinds of policy analysis and aims to provide relevant government decision-makers with the information necessary to evaluate the need for, and usefulness of, particular regulations. That information should include a real understanding of the problem the regulation addresses, the legal and policy basis for government action, the expected economic costs and benefits of the regulation and alternatives ways of solving the problem, and any other factors that will affect the effectiveness of the regulation. Of particular concern are the costs that a regulation imposes, for some regulations cost more to implement than they produce in benefits. In addition, there is also a major concern about the anticompetitive effects of a regulation. In free market economies, there is a presumption in favor of competition, and if a regulation injures the ability of parties to compete, it may injure the economy.

Today, with the effort to correct the abuses of the New Order and to undertake economic reforms, Indonesia has begun to concern itself with deregulation and regulatory review. Indonesia is seeking to undo the regulations that protected favored crony interests and imposed high costs on the economy. In addition, as a part of reform, Indonesia now seeks to regulate for the public interest rather than for the benefit of private interests. The international donors seeking to assist Indonesia support these efforts, believing that deregulation is essential to stimulating economic growth and recovery, and important to creating the good governance Indonesian reformers want.

Economic globalization also makes deregulation important. Indonesia's participation in generally beneficial global trade agreements, such as the WTO Agreement, exposes Indonesia's businesses, both private and public, to fierce competition in both domestic and international markets. Deregulation, in eliminating major causes of Indonesia's high cost economy, is one mechanism that can help Indonesian businesses become internationally competitive.

The regulatory review process consists of a careful analysis of the economic and other effects of proposed regulations and calls for consultation with parties proposed regulations may affect. The analysis and consultation lead to a *Regulatory Impact Assessment* (RIA). This is a document that analyses what a regulation does to the economy and to competition and that discusses the best ways a government can achieve its regulatory aims.² The RIA thus is a report that officials can use to assist them in deciding *whether* to regulate, and *how* to regulate if it is necessary to do so.

Until now, Indonesia has not undertaken to carry out regulatory reviews, and no Indonesian ministry responsible for enacting regulations has ever undertaken a regulatory assessment prior to adopting a regulation. Indeed, the public reaction to some recent regulatory decrees shows that this continues to be a problem in Indonesia. For example, within the last year, because of public outcry, the Ministry of Communications had to reverse a decree prohibiting foreign investment in Internet businesses, and the Ministry of Labor had to reverse a decree, regarding employee terminations, that had extremely bad consequences for businesses in Indonesia. In each case, had Indonesian regulators conducted an assessment of regulatory im-

² Many countries, including the U.S., Canada, Australia, Ukraine, and the U.K. carry out this process, and even in countries that have not implemented it, recognize it to be the international best practice with respect to regulatory reform.

pacts prior to issuing the regulations, they would have anticipated these problems and would have acted more appropriately.

The idea of seeking the best solutions to problems, which often calls for minimizing economic regulation and interference in the normal operations of markets, is an accepted approach in economics and public policy. The discipline of competitive markets has proven itself generally superior to the dictates of governments in producing good economic outcomes and sustainable growth over time. No socialist, command and control economy has ever succeeded economically, a fact attested to by the moves of former and current communist countries to establish market-based economies. Indeed, there remain only two genuine command and control economies in the world, those of North Korea and Cuba, and the economies of each are dismal. Clearly, there is economic wisdom in the realization that many thousands of highly motivated business entrepreneurs are better at making sound economic decisions than a few government officials.

To achieve desired social goals, markets should be as open and competitive as possible. Competition keeps businesses from charging prices significantly higher than costs, drives businesses to constantly find ways to increase efficiency, innovate and develop new products and services. Markets and competition have also been shown to be more effective than governments in solving some problems traditionally thought to be governmental, e.g., pollution control where a market based system of tradable emissions rights has proven superior to governmental directives.

This is not to say, however, that that markets solve all problems and that there is no longer a major role for government. The proper role of the government is to facilitate and enable the economy, rather than to control it. Only governments can insure the free operation of genuinely competitive markets. Governments also have the major task of providing public goods that the markets themselves would not otherwise provide, e.g., national security, a legal system and rule of law, infrastructure that supports economic and social activity, and the like.

Government regulation is often the source of noncompetitiveness in markets, either regulation that protects businesses from competition or regulation that inhibits the operations of markets. This has been found true around the world and is true in Indonesia. The Indonesian

people have only recently overthrown a regime that imposed regulations in virtually every sector and industry. While the Indonesian government did undertake some deregulation in the last decade, e.g., the reduction of import barriers and recent revocation of certain monopoly and monopsony rights, it continues to adopt and enforce laws and regulations that keep markets from being fair and competitive and that fail to deliver economic and social benefits greater than costs.

Three background principles for regulatory review and deregulation

There are three background principles that form the foundation for regulatory review and deregulation. These are

- The principle of minimum effective regulation
- The principle of competitive neutrality
- The principle of transparency and participation

The principle of minimum effective regulation holds that the government should not regulate any more than is necessary to achieve aims that cannot be achieved other than through regulation. This entails that government seek methods other than regulation, e.g., market solutions, to problems when such solutions would work. The earlier cited example of tradable emissions rights is one such case. It also requires that the government adopt whichever form of regulation is the least burdensome and costly to the public, business, and government itself.

The principle of competitive neutrality reflects the widely held and operatively successful view that properly functioning competitive markets work well to provide the public the best goods and services at the lowest price. Under this view, government regulations that unnecessarily injure the ability of firms to compete or unnecessarily impose costs are thought injurious to the economy. This principle would then require that the government rewrite such regulations so that they do not injure competitiveness. For example, suppose a government health and safety regulation required that egg sellers label each egg with a product freshness expiration date, even when eggs were sold in a carton. There is nothing wrong with the aim of the regulation, which is to provide buyers with information about product freshness, but is it necessary that each egg be labeled? This requires extra work and extra handling, so it imposes extra costs. Labeling cartons, by contrast, achieves the government aim, but more cheaply. In

these circumstances, the government should revoke the earlier regulation and adopt the carton-labeling version instead.

The principle of competitive neutrality also speaks to the situation of government owned enterprises. It does not say that in the interests of competition, the government cannot own its own enterprises. But it does require that governments create a level playing field for state and privately owned enterprises. What this means is that the government must treat state and privately owned enterprises equally, and that the government cannot, through its regulatory power, favor its own enterprises over competitors. Competitive markets discipline firms and make them efficient. It is in the government's interest, when it owns and operates firms, that its firms operate efficiently. Unfortunately, it is the experience of many governments that their firms are inefficient and wasteful because they need not compete. Sometimes governments even prop up inefficient firms and protect them from competition so that they can continue to operate in spite of the costs. This usually has adverse budgetary consequences and may disable governments from pursuing other worth goals.

A good example of adverse economic impact involves an Indonesian state owned enterprise, PT. Latinusa, the sole producer of tin plate in Indonesia. Access to tin plate at competitive prices is essential for Indonesia's agro-industrial exports, which use it for canning food. PT. Latinusa, which faced competition from imported tin plate, asked the Government of Indonesia to impose duties of up to 68% on imported tin plate because it was unable to compete with the imported tin plate on price and quality. As the cost of cans for canned food runs from 20 to 50% of the cost of the product, any increase in the cost of tin plate for cans increases the cost of producing canned food. Where such food is exported, higher prices for the canned food ultimately means less competitive exports. Where such food is sold locally, it means the consumer must pay more for the product. It also means that producers of canned food, in order to reduce costs, may switch packaging, for example packaging in plastic containers, bottles, or coated, sterile boxes and cartons.

The Indonesian Government did increase the duties on imported tin plate. Without getting into all the details of this case, if we assume that the Government's purpose in raising duties was to protect PT. Latinusa's market for tin plate sales, then the Government was using its power of regulation to protect an inefficient monopoly from competition, to the detriment of businesses and exporters that use tin plate as a component of their products. In order to protect the Government monopoly, the Government increased costs to producers and consumers.

This is a good example of the use of government regulatory power to distort the natural operation of competitive markets to the detriment of businesses, consumers, and the competitiveness of the Indonesian tin plate manufacturer. The principle of competitive neutrality, which was violated in this case, would instead require that the government not use its regulatory power to support its own entrepreneurial activities to the detriment of private competitors and the economy.

The principle of transparency and participation is implicit in the framework of RIA. From a theoretical viewpoint, in a democratic system, rulemaking, like lawmaking, needs to be carried out in full view of the public in order to gain stakeholder and popular support. From a practical viewpoint, interaction with the stakeholders usually provides the regulatory analyst with information not otherwise available about the subject of regulation and about the likely effects of any proposed provision. For these reasons, the principle of transparency and participation requires consultation in every step of an RIA.

With this background, now let us turn to ways in which governments can insure that the benefits of their regulations exceed their costs and that their regulations interfere neither with competition nor competitiveness. The major means is a regulatory impact analysis or assessment.

III

Regulatory Impact Assessments

When a government adopts regulations, it does so because it seeks to solve some problem. There are usually many ways to solve problems, and the regulation chosen may or may not be the best way to solve a particular problem. Sometimes one discovers that the regulation isn't really doing the job intended and that the problem persists or even becomes worse. Governments then often try to correct the regulation, either by amending it or by enacting further regulations that address the newly arisen problems caused by the original regulation.

In addition, regulations often have unintended consequences. Governmental actions in one area may produce problems in other areas. For example, when the government subsidizes kerosene sales to the entire public, some people will buy kerosene and smuggle it internationally to countries where the price of kerosene is much higher because it is not subsidized. In this case, while the original government policy may have been to help the poor who rely on

kerosene for light and fuel, the particular regulation does not exactly hit its target, which is the poor, and other people take advantage of a subsidy not meant for them.

Government ministries also often adopt regulations without regard to the regulations adopted by other ministries, with the result that there is an inconsistency between the regulations of different ministries. This would be the case, for example, where one government ministry, say Forestry, creates a national park where development is not allowed, while another ministry, say Mining, granted mining permits for national park areas. In this case, different government ministries are acting in contradictory ways, confuse parties attempting to obey government regulations, and interfere with one another's work and goals.

Finally, regulations often impose costs on various parties that the government doesn't really take into account at the time of regulation. For example, in Indonesia, in order to operate as a small business, entrepreneurs must obtain many different government permits and licenses. Each permit and license imposes a number of costs: the paperwork and time costs involved in filling out the applications; the time lost in going to government offices to file papers; the fees imposed for each license or permit. It has been reported, for example, that it takes an average small Indonesian business 14 months to obtain all the licenses and permits necessary to operate. All such costs, in money, time, and lost opportunities increase the cost of doing business. In order to survive, businesses must charge more for their products and services to recoup these costs. This makes goods and services more expensive than they would otherwise be and makes for a high cost economy that can't compete internationally.

For all of these reasons, it is important for the Government of Indonesia to look carefully at its regulations. It is important to see how they operate in practice, what results they produce, what costs they impose, whether they hinder competition and competitiveness, and whether they can be improved.

Regulatory impact assessments are rather simple in form, but, depending on the complexity and circumstances of particular regulations, may involve substantial analysis. In a regulatory impact assessment, we want to analyze what a regulation actually does, in terms of achieving the government's goals, the costs it imposes on business, the consumer, and the government, and its effects on competitiveness and competition.

All government regulations are a means to some end, and in a regulatory impact assessment, we seek to discover both how well the means selected serve the end and what other effects the regulation may have. We want to know what the government was trying to do, how well

it succeeded, and whether the regulation produces other effects that are unwanted, unnecessary, or damaging to persons or the economy. In such an analysis, we ask a series of questions:

- What was the problem or set of problems the government sought to solve with the regulation?
- Did the government have authority to issue the regulation and is the regulation consistent with other law?
- How does the regulation operate in practice?
 - What are the benefits of the government regulation
 - ✓ Is it producing the results the government wanted?
 - ✓ Is it producing other beneficial results? What are these other results?
 - What are the costs of the government regulation?
 - ✓ What costs does the regulation or its enforcement impose on businesses, consumers or the public at large, and on the government itself?
 - What is the effect of the regulation on competition and competitiveness?
 - ✓ On balance, do the benefits of the regulation exceed its costs? If a regulation produces benefits of less value than its costs, then it has failed and should be revoked.
 - ✓ Are there other obvious and better ways that the government could use to achieve its goals?

Example

Let us take as an example, Indonesia Government Regulation No 82/1999, regarding Transportation in Waters. This regulation provides that national sea transportation companies can act as general agents, which means that they can contract for sea shipment services. The regulation also requires that, in order to be appointed a general agent, the company must have seaworthy Indonesian flagships with a minimal size of GT. 5000.³

What problem was the government trying to solve with this regulation? The regulation does not provide a statement of the problem the government was trying to solve, but it may be in-

ferred. Subject to further investigation by talking to government officials, let's assume that the government has decided that Indonesia has too few Indonesian flagships of a minimal size of GT. 5000. If that is the problem the government was trying to solve, then it means the government's objective in adopting the regulation was to force those companies wishing to be general agents to buy, or otherwise obtain, at least one GT. 5000 vessel.

We need to ask whether, regardless of the government's intention, it had the authority to issue this regulation. To answer this question, we need to look at Indonesian laws on trade, sea transportation, and the authority of ministries. Arguably, and a conclusion here depends on further legal analysis, the government does not have the authority to issue such a regulation because no law provides the government with the authority to require shipping agents to own ships of a particular tonnage.

In any case, and subject to the conclusion on the legality of the government's action, if the government's objective is to increase the number of 5000-ton Indonesian flag vessels, then we must ask whether the regulation is producing the results that the government wanted. To answer this question would require some empirical research. We must go into the field and ask interested parties, i.e., national sea transportation companies, how many ships of GT. 5000 they have bought in order to satisfy the regulation. If the answer is none, or even if the answer is very few, then we must conclude that, at least up until the time of investigation, the regulation is not serving the government's purpose.

But we are not finished. Even if we find that some companies are buying such vessels, we must ask what other results the regulation is producing. In particular, we are interested in the costs the regulation imposes. Again, this is a question to be answered with fieldwork. In this case, there is an interesting lead, worthy of following up, which appeared in a story in the Jakarta Post.

The Jakarta Post reported an assertion that only Pt Pelni and Djakarta Lloyd own 5000-ton vessels. The Indonesian Shipping Agencies Association also claimed that if the regulation goes into effect, "More than 1300 local agencies of foreign shipping companies will certainly go bankrupt and more than 65,000 employees will face mass dismissal...."

³ This example is based on the regulation as the GOE attempted to apply it in 2001. For current purposes, that is, as a demonstrative example, it does not matter whether the regulation was ever enforced.

While not directly stated, the implication is that almost all existing general agents cannot afford to obtain 5000-ton vessels. If they cannot do so, they must give up their general agencies. This would result in massive costs to existing general agents and their employees.

If these are the true facts, something to be verified from field work, then at this point we could conclude that the government regulation does not serve the assumed purpose of increasing the number of Indonesian flag ships of the size of GT 5000, but that it does have the likely unintended consequence of injuring many people. On these assumptions, the regulation's costs clearly exceed its benefits, and the regulation should be revoked.

However, we must also concern ourselves with the effects on competition and competitiveness. Given the report in the Jakarta Post, we must also consider the possibility that the government's intention was not to increase the number of 5000 ton vessels, but rather to confer monopoly general agent rights upon PT Pelni and Djarkarta Lloyd. If the government is interested in competitive markets and in increasing competitiveness, it is difficult to find any satisfactory justification for the government conferral of a monopoly. Even though PT Pelni may be a SOE, the principle of competitive neutrality says that while the government may own businesses, it may not favor them at the expense of competitors, but must treat all alike. Clearly then, on the assumptions we have made, the effect of the regulation is completely anticompetitive. It creates a monopolistic, rather than a competitive, market, and it decreases, rather than increases competitiveness in general agency-shipping services.

To this point in the analysis, we have suggested two possible government aims for the regulation: to increase the number of 5000-ton Indonesian flag vessels and to confer effective monopoly rights on two companies. Let's now look at alternatives. If the government's aim is to increase the number of Indonesian flag vessels, are there better ways to do this than attempting to force those who wish to be general agents to buy such ships? Well, as a first cut, the government could create some kind of incentive program for parties who buy such ships. This could involve guaranteed financing at favorable interest rates, perhaps some government preference in shipping, favorable government tax treatment, and the like. At this stage, we don't know just exactly what kind of government incentive program would work to achieve the asserted goal. That's something we would have to work on. But we can say, even on this brief analysis, that an incentive program would be at least as good as the existing government regulation in producing the result the government wants. We can also say that the costs are far less than those imposed by the government regulation. Indeed, in a properly designed in-

centive program, neither the government nor participants would suffer significant, unjustified costs.

Now consider the possibility that the government's purpose really is to confer monopoly rights. Although in most cases, given a premise of a competitive free market, we should just conclude this is wrong as a matter of government policy, for the sake of analysis, let's continue. We must ask the further question of why the government wishes to confer monopoly rights on two firms. The only obvious and noncorrupt reason that comes to mind is that these firms are now not competitive in the general agent shipping services market, that they are not getting sufficient business of this kind, and that the government wants to remedy that.

If this is the problem the government is trying to solve, we again ask, is there a better way? If we assume that our general default principle is in favor of competitive markets and against the conferral of anticompetitive rights, we would conclude there are better ways. Ways that are better for the Indonesian economy, for the market, for competition, and for the consumer of general agent shipping services. If PT. Pelni and Djakarta Lloyd are not competitive, and the government wants them to be, then it should work to make them competitive – by making them more efficient, convincing them to provide better services at cheaper prices, by training, and so on. In fact, one can almost guarantee that conferring monopoly rights on them will make them less competitive and more inefficient, and cause them to provide poorer services at higher prices; for, without competition, they will have little incentive to improve.

IV.

Regulatory Reform and Decentralization

In granting greater autonomy to local governments, or decentralizing, Indonesia has enhanced the authority of local governments to enact regulations. Since decentralization began, DPRD's and local administrations have enacted many regulations. Because the central government does not fully fund local governments, many of the new local regulations impose taxes and fees of various kinds. These taxes range from tariffs on imports and exports from the locality, cargo hauling and loading and unloading levies, forced "contributions" from various kinds of production companies, to road and transport charges. In addition, local governments have added regulatory and quarantine inspection requirements. Some of these many levies and requirements interfere with free domestic trade, and many appear to lack any purpose other

than raising money. For example,⁴ the province of Lampung requires vehicle inspections every six months, which seems excessive even in a generous view of a potential governmental safety concern. Similarly, a number of kabupatens have created a requirement that parties having livestock within their jurisdictions must possess livestock cards for the animals (kartu ternak). Offhand, it is difficult to discern just what purpose, other than fee-generation, such a requirement serves.

In addition to local regulations imposed to raise funds, there are also a number of new regulations that aim at establishing local monopolies. Kabupaten Cirebon, for example, requires that all fish sold in the district must be sold through a local government owned cooperation. Similarly, a North Sulawesi Governor's decree limits the ability of nonlocals to establish pharmacies in the province and effectively permits the North Sulawesi Pharmacy Association to bar the entry of nonlocals into the pharmacy business.

When it comes to domestic commercial matters, local regulatory power differs from national regulatory power only in geographical scope. All the concerns that counsel regulatory reform and regulatory impact assessment at the national level advise it as well at the local level. As the examples above show, local regulations can increase the costs of doing business, and thus interfere with competitiveness; and local regulations can impede competition.

Even more importantly, as noted earlier, regulatory reform is a good governance issue. Indonesian regulatory reform at the national level would introduce transparency, responsiveness, and accountability into the use of regulatory power. It would also produce regulations better designed to serve legitimate government purposes than current regulations do, as well as regulations whose benefits exceeded their costs.

All the arguments for regulatory reform at the national level apply with equal or greater force to regulatory reform at the local level. What may make the arguments stronger for local level regulatory reform are the multiplicity of jurisdictions in Indonesia, and the fact that some local regulations may have effects outside the jurisdiction. Consider, for example, a river that passes through a number of local government jurisdictions. Each jurisdiction might have its

⁴ The examples I use are taken from a report written by David Ray for the Partnership for Economic Growth, a USAID-GOI joint project: Ray, David, *Inventory of Trade-Distorting Local Regulations* (Dec. 2001). Copy in author's possession.

own environmental regulations, and upstream regulations will affect all downstream users of the river. Thus if the first jurisdiction through which the river passes allows excessive pollution to be dumped into the river, those living in downstream jurisdictions will suffer the effects. Another example is the relationship between local regulation, local development, and flooding. A jurisdiction might allow development to take place in such a manner as to interfere with the natural flow or river and drainage waters. The result might be that the runoff is cast onto another jurisdiction, causing flooding when there had been none before.

These examples show that some local regulations, while perhaps benefiting some insiders, impose costs on outsiders. In other words, regulations can have externalities that regulators might not take into account – unless the regulatory process itself brings them to governmental attention. The regulatory reform procedures this paper advocates – administrative due process that includes public notice of proposed government action, public consultation, public hearings, required regulatory impact assessments, and a right of review – would disclose these potential regulatory problems.

In addition, suppose Indonesia undertakes national regulatory reform, but does not undertake local government regulatory reform. Improvements in national level governance would not, in any direct way, pass to local governments, but all the regulatory problems that now exist at the national level would appear at local levels – as already seems to be the case. The reform, while bringing some benefits, would be seriously incomplete. The governments closest to the people, the local governments, will have no enforceable obligation to act transparently and accountably, and will lack the tools that make for good regulation in the public interest.

Regulatory reform at the local level is intertwined with reform at the national level. As it is a model, absent central government regulatory reform, it is unclear whether local governments will undertake regulatory reform on their own accord. Some progressive local governments might do so because they realize that such reform will confer competitive advantages on them and their businesses. If this does occur, other local governments might follow their lead. It is too early to tell whether this will come about, and such evidence as we have suggests that local governments are busily regulating, and in objectionable ways, rather than deregulating or working to improve existing regulations. On the other hand, if the central government engages in regulatory reform, local governments may find the national model attractive and introduce their own reforms. Of course, the national government could mandate regulatory re-

form at the local level, but this would not likely be effective without national level reform as well.

For these reasons, regulatory reform at the local level is as important as, perhaps more important than, regulatory reform at the national level, and it is in Indonesia's interest to insure that this occurs.

V.

Corruption, Administrative Law, and Regulatory Reform

Most observers assert that there is widespread corruption in Indonesian governmental agencies, both national and local.⁵ Without seeking to prove this here, let us assume that there is some corruption in such agencies, and that the corruption is not incidental, but great enough to be of concern.

If, in an effort to curb the corruption, we ask how the corruption occurs, we can use to good effect Robert Klitgaard's formula: corruption equals monopoly plus discretion and an absence of accountability. Administrative and regulatory agencies effectively have, for matters falling under their jurisdiction, monopoly power. Agencies control access to information, the issuance of permits, licenses, and contracts. Many of them can issue regulations that can help or injure businesses; some of them may have the power to issue administrative sanctions for regulatory violations. Depending on what a citizen may want to do, there is undoubtedly some agency he must deal with. As far as the citizen is concerned, he may not be able to act legally unless he gets agency approval, *e.g.*, a business license. While no one is obliged to open a business, if one wishes to do so, he must deal with all those government offices that issue all the licenses and permits one needs to operate a business lawfully.

While laws may require government agencies to take certain actions when citizens provide certain information and pay certain fees, where there is little oversight of government employees, they may act as though they had discretion whether or not to grant a request. In addi-

⁵ ⁵ The 2001 Transparency International Corruption Perception Index (CPI) ranks Indonesia as 88th out of a survey of 91 countries, above only Nigeria and Bangladesh. The survey attempts to measure perceptions of corruption across countries. *Corruption Perception Index 2001*, Transparency International: 2001. <http://www.transparency.org/documents/cpi/2001/cpi2001.html>

tion, where laws and regulations are vague, multiplicative, or inconsistent, government agents must of necessity interpret them. This need to interpret confers on them a power of discretion. That discretion allows them to grant, or to refuse to grant, what a citizen may request. In such circumstances, the power to refuse creates an opportunity to grant a request for a price. The government agent's control over something a citizen needs gives the agent the power to demand a payment to himself, over and above any proper fees required.

Similarly, officials can use agency power to issue regulations to extract rents. A domestic business that produces a product for which there is import competition could ask the relevant Ministry to issue a regulation restricting imports of the competing product. Because the Ministry has so much discretion over such matters and because there is neither openness nor accountability in the issuance of ministerial regulations, this creates an opportunity for the relevant officials, if they are so inclined, to seek a payment in exchange of the requested regulation.

The fact that Indonesia does not have an administrative procedures law and does not undertake regulatory impact assessments facilitates the ability of officials to abuse their positions and to obtain corrupt payments. A proper administrative law would make agency actions open and transparent by making them public, something perfectly proper as agencies are supposed to do the public's business. In making agency actions public, such a law would also make agency officials accountable, for agency actions would be of record, and the public could surveill agency activities. An administrative procedure law would not prevent all instances of corruption in government agencies, but would make them more detectable and therefore more difficult to carry out.

In addition, on the regulations side, an administrative law that defined the procedures to be followed in the drafting and adopting of regulations could curb the corrupt use of regulatory power. Pre-issuance public hearings, and the stakeholder consultation, and cost-benefit analysis called for in regulatory impact assessments also present strong tests that proposed regulations must pass before being placed into law. Corruptly induced regulations that serve particular special interests would have difficulty passing these tests, for the tests expose who benefits and who loses from a proposed regulation and also insure that regulations have a valid and understandable public justification.

In these ways, administrative law and regulatory reform in Indonesia would not only improve administrative performance and enhance competition and competitiveness, but also provide an important tool for reducing and ending corruption in government agencies.

VI.

Institutionalizing Regulatory Reform in Indonesia

Regulatory review and deregulation are disciplines that many governments have adopted to improve regulation, enhance competitiveness, and improve the regulatory environment. The real benefits that these disciplines deliver only arise, however, when governments institutionalize them and make them a part of ordinary governmental functioning.

The current crisis has impelled Indonesia to recognize the importance of deregulation for economic recovery and growth. In August 1998, the People's Consultative assembly (DPR) approved Law No. 5 on Monopoly and Healthy Competition. This law establishes the Supervisory Commission on Business Competition (KPPU), and Article 35e of the law authorizes the Commission to comment on the anti-competitive effect of laws, regulations and policies. While the Commission may comment on them, its main function is to police the anticompetitive practices of private businesses, not the Government's efforts to reduce competition or regulate in ways that result in the costs of regulation exceeding the benefits.

If, however, Indonesia wants to realize the benefits of regulatory review and regulatory impact statements – optimized policy, better governance, more efficient and better regulation, more competitive businesses and a more efficient, lower cost economy – then it must consider institutionalizing these disciplines, as other governments have done. The questions to address here are how best to institutionalize them and what resources are needed to do so.

Framework: An Administrative Procedures Law

Were Indonesia to adopt a framework law regulating all administrative agencies, including local governments – an administrative procedures act – that required openness and transpar-

ency in administrative agencies and proceedings, it would go a long way toward improving administrative performance. In doing so, it would also lay the groundwork for an effective system of regulatory review. Even without systematic regulatory review, which calls for cost-benefit analyses, however, openness, transparency, and due process in administrative actions and proceedings would lead to better regulations. This is simply because stakeholders, that is, parties potentially affected by proposed governmental regulations, would have the opportunity to comment on and critique the regulations before they went into effect. This would ultimately insure that the government was made aware of unseen problems and would enable it to tailor regulations in the least burdensome and most effective ways possible.

Although it would be best to do so, Indonesia need not necessarily adopt an administrative procedures law in order to obtain some of the benefits of regulatory review. Indeed, it would be a positive step were any Indonesian ministry or local government to begin conducting regulatory impact assessments of proposed regulations. Undoubtedly, too, because Ministries and local governments could do this of their own accord, this would be an easier reform to institute than calling on the DPR to enact a major framework law applying to all Indonesian administrative agencies and local governments. In what follows, we propose an immediate and incremental strategy for introducing the benefits of regulatory review in Indonesia. This strategy does not presume the passage of a framework administrative procedures law, but does assume the willingness of some Ministry and some local governments to undertake pilot regulatory review projects.

Incrementally Institutionalizing Regulatory Review

Most governments that conduct regulatory reviews require that each agency proposing a new regulation itself carry out a regulatory impact assessment prior to adoption. There are significant advantages in assigning the regulatory review task to the regulators themselves. Firstly, the agencies proposing regulations have the most knowledge about them. Secondly, when each agency does its own regulatory impact assessment, it can incorporate the regulatory review ethos into all its work. In other words, it becomes an important, yet routine, part of agency work. Finally, the other major alternative way of conducting regulatory reviews, creating a special agency to do so, would appear to create a super bureaucracy and would undoubtedly create delay and inefficiency in the adoption of regulations.

While it seems best to require all government agencies to conduct their own regulatory reviews and assessments of proposed regulations, there are nonetheless issues that must be addressed. These are issues of agency bias, consistency of regulatory review and assessment across agencies, and quality control.

Special interests oftentimes capture, to a certain degree, the regulatory agencies that regulate them. In addition, agencies often have special expertise in the areas they regulate, and even when they don't, they may believe they have such expertise. This can lead to a "the agency knows best" attitude, which, in turn, may mean that the agency does not conduct regulatory reviews and assessments in a truly objective and impartial way. These two together, special interest pressure and agency partiality, comprise agency bias.

The second issue, consistency of regulatory review practices across government agencies, is really a quality control problem. When the same task, here regulatory review, is assigned to many different actors, there will undoubtedly be great variation in performance, ranging from the good to the bad. It is therefore necessary to have some sort of check on agency regulatory review performance.

As regulatory review has little value unless performed objectively, governments need some way to oversee and review agency regulatory review work. Similarly, to spread the benefits of good regulatory review, governments must insure that each agency achieves a certain quality of regulatory review. For these reasons, while most governments do assign regulatory review to regulatory agencies themselves, they also create a government agency, and office of regulatory review, that has the responsibility of reviewing the regulatory review work of other governmental agencies.

To be clear, an office of regulatory review does not have first-line responsibility for conducting regulatory reviews and assessments. Instead its function is to review the first-line work of other governmental agencies to insure objectivity, impartiality, and regulatory review consistency. In order not to delay the adoption of important government regulations, government agencies need not necessarily await office of regulatory review approval prior to issuing a regulation. Post-issuance review, with some authority to remand a regulation for revision, is all that is necessary.

Other major issues in institutionalizing regulatory reviews and assessments involve administrative process and training. As Indonesian governmental agencies do not now conduct such activities, it is obvious that to do so, regulatory review and regulatory impact assessments would have to become an official step in regulation preparation and issuance. In each agency, some personnel – perhaps those who now initially draft regulations – would be given the function of carrying out regulatory review and assessment activities. In proper sequence, they would receive requests for proposed regulations, do their analysis, draft a regulatory review assessment, make regulatory drafting suggestions or redrafts, and then make their recommendations. A Minister or other responsible official would then decide on the final form of the regulation.

In addition, it is clear that it would be necessary to provide these regulatory review personnel in each agency with adequate training to insure that they can carry out regulatory reviews and assessments and undertake drafting.

It is a fair assessment to say that today Indonesian Ministries and other governmental agencies, national and local, do not have the human resources and the technical ability to carry out large-scale and systematic regulatory review. Regulatory review and evaluation are not parts of the ordinary working of Indonesian bureaucracies, and, to our knowledge, these bureaucracies do not take cost-benefit considerations into account in decisions to regulate, nor do they give much consideration much consideration given to the best form of regulation. Introducing regulatory review and evaluation to the many Indonesian administrative agencies and educating Indonesian civil servants to the skill levels required to do such analyses and evaluations well would be a major reform and would call for long, sustained effort.

Notwithstanding, it is important for Indonesia to realize that this is an analytic discipline that it is important to acquire and spread through the national and local governments. In these circumstances, Indonesia is best advised to adopt an incremental program of regulatory review, introducing it first in those agencies where the immediate payoffs are demonstrable, where agency personnel have already acquired some of the knowledge and skills necessary to carry out such analyses, and where there may be agency and public support for the activity. As the local skills and expertise develop and such agencies learn how to incorporate regulatory review and evaluation into their normal work, Indonesia can develop a foundation on which to build a more thorough government-wide system of regulatory review.

There is at least one national Indonesian administrative agency that currently meets the conditions mentioned, the Ministry of Industry and Trade. The Ministry has been central in recent Indonesian governmental deregulation efforts. A number of its higher-level staff has received training in regulatory impact assessments, competition economics, and cost/benefit analysis. The Ministry appears quite interested in undertaking regulatory impact assessments of its own regulations and certainly has a concern about local regulations that interfere with competition or free trade within the country. Finally, there are a number of business associations, such as Kadin (Indonesian Chamber of Commerce), the textile association and various other trade groups, that have an intense interest in MoIT regulations and their impact on competition and competitiveness. Additionally, as one of Indonesia's Ministries that have an important role to play in the economy and business life, it is well positioned to model, and demonstrate, the usefulness of regulatory review.

As the ultimate goal is to institutionalize regulatory review in Indonesia incrementally, using MoIT as a pilot agency to demonstrate the feasibility and utility of regulatory review is a good start. But it would be well to involve other influential actors as well. It is unlikely that MoIT success with regulatory review would, of itself, lead other agencies of the Indonesian government to adopt the practice. Fortunately, Indonesia has two other governmental agencies that have crosscutting interests and authorities in regulatory matters. These are the Ministry of Justice and Human Rights and the Cabinet Secretariat. The former is on record as desiring to coordinate the drafting of legislation and regulations for the government. The latter has historically been a final checkpoint in the executive office for the issuance of presidential decrees and regulations.

In my judgment, Indonesia's efforts to use, and eventually institutionalize, regulatory review should involve these two key agencies. Of all Indonesian agencies of government, they each have an encompassing, and common, interest in the quality and consistency of Indonesian regulations. In the long run, they also appear to be the Indonesian agencies that would be critical actors in encouraging, or requiring agencies other than MoIT to undertake regulatory reviews.

Under Indonesian law, Indonesian Ministries have the authority to issue regulations relating to tasks delegated to them under the signature of the Minister. Any regulatory review institu-

tionalization pilot project, should first work with existing institutions and institutional authorities as they are. Thus, by proposing the involvement of the Ministry of Justice and Human Rights and the Cabinet Secretariat, I do not mean to suggest that these latter agencies should have any approval or review authorities they do not currently already have. Thus, following internal regulatory review within MoIT, the Minister of MoIT could issue regulations as before and the Ministry would not have to await approval or concurrence from the other agencies. These agencies would, however, receive copies of the regulations and regulatory impact statements and would be asked to serve as *post hoc* quality control agents. Their comments would provide feedback to MoIT and in that fashion affect the way future RIAs were done. In addition, depending on the character of the comments, their advice might prompt the Minister or MoIT to reconsider the regulation.

In addition to a regulatory review pilot project at the national level, it would be well to have a few regulatory review pilot projects that involve receptive local governments. Doing so would permit Indonesian policymakers, business owners, and citizens to see the results of regulatory reform. They would be in a position to compare local government jurisdictions and decide whether the good governance moves recommended here have the economic performance and public interest benefits claimed. In terms of good governance, there is also no downside, because none of the recommended reforms can damage governmental performance. The reforms would likely be detrimental to any special interests that now command, or buy, governmental solicitude, but this is not a negative result. If such experiments succeed at the local level in a few jurisdictions, it is also likely that other local governments would come to adopt the same measures, for success has many imitators. In this fashion, even without central government mandate, regulatory reform could spread through Indonesia's local governments, to the great benefit of many citizens.