

# Promoting inclusive growth and better trade relations with Indonesia

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## Question

- *What is the current government of Indonesia's approach to fiscal policy, international trade, and inclusive economic growth?*
- *What are international (bilateral and multilateral) donors currently working on to support trade and prosperity in/with Indonesia?*
- *Are there any existing models of international technical cooperation with Indonesia on trade / development, which aim to provide mutual benefits to both donor and Indonesia?*

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# 1. Summary

This rapid review synthesises the literature from academic, policy, and knowledge institution sources on the political economy of Indonesia, concerning recent inclusive growth efforts in Indonesia. It can be concluded that the transformation of Indonesia's economy to a more resilient economy, which is integrated within the Asia region, has been successful and gained the country more global political powers. However, the economic literature on Indonesia remains limited, and "studies that provide a comprehensive and integrated macroeconomic analysis are particularly scarce" (Breuer & Kinda, 2018, p.3). Still much of the existing recent literature focuses on the periods leading into either the Asian financial crisis or the global financial crisis. The literature used in this review, showed that:

- Indonesia's economic policy seeks stability before growth.
- The country has a favourable demographic trend of increasing the working population until 2030, and with healthy urbanisation rates, which could increase market development.
- Indonesia reduced poverty levels by half to 11% between 1996 and 2016, but this trend has slowed down in recent years.
- Indonesia faces a challenge with low tax revenue, which has limited the Government's ability to increase public investments in infrastructure, health and social safety nets. Indonesia's investment gap is larger than in other countries in the Asian region.
- The country faces a low level of Foreign Direct Investment (FDI). Low participation in global and Asian value chains limit Indonesia's ability to tap further into the growing Asian consumer market, complicating the transition from a commodity-dominated economy to a more innovative, services-oriented economy.

The government of President Joko Widodo has recognised that the country is undergoing a period of profound economic transition, and has focused on shifting its economy away from its dependence on commodities towards one that depends much more heavily on productive sectors and services. The Government's Mid-term Development Plan (RPJMN 2015-2019), focuses on human and community development (decentralisation), narrowing the income gap through increased productivity and poverty reduction measures (sector approach), and increasing development without environmental degradation. It seeks to raise infrastructure investment through state-owned enterprises and public-private partnerships. It tries to boost FDI and improve the business climate with a one-stop service to expedite investment approvals and streamlining the land acquisition process for investments, for example.

The Government also is preparing for major tax reforms to increase revenues. As this process is slow, the Government has tried to collect more taxes through short-term actions and through Presidential-level and Ministerial-level regulations. A Tax Amnesty Programme (TAP) launched in 2016 raised taxes and fees equivalent to 10.4% of average tax revenues in 2013-15. Through regulations issued annually, the government has also revised the tobacco excise, increasing the minimum regulated price and raising tariffs. The Government is also trying to improve its collection methods, by facilitating the payment of taxes so that the burden on complying taxpayers is reduced, mainly through digitalisation. The Government also restructured gasoline and electricity subsidies, sparking a critical shift in expenditures away from regressive energy subsidies towards higher investment in human and physical capital.

Over the past decade, Indonesia has become more protectionist in trade policy, mainly through non-tariff measures. More recently, the Government has tried to reform the trade policy, trying to make import and export flows more efficient, streamlining non-tariff measures and removing some bottlenecks of protectionist policies faced by (international) traders and investors. To graduate from the status of basic commodity exporter subject to global price swings, low value added, and limited employment growth, Indonesia needs to continue its structural reform efforts to improve its competitiveness in higher-technology products, economic complexity, and participation in global value chains.

International donors' (bilateral and multilateral) development programmes in Indonesia are in line and shaped around the Government's inclusive growth strategy. Key evidence from Australia, Denmark, Germany, Japan, Norway, and the US (including UNDP and the World Bank) is highlighted below:

- Environment, climate change, and renewable energy are key areas. All mentioned donors have invested substantially in areas of natural resources management, waste management, and renewable power infrastructures, in the fight against climate change, pollution and loss of biodiversity.
- In the area of poverty reduction, donors invest in social protection schemes and in specific sector programmes, e.g. agriculture, fishery and shipping. Donors work on improvements in markets, international value chains (e.g. regulations), and reducing the skills and investment gaps, in an attempt to reduce the rising inequality trends and improve investment climate during the economic transformation of Indonesia.
- Although supply chain development and trade facilitation do not seem to be the most important development topics for these international donors, they have established trade relations with Indonesia with strategic partnership agreements. Hence, development spending relate to economic sectors that are important for their businesses: e.g. wind energy (Denmark), fishery (Japan and Norway), hydro-power plants (US), electrification (Germany), maritime sector (Japan and Germany), and agriculture (Australia). This creates mutual benefits, through investments and technical assistance.
- Donor countries benefit from these development programmes through gaining access to better quality, more sustainably supplied inputs, like palm oil, timber, fish and meat. And indirectly through climate change measures.
- However, the development programmes and bilateral trade relations do not seem to have a large impact on the further development of the manufacturing sector that can add value; investments are concentrated in more "traditional" sectors, like those mentioned above.

## 2. The political economy of Indonesia's development

### General trends

Indonesia has a population of 264 million people, making it the fourth most populous country in the world.<sup>1</sup> It is the largest economy in Southeast Asia and the world's sixteenth largest economy, with Gross Domestic Product (GDP) of approximately US\$1 trillion (Breuer & Kinda,

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<sup>1</sup> Information retrieved from UNCTAD website: <https://unctadstat.unctad.org/countryprofile/generalprofile/en-GB/360/index.html>

2018, p.3). It ranks seventh largest in global purchasing-power-parity terms.<sup>2</sup> Indonesia has played an increasingly prominent role in the global policy debate, including as a member of the Association of Southeast Asian Nations (ASEAN) and the Group of 20 (G20). In the aftermath of the Asian financial crisis in the late 1990s, the country adopted a wide range of political and economic reforms (*reformasi*). A decentralisation programme gave greater direct authority, political power, and financial resources to regencies and municipalities (Nasution, 2016).

Reforms included the adoption of a floating exchange rate, fiscal rules that limited the deficit and capped public debt, and an inflation targeting regime. Sectoral reforms opened up the economy and have improved the business environment. The FDI regime was partially liberalised, including for logistics, tourism, and agriculture. Banking sector reforms overhauled regulation and supervision. Hence, as Breuer and Kinda (2018, p.5) conclude: “the economy became much more resilient, benefiting from comfortable external positions, low public debt, and ample international reserves”.

Economic growth has stabilised at approximately 5% since 2013 (5.1% in 2018), inflation is about 3%, the current account deficit is modest at less than 2% of GDP, and the fiscal deficit has been kept below the statutory deficit ceiling of 3% GDP. Although growth is solid, it is well below government ambitions to reach 7-8% GDP growth. Economic analysts’ view is that it is inadequate in terms of the job creation and economic modernisation required to meet Indonesia’s development needs and ambitions: “The problems are structural. Indonesia is hemmed in by the need to protect stability while its growth model has struggled to deliver the productivity gains necessary to grow faster within this constraint.”<sup>3</sup> Some analysts call this Indonesia’s “stability first mantra” above economic growth.<sup>4</sup>

In development terms, Indonesia reduced its poverty levels by half to 11% between 1996 and 2016 (Breuer & Kinda, 2018). However, the lower economic growth since the commodity boom has been accompanied by much slower progress in reducing poverty and informal employment, reflecting Indonesia’s need for faster growth in order to productively absorb its expanding working-age population.<sup>5</sup> Although there has been some progress, gender disparities remain prevalent. The gender gap in labour force participation declined slightly between 1996 and 2016, but is still substantial, with the female labour force participation rate at 51% compared with 82% for men (Breuer & Kinda, 2018, p.6).

The literature mentioned some major trends that are likely to transform the Indonesian economy in the future:

- **Favourable demographics:** Indonesia is undergoing a demographic transition: infant mortality has halved to 22 infants’ deaths for every 1,000 live births between 1996 and 2016, and fertility rate has reduced from 2.5 in 2000 to 2.4 children per woman in 2016

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<sup>2</sup> Information retrieved from IMF, World Economic Outlook, April 2018 database:  
<https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx>

<sup>3</sup> Cited from Roland Rajah online publication for Lowy Institute (August 2018):  
<https://www.lowyinstitute.org/publications/indonesia-economy-between-growth-and-stability>

<sup>4</sup> As cited by Roland Rajah in his online publication for Lowy Institute (August 2018):  
<https://www.lowyinstitute.org/publications/indonesia-economy-between-growth-and-stability>

<sup>5</sup> Information retrieved from Roland Rajah online publication for Lowy Institute (August 2018):  
<https://www.lowyinstitute.org/publications/indonesia-economy-between-growth-and-stability>

with the expectation of a 2.1 children in 2030 (Breuer & Kinda, 2018, p.6). The result is an increase in the working-age population (defined as persons 15 to 64 years old) of 2.5 million people a year between 2000 and 2016. The “demographic dividend” will last until 2030, after which the working population will decline (World Bank, 2015). This increasingly educated and IT-savvy youth can boost overall productivity with the right policies in place and is expected to increase the growth of Indonesia’s annual GDP per capita by close to 0.2 percentage points between 2020 and 2050 (Breuer & Kinda, 2018, p.7). McKinsey and Company (2016) estimated that Indonesia’s consumer class could grow by 90 million by 2030. Such an increase would represent the third-largest expansion of consumers in the world (after China and India), providing unique economic opportunities.

- **Rapid urbanisation:** By 2025, 68% of the population in Indonesia is projected to live in urban areas, compared to 52% in 2012 (World Bank, 2015). As income raises the demand for consumer durables, working space and housing will not only increase in metropolitan areas, but also increase significantly in smaller cities: “Connecting these cities and their inhabitants to rural areas, metropolitan areas and the global economy will be essential to attracting firms and achieving shared prosperity” (World Bank, 2015, p.14). There is evidence that urbanisation supports growth and poverty in Indonesia, relating to the presence of adequate infrastructure and services. This is why Indonesia has not gained as much economically for its degree of urbanisation as China and Vietnam, nor has poverty declined as much as in these countries, given the degree of urbanisation (World Bank, 2018c).
- **Emergence of the digital economy:** Due to demographic trends, Indonesia has the third-largest youth population in the world and 130 million active social media users (Breuer & Kinda, 2018). Therefore, Indonesia is poised to have the largest digital economy of all Southeast Asian countries. According to McKinsey and Company (2016), digitalisation could expand Indonesia’s economy by 10% by 2025. Most of the digital dynamism in the economy relates to ‘big data and advanced analytics’ and ‘e-money’. E-money, which is mostly used by lower-income individuals, almost quadrupled between 2014 and 2017 (McKinsey and Company, 2016). A recent survey by the Economist Intelligence Unit (2017) ranked Jakarta as the eighth best city in the world for digital companies, and particularly praised it for developing new technologies and for innovation and entrepreneurship.
- **Increasing role of Asia, particularly China, in the global economy:** With the highest expansion of consumers in the world expected in Asia, external demand for Indonesia’s products - ranging from agricultural goods to energy, commodities, tourism, and manufactured goods - is well positioned within the region, in particular the ASEAN group (Breuer & Kinda, 2018). Although China’s current rebalancing of its economy will affect commodity exporters such as Indonesia (IMF, 2016; Mathai et al., 2016), China’s consumption is expected to increase, which can benefit Indonesia’s agriculture, tourism, and manufacturing sectors in particular (World Bank, 2015).
- **Commodity prices:** The end of the commodity boom should also increase the relative profitability and attractiveness of manufacturing, and can help Indonesia develop its industrial base. Lower commodity prices are shifting the political economy in favour of reforms that would improve natural resource management. For example, lower prices are an opportunity to make more sustainable the growth trajectory of the palm oil industry (World Bank, 2015).

These economic opportunities also face some major challenges, as inequalities have increased significantly in Indonesia. Youth unemployment is high, as economic growth does not sufficiently absorb all new entries to the labour market, to make the most of the demographic dividend. This

has resulted into a large informal labour market (Breuer & Kinda, 2018).<sup>6</sup> As the section on fiscal policy (below) shows, Indonesia faces a challenge with low tax revenue, which has limited the Government's ability to increase public investments in infrastructure, health, and social safety nets. This also hampers investments in digital infrastructure and education, which are also important to reap the benefits of the digital economy.

Moreover, as the section on international trade policies shows (below), low level of FDI and low participation in global and Asian value chains limit Indonesia's ability to tap the growing Asian consumer market. This complicates the transition from a commodity-dominated economy to a more innovative, services-oriented economy (Breuer & Kinda, 2018). Furthermore, the impact of the changing global climate bringing higher temperatures, changes in precipitation, flooding and rising sea levels are expected to build in Indonesia over the next 20 years, with especially negative consequences for the poorest people. These impacts will be felt in food and water security and on all those who are dependent on climate-sensitive livelihoods such as fisheries and agriculture (World Bank, 2015).

## Government inclusive growth plan

The Government of President Joko Widodo (inaugurated in October 2014), has recognised that the country is undergoing a period of profound economic transition. It had to deal with lower GDP growth compared with its key Asian trade partners, particularly China. The reason is that commodity prices of key exports have fallen by 40% since their 2011 peak, and domestic private consumption which has been the main driver of growth, has softened. The Widodo administration therefore has focused on shifting its economy away from its dependence on commodities towards one that depends much more heavily on productive sectors and services (World Bank, 2018a; IMF, 2018). The Government's Mid-term Development Plan (RPJMN 2015-2019), reflects its strategy to meet these development challenges by focusing on human and community development (decentralisation), narrowing the income gap through increased productivity and poverty reduction measures (sector approach), and increasing development without environmental degradation.<sup>7</sup>

One of the pillars of the development plan is green economy, focussing on green cities. This includes eradicating illegal logging, fishing and mining, as well as improving governance in natural resources, and increasing community participation in forest management.<sup>8</sup> In addition, the development plan identified key sectors for future economic development. Priority sectors are food, energy, maritime affairs, manufacturing and tourism. Indonesia, for example has the ambition is to become a "maritime nation" and regional and global player in maritime affairs (JICA, 2018). To get the necessary funding for investment, in 2015, the Joko Widodo administration reduced fuel subsidies, which had been the cause of financial rigidity, and thereby created fiscal space for increasing the budget for infrastructure development. In order to overcome the constraints on development budget, efforts have been made to actively utilise

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<sup>6</sup> Information also retrieved from Roland Rajah online publication for Lowy Institute (August 2018): <https://www.lowyinstitute.org/publications/indonesia-economy-between-growth-and-stability>

<sup>7</sup> Link to the non-English development plan 2015-2019: <https://policy.asiapacificenergy.org/sites/default/files/Medium-Term%20National%20Development%20Plan%20%28RPJMN%29%202015%E2%80%932019.pdf>

<sup>8</sup> Information retrieved from the London School of Economics website: <http://www.lse.ac.uk/GranthamInstitute/law/national-medium-term-development-plan-2015-2019-rpjm-2015-2019/>

private funds for infrastructure, by promoting deregulation on foreign capital and developing the mechanism for public private partnership (PPP) (JICA, 2018).

On the other hand, the Government has focussed on reducing income disparity among regions with significant budget allocations to local governments. Furthermore, it has emphasised investments in education and health, medical care, and welfare policies for the poor. In particular, goals are set to achieve national public insurance, as well as improve the subscription rate of labour insurance by 2019 (JICA, 2018). Bearing in mind that the demographic bonus ends in the 2030s, the Indonesian Government has been trying to enhance the social security system.

To boost growth, the authorities have accelerated infrastructure development and improved the business environment. Public investment on infrastructure has increased with several projects currently under construction. The Government has selected 247 priority infrastructure projects, with a total cost of US\$323 billion (32% of GDP), to be implemented in 2015–22 (IMF, 2018). The plan centres on improving logistics, power generation, water and sanitation, and oil refineries. These include constructing 3,650 km of roads, 3,258 km of railways, 24 new seaports, and 15 new airports. The plan also includes developing power plants with total capacity of 35 GW, 33 new dams, and new oil refineries of 600,000 barrels per day (IMF, 2018).

The authorities can do this because they seek to raise infrastructure investment through state enterprises and public-private partnerships (PPPs). Also, coordination has been strengthened. The authorities established the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP) to coordinate priority projects, including by commissioning or amending feasibility studies. The Investment Coordinating Board (BKPM)'s one-stop service has also helped expedite investment approvals, and the land acquisition process has been streamlined and made more flexible (IMF, 2018).

The authorities have also implemented 16 economic policy packages since 2015 to streamline regulations and strengthen productivity. The FDI regime was partially liberalised, barriers to entry have been reduced, including on logistics, and the setting of the minimum wage has been made clearer (IMF, 2018). A single submission system, covering the licenses of both central and 534 regional governments, is being introduced to improve coordination with line ministries and local governments (IMF, 2018). Reflecting these efforts, Indonesia's World Bank's Doing Business ranking improved markedly to the 72nd position in 2018 from the 106th position in 2016 (World Bank, 2018b).

## **Fiscal policy**

Since the Asian Financial Crisis in 1997, the Indonesian government has taken several steps to improve its fiscal structure. Fiscal caution is reflected in State Law No. 17 in 2003, which limits Indonesia's budget deficit to 3% of GDP and Government debt to less than 60% of GDP. The Government's success in maintaining the budget deficit at less than 3% of GDP since 2000 ensured that the Government-debt-to-GDP ratio is now low at 30% of GDP, down from 90% in 2000 (Basri, 2018).

Indonesia still has a weak tax revenue performance (Jin, 2018; World Bank, 2018b). General government revenue has trailed behind other countries in the region, with the gap widening after 2008, mainly related to the sharp decline in oil and gas revenue. Non-oil and gas revenue as a share of GDP remains weak, close to its 2004 level, and has been declining in recent years (Jin,

2018). However, the low tax ratio is also the product of tax policy design decisions. As tax rates are similar with peer countries in the region,<sup>9</sup> sub-optimal policies include (World Bank, 2018b):<sup>10</sup>

- Extensive VAT exemptions;
- High VAT registration threshold level;
- Distortive preferential regimes;
- High non-taxable income threshold for personal income tax, and
- Underutilisation of externality-correcting taxation such as tobacco taxation and green taxes.

These policies were designed with different intentions. Ultimately, however, they have resulted in a collective narrowing of the tax base; a reduction in the tax burden on some sectors, types of taxpayers and types of economic activity; greater inefficiencies, and greater space for tax avoidance and evasion (World Bank, 2018b). In addition to revenue losses, tax incentives and exemptions encourage substantial arbitrage behaviour in the Indonesian economy, leading to inefficient resource allocation. The same value-added tax (VAT) threshold and numerous VAT exemptions also lead to breaks in the VAT chain, significantly compromising the VAT's efficiency and neutrality. In addition, all these exemptions and thresholds have significantly complicated tax administration (Jin, 2018).

The result is that the Government is constrained by its revenue-mobilisation capacity, as spending on infrastructure, health, and education is generally behind that of peers. For example, Indonesia's infrastructure spending is low compared with that of its peers (IMF, 2017). Total infrastructure spending was 2.2% of GDP in 2016, compared with the emerging market Asia average of 5.1% of GDP (World Bank, 2018b). Indonesia's access to infrastructure is particularly low in electricity, road transportation, and health facilities. Starting in 2017, 25% of central Government transfers to regions via the general allocation fund (Dana Alokasi Umum, or DAU) and revenue sharing were ear-marked for infrastructure. However, the non-central-government channels seem to involve more risk and entail less capacity to develop, plan, and implement

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<sup>9</sup> Jin (2018) states that at 10%, the standard value-added tax (VAT) rate is modest, but in line with other countries in the region. The statutory Corporate Income Tax (CIT) rate is 25%, in line with the OECD average and with that in major emerging market economies. The Personal Income Tax (PIT) schedule, comprising four marginal tax rates (5%, 15%, 25%, 30%), is also generally consistent with other emerging economies (Jin, 2018). However, Indonesia's C-efficiency ratio is about 0.6, which means the authorities only collect 60% of total VAT revenue. In addition, CIT productivity (defined as the ratio between CIT revenue as a percentage of GDP and the top CIT rate) is low (Jin, 2018). Factors that could explain such low tax productivity, include the numerous lower-rate regimes for corporations, generous exemptions, and weakness in tax administration. Jin (2018, p.88) states that "[t]hese findings suggest that there is much room to improve tax policy".

<sup>10</sup> Examples of lower-rate CIT regimes mentioned by Jin (2018) are: a 1% presumptive tax on gross revenue for small and medium enterprises with annual turnover of less than IDR 4.8 billion (about USD355,100), a rate reduction of 50% for taxable income corresponding to gross turnover up to IDR 4.8 billion for medium-sized enterprises with annual turnover of less than Rp 50 billion, and a reduced rate of 20% for publicly listed companies. Many VAT exemptions have been granted to both final and intermediate goods and services by the VAT law and government regulation, including for mining (unprocessed products); staple foods (agriculture); tourism (hotel and restaurant), transportation, and employment services; banking and insurance; art and entertainment services; education, medical, and social services; capital goods (machinery, plant, and equipment); agricultural, plantation, and forestry products; electricity (excluding that supplied to households whose consumption exceeds 6,600 watts); distributed piped water; cattle, poultry, and seeds; weapons for the army; educational books; ships, trains, and aircraft and their spare parts, and low-cost housing. Some of the exemptions (e.g. for staple foods) are commonly used in other countries to protect the poor, but most other exemptions in Indonesia are not common. The turnover threshold for mandatory VAT registration is IDR 4.8 billion, the same as the previously mentioned CIT threshold for the 1% turnover tax in lieu of the regular CIT. This threshold is very high compared with other ASEAN countries. This VAT threshold covers only 50,000 firms.

investment projects efficiently (IMF, 2018). Hence, based on IMF (2018) research, an indicator for physical access to infrastructure shows relatively low efficiency in Indonesia's public investment. The resultant efficiency gap between Indonesia and the most efficient countries with comparable levels of public capital stock per capita is 56%, much wider than the average gap for emerging market economies (41%), emerging and developing Asia (50%), and all countries (41%).

The impact of Indonesia's overall fiscal policy on inequality reduction has been very limited, compared with other emerging market countries, particularly those in Latin America (Jin, 2018). Where Latin American countries spent much of their windfall revenue from the commodity boom in the 2000s on equity-enhancing areas such as social assistance, health, education, and infrastructure, Indonesia has mandatory spending floors for health and education (5% and 20% of budgetary expenditure, respectively). However, as Jin (2018) mentions, Indonesia still has much room for spending on its most equity-enhancing programmes, particularly on conditional cash transfers (*Programme Keluarga Harapan*, or PKH), targeted rice transfers (*Beras untuk Rakyat Miskin*, or RASKIN), and scholarship programmes for poor students (*Bantuan Siswa Miskin*, or BSM).

Tax reform is a challenging process, as legislation is complex and requires balancing multiple political and business interests. So that it can be passed through cabinet and parliament, the Ministry of Finance is preparing major tax law changes, as well as preparing a medium-to-long term tax reform strategy to guide the reform process for the next few years. As the process is slow, the Government has tried to collect more taxes through short-term actions and through Presidential-level and Ministerial-level regulations (World Bank, 2018b). A Tax Amnesty Programme (TAP) launched in 2016 raised taxes and fees equivalent to 10.4% of average tax revenues in 2013-15, and led to declarations of total assets worth IDR 4,882 trillion, 39.3% of 2016 GDP (World Bank, 2018a). TAP success was driven in part by the ability of the Government to persuade high net worth individuals to participate. Efforts to collect more at the upper end of the tax bracket also took the shape of proactive involvement in the OECD-led Inclusive Framework to tackle base erosion and profit shifting (BEPS), which Indonesia adopted in July 2016. In June 2017, Indonesia became one of the signatories of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI); by September 2018, Indonesia is set to undertake the first information exchange as part of the automatic exchange of financial account information (AEOI) (World Bank, 2018b).

Through regulations issued annually, the Government has also revised the tobacco excise, increasing the minimum regulated price and raising tariffs. The Government is also trying to improve its collection methods, by facilitating the payment of taxes so that the burden on complying taxpayers is reduced. In July 2015, for instance, the Government launched an electronic VAT invoice online application that enables systematic submission of detailed information on taxable goods and services by taxpayers, as part of a policy of mandating VAT for businesses that came into effect in 2016-17 (World Bank, 2018b). Electronic e-filing systems are also being developed and rolled out, with the Directorate General of Taxes (DGT) seeking to gradually enforce e-filing of corporate income taxes and of withholding taxes from employees' payrolls.

The Government has recently spent more in areas that relate to inclusive growth. In 2015, the Government removed gasoline subsidies, sparking a critical shift in expenditures away from regressive energy subsidies towards higher investment in human and physical capital (IMF, 2018; Breuer & Kinda, 2018; World Bank 2018b). In 2017, the Government also improved the

targeting of electricity subsidies by moving the non-poor and non-vulnerable (900 VA) household customers under a non-subsidised tariff (World Bank, 2018b). The amount allocated under the Specific Allocation Fund (*Dana Alokasi Khusus*, DAK), designed to boost local infrastructure, has increased at a compound annual growth rate of 30% in nominal terms from 2008 to 2016 (World Bank, 2018b).

## International trade policy

Since the start of the new millennium, compared with the rapid expansion of domestic demand, Indonesia has become relatively less integrated with the global economy in both trade and finance, even though it has maintained its global market (Isnawangsih & Lu, 2018). Indonesia has doubled its merchandise trade with the rest of the world and maintained its overall share in the global market broadly unchanged at 1%. However, its exports as a percentage of GDP halved between 2000 and 2016. Exports and imports represented, respectively, 40% and 32% of GDP in 2002, and declined steadily to less than 20% by 2016 (Isnawangsig & Lu, 2018).

The decline in Indonesia's external sector exposure is in particular the result of falling trade with advanced economies. Between 2000 and 2016, the share of Indonesia's exports to advanced economies declined by about 25 percentage points, and the share of imports from advanced economies declined by an even larger 45 percentage points (Isnawangsig & Lu, 2018). The region that absorbed those declining shares from advanced economies was predominantly emerging Asia, to which Indonesia's export shares rose by about 20 percentage points and from which its import shares rose by about 30 percentage points, respectively (Isnawangsig & Lu, 2018).

Observers of Indonesia over the years note that this reflects a complex set of factors, including "legacies from the crisis along with a large domestic base and favourable demographics and urbanisation, which enabled strong growth without high reliance on exports" (Isnawangsig & Lu, 2018, p.163). More recently, the Government has adopted a protection policy, which also played a role in the decline. However, analysts show that achieving Indonesia's ambitious growth objectives - and generating quality jobs for its expanding labour force - will require higher productivity and technological innovations that may be best facilitated by greater integration (World Bank, 2018b; Isnawangsig & Lu, 2018).<sup>11</sup>

A closer look at the composition of exports from the perspective of competitiveness also shows that Indonesia has yet to improve its competitiveness in products with higher-technology components, and has low export sophistication and limited economic complexity; whereas some neighbouring countries have significantly improved competitiveness (e.g. Vietnam, Thailand, the Philippines) (Breuer & Kinda, 2018; Isnawangsig & Lu, 2018; World Bank, 2018a).<sup>12</sup> To graduate

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<sup>11</sup> Information also retrieved from Roland Rajah online publication for the Lowy Institute (August 2018): <https://www.lowyinstitute.org/publications/indonesia-economy-between-growth-and-stability>

<sup>12</sup> Isnawangsig and Lu (2018) show that five key traditional commodity products (gas, oil, coal, palm oil, rubber) have contributed much to the dynamics of Indonesia's exports. Their dynamics synchronised with global commodity price cycles. For example, their total share in exports jumped from 30% in 2000 to a peak of 50% in 2011 before gradually declining to 34% in 2016. Coal and palm oil have replaced oil and gas as the top two export products. The maturing of oil and gas fields, lack of infrastructure investment, and higher domestic demand have turned Indonesia into a net importer of oil and gas since 2011. The global share of palm oil exports almost doubled from 28.1% to 54.5% and that of coal almost tripled from 6.7% to 19.5%. However, the shares of key non-commodity exports, such as electrical appliances and textiles, in total exports declined between 2000 and 2016. Increased regional competition from Bangladesh, Thailand, the Philippines and Vietnam intensified as

from the status of basic commodity exporter subject to global price swings, low value added, and limited employment growth, Indonesia needs to continue its structural reforms efforts to improve its competitiveness in higher-technology products, economic complexity, and participation in global value chains (World Bank, 2018a).

Although Indonesia's declining openness may reflect weakness in the business environment, which has hampered investment and weakened competitiveness, particularly in the export sector (IMF, 2016), protectionist policies have also played an important role (World Bank, 2018a). The trade regime had become increasingly open after the Asian Financial Crisis, with complete deregulation of agricultural products and the removal of most non-trade barriers. However, since then, protectionist measures have risen, particularly on food crops, and these protections have increasingly taken the form of non-tariff barriers such as licensing requirements:

- **Tariffs:** In the past years, Indonesia has hiked import tariff rates, which increases the cost of production inputs and consumption goods, in contrast to the region's tendency towards tariff reduction. Between 2000 and 2017, Indonesia has increased its average import tariff rate by 1.3 percentage points and its tariff rate on intermediates by 0.3 percentage points (World Bank, 2018a). While the country started from relatively low import tariff rates, Indonesia's trend over time contrasts with that of most other countries in Southeast Asia, which have substantially reduced their tariff rates. The use of import tariffs has also included the imposition of antidumping measures on a number of products—including steel and yarn—to protect domestic producers from alleged unfair import competition.
- **Non-tariff measures:** Indonesia has also increased the application of non-tariff measures on goods imports, which are often justified by health, safety, and environmental concerns, but which can also significantly increase importing costs. These measures consist of import licenses and checks aiming to ensure that imported goods are safe for consumers and do not harm public health or the environment. These include diseases carried by plant and animal imports, or safety hazards from goods handled by children. While some of these are legitimate concerns, other measures appear to unnecessarily increase the costs of importing (World Bank, 2018a).
- **Import barriers on services:** Barriers to legal service imports include prohibiting foreign lawyers to set up a commercial presence or practice law in Indonesia; in distribution services - foreign investments are not allowed in a large part of retail distribution, including supermarkets and minimarkets; in maritime transport - foreign companies cannot transport goods between Indonesian ports, hence severely restricting competition in a key transport sector. Recent evidence shows that higher barriers in services stifle competitiveness in Indonesian manufacturing industries that use these services more intensively in production (World Bank, 2018a).
- **Barriers on financial flows:** The difference between Indonesia and its regional peers is especially noticeable - external assets and liabilities in the Philippines and Thailand are well in excess of 100% of GDP, while in Indonesia it counts for 80% (Isnawangsig & Lu, 2018). Some measures of regulatory restrictiveness indicate that Indonesia has one of the most restrictive FDI regimes within the ASEAN-9, including bans on foreign

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the World Trade Organisation (WTO) phased out quotas on textiles and clothing in 1995–2005, while competition from China rose after its accession to the WTO in 2001 (Pangestu et al., 2015).

participation in certain sectors. A host of policy barriers - many included in the Negative Investment List - raise the costs of investing in Indonesia, particularly for foreign investors (Isnawangsig & Lu, 2018). Key examples of such restrictions are included in Indonesia's negative investment list (*Daftar Negatif Investasi*, or DNI), in the form of foreign equity limits, sectoral reservations to micro, small, and medium enterprises (MSMEs), special licenses, and minimum local content requirements (World Bank, 2018a). These restrictions significantly reduce both foreign and domestic investments, reduce entry and performance, and increase prices in the sectors to which they are applied. Following the introduction of a DNI restriction (foreign equity limit, SME reservation, or special license), the entry of new foreign manufacturing plants declines, particularly those which are export-oriented, and so does the exit of domestic plants that are less exposed to competition (World Bank, 2018a).

The Indonesian Government has implemented a number of significant trade reforms in 2018. A national single window system to automate export and import permits has been introduced in more than 21 ports. The authorities are also planning to streamline non-tariff measures, gradually shifting control from border to post border, with an attempt to facilitate the processing of imports and exports (IMF, 2018; World Bank, 2018b). For example, the Government is aiming to move the inspection of documents required for the import of a number of products from the border to post-border audits. This measure has been so far applied to over 2,000 products included in the list of prohibited and restricted goods, so-called "Lartas", mainly through a series of new Ministry of Trade regulations. This list comprises 5,229 products, which are subject to the most stringent importation requirements (World Bank, 2018b). The reform should facilitate the importation process, as it would speed up the customs clearance process, which would become automatic. Given the burdensome documentary requirements associated with the import of many "Lartas" products, the potential gains in terms of costs and time savings are particularly large (World Bank, 2018b).

In a closely related reform, the Government has also sought to simplify and rationalise the documentary requirements for imports on several "Lartas" goods in two ways. First, the Ministry of Trade has abolished some of the import licenses for certain products, such as cement and related products, and has reduced the number of supporting documents required to obtain the import approval, such as the "Deed of Establishment" on corn imports, the technical recommendation by line Ministries for importing products such as tires, corn, iron, steel and related products (World Bank, 2018b). Second, the Government has reduced the existing duplications among various ministries and agencies that require the same supporting documents for issuing permits and licenses to import the same good (World Bank, 2018b).

These new trade policies seem measures to counter protectionist measures, however, at the same time, the Ministry of Trade also issued a new protectionist regulation. From April 2018 it has forced exporters of crude palm oil (CPO) and coal, as well as importers of rice and Government procured goods, to use Indonesian-flagged vessels and to insure their traded products with Indonesian companies. The ostensive objective is to promote the domestic shipping and insurance industries and reducing the large trade deficit, particularly in transport services (World Bank, 2018b).

### 3. Bilateral and multilateral inclusive development and trade support

#### Australia

The Australian Department of Foreign Affairs and Trade (DFAT) estimation is that it will spend US\$224 million of official aid in Indonesia in 2018-19. Australia's aid to Indonesia has been structured around its Aid Investment Plan 2015/16-2018/19, which aligns with the priorities of Indonesia's National Medium-Term Development Plan 2015-2019. This development plan has a strong focus on eastern Indonesia "to help address regional disparities in development, while maintaining growth momentum in other parts of the country." Australia's Aid Investment Plan has three objectives:

**1. Effective economic institutions and infrastructure:** Australia's efforts to boost inclusive growth and productive jobs through access to better quality of infrastructure includes support for financial sector stability, revenue mobilisation, and improved Government spending and tax collection. Furthermore, it centres support around sanitation, road infrastructure projects and agricultural markets for poor farmers in eastern Indonesia.

Examples of initiatives granted funding from DFAT, are:

- **Indonesia Australia Infrastructure Partnership** (US\$104 million for 2016-2021). This partnership also known as KIAT (*Kemitraan Indonesia Australia Untuk Infrastruktur*) aims to tackle Indonesia's infrastructure gap by supporting a reduction in regulatory constraints that impede infrastructure investment, and a greater a greater capacity of Government bodies responsible for infrastructure delivery. The Water and Sanitation Grant Programme and the Provincial Road Improvement and Maintenance Programme are implemented under this partnership.<sup>13</sup>
- **Multilateral Development Bank Infrastructure Assistance Programme** (US\$40 million for 2013-2019). Through this programme Australia works with the World Bank, the Asian Development Bank, and the Indonesian Government to support activities, including infrastructure project preparation support and implementation, feasibility studies, engineering designs, and environmental impact assessments. The programme also has supported the establishment of the Public Private Partnerships Centre in the Indonesian Ministry of Finance.<sup>14</sup>
- **Australia-Indonesia Partnership for Economic Development** (US\$103 million for 2018-2023). This partnership, also known as PROSPERA, aims to foster more effective Indonesian economic institutions and policies that contribute to inclusive economic growth. The partnership contains the idea of mutual benefits for a sustainable and inclusive economic growth of Indonesia, as Indonesia is the largest export market for

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<sup>13</sup> See also the investment design document: <https://dfat.gov.au/about-us/publications/Documents/indonesia-australia-infrastructure-partnership-facility-design-document.pdf>

<sup>14</sup> See also the evaluation report of the programme: <https://dfat.gov.au/about-us/publications/Documents/multilateral-development-bank-infrastructure-assistance-program-independent-evaluation.pdf>

Australia in Southeast Asia. Key development areas within PROSPERA are financial institutions, market development, transport sector and the public sector.<sup>15</sup>

- **Australia-Indonesia Partnership for Promoting Rural Incomes through Support for Markets in Agriculture** (US\$68 million for 2019-2023). This programme, also known as PRISMA-2, is the continuation of the Aid Investment Plan-Rural. The aim is to increase the incomes of an additional 700,000 smallholder farming households by a minimum of 30% using a market system development approach. It will strengthen the focus on policy influence by equipping decision-makers with evidence and the development of strategic partnerships with key policy and agri-business influencers.<sup>16</sup>
- **Indonesia-Australia Partnership on Food Security in the Red Meat and Cattle Sector** (US\$35 million for 2013-2024, with additional US\$7 million in non-ODA funding from the Department of Agriculture). This partnership aims to strengthen long-term economic relations between Indonesia and Australia to improve the cattle and beef sector supply chain. This is in order to support Indonesia's food security and to promote closer ties in the beef and cattle sector, with the aim to secure the Australian export market to Indonesia. Through the partnership, Australia has exchanged skills in beef processing, cattle production and husbandry and agriculture policy. In 2016, it established the Indonesia-Australia Commercial Cattle Breeding Programme.<sup>17</sup>

**2. Human development for a productive society:** Programmes within this cluster aim to develop human capital to create the conditions for higher and inclusive growth. It tries to identify local challenges and opportunities, and develops approaches to tackle problems and make the most of opportunities (i.e. to health and nutrition, such as for Indonesia's human and animal disease prevention) and response capacities to increase national, Australian and global biosecurity. Australia Awards Scholarships (US\$118 million for 2014-2022) are an important part of Australia's education assistance to Indonesia, which also includes technical assistance for education system strengthening (US\$8.5 million for 2015-2020), Australia-UNICEF Rural and Remote Education Initiative for Papuan Provinces (US\$12 million for 2014-2018), and the contributions to the World Bank Trust Fund for Improving Dimensions of Teaching, Education Management, and Learning Environment (US\$6.5 million for 2016-2019).<sup>18</sup>

**3. An inclusive society through effective governance:** Australia works with Indonesia to develop better quality economic and social protection policies and for developing a comprehensive social protection framework (from MAHKOTA Indonesia: US\$45 million for 2016-2019). In this cluster of programmes, Australia also aims to support women's (Australia-Indonesia Partnership for Gender Equality and Women's Empowerment: US\$77 million for 2012-2020) and marginalised groups' (Programme Peduli: US\$25 million for 2014-2019) economic and political empowerment. It also includes improving access to legal services and support for court

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<sup>15</sup> See for more information the investment design document <https://dfat.gov.au/about-us/publications/Documents/australia-indonesia-economic-cooperation-partnership.pdf> or on the PROSPERA website: <https://prospera.or.id/>.

<sup>16</sup> See for more information the investment design document: <https://dfat.gov.au/about-us/business-opportunities/Documents/aip-prisma-2-idd-17-nov-2017.pdf>

<sup>17</sup> See for more information the investment design document for the cattle breeding programme <https://dfat.gov.au/about-us/publications/Documents/indonesia-cattle-breeding-program-investment-design.pdf> or the websites: <http://www.redmeatcattlepartnership.org/> and <http://www.iaccbp.org/>.

<sup>18</sup> See for more information: <https://dfat.gov.au/geo/indonesia/development-assistance/Pages/human-development-in-indonesia.aspx>

reforms (Australia Indonesia Partnership for Justice Phase 2: US\$28 million for 2017-2022) and local community empowerment support for community-based development programmes and participatory local governance (Local Solutions to Poverty Programme: US\$135 million for 2008-2020).<sup>19</sup>

Australia and Indonesia signed the **Indonesia-Australia Comprehensive Economic Partnership Agreement** (IA-CEPA) on 4 March 2019.<sup>20</sup> This Free Trade Agreement (FTA) is the final step within the *Trade and Investment Framework* that seeks to enhance cooperation on trade, investment and business climate issues; forge a closer policy dialogue on mutual trade and investment issues; contribute to trade and investment facilitation through minimising impediments, promoting transparency in regulations, and reducing costs, and promote business competitiveness and closer linkages in sectors (including textiles, clothing and footwear, health, education and legal services, food and agricultural processing, energy and mining, and infrastructure development).<sup>21</sup>

## Denmark

In 2017, Official Development Aid from Denmark to Indonesia was US\$12.3 million.<sup>22</sup> More than three quarters of the aid budget was for the Environmental Support Programme (Phase 3), which ended in 2018. This programme supported three main themes: environmental management, energy sector initiatives, and improved Natural Resources Management. It is based on three components:<sup>23</sup>

- Improved local impact from implementation of policies and environmental management, also in the field of climate change mitigation and adaptation.
- Improved implementation of energy efficiency, energy conservation, and renewable energy policies.
- Climate change mitigation through natural resources management, including Community-based Natural Resources Management (CBNRM).

Denmark development cooperation with Indonesia focusses mainly on environmental and renewable energy projects (e.g. waste management, clean energy, and energy efficiency).<sup>24</sup> Many private sector and sector related initiatives are related to the same themes, with the aim to invest in renewable energy sector and waste management and create business-to-business partnerships. For example, Denmark and Indonesia launched a government-to-government energy cooperation initiative, with a focus on private sector involvement to the projects where

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<sup>19</sup> See for more information: <https://dfat.gov.au/geo/indonesia/development-assistance/Pages/inclusive-society-in-indonesia.aspx>

<sup>20</sup> Information retrieved from: <https://dfat.gov.au/trade/agreements/not-yet-in-force/iacepa/Pages/indonesia-australia-comprehensive-economic-partnership-agreement.aspx>

<sup>21</sup> Information retrieved from: <https://dfat.gov.au/geo/indonesia/Pages/trade-and-investment-framework.aspx>

<sup>22</sup> Information retrieved from the Danida OpenAid database: <http://openaid.um.dk/en/countries/ID?Y=2017>

<sup>23</sup> Information retrieved from the Environmental Support Programme (Phase 3) in Indonesia webpage on the Danida OpenAid database; <http://openaid.um.dk/en/Projects/DK-1-204597>

<sup>24</sup> Information retrieved from the Danida OpenAid database: <http://openaid.um.dk/en/countries/ID?Y=2017>

possible.<sup>25</sup> Although the main purpose was to build up capacity and understanding, as well as introducing new perspectives on the use of renewable as a reliable and affordable energy source, the cooperation also resulted in the signing of a power purchase agreement to develop a 72 MW wind farm in south Sulawesi. The wind farm project will be the first large scale wind project in Indonesia and it marks “a significant milestone for Danish technology providers to penetrate the Indonesian market.”<sup>26</sup>

In 2016, Denmark and Indonesia also signed a Memorandum of Understanding on supporting and developing cooperation in agriculture and food sectors. It consists of annual meetings in the Joint Agriculture Working Group with the aim to improve regulation and procedures on agricultural commodity trade and related investments, including food safety and promoting business partnerships.<sup>27</sup> One of the key areas is the livestock sector, aiming for a public-private cooperation between the two countries on introducing new breed of adapted tropical dairy and beef cattle in Indonesia.

Other important cooperation agreements between Indonesia and Denmark are on green shipping and transportation. Indonesia and Denmark facilitate joint industrial business solutions in ship building design, for example through Danish industry support in the Indonesian National Ship Design Centre.<sup>28</sup> Other cooperation relates to city transportation projects through the promotion of public transport and cycling.<sup>29</sup>

## Germany

At the government negotiations in 2017, Germany committed funding of US\$180 million to Indonesia. Of this amount, US\$37 million has been earmarked for Technical Cooperation and US\$143 million for Financial Cooperation.<sup>30</sup> The German Agency for International Cooperation (GIZ) is working in Indonesia on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ). It also carries out projects for the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU), the German Federal Foreign Office, and the European Union. The German-Indonesian cooperation focuses on three priority

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<sup>25</sup> Information retrieved from: [https://ens.dk/sites/ens.dk/files/Globalcooperation/indonesia\\_cooperation\\_0.pdf](https://ens.dk/sites/ens.dk/files/Globalcooperation/indonesia_cooperation_0.pdf)

<sup>26</sup> Information retrieved from the annual report of the Danish Energy Agency for the Strategic Energy Sector Cooperation between Indonesia and Denmark, 2016: <http://um.dk/~media/UM/Danish-site/Documents/Danida/Samarbejde/Ministerier/SSC/AArsrapporter%202016/Indonesien%20energi.pdf?la=da>

<sup>27</sup> Information retrieved from the Plan of Action 2017-2020 for the Partnership between the Government of the Kingdom of Denmark and the Government of the Republic of Indonesia: <http://um.dk/~media/UM/Danish-site/Documents/Udenrigspolitik/Lande%20og%20regioner/Strategiske%20partnerskaber/ID-DK%20Action%20Plan%202017-2020.pdf?la=da>

<sup>28</sup> Idem: <http://um.dk/~media/UM/Danish-site/Documents/Udenrigspolitik/Lande%20og%20regioner/Strategiske%20partnerskaber/ID-DK%20Action%20Plan%202017-2020.pdf?la=da>

<sup>29</sup> Idem: <http://um.dk/~media/UM/Danish-site/Documents/Udenrigspolitik/Lande%20og%20regioner/Strategiske%20partnerskaber/ID-DK%20Action%20Plan%202017-2020.pdf?la=da>

<sup>30</sup> Information retrieved from the Federal Ministry of Economic Cooperation and Development (BMZ): [http://www.bmz.de/en/countries\\_regions/asiensindonesien/index.html#section-31151852](http://www.bmz.de/en/countries_regions/asiensindonesien/index.html#section-31151852)

areas, on which good governance and cooperation with the private sector are cross-cutting issues:<sup>31</sup>

**1. Energy:** Germany works in particular on renewable energy programmes and projects. For example:

- **Energising Development Partnership (2009-2018):** GIZ claims that, to date, 189,000 people, 1,500 public institutions and 2,700 rural businesses have gained access to electricity through this partnership.
- **Electrification through Renewable Energy Programme (2016-2019):** It focuses on capacity building and knowledge exchange on off-grid electrification using renewable energy for Indonesian institutions.
- **1,000 Islands – Renewable Energy for Electrification Programme (2017-2020):** It aims to achieve a 23% share of renewable energies in Indonesia, with a focus on electrification projects on smaller islands.

**2. Environmental protection and climate change:** Indonesia plays a key role in the context of BMU's international cooperation for climate change mitigation and biodiversity conservation. Hence, GIZ supports the Indonesian Government in conserving the natural forests. It cooperates with Indonesian institutions on the development and implementation of a legal framework, methods and services for sustainable forest management in, for example, the Forest and Climate Change Programme (2009-2020). Other projects are:

- **Green Chillers and Energy Efficiency (2014-2019):** The project assists the Government of Indonesia, particularly Ministry of Energy and Mineral Resources, in establishing appropriate incentive mechanisms for the implementation of efficient Refrigeration and Air Conditioning (RAC) technology. To demonstrate the advantages of green cooling technology, pilot projects are implemented and RAC technicians are trained and nationally certified in the safe and efficient use of how hydrocarbons have an impact on the RAC sector.
- **Sustainable urban transport (2016-2020):** In order to improve the transport situation in cities, push and pull measures are required that make energy-intensive private transport less attractive, and at the same time increase the appeal of public transport systems and non-motorised transport infrastructure.
- **Low-Emission Oil Palm Development (2017-2022):** The project focuses its intervention into the lowering emission by saving forests (land use change) from conversion to plantation. It applies the landscape approach with the focus on district jurisdiction. The project aims to strengthen the capacity of Berau District Government in performing the critical functions in land use governance and plantation management: planning, monitoring, and licensing.

**3. Sustainable economic development and technical and vocational education and training:** GIZ promotes exchange and cooperation between state actors and the private sector to align training courses with the needs of the labour market. Projects on sustainable economic

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<sup>31</sup> Information retrieved from the GIZ website: <https://www.giz.de/en/worldwide/352.html>

development involves establishing and developing social security systems, for example a statutory health insurance system in Indonesia:

- **The Innovation and Investment Programme for Inclusive and Sustainable Economic Development (2017-2021):** This programme aims to develop the capacity of private sector actors in selected economic sectors to create inclusive employment. It addresses the issue of employment using instruments such as an integrative approach to employment promotion, vocational training, and inclusive business. By doing so, it harnesses the potential of both private and state actors to create employment and train people in line with their capacities and potential.
- **Standards in the South-East Asian food trade (2015-2018):** This project aims to increase export opportunities for the food sector in the ASEAN countries. It supports ASEAN in harmonising national standards and the ASEAN Standard for Organic Agriculture (ASOA). In the long term, quality standards in the ASEAN economic area are to be brought into line with internationally recognised standards such as Global GAP and the EU's organic certification label. The project activities has been carried out primarily in Cambodia, Indonesia, Laos, Myanmar, and the Philippines.
- **Inclusive Business Action Network (2014-2019):** This programme is part of a broader strategy of BMZ to promote cooperation with the private sector through inclusive business models. It pursues an integrated strategic approach, going wide with online knowledge sharing and strategic communications on inclusive business, and going deep with its focused Capacity Development Programme for selected companies and policymakers in developing and emerging countries.

Bilateral cooperation between the two countries focuses mainly on the same areas of renewable energy and vocational trainings, but also emphasises maritime cooperation. The countries signed a Memorandum of Understanding for Maritime Cooperation in 2017 with the intention to establish a strategical cooperation in the maritime sector.<sup>32</sup>

## Japan

Over the long term, Japan has been the largest development cooperation partner of Indonesia. Japan contributed 45% of the total gross disbursement of ODA to Indonesia from 1960 to 2016, which amounted to US\$87.34 billion (JICA, 2018, p.21). However, gross disbursement of ODA to Indonesia has declined in recent years (the largest ODA provider is now Germany) and because Indonesia has paid back many of the loans to Japan in recent years, the net disbursement of ODA to Indonesia is negative since 2004 and increasing, to up to US\$1.2 billion in 2016 (JICA, 2018, p.23). Technical assistance accounted for US\$54 million in 2016. Finance and investment cooperation in the form of ODA loans and private sector investment finance, is approximately 90% of the total ODA of around US\$672 million in 2016 (JICA, 2018, p.23-25). Aid in the form of grants had been used by Japan up to 2013, mainly in the “agriculture, forestry and fishery” and “health and medical care” sectors. Since 2014 no grants have been provided to Indonesia (JICA, 2018).

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<sup>32</sup> Information retrieved from the Indonesian Ministry of Foreign Affairs website: <https://www.kemlu.go.id/en/berita/Pages/Indonesia---Germany-Raised-Various-Cooperation-in-Comprehensive-Partnership-Scheme.aspx>

Japanese loans were used to fill budget deficits as well as enhanced policy and regulation reforms through policy dialogue in the fields of macroeconomic stabilisation, investment climate and trade facilitation, public financial management, poverty reduction, climate change measures, and infrastructure development reform (JICA, 2018). For example, 266.3 billion yen (US\$2.39 million) for programme loans disbursed for 2005-2013 filled approximately 4.5% of total budget deficits during the same period (JICA, 2018, p.32). Furthermore, through policy dialogue on investment climate and trade facilitation, Japan supported amendment of the Investment Negative List (*Daftar Negatif Investasi*), introduction of the Investment One Stop Service, and issuing of transfer pricing regulation.

According to the Japanese International Cooperation Agency (JICA), Japanese technical cooperation has facilitated economic institutional reforms and capacity development in areas such as the national development plan (RPJPN), economic policy support, tax administration, and public-private partnerships for infrastructure development. Japan has enhanced infrastructure development through supporting the establishment of regulatory frameworks, such as PPP regulations (the Presidential Regulation No.38/2015, the BAPPENAS Regulation No. 4/2015 and the LKPP Regulation No.19/2015) and Availability Payment regulations (the Ministry of Finance Regulation No.190/2015 and No. 260/2016 and the Ministry of Home Affairs Regulation No.96/2016) (JICA, 2018, p.32).

Japan uses its development aid to Indonesia in a wide variety of sectors and sub-sectors (JICA, 2018):<sup>33</sup>

- **Transport:** Newly formed projects have focused mainly on technical cooperation (including preparation for new ODA loan projects) in the subsectors such as road, air, port, and sea transport, because the Indonesian Government indicated its intention to reduce external debt. Still, ODA loans have been continuously provided by Japan for large infrastructure projects such as urban railways and international harbour development. Indonesian Government institutions and enterprises have become technically more capable of implementing large-scale transportation projects, however, there is still need for assistance including transfer of Japanese technology for infrastructure development.
- **Energy:** Since the late 2000s, Japan has provided comprehensive assistance, including human resource development, to promote geothermal and hydro-power development to Indonesia, as well as clean coal technologies, to achieve Indonesia's policy goals towards sustainable growth and a decarbonised economy.
- **Waste and environmental management:** In the 2010s, JICA has supported 3R initiative (reduce, reuse and recycle) activities, capacity development in waste management, as well as establishment of the Act on Solid Waste Management (No.18/2008) and other related rules and regulations at the national and regional levels. In general, Japanese cooperation contributed to institutional capacity building through the training of technical staff also on the district and local levels. Furthermore, a network for environmental monitoring of river and air pollution around the Environmental Management Centre was established. JICA states that this has contributed to the collection of "quality" air and water data.

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<sup>33</sup> Information on development cooperation on sector level, comes from JICA (2018) report on Indonesia.

- **Private sector development:** In the 2000s, in the reform period of democratisation and decentralisation, the mainstream of Japanese assistance in private sector development shifted to technical cooperation programmes to support industry promotion and SME promotion, to meet the national policy of strengthening the private sector nationwide. Since 2015, technical cooperation has focussed more on institutional improvement in areas such as intellectual property rights protection and consumer protection. In addition, JICA supports the strengthening of car, electric and electronics, and food processing value chains, with the aim to improve the international competitiveness of the manufacturing industry in Indonesia. Key functions for vocational training and industrial human resource development were established through a series of financial assistance and technical cooperation. Institutional arrangements were made for foreign investment and business activity through a number of experts and public-private policy dialogue. An activity model was formulated for product development and marketing promotion under the initiative of the local industry (SMEs), in collaboration with the relevant stakeholders such as central/local governments and supporting institutions (the Chamber of Commerce, higher education institutions, NGOs, etc.). This model has been disseminated to the rest of the country through the Ministry of Industry.
- **Agriculture, forestry and fishery:** Irrigation projects in agriculture, and support for livestock and fishery have been priorities for the Japanese development aid. Cooperation in the fisheries subsector has aimed at improving protein intake from the aquaculture cooperation. There is also a long support for some important fishing ports, such as in Jakarta. Japan will support the Indonesian Government with implementation of the “National Sea Policy,” and would like to position it further in the economic development of sustainable marine fishery resources. In the livestock subsector, technical cooperation concentrated on 41 targeted “hub institutions”. In particular, the artificial insemination technology was used in South-South and Triangular Cooperation after the completion of technical cooperation. The production of frozen semen increased drastically from 200 thousand doses (1985) to 3.5 million doses (2015), which according to JICA (2018) contributed to an increase in the national cattle population from 8 million to 13 million.
- **Climate change:** JICA assisted in mechanisms such as Joint Crediting Mechanism (JCM), Reducing Emissions from Deforestation and Forest Degradation in Developing Countries (REDD+). Assistance for climate change measures such as the Climate Change Programme Loans contributed to mainstreaming climate change within the Indonesian government and improving the capacity to cope with climate change issues. A strategy was launched for the government to manage forest protection and conservation areas together with local residents. For example, Manggala Agni (firefighting brigade) rooted in the local community and modelled on the Japanese volunteer fire corps was established. JICA also contributed to the establishment of the Mangrove Information Centre (MIC) and activities such as mangrove-related training, environmental education and ecotourism. Furthermore, Japan increasingly use knowledge and skills shared among ASEAN countries this field.

Other important areas for Japan’s development cooperation are: decentralisation, education, health, and reducing disaster risks.

## Norway

The Norwegian government, via its agency for development cooperation Norad, funded US\$32.5 million (279.3 million Norwegian Krone) in development programmes in Indonesia in 2017.<sup>34</sup> Almost 90% of the aid money (252 million Krone or US\$29 million) went to development programmes related to environment (forest protection). Only 0.4% of the aid (less than 1 million Krone or US\$115,000) went to programmes for economic development and trade, which focused mainly on agriculture and fishery in 2017.<sup>35</sup> Economic development and trade is the least funded, less than for education, health and good governance, which combined received 27 million Norwegian Krone (US\$3.1 million) in 2017.

Norway has supported Indonesia mainly through its **Climate and Forest Initiative** to reduce greenhouse emissions by 26% between 2009 and 2020 through domestic efforts and by 41% with international support. On top of its aid commitments, Norway has committed to disburse up to US\$1 billion in the period between 2011 and 2020, on the condition that Indonesia reduce its emissions of greenhouse gases through its efforts in the **Reduce Emissions from Deforestation and Forest Degradation (REDD+)**.<sup>36</sup> Before the funds are released to the partnership, requirements placed on Indonesia include to establishment of a verifiable and internationally accepted method for measuring deforestation. As part of this agreement, Indonesia established a suspension on new permits to clear primary forests (Presidential Instruction no.10/2011).

According to Norad, progress has been made, but work still remains to be done. It states on its website: "Under the partnership with Norway, Indonesia has strengthened its enforcement of laws pertaining to illegal logging. Local communities, indigenous peoples and the environmental movement have increasingly been included and consulted in the design of relevant policies. The rights of indigenous people are enjoying greater recognition."<sup>37</sup> According to an independent evaluation, the Norwegian contributions through the Climate and Forest Initiative have helped put preservation of the rainforest onto the political agenda in Indonesia.<sup>38</sup> In 2018, the suspension on the granting of new licences, mainly for palm oil plantations to clear primary forests was for a second time renewed for three years.

Examples of projects that have been granted support through the Norwegian Climate and Forest Initiative in Indonesia include:

- An agreement with the Global Green Growth Institute to contribute to Indonesia's economic development plans and to provide technical assistance to the Indonesian REDD+ process.
- A programme under the auspices of the United Nations Office on Drugs and Crimes (UNODC) to fight forest crimes. The programme has reinforced The Special Responsive

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<sup>34</sup> Information retrieved from Norad website: <https://norad.no/en/front/countries/asia-and-oceania/indonesia/>

<sup>35</sup> Idem: <https://norad.no/en/front/countries/asia-and-oceania/indonesia/>

<sup>36</sup> Information retrieved from REDD task force website: <http://theredddesk.org/countries/indonesia/>

<sup>37</sup> Information retrieved from Norad website: <https://norad.no/en/front/countries/asia-and-oceania/indonesia/>

<sup>38</sup> See here for the evaluation of Rainforest Foundation (2017) on Norad's work on Climate and Environment in Indonesia: <https://norad.no/en/toolspublications/publications/2017/evaluation-of-rainforest-foundation-norways-work-in-indonesia/>

Police Forest Task Force, improved capacity in the legal system and provided support to civil society.

- The World Bank's work on provision of quality assurance for the funding mechanism REDD+.
- Training for journalists with regard to climate and REDD+ issues. This support was granted to the Dr. Soetomo Press Institute, Jakarta.

Norway has been a key player in the global sustainable palm oil value chain movement. At least 285 companies worldwide have made commitments in the palm oil sector, with 267 of them aiming to achieve their goals in whole or in part by purchasing palm oil that has been certified as sustainable. Exporting companies with commitments have shifted from zero-deforestation commitments to more specific and detailed no-deforestation, no-peat, no-exploitation (NDPE) commitments developed in cooperation with non-governmental organisations (NGOs). They also include commitments to restore previously disrupted forests and peatlands, and to embrace fair labour practices. Furthermore, Norway became the first country in 2018 to introduce a ban on the import of palm oil for use in biofuels by 2020 in the fight against deforestation, in particular in Indonesia and Malaysia (producing together 80% of the palm oil in the world).<sup>39</sup>

Norway-Indonesia business relations focus mainly on energy and fishery sectors. There are approximately 150 Norwegian companies present in Indonesia in some way.<sup>40</sup> Green technologies or sustainable solutions are key in the business relationship as there is a growing demand for such technologies in Indonesia. Norway and Indonesia have had several bilateral Energy Dialogues, and Norwegian businesses see an opportunity to offer solutions that can contribute to the Indonesian ambition of an additional electricity production capacity of 35,000 MgW by 2019. This is particularly relevant for the renewable energy sector. Over the past years, Norway granted development funding for the construction of solar-powered irrigation and biogas installations in Indonesia, mainly through projects of the Asian Development Bank and the Dutch development NGO Hivos. However, since 2017 no further funding went to energy related projects. Nevertheless, Norwegian businesses are also involved in further development of the Indonesian oil and gas sector. Additionally, Norway and Indonesia cooperate on fisheries and sustainable management of marine resources. Norwegian businesses are working with Indonesian aquaculture and fisheries industries, and Norwegian experts have contributed with knowledge and experience when it comes to combatting fisheries crime.

## United States of America

The US government's foreign aid to Indonesia was US\$277 million in 2017. The largest part (US\$148 million) was implemented through the US Agency for International Development (USAID), followed by US\$72 million through the Department of Health and Human Services, US\$31 million through the Department of State, and US\$17 million through the Department of Army.<sup>41</sup> The largest part of the foreign aid budget to Indonesia went to basic health, like infectious disease control (US\$81 million). Other main target areas, were: legal and judicial

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<sup>39</sup> Information retrieved from: <https://www.ecowatch.com/norway-bans-palm-oil-2622712445.html>

<sup>40</sup> Information retrieved from the Norway Embassy in Jakarta website: <https://www.norway.no/en/indonesia/values-priorities/energy-marine-res/#local-content>

<sup>41</sup> Information retrieved from USAID website: [https://explorer.usaid.gov/cd/IDN?fiscal\\_year=2017&measure=Obligations](https://explorer.usaid.gov/cd/IDN?fiscal_year=2017&measure=Obligations)

development (US\$33 million); reproductive health care (US\$19 million); biodiversity (US\$18 million); security system management and reform (US\$17 million); higher education (US\$17 million); biosphere protection (US\$16 million); public sector policy and administrative management (US\$13 million); HIV/Aids control (US\$9.5 million); disaster prevention and preparedness (US\$9 million), and basic drinking water supply and basic sanitation (US\$7.8 million).<sup>42</sup> Hence, it can be concluded that the main area for US foreign aid is health, followed at a distance by governance, and then environmental protection.

Most of the funding for basic health to Indonesia was implemented by the Department of Health and Human Services, while USAID focused on the reproductive health care, HIV/Aids control, and basic drinking water and sanitation programmes. USAID furthermore focussed on the environmental protection, higher education, governance and disaster prevention programmes. Compared with the whole aid structure, there is less focus on infrastructure (US\$3.5 million), agriculture (US\$2.9 million), and economic growth (US\$3.7 million).<sup>43</sup> All the aid labelled for infrastructure went to the energy sector for hydro-electric power plants and capacity building for energy policy and management. Most of the economic growth programmes relate to improvement of trade (US\$2.4 million), through trade facilitation and trade policy and management support. Far less went to financial sector development, industrial development, and support for SMEs.<sup>44</sup>

The US-Indonesia development cooperation has evolved from traditional development assistance to the provision of technical assistance and tools to address development challenges, particularly through private sector engagement and the utilisation of science and technology: “USAID mechanisms are designed to strengthen Indonesian systems and institutions, mobilise domestic resources, leverage the private sector and ‘crowd’ in new sources of financing”.<sup>45</sup> As a middle-income country USAID’s assistance to Indonesia is designed on its “Journey to Self-Reliance”. USAID defines “self-reliance” as a country’s ability to plan, finance and implement solutions to address its own development challenges.<sup>46</sup>

USAID’s country development cooperation strategy for Indonesia runs from 2014 to 2020 and has three development objectives:

- **Democratic governance and security** strengthened, which focuses on improving government accountability, combating corruption, protection of human rights, and strengthening key institutions’ ability to counter extremism.
- **Essential human services** to targeted populations improved and sustained, which aims to reduce preventable deaths of women and children, expanding access to water and sanitation, and improving the capacity of educational institutions.

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<sup>42</sup> Idem: [https://explorer.usaid.gov/cd/IDN?fiscal\\_year=2017&measure=Obligations](https://explorer.usaid.gov/cd/IDN?fiscal_year=2017&measure=Obligations)

<sup>43</sup> Idem: [https://explorer.usaid.gov/cd/IDN?fiscal\\_year=2017&measure=Obligations](https://explorer.usaid.gov/cd/IDN?fiscal_year=2017&measure=Obligations)

<sup>44</sup> Idem: [https://explorer.usaid.gov/cd/IDN?fiscal\\_year=2017&measure=Obligations](https://explorer.usaid.gov/cd/IDN?fiscal_year=2017&measure=Obligations)

<sup>45</sup> Information retrieved from the USAID website: <https://www.usaid.gov/indonesia/cdcs>

<sup>46</sup> See for more information on self-reliance: <https://selfreliance.usaid.gov/country/indonesia>

- **Global development priorities of mutual prosperity** advanced, which highlights reducing infectious disease threats, enhancing environmental security and resilience, and decreasing constraints to economic opportunity.

Next to renewable energy and forest protection programmes, one of the key areas in the environmental strategy is the protection of the marine ecosystem by strengthening the management of over one million hectares of Marine Protected Areas (MPA) in Maluku and West Papua. This has resulted in that West Papua's Dampier Strait as a legally-protected Territorial Use Rights in Fisheries (TURF) to help ensure a sustainable food supply for local communities. At 211,000 hectares, the Dampier Strait network is the largest TURF-Reserve network in the world.<sup>47</sup> The USAID Oceans and Fisheries Partnership (USAID Oceans) works with businesses on sustainable, traceable fisheries to encourage private sector commitments. The annual Our Ocean Conference was held in Bali in 2018. During the conference, the USAID and Walton Family Foundation launched a US\$15 million Blue Abadi Fund for long-term marine conservation, expanding the impact for two of USAID's current marine resource conservation activities: Indonesia Sustainable Ecosystem Advanced (SEA) and Supporting Nature and People – Partnership for Enduring Resources (SNAPPER).<sup>48</sup>

## United Nations Development Programme (UNDP)

The UNDP in Indonesia works on democratic governance, environment and energy, poverty reduction, and disaster prevention and recovery. Their poverty reduction work focusses mainly on gender equality and health. Current programmes are, for example, the Sistem Monitoring Imunisasi Logistik secarea Elektronik (SMILE), which is an innovative technological solution that aims to strengthen the immunisation supply chain system in Indonesia. Other projects include reducing polybromodiphenyl ethers and other unintentional persistent organic pollutants, and the reform of the justice system in Indonesia.

UNDP has the most projects in environment and energy programmes, for example, in strategic planning and action to strengthen climate resilience of rural communities in the province East Nusa Tenggara. The Biodiversity Finance Initiative (BIOFIN) provides an innovative methodology enabling countries to measure their current biodiversity expenditures, assess their financial needs in the medium term and identify the most suitable finance solutions to bridge their national biodiversity finance gaps. UNDP also works on wind hybrid power generation; strengthening community-based forestry and watershed management; fighting deforestation with REDD+, and the BIOCHAR project on reduction of greenhouse gas emissions.

## World Bank Group

Currently the World Bank has invested in 25 projects in Indonesia (6 on Environment and Natural Resources; 5 on Energy and Extractives; 5 on Social, Urban, Rural and Resilience; 4 on Water; 2 on Finance and Competitiveness; 1 on Transport; 1 on Education; 1 on Agriculture). These total

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<sup>47</sup> Information retrieved from the USAID website: <https://www.usaid.gov/indonesia/environment>

<sup>48</sup> Information retrieved from US embassy in Jakarta website: <https://id.usembassy.gov/usa-id-walton-family-foundation-launch-new-partnership-protect-indonesias-fisheries-marine-biodiversity/>

US\$4.2 billion and operate in 790 locations. IFC, which is member of the World Bank Group, invested in 32 projects in Indonesia. In the Country Partnership Framework 2016-2020 for Indonesia, the World Bank Group has identified six engagement areas (World Bank, 2015):<sup>49</sup>

- **Infrastructure platforms at the national level:** Investments have mainly focussed on three development outcomes, related to: increased access to water irrigation and dam safety (i.e. the number of people benefiting from improved irrigation and dam safety); increased access to affordable housing, for example the number of low-income households with access to affordable 'core starter' public housing units and through credit-linked down payment subsidies; and, improved integrated tourism development with infrastructure projects (such as increasing the number of integrated tourism destinations established, or the number of integrated tourism master plans prepared).
- **Sustainable energy and universal access:** The government of Indonesia has set some important goals to reduce the US\$50 billion investment deficit, with 60 million people with no dependable access, and limited success using renewables for generation. The World Bank Group therefore engages with the Government to use a full set of interventions including private sector investment, lending, DPLs, and knowledge services to: improve operational efficiency and reliability of services through transmission and distribution, improvement in pumped storage support renewable energy, and low carbon development increase access to modern energy services. The reform efforts simultaneously improve IFC's ability to come in with financing and syndications from commercial banks to support additional renewable generation (particularly geothermal and hydro-power).
- **Maritime economy and connectivity:** To support the Government of Indonesia in its goal of Indonesia as a Maritime Nation, the World Bank Group interventions include a blend of investment lending, DPLs, possible IFC investment, Multilateral Investment Guarantee Agency (MIGA) guarantee and knowledge services to support: creation of an improved regulatory and operating environment which supports investment by both public and private sectors, port development and operation, hinterland connectivity in port areas including land and air-based transport, and development of the blue economy. The World Bank Group will also look to help integrate sustainable marine and fisheries natural resources into the overall maritime approach. It is expected that particular emphasis will be in eastern Indonesia.
- **Delivery of local services and infrastructure:** To fight inequality, the World Bank Group focusses on access to health and education services and basic infrastructure such as sanitation. This engagement will be organised around three pillars using investment and knowledge services: strengthening the decentralisation framework to improve local service delivery; supporting the delivery of quality education and health services, water and sanitation in rural areas to directly address inequality of opportunity, and ,supporting the sustainable urbanisation of cities, particularly through infrastructure development.
- **Sustainable landscape management (environmental policy):** Because one fifth of Indonesia's poor live in coastal and forest regions, the World Bank Group focusses on limiting over-exploitation and degradation of natural resources to reduce poverty in Indonesia, as well as global impact in terms of climate change. This engagement seeks

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<sup>49</sup> The information on the engagement areas is all retrieved from the World Bank (2015) publication on the Country Partnership Framework: <http://documents.worldbank.org/curated/en/195141467986374707/pdf/99172-REVISED-World-Bank-Indonesia-Country-Partnership-Framework-2016-2020.pdf>

to change World Bank Group's approach from incremental to one that focuses on managing landscapes through improved spatial planning, and land allocation to help shift the development trajectory. The World Bank is doing this through: support for design and implementation of programmes to improve management and benefits of terrestrial natural assets, support land management and spatial planning to address problem of dual land management system, create demonstration models of sustainable development of natural resources with the private sector, and disaster management, mitigation and preparedness.

- **Collecting more and spending better (fiscal policy):** To improve Indonesia's revenue-to-GDP and tax-to-GDP ratios, the World Bank Group supports the Government of Indonesia to raise revenues, transform tax collection administration, and improve the composition and effectiveness of public spending. This engagement uses investment and policy-based lending and knowledge services to support government in the following areas:
  - **Revenue:** supporting the revision of select tax policies, supporting reforms to increase tax compliance and strengthening and mainstreaming non-tax revenue administration.
  - **Improve spending** through: advancing energy (fuel and electricity) subsidy reforms, better quality through improved allocative efficiency, and better budget execution in key areas such as infrastructure, strengthen institutional capacity to modernise procurement and contract management and control environment.

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