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Competition Policy in Indonesia

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Introduction

The Indonesian economy was dominated by the government in the decades of the 1970s and 1980s through its control of major mining, manufacturing and agricultural activities. Hill (2000) estimates that as much as 40% of non-agricultural GDP was accounted for by government entities in the late 1980s There were still a lot of government corporations up until the late 1980s and early 1990s and governmental control over the banking system was still substantial.

Non-financial state owned enterprises (SOEs) contributed 14.5% of GDP in the late 1980s. They also accounted for another 9% of gross domestic investment which rose to 15.7% over the period 1990 –1997 (World Bank, 2000). Three SOEs are of particular note that dominate the sector in terms of revenue and assets are Pertamina (monopoly in oil and gas with diversified holdings in hotels, an airline and office buildings); PLN and PTTelkolm (monopoly in power and telecommunications industry respectively). The SOEs also employ a significant percentage of the labor force (25% according to data from the Indonesia' Statistics Office).

This strong role of the state was derived from the historical break with its colonial past under President Suharto and the distrust of "capitalists". There was also a need for the Suharto regime in the three decades when he ruled to maintain control of enough industries to maintain its base for extortion and corruption.

There was only a gradual and delayed shift toward export promotion and away from import substitution. This was partly the result of lobbying by entrenched interests that were making monopoly profits from new protected industries and corrupt officials that were operating the customs and port facilities. It also had to do with the control of key allocation and production agencies like Bulog and Pertamina.

The decline in oil prices in the mid-1980s put pressure on the government to develop a more competitive economic environment which was reinforced by the growing integration of economies in Southeast Asia in conjunction with commitments to the ASEAN Free Trade Agreement. Policy measures focused on trade barriers. Tariffs were lowered and some import monopolies and import licenses were converted to tariff equivalents. There were also reforms in banking and the regulation of foreign direct investment. However, these reforms were partial in nature. Several banks remain under government control and policy required domestic partnerships for foreign direct investment (FDI) approval (see Dowling and Yap (2005) for further details.

Nevertheless, despite these shortcomings in the policy environment, there was a measurable improvement in competition and economic efficiency, particularly in the manufacturing sector. Pangestu et al (2002) show that there was a decline in the level of industrial concentration and that the size distribution of firms has become more equal over time. There was also a decline in the prevalence of dominant firms therefore enhancing competition and reducing monopoly power. Finally, there was less stability in market shares after 1990, a development which reflects greater competition[1].

The evidence of enhanced competition over the decades of the ‘80s and’90s is much less compelling in other sectors of the economy, including agriculture, services, infrastructure and some parts for manufacturing and mining sectors. There are a number of examples that can be cited to support this conclusion including the cement industry (where there were high tariffs on imports, restrictions on number of distributors and allocation of markets) as well as gas distribution, telecommunications and electricity (where an opaque regulatory framework prohibited a level playing field from developing as new entrants came into the market). Furthermore, in the telecoms sector the government remained the majority shareholder in PT. Telkom and Indosat.

Developments in Competition Policy

In the late 1990s a debate developed as to whether the country was in need of detailed legislation and government policy regarding the regulation and supervision of domestic competition. On the one hand Hill (1999) and Bird (1999)

[1] Despite these positive developments some economists have argued that these measures of concentration alone are not a necessary and sufficient condition of evidence for increased competitiveness and economic efficiency. It is possible in the Indonesian context, for example, that concentration results from greater economic efficiency (See (Bird (1999), Aswicahyono et al (2001) and Pangestu et al (2002).

argued that an open trading environment was a sufficiently powerful and yet simple way to handle monopoly. In their view, if markets were ‘contestable’ the issue of high levels of concentration would not arise. Liberalization of international trade would accomplish this and there would be no need to develop another bureaucratic entity to enforce competition. The market would ensure the maintenance of competition in an open Indonesian economy.

Other economists suggested that some form of antitrust/antimonopoly agency was needed to regulate dominant firms (Boner and Krueger (1991) and Khemani (2000) if they were able to exploit market power. Boner and Krueger (1991), Khemani (2000) and other economists holding this view were careful to note that big doesn’t necessarily mean bad and that careful analysis is needed to determine whether these dominant firms were engaged in anti-competitive or restrictive business practices. They also noted the importance of curbing anti-competitive behavior in the non-traded goods sectors where markets were not ‘contestable’. Antitrust and monopoly laws are often invoked to restrict mergers between major competitors as well as to prohibit or control the formation of interlocking directorates of major competitors. The potential for abuse of market power through vertical integration would also be within the purview of such a regulatory agency overseeing competitive practices.

The Role of the IMF and the Competition Law of 1999

The 1997 financial crisis and the insistence of the IMF that a number of policy reforms be introduced created a dramatic change in the regulatory environment in Indonesia. The IMF bail out package of $46 billion was extensive and covered reforms in many areas including reduction in some export taxes; elimination of Bulog and the clove monopoly; liberalization of imports of many agricultural commodities including wheat, soybeans and sugar; reduction in import tariffs; removal of trade monopolies in cement, rattan and plywood; removal of local content requirements for automobiles; removal of restrictions on FDI and enforcement of extensive macroeconomic targets.

Furthermore, the IMF required Indonesia to pass laws that ensure fair competition. This eventually led to the enactment of Law No. 5 of 1999 Concerning the Prohibition of Monopolistic Practices and Unhealthy/Unfair Business Competition (popularly know as the Competition Law or the Law) in 5 March,1999. The general purpose of the Law is similar to competition laws in other countries. It prohibits/prevents monopolistic practices and restricts mergers or acquisitions that increase market concentration as well as prohibiting exploitation by firms with market control. As with most competition laws the letter of the law is subject to interpretation. In the Indonesian case the objectives of the Law are loosely written to allow a variety of different interpretations. We discuss a few cases below.

Market dominance. The general objectives of the Law are spelled out in article 3 of the legislation. It aims to improve economic efficiency and people's welfare, regulating the business climate to ensure competition in order to maintain equal opportunities for small, medium and large business firms, to prevent unhealthy business competition practices and finally to encourage effectiveness and efficiency in business practices through fostering competition and best business practices. This article contains several different provisions and has been subject to several different interpretations. As a result the basic thrust of the Law, which should be to maintain and promote competition as a means to achieving economic efficiency, has been lost. For example, (Thee, 2002) argues that a different interpretation of the provision to "maintain equal opportunities for small, medium and large business firms" could suggest market segmentation and protection of the rights of different sized firms when the spirit of the Law is to ensure competitive markets no matter how large firms are.

Several articles of the Law spell out the maximum market shares for monopolies, monopsonies, oligopolies and oligopsonies that would trigger action by the commission charged with enforcing the Law, Commission to Monitor Business Competition (the KPPU). Another provision prohibits the acquisition of a competitor's stock if it results in a market share of the firms together that is too large. These two provisions of the law suggest that there is an overarching concern with the size of large firms rather than whether they are involved in unfair business practices. These provisions also seem to suggest that "Big is bad" based on *prima facia* evidence of the size of firms.

A more realistic objective would be to set market shares as a trigger point for possible investigation of violations of competition rather than as a blanket rule for prohibiting the growth or the establishment of large companies. In a global marketplace a highly efficient firm could have a large share of the domestic market and still be a highly competitively player in international markets.

Protection of small firms. The explicit inclusion of the terms small, medium and large to describe different kinds of business enterprises creates an impression that competition and competition policy will take into special account the nature of the size of enterprise. A predisposition to protect small enterprises is certainly reasonable within the context of Indonesia and other countries. In the United States, antitrust law had a pro small business orientation in the years following WW II. However a shift in emphasis toward ensuring economic efficiency has become more evident in the United States as the forces of globalization have made more markets contestable and the ability of small firms to meet international competition has been eroded (see Fox (2001)). Indonesia would do well to follow a similar strategy in response to globalization.

Protection of market share. Complementary to the general protection of the rights of firms of different sizes under the Law, several articles - 4,13,17,18 - suggest that the objective is to limit the growth of large firms while protecting the market share of smaller firms Wie (2002). Furthermore, exemptions from the Law are granted to small–scale businesses and cooperatives. This framing of the Law's provisions implies that there is a concern for protecting some sectors of the business community rather than promoting free competition by guaranteeing a level playing for all firms, no matter what their size.

Horizontal and vertical integration. Horizontal integration is addressed in several articles of the Law, particularly in restrictions in market control and in the restrictions against price fixing, bid rigging, market segmentation/allocation. Vertical integration is more difficult to ascertain, particularly as it pertains to small businesses. In the United States, for example, the small business administration does not explicitly prohibit vertical integration. Vertical integration can facilitate competition by introducing more efficient product distribution yet it can also reduce competition by developing collusive tactics or restricting entry. In the case of industries having close linkages with overseas businesses it is possible that vertical integration can serve to lock out potential competitors. In any event it is important that Indonesia develop the expertise required to evaluate the various aspects of (particularly) vertical integration. For example, Wie (2002) argues that vertical integration in the engineering goods assembly sector including motor vehicles, diesel engines and other motorized equipment should be analyzed with an open mind. This is particularly true when it is recognized that many of these vertically integrated relationships were undertaken and encouraged by the Department of Industry as part of its industrial deepening strategy. A major objective should be to examine whether the existing relationships restrict competition by prohibiting the entry of new firms.

Exemptions. Several sectors are exempt from the provisions of the Law. These include intellectual property and small-scale enterprises (SMEs). The justification for this latter exemption is to give SMEs some protection against the predatory actions of large firms as well as to maintain a diverse distribution of firms of different sizes with different skill requirements. On the other hand, Wie (2002) argues that the exemption of small-scale enterprises will not enhance their competitive advantage relative to larger scale enterprises. Rather it could allow SMEs and cooperatives to engage in anti-competitive behavior.

Policy and administrative barriers to competition. There are already a number of existing barriers to competition as a result of past government policy. There are many cartels in existence, including for cement, plywood, paper and fertilizer. There are also price controls on sugar, rice and cement as well as exclusive licensing for clove marketing and wheat flour milling (see Wie (2002)). The Law is silent on the continued existence of these restrictions on competition and there are no stipulations in the Law that prevents the future actions of Government to create new monopolies or other barriers to competition. For example, with the devolution of power to the provinces and local authorities, local governments may put up barriers to competition and trade by introducing preferential government procurement practices or by requiring local content for the production of some products (see Goodpaster and Ray (2000). For example Central Sulawesi government established a private cartel to control shipment of raw rattan (see Bennet et al (1998)) by prohibiting others from trading raw rattan.

Implementation experience

So far the KPPU has investigated a number of complaints and issued decisions in several others. Here we review the two major cases that were handled up to 2003 and comment on several others.

Caltex Pacific Indonesia(CPI). This was the first case handled by KPPU. KPPU ruled that there had been collusion between bidders to supply pipe requirements for a particular project to CPI. The alleged violation resulted from a change in tender requirements initiated by Pertamina that all bidders offer a package of both low and high grade quality pipes that was not announced publicly in the newspapers. KPPM found that there had been collusion between bidders. It ordered that the tender bidding be stopped. Since the change in tender requirements was initiated by Pertamina there was a possibility that the change in requirements could have led to confusion in the bidding process. This may not have been well understood by KPPU (For further details see Pangestu et al (2002) and references contained therein).

P.T. Indomaret This was an action brought against a large retail chain (P.T.Indomaret.) for competing unfairly with smaller traditional retailers in the greater Jakarta region. After investigation, KPPU did not find a strong case for predatory pricing by lowering prices temporarily to drive out competitors nor did it find a strong case for vertical integration. Nevertheless, perhaps under political pressure) KPPU ruled that P.T. Indomaret should not continue to expand in markets where they were in direct competition with traditional sellers. They did not find any violations of the Law by P.T. Indomaret. This decision is a blow to large retailers who might undertake further expansion into large urban markets, particularly Jakarta, and also to consumers who might benefit from the large scale economies that such retailers bring (e.g. WalMart chain in the US).

New Cases KPPU is investigating a number of private and state owned enterprises for violations of the Law. A list compiled by Pangestu et al (2002) includes cooking oil, instant noodles, wheat flour, mineral water, detergent, lubricating oil, sea, land and train transport and the telecoms market. In addition a team from USAID (Loughlin et al 1999) has suggested several other markets that might be subject to restrictive practices, including pulp and paper, cement, rattan and sandlewood, and foreign films import. Some of these industries and activities are protected from foreign competition while in other cases markets are closed to other domestic producers. In other instances, government restrictions favor local producers and in others the government has created a monopsony which suppresses prices to producers. In addition further investigations may have been initiated since these research papers were written.

State owned enterprises (SOEs). There are a number of SOEs that may be in violation of the Law. Among the most inefficient appear to be Pertamina (where the new President just removed all of the directors) and Krakatau Steel. SOEs are generally beyond the reach of KPPU, although KPPU could bring pressure on the government to open them up to greater competition. For example, Loughlin et al (1999) suggest that KPPU can provide an effective lobby to open up the steel industry to foreign competition. It could also serve as an advocate for the introduction of more transparent antidumping legislation that imposes duties on a wide variety of imported steel products.

Enforcement Issues[2]

Legal enforcement of decisions by the KPPU is an issue that is still being reviewed and revised. KPPU can impose a variety of sanctions including administrative and criminal sanctions. Class actions are also possible wherein case the KPPU commission could act both as prosecutor and judge. These could include compensation for damages to injured parties as well as criminal sentencing. The KPPU serves as a judiciary body equivalent to the District Court. The District Court itself hears appeals rather than the Appeals Court. Further appeals would go to the Supreme Court. Because the KPPU is new a good deal of coordination is required with the Courts and law enforcement. Maarif (2004) argues that the KPPU Commission should be flexible in application of its ruling so that cease and desist orders can be enforced and penalties imposed without any civil or criminal action being taken. Agreement to cease and desist could also occur without the Commission having to declare a verdict. This system of procedures is similar to that followed by the US Federal Trade Commission.

As far as sanctions of Government officials is concerned, the Law appears to prohibit any legal action against them. Its authority only extends to the private sector. The alternative would be for the KPPU Commissioners to urge the Government to sanction its officials. This could be done informally or through the courts. In the latter case, the KPPU would ask the Attorney General to file a case.

There are a number of other issues to be considered in order for KPPU to operate more effectively. These include the opening of regional offices of the KPPU so that logistically it would be easier for those involved in provincial disputes, the speedy dissemination of information to relevant businesses and government agencies regarding the role and scope of authority of the KPPU.

Conclusions and suggestions for further action

[2] This section is based, in large part, on Maarif (2004)

In general, competition policy plays an important role in increasing competitiveness and economic efficiency. Indonesia has made substantial progress in raising competitiveness. Indonesia has been compared to industrial and developing countries in a number of surveys. While ranked next to last in a ranking of 60 countries in the World Competitiveness Report (2005) it was ranked 44 out of 103 countries in terms of business competitiveness in the Global Competitiveness Report (2005) and 69 out of 104 countries in terms of growth competitiveness. In another ranking of export competitiveness compiled by Ganeshan Wignaraja (2003) based on manufactured export growth, manufactured exports per capita and the share of technology-intensive exports in total exports, Indonesia ranked 16^{th} out of 82 developing countries. It ranked 2^{nd} in manufactured export growth between 1980 and 1999. Of the 82 countries reviewed, only Mexico ranked higher.

While much has already been done to intensify competition and create contestable markets, much remains to be done. First, enforcement of competition policy prevents/discourages existing firms from preventing entry of potential rivals. This will help create incentives for innovation by new companies as well as existing firms that face potential competition. New firms recognizing a level playing field are more likely to invest in innovation.

Second, interfirm rivalries are generally associated with greater levels of innovation and productivity increase, although there may be cases when inefficiency would result from unlimited entry. These cases must be reviewed carefully.

Third, by preventing restrictive practices, competition policy guarantees a wider array of products and service at competitive prices.

Fourth, there is a dynamic tension between protection of intellectual property and the enforcement of competition. Protection of intellectual property protects and preserves the incentives for innovation since firms are more likely to innovate if they are protected from free riders. On the other hand, continued protection can lead to the development of monopoly power if these rights are not flexible enough to respond to new innovations and ideas. In the case of Indonesia much of the protection of intellectual property involves infringement of the rights of foreign firms through illegal copies of music, videos and consumer products.

Fifth, there are significant export constraints that relate to the imposition of illegal duties and levies and local government regulations. Surveys of exporters by Kunchoro (2004) suggest that around 40 percent of respondents mentioned these factors as key export constraints. Elimination of these constraints and the corrupt practices that go along with them would go a long way toward increasing the economic efficiency of exporters and of the private sector.

Turning to specifics, KPPU has been and will continue to be pressured by different interest groups including the branches of Government to move in particular directions. Small businesses want protection from large conglomerates and large firms want the flexibility to form strategic alliances and to avail of economies of scale to increase efficiency and meet foreign competition. In the face of these competing interests, KPPU has to develop a clear vision of its role in increasing economic efficiency through greater competition and be actively involved in explaining this role to the public. It is all the more critical since the Law itself is difficult to understand and somewhat vague and subject to different interpretations. In decisions taken so far the KPPU seems to have favored small business. One alternative would be for the Government to introduce policies that support small business so that KPPU can focus more on policies that promote competition and economic efficiency irregardless of the size of the firms involved. In any event the

"*…conflict between a pro-competitive or efficiency approach, and an anti-big business approach or market power approach which is politically more popular needs to be resolved.*" (Pangestu et al (2002, p. 223)

It may be more appropriate to develop other instruments to deal with equity issues rather than applying competition policies to achieve this end.

KPPU and the Government need to coordinate the work of the Law with other agencies that deal with the deregulation of state owned enterprises in the electricity, telecommunications and oil and gas sectors. This should include a clear distinction between jurisdictions and coordination of respective policies to ensure that competition and economic efficiency are best served.

Many of the competition issues to be resolved require extensive economic analysis. The work done by the team that prepared the USAID paper (Loughlin et al (1999) is a good example of the kind of expertise involved. This would require KPPU to develop a strong staff capability to undertake such analysis. The size of this staff would depend upon the work load and the number of cases brought to it and the scope of its own initiatives. Without such staff support to provide solid analysis its decision making power could be undermined and its decisions questioned.

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