

9. Indonesia

Ningrum Natasya Sirait

1. INTRODUCTION

This chapter analyzes the factors that influence Indonesian economic development and the challenges inherent in adopting competition policy reforms. Geographical, historical, political, and socio-economic issues will be considered before tackling the legal framework of Indonesia's pro-competitive strategy.

2. BACKGROUND FACTORS

2.1 Geography, Geology and Climate

Indonesia is the world's largest archipelago, with five major islands and about 30 smaller groups consisting of more than 17,000 islands¹ on a crossroads between the Indian and Pacific Oceans. This strategic position has always influenced the cultural, social, political, and economic life of the country.

The five main islands are: Sumatra, Java/Madura (the most fertile and densely populated islands), Kalimantan, Sulawesi, and Papua (formerly Irian Jaya, which is part of New Guinea). The climate of Indonesia is characterized by two tropical seasons – the west and east monsoons, and the rainy and dry seasons are a prevalent feature. The dry season is from June to September, while the rainy season lasts from December to March. Tropical areas have rains almost all the time. The land area is covered by thick tropical rain forests, with fertile soils continuously replenished by volcanic eruptions.

¹ Bowie, Alasdair and Unger, Danny (2009), *The Politics of Open Economies Indonesia, Malaysia, the Philippines, and Thailand*, Cambridge: Cambridge University Press.

Agricultural fertility has historically sustained the high population densities of Java and Bali.²

2.2 Historical Background

The Indonesian archipelago has been the center of an important trading region since at least the seventh century. Local rulers gradually absorbed foreign cultural, religious, and political models from the early centuries CE, and Hindu and Buddhist kingdoms flourished.

Islam arrived in Indonesia sometime during the 12th century and supplanted Hinduism by the end of the 16th century in Java and Sumatra. Beginning in 1602, the Dutch slowly established themselves as the rulers of Indonesia. The only exception was East Timor, which remained under Portugal's control until 1975. During 300 years of rule, the Dutch developed the Netherlands East Indies into one of the world's richest colonial possessions, extracting natural resources through co-opted local elites, but doing little to modernize Indonesia.

Early in the 20th century, an Indonesian independence movement began and expanded rapidly, particularly between the two world wars. Harsh Japanese rule strengthened the prewar independence movement, and on 17 August 1945, three days after Japan's surrender to the Allies, a small group of Indonesians, led by Soekarno and Mohammad Hatta, proclaimed independence and established the Republic of Indonesia.

Soekarno moved Indonesia from democracy to authoritarianism, and maintained his power base by balancing the opposing forces of the military and the Communist Party of Indonesia (PKI). An attempted coup on 30 September 1965 was countered by the army and around 500,000 people were killed. The head of the military, General Suharto, out-maneuvered the politically weakened Soekarno, and was appointed president. His New Order administration was supported by the US government, and encouraged foreign direct investment in Indonesia, which was a major factor in the subsequent three decades of substantial economic growth. However, the authoritarian 'New Order' was widely accused of corruption and repression of political opposition.³

In mid-1997, Indonesia suffered from the Asian financial and economic crisis, accompanied by the worst drought in 50 years and falling

² 'Volcanoes of Indonesia'. Retrieved from <http://www.volcano.si.edu/world/region.cfm?rnum=06&rpage=list> (last accessed 2 February 2013).

³ 'Indonesian War of Independence'. Retrieved from <http://www.globalsecurity.org/military/world/war/indo-inde.htm> (last accessed 2 February 2013).

prices for commodity exports. As the exchange rate changed from a fixed to a managed float to fully floating, the rupiah (Rp.) depreciated in value, inflation increased significantly, and capital flight accelerated. Demonstrators, initially led by students, called for Suharto's resignation. Amid widespread civil unrest, Suharto resigned on 21 May 1998.

In 1999, East Timor voted to secede from Indonesia, after a 25-year military occupation that was marked by international condemnation of the army's treatment of the East Timorese.⁴ Since Suharto's resignation, a strengthening of democratic processes has included a regional autonomy program and the first direct presidential election in 2004.

2.3 Demographics and Ethnicity

According to the 2010 national census, the population of Indonesia is 237.6 million.⁵ 58 percent of the population lives on Java, the world's most populous island. There are around 300 distinct native ethnicities in Indonesia, and 742 different languages and dialects.⁶ The largest ethnic group is the Javanese, who comprise 42 percent of the population, and are politically and culturally dominant. The Sundanese, ethnic Malays, and Madurese are the largest non-Javanese groups. A sense of Indonesian nationhood exists alongside strong regional identities. Society is largely harmonious, although social, religious, and ethnic tensions have been a trigger for severe violence in Indonesia.

Chinese Indonesians, who own much of the country's privately owned commerce and wealth, are an influential ethnic minority comprising 3–4 percent of the population. This has contributed to resentment and anti-Chinese violence at various times.

2.4 Poverty and Regional Inequality

Changes in government in 1965 triggered essential progress in lowering the country's poverty rate. From steep recession in 1965, with an 8 percent decline in gross domestic product (GDP), the country began to develop

⁴ Hefner, Robert W. (2000), 'Religious Ironies in East Timor', *Religion in the News*, 3 (1). Retrieved from http://www.trincoll.edu/depts/csrl/RINVol3No1/east_timor.htm (last accessed 2 February 2013).

⁵ Central Bureau of Statistics: Census 2010 (2010), 'Badan Pusat Statistik'. Retrieved from http://www.bps.go.id/65tahun/SP2010_agregat_data_perProvinsi.pdf (last accessed 2 February 2013).

⁶ 'An Overview of Indonesia'. Retrieved from <http://www.expat.or.id/info/overview.html> (last accessed 2 February 2013).

economically in the 1970s, benefiting from the oil price shock in 1973–5, and continuing throughout the 1980s and 1990s. The GDP level rose at an average rate of 7.1 percent. The official poverty rate fell from 60 percent to 15 percent.⁷ Despite this, 12.49 percent of the population remains below the poverty line,⁸ and poverty is higher in the outer islands. Java, Bali, and Sumatra have benefited due to the rise of manufacturing and better infrastructure. Economic disparity and the flow of natural resource profits to Jakarta have led to discontent and have contributed to separatist movements in Aceh and Irian Jaya.⁹

2.5 Religion

Indonesia is the world's most populous Muslim nation, with 90 percent Muslims and the remaining 10 percent made up of Hindus, Christians, and Buddhists. The majority of the Muslims in the country are tolerant moderates. However, terrorist attacks have taken place, with threats to the Liberal Islamic Network, and issuing of *fatwas* against pluralism, secularism, and liberal Islam, indicating that radical organizations are still active.¹⁰

2.6 Military Influence

The Indonesian military (*Tentara Nasional Indonesia* or TNI), has played an exceptional role in Indonesian politics since its establishment in 1945.

Addressing the crowd assembled to celebrate the TNI's 50th birthday, the President of Indonesia, General Suharto, emphasized the distinctive nature of the Indonesian military and the fact that it needed to develop Indonesian doctrine, strategies, tactics, and techniques based on Indonesian ideals and experiences.¹¹

⁷ 'Indonesia Poverty and Wealth'. Retrieved from <http://www.nationsencyclopedia.com/economies/Asia-and-the-Pacific/Indonesia-POVERTY-AND-WEALTH.html> (last accessed 2 February 2013).

⁸ Schonhardt, Sara (2011), 'As Indonesia Grows, Discontent Sets in Among Workers', *The New York Times*, 26 December. Retrieved from <http://www.nytimes.com/2011/12/27/business/global/as-indonesia-prospers-discontent-sets-in-among-workers.html> (last accessed 2 February 2013).

⁹ Id.

¹⁰ 'Commemoration of 3rd Anniversary of Bombings' (2006), *AAP* (The Age Newspaper), 10 December. Retrieved from <http://www.theage.com.au/news/war-on-terror/services-to-honour-victims-of-2002-bali-bombing/2005/10/12/1128796537208.html> (last accessed 2 February 2013).

¹¹ Anderson, Benedict (1990), *Language and Power: Exploring Political Cultures in Indonesia*, Ithaca, NY: Cornell University Press.

Unlike officers in the professional militaries of the West, whose duties are restricted to the management of violence in order to guarantee security, TNI doctrine suggests an additional responsibility as a manager and guide in relation to socio-political affairs. The TNI considers itself to be the guardian of national unity, development, and cohesion.¹²

2.7 Corruption

According to the World Bank and International Financial Corporation (IFC) Enterprise Surveys 2009, nearly 15 percent of companies surveyed expect to pay bribes to public officials to ‘get things done’ and 14 percent believe that corruption is a major problem when doing business in Indonesia.¹³ In the World Economic Forum’s ‘Global Competitiveness Report 2010–2011’, business executives state that it is common for companies to make irregular payments or bribes in connection with imports and exports, public utilities, annual tax payments, and awarding of public contracts and licenses.¹⁴

Although Indonesian government has appointed the Indonesian Anti Corruption Commission (Komisi Pemberantasan Korupsi (KPK)), which has ruled on many corruption cases, with some even involving high-level officials, corruption is continually a significant factor in the political economy of the country.

2.8 Corporate Regulation

While financial sector regulation is effective, most listed companies are either family-owned or government-controlled and systems of corporate governance and auditing often do not meet international standards. Many political parties rely on support from private companies and corporate donations are often associated with influence-peddling in the form of kickbacks from companies or state agencies.¹⁵

¹² Shiraishi, Takashi (1999), ‘The Indonesian Military in Politics’, in Adam Schwartz and Jonathan Paris (eds), *The Politics of Post-Suharto Indonesia*, New York: Council on Foreign Relations.

¹³ World Bank and International Financial Corporation (2009), ‘Enterprise Surveys 2009’. Retrieved from <http://www.enterprisesurveys.org> (last accessed 2 February 2013).

¹⁴ World Economic Forum (2011). ‘The Global Competitiveness Report 2010–2011’. Retrieved from http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf (last accessed 2 February 2013), p. 15.

¹⁵ ‘Business Anti-Corruption Portal. Indonesia Country Profile’. Retrieved

3. POLITICAL SYSTEM

Indonesia is a presidential republic where sovereignty is held by the people and represented by the People's Consultative Assembly (MPR). The president serves as head of the state and government. The House of Representatives (DPR), Regional Representatives Councils (DPD), and president are elected.¹⁶

This system is unique, formed from Indonesia's distinctive socio-political past. Theoretically, the civil and political rights of citizens include the right to equality. Articles 22–27 of Law No. 39/1999 regarding Human Rights provide the rights of all citizens to economic and social benefits such as social security and education. The Act stipulates that every citizen deserves the right to access the *welfare state*. Furthermore, state apparatuses play a strategic role in facilitating national development and their performance continues to be refined and improved following the demands of both politicians and voters.¹⁷

Adjudication of cases in the judicial system lacks efficiency. This is partly due to the lack of communication between judges and because of weak administrative support. Weaknesses in the institutional framework hinder efficient law enforcement. The development of a strong and efficient judiciary is not supported by a sufficient bureaucracy, and salary and benefit levels are too low.

In the sphere of public service, weaknesses and shortcomings are numerous, and malpractice by government officials is significant. Criticisms are primarily concerned with the cumbersome bureaucratic system and procedures which inevitably lead to bribery.¹⁸ Long delays are common, information lacks clarity, and officials' attitudes are not focused on serving the public.¹⁹

One of the weaknesses of Indonesia's political system is the lack of resources to enforce laws at both national and regional levels. A more

from <http://www.business-anti-corruption.com/COUNTRY-PROFILES/EAST-ASIA-THE-PACIFIC/INDONESIA/RESOURCES> (last accessed 2 February 2013).

¹⁶ Poesonegoro, Marwati Djoened and Notosusanto, Nugroho (2008), *Sejarah Nasional Indonesia V: Zaman Kebangkitan Nasional dan Masa Hindia Belanda [Indonesia's National History V: The Period of National Awakening and the Netherlands East Indies Era]*, 2nd printing, revised edn, Jakarta: Balai Pustaka, pp. 1–82.

¹⁷ 'BAB VI: Reformasi Aparatur Negara'. [CHAPTER VI: Reform of the State Apparatus]. Retrieved from www.bappenas.go.id/get-file-server/node/6415/.

¹⁸ The unofficial levy *transaction cost* is a result of the cumbersome bureaucracy leading to high-extortion charges.

¹⁹ N 17.

effective socio-political strategy also requires more legislative effectiveness. Political parties are often used as vehicles to obtain a powerful position that provides a platform from which to exploit the country's resources. Many members of parliament (MPs) and legislative body officials profit from participating in bogus government projects. In relation to public procurement, the 2010 PERC survey concluded that Indonesia was the most corrupt of the 16 countries in Asia Pacific.²⁰ Among the most corrupt institutions are the police force, the Public Prosecutor's office, and members of the House of Representatives.²¹

Early in Indonesia's existence, Bung Hatta considered that the basis of the Indonesian economy was to attain reform and prosperity through cooperation.²² However, Sumitro Djojohadikusumo, in 1949, asserted that the government aspired to a mixed economy. Agreement on a new form known as the Pancasila Economic System contained a reference to economic democracy,²³ which included the Fifth Principle of the Pancasila Economic System – social justice for the whole Indonesian people – and this proposed that the government should guarantee the welfare of all Indonesian people.²⁴

Indonesia theoretically does not allow:²⁵

- i. *Free fight liberalism*: that is to say, the uncontrolled freedom of business allowing the exploitation of the economically weak which results in the increasing divisions between rich and poor.

²⁰ 'PERC: Indonesia Negara Paling Korup!' [PERC: Indonesia is the Most Corrupt Country!]. Retrieved from <http://nasional.kompas.com/read/2010/03/08/21205485/PERC.Indonesia.Negara.Paling.Korup> (last accessed 2 February 2013).

²¹ Wibowo, Rezki Sri (2009), 'Indeks Persepsi Korupsi Indonesia 2008' [Indonesia's Corruption Perception Index]. Retrieved from <http://www.ti.or.id/index.php/publication/2009/01/21/indeks-persepsi-korupsi-indonesia-2008-2> (last accessed 2 February 2013).

²² Abbas, Anwar (2010), *Bung Hatta dan Ekonomi Islam: Menangkap Makna Maqâshid al Syarī'ah [Bung Hatta and Islamic Economy: Capturing the Meaning of the Maqâshid al Syarī'ah]*, Jakarta: Kompas Media Nusantara, pp. 201–10.

²³ Soesastro, Hadi, et al. (2005), *Pemikiran dan Permasalahan Ekonomi di Indonesia dalam Setengah Abad Terakhir: Krisis dan Pemulihan Ekonomi [Thoughts and Economic Issues in Indonesia in the Last Half Century: Crisis and Economic Recovery]*, Yogyakarta: Kanisius, pp. 61–6. See also: 'Sistem Perekonomian Indonesia' [Indonesia's Economic System]. Retrieved from http://www.elearning.gunadarma.ac.id/docmodul/perekonomian_indonesia/bab1sistem_perekonomian_indonesia.pdf (last accessed 2 February 2013).

²⁴ See Article 33 of Constitution of Indonesia 1945.

²⁵ Id.

- ii. *Elitism*: namely the domination of government by a small group which inhibits social and political mobility.
- iii. *Monopoly*: as a form of economic power concentration in a particular group, thus providing consumers with no other choice.

4. ECONOMIC SYSTEM – OVERVIEW

4.1 Indonesia's Unique Economic 'Constitution'

The period from the early 1950s to the 1960s was marked by the existence of a free market economy until the establishment of the New Order Era,²⁶ which brought with it a variety of economic problems collectively known as the KKN (corruption, collusion, and nepotism).

After the fall of Suharto to the incumbency of President Megawati, Indonesia's economy began to improve, with economic growth of 4.1 percent per annum, through privatization of state-owned enterprises (SOEs). This policy resulted in controversy as some of the privatized SOEs were sold to foreign companies.²⁷

The period of the government of President Susilo Bambang Yudhoyono from 2005 to date has seen the development of Indonesia's economy at an impressive rate of 6.1 percent growth per annum. Increases in fuel levies have allowed more spending on education, health care, and other areas that support public welfare. However, direct cash aid (BLT Fund²⁸) for the poor did not reach its intended recipients and resulted in social problems. New policies agreed upon included a greater focus on infrastructure development²⁹ to stimulate economic growth and attract foreign investors.

In 2008, when the United States experienced an economic downturn, Indonesia's economy did not suffer substantially as China and India had become important economic partners and also domestic consumption drove national economic growth.

²⁶ Boediono (2009), *Ekonomi Indonesia, Mau ke Mana?: Kumpulan Esai Ekonomi [Indonesia's Economy, Where to Go?: Collection of Economic Essays]*, 3rd edn., Jakarta: Kepustakaan Populer Gramedia), p. 16.

²⁷ Id, pp. 237–8.

²⁸ Bantuan Langsung Tunai, a direct cash aid program for the poor.

²⁹ Chin, Yee Wah (2010), 'M&A under China's Anti-Monopoly Law – Emerging Patterns', *Business Law Today*, September. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1627327 (last accessed 2 February 2013).

Indonesia is a member of the G20.³⁰ Sri Mulyani Indrawati, as Indonesia's Minister of Finance between 2005 and 2010, improved transparency in all governmental systems in order to gain the trust of Indonesian voters, inadvertently gaining the trust of the G20.³¹ Increased tax revenues during Sri Mulyani's term in office combined with the already well-established Islamic (Sharia) banking system to cushion Indonesia from the impact of the economic crisis in 2008.

Extractive sector Low technology levels in the production system hamper the extractive sector.³² Joint Venture Enterprises, made up of foreign companies established to exploit natural resources³³ on a build–operate–transfer (BTO) basis, are required to engage in technology transfer. However, problems have arisen in connection with the ability of the Indonesian government to adopt some technologically advanced equipment and processes.³⁴

Manufacturing sector In the last 20 years, the role of the manufacturing sector in the Indonesian economy has increased substantially to reach 26 percent of GDP in 2009, despite the industrial sector having declined in 1998–2008 due to the financial crisis. The increase in manufacturing employment however rose only from 10 percent to 12 percent.

Service sector Following the Uruguay Round, which established the WTO (World Trade Organization), there is wider access to markets and new issues relating to the trade in services have arisen. APEC (Asia Pacific Economic Cooperation) was established in 1989, and AFTA (ASEAN

³⁰ The G20 is an informal forum for discussion between advanced and emerging countries that seeks to strengthen international cooperation and ensure global economic stability. The economies that make up the G20 represent almost 90% of global GDP and two-thirds of the world's population. Retrieved from <http://www.g20.org/en/faqs>.

³¹ Soempeno, Femi Adi (2008), *Mereka Mengkhianati Saya: Sikap Anak-Anak Emas Soeharto di Penghujung Orde Baru [They Betrayed Me: The Attitudes of Soeharto's Golden Children towards the End of the New Order Era]*, 1st edn, Yogyakarta: Galang Press, p. 86.

³² Besari, M. Sahari (2008), *Teknologi di Nusantara: 40 Abad Hambatan Inovasi [Technology in the Archipelago: 40 Centuries of Innovation Barriers]*, Jakarta: Salemba Teknika, pp. 9–10.

³³ PT Freeport Indonesia, e.g., is engaged in the extraction of iron ore and gold mining.

³⁴ Levy, Sidney M. (1996), *Build Operate Transfer: Paving The Way for Tomorrow's Infrastructure*, Hoboken, NJ: John Wiley & Sons, Inc.

Free Trade Area) was set up in the ASEAN Area in 1992. APEC encourages the free flow of trade and investment in the Asia Pacific Region, and AFTA aimed to reduce entry tariffs for a wide range of products and services to 0–5 percent by 2003.³⁵

These developments assisted liberalization, deregulation, and transparency in all sectors in Indonesia, so promoting competition in domestic products markets through greater imports of goods, higher foreign investment levels, and the transfer of technology.³⁶

In 2010, Indonesia's economy grew by 6.1 percent, and GDP per capita was US\$16.64 trillion.³⁷

Trade liberalization (deregulation) policy has been a feature of Indonesia since the 1980s, when the government gradually opened up the economy by reducing tariffs and eliminating non-tariff policies which inhibited the entry of imported goods. Indonesia has conducted regional trade cooperation through AFTA. Furthermore, trade liberalization policy has increased in line with the WTO Agenda. The average Indonesian tariff dropped from 20 percent in 1994 to less than 8 percent in 2000.³⁸ Furthermore, since 18 April 2011, the Ministry of Finance has changed tariffs on 190 products, and a total of 182 products – mostly raw materials for capital goods – had their import duties removed entirely.³⁹

Indonesia's policy in the service sector has also responded to both multilateral and bilateral trade liberalization. Following agreement on GATS

³⁵ Sachari, Agus (2007), *Budaya Visual Indonesia [The Visual Culture of Indonesia]*, Jakarta: Erlangga, pp. 14–15.

³⁶ Abimanyu, Anggito (1996), 'Impact of Free Trade on Industrial Pollution', *ASEAN Economic Bulletin*, 13, p. 41; See also Dunn, Malcolm H. (1997), 'The Economic Development of East and South East Asia Reconsidered: A Critical Comment on the Current Debate', Working Paper, University of Frankfurt. Retrieved from http://www.uni-potsdam.de/fileadmin/projects/wirtschaftspolitik/assets/Publikationen_Malcolm/The_Development_of_East_and_Southeast_Asia_Reconsidered_A_Critical_Comment_on_the_Current_Debate.pdf (last accessed 2 February 2013), p. 8.

³⁷ Central Bureau of Statistics (2011), 'Pertumbuhan Ekonomi Indonesia', [Indonesia's Economic Growth], No. 12/02/Th. XIV, 7 February.

³⁸ Astiyah, Siti, et al. (2005), 'Dampak Liberalisasi Perdagangan terhadap Perilaku Pembentukan Harga Produk Industri melalui Structure – Conduct Performance Model' [The Impact of Trade Liberalization on the Pricing Behavior of Industrial Products through the Structure – Conduct Performance Model]. *Bulletin of Monetary and Banking*, p. 527.

³⁹ No.80/PMK.011/2011 concerning the Seventh Amendment of the Regulation of the Minister of Finance No.110/PMK.01 0 / 2006 on the Regulation of Goods Classification System and the Imposition of Import Duty on Imported Goods. This PMK was issued on 13 April 2011 and effective since 18 April 2011.

(the General Agreement on Trade in Services), the government made adjustments in the service sector, including laws on banking, telecommunications, oil, natural gas, fishery, and investment.

4.2 Infrastructure Bottlenecks

One of the barriers to industrial growth and FDI has been the slow development of national infrastructure. Resolving this issue will be the key to advancing Indonesia's economy in the future. Many investment opportunities have been delayed or diverted to other countries due to infrastructure problems.⁴⁰

Since 2008, Indonesia has suffered from a shortage of electricity and industrial production has incurred large losses as a result. A number of foreign invested companies have threatened to leave Indonesia if the electricity supply problems are not addressed.

Uncertainties about completion of additional power stations and the lack of a reliable supply has led to the failure of investment projects, with alternative independent power supply being prohibitively expensive. This dilemma has seriously undermined the investment climate in Indonesia.

Poor quality highways and associated land acquisition policy also pose a serious hindrance to investment.⁴¹ Currently, the Indonesian government and Parliament is completing the Bill of Land Acquisition for Good of Public Interest, but it remains unclear whether the policy will be effective in speeding up the necessary infrastructure improvements.

⁴⁰ Sumantri, Jajang (2011), 'Amerika Keluhkan Infrastruktur Indonesia Jadi Hambatan' [America Complains about Indonesia's Cumbersome Infrastructure], *Media Indonesia*, 3 April. Retrieved from <http://www.mediaindonesia.com/read/2011/04/04/215071/4/2/Amerika-Keluhkan-Infrastruktur-Indonesia-Jadi-Hambatan> (last accessed 2 February 2013). See also *Bisnis Indonesia* (2010), 'Banyak Regulasi yang Membuat Sulit Berbisnis di Indonesia' [There are Many Regulations which Make It Difficult to Run a Business in Indonesia], 3 November.

⁴¹ 'Masalah Infrastruktur Masih Menghambat Investasi' [The Problem of Infrastructure Still Inhibits Investment], (2011), *Indonesian Commercial Newsletter*, 10 May. Retrieved from <http://www.datacon.co.id/Tekstil-2009Fokus.html> (last accessed 2 February 2013). See also 'Sektor Riil: Infrastruktur Harus Bisa Memacu Pertumbuhan' [Real Sector: Infrastructure must have been Able to Enhance Growth] (2010), 20 October. Retrieved from <http://nasional.kompas.com/read/2010/10/20/04345019> (last accessed 2 February 2013); 'Minat Investor Terhalang Infrastruktur' [Investors' Interest is Blocked by Infrastructure]. (2010), 30 September. Retrieved from <http://nasional.kompas.com/read/2010/09/30/03370874> (last accessed 2 February 2013).

4.3 Human Capital

4.3.1 As measured by the Human Development Index (HDI)

According to the UNHDR (United Nations Human Development Report) in 2010, the HDI value of Indonesia rose from the previous year and the country was ranked 108th of 169 countries.⁴² The improvement of human capital is clearly a necessary precondition for sustained economic progress.

4.3.2 Literacy and educational levels

Indonesia's literacy in 2010 reached 92 percent. According to the EDI (Education Development Index) scoring system, where scores are divided into three categories, high, moderate, and low, Indonesia, Malaysia, the Philippines, Vietnam, Myanmar, and Cambodia were in the group of countries with a moderate education index, whilst the EDI of Brunei Darussalam was ranked high.⁴³

Indonesia is characterized by substantial regional differences, a low average length of schooling, and substantial differences between the participation rates of men and women.⁴⁴

A nine-year Compulsory Education Programme was launched by the government in 1994. The average length of schooling in Indonesia in 2006 was 7.44 years. This figure indicates that the average Indonesian reached only the first grade of Junior High School. Therefore, there is an urgent need for the government to develop and implement a strategy to address this poor educational attainment level.⁴⁵

4.4 Industrial Ownership Structures

The main challenge faced by national industry today is the declining trend in industrial competitiveness in international markets. Rising energy costs, smuggling, and incompetent bureaucracy are significant problems.⁴⁶

⁴² 'HDI Indonesia 2010 (Metode dan Indikator Baru)' [Indonesia's HDI 2010 (New Methods and Indicators)]. Retrieved from <http://Data.Menkokesra.Go.Id/Content/Hdi-Indonesia-2010-Metode-Dan-Indikator-Baru> (last accessed 2 February 2013).

⁴³ Kompas, 31 December 2007: 14, in Sulistyastuti, Dyah Ratih (2007), 'Pembangunan Pendidikan dan MDGs Di Indonesia: Sebuah Refleksi Kritis' [Educational Development and MDGs in Indonesia: A Critical Reflection], *Indonesia's Journal of Population*, 2.2.

⁴⁴ Id.

⁴⁵ Education Statistics 2006: 57 in id.

⁴⁶ Idris, Fahmi (2007), 'Kebijakan dan Strategi Pengembangan Industri'

The utilization rate of industrial production capacity is below 70 percent, coupled with continued high costs of imported components and raw materials. Therefore, the ability of the industrial sector to employ workers is still limited. Small- and medium-sized enterprises (SMEs) that provide substantial employment have various limitations which have not been overcome. The main problems suffered by the SME sector include access to capital, skilled labor, and limited access to information.⁴⁷

Encouraging industrial development in regions outside Java is problematic due to limited physical infrastructure and skilled labor shortages. The government is aware that manufacturing industry has huge potential, but development is hampered thanks to the various weaknesses mentioned. If these shortcomings are addressed, the industrial sector has the potential to become a primary motor of the national economy and the backbone of national economic development.⁴⁸

In an attempt to address industrial development issues, the government has, in the last decade, established ten groups of core industries; the food and beverage industry, the seafood processing industry, textile industry, footwear industry, palm oil industry, wood products industry (including rattan), and rubber industry. Unfortunately, the policy has not been particularly successful.⁴⁹

Incentives in the form of import duty reductions instigated in 2009 have had little effect as five out of the 14 industry sectors did not utilize them.

Indonesia's industrial sector is very concentrated, with major ownership by family-controlled conglomerates and state-owned enterprises (SOEs). Efforts to reduce these levels of concentration have included privatizations of SOEs.

However, most investors in such SOE privatizations were foreigners. Privatization can assist efficiency in a number of areas including corporate governance, but merely transferring a state monopoly to private hands does not lead to a more competitive environment.⁵⁰ SOEs and privatized

[The Policy and Strategy of Industrial Development], The State Secretariat of the Republic of Indonesia, 23 May.

⁴⁷ Id.

⁴⁸ 'Bataviase. Sektor Industri Perlu Pembinaan yang Terstruktur dan Terukur' [Industrial Sectors Need Structured and Measurable Improvements]. Retrieved from <http://bataviase.co.id/node/338569> (last accessed 2 February 2013).

⁴⁹ Id.

⁵⁰ Sagala, Parluhutan (2009), 'Penyebaran Kepemilikan Saham Pemerintah Pada Badan Usaha Milik Negara (BUMN) Untuk Menciptakan Perusahaan yang Sehat dan Efisien' [Distribution of the Government's Share Ownership in the SOEs to Establish Sound and Efficient Companies], Medan: Dissertation,

monopolies have contributed to corruption, collusion, and nepotism.⁵¹ Efforts have been made to disperse the ownership of the SOEs shares to the public through the privatization program, but these efforts have not been very successful.⁵²

4.5 Levels of Foreign Investment

Efforts to attract foreign capital have been made since the enactment of the Law No. 1/1967 on Investment. Membership in the WTO has influenced the development of investment regulations in Indonesia. After the economic crisis, Indonesia reformed its Investment Law and enacted Law No. 25/2007. The Law takes into account changes in the global economy and seeks to create a conducive, clear, and fair investment climate, while still adhering to a public welfare goal.⁵³

Indonesia is the third fastest-growing economy in Asia and the largest economy in South Asia. It was not affected significantly by the global financial crisis, with economic growth of 4.5 percent in 2009. This figure is expected to increase to 5.6 percent in 2010 and 6.5 percent in 2011, so that Indonesia is often juxtaposed with the BRIC countries (Brazil, Russia, India, and China).

Economic success is due in part to the good management of state finance, with the focus on reducing the public debt burden. Indonesia's debt to GDP ratio declined steadily from 83 percent in 2001 to 29 percent by the end of 2009, the lowest among the ASEAN countries other than Singapore. According to Standard & Poor's, Indonesia was ranked first for management of fiscal balances out of the countries in the Asia-Pacific region.⁵⁴

In January 2010, the rating agency Fitch Ratings raised Indonesia's

Graduate School of North Sumatra University, p. 1.

⁵¹ The flow of official corruption funds awarded to companies investing in Indonesia's Capital Market Indonesia amounts to Rp. 200 billion. In 'Melinda Kelola Dana 27 Pejabat' [Melinda Managed the Funds of the 27 Officials]. Retrieved from <http://www.poskota.co.id/berita-terkini/2011/04/28/melinda-kelola-dana-27-pejabat> (last accessed 2 February 2013).

⁵² Patriadi, Pandu (2004), 'Segi Hukum Bisnis Dalam Kebijakan Privatisasi BUMN Melalui Penjualan Saham di Pasar Modal Indonesia' [The Legal Business Aspect of the Privatization Policy through the Share Sales in Indonesia's Capital Market], *Journal of Economic and Financial Review*, 8(1), 1 March. See also Sagala (n 50).

⁵³ Part of considering point (a) of the Law No. 25 of 2007 on Investment.

⁵⁴ 'Why Invest in Indonesia'. Retrieved from <http://www.indonesiahouston.net/Why-Indonesia.html> (last accessed 2 February 2013).

credit rating to BB+ with a stable outlook for the future. With this ranking change, Indonesia has attracted investment and capital flow in larger quantities.

According to the World Economic Forum (WEF), an independent international organization committed to improving the state of business,⁵⁵ Indonesia's investment competitiveness ranking rose from 54th in 2009 to 44th in early 2011.⁵⁶ Competitiveness indicators for this analysis are based on institutions, infrastructure that supports investment, health and education, market size, and macroeconomic environment. Indonesia's rising ranking was driven by a sound macroeconomic environment and improvements in education indicators.⁵⁷ For the ASEAN region, Indonesia ranks fifth after Singapore, Malaysia, Brunei, and Thailand. The 2010–11 GCR (Global Competitiveness Report) also showed that among the many countries experiencing sizable budget deficits, Indonesia had successfully managed to overcome its deficit problem. The report noted improvements in almost all sectors of the economy.

In 2011, the government aims for an economic growth rate of around 6.5 percent. To achieve this, the government needs to increase investment in infrastructure to foster the creation of new job opportunities.

5. COMPETITION POLICY AND LAW

Indonesia regulates business competition through Law No. 5/1999 on the Prohibition of Monopoly Practice and Unfair Business Competition, which was legalized and enacted on 5 March 1999. Constitutionally, this law aims to implement the mandate of the 1945 Constitution to realize people's welfare based on the Pancasila⁵⁸ and the 1945 Constitution. The preamble of Law No. 5/1999 ('the Law') clearly mentions that a more 'democratic' economy requires fair opportunities for citizens to participate in the processes of the production and marketing of goods and/

⁵⁵ World Economic Forum. Website: <http://www.weforum.org> (last accessed 2 February 2013).

⁵⁶ See World Economic Forum (n 14).

⁵⁷ 'Peringkat Daya Saing Investasi Negara Indonesia Meningkatkan' [Indonesia's Rate of Investment Competitiveness is Rising]. (7 April 2011). Retrieved from <http://ekonomi.kompasiana.com/bisnis/2011/04/07/peringkat-daya-saing-investasi-negara-indonesia-meningkat> (last accessed 2 February 2013).

⁵⁸ Pancasila, also known as the 'Five Moral Principles', is the philosophical basis of Indonesian life and society, embracing humanitarian ideals that are mutually interlinked and inseparable. Retrieved from http://www.indonesianembassy.org.uk/human_right-2.htm (last accessed 2 February 2013).

or services in an efficient, effective, and sound business climate. It thus encourages economic growth and a fair market economy. Theoretically, people conducting business in Indonesia must behave and act accordingly, promoting sound and fair business in order to prevent the concentration of economic power. The purposes of the Law are stated in Article 3:

- A. To maintain public interest and to increase the efficiency of national economy as one of the attempts to improve people's welfare;
- B. To create a conducive business climate through the regulation of sound business competition that business certainty for the practitioners of big, medium and small scale businesses is guaranteed;
- C. To prevent the practice of monopoly and/or unfair competition inflicted by the business practitioners; and
- D. To create effectiveness and efficiency in business activities.⁵⁹

Therefore, the purposes of the Law include the Principles of the Pancasila Economic System, based on mutual aid and the principles of brotherhood. Society is the motor generating a national economy with a spirit of social justice within the context of welfare as a basic way of cultivating national resilience. This society supposedly enables Indonesia to become an autonomous, strong, and respected economy in the world, based on the principle of solidarity. This entails the upper, middle, and lower classes acting together to contribute to a better future for the nation.

5.1 Nature of Competition Policy

Competition policy has two important objectives in regulating competition: the public interest and economic efficiency, which are reflected in the aims of the Law.

Articles 2 and 3 of the Law express the law's principles and main purposes. The law proposes that competition will assist in bringing about economic democracy,⁶⁰ guaranteeing a free and fair business competition system, so improving the people's welfare, and will help create an efficient economic system (Article 3). Similar sentiments are also found in the preamble of the 1945 Constitution. The preamble focuses on economic structures for the purpose of national welfare, and on the principles of economic democracy. The preamble indicates a legal presumption of equal

⁵⁹ Article 3 of Law No.5/1999 on Prohibition of Monopoly Practice and Unfair Business Competition.

⁶⁰ Article 33 paragraph 1 of the 1945 Constitution.

opportunity for all enterprises and also suggests that business competition should not be limited by the government.

Effective competition policy prevents the inefficient use of resources and a lack of competition results in high prices, low output, and a lack of innovation. In a competitive environment, businesses identify consumers' needs, produce these at the lowest possible price, and innovate to improve sales. Resources are used more productively and consumers get what they need.⁶¹

Using available resources more productively leads to increased output and contributes to economic growth and greater wealth. Low prices enable consumers to enjoy greater spending power. Total consumer and producer surplus increases. Competition policy increases benefits to society.

Consumer protection and competition are related. Low prices, high quality of products, and good service are the three basic requirements for consumers, and competition is the best way to guarantee them. Therefore, a competition law must go hand in hand with consumer protection law.

The objective of the Law is not only to provide benefits for the consumer but also to promote public welfare. Article 3 distinguishes the Competition Law of Indonesia from competition law in some other countries in the way that it guarantees the existence of consumer welfare, preserves the public interest, and promotes the efficiency of the national economy. This may be seen as controversial and contrary to the purpose of competition law in some other countries, which focus on a single objective. The Indonesian objectives may create problems in interpreting these potentially conflicting objectives and determining what should be prioritized; balancing these interests may be difficult, but can be achieved given clear social and political priorities.

5.2 Government's Commitment to the Competition Policy

Government commitment to establishing competition is important. The complexity of problems in the Indonesian business environment (inefficient bureaucracy, weak infrastructure, unfair competition practices, monopolistic market structures, low competitive ability) requires an integrated and comprehensive approach. Competition law needs to be reinforced through implementation of government policy and regulation.

⁶¹ Loughlin, Coleen, Marks, Stephen V., Shauki, Achmad, and Sirait, Ningrum (2000), 'Laporan Kebijakan Persaingan Indonesia' [Indonesian Competition Report] (Indonesian and English versions), Economic Law and Improved Procurement Systems (ELIPS) Project, USAID and Republic of Indonesia.

Nevertheless, the KPPU (the Supervisory Commission for Business Competition) and the government have not come to an agreement on all of these issues. Harmonization between government policy and competition policy is needed. The definition, role, and function of the KPPU also need to be better understood by the government, the legislature, the courts, business, and the general public.

The lack of harmony between the government's view and that of the KPPU is possibly caused by a divergence in understanding of the purpose and functions of competition law, what it can and cannot achieve, and how it should be integrated into a comprehensive pro-competition stance.⁶²

Another view of these difficulties is that the problems are caused by the novelty of the law. The KPPU is an independent institution that has authority to enhance business competition, but KPPU often experiences constraints from private companies or the government itself. Many government regulations are contrary to the principles of competition law. In addition, the effectiveness of the law sometimes conflicts with local government autonomy and local political priorities and there are often many differing local policies that restrict competition, for example, policies prioritizing local state-owned enterprises (BUMD) or local business practitioners by blocking business practitioners from other areas entering local markets.⁶³

Between 2007 and 2009, KPPU budget was reduced from Rp. 89 billion in 2007 to Rp. 82 billion in 2009,⁶⁴ even though the amount contributed to government funds by KPPU-levied fines exceeded the KPPU budget substantially. Consequently as can be seen, political opponents of increased pro-competition enforcement remain influential.⁶⁵

⁶² KPPU (2011), 'Putusan KPPU untuk Kepentingan Konsumen' [KPPU's Decision in the Interests of the Customers], 9 February. Retrieved from <http://www.kppu.go.id/id/putusan-kppu-untuk-kepentingan-kosumen> (last accessed 2 February 2013).

⁶³ Tjokrowarsito, Mardiharto (2009), 'Kebijakan Persaingan pada Industri Jasa Penerbangan Dilihat dari Perspektif Perlindungan Konsumen' [The Competition Policy on the Industry of Airline Services Seen from the Perspectives of Consumer Protection]. Retrieved from www.bewppenas.go.id (last accessed 2 February 2013).

⁶⁴ 'Komisi Yang Jatuh Ketika Sedang Bersinar: Catatan Akhir Tahun KPPU' [The Falling Commission While on the Rise: The Annual Report of KPPU], (31 December 2008). Retrieved from <http://www.hukumonline.com/berita/baca/ho120819/komisi-yang-jatuh-ketika-sedang-bersinar> (last accessed 2 February 2013).

⁶⁵ As a whole, the budget of the KPPU for nine years was Rp. 471 billion; meanwhile, the amount contributed by the KPPU to the state through fines reached Rp. 1 trillion; id.

In addition to implementation of the Law, the KPPU provides opinions on the competition policies proposed by government. Changes to policies are suggested before or when regulations are made, or subsequent to regulations being enacted as a policy evaluation. The KPPU considers whether proposals contradict sound competition principles and also makes suggestions to government on how to improve the relevant law or regulations. In 2010, the KPPU provided 13 such opinions, three of which were accepted by the relevant institutions.⁶⁶

The KPPU also investigates and adjudicates upon competition law violations. Initially, the authority of the KPPU to act as both public prosecutor and judge was controversial because the two functions are usually separate in Indonesia and procedural challenges were initially made to this role. Ultimately, the Supreme Court supported KPPU's role.

However, the KPPU needs to improve its performance in handling cases by adopting better analysis of market structures and market segments, supported by accurate data, even if reliable market studies are often difficult to obtain.

The role of the judiciary in competition cases is to hear objections filed by parties to decisions made by the KPPU. Parties who disagree with the decision of KPPU can file such cases at the Court of First Instance and can appeal to the Supreme Court.

On 14 July 2005, the Indonesian Supreme Court amended the Supreme Court Regulations to settle uncertainties about handling objections to a KPPU decision.⁶⁷ Based on Article 2 paragraph 1 of this Supreme Court Regulation, any objection to a decision made by the KPPU can only be filed by the reported business practitioner to the Court of First Instance at the legal domicile of the business practitioner.

This initial hostility of the judiciary to the KPPU has moderated in recent years. In 2009, 72 percent of the KPPU's decisions appealed to Supreme Court were confirmed. This indicates that the Court is satisfied that the KPPU has acted in accordance with current procedure and upon the admissible evidence.⁶⁸

Despite this judicial approbation, many problems remain to be addressed in order to make the law more effective. Some of these problems are contained within the structure of the law itself, such as various definitions,

⁶⁶ KPPU RI (2010), *2010 Annual Report*. Jakarta: KPPU, pp. 10–24.

⁶⁷ Supreme Court Regulation No. 3/2005.

⁶⁸ KPPU (2009), '72% Kasasi Putusan KPPU Dikuatkan MA' [72% of the KPPU's Cassation Verdict was Strengthened by the Supreme Court]. Retrieved from www.kppu.go.id (last accessed 2 February 2013).

procedural issues, sanctioning and remedy problems, and the relationship of competition violations with criminal cases.

5.3 International Trade and the Openness of the Economy

In the 1980s, the Indonesian government implemented a trade liberalization policy. The government gradually introduced policies to lower tariffs and to abolish non-tariff barriers to imports. Aside from these, Indonesia began to implement mutual regional trade agreements in the AFTA and Indonesia is also a member of the WTO. The financial crisis in 1997 caused a further 'opening up' of trade policy in accordance with the agreement between the Indonesian government and the IMF as part of the IMF financial package to assist Indonesia at that time.⁶⁹

One of the advantages usually obtained from more liberal trade policies is increased efficiency: first, increased productivity in allocating industrial resources, and secondly, increased competition. Liberalization can increase competition between domestic and foreign producers so that inefficient domestic producers leave the industry and the sector becomes more efficient. Moreover, the more efficient and competitive an industry becomes, the lower the profit margins, which increases consumer welfare. Post-liberalization, prices of domestic and imported goods will also become relatively lower and will also help reduce inflation.⁷⁰ These beneficial effects were noted in Indonesia in the sectors that benefited from such liberalizations.

As regards international collaboration, Indonesia is a member of the ICN (International Competition Network), and KPPU actively participates in various meetings. Indonesia is an observer at the OECD (Organisation for Economic Co-operation and Development). In participating in the activities of these two prominent organizations in the field of competition, the KPPU has attempted to transplant various regulations into the Indonesian system, including several guidelines on topics such as cartels. But adopting these standards has proved problematic in the domestic environment.

5.4 Barriers to the Improvement

KPPU has been trying to improve its internal processes and has advocated a revision of the law itself where changes to both substantive rules and

⁶⁹ Astiyah et al. (n 38), p. 524.

⁷⁰ Id.

procedures are required. However, this process is difficult due to political and bureaucratic obstacles in the House of Representatives. Budget constraints and limited human resources are also significant barriers to enforcement at KPPU. Resistance to further and more effective enforcement of pro-competition policies also emanates from vested interests in several industrial sectors. Corrupt legislators may well continue to resist substantial improvements in the law and increased budgeting provision to enhance enforcement. Nevertheless, competition policy is now on the political agenda and it is hoped that incremental improvements will be made over time.

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