

Investment Coordinating Board, Indonesia  
Republic of Indonesia

# The Study on the Improvement of Investment Policy in the Republic of Indonesia

Final Report

January 2007

JAPAN INTERNATIONAL COOPERATION AGENCY  
UNICO INTERNATIONAL CORPORATION

## **PREFACE**

In response to a request from the Government of the Republic of Indonesia, the Government of Japan decided to conduct a study on Improvement of Investment Policy and entrusted to the study to the Japan International Cooperation Agency (JICA).

JICA selected and dispatched a study team headed by Mr. YAMAUCHI Hirofumi of Unico International Co., LTD. between January 2006 and December 2006.

The team held discussions with the officials concerned of the Government of the Republic of Indonesia and conducted field surveys and pilot projects at the study area, as well as comparative studies in neighboring countries. Upon returning to Japan, the team conducted further studies and prepared this final report.

I hope that this report will contribute to the promotion of Investment into Indonesia and to the enhancement of friendly relationship between our two countries.

Finally, I wish to express my sincere appreciation to the officials concerned of the Government of the Republic of Indonesia for their close cooperation extended to the study.

January 2007

IZAWA Tadashi,  
Deputy Vice President  
Japan International Cooperation Agency

January 2007

Mr. Tadashi IZAWA  
Vice President  
Japan International Cooperation Agency  
Tokyo, Japan

Dear Mr. Izawa,

### **Letter of Transmittal**

We are pleased to submit the “Final Report for the Study on the Improvement of Investment Policy in Indonesia”. The study was implemented for almost a whole year of 2006 with a significant mission to assist the Government of Indonesia to succeed in their bid to have foreign investment flow.

Indonesia is characterized among the lower middle-income countries in the world. Total gross national income in 2003 was US\$172 billion and per capita income was US\$ 810. The unemployment rate of Indonesia was high-9.86% in 2004. It is said that the economic growth rate of Indonesia just before the change of government was 4% or more, and further approach on economic growth was necessary.

Since 1998’s Asian currency crisis, Indonesia has lost their seat as a leading group of foreign direct investment destination. On the contrary, Vietnam, for example, has steadily consolidated its position as the foreign investment destination. As for the economy after the crisis, Indonesia has experienced lower growth and the ratio of unemployment has become bigger than ever before.

As soon as the start of the new government, president Yudhoyono executed various economic reforms and action plans, and tried a re-organization that aimed at efficient management of the ministries and removal of the economic growth barriers. Economic growth is one of the primary driving forces of creating employment opportunities to absorb labor force pumped into the labor market every year. During the past seven years, foreign direct investments made in Indonesia declined appreciably in comparison to the neighboring countries that offered similar labor and resource supply capabilities. To reverse the trend, the Yudhoyono administration announced a basic policy setting the improvement of investment policy as the highest priority in economic expansion.

The study has the following three major objectives to comply with the national plan: 1) to prepare a rational and feasible investment promotion policy based on the comparison of legislation and operational conditions of competing neighboring countries, 2) to disseminate the recommendation of the study to stakeholders and all the concerned parties to enhance their motivation and 3) to implement pilot project(s) which can be started immediately to measure effectiveness of the policy recommendation. Each objective is linked to the established goal of “improving Indonesia’s investment climate.”

Recommendations covered in the report consist of three major stages: starting investment, doing business and promoting policies and strategies. Note that not only BKPM but also many public and private parties are requested to take part in the improvement activities at each stage. It is true that joint activity straddling plural parties is difficult. However, we sincerely recommend Indonesian government to struggle with such difficult challenge to encourage foreign direct investment into the Republic.

Finally, we would like to express our sincere gratitude to the valuable guidance and support provided by your agency, Investment Coordinating Board (BKPM), and the Japanese embassy in Indonesia. We would also like to express our appreciation to cooperation and support extended by the Indonesian counterpart, especially the working group member of BKPM and other public and private stakeholders during the study.

Very truly yours,

**Hirofumi YAMAUCHI**  
UNICO International Corporation  
Team Leader,  
Study Team on Improvement of  
Investment Policy in  
Republic of Indonesia

## Abbreviations and Acronyms

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APIT	:	Limited Importer Reference Number
APINDO	:	Indonesian Employers' Association
BAPPENAS	:	National Development Planning Agency
BKPM	:	Investment Coordinating Board
BKPMD	:	Provincial Investment Coordinating Board
BOI	:	Board of Investment
BOT	:	Build Operate Transfer
BOO	:	Build-Own-and-Operate
BPS	:	Statistic Bureau
BTO	:	Build Transfer-Operate
BUMD	:	Regional Administration-owned Company
BUMN	:	State-owned Company
CAO	:	Contract Add and Operate
CMNP	:	P.T. Citra Marga Nusaphala Persada: Public-private Joint Stock Company
CMS	:	P.T. Citra Marga Surabaya
DOT	:	Develop-Operate and Transfer
EDI	:	Electric Data Inter
EPZ	:	Export Processing Zone
EPTE	:	Bonded factory
FAKTUR PAJAK	:	Tax Invoice
FDI	:	Foreign Direct Investment
FIAN	:	Notary Application Form
HO	:	Nuisance Permit
IMB	:	Building Construction Permit
IMTA	:	Expatriate Work Permit
IPP	:	Investment Priority Plan
IUT	:	Permanent Business License
Izin Lokasi	:	Location Permit
Izin Usaha Industry	:	Industry Permit
JAMSOSTEK	:	Employees' Social Security
JBIC	:	Japan Bank for International Cooperation
JJC	:	Jakarta Japan Club
Kabupaten / Kota	:	Local administrative unit (City)
KITAS	:	Stay Permit for Specified Time Card
KKPPI	:	The National Committee on Policy and Acceleration of Infrastructure Development

KTP	:	Copy of Identification Card
LKPM	:	Report of Investment Activity
Master List	:	Customs Approval Letter
MOI	:	Ministry of Industry
MOT	:	Ministry of Trade
NPWP	:	Tax Registration Code Number
O & M	:	Operation and Maintenance
PDAM	:	Drinking water supply regional company
PDKB	:	Business operator/factory in bonded Area
PEZA	:	Philippine Economic Zone Authority
PGB	:	Administrator of bonded warehouse
PLN	:	Persahaan Listrik Nagara (State Owned Energy Company)
PMA	:	Foreign Investment
PMDN	:	Domestic Investment
PNBP	:	Non Tax Government Income
PPGB	:	Warehouse Operation in Bonded Area
PPP	:	Public-Private Partnership
PT	:	Limited Liability Company
ROO	:	Rehabilitate-Owned and Operate
ROT	:	Rehabilitate-Operate-and Transfer
RPTKA	:	Expatriate Employment Planning
SEC	:	Security Exchange Center
SIUP	:	Trade License
SK	:	Decision Letter ( Ministry of Justice)
SP	:	Investment Approval Letter
SPAM	:	Drinking Water Supply System
SUCOFINDO	:	Government and International Institution Service Strategic Business Unit
TA.01	:	Recommendation Letter for Working Visa
TDP	:	Certificate of Company Registration
TKA	:	Hiring Expatriate
VAT	:	Value Added Tax
VOA	:	Visa on Arrival

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## **Chapter 1 Background and the Objective of the Study**

## **Chapter 1 Background and the Objective of the Study**

*Despite the fact that most Asian competing countries after the currency crisis have recovered from the bottom of the economy, Indonesia needs more effective and quick effects development strategies since the republic has not yet fully returned to the growing tide.*

### **【Preface】**

Indonesia is ranked 4th in the world in terms of population with 240 million people residing in the country in mid-2004. According to World Bank estimates, during 1997-2003, seventeen (17) % of Indonesia's population lives below national poverty line. Indonesia's labor force growth rate of 1.2 % in last six years was close to that of the other East Asia-pacific countries' where workforce has grown at a rate of 1.1% during these years.

Indonesia is characterized as the lower middle-income country of the world. Total gross national income in 2003 was US\$ 172 billion. Per capita income was US\$ 810. The growth rate of GDP was 4.1% in 2003 and is predicted to be around 4.5% in the coming 2-3 years.

The unemployment rate of Indonesia was high, and year 2004 was 9.86%. The improvement of this high unemployment rate is a priority policy in the current government. It is said that the GDP growth of 7.5% is necessary to deal with the current unemployment and new entrants into the labor market since about 400,000 employments is created if there is GDP growth of 1% in Indonesia.

The economic growth rate of Indonesia just before change of government was 4% or more, and a further approach on economic growth was necessary. The government move onto the improvement of investment policy to assures the investment growth by more than 10 percent.

As soon as the start of the new government, President Yudhoyono executed 100-day plan (short-range plan), and tried the re-organization that aimed at efficient management of the ministries and to remove ease the economic growth barriers. Afterwards, economic growth is being somewhat improved compared with the former government though the TSUNAMI influences in Aceh according to the earthquake off the coast of the Indian Ocean. However, the unemployment rate is in a still high level. In addition, because getting depressed of consumption and further deterioration of employment are feared since the petroleum product raises the price and was executed greatly in October, 2005, the decrease in the economic growth rate by this is projected.

The reconsideration of the investment climates becomes a more important problem from

such a social economy background.

## **1.1 Background and Objective of the Study**

### **1.1.1 A New Economic Development Strategy by the New Government (Mid-term Development Plan 2004-2009)**

Growth of economy during 1997 to 98, after the Asian currency crisis, stayed merely at around 4%. In addition, it is not sufficient to accommodate new employment seeker sent off to labor market every year since the small growth was somewhat supported by domestic consumption. It is said that the unemployed or the latent unemployed in Indonesia will go up so to about 40 million.

Under such socio-economic difficult condition of the Republic, improvement of investment climate and reduction of poverty became a challenging plan for Yudhoyono administration (the new government). The mid-term development plan stipulate practical action plans as listed below:

- ◆ Enacting investment relating regulations
- ◆ Simplifying investment procedures
- ◆ Providing attractive investment incentives
- ◆ Integration of investment plan between the center and the provinces
- ◆ Implementing monitoring, evaluation and instruction of both domestic and foreign investment
- ◆ Development of central and local investment information system
- ◆ Strengthening of public services both at central and local level.
- ◆ Verification of domestic and foreign investment policy

The new 5 year development plan is acknowledged as a guideline of the most upper stream national plan until the end of the new government. The plan was drawn up on the basis of a vision and mission of the president during his presidential campaign and, has a strategy to attain socio-economic target by focusing capacity building at political, economical and social field.

The plan considered to have declared a clear message by the government that they have strong wishes to encourage FDI (Foreign Direct Investment) since the government indicates practical measures that they would expand GDP growth through increasing of investment. Though the contribution of investment to GDP in 2004 accounted merely for 16.7%, it suggests that the share being 30% is a realistic target. The following table summarizes quantitative target of the plan.

**Table 1-1 Target Economic Attainment in 2009**

Economic indicator	Value at base year	Target value in 2009
Real GDP growth rate	4.8% in 2004	7.6%
Total unemployment ratio	10.1% in 2004	5.1%
Poverty ratio	17.54% in 2004	8.2%
Income per capita	US\$968	US\$1,731
Export growth	5.7% in 2005	10.1%
<b>Share of FDI to GDP</b>	<b>16.7% in 2005</b>	<b>30%</b>

In addition, the government plans to accelerate economic development by applying to private sector participation in improvement of efficiency of existing infrastructure.

### **1.1.2 The Public and Private Sectors Joint Forum and Expectations for Japan**

The participation of China in the WTO in 2001 signified the world recognition that the country achieved separation of politics and economy and triggered growth of capital investment from all over the world at an explosive rate. For production seekers<sup>1</sup> (Note 1), China offered sufficient conditions for foreign direct investment, especially low cost labor force and a massive market opportunity, and it became the primary candidate location. In fact, East Asian countries that competed with China for attraction of foreign investment were once clouded with a pessimistic view for the future prospect because of China's overwhelming advantages. However, as ASEAN countries led by Thailand and Singapore, as well as Hong Kong (which maintains the status of a special economic zone after its return to China and offers a different investment climate), have successfully attracted foreign investment by effectively using their advantages, other countries regained confidence by relying on comparative advantage.

Under the favorable environmental changes in East Asia, especially ASEAN countries, however, Indonesia seems to be lagged far behind its rivals in terms of competitiveness to attract foreign direct investment. More precisely, the country's appeal for foreign investors has declined significantly since the Asian economic crisis, particularly up to the birth of the new administration.

Major reasons for sluggish foreign and domestic investment are said to be, among other things, labor problems, and the lack of transparency in operating cost due to corruption, the delay in infrastructure development, and the low levels of industry's competitiveness. And the Yudhoyono administration, which came to power at the end of 2004, heightens expectation for

---

<sup>1</sup> Investors who look for a location to which they can transfer their business operation; especially labor-intensive manufacturing operation - and where labor costs are low enough to allow them to establish an advantageous position in price competition.

reconstruction of the country's economic infrastructure to regain the inflow of foreign investment.

As President Yudhoyono announced a message to attract infrastructure investment at the infrastructure summit meeting in January 2005, various actions were launched to formulate necessary measures. Meanwhile, Japan and Indonesia agreed on the cooperation in the improvement of Indonesia's investment climate, which was declared at the "Indonesia/Japan Public and Private Sectors Joint Forum" in December 2004. Furthermore, Japanese cooperation is highly expected in formulation of measures to attract infrastructure development. While labor problems and the lack of transparency in government procedures have to be left to the Indonesian government's administrative capability, the Japanese government is expected to propose the ways to deal with the delay in infrastructure development and the low level of industry's competitiveness on the basis of the country's expertise and experience in the area.

**【SIAP(Japan-Indonesia Strategic Investment Action Plan:】**

In June 2005, Prime Minister Junichiro Koizumi and President Susilo Bambang Yudhoyono, in sharing the understanding that higher and sustainable economic development through the increase in real investment is essential in poverty reduction and job creation in Indonesia, announced the SIAP as a new initiative to promote foreign investment in Indonesia, especially that from Japan.

The SIAP was developed at the High-level Public and Private Sectors Joint Investment Forum, which was established in Jakarta, on December 16, 2004, based on the agreement made by the Japanese prime minister and the Indonesian president in November 2004, in Santiago, Chile. It is composed of action plans covering the following four areas: (1) labor force; (2) taxation and tariff; (3) infrastructure; and (4) industrial competitiveness and SMEs. It represents Indonesia's strategy to promote and support the national goal of "doubling foreign investment in Indonesia during the five-year period starting in 2005.

The SIAP has been developed at the High-level Public and Private Sectors Joint Investment Forum, which agreed on collaborative efforts to improve the country's investment climate under the president's strong leadership. In particular, action plans to implement the collaborative efforts are divided into four categories, (1) taxation/customs clearance, (2) labor force, (3) infrastructure, and (4) industrial competitiveness and SMEs, and the Japanese government and the Federation of Economic Organizations make active support to ensure effective growth of foreign investment in Indonesia.

### **1.1.3 Politics**

A big socio-political change of Indonesia of recent years might be collapse of the Suharto dictatorship in May, 1998. The political power changed with Habib, Wahid, and Megawati since of this collapse, and the present Yudhoyono's administration was born in October, 2004 by a direct election in Indonesia in the history. Both Habib government and Wahid government is weak, and the people's confidence are not obtained.

The Megawati administration was not able to be started the reform expected by the people while the rot of the administrative service became remarkable, and defeated by the presidential election about stable management and the macroeconomics of the political power though were with stability distinguished services.

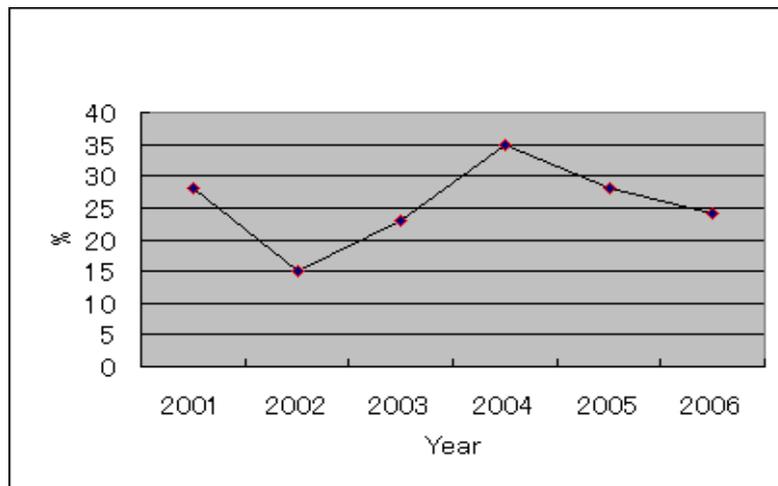
The Yudhoyono's administration does steady political management by intimate roles with the vice president; Mr.Kalla. The political power inauguration secures the crisis responsive capability of the political power by president and vice president's roles though caused the delay of the policy execution by the Indian Ocean tsunami at first.

The new administration has given the establishment of the 1-macroeconomic stabilization, 2-job creation, 3-stably energy supply and 4-establishment of rule of law. According to public opinion poll announced in March, 2006 by one of leading news paper, the public dissatisfaction is seen because of far short of economic target while there is an excellent evaluation to social order. However, the approval rating secures about 60 percent, and maintains a steady political power.

### **1.1.4 Macroeconomic Conditions in Indonesia**

An opinion survey conducted by new media in the country reveals that more than 70% of population is satisfied with the Yudhoyono administration's democratic policy. On the other hand, another survey entitled "Confidence of Population" conducted by a local research institute indicates the level of satisfaction in the area of economy is relatively low; it peaked at 35% in early 2004 and has declining since then.

**Figure 1-1 Public Confidence in the Economy**



Source: The Indonesian Survey Institute (LSI), (based on a survey of 1,400 respondents)

The survey results suggest that Indonesian people are rather disappointed by the government's economic policy implementation.

#### (1) GDP

The Indonesian economy has been steadily growing between 1980 and the 1990s. Major drivers were direct exports of natural resources, such as crude oil, minerals, and agricultural products. GDP grew by 9% over the decade between 1985 and 1995, while the inflation rate remained at merely 10%. During the period, the Indonesian economy underwent structural changes; the agricultural sector lost its share of GDP by seven percentage points to 17%, while the manufacturing sector expanded its GDP share from 13% in 1980 to 26% in 1995.

Although the government forecasted steady growth thereafter, the Indonesian economy experienced hard times until 2000.

As a result of the Asian currency crisis that occurred in mid-1997, investors faced heavy burdens from external debt and lost confidence. It hit Indonesia and its currency was devaluated, creating serious concern in the government sector as well as banks and industries about their external debt repayment capacity.

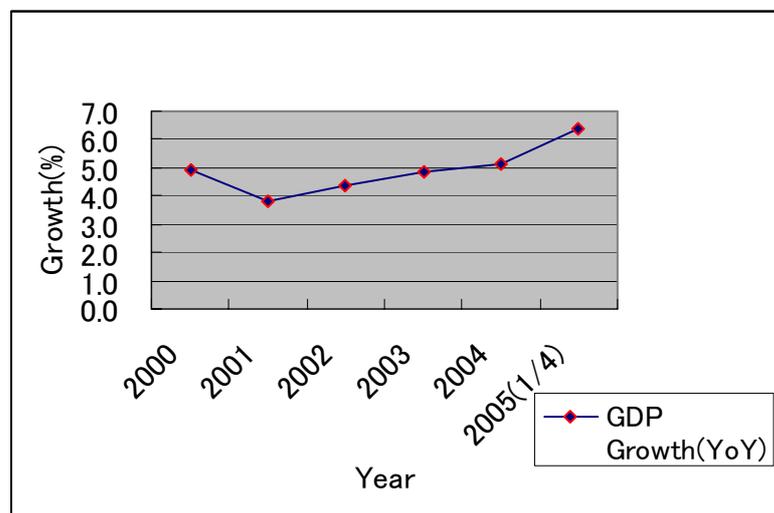
The currency crisis became worst in 1998 when the IMF decided to withdraw its loans as the government failed to comply with the IMF's austerity requirements, and DGP fell by 13.2% over the previous year.

From the outbreak of the Asian currency crisis in 1997, the Indonesian economy managed to maintain 4% growth as underpinned by domestic consumption. Nevertheless, the growth rate was not sufficient enough to create jobs for around 40 million unemployed persons. Clearly, Indonesia's industry lost dynamism to help overcome socioeconomic problems and expand the national economy.

During the past seven years, foreign direct investment made in Indonesia declined appreciably in comparison to neighboring countries that offered similar labor and resource supply capabilities. To reverse the trend, the Yudhoyono administration announced basic policy setting the improvement of investment policy as the highest priority in economic expansion. Then, it started to implement its new investment policy by developing concrete measures, such as the enactment of the new investment law, the rationalization of investment-related approval and permit procedures, and the introduction of financial incentives.

At present, the Indonesian economy continues relatively firm growth. As seen in Figure 1-2 (GDP Growth), GDP grew moderately from the latter half of the previous administration and after the inauguration of the present administration. The annual growth rate is fairly good, although it falls below the target growth rate of 6.6% set by President Yudhoyono.

**Figure 1-2 GDP Growth (YoY)**



Source: World Bank National Accounts Data

Note: 2005(1/4) denotes the first quarter of 2005.

This growth was driven by investment and exports. In particular, according to the BKMP's statistics, investment in 2005 grew by more than 90% over the previous year, by both local and foreign investors. Economic development in the Megawati era was bolstered

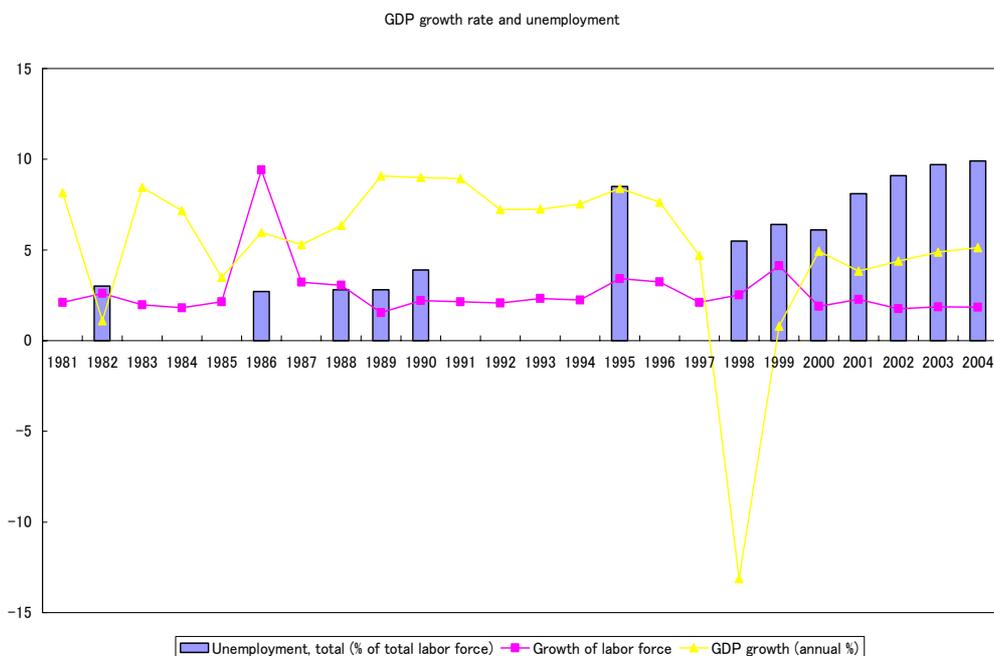
by healthy domestic consumption, while the current economic growth under the Yudhoyono administration is largely attributable to the expansion of investment that was so targeted, and some positively view it as the government's effort to improve the investment climate and eradicate corruption.

The continued sluggishness of investment in the country seems to reflect unfavorable evaluation on the investment climate and opportunity by both local and foreign investors. Now that domestic investment has moved out of the stagnation period, evaluation by foreign investors is expected to improve further. According to KADIN's consultant, local investment trends by Chinese Indonesians who are sensitive to the local economic changes are traditionally used as a major indicator to judge the country's economic condition, and the indicator is now showing invigoration of their investment activities and represents positive signs for the future economic trend.

(2) Economic development and employment

Figure 1-3 reveals the growth rate of labor force and the contribution of employment and unemployment. The growth of unemployment has showed decreasing trends since 2001. Due to lower pace of growth of employment, however, the rate of unemployment has steadily increased.

**Figure 1-3 GDP Growth and Unemployment**



Note: Unemployment rate is missing in some of years.  
 Source: The World Bank

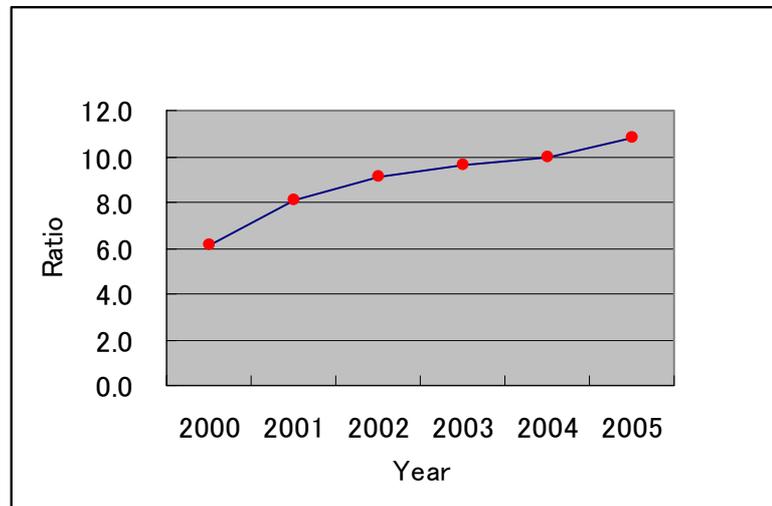
Economic growth is one of primary driving force of creating employment opportunities to absorb labor force pumped in the labor market every year. Considering constantly increasing labor force, the much higher economic growth is necessary to accelerate the growth rate of employment so as to decrease the unemployment rate.

After the Asian currency crisis, Indonesia has experienced lower economic growth (Figure 1-2). The average annual growth rate from 1999 to 2004 was 3.4%, while that from 1990 to 1997 was 7.0%. This indicates 3.6% point decrease after the currency crisis. In spite of the economic slow down, the number of total labor force (number of employment and unemployment) has been increasing at almost same pace since 1990. From 1999 to 2004, the average growth rate was 2.2%, while that from 1990 to 1997 was 2.4%, 0.2% point difference only. Owing to the slow economic growth and stable increase of labor force, the unemployment rate has surged to 10.26% in 2005<sup>2</sup>

### (3) Labor market and employment

The unemployment rate in the country was on the steady rise between 2000 and 2005. (See Figure 1-4.)

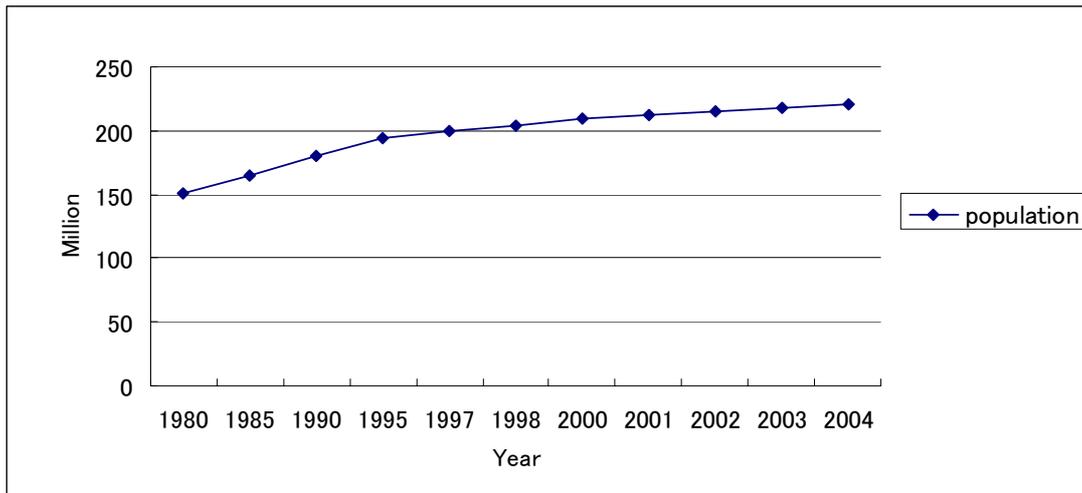
**Figure 1-4 Changes of Unemployment Ration**



Source: BPS–Statistics Indonesia (2005). Statistical Yearbook of Indonesia, 2002. Indonesia: BPS.

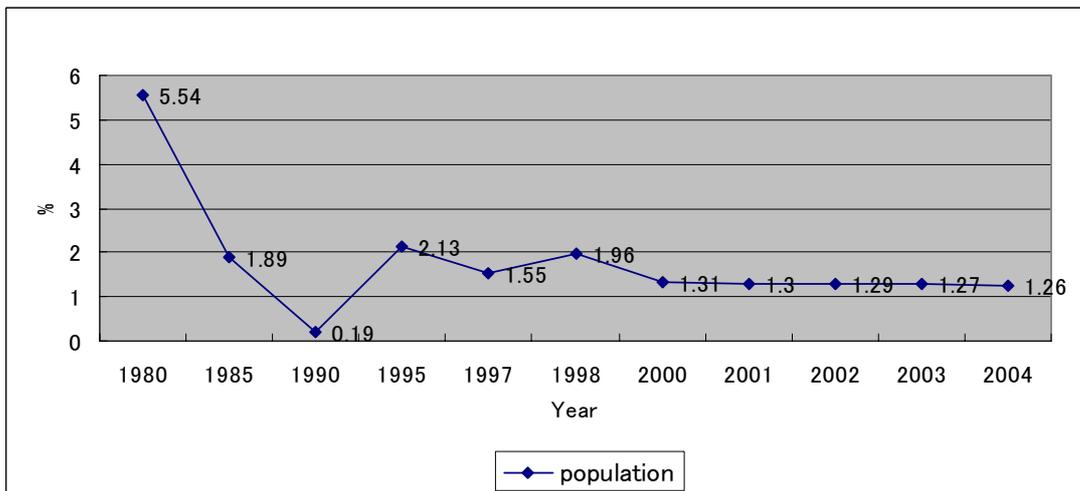
Although GDP grew substantially between 2004 and 2005, it is clear that economic growth failed to catch up with the increase in the number of new job seekers. Thus, the GDP growth rate of 5-6% is not enough to halt the rise in the unemployment rate.

<sup>2</sup> Figure 1-3 includes data until year 2004 because the figure in 2005 was retrieved from BPS from which we could not obtain consecutive data for all items.



Source: BPS–Statistics Indonesia (2005). Statistical Yearbook of Indonesia, 2002. Indonesia: BPS.

**Figure 1-6 Population Growth**



Source: BPS–Statistics Indonesia. (2005). Statistical Yearbook of Indonesia, 2002. Indonesia: BPS.

Indonesian population shows a gradual decline since 1998. In particular, the rate of decline has risen to 1.3% in the 2000s. Nevertheless, even in 2015 when babies born in 2000 will reach the working age of 16 years old, approximately 2.3 million people will enter the job market annually to create sizable demand that is difficult to meet.

(4) Trade balance

Table 1-2 reveals the trade balance in the late years.

**Table 1-2 Trade Balance of Indonesia**

Unit: Million US\$

Fiscal year	2001	2002	2003	2004	2005	2001/2005 growth rate%
<b>Export</b>	56,321	57,159	62,527	71,585	85,660	52.1%
Oil/Gas	12,636	12,113	13,651	15,645	19,232	52.2%
Others	43,685	45,046	48,876	55,939	66,428	52.1%
<b>Import</b>	30,962	31,289	33,086	46,525	57,701	86.4%
Oil/Gas	5,472	6,526	7,630	11,732	17,458	219.0%
Others	25,490	24,763	25,456	34,792	40,243	57.9%
Trade balance	+25,359	+25,870	+29,441	+25,060	+27,959	10.2%
Excluding Oil/Gas	+18,195	+20,283	+23,420	+21,147	+26,185	43.9%
Current balance of payment	N.A.	+7,822	+7,425	+2,875	N.A.	
Foreign currency reserves	N.A.	30,970	34,962	34,952	N.A.	

Source : Central Board of Statistics/NAFED

As for total exports in fiscal year 2005 increased by 20% from the previous year and accounted for US\$ 85.6 billion. Amount of exports grow by 52% in five years since 2001, and grew by 11.5% in average. Export of oil/natural gas in 2005 increased by 23% than the previous year though the volume stayed at the same level. It was caused by increase of crude oil price hike. On the other hand, export of palm oil and coal which is included in non-oil/gas category, had expanded by 18% in price than the previous year. This was due to the increase of export volume.

The import increased by 24% than the previous year (2004) and reached US\$ 57.7 billion. It is basically caused by the expanded more than became 24% increase compared with the previous year and an expansion more than export US\$ 57.7 billion. It is principally caused by the rapid hike of oil import for fuel. It increased by 48%, compared with the previous year (2004). (Though Indonesia is an oil-producing country, the import dependency becoming higher in Indonesia recently because of shortage of refining plant, slow-down of domestic production.)

The trade balance is almost a level of the level-off for these several years though the trade balance secured the surplus of US\$ 28 billion.

#### (5) Export

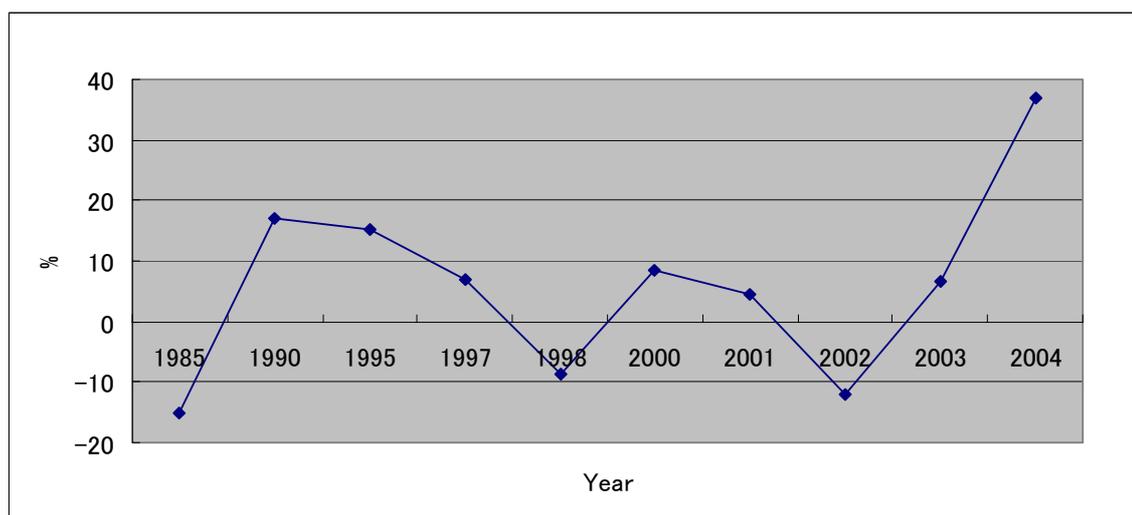
Figure 1-7 indicates year to year basis change of exportation. As seen in the figure, export declined largely than the previous year caused by the currency crisis in 1997. Afterwards, a cost increase in the import raw material depressed the manufacturing cost and it became disincentive of export in 2001 and 2002 though the export getting on the recovery

because of rupiah appreciation.

On the other hand, share of export (see Figure 1-8) in GDP indicates that the depression of national economy caused by currency crisis was somehow supported by the export. However, as seen in the figure, the major export items from the republic were biased in natural resources such as crude oil and natural gas but supported industrial products of processed items other than energy resources. The government of Indonesia is expecting to expand share of export of such industrial products since their export to ASEAN market is small.

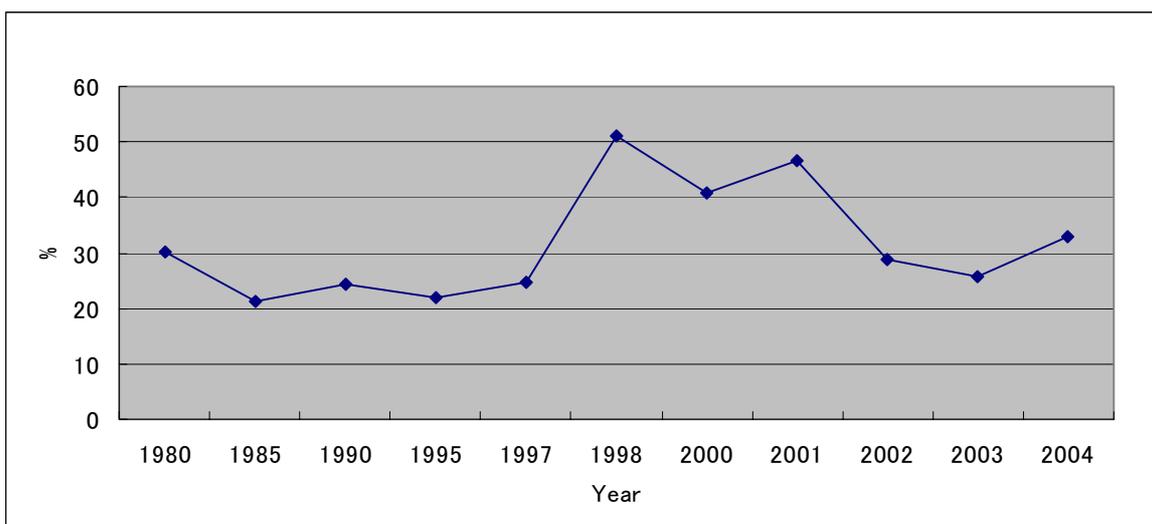
Noteworthy phenomena in export are that the active consumer propensity of the domestic market became a locomotive of economic growth by compensating the decrease of export in 2002.

**Figure 1-7 Annual Growth Rate of Exports**



Source: BPS–Statistics Indonesia. (2005). Statistical Yearbook of Indonesia, 2002. Indonesia: BPS.

**Figure 1-8 Share of Exports in GDP**



Source: BPS–Statistics Indonesia. (2005). Statistical Yearbook of Indonesia, 2002. Indonesia: BPS.

1) Merchandize export trend

**Table 1-3 Export of Indonesia (by category)**

Unit: Million US\$

Fiscal year	2001	2002	2003	2004	2005	2001/2005 growth rate (%)
Oil/gas	12,636	12,113	13,651	15,645	19,232	52.2%
Crude oil	5,715	5,228	5,621	6,241	8,146	42.5%
Oil products	1,189	1,307	1,554	1,654	1,932	62.5%
Natural gas	5,732	5,578	6,477	7,750	9,154	60.0%
Non Oil/Gas	43,685	45,046	47,407	55,939	66,428	52.1%
Agro/fishery prod	2,430	2,568	2,526	2,496	2,880	18.1%
Minerals	3,575	3,748	4,001	4,766	7,955	122.5%
Other industrial prod	37,671	38,730	40,880	48,677	55,594	47.6%
Total	62,124	56,321	57,159	62,527	71,585	52.1%

Source : Central Board of Statistics/NAFED

Petroleum and natural gas exports are monopolized by state enterprise, PT Pertamina. Thus, statistical data are classified into “petroleum and gas products” and “non-petroleum and gas products.” (Pricing and production are completely controlled by the government.)

Exports of non-petroleum and gas products (cocoa, coffee, shrimp, and fish) increased, both on a volume and value basis, due to the flattening of international prices. On the other hand, mineral exports (coal, copper, nickel, tin, etc.) expanded in 2005 on account of

international price hikes. Finally, other industrial products including traditional ones (textile, lumber, plywood, and furniture) remained unchanged or decreased slightly.

Recently, exports of non-ferrous metal products are expanding, including nickel, vegetable oil and fat (palm oil), and crude rubber produced from plantations. Industrial products including electrical machinery and automotive parts showed slight increases and failed to drive exports partly because of limited product types.

## 2) Export markets

**Table 1-4 Export of Indonesia(by country)**

Unit: Million US\$

Country	2001	2002	2003	2004	2005	share %	Growth rate %
Japan	13,010	12,045	13,603	15,962	18,049	21.07	38.73
USA	7,749	7,559	7,374	8,767	9,868	11.52	27.35
Singapore	5,364	5,349	5,400	5,998	7,835	9.15	46.07
S. Korea	3,772	4,107	4,324	4,830	7,086	8.27	87.86
China	2,201	2,903	3,803	4,605	6,662	7.78	202.68
Malaysia	1,779	2,030	2,364	3,016	3,431	4.01	92.86
India	1,054	1,302	1,742	2,171	2,878	3.36	173.06
Taiwan	2,188	2,067	2,233	2,854	2,475	2.89	13.12
Thailand	1,064	1,227	1,393	1,976	2,246	2.62	111.09
Holland	1,498	1,618	1,401	1,798	2,234	2.61	49.13
Others	16,643	16,950	17,422	19,608	22,892	26.72	37.55
Total	56,321	57,159	61,058	71,585	85,660	100.00	52.09

Source : Central Board of Statistics/NAFED

The above table presents the ten largest export markets for Indonesia and Japan is the largest importer of Indonesian products.

In 2005, Indonesia exported approximately \$848.7 billion worth of crude oil and natural gas to Japan. In fact, Japan relies almost all of its natural gas imports on Indonesia. In the same year, it also imported \$956.2 billion of products other than crude oil and natural gas, being the largest export market for Indonesia, surpassing the U.S.

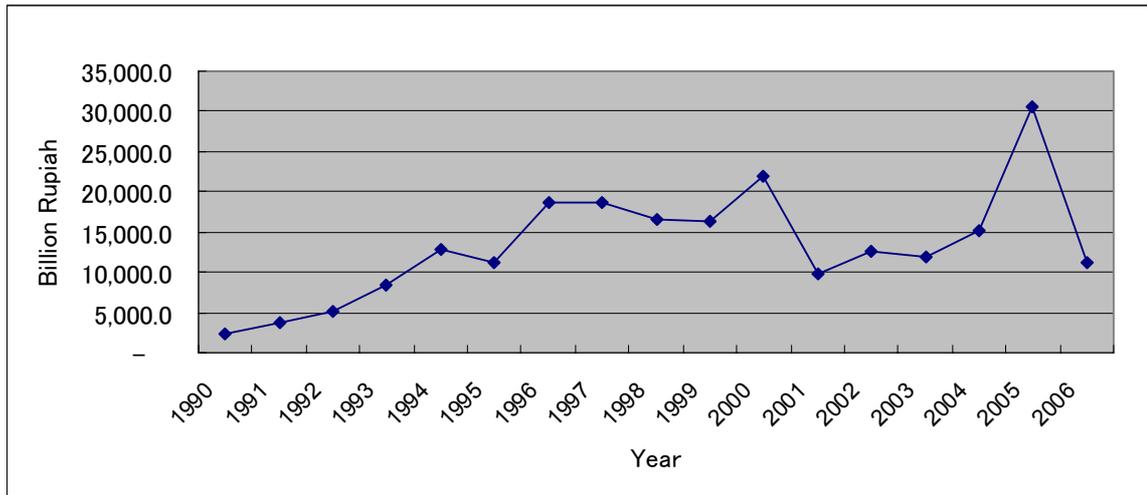
The U.S. is the largest market for non oil and gas exports, but their growth slows down recently. On the other hand, trade with China, India, Thailand and Malaysia is on the steady expansion.

(5) Investment

1) Domestic investment

Domestic investment, after stagnation due to the currency crisis in 1998 and the downturns in 2001, shows firm growth since 2002.

**Figure 1-9 Changes of Domestic Investment**

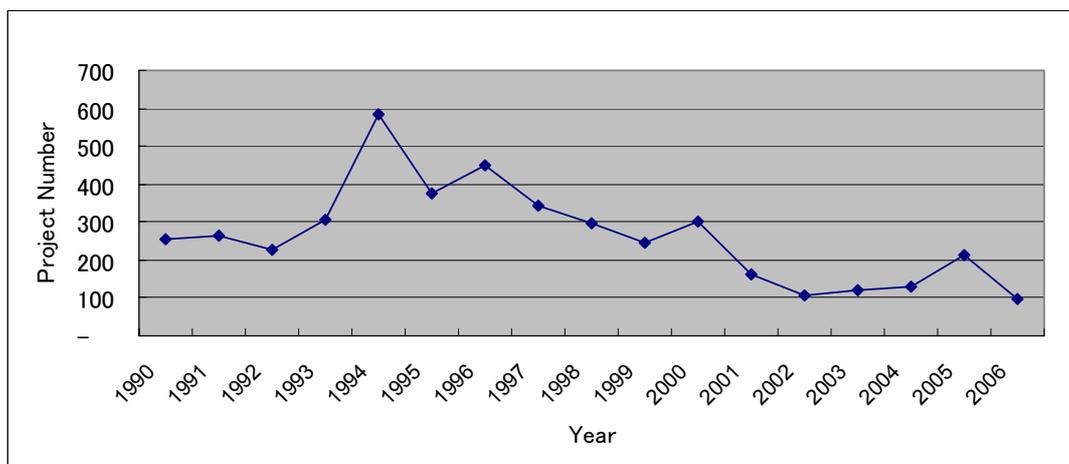


Source: BKPM

Note: Data in 2006 cover the first half only.

Figure 1-9 shows the yearly trend in the number of domestic investment projects. Note that the trend mostly accords with the change in value of investment during the period, albeit some difference in variation. The number of investment projects turned slightly upward in 2002.

**Figure 1-10 Domestic Investment Project**



Source: BKPM

Based on BKPM's investment licensing data, the recent domestic investment trend is

analyzed. The following table compares the data during the same period (January and June) in 2005 and 2006. The number of permanent licenses for investment projects issued in the first half of 2006 totaled 96, valued at 1,185.3 billion rupiah, compared to 113 licenses and 7,847.9 billion rupiah, respectively, in 2005. Thus, while the number of licenses in 2006 decreased by 15%, the value of investment per license increased by 42.5%.

**Table 1-5 The Number of Permanent Licenses Issued and the Value Investment in the First Half of 2005 and 2006**

PMDN/ Domestic Investment Realization	Jan 1 – June 30, 2006		Jan 1 – June 30, 2005		Ratio ( % )	
	P (1)	I (2)	P (3)	I (4)	P (1:3)	I (2:4)
<i>Investment Realization (Permanent Licenses)</i>	96	11.185,3	113	7.847,9	84,9	142,5
<i>Realization of Manpower Absorption</i>	41.776 <i>persons</i>		59.712 <i>persons</i>		69,9	

Source: BKPM

Note : :

1. P = Total of Issued Permanent Licenses  
I = Investment Realization Value in Rp. Billion
2. Excluding of investment in Oil and Gas, Banking, Non Bank Financial Institution, Insurance, Leasing, Mining in Terms of Contracts of Work, Coal Mining in Terms of Agreement of Work, investment which licenses issued by technical/sector agency, Porto folio as well as household investment

The sector receiving the largest share of investment is metal, machinery and electronics, totaling 16 projects (3,144.5 billion rupiah), followed by food processing 12 projects (2,055.3 billion rupiah), other services 6 projects (1,606.5 billion rupiah), and food crops/plantation 8 projects (1,509.9 billion rupiah).

**Table 1-6 Ranking of Domestic Investment Realization (Permanent Licenses) Sector**

<i>Sector</i>	<i>Project</i>	<i>Value</i>	<i>%</i>
<i>Metal, Machinery and Electronic Industry</i>	16	3,144.5	28.1
<i>Food Industry</i>	12	2,055.3	18.4
<i>Other Services</i>	6	1,606.5	14.4
<i>Food Crops &amp; Plantation</i>	8	1,509.9	13.5
<i>Transport, Storage &amp; Communication</i>	11	817.4	7.3
<i>Wood Industry</i>	7	540.3	4.8
<i>Chemical and Pharmaceutical Industry</i>	5	368.3	3.3
<i>Trade &amp; Repair</i>	3	258.3	2.3
<i>Construction</i>	2	224.5	2.0

<i>Sector</i>	<i>Project</i>	<i>Value</i>	<i>%</i>
<i>Hotel &amp; Restaurant</i>	1	180.2	1.6
<i>Motor Vehicles &amp; Other Transport Equip.Ind.</i>	4	116.5	1.0
<i>Rubber and Plastic Industry</i>	4	99.0	0.9
<i>Livestock</i>	6	83.9	0.8
<i>Non Metallic Mineral Industry</i>	1	57.0	0.5
<i>Real Estate, Ind. Estate &amp; Business Activities</i>	2	28.1	0.3
<i>Paper and Printing Industry</i>	3	27.8	0.2
<i>Textile Industry</i>	3	26.6	0.2
<i>Mining</i>	1	21.0	0.2
<i>Forestry</i>	0	20.0	0.2
<i>Fishery</i>	1	0.2	0.0
<i>Leather Goods and Footwear Industry</i>	0	-	-
<i>Medical, Precisi.,Optical Instru., Watch &amp; Clock Ind.</i>	0	-	-
<i>Other Industry</i>	0	-	-
<i>Electricity , Gas &amp; Water Supply</i>	0	-	-
<b>Total</b>	<b>96</b>	<b>11,185.3</b>	<b>100.0</b>

Source: BKPM (January 1 - June 30, 2006) , Billion Rupiah

Regionally, Batam holds the largest share (12 projects and 3,297.4 billion rupiah), followed by the Jakarta Metropolitan Region (22 projects and 2,721.3 billion rupiah), Riau (6 projects and 1,701.4 billion rupiah), and Central Kalimantan (3 projects and 774.1 billion rupiah). Among them, Jakarta is characterized by a relatively small amount of project compared to the number of projects, suggesting that more investment is directed to the service sector, than the manufacturing sector. Overall, investment in the domestic demand-oriented sectors remains robust, including food (ranked second), other services (third), transport, storage & communications, construction, and hotel & restaurant.

## 2) Foreign direct investment

Table 1-7 Foreign Direct Investment

NO.	Sector	1997		1998		1999		2001		2002		2003		2004		2005		2006	
		P	I	P	I	P	I	P	I	P	I	P	I	P	I	P	I	P	I
I	<b>Primary Sector</b>	9	31.4	25	62.5	25	126.0	23	144.7	17	102.5	22	253.4	23	308.5	45	407.8	16	289.7
1	Food Crops & Plantation	3	2.4	14	28.6	4	48.5	6	64.1	1	9.0	8	219.2	4	161.0	17	171.5	6	257.8
2	Livestock	1	1.5	2	23.2	5	35.3	3	4.3	1	8.0	1	1.1	6	20.2	3	52.8	2	11.3
3	Forestry	0	-	0	-	2	17.5	0	-	0	-	0	-	0	-	2	118.8	0	-
4	Fishery	1	1.8	5	9.4	5	11.2	7	11.0	1	1.1	2	1.0	2	5.3	7	5.8	2	13.7
5	Mining	4	25.7	4	1.3	9	13.5	7	65.3	14	84.4	11	32.1	11	122.0	16	58.9	6	6.9
II	<b>Secondary Sector</b>	242	2,629.8	290	4,028.5	309	5,637.0	252	2,198.5	233	1,552.2	283	1,880.4	245	2,803.3	336	3,502.1	207	2,541.1
6	Food Industry	27	196.6	24	391.8	32	310.9	22	133.1	22	219.3	27	319.2	29	574.3	46	598.8	21	175.7
7	Textile Industry	18	117.5	24	128.6	32	121.7	29	286.9	32	117.7	41	152.4	24	165.5	30	70.9	33	372.6
8	Leather Goods & Footwear Industry	13	142.3	14	38.9	9	22.5	8	21.4	6	57.4	7	5.8	6	13.2	6	47.8	10	51.5
9	Wood Industry	6	11.7	8	13.0	14	36.7	11	45.9	12	19.3	24	157.8	6	4.1	19	91.0	8	7.1
10	Paper and Printing Industry	4	10.0	7	234.6	12	72.1	12	376.5	4	26.5	7	8.4	15	414.3	6	9.9	8	438.4
11	Chemical and Pharmaceutical Industry	39	854.9	42	1,418.1	30	968.4	32	710.1	26	527.5	29	282.2	39	614.1	41	1,152.9	19	86.6
12	Rubber and Plastic Industry	29	239.3	29	504.2	32	239.3	30	103.0	19	57.7	18	99.9	16	81.0	28	398.5	19	86.5
13	Non Metallic Mineral Industry	5	42.7	17	187.7	13	100.0	3	13.2	9	54.1	4	42.9	9	107.1	11	66.2	3	78.8
14	Metal, Machinery & Electronic Industry	69	687.1	98	857.3	87	3,292.0	74	385.3	66	352.5	56	434.5	51	312.8	87	522.9	55	812.8
15	Medical Preci. & Optical Instru. Watches & Clock Industry	3	13.7	1	1.6	7	42.2	2	3.7	1	0.4	3	6.5	4	13.0	2	3.1	1	0.2
16	Motor Vehicles & Other Transport Equip. Industry	24	305.5	16	244.4	20	332.0	12	91.7	11	90.0	29	313.5	22	402.6	31	359.7	14	316.3
17	Other Industry	5	8.5	10	8.3	21	99.2	17	27.7	25	29.8	38	57.3	24	101.3	29	180.4	16	114.6
III	<b>Tertiary Sector</b>	80	812.2	97	774.7	170	2,466.9	179	1,166.2	192	1,435.4	265	3,316.6	276	1,489.3	528	5,004.7	264	679.2
18	Electricity, Gas & Water Supply	3	24.3	1	1.0	1	184.5	1	195.3	0	-	1	76.7	2	6.1	2	68.7	1	98.5
19	Construction	15	126.6	8	63.8	15	252.5	19	129.5	11	13.7	19	106.7	18	385.6	35	921.9	11	47.7
20	Trade & Repair	14	14.9	19	27.3	39	47.3	72	81.8	89	162.8	128	307.4	127	672.7	260	380.2	142	299.3
21	Hotel & Restaurant	4	127.2	7	121.5	12	646.8	10	35.5	12	18.2	8	80.3	8	89.5	33	180.3	19	28.5
22	Transport, Storage & Communication	11	233.4	9	10.9	20	897.7	22	190.7	28	1,166.9	35	2,667.5	27	103.8	53	2,946.8	21	21.9
23	Real Estate, Ind. Estate & Business Activities	6	261.8	10	519.3	8	119.6	6	133.9	3	15.3	3	0.7	6	35.2	5	208.3	12	140.3
24	Other Services	27	24.0	43	30.9	75	318.5	49	399.5	49	58.5	71	77.3	88	196.4	140	298.5	58	43.0
	<b>Total</b>	331	3,473.4	412	4,865.7	504	8,229.9	454	3,509.4	442	3,090.1	570	5,450.4	544	4,601.1	909	8,914.6	487	3,510.0

Source: BKPM

Note 1. Excluding of Oil & Gas, Banking, Non Bank Financial Institution, Insurance, Leasing, Mining in Terms of Contracts of Work, Coal Mining in Terms of Agreement of Work, Investment which licenses issued by technical/sectoral agency, Porto folio as well as Household Investment.

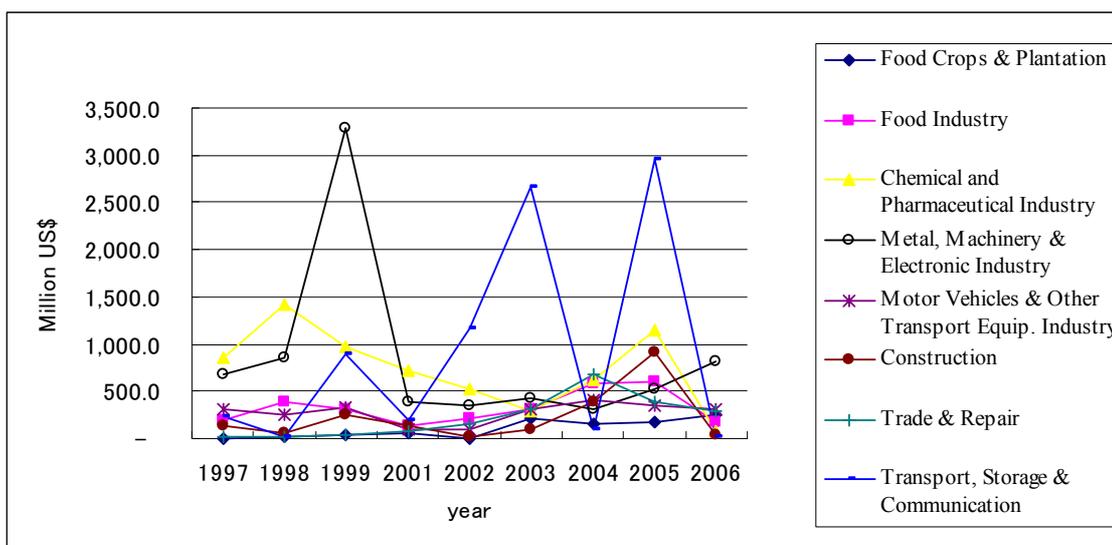
2. P : Total of issued Permanent Licenses

3. I : Value of Investment Realization in Million US\$.

4. Tentative data, including permanent licenses issued by regions received by BKPM until June 30, 2006.

Table 1-7 shows the yearly trend in foreign direct investment since 1997. Both the number of investment projects and the value of investment vary greatly year by year, and there is no sign of recovery in terms of investment opportunity. This substantiates the fact that Indonesia does not have the legal system and other systems and institutions to encourage foreign investment, while it is endowed with competitive infrastructure including the large domestic market, abundant labor force, and rich natural resources.

**Figure 1-11 Foreign Direct Investment**



**Figure 1-12 Annual Changes of FDI**

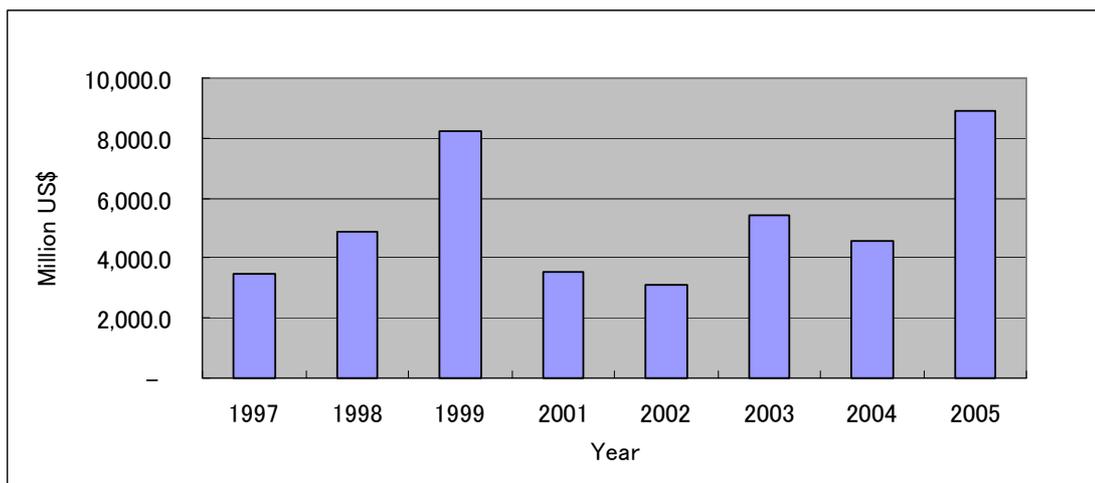


Figure 1-11 shows investment trends by major sectors and Figure 1-12 the overall foreign investment trend. The statistical data do not suggest a specific sector that has any strength peculiar to Indonesia. Also, from the comparison to the investment levels before

1997, it is difficult to say that foreign investment is returning to Indonesia, although a gradual increase is seen after 2002.

The Web site of BKPM's office in Japan states that foreign investment in support industries for automotive, electronics, and machinery manufacturers is desirable from the viewpoint of encouraging job creation, but notable programs or measures have still to be taken to induce investment in these sectors.

Table 1-8 presents the foreign investment ranking by sector. From the investment trend in the first half of 2006, foreign investment seems to center on the manufacturing sector that can create a large number of jobs. Meanwhile, Indonesia seems to be lagged behind other ASEAN countries, which are actively engaged in attraction of foreign investment to taken advantage of the AFTA Agreement. Thus, it is difficult to conclude that foreign investment is redirected toward Indonesia.

As for Japanese investment that has been supporting the Indonesian manufacturing sector (Table 1-9), investment relating to business expansion and capacity buildup exceeds new investment.

**Table 1-8 Ranking of Foreign Direct Investment Realization  
(permanent Licenses) Sector**

Unit: Million US\$

Sector	Project	Value	%
<i>Metal, Machinery and Electronic Industry</i>	55	812.8	23.16
<i>Paper and Printing Industry</i>	8	438.4	12.49
<i>Textile Industry</i>	33	372.6	10.62
<i>Motor Vehicles &amp; Other Transport Equip.Ind.</i>	14	316.3	9.01
<i>Trade &amp; Repair</i>	142	299.3	8.53
<i>Food Crops &amp; Plantation</i>	6	257.8	7.34
<i>Food Industry</i>	21	175.7	5.01
<i>Real Estate, Ind. Estate &amp; Business Activities</i>	12	140.3	4
<i>Other Industry</i>	16	114.6	3.26
<i>Electricity, Gas &amp; Water Supply</i>	1	98.5	2.81
<i>Chemical and Pharmaceutical Industry</i>	19	86.6	2.47
<i>Rubber and Plastic Industry</i>	19	86.5	2.46
<i>Non Metallic Mineral Ind</i>	3	78.8	2.25
<i>Leather Goods and Footwear Industry</i>	10	51.5	1.47
<i>Construction</i>	11	47.7	1.36
<i>Other Services</i>	58	43	1.23
<i>Hotel &amp; Restaurant</i>	19	28.5	0.81
<i>Transport, Storage &amp; Communication</i>	21	21.9	0.62
<i>Fishery</i>	2	13.7	0.39
<i>Livestock</i>	2	11.3	0.32
<i>Wood Industry</i>	8	7.1	0.2
<i>Mining</i>	6	6.9	0.2
<i>Medical, Precisi.,Optical Instru., Watch &amp; Clock Ind.</i>	1	0.2	0.01
<i>Forestry</i>	0	-	0
	<b>487</b>	<b>3,509.80</b>	<b>100</b>

Source: BKPM (January 1 - June 30, 2006)

**Table 1-9 Investment relating to business expansion and capacity buildup exceeds new investment**

*Trend of Foreign Investment Planning New Approvals, Expansion & Change of Status by Country of Origin, 2005 and 2006*

NO.	Country of Origin	2005						2006 ( up to June )					
		New		Expansion		Change of Status		New		Expansion		Change of Status	
		P	I	P	I	P	I	P	I	P	I	P	I
5	Hong Kong ( SAR )	12	19.6	3	59.7	5	46.2	9	268.8	2	13.8	1	1.1
9	Japan	71	154.2	91	1,000.5	5	21.7	28	52.1	33	187.5	3	0.6
10	South Korea	301	333.8	52	80.8	8	2.7	170	112.9	30	379.7	2	0.1
13	Malaysia	161	301.1	15	235.5	12	50.8	72	110.3	6	29.3	11	638.3
17	People's Republic of China	80	159.7	6	30.3	4	15.1	40	66.5	3	14.7	2	1.9
19	Singapore	156	418.7	46	3,084.1	47	430.4	78	304.0	25	147.9	28	354.7
21	Taiwan	41	82.0	17	51.0	2	0.3	12	4.9	11	198.3	1	0.6
41	AUSTRALIA / Australia	62	397.4	12	111.5	6	4.7	30	16.9	4	2.0	2	0.6
45	United States of America	41	16.5	13	71.9	3	2.7	19	65.9	2	5.6	3	12.2

Source: BKPM

CATATAN / Note :

- <sup>1</sup> Excluding of Oil & Gas, Banking, Non Bank Financial Institution, Insurance, Leasing, Mining in Terms of Contracts of Work, Coal Mining in Terms of Agreement of Work, Investment which licenses issued by technical/sectoral agency, Porto folio as well as Household Investment.
- <sup>2</sup> P : Number of Project
- <sup>3</sup> I : Value of Investment Planning in Million US\$.
- <sup>4</sup> Tentative data, including investment planning approvals issued by regions received by BKPM until June 30, 2006.

## **1.2 Objective of the Study**

The Study has three major objectives as shown below:

- (1) To prepare a rational and feasible investment promotion policy based on the comparison of legislation and operational condition of competing circumference countries
- (2) To disseminate the recommendation of the study to stakeholders and all the concerned parties to enhance their motivation
- (3) To implement pilot project(s) which can be started immediately to measure effectiveness of the policy recommendation

Each objective is linked to the established goal of “improving Indonesia’s investment climate.” Thus, the study schedule has been developed to ensure the efficient accomplishment of the goal. It is described in detail in “1.2.1 Outline of the Study and Methodology.” Furthermore, the following policy was established to maximize the level of achievement made by the Study.

Basic policy of the Study:

### **【Technical policy】**

- 1) To prepare a stubborn recommendation
- 2) To conduct comparative study of neighboring countries from the viewpoint of contributing to the improvement of the country’s investment climate.
- 3) To conduct the current status survey of the investment climate in due consideration to the operational aspects of related systems and institutions.
- 4) To approach the proposals for the improvement of the investment climate from two sides, the institution and the implementation body (investment board).
- 5) To use document research and study to maximum extent.

### **【Operational policy】**

- 6) To emphasize technology transfer to the counterpart staff (human resource development).
- 7) To emphasize the linkage to the upstream plan and related projects.
- 8) To ensure close communication with parties relating to the counterpart.
- 9) To ensure efficient and flexible management of the study team.

### **1.2.1 Outline of the Study and Methodology**

The Study is divided into three categories as Section-I, Section-II and Section--III.

Each section is summarized as below:

- Section I
  - ★ Common theme
  - ★ Policy recommendation, time-frame
  - ★ Publicity activity
  
- Section II
  - ★ Investment climate comparison survey
  - ★ BOI (board of investment) or FDI (foreign direct investment) related agents survey
  
- Section III
  - ★ Pilot Project
  - ★ Database development

Activities under Section II will complete by the end of the second field survey. Section III will complete by the end of third field survey. Whereas the activity under Section I will last at the completely end of the project by increasing its importance according to progress of the project.

Also, in view of the content of the activity, we separated the Study in to two time-frames as Phase-I and II. Phase I cover Section I and II and named as “5 countries investment climate comparison survey”. Phase II covers Section II and named as “Preparation of Policy Recommendation and Publicity of Project Timeframe”.

	<b>Prep. at Home</b>	<b>2<sup>nd</sup> Site Study</b>	<b>3<sup>rd</sup> Site Study</b>	<b>4<sup>th</sup> Site Study</b>
<b>SEC-I</b>	<b>1st Site Study</b>	<b>Joint work with WG</b>		<b>Policy Recommendation</b>
<b>Common theme</b>	<b>Underst'ng of concept, conf'n of strategy</b>	<b>Share of common information</b>	<b>Study on operation method</b>	<b>Realistic Improvement Plan</b>
<b>Policy recom'n, time frame</b>	<b>Data analysis: Priority theme by country</b>	<b>Study on operation method</b>	<b>Test Run</b>	<b>Evaluation and Publicity</b>
<b>Publicity activity</b>	<b>Concept</b>			
<b>SEC-II</b>				
<b>Inv. Climate comparison, BOI survey</b>				
<b>SEC-III</b>				
<b>Pilot-Project Data-Base</b>				

## Section I

- **Prep.of ICR(Basic Concept : 5 country comparative survey, PP、 Database, Timeframe of the whole study)**
- **Explanation on ICR and consensus building**
- **Implementation of the Study and intermediate evaluation**
- **Improvement of the Study, exchange of opinions from stakeholders**
- **Explanation of DFR and discussion for consensus**
- **Holding seminar, press-release**

## Section II

- **Analysis on existing investment climate data**
- **Consensus development for 5 countries survey**
  - **Advantageous and disadvantageous topics**
  - **Making of the field survey report - I**
- **Implementation of 2nd field survey**
- **Making of the 2nd field survey report**
- **Making of Investment climate comparative table**

## Section III

- **List up of PP and development of DB concept**

- **Explain draft PP & preliminary selection**

- **Discussion on the concept & decision of project rule**

- **Selection of local consultant**

- **Implementation of PP & DB, supervision**

- **Test run, evaluation, making of manual**

- **Handover and real operation**



## **Chapter 2 Current Situation of the Investment Climate in Indonesia and Comparative Analysis**

# **Chapter 2 Current Situation of the Investment Climate in Indonesia and Comparative Analysis**

**(Investment Law, Negative List, Investment Approval Procedure)**

## **2.1 Investment Law**

Following a critical summary of Indonesia's New Investment Law, here we survey the comparable laws of Viet Nam, Thailand, the Philippines and China, for purposes of comparison with the Indonesian law and to facilitate its evaluation. Although more than the relevant law is involved in attracting foreign direct investment, it is implicit that the law is of great importance.

### **2.1.1 The New Investment Law in Indonesia**

#### **(1) Significant challenges in the changing investment environment**

Under the recognition that faster growth of the Indonesian economy is achievable only through augmented FDI inflows, the current investment law is about to be revised. The new law has been drafted and sent to the House of Representatives of the Republic of Indonesia for deliberation. The law has uniqueness in stressing promotion aspects for, rather than regulation aspects of, foreign direct investment, and it seems to reflect the eager attitude of the Indonesian government to attract foreign companies as investors in Indonesia. However, as it is stated below, the New Investment Law stipulates only the basic philosophy, and details remain to be announced in succeeding Presidential decrees and regulations. Therefore it is impossible to judge whether or not the law could provide competitiveness against investment laws in other countries as a basic guideline for attracting foreign direct investment. Especially, this holds true in connection with incentives and licensing procedure.

The basic idea and concept of the new law is evaluated as being appropriate. Especially, the following provisions are highly evaluated:

- The attention given to “integrated service” for management of permits (refer to Administration (Article 1(11) and 14).
- Stipulations regarding legal certainty, openness, accountability and equal treatment as one of the law's principles (Article 3(1)).
- Reference to the development of a business climate which is conducive for capital investment as a basic principle of the law (Article 4(1)).
- Refer to equal opportunities to both foreign and domestic capital investment (Article 4(2)). Also, the reference to equal treatment to all investors, regardless of their country of origin (Article 6(1)).
- Reference to regional governments' active involvement in implementation of capital

investment (Article 4(3)). It is understood that a decentralized procedure of investment approval is confirmed.

- Reference to government's compensation to owners, based on market value, in the event that the government nationalizes or takes over ownership rights (Article 7(2)).
- Reference to free transfer of assets to parties appointed by the investor (Article 8(1) and (3)).
- Reference to the investor's business having the right to utilize foreign experts for particular positions and skills (Article 10(2)).
- Reference to the Standardized Classification of Business Field (KBLU) and Industrial Classification (ISIC) as basis of the Negative List (Article 11(2)). It says as follows.  
“The business sectors that are closed or open with restrictions shall be stipulated clearly and in detail using standard classifications regarding business sectors that are applied in Indonesia and stipulated in or pursuant to law and regulations ”
- Reference to fiscal facilities (Article 12(1)).
- Reference to the organization that is to provide integrated service (Article 14(2)).
- Reference to the Coordinating Minister's role of coordinating capital investment policy (Article 15(2)).
- Reference to BKPM's basic functions (Article 16(2)). It is interpreted that the investment approval function is excluded from BKPM's major functions.

Among the above Articles, the most important are Articles 14 and 16. In these two articles, it is clearly stated that the investment approval procedure is transferred to regional governments from BKPM. As a result, the functions of BKPM will be confined to investment promotion.

## (2) Areas remaining to be clarified

On the other hand, there still remains to be made clear in the new Government regulations or decisions that will followed as ancillary to the law. They are these.

- **Contents of “Integrated service”** By integrated service, what kind of service is meant? Does it mean a series of services including local permission?
- **Function sharing for investment related approval between central government and regional or local government** Is the prevailing system to be followed or is there to be a new system designed toward decentralization? The vagueness on this point is the biggest drawback. It should be described more clearly. It is written in the draft for the New Investment Law that procedures for the integrated service are to be further stipulated through a Presidential Regulation. The Regulation should be announced with the same timing as the announcement of the New Investment Law. Which procedure is most desirable among several options is discussed in section 2.3 “**Improvement of Investment Approval Procedure.**”

- **Basic stance toward incentives** Other countries such as Thailand and Viet Nam stipulate incentives in their investment law. While in Indonesia too, investment incentives were stipulated in the past, no incentive is explicitly mentioned in the prevailing investment law. This is because the government fears market distortions that can be produced by incentives. Article 12 of the New Investment Law indicates that the Government provides incentives, though details on types of incentives and areas are not suggested.
- **Opening the same opportunities for both foreign investors and domestic investors** The new law states that the government shall offer opportunities equally to both foreign investors and domestic investors in the implementation of investment (Article 4(2)). It is not clear whether the stipulation is applied to so-called Negative List or not. If it is to be applied, the Negative list II which is only open to domestic investors will disappear.
- **Infrastructure projects** It should be clearly stated that investment under the New Investment Law includes investment in infrastructure projects because this type of investment is clearly different from investment in other sectors and different treatment should be given to them. Line ministries who handle bidding procedures shall be responsible to grant investment approval, instead of regional governments or the BKPM. The new investment law which is under deliberation does not take into consideration the important changes taken place in infrastructure development. The development has been paid attention mainly as an input factor for developing industries, but less attention has been paid to the development as target of “investment”. In the past, most of infrastructure development has been carried out by public sectors with government funds. Under the situation, private sectors have acted as contractors and /or constructors. However, such the environment has dramatically changed. With the lack of government funds, the government has begun to change strategies of infrastructure development. It is to expect private sectors’ participation in the development. The new scheme is so called, PPP (Public-Private-Partnership). With the change, a concept of “infrastructure development” has changed from public works to investment. It is because private sectors became principal actors for not only constructing the projects but also managing the projects for long years. As the result, infrastructure development has become one of important targets for foreign direct investments. However, the new law seems lack of the sense of the importance in the change. It is necessary for the government to understand the change deeply because infrastructure development is important targets for foreign investments as well as is important for public goods. With the change, BKPM also should develop internal organization which will make it possible to be involved in the investment promotion of infrastructure sector.
- **Economic zones** Reportedly, the government plans to set up several new, special economic zones. Since such zones provide special investment opportunities and new fiscal and non-fiscal incentives to investors, related basic provisions should be included in this new law. The provisions related to special economic zones are crucial ones in investment laws and appeared in every investment law in other Asian countries where such zones are

set up.

- **Negative list** Unlike investment law in other Asian countries as is referred to below, details on the negative list are not stated. Comprehensive explanation on the negative list should be given in the New Investment Law because the law is a kind of Constitution on foreign investment. Besides the list itself, basic philosophy on the selection of sectors that are prohibited or restricted to foreign direct investments should be disclosed. This is important from the viewpoint of transparency.

### (3) Expected speedy enforcement

One of characteristics of Indonesian investment law is simplicity. As the result, details are to be stipulated separately in Presidential Decrees followed the law. Therefore, only when the decrees are made public, the whole picture of spirits or contents of the law becomes clear. It is expected that the related decrees are announced simultaneously with the law. Otherwise, potential investors will continue to take a stance of “Wait and See” which leads to delay in investment. This is also important for maintaining legal certainty.

## 2.1.2 The New Investment Law in Viet Nam

In Viet Nam, the New Law on Investment was enacted on 29th November 2005 and became effective 1st July 2006. The features of the new law are shown below.

### (1) Composition

The new law consists of ten chapters with 89 articles:

Chapter 1: General Provisions (5 articles)

Chapter 2: Investment Guarantees (5 articles)

Chapter 3: Rights and Obligations of Investors (8 articles)

Chapter 4: Form of Investment (6 articles)

Chapter 5: Investment Sectors and Geographical Areas, Investment Incentives and Support (18 articles)

Chapter 6: Direct Investment Activities (21 articles)

Chapter 7: Business Investments Funded by State Capital (7 articles)

Chapter 8: Offshore Investment (6 articles)

Chapter 9: State Administration of Investment (8 articles)

Chapter 10: Implementing Provisions (2 articles)

### (2) Selected Important Provisions

In Article 4 of Chapter 1, policies on investment are given. Among them, the unique one is equal treatment for all investors from all economic sectors, regardless of whether the

investor is domestic or foreign. In Article 6 of Chapter 2, guarantees for investment capital and assets are stated. Also, in Article 7, provision is made for protection of intellectual property rights. In Chapter 3, statements on basic rights of investors are given, covering rights to import, export and purchase foreign currencies. Access to incentives is also included. In Article 23 of Chapter 4, investment in infrastructure by BTO and BT is explicitly referred.

Chapter 5 contains several important articles. In Articles 27 and 28, incentive investment sectors and geographical areas are stipulated. Articles 29, 30, and 31 have the so-called negative list. In Articles 32 to 37, the types of investment incentives are described. They are tax incentives, carrying forward of losses, depreciation of fixed assets, land use incentives and incentives applicable to investors who invest in industrial zones, export processing zones, high-tech zones, and economic zones. In Articles 40 to 44, supports extended by the government are specified. The list of support items includes technology transfer and entry and exist visas.

Chapter 6 stipulates investment procedures and commencement of implementation of investment projects. It is evident from this that the procedures are decentralized in Viet Nam. Article 46 deals with procedures for registration of foreign investment. According to the article, registration of projects which have an invested capital of below 300 billion Vietnamese dong and which are not included in the list of sectors of investment subject to conditions, is made by a provincial State administrative body and this body issues investment certificates. The certificates are to be issued within 15 days from the date of receipt of the complete and valid filing for investment registration. In the case of projects whose investment exceeds 300 billion Vietnamese dong and projects on the list of sectors of investment subject to conditions, Article 47 stipulates that it is necessary to go through an evaluation process before granting of an investment certificate. With respect to authority to conduct the evaluation study, for the projects including important national projects, Articles 47-3 and -4 state that the government shall provide the relevant regulations. According to the prevailing regulations, local governments will be given authority to conduct the study for some areas. The time limit for evaluation shall not exceed 30 days from the date of the receipt of a complete and valid file. When necessary, the time limit may be extended, but not beyond 45 days. Evaluation includes not only compliance with master planning and zoning for land use, but also land use requirements, and environmental solutions. With respect to important national projects, the central government (Ministry of Planning and Investment) evaluates the projects and issues the investment certificates. Details are introduced in section 2.3 "Improvement of Investment Approval Procedure." It should be noted that with the enactment of the new investment law, related regulation on investment procedure will be also amended. Article 52 stipulates the operational duration of foreign invested projects not to exceed 50 years, though it could be extended up to 70 years depending upon the government's decision.

### 2.1.3 Investment Law in Thailand

Laws governing foreign investment in Thailand consist of the Foreign Business Act B.E.2542 (1999), and Investment Promotion Act B.E 2520 (1977), which was amended twice by Investment Promotion Act (No. 2) B.E.2534 (1991) and Investment Promotion Act (No. 3) B.E.2544 (2001). The latter Investment Promotion Act, 2001 version, suggests how Thailand assigns importance to foreign direct investment. The Foreign Business Act is composed of 46 sections. The characteristics of the law are summarized in the following:

- Negative list (Sections 8, 9 and 15)

There are three lists. One is a list of areas where foreign investments are prohibited. The second is a list of areas where foreign investments are prohibited unless permitted by the minister with the approval of the Cabinet. In this case, the Thai nationals' share shall be not less than 40%. However, if there is a reasonable cause, the permissible percentage share can be reduced, but not to less than 25% and provided that the number of Thai directors shall not be less than two-fifths of the total number of directors. The third is a list of areas where Thai nationals are not ready to compete unless permitted by the Director-General with the approval of the Committee (Sections 8 and 15). Every kind of business operation other than categorized under List 2 and 3 is open to for foreign investors without requirements for getting permission or for submitting applications. In Section 9, it is stipulated that these lists can be amended or changed at one-year intervals. Based on the above definition, if a majority of the shares of a limited company is held by Thais, it is regarded as a Thai company and thus not subject to the Act.

- Minimum capital used (Section 14)

It is stipulated that the minimum capital used shall not be less than 2,000,000 Baht (Section 14), while investors in businesses in Lists 2 and 3 are required to inject capital not less than 3,000,000 Baht.

- Application for permission (Section 17)

Application shall be submitted to the Minister or Director-General in case of Lists 2 and 3. The approval, if granted, is given within 60 days of the date of the application. The license will be given within 15 days of the date of the Cabinet's approval (Section 17).

- Ministerial regulations (Section 18)

Beside the negative list, the Thai government attaches conditions to foreign investments in regard to the following items (Section 18):

- Debt-equity ratio
- Number of foreign directors

- Number and period for keeping the minimum capital in Thailand
- Technology or assets
- Other necessary conditions

- Foreign Business Committee (Sections 23, 26, and 29)

The Committee has the authority of advising, recommending or giving opinions to the Minister on the enactment of royal decrees and issuance of ministerial regulations. The Commercial registration department at the Ministry of Commerce shall act as the Secretariat of the committee.

#### **2.1.4 Investment Law in the Philippines**

The Philippines' investment law consists of the following three basic laws.

(1) The Omnibus Investments Code of 1987

This law governs domestic and foreign investments with incentives. It consists of 43 articles, including:

- Article 1-2: Title of the law and investment policies.
- Article 3-9: Board of Investments.

It is stipulated that Board of Investment attached to the Department of Trade and Industry implements the provisions.

- Article 10-26: Definition of terms; Preferred areas of investment are defined.
- Article 27-31: Investment priorities plan: the plan by which investment incentives are determined.
- Article 32-37: Registration of enterprises: Registration process for enterprises entitled to have incentives is explained. Qualifications of a registered enterprise are given as well as approval and registration procedures. The Board evaluates the project according to certain criteria and grants approval.
- Article 38: Basic rights and guarantees.
- Article 39: Incentives to registered enterprises: Various incentives, mainly fiscal incentives, are enumerated.
- Article 40-43: Incentives to less-developed-area registered enterprises: Pioneer incentives and other incentives are introduced.

(2) Foreign Investments Act of 1991

This law governs foreign investment without regard to incentives and consists of 18 sections, including:

- Section 1-4, 6-8: Title of the law, policy, definitions and scope

It is defined that foreign investment negative list (FINL) means a list of areas of economic

activity where foreign ownership is limited to a maximum of 40% of the equity capital of the enterprises.

- Section 5: Registration of investments of non-Philippine nationals

In case of investments without incentives, there is no necessity to obtain approval. What is needed is only registration of the enterprise.

- Section 9-18: Others

### (3) Special Economic Zone Act of 1995

This law governs investment in economic zones or export zones and consists of 57 sections including:

- Section 1-4: Title of the law, policy, purposes and intents and objectives, and definitions

Special economic zones (ECOZONES) include industrial estates, export processing zones, free trade zones and tourist/recreational centers.

- Section 5-6: Establishment of ECOZONES and Criteria for the Establishment of other ECOZONES

At present there exist 38 zones in the Philippines, but depending on the criteria used, new zones could be established. Under the law, the Philippine Economic Zone Authority (PEZA) was established.

- Section 7: Decentralized ECOZONE

It is said that ECOZONE shall be developed as much as possible, into a decentralized, self-reliant and self-sustaining investment center with minimum government intervention. This concept underpins the decentralized operation of ECOZONES.

- Section 8: Operated and managed as separate customs territory

- Sections 9-10: Defense and security, and immigration

It is stipulated that the minimum initial investment shall not be less than US\$150,000.

- Sections 11-20: PEZA Board

PEZA is attached to the Department of Trade and Industry. The organizational structure, function and power are stipulated as well as matters related to the administration of each ECOZONE.

- Sections 21-36: Operations within the ECOZONE

Section 35 states that business enterprises within an ECOZONE are to be registered with the PEZA. Section 36 states that the PEZA shall establish a one-stop shop center for the purpose of facilitating the registration of new enterprises in the ECOZONE. Under these two stipulations, all appropriate government agencies that are involved in registering, licensing or issuing permits to investors are to send their representatives to the ECOZONE to attend to investor's requirements.

- Section 37-57: Others

The minimum capital required is Peso 5,000. Application for investment differs

depending on the preferential treatment available, as follows. In the case of preferential treatment, regardless of the foreign capital's share, it is requested to apply to the Board of Investment or Philippine Economic Zone Authority. After getting approval, the investors register the company at SEC or BTRCP. In cases of without preferential treatment, only registration at SEC or BTRCP is required.

The Investment law in the Philippine is unique in its formulating various preferential treatments for investment in special areas. Details of this treatment differ by percentage shares by foreign capital, investment areas and investment sectors.

### **2.1.5 Investment Law in China**

Foreign investment to China is allowed under the following two laws.

- The Law of The People's Republic of China on Chinese-Foreign Joint Ventures, 1979  
The law consists of 15 articles and is simple. The following are the articles to be noted.
  - The joint venture agreement shall be submitted to the Foreign Investment Commission of the People's Republic of China and the Commission shall, within three months, decide whether to approve or disapprove. After approval, the joint venture shall register with the General Administration for Industry and Commerce, to obtain a license to do business and start operations. (Article 3)
  - It is requested for foreign capital to be not less than 25% of the registered capital of a joint venture. (Article 4)  
A foreign joint venture that possesses advanced technology is given tax incentive in the form of reduction of or exemption from income tax for the first two to three profit-making years. (Article 7)
  
- The Law of Foreign Companies in The People's Republic of China, 1986  
The law consists of 22 articles and is simple. In Article 2, it is stipulated that the foreign companies mean those established in China with 100% foreign equity . In Article 3, it is stipulated that restricted sectors or prohibited sectors to foreign investment are specified by Ministry of State (Article 3).

Besides the above basic laws, China has adopted a guideline on foreign investment. It dates to April 2004 and consists of 17 articles. Notwithstanding that 100% foreign-owned companies were allowed in China under the "The Law of Foreign Companies in The People's Republic Of China, 1996," in Article 8 of this guideline, this is modified to limit foreign investment projects to joint ventures with Chinese companies who own a majority of equity. In Article 5-7, as well as in promoted sectors, restricted sectors and prohibited sectors for foreign investment are specified.

## 2.1.6 Comparison of Investment Law, Indonesia and Other Asian Countries

The above comparison on current invests law for five countries is given in Table 2-1.

**Table 2-1 Comparison Table of Investment Law in Indonesia and Other Asian Countries**

	Indonesia	Thailand	Viet Nam	The Philippines	China
Law	<ul style="list-style-type: none"> <li>● New Investment Law, 2006</li> </ul>	<ul style="list-style-type: none"> <li>● Foreign Business Act, 1999</li> <li>● Investment Promotion Act, 2001</li> </ul>	<ul style="list-style-type: none"> <li>● Law on Investment 2006</li> </ul>	<ul style="list-style-type: none"> <li>● The Omnibus Investments Code of 1987</li> <li>● Foreign Investments Act of 1991</li> <li>● Special Economic Zone Act of 1995</li> </ul>	<ul style="list-style-type: none"> <li>● The Law of The PRC on Chinese-Foreign Joint Ventures (1979)</li> <li>● Law of Foreign Company in China (1986)</li> <li>● A guidance on Foreign Company Investment (2002)</li> </ul>
No. of articles or sections	23	46	89	43,18 and 57 respectively	15 & 22 & 17 respectively
Attachment	None	Negative list	None	Negative list	Negative list
Review of negative list	Not mentioned	Yes	Yes	Not mentioned	Not mentioned
Equal treatment	Yes	Yes	Yes	No	No
<b>Stipulation on</b>					
• Minimum capital used	No	Yes	None	Yes	No
• Infra- structure investment (BOT etc.)	No	Yes	Yes	No	No
• Duration of investment	Yes	Yes	Yes	Yes	No
• Investment guarantee	Yes	No	Yes	Yes	Yes
• Settlement of dispute	Yes	No	Yes	No	Yes
• Incentive investment sectors and geographical areas	No	Yes	Yes (Tax incentive, Carrying forward losses, depreciation of fixed assets, land use incentives, other special incentives)	Yes	Yes (Tax incentive)

	Indonesia	Thailand	Viet Nam	The Philippines	China
• Intellectual property rights	Yes	No	Yes	No	No
• Investment support	Yes	Yes	Yes	No	Yes
• Investment procedure	Yes (Centralization)	Yes (Centralization)	Yes (Decentralization)	Yes (Decentralization)	Yes (Centralization)

### 2.1.7 Conclusion

It is expected that s basic policy on function sharing for decentralization, incentives, special economic zones and the negative list and its criteria will be clearly stated in Presidential decrees.

### 2.1.8 Outline of Proposed Action Plans

Outline of proposed action plans regarding the New Investment Law is given in Table 2-2

To suggest the followings in case the New Investment law is still under deliberation and there are rooms to be improved or Indonesian government intends to stipulate the details of each article by Presidential decree.

- Include in the New Investment Law articles on establishment of new Special Economic Zones. Or, prepare Presidential decree on the matter.
- Include in Presidential decree, which will be successively prepared, articles on BOT, BOO and other type of infrastructure development
- Include in Presidential decree, which will be successively prepared, articles on function sharing on investment approval procedure among BKPM, regional and local government
- Include in the New Investment Law articles on introduction of new fiscal and non-fiscal incentives. Or, prepare Presidential decree on the matter
- Add a phrase regarding criteria for determination on negative list
- E-announcement: The new investment law will be announced to public by using information technology for the purpose of speedy and transparent dissemination
- Develop an organization, which handles and promotes infrastructure projects, as one of strategic sections at BKPM

**Table 2-2 Action Plans Regarding the New Investment Law**

Plan	Contents	Effects	Responsible agencies
1. Deregulation			
1. 1. Deregulation on retail business	<ul style="list-style-type: none"> <li>● Revise current Negative list so that manufacturer might be able to distribute their products at their retail shop including chain stores</li> </ul>	<ul style="list-style-type: none"> <li>● It is expected that investment in manufacturing sector expands because the sector can follow new business strategy</li> </ul>	Ministry of Trade Coordinating Ministry for Economic Affairs BKPM
1.2. Cope with new reality in business environment	<ul style="list-style-type: none"> <li>● Study always how business environment changes and what kind of new business model is being invented</li> </ul>	<ul style="list-style-type: none"> <li>● It is expected that foreign investors will find a great potential in Indonesian business</li> </ul>	Ministry of Trade Coordinating Ministry for Economic affairs BKPM
2. Operational matter			
2.1 Publish an explanatory pamphlet for new negative list	<ul style="list-style-type: none"> <li>● Considering the importance of coming change, new negative list is explained in details as well as criteria and new determination procedure</li> </ul>	<ul style="list-style-type: none"> <li>● Transparency will be enhanced</li> </ul>	BKPM
2.2. Announce timely changes in Negative list to public	<ul style="list-style-type: none"> <li>● Changes should be announced not by law but Presidential decree or regulation</li> <li>● Whenever the list changes, BKPM lets investors know the changes with explanatory documents</li> <li>● “Notice to investors from BKPM”</li> </ul>	<ul style="list-style-type: none"> <li>● It becomes possible for investors to know the changes in regulation and to avoid their misunderstanding</li> <li>● It will also contribute to shorten the pre-application process</li> </ul>	BKPM
2.3. Publish a guide book on Negative List for investors	<ul style="list-style-type: none"> <li>● Explanatory guide book</li> <li>● Includes not only official Negative list but also government regulations and BKPM’s internal regulations</li> <li>● Stress be given to controversial sectors</li> </ul>	<ul style="list-style-type: none"> <li>● It will contribute to shorten the pre-application process</li> </ul>	BKPM

Plan	Contents	Effects	Responsible agencies
	such as service sector and SME sector		
2.4. Publish English version of “Klasifikasi Buku Lapangan Usaha 2005”	<ul style="list-style-type: none"> <li>● To publish English version of guidance to which BKPM refer in judging whether an industry belongs to the sector in Negative list</li> </ul>	<ul style="list-style-type: none"> <li>● It will contribute to shorten the pre-application process</li> </ul>	BKPM
2.5 E- announcement	<ul style="list-style-type: none"> <li>● To let the contents of the new law made public by using information technology</li> </ul>	<ul style="list-style-type: none"> <li>● It will contribute to secure speedy and transparent dissemination of the law</li> </ul>	BKPM

## 2.2 Negative List

### 2.2.1 What a “Negative List” is

A negative list is a list of sectors that are not open to, or are open under special conditions, to foreign direct investment (FDI). Here, only the negative list in which BKPM is involved is taken up for investigation. The lists prepared by the Ministry of Finance and Ministry of Energy and Mining are out of the scope of this study. While every country stresses the importance of FDI and promotes it, usually some sectors are reserved, that is, are not open to foreign investment, as a matter of policy and strategy. The list of these reserved sectors is called a “negative list.” The list differs considerably by country. However, there are also similarities. For example, sectors, which would intimately involve core cultural values are not open. Sectors are not open if they have a strong presence of local industries that are weak compared with foreign companies and if the sectors were to be opened to foreign capital, local industries would find it difficult to survive. Sectors where investments may have serious adverse effects on the environment may be closes.

In addition to its contents, simplification and transparency of Negative list are so important because they make it possible for investment approval procedure to be streamlined. In this sense, how Negative list is stipulated has a large impact on the investment approval procedure. The more simple and transparent Negative list is, the simple the procedure is.

### 2.2.2 How the List is Decided

In Indonesia, related ministries such as the Ministry of Agriculture, Ministry of Industry, Ministry of Trade, Ministry of Minerals and Mining, and Ministry of Public Works, have

proposed their negative list and BKPM has coordinated the lists. In coordinating, Coordinating Ministry for Economic Affairs assisted BKPM in the past. However, as is stated below, since the Ministry of Trade became responsible for determination of the list, the decision system changed. The list is made public by Presidential decree. According to the prevailing investment law, the list is to be reviewed once in three years. The prevailing list was stipulated in the following Presidential Decrees of 2000 and 2001: Presidential Decree No.96/2000, Presidential Decree No.118/2000, and Presidential Decree No.127/2001.

With enactment of the New Investment Law, it is expected a new Presidential Decree with a new negative list will be announced.

From time to time, a related ministry has proposed additional sectors to be newly included in the negative list, or sectors to be removed from the prevailing negative list. When BKPM received such a proposal, it held a ministerial meeting and coordinates administrative policy relating to the proposal. In thus acting as coordinator, BKPM took into account the ministries' and investors' opinion. Recently, the sugar refining sector has newly been selected as a negative list item. However, the prevailing Negative list itself was not changed but Ministry of Industry stopped issuing FDI "Recommendations", the content of which is stated below. This decision had the same effect as creating a negative list

On the other hand, there exist cases when a sector is deleted from the current list at the minister's request. FDI in the munitions industry is such a case. The Ministry of Industry feels it necessary to accelerate technological development in this sector through cooperation with foreign companies that possess the needed technology in this sector. In order to modernize the industry, the Ministry is proposing to open the sector to FDI with the requirement that the investment be by means of forming joint venture with domestic capital. The issue, however, is not yet settled.

### **2.2.3 The Prevailing Negative List in Indonesia**

The current negative list is composed of six lists. The first is a list of sectors which are not open, not only to FDI but also to local capital (List 1). The second is a list of sectors, which are only open to local capital (List 2). The third is a list of sectors which are open to FDI under specific conditions (List 3). The fourth is a list of sectors which are open to FDI under joint venture schemes (List 4). The minimum percentage share of local capital in a joint venture is set at 5%. The percentage seems to be small. However, even 5% is still high for some sectors. Investment in an infrastructure project is such a case because the project generally requires a large amount of funds, and local partners do not find it easy to obtain such amounts of capital. The fifth is a list of sectors which are only open to small-scale domestic investors, regardless of whether there is FDI or domestic capital participation (List 5). The last and sixth is a list of sectors which are open to FDI if cooperation from a medium- or large- sized corporation is

available (List 6). Sectors which do not appear in the six lists are regarded as open to FDI without any reservation. In these sectors, 100% of FDI is allowed. Indonesian government has made every kind of effort to shorten the list as much as possible. However, reportedly there still exists room for shortening the list.

#### **2.2.4 Arguments Regarding the Negative List**

##### **(1) Lack of transparency**

Foreign investors have requested the Indonesian government to shorten the current list as well as to make it more transparent. The list is a “negative list” and not a “positive list,” but the Government imposes some conditions on investment even though when a sector is not included in the negative list. Such conditions cover, for example, the scale of production capacity and so on. These conditions are made public in the “Technical Guidance” but it seems that they do not always cover all conditions. This means that the policy is lacking in transparency. The lack of transparency seems to be one of the causes for the long time required before investment approvals are obtained, because investors have to spend much time on fixing their line of business so that BKPM can understand that the business is not included in the negative list. The drafting and adoption of regulations has not fully kept up with the creation of many new service industries, and as a result officers at the front line of BKPM could not judge whether these industries are in the negative list or not. Such a situation brings about a time lag in the making of approval decisions.

Another issue is that it is not always so clear whether a certain sector is included in the list. For example, it is not so clear whether investment in toll road project is included in negative list or not. Since there is no description for this sector, it could be interpreted that the investment is free and 100% foreign direct investment is possible. However, in “Technical Guidance” it is suggested that investors cooperate PT. JASA MARGA, a Government corporation, but it is not clear what this means. By the same token, it should be made clear how BOT, BTT or BOO is treated under the New Investment Law.

Lack of transparency is one of major sources for time-consuming investment approval procedure. As is stated in 2.3 Improvement of Investment Approval Procedure, it could happen that due to the lack, interpretation on whether a certain sector falls in the negative list or not differs between BKPM officers and investors. If it happens, it takes much time to settle the issue because investors have to discuss the matter with the people in their home countries. The cost caused by such a lack of transparency is too much to be neglected. The cost is a kind of “Indonesian cost”

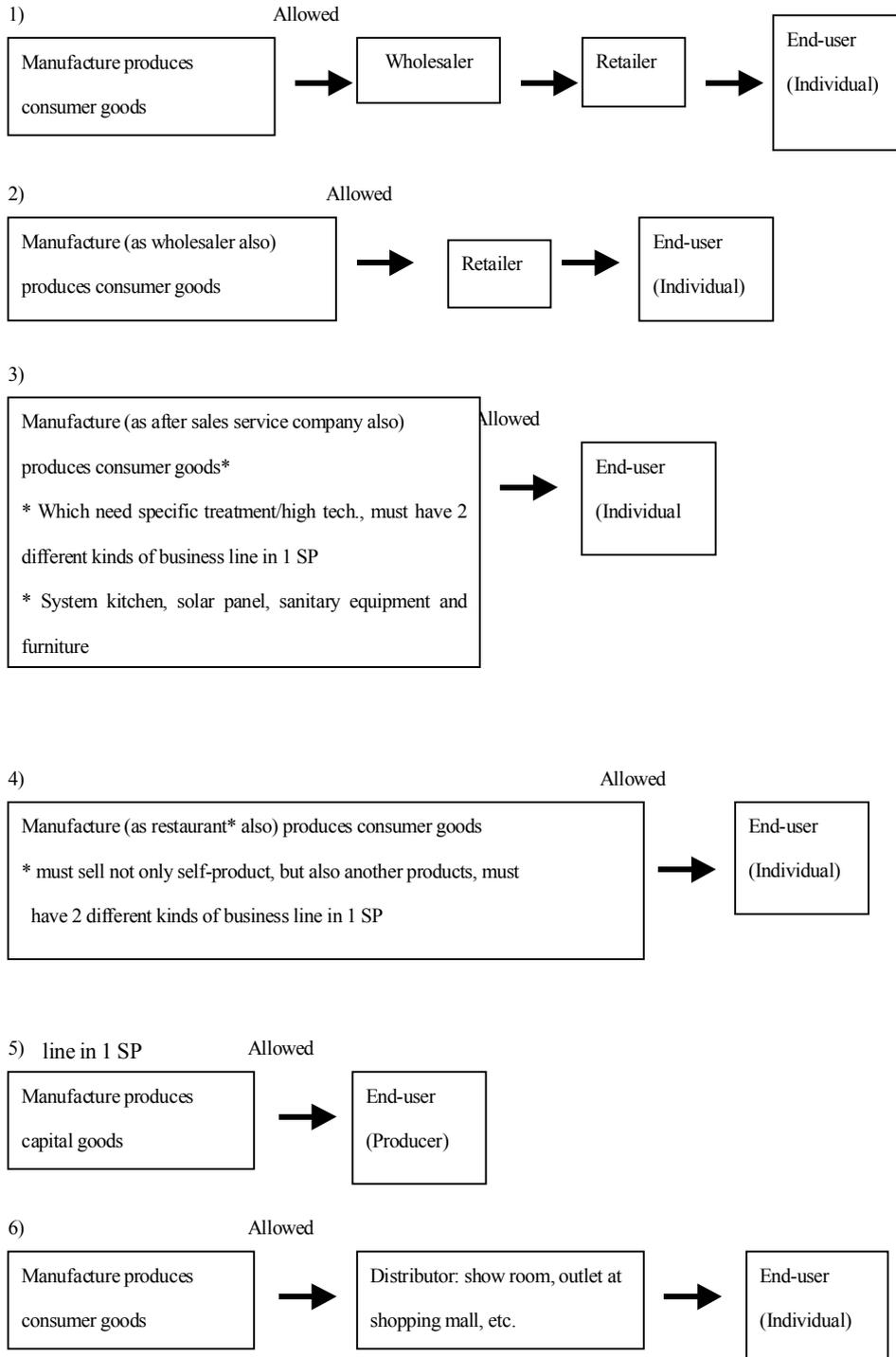
## (2) Necessity of speedy response to new business models

How to cope with new realities wherein many new businesses, especially in the service industries, are being created, it is another issue. Nowadays, manufacturing and service are becoming fused, and a new concept of “Brain-facturing” is advocated instead of “Manu-facturing.” If the “negative list” is a list prohibiting foreign investment, and is not a “positive list,” unlisted sectors should be quite open to investors. This philosophy should be confirmed. An example is seen in retail business. The problem seems to be not so complicated in case the industry is engaged in only external trade, that is, import and export transactions. It is reasonable to place a part of wholesale and retail business on a negative list as from the viewpoint of protection of small business. However, it is necessary to open some types of this business to manufacturers of products, as this is consistent with business strategy, and hence is realistic. Manufacturing industry is intimately linked to the distribution sectors. In this regard, for producers there are mainly two modes or methods of distribution of products. The first one is to distribute products to end-users by producers themselves. In this case, they create and maintain a sales network by themselves. This is direct sales by producers. The second one is to separate distribution from manufacturing. In this case, there are two alternatives. One is that manufacturers set up their own or captive sales companies, as subsidiaries, and the subsidiaries are specialized in sales to end-users. The other is to entrust the distribution to third parties (wholesalers or jobbers or distributors). Which type of distribution system is selected depends on the producer’s business strategy. While small wholesalers or retailers should be given a degree of protection from competition with large companies in the distribution sector, it is indispensable to take into account the above-mentioned changing circumstances of the distribution system. Distributing systems for manufactured products are closely connected to producers’ business strategies. It is highly recommended, therefore, to open retail business to foreign investors when it is strategically developed by manufacturers themselves. The point is that producers deserve to be given the opportunity to sell “their” products, regardless of whether they are capital goods or consumer goods, to end-users by “themselves.” Since foreign manufacturers do not have any intention of selling their products with foreign expertise instead of Indonesian people at their retail stores, there is no danger of depriving Indonesians from access to job opportunities. In this regard, the current regulation shown in Figure 2-1 is too restrictive and is not matching with the changes in business models.

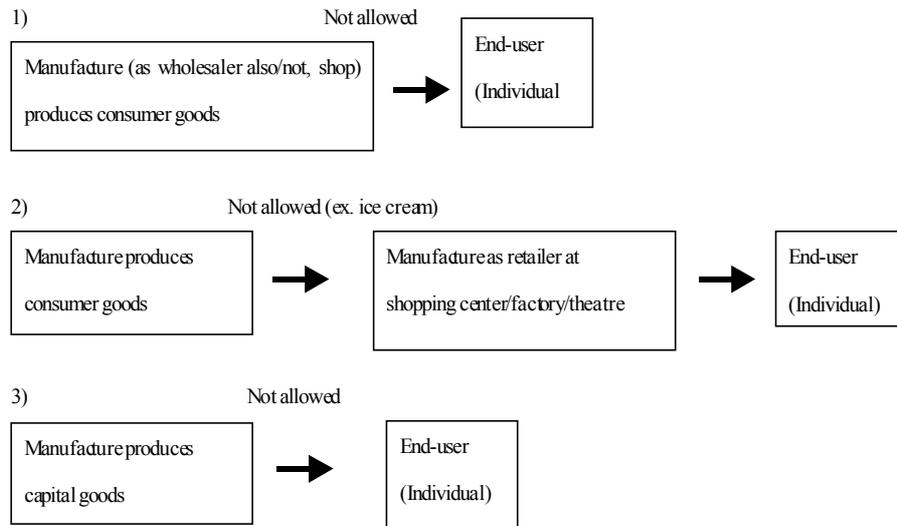
## Figure 2-1 Current Regulation on Wholesale and Retail Business

Based on Keputusan Mentri No.23/1997 & Keputusan Mentri (Menperindag) No.47/2001

Possible:



Impossible:



Source: compiled by Miss. Pipin , an assistant to JICA study team

To sum up , restrictions on business sector and those on business strategy are quite different. While it is not necessarily blamed to restrict some business sectors to foreign direct investment, restrictions on business strategy are not recommended. In this respect, considering the increasing importance of service industry as source of job creation, Indonesian government should not spoil the vitality of the industry in design of negative list (refer to Box.2.1).

### Box 2.1 Changes in the Distribution System

Products supplied by manufacturers are of two types. One is a product for which there is a requirement for special know-how or technical advice in selling it to consumers. A “system kitchen” (kitchen having all equipment and fixtures integrated and planned by a single controlling principle), sanitary equipment and automobile are classified under this category. Fashion goods are also included because, even though the seller does not need any specific and technical know-how, there is a need for a kind of “emotional art” in the work of sales. The other is a product for which there is no need of any specific know-how or information. Stationery, shoes and foodstuffs are such examples. In these cases, the retailer is not required to have specific know-how in order to handle sales. Considering the above difference, in the former case, producers should be allowed to distribute these goods themselves to end-users if they feel it is necessary or advisable to do so, while in the latter case, it is not necessary for producer to distribute these products by themselves.

## 2.2.5 Other Restrictions than the Negative List

### (1) “Recommendation”

Another factor should be taken into consideration, namely that, even if a certain sector is not on a negative list, it does not always mean that investment in the sector is free. Investment in some sectors is required to acquire the “recommendation” on investment from the related ministry. Which sectors need such recommendations for FDI is stated in “Technical Guidance.”

The “Recommendation” system has an advantage that Indonesian government could easily adjust the inflow of FDI to match the demand and supply situation of the industry concerned. When the ministry recognizes that a proposed new investment in the sector may disrupt the market, it does not recommend the new investment. As an example of “Recommendation” there is are cases when the related ministry proposes the temporary closing of the sub-sector to new investment for new factories. Such cases were reported for closing of the sugar refining and cigarette manufacturing sectors to new investment. Unfavorable demand and supply situations in these sub-sectors was the main reason for the closing. However, the problem is that a system is likely to lack transparency. This is because line ministries, as protectors of domestic industry from foreign competition, tend to propose to close the markets. It should be understood that too much of this kind of regulation will lead eventually to the weakening of competitiveness in Indonesian industry.

In order to avoid such happenings, it is necessary to adopt in advance clearly-defined criteria so that reasons for not accepting a given proposal will be knowable. The government is planning to formulate such criteria as stated below.

### (2) The government’s guidelines or instructions

The government’s guideline or instruction is another type of restriction on FDI. These guidelines or instructions are usually provided in official and written form. In this sense, they are not confidential. However, these documents are not disclosed to the public. Generally speaking, only when a company in the private sector proposes an investment in a relevant area, does that company get to know that such a regulation is in existence.

As an example, maritime industry used to be open to FDI in the form of a joint venture with local partners. The foreign partner could hold a share of up to 95%. However, considering the necessity of protecting the domestic maritime industry, the percentage allowable for foreign capital was decreased to 49% by the instruction of the Minister of Transport in August 2005. In such a case, the Government has to issue a regulation and make it public. However, this has not been done, and instead, responding to BKPM Chairman’s

inquiry on the matter, the Minister of Transport confirmed the policy by letter to the Chairman. It was not made open to investors. Investors can know the relevant facts only when they submit their investment application forms to BKPM. A similar case happened in the telecommunication industry, too. In these cases, the Government should revise the prevailing list and announce to the public as soon as possible, but this is yet to be done.

(3) Hidden and unofficial restrictions: BKPM's internal guidelines

Besides the negative list and recommendation list, there are other restrictions. These are based on internal regulations, which are not always made public. For example, capital of US\$100,000 is requested by BKPM as minimum capital. This type of restriction is taken to be BKPM's hidden guideline. However, BKPM officially denies the fact and has indicated that if a front-line officer suggests that this is a necessity, it is based on a judgment that the proposed investment needs more than US\$100,000 as appropriate capital as is requested in Presidential decree No.20/1994 Article 24.

It appears that the above minimum capital does not pose any serious problem for the manufacturing sector. This is because considering debt-equity ratio required is at least 4:1, the minimum investment value is US\$350,000 and investment in the manufacturing sector generally exceeds that amount. However, in case of the services sector, there is some possibility that the restriction poses a bottleneck for the investment since generally speaking a company in the services sector has been established with a very small amount of capital.

On behalf of investors, consultants are quite often engaged for assistance in obtaining investment approvals. It is said that their consulting fee depends on the investment amount. Therefore, they tend to advise investors to invest larger rather than smaller amounts of investment. If this is true, it may be one of reasons why a discussion on minimum capital is held at front office of BKPM between the official in charge and consultants. Taking into account the confusion on the requirement of minimum capital, BKPM should officially announce that there is no such a regulation.

Problem in this area lies in discrepancy on interpretation about existence of hidden regulation among BKPM officers. While lower echelons admit the existence of hidden regulation, higher echelons deny. The inconsistency leads to investors' lack of confidence.

(4) Individual officials' discretion

It could be happen that investment applications are not accepted for the reason that information written in application documents is insufficient. Investors prepare these documents by using the standard BKPM form. Nevertheless, they are often ordered to rewrite them. For example, investors are requested to submit a flow chart for their manufacturing.

However, there is no specification of to what extent details are required. Once the chart is submitted, if the front-line officer can't understand it, the investors are required to rewrite and resubmit it. Whether that officer can understand or not depends on the front officer's personal "feeling" and not on scientific judgment. Investors are specialists in the sector where they intend to invest and the front-line official at BKPM is bound to be almost an amateur in the field. In order to improve the interaction between investors and these officials, and to improve the reliability of the officials' work, it is essential to prepare an "investors-friendly manual." Otherwise, there will be criticism that the official's judgment was discretionary and lacked transparency. To prepare a more detailed operation manual or to delete items not fundamental for getting investment approval -- these are only ways to eliminate the problem of the too-wide scope of officials' discretion.

## **2.2.6 Comparison with Negative Lists in Other Asian Countries**

### **(1) Viet Nam**

Compared to negative lists in Thailand and Viet Nam, the Indonesian list seems not to be unreasonable. It is not proper to say that Indonesian list is longer than other countries' lists. The Vietnamese situation is a special case, because whether a certain sector is open to FDI or not is decided by the Prime Minister except for certain specific fields in which investment licenses will not be issued. In this sense, transparency seems to be low in Viet Nam. While there is no negative list, Viet Nam announces the following positive lists. In the New Investment Law, Articles 29, 30 and 31 provide the legal basis for a negative list, but, details shall be shown in "Detailed regulations on the implementation of the law on foreign investment in Viet Nam" as they were shown in the old regulations on 31st July, 2000 for the old Investment Law, 9th June, 2000.

- List of fields where investment is specially encouraged (16 fields)
- List of fields where investment is encouraged (33 fields)
- List of areas where investment is encouraged (61 districts)
- List of investment fields with conditions (14 fields)
- List of fields in which investment licenses will not be issued (4 fields)  
(Government Decree, No.24/2000/ND-CP dated 31 July 2000)

With respect to revision of the list, it is stated that the government will issue lists of encouraged investment projects and lists of sectors in which investment will not be licensed.

### **(2) Thailand**

In Thailand, the negative list is stipulated as detailed regulations connected to the Foreign Business Act, while in Indonesia, it is stipulated as one of Presidential decrees. With respect to revision of the list, it is stipulated that it is to be revised at least once every year

(Foreign Business Act Section 9).

### (3) The Philippines

The Foreign Investments Act of 1991 stipulates the negative list. It is “Foreign Investments Negative List” (FINL) and is a list of areas of economic activity whose foreign ownership is limited to a maximum of 40% of the equity capital of the enterprises. FINL has two component lists: A and B. These lists are re-evaluated in every two years.

List A enumerates the areas of activities reserved to Philippine nationals by mandate of the Constitution and specific laws. List B contains the areas of activities and enterprises regulated pursuant to law. The areas include defense-related activities and public health and morals related activities. Small and medium-sized market enterprises with paid-in equity capital of less than US\$200,000 are reserved to Philippine nationals. However, enterprises involving advanced technology or employing at least 50 direct employees, with a minimum paid-in capital of US\$100,000, shall be open to non-Philippine nationals.

As of October, 2002, List A is as follows.

#### (List A)

- No foreign equity: Mass media, practice of professions, retail trade, cooperatives, private security agencies, small-scale mining, etc.
- UP to 20% foreign equity: Private radio communication network
- Up to 25% foreign equity: Private recruitment, etc
- Up to 30% foreign equity: Advertising
- Up to 40% foreign equity: Exploration of natural resources, etc.
- Up to 60% foreign equity: Financing companies, etc.

#### (List B)

Up to 40% foreign equity:

- Manufacture, repair, storage and/or distribution of products and/or ingredients requiring approval by the Philippine National Police and Department of National Defense
- Manufacture and distribution of dangerous drugs
- Sauna and steam bathhouses, etc.
- Gambling
- Domestic market enterprises with paid-in equity capital of less than US\$200,000
- Domestic market enterprises which involve advanced technology or employ at least 50 direct employees with paid-in equity capital of less than the equivalent of US\$100,000

### (4) China

Regulations related to the negative list are stipulated in “Directions for Foreign

Investment Guidance” which has been in force since April 2002. According to the regulations, foreign investments are classified into four groups. They are promoted investment, approved investment, restricted investment and prohibited investment. An outline of these type of investment is as follows.

■ Promoted investment (262 sectors as of April 2002)

Investment where one of following conditions, at least, is applicable is defined as promoted investment.

- 1) New agricultural technology, overall agricultural development, energy, transportation and important raw material industry
- 2) High-tech industry, advanced applied technology related industry
- 3) Industry that is able to develop a market as well as to enhance international competitiveness
- 4) Related to energy conservation and environment protection
- 5) Industry that can full utilize human resources and natural resources in the central and west regions
- 6) Others which are specified in law

■ Restricted investment (75 sectors as of April 2002)

Investment where one of following conditions, at least, is applicable

- 1) Technology level lags
- 2) Not contributing to energy conservation or improvement of the natural environment
- 3) Area where the government is engaged in by its nature
- 4) Industry which the government is gradually opening to foreign companies
- 5) Others which are specified by law

■ Prohibited investment (34 sectors as of April 2002 )

Investment where one of following conditions, at least, is applicable

- 1) Possible threat to national security
- 2) Danger of environmental pollution
- 3) Disadvantageous for land development and protection because of heavy utilization of land
- 4) Damaging to military facilities
- 5) Products made by Chinese-specific technology
- 6) Others which are specified by law

The most remarkable changes that have been made in the list are the following two. Both are related to “Restricted” investment. One is the condition regarding “Technology level lags.” In the past, when production capacity met domestic demand, the investment in such a sector was restricted by using the category “Products areas which were already domestically

developed and meet domestic demand.” This was because the government feared excess production over demand. However, it was changed to “Technology level lags,” and after the change, even if the domestic demand and supply situation is not tight, if the sector’s technology level is low, the government can open the market to foreign capital. This philosophy can be highly informative to Indonesia where line ministries often propose restrictions on new investment from foreign countries in order to protect local industries. The other is related to the services sector. Some of the wholesale or retail sector that deals in specific types of business or specific products has been deleted from the restrictive list. Considering that Indonesian government still reserves retail sector for small sized business people and does not open the sector to foreign direct investment, China’s decision on the matter is worthy of paying attention.

### **2.2.7 Future Prospects**

#### **(1) Changes in the decision-making procedure**

The procedure for deciding on the contents of the negative list in Indonesia was changed by Presidential Instruction No.96/2006. Instead of BKPM, the Ministry of Trade has become the principle entity responsible for coordinating proposals. In 2005, the Ministry of Industry and Trade was separated into the Ministry of Industry and Ministry of Trade, and since investment is closely related to WTO accession and international trade, the Ministry of Trade was placed in charge of the negative list. The reason for the change lies in that BKPM, a non-ministry organization, is not in a strong position to sort out various ministers’ many requests for additions to be made to the current negative list.

With the New Investment Law, the prevailing Negative list is to be revised. One official in charge of the negative list at the Ministry of Trade says that the new negative itself becomes longer than the current list because, considering the importance of transparency, legal certainty, harmonization with international trends, and clear and understandable interpretation, the list necessarily becomes more detailed one than the current one. Industrial areas restricted for FDI under the negative list will not be expanded. Nobody, either investors or government official, will misunderstand whether a certain investment project will be controlled by the negative list or not. This will make it possible to trim the time for investment application procedures.

#### **(2) Setting of criteria for decisions**

With respect to the future decision process on the negative list, the following procedure will be taken. Using criteria which is under preparation by the Ministry of Trade, the government is to review the current list and decide whether the list is to be revised or not. At the same time, many requests from line ministries on addition of industries to the list will be

evaluated and decisions will be made to include them or not. For such a procedure, first, a Presidential decree on criteria will be issued and simultaneously the new negative list that is to be revised based on the above criteria as announced by another Presidential Decree. Even though it is not yet final, in outline the criteria are reported to be as follows.

- Security / defense
- Environment
- Culture
- Health
- Moral
- National interest

With regard to “National interest”, special attention will be given to the following factors.

- Development and protection of small and medium-sized industry for enhancing technological capability
- Expand of technological capacity
- Harmonization with international cooperation
- Save people’s life
- Creation of job opportunity
- Improvement in technology

The main reason for setting criteria is to secure as much transparency as possible in finalizing the negative list or changing the current negative list under the condition that line ministries tend to request additions in order to protect local companies. Needless to say, criteria are not for determining “Positive list” but for “Negative list”

It is to be stipulated that when line ministries propose a new negative list, there are requested to testify the followings.

- Market mechanism is not always effective for achieving national interests
- It is impossible to protect national interests through other policy
- Closure or conditional openness is effective for protection of state owned enterprises
- Benefit by closure or conditional openness is bigger than the cost brought about the restriction

In designing the new negative list as well as criteria, Indonesia will be able to get useful hints from the China’s case mentioned above.

## **2.2.8 Conclusion**

Since lack of transparency in the negative list tends to be a major reason for excessive time to be lost in the investment approval procedure, the list should be given in a clear and transparent form. In designating the negative list, the necessity of strengthening Indonesian

competitiveness through introduction of new business models should be taken into account as well as necessity of protection for weak local industry. Information on restrictions on investment besides that provided by the negative list should be made available to investors in advance. At the same time, it is recommended to make public disseminate the contents of changes in the negative list by using information technology as much as possible in order to secure speedy and transparent enforcement. This is a kind of e-announcement.

## 2.2.9 Outline of Proposed Action Plans

Outline of action plans regarding negative list is given in Table 2-3.

1. Deregulation
  - Deregulation on retail business
  - Cope with new reality in business environment
2. Operational matter
  - Publish an explanatory pamphlet for new negative list
  - Announce timely changes in Negative list to public
  - Publish a guide book on Negative List for investors
  - Publish English version of “Klasifikasi Buku Lapangan Usaha 2005”

**Table 2-3 Action Plans for Negative List**

Plan	Contents	Effects	Responsible agencies
1. To suggest the followings			
1.1 Include in the New Investment Law articles on establishment of new Special Economic Zones. Or, prepare Presidential decree on the matter.	<ul style="list-style-type: none"> <li>● Based on study on Special Economic Zone as well as related comparative studies in Asian countries, how to proceed the project will be made clear focusing on the followings               <ol style="list-style-type: none"> <li>(1) Concept of the zone</li> <li>(2) Institutional framework to be prepared</li> <li>(3) Management body</li> <li>(4) Specific incentives to be provided to investors</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>● It will become possible to speed up the realization of Special Economic Zone</li> <li>● It will contribute to the expansion of foreign direct investment in Indonesia</li> </ul>	SEKNEG BKPM
1.2. Include in Presidential decree, which will be successively prepared, articles on BOT, BOO and other type of infrastructure	<ul style="list-style-type: none"> <li>● Following enactment of the New Investment Law, Presidential decree on investment in infrastructure project is issued. In the decree,</li> </ul>	<ul style="list-style-type: none"> <li>● It is made clear how investment in infrastructure is treated in the New Investment Law</li> <li>● By clarifying</li> </ul>	SEKNEG BKPM

Plan	Contents	Effects	Responsible agencies
development	investment approval procedure is made clear for infrastructure investment <ul style="list-style-type: none"> <li>● BKPM will not be directly involved in issuance of investment approval for the infrastructure investment</li> </ul>	BKPM's function on infrastructure investment approval, it is made clear what is BKPM's main function for the infrastructure investment. Also, it becomes clear in which way BKPM can contribute for infrastructure investment	
1.3. Include in Presidential decree, which will be successively prepared, articles on function sharing on investment approval procedure among BKPM, regional and local government	<ul style="list-style-type: none"> <li>● In the Presidential decree, followings should be made clear <ul style="list-style-type: none"> <li>(1) Centralization or decentralization?</li> <li>(2) Role of regional government and local government</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● It becomes possible to avoid confusion about function of investment license approval among BKPM and regional and local governments</li> <li>● It is to be made clear what BKPM should do in capacity building for regional and local governments</li> </ul>	SEKNEG BKPM
1.4. Include in the New Investment Law articles on introduction of new fiscal and non-fiscal incentives. Or, prepare Presidential decree on the matter.	<ul style="list-style-type: none"> <li>● Based on study on Special Economic Zone as well as related comparative studies in Asian countries, what kind of incentives are useful for attraction of foreign direct investment is presented.</li> </ul>	<ul style="list-style-type: none"> <li>● It will contribute to the expansion of foreign direct investment in Indonesia</li> </ul>	SEKNEG BKPM
1.5. Add a phrase regarding criterion for determination on negative list	<ul style="list-style-type: none"> <li>● For transparency, it is mentioned what kind of criteria are taken into consideration when negative list is discussed</li> </ul>	<ul style="list-style-type: none"> <li>● It becomes possible to hold transparency in determining sectors protected from foreign investment</li> <li>● It becomes possible to exclude political intervention for protection of local industry</li> </ul>	SEKNEG Ministry of Trade Coordinating Ministry for Economic Affairs BKPM
1.6 E-announcement	<ul style="list-style-type: none"> <li>● To disseminate the changes in the negative list to public by using information technology</li> </ul>	<ul style="list-style-type: none"> <li>● Speedy and transparent publicity will become possible</li> </ul>	BKPM
1.7 Develop a strong organization which handles and promotes infrastructure projects as one of strategic sectors at BKPM	<ul style="list-style-type: none"> <li>● Reorganize the current infrastructure section in a direction that the section can promote infrastructure project</li> <li>● The section is knowledgeable about PPP,</li> </ul>	<ul style="list-style-type: none"> <li>● Infrastructure projects by PPP will be smoothly realized</li> <li>● BKPM's promotion activity on infrastructure project will be enlarged</li> </ul>	BKPM

Plan	Contents	Effects	Responsible agencies
	project finance, risk analysis and regulatory frameworks regarding PPP		

## 2.3 Improvement of Investment Approval Procedure

*Confidence – hard to acquire, even harder once it is lost*

*Keywords: New business model, integrated service, one roof (door) service, e-process, negative list, special incentives, reduction of technology divide, standard deviation (variance), decentralization, reform of BKPM*

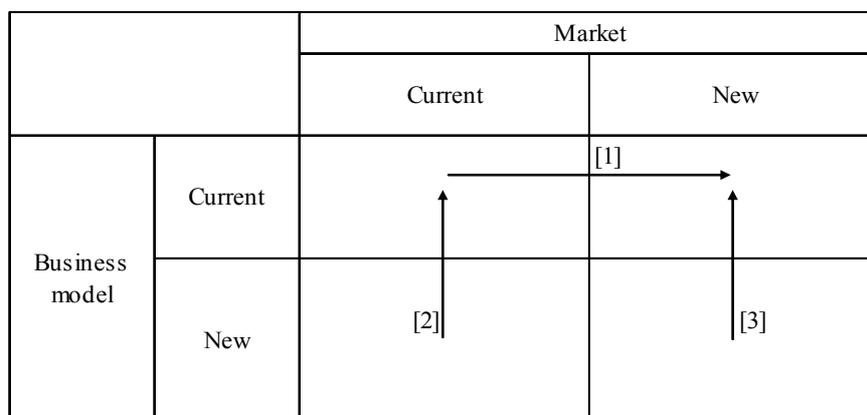
### 2.3.1 Changing Foreign Direct Investment Pattern

Investment approval procedure is principally to be designed considering changes in investment pattern. Here, a pattern of investment to Indonesia is briefly reviewed. Several changes in the pattern are observed.

#### (1) Investment approval procedure affected by BKPM's investment promotion

BKPM's investment promotion is conducted in three dimensions as is shown in Figure 2-2. First dimension is to promote investment by new countries which do not show up themselves in Indonesia. Second dimension is to promote investment in new business model in Indonesia. Third is to promote investment in new business model to new countries which do not yet invest in Indonesia. By each dimension, investment approval procedure may be different. For example, in the first case, since BKPM is already accustomed in the procedure, it can provide the best service to investors by trimming the time required. In the second case, since BKPM is not always to be accustomed in the procedure, it may take some long time for approval operation. It is necessary to accumulate experiences as much as possible and disseminate these experiences to officers concerned. In the third case, it takes much time to promote investment and accomplish the procedure. On the other hand, as quite a new model, BKPM could gain very useful information for investment promotion through the operation.

**Figure 2-2 Three Dimensions of Investment Promotion**



(2) Overall investment trend

Following tables show a fifteen years trend of realized foreign direct investment. Here, only new investments are observed. It is because approval procedure for new foreign investment is mainly relevant to the necessity of improvement. A trend of job created by the foreign direct investment is also shown since one of the most important functions expected to foreign direct investment is job creation.

As Table 2-4 shows, number of investment project is in a trend of increase, however, investment amount in terms of UFS is in a declining trend. It means that, as a long term trend, investment's scale is downsizing. Number of Job which one project creates is declining in terms of both per project and per US\$M, too.

**Table 2-4 Investment Trend and Job Creation by Investment: 1990-2005**

Year	Investment		Employment (3)	(2)/(1)(US\$M)	(3)/(1)	(3)/(2)
	No. of project (1)	US\$M (2)				
1990	100	705.9	25,298	7.0	253	36
1991	147	1,059.3	62,494	7.2	425	59
1992	151	1,926.5	72,038	12.8	477	37
1993	184	5,682.1	64,816	30.8	352	11
1994	392	3,769.1	151,178	9.6	386	40
1995	287	6,698.3	143,713	23.3	501	21
1996	357	4,628.1	84,325	13.0	236	18
1997	331	3,473.4	89,017	10.5	269	26
1998	413	5,015.8	108,374	12.1	262	22
1999	504	8,229.9	148,363	16.3	294	18
2000	638	9,876.0	162,293	15.5	254	16
2001	452	3,508.4	101,115	7.8	224	29

Year	Investment		Employment (3)	(2)/(1)(US\$M)	(3)/(1)	(3)/(2)
	No. of project (1)	US\$M (2)				
2002	444	3,091.1	88,386	7.0	199	29
2003	570	5,450.4	117,216	9.6	206	22
2004	544	4,601.1	147,977	8.5	272	32
2005	909	8,914.6	156,109	9.8	172	18
<b>Total</b>	<b>6,423</b>	<b>76,630.0</b>	<b>1,722,712</b>	<b>11.9</b>	<b>268</b>	<b>22</b>

Note: Realization base

Source: BKPM

### (3) Investment trend by sector

Looking at investment by sector, as is shown in Table 2-5 in terms of number of project, expansion of share in tertiary sector is obvious. The fact implies that there will be a profound influence on investment approval procedure. In terms of investment amount, too, two, % share of tertiary sector is expanding (Table 2-6).

**Table 2-5 Trend in Investment by Sector: 1990-2005 (Number of Project)**

Year	Primary sector (%)		Secondary sector (%)		Tertiary sector (%)		Total (%)	
1990	12	12	78	78	10	10	100	100
1991	15	10	115	78	17	12	147	100
1992	18	12	104	69	29	19	151	100
1993	4	2	159	87	21	11	184	100
1994	19	3	296	77	77	20	392	100
1995	8	3	233	81	46	16	287	100
1996	15	4	251	71	91	25	357	100
1997	9	3	242	73	80	24	331	100
1998	25	6	290	70	98	24	413	100
1999	25	5	309	61	170	34	504	100
2000	27	4	359	57	252	39	638	100
2001	23	5	250	55	179	40	452	100
2002	17	4	235	53	192	43	444	100
2003	22	4	283	50	265	46	570	100
2004	23	4	245	45	276	51	544	100
2005	45	5	336	37	528	58	909	100
<b>Total</b>	<b>307</b>	<b>5</b>	<b>3,785</b>	<b>59</b>	<b>2,331</b>	<b>36</b>	<b>6,423</b>	<b>100</b>

Source: BKPM

**Table 2-6 Trend in Investment by Sector:1990-2005 (Investment Value (US\$M))**

Year	Primary sector		Secondary sector		Tertiary sector		Total	
	(%)		(%)		(%)		(%)	
1990	38	5	579	83	87	12	705	100
1991	35	3	825	78	198	19	1,059	100
1992	86	4	1,648	86	191	10	1,926	100
1993	6	-	5,535	98	140	2	5,682	100
1994	157	4	2,677	71	934	25	3,769	100
1995	168	3	5,881	87	648	10	6,698	100
1996	123	3	3,120	67	1,384	30	4,628	100
1997	31	1	2,629	76	812	23	3,473	100
1998	62	1	4,022	80	931	19	5,015	100
1999	122	1	5,639	69	2,467	30	8,229	100
2000	105	1	4,766	48	5,004	51	9,876	100
2001	144	4	2,197	63	1,166	33	3,508	100
2002	102	3	1,553	51	1,435	46	3,091	100
2003	253	5	1,880	34	3,316	61	5,450	100
2004	308	7	2,803	61	1,489	32	4,601	100
2005	407	5	3,502	39	5,004	56	8,914	100
Total	2,147	3	49,256	64	25,206	33	76,624	100

Source: BKPM

Job creation by sector shows that, even though secondary sector is still a major actor, the importance of tertiary sector should not be overlooked (Table 2-7). Actually, contribution by tertiary sector is getting importance. It is made clear when major sources for job creation is analyzed by industrial sub-sector. In this regard, three factors should be stressed. The first is contributor's diversification and percentage shares in top 5 sectors are declining (Table 2-8). The second is appearance of service sectors in top 5 after 1999. The third is that, among manufacturing sectors, such non-ultra high tech industries as textile, food and leather and shoes industry still hold large shares.

**Table 2-7 Job Creation of FDI by Sector:1990-2005**

Year	Primary sector		Secondary sector		Tertiary sector		Total	
	(%)		(%)		(%)		(%)	
1990	3,124	12	20,647	82	1,527	6	25,298	100
1991	1,921	3	57,616	92	2,957	5	62,494	100
1992	10,234	14	59,396	82	2,408	4	72,038	100
1993	254	-	63,111	97	1,451	3	64,816	100
1994	13,413	9	126,192	83	11,573	8	151,178	100
1995	29,736	21	109,512	76	4,465	3	143,713	100
1996	5,376	6	65,689	79	13,260	15	84,325	100
1997	2,050	2	79,476	89	7,491	9	89,017	100

1998	11,889	11	89,424	83	7,061	6	108,374	100
1999	13,443	9	115,204	78	19,716	13	148,363	100
2000	20,048	12	102,399	63	39,846	25	162,239	100
2001	10,418	10	82,106	81	8,591	9	101,115	100
2002	2,465	3	73,839	84	12,082	13	88,386	100
2003	18,273	16	69,188	59	29,755	25	117,216	100
2004	9,677	7	91,304	62	46,996	31	147,977	100
2005	23,190	15	97,326	62	35,593	25	156,109	100
Total	175,511	10	1,302,429	76	244,772	14	1,722,658	100

Source: BKPM

**Table 2-8 Top 5 of Job Creation Sector :1990-2005**

Rank Year	1	2	3	4	5	% share of top 5 sectors
1990	Textile	Chemical & pharmaceutical	Metal & machinery	Leather & shoes	Wood industry	67
1991	Leather & shoes	Textile	Food	Chemical & pharmaceutical	Non-metal mining	75
1992	Food	Crops & plantation	Textile	Leather & shoes	Metal & machinery	75
1993	Leather & shoes	Textile	Metal & machinery	Transport equipment	Chemical & pharmaceutical	75
1994	Leather & shoes	Textile	Metal & machinery	Other manufacturing	Crops & plantation	72
1995	Crops & plantation	Leather & shoes	Textile	Food	Pulp & paper	68
1996	Metal & machinery	Transport equipment	Food	Leather & shoes	Textile	62
1997	Leather & shoes	Transport equipment	Chemical & pharmaceutical	Food	Textile	75
1998	Metal & machinery	Chemical & pharmaceutical	Crops & plantation	Leather & shoes	Rubber & plastic	64
1999	Metal & machinery	Food	Textile industry	Other industry	<b>Other services</b>	63
2000	Metal & machinery	Textile	<b>Trade &amp; repair</b>	Mining	Food	55
2001	Metal & machinery	Textile	Crops & plantation	Pulp & paper	Wood industry	61
2002	Leather & shoes	Metal & machinery	Textile	Food	Chemical & pharmaceutical	67
2003	Textile	<b>Trade &amp; repair</b>	Crops & plantation	Metal & machinery	Wood industry	59
2004	Textile	<b>Trade &amp; repair</b>	Food	<b>Other services</b>	Metal & machinery	60
2005	Metal & machinery	Crops & plantation	Textile	<b>Trade &amp; repair</b>	Food	50

Source: BKPM

However, when investment value is taken for analysis, as is shown in Table 2-9, even though tertiary sector shows remarkable expansion, secondary sector is still a main player. This is because secondary industry's investment is usually large scaled.

**Table 2-9 Investment by Sector: Top 5 in Investment Value:1990-2005**

Rank \ Year	1	2	3	4	5	% share of the top 5 sectors
1990	Metal & machinery	<b>Hotel &amp; restaurant</b>	Pulp & paper	Food	Wood industry	37
1991	Chemical & pharmaceutical	Non-metal mining	Textile	Metal & machinery	<b>Construction</b>	66
1992	Metal & machinery	Food	Chemical & pharmaceutical	Textile	<b>Construction</b>	52
1993	Rubber & plastic	Chemical & pharmaceutical	Transport equipment	Metal & machinery	Textile	94
1994	Chemical & pharmaceutical	<b>Hotel &amp; restaurant</b>	Metal & machinery	Textile	Pulp & paper	77
1995	Chemical & pharmaceutical	Pulp & paper	Food	Metal & machinery	Textile	83
1996	Metal & machinery	Chemical & pharmaceutical	<b>Hotel &amp; restaurant</b>	Transport equipment	Food	66
1997	Chemical & pharmaceutical	Metal & machinery	Transport equipment	<b>Real estate</b>	Rubber & plastic	68
1998	Chemical & pharmaceutical	Metal & machinery	<b>Real estate</b>	Rubber & plastic	Food	73
1999	Metal & machinery	Chemical & pharmaceutical	<b>Transport, storage &amp; communication</b>	<b>Hotel &amp; restaurant</b>	Transport equipment	75
2000	<b>Electricity, gas &amp; water</b>	Chemical & pharmaceutical	Metal & machinery	<b>Transport, storage &amp; communication</b>	Transport equipment	65
2001	Chemical & pharmaceutical	Metal & machinery	Pulp & paper	<b>Other services</b>	Textile	61
2002	<b>Transport, storage &amp; communication</b>	Chemical & pharmaceutical	Metal & machinery	Food	<b>Trade &amp; repair</b>	79
2003	<b>Transport, storage &amp; communication</b>	Metal & machinery	Food	Transport equipment	<b>Trade &amp; repair</b>	74
2004	<b>Trade &amp; repair</b>	Chemical & pharmaceutical	Food industry	Pulp & paper	Transport & equipment	58
2005	<b>Transport, storage &amp; communication</b>	Chemical & pharmaceutical	<b>Construction</b>	Food	Metal & machinery	69

Source: BKPM

(4) Investment by origin of country

As is shown in Table 2-10, by investors' origin, Asia holds the biggest share, however, the share is clearly on a declining trend and other areas capture the decreased shares of Asia. Joint investment's increase is another characteristic. Increase in a number of origin of country is another remarkable feature, which shows a diversification of investors or participants. By country, Japan is ranked as top 1 and Korea and Singapore are also positioned in the high ranking (Table 2-11).

**Table 2-10 Investors' Origin of Country (%): 1990-2005**

Area \ Year	Asia	Africa	Australia	America	Europe	Joint	World total	No. of country
1990	70	1	1	9	15	4	100	16
1991	73	0	1	6	15	5	100	17
1992	74	0	2	7	14	3	100	17
1993	72	1	2	4	13	7	100	18
1994	70	0	2	4	13	11	100	26
1995	66	0	4	8	16	6	100	23
1996	66	0	2	8	16	8	100	24
1997	65	1	3	5	15	11	100	26
1998	64	0	4	5	17	10	100	23
1999	61	1	6	7	16	9	100	29
2000	56	1	4	7	16	16	100	35
2001	54	1	4	5	17	19	100	36
2002	55	2	4	7	16	16	100	38
2003	55	1	4	6	20	14	100	38
2004	53	3	4	4	18	18	100	29
2005	52	1	4	6	19	18	100	40
Total	60	1	4	6	17	12	100	-

Source: BKPM

**Table 2-11 Top 7 Investors: 1990-2005**

(Number of project)

Rank \ Year	1	2	3	4	5	6	7	Top 7 (%)
1990	Japan	Korea	Hong Kong	Taiwan	Netherlands	Singapore	USA	82
1991	Japan	Korea	Hong Kong	Taiwan	Joint	Singapore	Netherlands	82
1992	Hong Kong	Japan	USA	Singapore	Taiwan	UK	Joint	82
1993	Japan	Korea	Taiwan	Hong Kong	Singapore	Joint	USA	83
1994	Japan	Korea	Joint	Taiwan	Hong Kong	Singapore	USA	82
1995	Japan	Singapore	Korea	Taiwan	UK	USA	Joint	77

1996	Japan	Singapore	Joint	Taiwan	Hong Kong	Korea	USA	77
1997	Japan	Singapore	Joint	Korea	Hong Kong	USA	Taiwan	75
1998	Japan	Joint	Singapore	Taiwan	Korea	UK	USA	77
1999	Japan	Singapore	Joint	Korea	Hong Kong	USA	Australia	68
2000	Japan	Joint	Korea	Singapore	Taiwan	USA	Hong Kong	74
2001	Joint	Japan	Singapore	Korea	Taiwan	UK	USA	74
2002	Japan	Joint	Singapore	Korea	USA	Taiwan	UK	73
2003	Japan	Joint	Korea	Singapore	UK	Taiwan	UK	71
2004	Japan	Joint	Korea	Singapore	UK	Netherlands	Australia	72
2005	Joint	Japan	Singapore	Korea	UK	Malaysia	USA	75

Source: BKPM

(Value)

Rank Year	1	2	3	4	5	6	7	Top 7 (%)
1990	Joint	Japan	France	Hong Kong	Netherlands	Korea	Singapore	91
1991	Japan	Hong Kong	Korea	Joint	France	USA	Singapore	81
1992	Japan	Korea	Singapore	Belgium	Hong Kong	Taiwan	UK	96
1993	USA	Japan	Joint	Korea	Hong Kong	Taiwan	UK	97
1994	Japan	Joint	Hong Kong	Korea	UK	USA	Taiwan	85
1995	Joint	Taiwan	UK	Japan	Luxemburg	USA	Singapore	91
1996	Japan	Joint	Singapore	Hong Kong	Netherlands	UK	USA	83
1997	Japan	Joint	Singapore	Hong Kong	Netherlands	Germany	Korea	87
1998	Joint	Japan	Taiwan	Singapore	UK	Netherlands	USA	89
1999	Japan	Joint	Singapore	Korea	Italy	USA	Hong Kong	82
2000	Joint	Japan	USA	Singapore	UK	Netherlands	Hong Kong	92
2001	Japan	USA	Joint	UK	Singapore	Taiwan	Hong Kong	88
2002	Joint	Netherlands	Japan	Singapore	UK	Germany	Mauritius	86
2003	Mauritius	Joint	Japan	UK	Singapore	Netherlands	France	90
2004	Japan	Singapore	Joint	Mauritius	UK	Hong Kong	Australia	78
2005	Singapore	UK	Japan	Joint	Mauritius	Netherlands	Korea	90

Source: BKPM

#### (5) Trend in investment by major country

Following is a result of analysis on major country's investment by sector.

##### 1) Japan (Table 2-12)

Percentage share of investment in heavy and chemical industry is still high over the years, however, those in service industry is becoming a main stream for investment.

**Table 2-12 Japan : Investment by Sector: 1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	8 (Crops & plantation, forestry etc)	80 (Metal & machinery, transport equipment)	12 (Construction)
1991	1 (Fishery)	82 (Non-metal mining, Chemical & pharmaceutical, textile)	17(Real estate, construction)
1992	-	92 (Metal & machinery, chemical & pharmaceutical, transport equipment)	8 (Trade, construction, real estate)
1993	1 (Fishery)	88 (Transport equipment, metal& machinery, chemical & pharmaceutical)	11 (Real estate, hotel & restaurant)
1994	2(Fishery)	83 (Chemical & pharmaceutical, metal & machinery, textile)	15 (Construction, real estate)
1995	1(Fishery)	81 (Metal & machinery, food, chemical l& pharmaceutical)	18 (Construction, other service)
1996	1(Fishery, mining)	93 (Transport equipment, metal machinery, chemical & pharmaceutical)	6 (Other service, hotel& restaurant)
1997	-	97 (Chemical & pharmaceutical, metal & machinery, transport equipment)	3 (Transport, storage& communication, real estate)
1998	1(Fishery)	98 (Metal & machinery, chemical & pharmaceutical rubber & plastic)	1 (Trade, transport)
1999	-	98( Metal & machinery, chemical & pharmaceutical, transport equipment, food)	2(Trade)
2000	-	88(Chemical & pharmaceutical, transport equipment, rubber & plastic)	12 (Real estate, construction)
2001	1 (Fishery, mining)	75 (Pulp & paper, chemical & pharmaceutical, textile, metal & machinery)	24 (Other services, construction)
2002	1 (Mining)	92 (Metal & machinery, chemical & pharmaceutical, textile)	7 (Trade, transport, storage, communication)
2003	-	92 (Metal& machinery, transport equipment, textile)	8 (Hotel & restaurant, trade)
2004	1(Mining)	84 (Transport equipment, chemical & pharmaceutical, metal & machinery)	15 (Trade, other services)
2005	10 (Forestry)	81 (Transport equipment, rubber & plastic, other industry)	9 (Trade, other services)

Note: figure is percentage share in total investment

Source: BKPM

## 2) USA (Table 2-13)

Investment in each sector fluctuates and dose not show a clear tendency. However, by sector, there is a characteristic. In primary sector, crops and plantation and mining are main, while in secondary sector, chemical & pharmaceutical, food and metal& machinery are main targets for investment. In service sector, trade, real estate and transport are major sources for investment.

**Table 2-13 USA : Investment by Sector: 1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	37 (Mining)	50 (Chemical & pharmaceutical, wood industry)	13 (Other services)
1991	6 (Mining)	91 (Chemical & pharmaceutical, metal & machinery)	3 (Other services)
1992	50 (Crops & plantation, mining)	50 (Leather & shoes, metal & machinery)	-
1993	-	100 (Rubber & plastic, chemical & pharmaceutical)	-
1994	16 (Crops & plantation)	49 (Chemical & pharmaceutical, other industry)	35 (Hotel & restaurant, other services)
1995		25 (Chemical & pharmaceutical, food, metal & machinery)	75 (Electricity, gas, water)
1996	1 (Livestock)	32 (Chemical & pharmaceutical, metal & machinery)	67 (Real estate, transport, storage and communication)
1997	-	80 (Rubber & plastic, pulp & paper)	20 (Electricity, gas, water)
1998	4 (Crops & plantation)	92 (Transport equipment, chemical & pharmaceutical)	4 (Hotel & restaurant)
1999	-	69 (Metal & machinery, non-metal mining, chemical & pharmaceutical)	31 (Construction, other services, transport, storage, communication)
2000	1 (Mining, crops and plantation)	67 (Metal & machinery, food, rubber & plastic)	32 (Electricity, gas water, other services)
2001	9 (Mining)	4 (Pulp & paper)	87 (Other services, electricity, gas, water)
2002	28 (Crops & plantation, mining)	54 (Food, non-metal )	18 ( Other services, trade)
2003	3 (mining)	83 (Food, metal & machinery, transport equipment)	14 (Trade)
2004	-	77 (Metal & machinery, food)	23 (Trade)
2005	4 (Mining)	25 (Non-metal, food)	71 (Trade, other services, real estate)

Note: figure is percentage share in total investment

Source: BKPM

### 3) Singapore (Table 2-14)

Reflecting Singapore's unique location that she is a near neighboring country to Indonesia, investment in tertiary sector such as real estate and hotel and restaurant is large. Large structural change in investment is not seen in the past fifteen years.

**Table 2-14 Singapore : Investment by Sector: 1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	22 (Livestock)	78 (Metal& machinery)	
1991	9 (Mining)	63 (Food, Chemical & pharmaceutical, metal & machinery)	28 (Construction)
1992	5 ((Mining)	29 (Wood, metal & machinery, rubber & plastic)	66 (Construction, transport, storage, communication)
1993	-	71 (Wood, metal & machinery, textile)	29 (Transport, storage, communication)
1994	33 (Mining)	43 (Metal & machinery, Non-metal)	24 (Real estate, transport, storage and communication)
1995		55 (Metal& machinery, Chemical & pharmaceutical, rubber & plastic)	45 (Hotel & restaurant, construction, real estate)
1996	7 (Mining)	34 (Metal & machinery, food, non-metal)	59 (Other services, hotel & restaurant, real estate)
1997	2 (Mining)	21 (Metal & machinery, food, chemical & pharmaceutical)	77(Hotel & restaurant, real estate, construction)
1998	-	23 (Food, metal & machinery)	77 (Real estate, construction)
1999	-	47 (Metal & machinery, transport equipment, chemical & pharmaceutical)	53 (Other service, real estate, construction, hotel & restaurant)
2000	-	21 (Food, metal& machinery, rubber & plastic)	79 (Hotel & restaurant, construction, transport, storage, communications)
2001	-	71(Textile, rubber & plastic, metal & machinery)	29 (Real estate, Hotel & restaurant)
2002	-	56 (Metal & machinery, transport equipment, non-metal mining, food)	44 (Trade, other services, hotel & restaurant)
2003	-	15 (Food, textile)	85 (Transport, storage, communications, trade, other services)
2004	5 (Crops & plantation)	84 (Pulp & paper, food, rubber & plastic, metal & machinery)	11 (Trade, construction)
2005	3 (Livestock)	7 (Rubber & plastic, chemical & pharmaceutical)	90 (Transport, hotel & restaurant, trade, other services)

Note: figure is percentage share in total investment

Source: BKPM

4) Korea (Table 2-15)

In the early stage, Korean investment concentrated in labor intensive manufacturing sectors. After Asian financial crisis in 1997, due to increase in labor cost in Indonesia, she changed investment strategy to more capital intensive and high technology industries. Actually, number of employee has reduced from 1,000,000 before 1997 to 500,000 at the present. Recently, domestic market oriented investment shows an increase, however, Korean investment targets mainly overseas market.

**Table 2-15 Korea : Investment by Sector: 1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	-	100 (Chemical & pharmaceutical, textile)	
1991	-	100 (Leather & shoes, textile)	
1992	6 (Forestry)	94 (Food, textile, other industry)	
1993	-	100 (Chemical & pharmaceutical, metal & machinery, leather & shoes)	
1994	-	100 (Textile, chemical & pharmaceutical, leather & shoes, metal & machinery)	
1995	-	100 (Textile, leather & shoes, non-metal)	
1996	-	100 (Chemical & pharmaceutical, metal & machinery, textile, food)	
1997	-	99 (Chemical & pharmaceutical, textile, leather & shoes, metal & machinery)	
1998	-	100 (Metal & machinery, food, chemical & pharmaceutical)	
1999	-	100 (Metal & machinery, food, rubber & plastic)	
2000	4 (Trade, other service)	96 (Wood, metal & machinery, textile)	
2001	-	95 (Metal & machinery, leather & shoes)	5 (Trade, construction)
2002	-	88 (Chemical & pharmaceutical, metal & machinery, leather & shoes, textile)	12 (Trade, transport)
2003	1 (crops & plantation)	91 (Metal & machinery, textile, rubber & plastic)	8 (Other service, trade, construction)
2004	-	87 (Metal & machinery, Other industry, textile)	13 (Trade, other services)
2005		94 (Metal & machinery, food, leather & shoes, rubber & plastic)	6 (Trade, transport, storage, communication)

Note: figure is percentage share in total investment

Source: BKPM

5) Hong Kong (Table 2-16)

Investment in a wide range of sector is observed, though investment value concentrates

on several sectors including service sectors.

**Table 2-16 Hong Kong :Investment by Sector: 1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	16 (Livestock)	55 (Wood, chemical & pharmaceutical, textile)	29 (Hotel & restaurant)
1991	-	65 (Metal & machinery, Chemical & pharmaceutical)	35 (Construction)
1992	3 (Mining)	95 (Wood, textile)	2 (Transport)
1993	-	77 (Metal&machinery,textile, wood)	23 (Construction)
1994	1 (Livestock)	98 (Chemical & pharmaceutical, textile, pulp & paper wood, Food)	1 (Trade)
1995	15 (Mining)	58 (Food, textile, leather & shoes, metal & machinery)	27 (Real estate)
1996	-	93 (Metal&machinery,chemical&pharmaceutical, leather & shoes, food, wood)	7 (Hotel & restaurant, transport)
1997	-	63 (Leather & shoes, chemical & pharmaceutical,, food)	37 (Real estate)
1998	6 (Crops Plantation)	55 (Food, non-metal)	39 (Real estate)
1999	7 (Forestry, livestock)	22 (Food, textile, other)	71(Construction, real estate, hotel & restaurant)
2000	2 (Livestock)	81(Textile, non-metal, food, wood, metal & machinery)	17 (Real estate, hotel & restaurant)
2001	1 (Mining))	56 (Chemical & pharmaceutical, textile)	43 (Real estate)
2002	-	98 (Textile, chemical & pharmaceutical, food)	2 (Other services)
2003	3 (Livestock)	92 (Wood, textile)	5 (Construction)
2004	45 (Mining)	45 (Non-metal, chemical & pharmaceutical)	10(Other services, transport, storage, communications)
2005		21(Wood, chemical & pharmaceutical)	79 (Real estate, construction)

Note: figure is percentage share in total investment

Source: BKPM

6) Australia (Table 2-17)

Investment activity is remarkable in tertiary sector.

**Table 2-17 Australia : Investment by Sector:1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	-	-	-
1991	-	-	
1992	85 (Mining)	7 (Chemical & pharmaceutical)	8 (Trade)
1993	-	92 (Chemical & pharmaceutical)	8 (Transport, storage, communications)
1994	-	57 (Non-metal, metal & machinery)	43 (Hotel & restaurant, other services, construction)
1995		71 (Metal & machinery, non-metal mining)	29 (Electricity, gas water)
1996		91 Chemical & pharmaceutical, non-metal, metal& machinery)	
1997	27 (Mining)	73 (Non-metal, metal & machinery)	
1998	23 (Livestock)	66 (Non-metal mining, food)	11 (Other services, construction)
1999	-	16 (Metal & machinery)	84 (Electricity, gas, water, transport, storage ,communication)
2000	-	13 (Non-metal mining)	87 (Other services, construction)
2001	-	60 (Chemical & pharmaceutical, metal & machinery)	40 (Construction)
2002	75 (Mining)	16 (Metal & machinery)	9 (Trade, transport, storage, communication)
2003	-	38 (Other manufacturing)	62 (Trade, other services)
2004	-	7 (Chemical & pharmaceutical. non-metal mining)	93 (Construction, other services)
2005	-	20 (Metal&machinery)	80 (Construction, trade)

Note: figure is percentage share in total investment

Source: BKPM

#### 7) Netherlands (Table 2-18)

Traditionally, investment in service sector is active. Major investment in secondary sector is food and chemical & pharmaceutical. As one of recent movements, investment in horticulture attracts attention. Competitive advantages in the sector are deep experience in home country and their technology. Horticulture products are mostly exported to other Asian countries. They crop the products here and export them to other Asian countries. Most of investment is carried out by small companies and products are mostly directed to domestic market.

**Table 2-18 Netherlands : Investment by Sector: 1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	3 (Mining)	91 (Food, leather & shoes, metal & machinery)	6 (Hotel & restaurant)
1991	-	100 (Chemical & pharmaceutical)	-
1992	-	22 (Transport equipment)	78 (Construction)
1993	-	100 (Metal & machinery, Chemical &	-

		pharmaceutical)	
1994	-	93 (Food, metal & machinery)	7 (Trade)
1995	-	19 (Metal & machinery, ,food)	81 (Construction)
1996	6 (Crops & plantation)	28 (Metal & machinery, food, chemical & pharmaceutical)	66 (Transport, storage, communication, construction)
1997	-	90 (Chemical & pharmaceutical, metal & machinery)	10 (Construction)
1998	-	61 (Food, chemical & pharmaceutical)	39 (Real estate, trade)
1999	-	74 (Food, chemical & pharmaceutical, other)	26 (Construction, other services)
2000	-	10 (Chemical & pharmaceutical, other)	90 (Transport, storage, communication, trade, construction)
2001	-	67 (Food, wood, rubber & plastic)	33 (Construction, other services)
2002	-	4 (Pulp & paper)	96 (Transport, storage & communication)
2003	25 (Crops & plantation)	61 (Food, chemical & pharmaceutical)	14 (Other services)
2004	-	83 (Food, chemical & pharmaceutical, metal & machinery)	17 (Trade, transport, storage, communication)
2005	-	56 (Chemical & pharmaceutical, food, transport equipment)	44 (Transport, storage, communication, trade, Electricity, gas, water)

Note: figure is percentage share in total investment

Source: BKPM

#### 8) England (Table 2-19)

Since 1995, investment shows a large increase both in secondary and tertiary sector. In secondary sector, food, chemical & pharmaceutical is main actors

**Table 2-19 England : Investment by Sector:1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	100 (Mining)	-	-
1991	2 (Crops & plantation)	7 (Metal & machinery)	91 (Construction)
1992	81 (Crops & plantation, mining)	18 (Food, chemical & pharmaceutical)	1 (Trade)
1993	2 (Mining)	98 (Chemical & pharmaceutical, textile)	-
1994	2 (Crops & plantation)	88 (Pulp & paper, textile, metal & machinery)	10 (Other services)
1995	6 (Crops & plantation)	87 (Food, chemical & pharmaceutical, metal & machinery)	7 (Hotel & restaurant)
1996	1 (Crops & plantation)	87 (Food, chemical & pharmaceutical)	12 (Hotel & restaurant)
1997	-	86 (Rubber & plastic, chemical & pharmaceutical)	14 (Electricity, gas water, trade)
1998	2 (Crops & plantation)	41 (Metal & machinery, non-metal, chemical & pharmaceutical)	57 (Electricity, gas water, real estate)
1999	27 (Crops & plantation)	52(Chemical & pharmaceutical, food, transport	21 (Other services)

		equipment)	
2000	-	71 (Pulp & paper, chemical & pharmaceutical, food metal & machinery)	29 (Hotel & restaurant, electricity, gas, water, transport)
2001	6 (Crops & plantation)	82 (Chemical & pharmaceutical, food, rubber & plastic)	12 (Hotel & restaurant, other services)
2002	-	94 (Food, leather & shoes, textile, pulp & paper)	6 (Trade)
2003	13 (Crops & plantation)	46 (Food, chemical & pharmaceutical, rubber & plastic wood, non-metal, metal & machinery)	41 (Construction, electricity, gas, water, trade, transport)
2004	28 (Crops & plantation)	68 (Food, textile, pulp & paper)	4 (Hotel & restaurant)
2005	6 (Crops & plantation)	17 (Food, Chemical & pharmaceutical)	77 (Construction, trade, transport, storage communication)

Note: figure is percentage share in total investment

Source: BKPM

#### 9) Taiwan (Table 2-20)

Main investment sector is manufacturing. In the early stage, labor intensive industry such as wood, food, textile and leather industry lead the investment, however, after 1996, machinery and chemical industry emerged as leading sectors. This shows that investors have begun to follow a strategy to go to upstream sectors such as raw materials for textile and leather industry in order to provide them to down stream sectors. They call the strategy as cluster formation. Their products are mostly exported to USA and European countries. Most of Taiwanese investors are OEM suppliers for clients in these countries. In terms of size of investor, 95% is small and medium sized company. Number of company invested in Indonesia is 1,129 as of the end of September 2006

**Table 2-20 Taiwan : Investment by Sector 1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	-	100 (Wood, Food)	-
1991	-	100 (Leather & shoes, metal & machinery, textile)	-
1992	-	73 (Leather & shoes, metal & machinery)	27(Real estate)
1993	-	100 (Textile, Leather & shoes)	-
1994	3 (Crops & plantation)	97 (Leather & shoes, textile, food, wood, metal& machinery)	-
1995	-	100 (Pulp & paper, chemical & pharmaceutical)	-
1996	-	76 (Metal & machinery, textile, chemical & pharmaceutical)	24 (Transport, storage & communication)
1997	-	100 (Metal & equipment., leather & shoes)	-
1998	-	99 (Chemical & pharmaceutical, pulp & paper, metal & machinery)	1 (Transport)
1999	8 (Fishery)	89 (Metal & machinery, pulp & paper)	3 (Other services)
2000	-	98 (Transport equipment, metal & machinery, textile)	2 (Trade)

2001	1 (Crops & plantation)	99 (Pulp & paper, metal & machinery)	-
2002	-	99 (Transport equipment, metal & machinery)	1 (Trade)
2003	-	98 (Metal & machinery, transport equipment, food)	2 (Trade)
2004	8 (Fishery)	89 (Leather & shoes, non-metal mining, chemical & pharmaceutical)	3 (Trade)
2005	-	92 (Food, transport equipment)	8 (Trade)

Note: figure is percentage share in total investment

Source: BKPM

#### 10) Joint investment (Table 2-21)

In secondary sector, chemical & pharmaceutical industry is a key player, while in tertiary sector, hotel & restaurant and transport are active areas for joint investment.

**Table 2-21 Joint Investment : Investment by Sector:1990-2005**

Year	Primary sector	Secondary sector	Tertiary sector
1990	-	98 (Chemical & pharmaceutical)	2 (Hotel & restaurant)
1991	-	100 (Chemical & pharmaceutical, textile, wood)	-
1992	-	100 (Chemical & pharmaceutical)	-
1993	-	96 (Chemical & pharmaceutical, rubber & plastic)	4 (Hotel & restaurant)
1994	4 (Fishery)	36 (Metal & machinery, textile, food, rubber & plastic)	60 (Hotel & restaurant)
1995	-	98 (Chemical & pharmaceutical, metal & machinery)	
1996	8 (Crops & plantation)	44 (Chemical & pharmaceutical, Metal & machinery, textile)	48 (Hotel & restaurant, construction)
1997	-	75 (Metal & machinery, chemical & pharmaceutical, textile)	25 (Construction, real estate)
1998	-	90 (Chemical & pharmaceutical, rubber & plastic, food, metal & machinery)	10 (Hotel & restaurant)
1999	-	51 (Chemical & pharmaceutical, metal & machinery)	49 (Transport, storage communication)
2000	1 (Crops & plantation)	18 (Chemical & pharmaceutical, metal & machinery)	81 (Electricity, gas, water, real estate)
2001	7 (Crops & plantation)	69 (Metal & machinery, food, chemical & pharmaceutical, textile)	24 (Transport, storage, communication, trade)
2002	1 (Livestock)	27 (Chemical & pharmaceutical, metal & machinery)	72 (Transport, storage, communication, trade)
2003	-	29 (Chemical & pharmaceutical, transport equipment)	71 (Transport, storage, communication)
2004	2 (Mining)	65 (Food, chemical & pharmaceutical, textile, others)	33 (Other services, Trade, construction)
2005	4 (Crops & plantation)	75 (Chemical & pharmaceutical, food, rubber & plastic)	21 (Other services, transport, storage, communication, trade)

Note: figure is percentage share in total investment

Source: BKPM

(6) Investment strategy observed in main investors

The above tables showing investment trends imply how investment strategy differs by country. The difference is summarized in Table 2-22

**Table 2-22 Changes in Investment Strategy by Each Country**

Country	Production base for export	Domestic market being targeted (Goods)	(Service)	Resource development and import	Investment in 1990-2005 (US\$ million)
Japan	XX	XX			16,972
USA		XX	XX	XX	6,957
Singapore			XX	XX	7,332
Korea	XX	XX			3,275
Australia			XX		1,102
Netherlands		XX	XX		3,683
England		XX	XX		5,399
Hong Kong	XX	XX	XX		3,430
Taiwan	XX				3,311
Joint			XX	XX	14,029

Note: Investment is new investment

Source: Investment-BKPM

### 2.3.2 Notorious Indonesian Investment Approval Procedure

The World Bank reports that the duration required for investment approval procedures in Indonesia is much longer than in other countries such as Thailand and Viet Nam (Table2-23). Investors to Indonesia share the same opinion and complain that the procedure should be streamlined. Here then is one of the deterrents to success in attracting investment to Indonesia. Even though Indonesian investment approval procedure is not entirely composed of discouraging factors to foreign investment, and lack of fiscal incentives may also be an important deterrent, the unavoidable, time-consuming and bureaucratic procedures are likely to implant a bad impression in potential investors' minds. In this sense, it is far important to improve investment approval procedures than to make other changes. Otherwise investors will not come knocking at Indonesia's door.

It is amply evident that Indonesia is already late in making such changes and needs to concentrate on accelerating the process of improvement. However, what should be scrutinized is whether this is still true or not because several changes in approval procedure have recently taken place. In the case that the duration required for procedures is still too long, it should be carefully analyzed why and inquiry should be made to identify the steps where time is lost. The following table compares the time needed to obtain approval for five countries, as determined

by a law firm's study for the World Bank. This tabulation, however, does not include time for investment approval procedures in BKPM and central and local government permits. Nevertheless, it is considered useful for present purposes.

**Table 2-23 Time for Starting a Business and Dealing with Licenses**

Country	Starting a Business		Dealing with Licenses	
	Procedurs (No.)	Time (days)	Procedurs (No.)	Time (days)
Indonesia	12	151	19	224
Thailand	8	33	9	147
Viet Nam	11	50	14	138
The Philippines	11	48	23	197
China	13	48	30	363

Source: World Bank website

A similar study as the above World Bank study has been conducted by University of Indonesia under financial support of World Bank and Government of the Netherlands. The study report named as "Monitoring The Investment Climate in Indonesia (LPEM's study)" breakdowns the process of investment approval procedure and suggests sources of improvement as is shown in Table 2-24. In the same table a breakdown of the above mentioned World Bank's figure on "Starting a Business" is given with its breakdown.. Again it is to be noted that the data dose not include days for investment approval. While World Bank's figure is 151 days for starting a business, LPEM's figure is 80 days in calendar days and 57days in working days. Such a wide difference comes mainly from the difference in process of Ministry of Justice for company registration. Different method of obtaining the data yields the difference. World Bank's data is derived from law firm interview, while LPEM's data is derived from notary public survey.

We tried to conduct the similar investigation. Our study shows almost the similar result as LPEM's study if working days are taken for measurement. As is shown in Table 2-24, JICA's survey dose not include process of No.2, 7, 10, 11and 12. However, these figures are not large except No.10. The biggest difference between Notary Survey and JICA's survey lies in the figure of No.8. If same number is used in calculating total days required for establishing a new company for both Notary Survey and JICA 's survey, the time is nearly equal.

When investment approval procedure is discussed, not only company registration procedure but also investment approval procedure and local permits procedure should be covered. Therefore our study deals whole process related to investment approval, details of which are stated below.

**Table 2-24 Average Days to Establish a PT Company in Indonesia:  
Comparison of Three Studies**

No.	Activities	Survey by LPEM (2005)	Law Firms Interview (IFC, 2005)	Law Firms Interview (IFC, 2006)	JICA study team (2006)
1	Obtain clearance for the company name from MOJ	2	7	7	1
2	Founders draw up the deed of establishment	2	7	7	-
3	Obtain a certificate of domicile from the local municipality	4	10	10	2
4	Obtain a taxpayer registration number(NPWP) and taxable entrepreneur identification number (NPPKP)	6	14	14	4
5	Open a bank account	4	4	4	2
6	Pay to the State treasury the non-tax state revenue (PNPB)	1	1	1	1
7	Arrange for the notary to apply for the publication of the articles of association of the company	1	2	2	-
8	Submit physical documents to the Ministry of Justice and issuance of SK	15	75	22	10
9	Register with the Company Register at the local Trade Office	9	15	15	9
10	Apply for the business trading license	11	14	14	-
11	Register with Minister of Manpower	1	1	1	-
12	Apply for workers social security program	1	1	1	-
	<b>Total Time in Working days</b>	<b>57</b>			<b>29</b>
	<b>Total Time in Working days excluding No.2,7,10,11and12</b>	<b>31</b>			<b>29</b>
	<b>Total Time in Calendar days</b>	<b>80</b>	<b>151</b>	<b>97</b>	

Footnote

- 1) Figures in JICA study team are derived from interviews to various actors
- 2) MOJ: Ministry of Justice

### **2.3.3 Changes in Institutional Frameworks in the Past**

Investment approval procedure is carried out in line with government laws, regulations and decrees in Indonesia. The procedure experienced the following changes in the past six years.

(1) In 1999

- 1) Law No.22/1999 on Regional Government

In 1999, in keeping with the philosophy of regional autonomy, the law on Regional Government of No. 22 was enacted. Article 7 stipulated that while the central government has power to conduct matters in such areas as foreign affairs, national security and judicial matter,

finance and national budget and religion, power in other areas was transferred to regional and local government.

In the same law, it was stipulated that the regional government is to conduct only central government related matter on behalf of the government. Therefore, investment approval was transferred to local government with an exception of projects, which cover plural local governments.

In the law it was mentioned that the administration concerning capital investment was one of the governance fields that must be performed by region. Region means “ Districts and Municipals”.

## 2) Presidential Decree No.117/1999 on Procedures for Investments

Recognizing that the detailed scope of authority regarding investment license among each level government was not stated in the above Law, a supplemental decree, No.177/1999, was announced. The decree distributes authority on investments as follows. As for PMA, investment approval, IUT, master list, APIT and RPTKA are issued by BKPM and BKPMMD, while local government issues only local permits. Thus, as far as investment approval is concerned, not only BKPM but also BKPMMD has authority of its issue. BKPM confirms it by Decree No.38/1999 on Guideline and Procedure for Filling Applications for Investment and Foreign Capital Investments.

## 3) Presidential Decree No.122/1999 on the Establishment of Regional Investment Coordinating Boards (BKPMMD)

It describes BKPMMD’s tasks and functions, while those by BKPM are described in Presidential Decree No.120/1999 and No.121/1999 on BKPM.

## (2) In 2000

As the complement of the Law No.22/1999, Government Regulation No.25/2000 on Government Authority and Provincial Authority as an Autonomous Region and Decree of Minister of Home Affairs the authority of central and provincial government was issued.. It describes that the authority of central government on capital investment is the issuance of permits and the control for certain business with strategic technology, while provincial government carries out cooperation in the field of capital investment with local government. Based on this, some local governments insist that they still hold authority to issue investment approval for PMA. Here, perception on authority of issue of investment approval obviously differs between local government and central government (BKPM).

In addition, a Decree of the Minister of Home Affairs was issued. It states that the investment approval (SP) master list and work permit for PMA are issued by regional government, while those for PMDA are issued by local government.

(3) In April 2004

In April 2004, a new law, No.32, was enacted. Article 10 states that a regional government's power is not automatically given by the law but is to be approved by central government through a certain process. In such a process, three criteria are to be followed. The first relates to external factors. When the impact of a project is nation-wide, central government is responsible for the project. By the same token, if the impact is regional- wide, the regional government takes care of the project. On the other hand if the impact is limited to a local area, the local government is responsible for the project. The second factor is accountability. The government sector directly linked to the project handles the project. By doing so, it is possible to locate accountability. The third factor is efficiency, meaning which level of government is most efficient to conduct the project.

In line with the above law, in regard to the investment approval procedure, a new Presidential decree (No. 29, 2004) was issued for the purpose of providing one-roof service with respect to investment approval procedure. As the result, except for local permits, the procedure was moved back to the central government, though some regional governments still take care of some parts of the process. BKPM became the responsible organization, provide the one-roof service by means of delegation of authority by the related ministers. All of the operations have come to be taken over by BKPM. To assure consistency with the above Presidential Decree No.29, 1999, it is stipulated that regional government could delegate power to issue of related approvals to BKPM.

### **2.3.4 Current Procedure**

(1) Overview

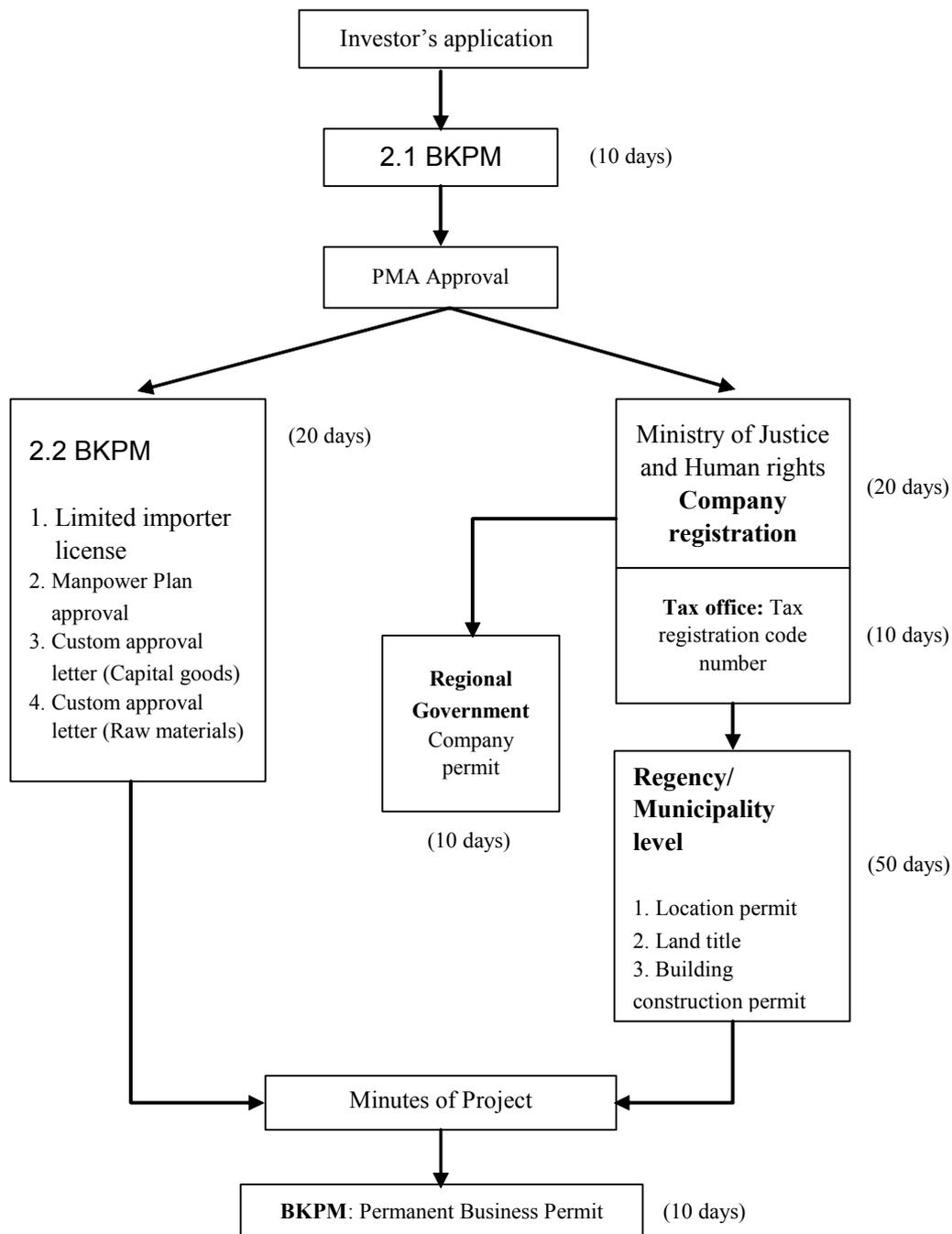
Operation for grant of investment approval is done along the following six steps.

- Initial contact with BKPM
- Acquire investment approval (“ SP ”) from BKPM
- Registration of a newly established company at the Ministry of Justice and Human Rights
- Acquire necessary central government permits for startup of the company
- Acquire necessary local government permits for startup of the company
- Acquire permanent business permit from BKPM

Figure 2-3 shows the process of acquiring FDI application approval and the investment

implementation permit. The numbers in parentheses indicate the average duration for each operation in terms of working days. Time needed to obtain approval and permits was derived by the JICA consultant's interview of the main actors. An outline of each step is as follows.

**Figure 2-3 Outline of Process to Obtain Investment Approval and Permits, and Their Standard Time : Starting a Business (Working Days)**



## (2) Initial contact with BKPM

### 1) Current process

When investors decide to make an investment in Indonesia, they come into contact with BKPM first by themselves or through agents such as law firms, notaries and consultants. Front-line officials in BKPM say that cases of being directly contacted by investors are not so many though it depends on the industry in which investment will be made, or investors' experience in the past (refer to Box.2.2) When investors already have experience in investing in Indonesia, they contact BKPM directly. However, if this is not the case, initial contact will be done through agents. According to the opinion of BKPM's front-line officials, investors or agents visit BKPM at least twice before submitting correct and complete applications. The duration of time for this initial contact differs widely, from one or two weeks to even one year. Therefore, it is not advised to include the duration of these steps in "Time to obtain investment approval."

Why this could happen? It is unbelievable considering that around 50-80% of initial contact with BKPM is through capable, knowledgeable consultants or law firms acting on behalf of investors. Two reasons are suggested. One is that BKPM officers lack experience and knowledge and find it difficult to understand the proposal. The other is that there is a hidden negative list. Documents to be submitted are not so complicated, therefore, there seems few room for applicants to fail in filling the application form. However, negative list is exception. The list is stipulated in a very simple form and lacks transparency. Therefore, it could happen that it takes much time for investors to finalize their business concept.

At the time of the initial contact, investors confirm the necessary documents to be submitted for acquiring investment approval. Based on that confirmation, they prepare the documents and write in the necessary information in the application form and submit it.

### 2) Problems investors often face

It is a rather rare case when an application is accepted without any complaint by BKPM. It could happen that investors are requested to correct part of the application. In case of minor change or correction of a careless mistake, it will be taken care of instantly. However, sometimes there is need for a large and substantial change. In such cases, the applicants go back to their offices, do the necessary work, and again visit to submit corrected applications. The officials quote the following as areas in which investors often mistake or have a misunderstand when filling out the application form.

- Main line of business
- Annual production: unit
- Annual sales of products: unit

- Inconsistency between capacity and amount of investment
- Mistake of signature
- Simple calculation mistakes: source of investment funds---total of equity and loan
- Flow chart in manufacturing sector: unclear to understand
- Capital: internal regulation
- Debt-Equity ratio: internal regulation

Besides simple careless mistakes, most of the above cases are related negative lists. The most frequent correction is for equity, BKPM officers say. As far as the prevailing investment law is concerned, there is no stipulation on the amount of equity. Therefore, investors propose the lowest equity they think may be accepted. However BKPM has an internal policy that the minimum capital that it should be more than US\$100,000 and total investment should be more than US\$ 250,000. The latter figure comes from the view that the debt: equity ratio should be 4:1 which is based on Company Law No.1/1995, (Article 26).\*

\* At the time company is established, at least 25% of the authorized capital referred to in Article 25 must be issued.

This policy is based on BKPM's belief that small investment is too weak to assure that the business can continue operating. However, as is stated in section 2, Negative List, the policy is not made known to the public. The policy is stated in the form of a "Letter of Intent" in BKPM, one of BKPM's officers disclosed, but this has not been confirmed. It is said that the amount of US\$100,000 is determined by the following logic. A small size company is defined as a corporation whose capital is less than Rp 200 million (US\$100,000) by Small Sized Company Business Law and FDI in Indonesia cannot be made in a small sized company.

#### **Box.2.2 Initial Contact with BKPM**

There will be an argument on whether time needed for initial contact to BKPM is counted or not for evaluating efficiency of investment approval procedure. In case of investments to Indonesia, investors tend to become very careful and prudent and visit BKPM to get necessary information. The frequency of visit reaches three to four times. However, exact figure on the frequency and time is not available. Considering the situation, time consumed for the initial contact should not be included when complication of investment approval procedure is discussed.

### 3) Sources of the problems

It could happen that an investor's proposal is rejected for the reason that their flow chart is not so easy for BKPM's officer to understand. This could partly be due to the inadequate drawing of the chart, but also partly due to lack of the officer's knowledge. There is a discrepancy between what investors consider their investment and what BKPM officers feel about the investment. With the increase in new types of business, the gap tends to widen.

BKPM's officials are not so familiar with such new business models, and therefore they feel difficulty in understanding the investors' intention. Further, in case of a merger and acquisition project, BKPM's officers lack enough knowledge about the financial transactions involved and this poses another reason for the time-consuming check on investors' proposals.

Considering that the substance of investment approval process is to check whether the investment proposal is not against negative list, such information as flow chart seems to be unnecessary.

As is stated above, the description of the main line of business becomes a factor, for which correction of the application form becomes necessary. Investors are to blame for this, because they are not serious enough in specifying their business and they often want to put various businesses into one application since if they have to change line of business later, it would mean loss of much time. Delay in procedures is partly due to investors' attitude of being too demanding. However, this matter relates to negative list. If the list is transparent, investors will not misunderstand how to describe their main line of business.

Finally, with respect to critics on lack of transparency in their initial contact with BKPM, the Philippines' case should be referred to. As is in Indonesia, in the Philippines too, when applications are filed, only completed documents are accepted and then registration will be done within fifteen working days from official acceptance of the documents. In this regard, to avoid loss from incompleteness, pre-processing of documents is undertaken to assist the investor in determining the completeness of his documents. Even though the Philippines' procedure seems to be the same as Indonesia's process, it differs in that the system is clarified in the "Implementing Rules & Regulations of The Foreign Investments Act of 1991." It is advisable for Indonesia to adopt a similar system of "Pre-processing of documents" by establishing a section which is separated from the front office.

### (3) Acquiring investment approval letter (SP) from BKPM

#### 1) Recent reforms in the process

In the past couple of years, important institutional reforms have taken place in the process. They are the following and have made a contribution to efficient and transparent operation in BKPM.

- Separation between front office and back office (June 2005)
- Introduction of a system in which a receipt for an application form is issued (2003 and Aug. 2005)
- Introduction of a queuing system (Dec. 2005)
- On-line tracking system for some parts of operations (2003-2005)

The front office that receives the investment application was separated from the back office, which grants approval, in 2005. In relation to the front office operation in BKPM, a new system introduced in May 2005 is to be noted. The system calls for issuance of a receipt for the application form when investors submit same to BKPM. Through the system, BKPM eventually makes a commitment regarding the deadline for granting investment approval. In addition, a “queuing system” was introduced in February 2006. Under the system, visitors stand in a queue to obtain a reception number and according to the queue a front officer receives them. It is not allowed for the front-line official to select his clients, say investors, and have a specific relation with them. In addition, a tracking system for approval status which makes it possible for investors to know current status of the procedure through a website was introduced in March 2003 and completed in 2005, though part of there system is still under construction,

Investors visit BKPM and submit the documents necessary for acquiring approval. BKPM checks the documents as to whether the investment is included in the negative list. Also, BKPM checks whether the content of the investment is reasonable from the viewpoint of business operations, based on their experience. If the sector specified in the investment proposal is not on the negative list and there is no problem in the content of the application, it is approved. The documents to be submitted are an outline of the investment program to which are attached documents such as the Articles of Association of the investing company and copy of a valid passport for foreign individuals.

Even though the proposed sector for investment is not on the negative list, there are some conditions to be met for approval. These conditions are mentioned in “Technical Guidance.” If all of the submitted documents meet the requirement, approval is granted within 10 working days. However, according to BKPM, it could happen that due to an inadequate description of “line of business,” investors are requested to redefine the business of their intended investment. This is a main reason why it takes more than 10 days to finalize the approval process. Since the authority to give a signature of approval is delegated to the Main secretary, it does not happen for investor to wait for many days for getting the signature on the approval

## 2) Improved performance of operation

By compiling data provided from BKPM, an analysis has been made on how many days it takes for investment approval to be given. Table 2-25 shows duration from receipt of correct and proper documents to issue of so-called “SP.” The result is shown in Table 2-6. Here “Time” means duration from the day of submittal of “proper” application documents to the day of issue of the SP. Therefore it does not include the time for which investors submit the documents but the documents are not accepted due to being incomplete. Since May 2005,

the average time is within eight days. Although the figure is not shown in the table, before June 2005 when the back office was separated from the front office, investors were quite often requested to submit another application after BKPM once received an application. Such cases amounted to around 25% of total applications. This happened because there was no established rule or procedure to check the application. What should be noted in Table 2-6 is that standard deviation for the average throughout the year of 2005 was low, at 4.4. It means that so long as investors submit “proper” application documents, they can obtain the SP within 7 - 8 days.

**Table 2-25 Time Required to Obtain Investment Approval Letter in Indonesia (Working Days)**

Month (2005)	Number of project	Average(day)	Max.(day)	Min.(day)
January	94	8.9	19	1
February	89	6.9	28	2
March	98	15.2	43	2
April	135	13.7	33	3
May	117	8.8	16	3
June	161	7.7	19	2
July	125	7.2	15	3
August	105	7.3	15	4
September	146	7.1	17	4
October	134	7.4	20	3
November	96	6.4	12	3
December	141	6.3	13	4
Total	1,441	7.9	-	-
Standard deviation		4.4		

Source: Data are available from Bureau For Planning & Information of BKPM. Compiled by Miss Pipin, an assistant to JICA study team

In addition, which sectors have taken a long time, more than 21 days, for obtaining investment approval, is analyzed. As is shown below, most of them are categorized as services industry. It should be noted that manufacturing sectors are smoothly processed. This may be attributable to that investment to manufacturing sector being by nature clear in concept, while investment to in services does not always have an established basic concept and has wide variation in its interpretation. As is stated in above section 2, Negative List, investment in wholesale or retail business tends to invite arguments because manufacturing sectors are sometimes directly engaged in these sectors as business strategies. However, it is interesting that after April 2005, these cases disappeared. BKPM’s officers may have become accustomed to handling cases involving these industries.

- Textile industry (43 days)
- Wholesale- import trading (33 days, 28 days, 27 days 23 days, 22 days and 20 days)

- Hotel and property consulting service (31 days)
- Restaurant & recreation (30 days)
- Hotel and tourism (29 days)
- Export trading, software consulting service (28 days, 23 days and 21 days)
- Metal goods industry (28 days)
- Wholesale-export & import service (27 days and 23 days)
- Warehouse and safety service (26 days)
- Working safety training consulting service (25 days)
- Cottage and water tourism (25 days)
- Warehouse safety service (25 days)
- Business and management consulting service (25 days)
- Property management service (23 days and 22 days)
- Water processing service (23 days)
- Environmental technology consulting service (23 days)
- Electronic home appliances industry (23 days)
- General mining contractor service (23 days)
- White cigarettes (23 days)
- Special processing for metal industry (22 days)
- General mining support service (21 days)
- Export trading and advertising consulting service (21 days)
- Soft drink (21 days)

A similar analysis is made for West Java investment projects though the months covered are limited to only five (Table 2-26). The result is shown below. Actual time needed to obtain approval for West Java FDI projects from BKPM is shown below. Unlike BKPM's policy that approval will be issued within 10 working days, the time was quite long before March 2005. However, after then, the situation has been dramatically improved.

**Table 2-26 Time Required to Obtain Investment Approval Letter for West Java Investment Project (Working Days)**

Working days	Jan.2005	Feb.2005	Mar.2005	Apr.2005	May 2005
Less than 10	3	2	2	12	8
11-15	5		8	6	1
16-20	5	3	6	1	
21-30	3	1	4		
More than 31	2		4		
Total	18	6	24	19	9
Averaged days	17.7	16.0	17.8	9.9	7.9
Min.	8	8	8	5	3
Max.	47	27	35	23	11

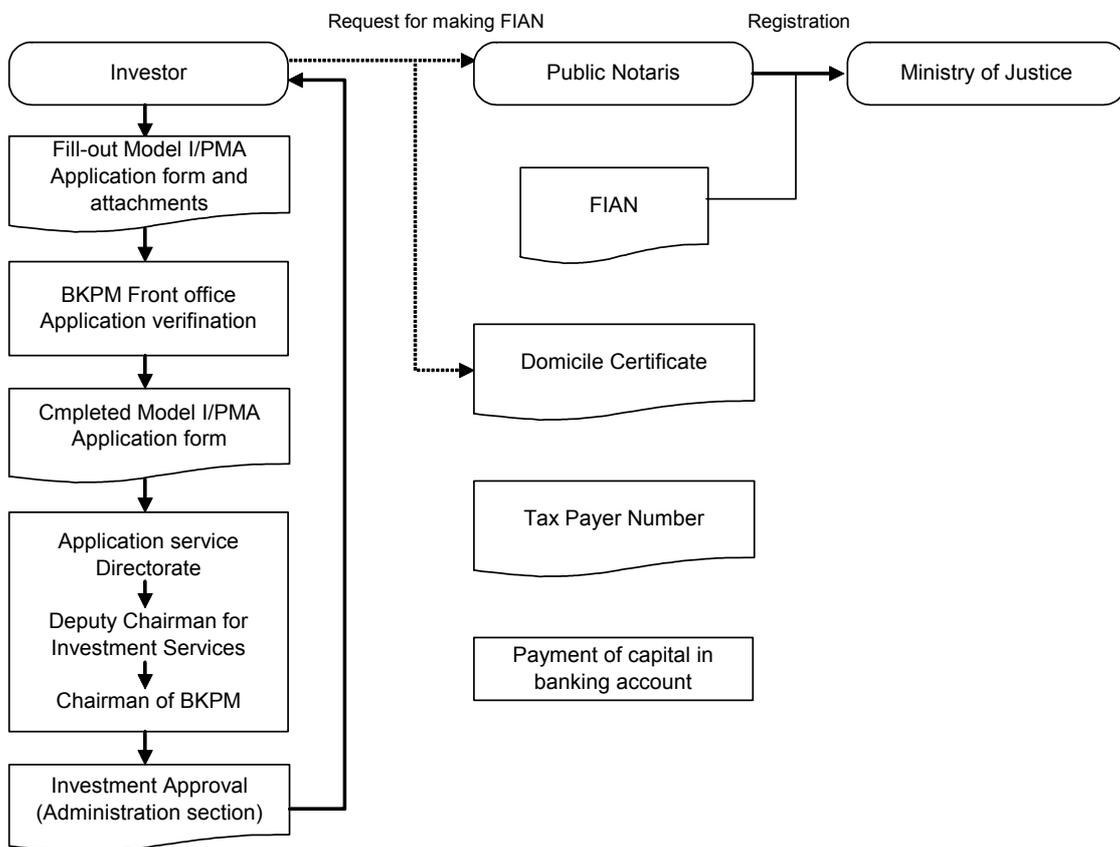
Sources: West Java Regional Board of Promotion for Investment

(4) Register a newly established company at the Ministry of Justice and Human Rights (SK)

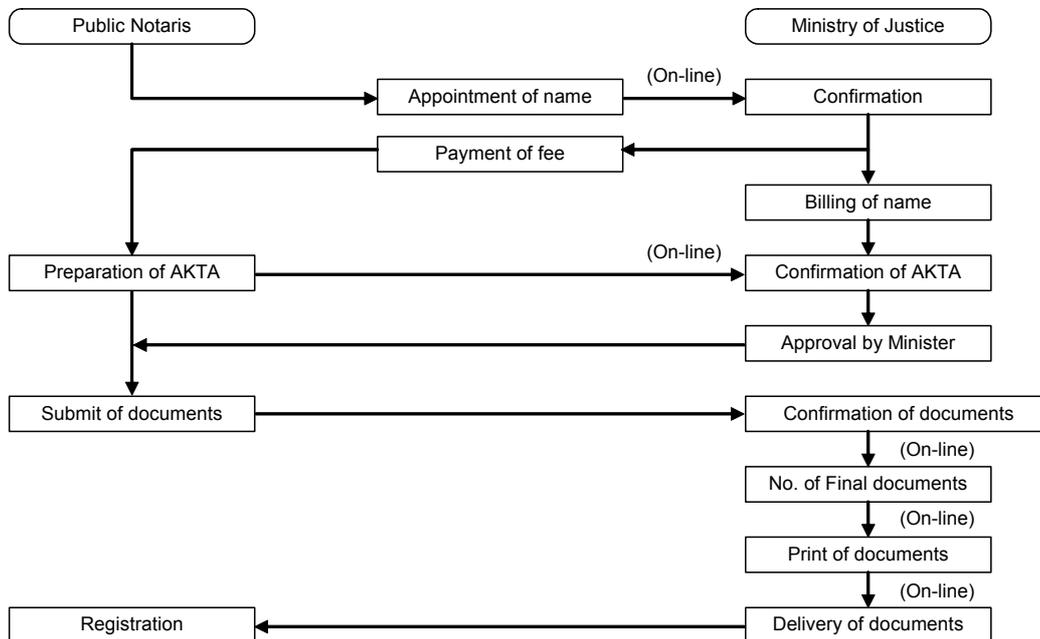
1) “On-line” operation between the Ministry and notary public

After getting investment approval from BKPM, investors have their newly established company registered at the Ministry of Justice and Human Rights. This is done by a notary public. The Ministry’s main concern is to check whether the name of the newly established company was already registered. The registration is processed in keeping with the Corporation Law as is shown in Figure 2-4 and 2-5

**Figure 2-4 Process of Company Registration**



**Figure 2-5 Detailed Procedure of Company Registration at the Ministry of Justice and Human Rights**



The investor visits a notary public and asks him or her to accomplish the registration procedure for the newly established company's name. The notary public checks whether the name has not been registered in the past and if it has not been, he or her proceeds to register the name at Ministry of Justice and Human Rights through an on-line computer connection. Since the operation is done on-line, it does not take much time, say one day. Next, the notary public prepares the Deed of Company (AKTA) by collecting such documents as copies of passports, articles of association of the company and power of attorney statements from the investor. Further, the notary public, on behalf of the company, acquires domicile certification for the company, a tax number and copy of certificate of capital payment at the bank. After preparing these documents, the notary public again contacts the Ministry of Justice and Human Rights and asks for registration of the newly established company itself. The Ministry of Justice and Human Rights checks the data for the Deed of Company sent via the on-line connection and if it is correct, the ministry approves it and starts the registration process. To complete the process, the ministry asks investors to send a hard copy of the above documents. After receiving the documents and checking them, if there is no mistake in descriptions, they grant a registration number to the investor.

2) Flow of the procedure and duration for each process

The procedure has some special features in addition to the on-line filing. One is that the length of time required depends on not only the ministry's efficiency but also efficiency of

other parties concerned. Throughout the whole operation, investors, notary public, financial institution and local government are involved in. Second, due to this characteristic, interruptions can occur. The ministry cannot do anything regarding such interruptions.

In 2005, the ministry issued 1,156 SKs for foreign direct investments. Table 2-27 shows a term structure for the issued SK. Here term means the duration from the date of reservation of the name of registered company by notary public to sign on company registration document by the ministry. Duration for three months more is relatively high with 36% shares. It is because interruption is included as is explained in details later.

**Table 2-27 Duration Required for a Company Registration**

	Within 2 weeks	2 weeks – one month	One to two months	Two to three months	Three months or more	Total
No. of SKs	116	147	267	210	416	1,156
Percentage distribution	10.0	12.7	23.1	18.2	36.0	100.0

Note: The same day operation is counted as one Source: Ministry of Justice and Human Rights Compiled by Miss. Pipin, an assistant to JICA study team study team

The major interruption occurs when investors prepare necessary documents for company registration after the registration name is confirmed. The following table shows how many days are needed for investors to prepare these documents. If investors prepare these documents in advance, they do not need so much time. Actually, most of investors prepare them within one month. However, some investors need much time. About 24% requires a long duration, one of more than three months. Table 2-28 is explained by the long term for preparation of documents.

The Ministry of Justice and Human Rights cites the followings as the reason why duration is large after new name registration until submit of necessary documents such as article of association. First, investors do not always take quick actions for the next step. Actions include preparation for getting tax-payer registration number of the company and the evidence of paid-in capital from the banks concerned. Some investors are not serious in getting these documents as soon as possible. Second, they lack knowledge about the procedure. Though, in many cases, lawyers or consultants support investors, they also lack knowledge. In this regard, one of high ranking officers at Ministry of Justice and Human Rights says that, even though every notary public is required to attend four days' training course for the operation before he or she is qualified as a notary public, some of notaries public can not keep pace with the current development of information technology and tend to commit mistakes in on-line operation. Third, BKPM also commits mistakes, an officer at Ministry of Justice and Human Rights says. BKPM fails to judge whether an investment

sector is included in Negative list or not. If BKPM misses the point, BKPM has to reissue SP. In this regard, it is said that industrial classification used by both parties seems to be different. Coordination between both institutions is indispensable. Fourth, BKPM will overlook the discrepancy between the name of registered new company and its line of business. For example, the registered name is “Tokyo trading” but its line of business includes not only trading business but also construction business, the officer at the Ministry points out.

Even though investors, notaries public and consultants are primarily blamed for the above long duration, it is necessary to scrutinize whether or not the procedure imposed by Ministry of Justice and Human Rights is something wrong. It is because the frequency of long duration is too large. It is natural to speculate that there will be some room for improvement in the system itself. In other words, there will be a high possibility of not only human errors but also institutional or system error being involved in the large frequency.

**Table 2-28 Duration Needed for Investors to Prepare Documents for a Company Registration**

	Within one month	One-two months	Two-three months	Three to four months	More than four months	Total
No. of cases	492	264	122	90	188	1,156
Percentage distribution	42.6	22.8	10.6	7.8	16.2	100.0

Source: Ministry of Justice and Human Rights Compiled by Miss. Pipin, an assistant to JICA study team

Duration for check of submitted data from investors for company registration is short with 90% of the cases being handled within 3 days as is shown in Table 2-29.

**Table 2-29 Duration for Check of Submitted Data at the Ministry of Justice**

	Within 3 days	4-7 days	8-14 days	15 days or more	Total
No. of cases	1,037	57	28	34	1,156
Percentage distribution	89.8	4.9	2.4	2.9	100.0

Source: Ministry of Justice and Human Rights Compiled by Miss. Pipin, an assistant to JICA study team

Again, duration from confirmation of hard copies submitted to sign of company registration form is short. 95% of the work is done within two working days (Table 2-30).

**Table 2-30 Duration from Confirmation of Hard Copies Submitted to Sign of Company Registration Form at the Ministry of Justice**

	One day	Two days	Three days	Four days	Five days or more	Total
No. of cases	597	490	42	7	20	1,156
Percentage distribution	51.7	42.4	3.6	0.6	1.7	100.0

Source: Ministry of Justice and Human Rights Compiled by Miss. Pipin, an assistant to JICA study team

Looking the duration for each investment in Table 2-31, we recognize several types of proceedings. While some are in a very smoothing procedure, others stacks in one or another procedure as follows.

**Table 2-31 Observed Several Types of Proceedings (Days)**

Type	Name registration	Data preparation	Submit documents	Confirm the documents	Signature by the Ministry	Total days
Very smooth	2	3	9	1	1	16
Stack up in a half way	2	2	37	103	1	145
Stack up in a half way	2	90	36	1	2	101
Stack up in a half way	2	60	12	2	1	77

Summing up the above data analysis, the following picture emerges (Table 2-32).

**Table 2-32 Summary of Whole Process for a Company Registration**

No.	Process	Actor	Standard duration	Statistical data		Sample data	Cf. % of duration within 7 days
				(Average)	(Standard deviation)		
1	To obtain a new company's name	The Ministry of Justice	2 days	2.4	2.9	1,120(*)	95
2	Preparation of documents	Investor, Notary Public, Bank, Tax office, Local government	One month	-	-	1,156	-
3	Confirmation of documents	Ministry of Justice	5 days	4.9	5.4	1,042(*)	81
4	Submit final data	Notary Public (Investors)	2 days	2.1	3.2	1,146(*)	79
5	Data check	Ministry of Justice	6 days	5.7	4.5	1,130(*)	95
6	Issue of SK	Ministry of Justice	2 days	1.6	1.1	1,156	99

Note: (\*) Extraordinary figure more than 30 days more is excluded

Source: Ministry of Justice and Human Rights Data is compiled by Miss Pipin of JICA study team

3) Exceptionally fast case

As is mentioned above, most of the procedure is done through an on-line computer connection, therefore, it does not take so much time as far as the Ministry’s operation is concerned. Key is whether or not investors and notaries public can prepare necessary and correct documents timely. If these documents become available, in the shortest case, it takes only 4 to 5 days to complete the above whole process. Some actual examples which are supplied by the Ministry are shown below. The Ministry of Justice and Human Rights, however, admits that there are input mistakes by the notary public. The Ministry says they happen with a probability of 5% of registrations. If it happens, the Ministry of Justice and Human Rights asks the notary public to input the correct data again and resend the information to the Ministry through an on-line connection. It takes another days for this operation. Table 2-33 shows examples of the time required for steps up to the obtaining of a registered number.

**Table 2-33 Time Required to Obtain a Registered Number :The Most Fast Case**

Process	Done by	Case 1	Case 2	Case3
1.Reserve a new company’s name	Notary public	Jan.16	Jan.18	Jan.20
2.Confirm the name	Ministry of Justice	Jan.17	Jan.18	Jan.20
3.Pay business fee (PNBP)	Notary public	Jan.17	Jan.19	-
4.Submit data of Deed of Company	Notary public	Jan.17	Jan.19	Jan.23
5.Confirm the above data	Ministry of Justice	Jan.19	Jan.20	Jan.24
6.Inform the finish of confirmation	Ministry of Justice	Jan.19	Jan.20	Jan.24
7.Send hard copies of documents	Notary public	Jan.19	Jan.20	Jan.25
8.Receive and check the documents	Ministry of Justice	Jan.23	Jan.23	Jan.25
9.Determine the register ed number	Minister of Justice	Jan.24	Jan.24	Jan.26
10.Send the registration paper to investor	Ministry of Justice	Jan.26	Jan.25	Jan.27
Total days to be spent for operation	-	10	8	8

Source: On-line computer data submitted by Ministry of Justice and Human Rights

Since the steps from 1 to 6 above are done through on-line computer, the duration is short if there is no trouble. However, in step 9, a different type of work cuts in. It is the work needed by the ministry’s officer to confirm whether the on-line data and the hard copy data sent by notary public coincide.

The study team tried to obtain similar data from notaries public for cross-check purposes. Table 2-34 shows an example. Except for the time needed to prepare the necessary documents on the investor’s side, it took only seven days to complete the main procedure. However, the final stage, delivery of hard copies of the registration documents, takes usually two to three weeks. Even though the exact reason is not clear, it may be due to the manual work by postal

employees. In addition, the step involving the printing of the Gazette takes more time. Actually it takes one month to print the Gazette and takes more two to three months to print attached documents to the Gazette. Its main reason is that operators, who are in charge of producing the Gazette, input the data by hand, without using the data on a disk compiled by the notary publics when they prepare for registration of new companies. The long duration of this step is a headache for newly established companies because according to the Company Law Article 23, they are liable for the action of the company even while the registration and announcement has not been completed (Article 23: For so long as the registration and announcement as referred to Article 21 and 22 have not been made, the Board of Directors is jointly liable for any action of the Company [Law of Limited Liability Companies, 1995]). The Association of Notary Publics recommends that the officials who prepare the Gazette use their disks that contain the main data to be included in the Gazette, in order to shorten the time needed to issue the Gazette. The Gazette office is now planning to shorten the duration by taking the Association's suggestion. The office says that by means of this, the printing of the Gazette will be shortened from one month to two weeks and the printing of attachments will be shortened from two-three months to one month.

**Table 2-34 Confirmation of Table 2-33 Data by One Notary Public**

Operation	Date
Reserve a new company's name (Notary public )	Aug.19, 2005
Confirm the name (Ministry of Justice)	Aug.19, 2005
Director's confirmation (Ministry of Justice)	Aug.19, 2005
Preparation for documents (Investor)	Aug.26, 2005
Registration of name (Notary public)	Aug.26, 2005
Pay business fee(PNBP)( Notary public)	Aug.26, 2005
Submit data of Deed of Company (Notary public)	Aug.29, 2005
Confirm the documents by director (Ministry of Justice)	Aug. 30, 2005
Determine the register No.(Ministry of Justice)	Aug.30, 2005

Source: A notary public in Jakarta

As stated above, this registration process is done through an on-line connection. The system was completed in April 2001. Before then, it took much time for registration, sometimes, six months to one year. The on-line system was planned to shorten the registration process as well as to prevent corruption. It is because all procedure is done only through the on-line system and notary public is not given any chance to have a face to face contact with the Ministry of Justice and Human Rights and notary public. Every notary public is provided with a password and only through use of the password can the notary public access the key Ministry of Justice and Human Rights website page. The number of notary publics is around 6,000 in Indonesia as a whole. For the entire nation, in 2005, there were about 54,000 registration documents issued, as is shown in Table 2-35.

**Table 2-35 Number of Registration Documents Issued in 2005 (All Indonesia)**

Month	New investment	Changes	Just report	Total
January	1,648	547	1,799	3,994
February	1,722	467	1,738	3,927
March	2,319	594	2,039	4,952
April	2,158	575	1,928	4,661
May	2,116	587	2,096	4,799
June	2,220	643	2,263	5,126
July	1,920	526	2,178	4,624
August	2,038	614	2,172	4,824
September	2,004	547	2,136	4,687
October	1,866	515	2,145	4,526
November	1,115	309	1,442	2,866
December	2,168	648	2,335	5,151
Total	23,294	6,572	24,271	54,137

Source: The Ministry of Justice and Human Rights

#### 4) Problems remaining to be solved

One of notaries publics interviewed stated that the procedure took much time, say, a few months before on-line system was introduced. Nowadays, however, it takes only one to two weeks. Further, it is possible to confirm whether the submitted documents were proper or not through the provider of the system. In addition, the Ministry of Justice and Human Rights started a service whereby answers are provided to customers' inquiries as to which stage the registration process for the customer is presently at. The service is available every Tuesday and Thursday. If a notary public makes full use of this service for its customers, they can know the current status of procedures, find mistakes if any, and avoid loss of time, the notary public says. Ignorance of the system produces lags in procedures. The notary public suggests that notary publics should follow the proceeding by themselves and not leave everything to the Ministry of Justice and Human Rights.

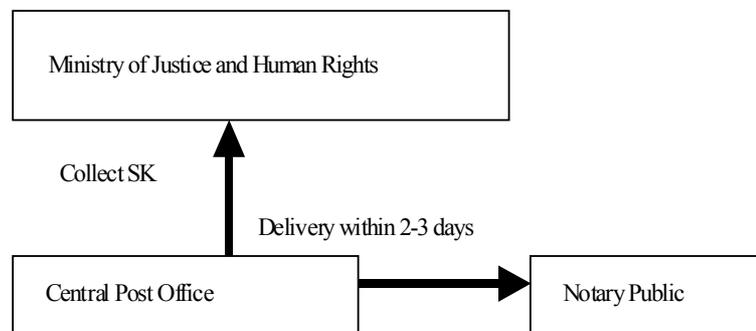
Another notary public, who handles several PMA projects every year, says that she reminds her clients of the need for allowing around one month to complete the registration procedure. In case clients are ready to register their companies, having prepared all necessary and proper documents, it takes only two weeks to complete the procedures. However, this is not the usual case. It could happen that the client's data are incorrect or insufficient. It could also happen that the client does not finish to paying in the initial capital to a bank account for some or another reason.

While the duration from checking of documents, signature by the head of the Ministry of

Justice and preparation of a print-out of the SK for delivery to the Central Post Office is 3-7 days, it is said that the duration for delivery of the SK from the Central Post Office to each notary public takes around one to two weeks. The reason why it takes 3-7 days for checking of the SK, signing and delivery of the SK is that a total of no less than six officers check the SK and the signature is made only by the director general, and, moreover, it is not delegated to the next-in-charge official except when the director general leaves his office more than two days.

The process of delivery of SK to a notary public is shown in Figure 2-6. The Indonesian Central Post Office collects the SK at the ministry and is supposed to deliver it to the notary public within 2-3 days (Table 2-36). However, some notaries public complain that it takes more days than that to get an SK. The Central Post Office admits the fact but quotes the reasons as follows. First, notaries public count the days from the issue date of SK at the Ministry. Second, notaries public change often their address but the change is not reported to the Central Post Office. Third, the notaries public are sometimes out of the office when documents are delivered and in this case the documents are returned to the post office. In this system, it is to be remarked that the Central Post Office has developed an on-line tracking system. Using this system, a notary public can track where their SK is positioned (Refer to Box.2.3).

**Figure 2-6 Delivery of the SK**



**Table 2-36 Collection of Company Registration Documents by Central Post Office in May 24**

Issuing date of SK	No. of cases	Percentage distribution
May 24 (Wed.)	1	-
May 23 (Tue.)	38	13
May 22 (Mon)	136	50
May 19 (Fri.)	107	35
Earlier May 18 (Thu.)	5	2
Total	287	100

Source: Indonesian Central Post Office

**Box.2.3 Tracking System for Delivery of SK to Notary Public**

( Example )

Date	Time	Status
23-05-2006	15:12:13	Received by public notary
22-05-2006	15:09:13	Resend
22-05-2006	22-05-2006	Delivery to public notary, except for Batam
22-05-2006	08:12:30	Received by local post office in Batam
19-05-2006	09:06:45	Sorting and processing at Central Post Office
19-05-2006	09-06-45	Received by Central Post Office

Duration to print the Gazette takes more time. Even though the duration is not usually counted in calculation of investment approval procedure, the long duration is a headache to executives of newly established companies because according to the Company Law Article 23, they are liable for the action of the company while the registration and announcement is not made.

Article 23

For so long as the registration and announcement as referred to Article 21 and 22 have not been made, the Board of Directors is jointly liable for any action of the Company (Law of Limited liability Companies, 1995)

It takes one month to print the Gazette and takes more two to three months to print attached documents to the Gazette. Its main reason is that operators, who are in charge to make it, input the data by hand, not using disk compiled by notaries public when they prepare for registration of new companies. Association of Notary Public recommends printing office use their disks that contain main data to be included in Gazette in order to shorten time to

issue the Gazette. The Gazette printing office is now planning to shorten the duration by taking the Association's suggestion. The office says that with the idea, the print of Gazette will be shortened from one month to two weeks and the print of attachment will be shorten from two-three months to one month.

- (5) Obtain necessary central government permits and licenses for implementation of investment

The permits are;

- Manpower plan approval and work permit, and visas for foreign experts
- Limited importer license
- Custom approval letter (Master list for capital goods)
- Custom approval letter (Master list for raw materials)

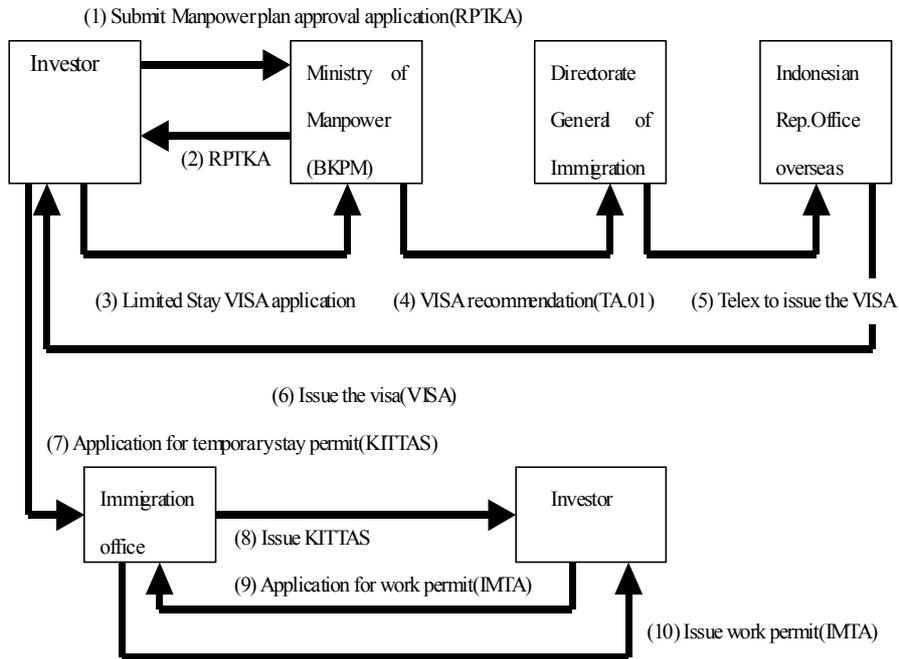
These permits and licenses are granted by BKPM on behalf of related ministries such as the Ministry of Trade, the Ministry of Manpower, the Ministry of Finance and the Director General of Immigration.

Even though the total number of permit is six, since these permits are processed simultaneously, it is said that duration required to get all the permits is around 20 days at the earliest. The most important is that these processes are carried out under the "one roof of the BKPM." For this reason, it is said that it is one-roof service.

#### 1) Labor related permits

As is shown in Figure 2-7, it took three steps for an expatriate to obtain work permit. The first step is to obtain a limited stay visa. The visa is issued by Indonesian embassy in the expatriate's home country. The second step is to obtain temporary stay permit and the permit is given by Immigration office in Indonesia when the expatriate enters Indonesia and applies. The third step is to obtain work permit and it is issued by Immigration office in Indonesia. However, the procedure has been streamlined with Minister Regulation No.Per-07/III/2006. Under the previous procedure, entering Indonesia, the expatriate started a process of getting work permit, however, under the new procedure, the expatriate can start the procedure and obtain the permit in his or her country.

**Figure 2-7 Previous Procedure for Expatriate Work Permits**

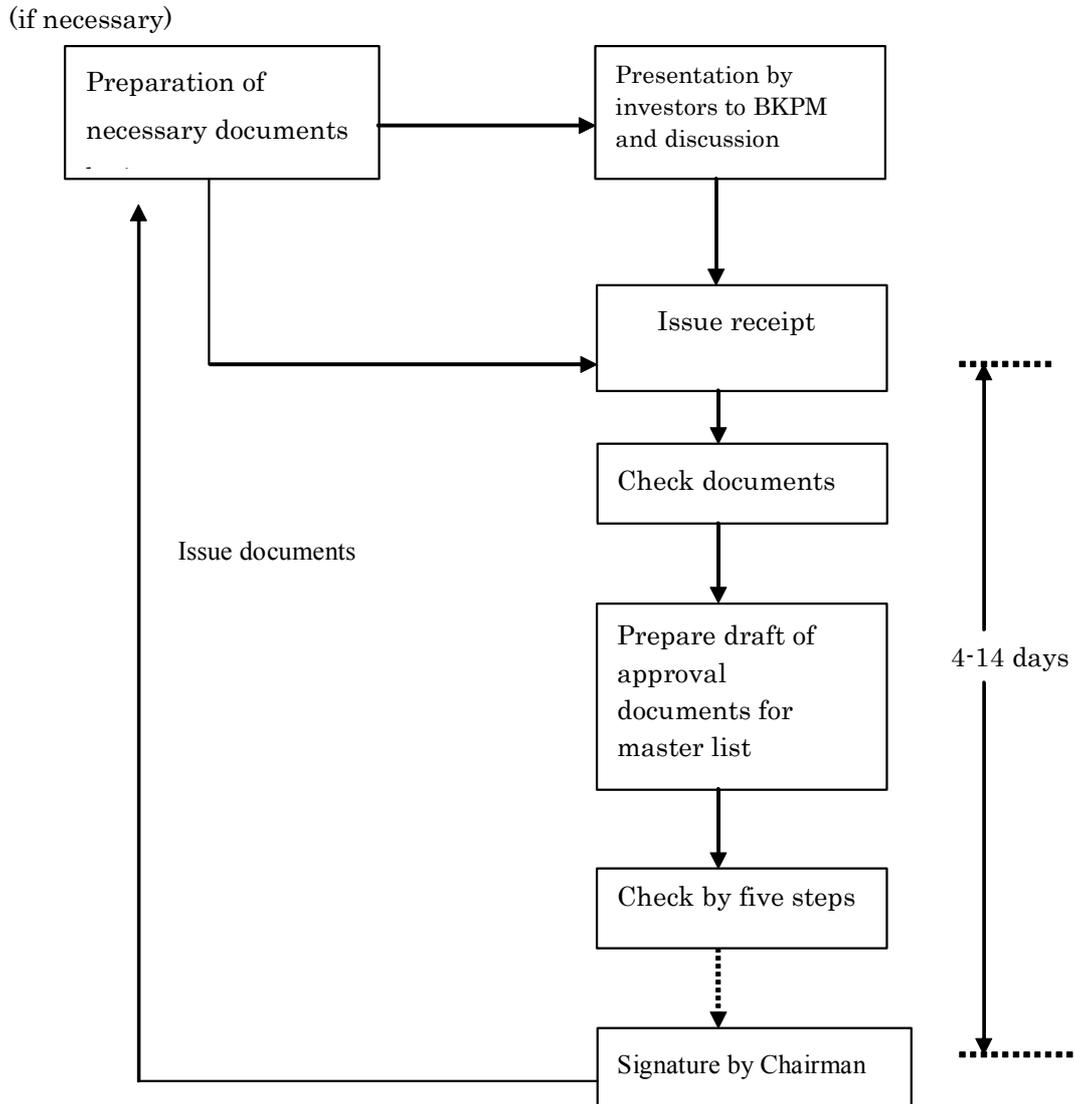


In BKPM, an officer dispatched from the Ministry of Manpower handles the operation.

## 2) Customs approval letters

Customs approval letters are issued in the following steps (Figure 2-8). It is to be noted that the time before the documents are received is fairly long. Effective measures to shorten the time should be given high priority. The duration for the operations after the receipt of documents is four working days at the shortest and fourteen working days at the longest. The duration depends on the complexity of the investment. Especially when second-hand equipment is included in the list, much time is required. In case the investment is large and is accompanied with many kinds of imported capital goods, since it takes much time to check these goods, the duration becomes longer. On the other hand, in case the investment project is simple and importation of capital goods is small, the duration will be short. However, there may be some room to trim the duration of checking tasks in final check steps.

**Figure 2-8 Process of Issuing Customs Approval Letters**



The number of officers in charge of the process is 20 and most of them are engineers. This section has a unique history among BKPM's various sections. After BKPM started to handle this operation, the function was transferred to SGS, a European company. Then it was re-transferred to SCOFIND, a state owned survey company. In 2004, it was returned to BKPM. The volume of applications for letters handled was 315 in 2005 and 100 in 2004.

Efficient operations for master list procedures are important for investors. This is because investors have to prepare shipments of machinery and equipment from exporting countries as soon as possible after approval of the investment. Only when investors get the approval for the master list can they start shipment. Therefore, if the approval date is delayed, the shipment also is delayed and this results in delay in installation of machinery and

equipments in the factory. As a natural result, the start of commercial operation of the investment is delayed. Table 2-37 shows the duration taken for issuance of the SP for the master list, starting from receipt of the application form. The number of cases is 155 for January to August of 2005. The average duration is around 19 days. Its standard deviation is relatively high at 9.9. The duration means the time from receipt of necessary documents until issue of the master list. Therefore, it includes not only time for an internal check but also time for holding a technical meeting with investors. In the meeting, master list officials at BKMP receive a presentation on technical matters from the investors. When the date for such a meeting is delayed, the duration for issue of the SP for the master list is delayed in turn. This is a reason why the standard deviation becomes large. It could easily happen that one month is needed for finalizing the meeting because investors invite specialists from their home countries for the presentation. The duration after the meeting is within 14 days as illustrated in Figure 2-8. Thus, the duration for the technical meeting is around 5 days on average. However, it should be noted that the cases when it is longer than one month accounts for 14%. The longest case was 56 days for an investment in the gold mining industry, while the shortest case was 3 days for an investment in the telephone service industry

**Table 2-37 Duration Needed for Issuance of an Approval Letter for a Master List**

	Less than 14 days	14 - 20 days	21-30 days	31-40 days	More than 41 days	Total	Average	Standard deviation
Case	54	37	42	13	9	155	19	9.9
Percentage distribution	35	24	27	8	6	100	-	

Source: BKPM's Master List section. Compiled by Miss. Pipin ,assistant to JICA study team

BPKP monitors the performance of the section's operations and reports as is shown in Table 2-38. The figure does not include the duration for the technical meeting. As far as the sampled projects are concerned, the time consumed for the issue is less than 14 days. The duration does not include time for the technical meeting which varies widely because the meeting is arranged to conform to schedules of both the master list officer and investor

**Table 2-38 Duration for the Issuance of the Letter in 2005**

Month	No. of samples	No. of projects finalized in 14 days	No. of projects which took more than 14 days	No. of project denied for issue of Master list
January	13	9	2	2
February	21	19	1	1
March	13	11	0	2
April	15	14	0	1
May	11	7	1	3
June	9	7	0	2
July	9	5	0	4
August	23	20	0	3
September	21	13	0	8
October	21	13	0	8
November	6	5	0	1
December	6	6	0	0
Total	168	129	4	35

Source: Monitoring report by BPKP

Those data in the above two tables includes not only PMA(foreign direct investment ) but also PMDN(domestic investment). The procedure is the same and the master list office undertakes its work without discriminating among them. Table 2-39 shows the duration for PMA only. 85% of the total cases are processed within one month.

**Table 2-39 Percentage Distribution of Duration for Issuance of an Approval Letter for a Master List**

	Less than 14 days	14 - 20 days	21-30 days	31 days more	Total
Case	44	17	19	14	94
% distribution	47	18	20	15	100

Source: BKPM's Master List section. Compiled by Miss. Pipin, assistant to JICA study team

(6) Acquire necessary local government permits for implementation of investment

1) Type of permit and its standard procedure

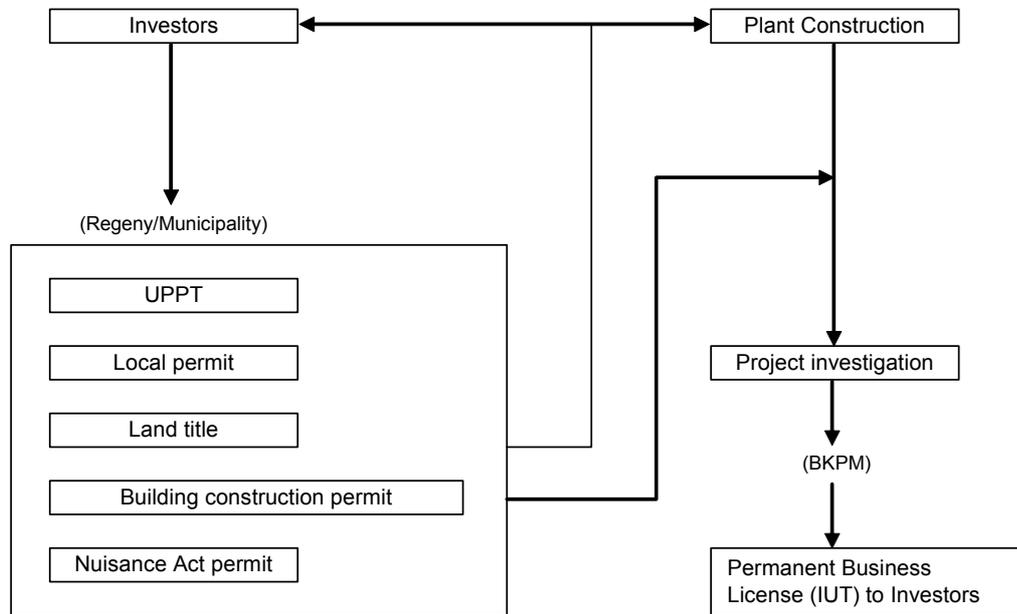
Actual investment is executed in a specific regional area. Therefore, investor has to acquire permits for implementation of the investment in the area where investment is realized. This is a reason why local government is involved in. Permits to be granted are:

- Location permit
- Land title
- Building construction permit

- Nuisance act permit.

Typical procedure for obtaining local permits is shown in Figure 2-9.

**Figure 2-9 Procedure for Local Government Permits**



Duration needed for obtaining of local permits differs by type of project . In case of manufacturing projects, they are mostly carried out in already established industrial zones. Therefore, all infrastructures are already laid and the duration may be not so long because environment assessment has already been done. On the other hand, in case of service industry projects such as hotel and restaurant, they are invested near residential areas. Therefore new environment assessment will become necessary and resident people’s resistance to these projects is likely to be strong. As the result, the duration tends to become long. In such a case, it is never rare to take one year to finalize the local permits.

## 2) Examples of the procedure

Followings show how local permits are provided in local governments. The process seems to be different by district reflecting district’s economic and industrial situation. For example, industrial structure in some areas is quite simple, therefore local permits process is simple, while in other areas, the situation is reverses and the process tends to be complicated. Therefore, in designing desirable local permits process, it is necessary to take into consideration these differences.

### ■ Procedure in Kabupaten Tangerang

The procedure for local permits may differ region by region. The following is an

example in Kabupaten Tangerang. In Kabupaten Tangerang, an integrated unit for permits was established within the local government in May 2005. The unit is temporarily controlled by Construction Department of Kabupaten, Tangerang, which grants construction permits. Under the unit, four departments grant one each of the permits stated above. The sequence for acquiring permits is land title, location permit, construction permit and nuisance act permit. BKPMMD in Kabupaten Tangerang expects to become a window for the unit and coordinate it.

Since these permits are to be issued in sequence, it takes around 50 days to complete the procedures. However, this duration is a theoretical one and one local officer admits that it could happen that it takes around one month for each process. The officer says that this is due to lack of diligence on the part of investors. Some of investors do not care about acquiring a permit as soon as possible and even though the procedures have been completed, they do not promptly go on to the next step (Table 2-40).

**Table 2-40 Time Required for Obtaining Local Permits in Tangerang**

	Location permit (Space)	Location permit (Land)	Construction permit	Nuisance act permit
No. of documents to be submitted	8	8	6	5
Duration for procedure (working days)	13	12	12	13

Source: BKPMMD in Tangerang

■ Procedure in Kota Bekasi

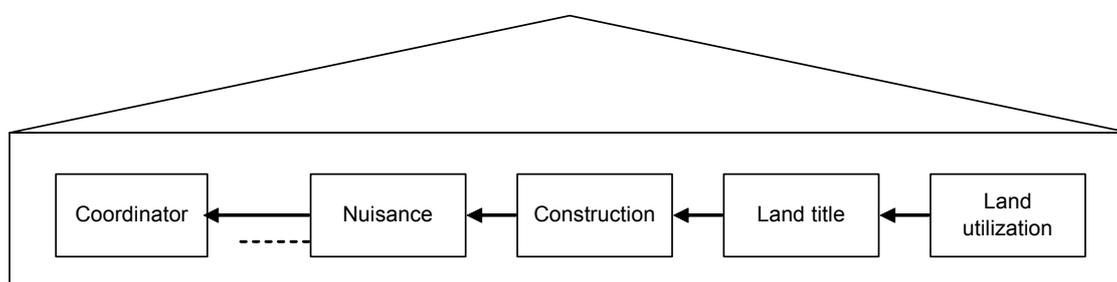
BKPMMD in Kota Bekasi was established in July 2004 but it does not function and not issue any local permits. Local permits are to be issued by each related department at the Kota Bekasi government. However, there was no PMA project last year. There is a one-stop window for various services, from local permits to issue of various certificates. Last year, around 500 permits for construction were issued and most of them were for individual houses and the number of PMA related permits was zero. The officer at the one-stop window called UPT says that it takes about two weeks to get a permit for housing but, for an investment project, it will take around one month.

■ Procedure in Kota Bandung

Kota Bandung has the most well established one roof service system. Unlike the two cases of Kabupaten Tangerang and Kabupaten Bekasi mentioned above, local permits are issued in a simple but well organized scheme. There are seven windows handling permits such as location permits, land titles, building construction permits, nuisance act permits, transportation permits, tourism permits and TDPs. And a management coordinator is stationed there. These windows are placed in a line expressing the flow of operations and the

system is very clear and understandable to visitors as is shown in Figure 2-10. Each permit will be issued in 12 working days other than the nuisance act permit, issuance of which takes 22 working days. It is possible for each window to know which project is under operation, but they are not connected to each other through an on-line computer arrangement. Connection through an on-line system is possible, but due to budget constraint, has not yet been realized. The volume handled at the windows is shown in Table 2-41. Here again, the number of non- PMA/PMDA is by far the larger. It includes not only general business permits but also individual housing projects. The window could be referred as a model for others to emulate.

**Figure 2-10 One Roof Service at Kota Bandung**



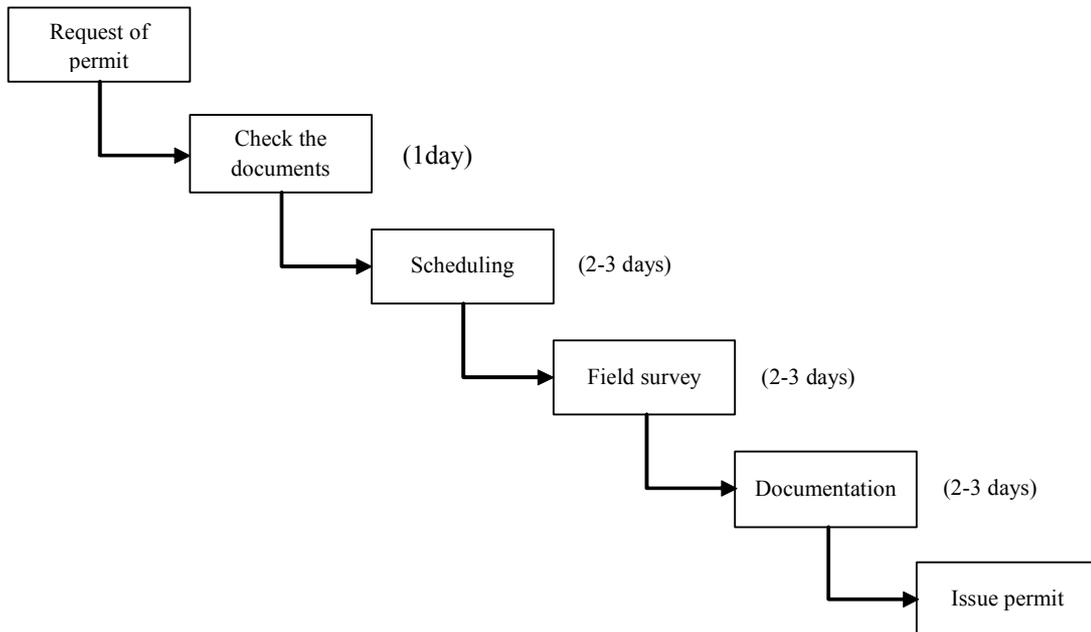
**Table 2-41 Number of Projects for Local Permits**

Year	2002	2003	2004	2005
PMA	18	22	16	13
PMDA	2	6	1	1
Non-PMA/PMDA	1,200	1,829	2,456	2,810
Total	1,220	1,857	2,473	2,864

Source: Kota Bandung local government office

The flow of acquiring each permit is almost the same as is shown in Figure 2-11. No step needs so much time, but it seems that scheduling of the operation is not so efficient and this is a main reason why it takes more than 10 days. In this connection, it should be stressed that the section providing the above permits handles every kind of projects from FDI to individual housing projects and construction of retail shops. There is no specialist on FDI. Therefore, in arranging the schedule for checking, FDI is not given any priority. If there are many individual housing projects, it could be happen that FDI project will be given less priority. In other words, they have no sense of urgency concerning the procedure of FDI approval.

**Figure 2-11 Standard Flow of Issuing a Local Permit**



■ Procedure in Kabupaten Kudus

Kabupaten Kudus is one of 14 Kabupaten in Central Java. Its local office, named the Investment & Integrated License Service Office, handles local permits for various investments. They issue nine different permits such as location permits, construction permits, nuisance act permits and commercial operation permits. The type of permit differs by project. The duration needed to obtain permits differs by type. For example it takes 21 days for a construction permit, while it takes 10 and 15 days for a location permit and nuisance act permit respectively, though these figures are the maximum ones. Some of permits could be obtained simultaneously. The number of permits issued in 2005 is shown in Table 2-42. Enterprise operation permits account for the largest with 1,238.

**Table 2-42 Number of Permits by Type (2005)**

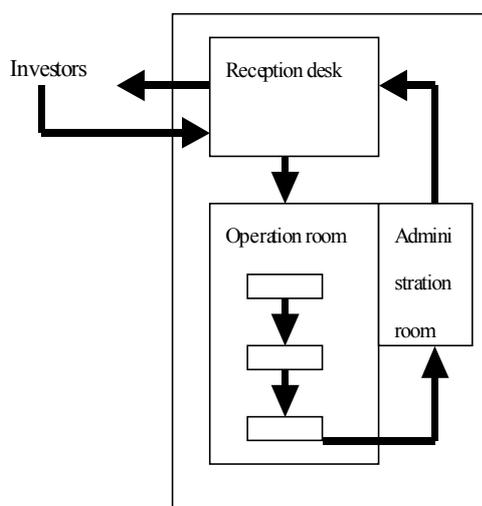
Permit	No. of Issue	Maximum days to obtain a permit
Location permit	29	10
Change in land utilization	89	15
Construction permit	785	21
Nuisance act	256	15
Industrial operation	21	7
Industrial registration	310	5
Expansion approval	2	5
Commercial business operation	1,109	5
Business operation	1,238	5
Total	3,839	-

Source: Kantor Penanaman Modal dan Pelayanan Perizinan Terpadu, Kabupaten Kudus

The number of project that the Kudus local office handled in 2005 was 1,236. Among them small industry was 1,107 and medium size industry was 79. The rest, 50, were for large industry. Among the 1,236 projects, foreign investment projects accounted for only two.

Investment & Integrated License Service Office has around 30 employees. The operation is executed under a system, which is called “One stop service” or “One door service” as is shown in Figure 2-12. When investors visit the office with necessary documents, they are received by a staff at the reception desk. After receiving and checking the documents, the receptionist sends them to the back office. Staff at the back office works on the documents one by one and when all permits become available, investors are informed to visit the office again to pick up these permits. Investors are not required to visit each related office to obtain each permit. In this sense, the system is called “One stop service.” In the above operations, an investor is able to know where his or her project is at any time, though a website or inquiry made to the above reception desk.

**Figure 2-12 One Door Service at Kabupaten Kudus**



■ Procedure in Kota Medan

In Kota Medan, neither one-stop service nor one-roof service is yet established.

■ Procedure in Kabupaten Parepare

Reportedly Kabupaten Parepare has established one-stop service. As long as investors submit the necessary and correct documents for several permits at the reception desk, the one-stop service office completes the procedures and provides these permits to the investors at the same reception desk. In this meaning, the service could be called one door service..

### 3) Wide difference in operation style among local governments

Even though investigation is limited to only several examples, it is clear that there are wide differences among the examples. While some local governments have already set up a one-stop service or one-door service, others have not reached such a level, although they may have a plan to do so. In addition, some governments already established capability to response to investors' inquiries on the status of local permit operations, but others are not yet ready. It is expected that the Ministry of Interior will standardize the operations among local governments by extending finance and human resources to them.

Business operation certificate (TDP) is one of local permits. Company Register is a certificate for business operation issued by Department of Commerce in local government. Following is an example observed in a certain local government in Jakarta area. Raw documents necessary for the issue are Association of Company, Certification of registration at the Ministry of Justice and Human Rights, SP issued by BKPM, Certificate of domicile issued by local government, Tax number, and passport number of directors and KOMISARIS. As well as these documents, investors are requested to submit a 13 pages application form. Even though it is only to copy some information in the above documents to the form, it takes some time to prepare. The officer at the department receives these documents and the form, and confirms whether there is no shortage and no mistakes. After confirmation, the officer inputs information in the above 13 pages in computer. Then the officer makes TDP with the computerized data. In 2-3 days, the officer asks the investor to visit again to know the current procedure. If the process is ready to issue TDP, the officer orders the investor to pay official fee in a bank and bring its receipt back. After paying the fee in the banking account and getting its receipt, the investor visits again the office and submits the receipt. Two days later, the investor visits again the office to pick up TDP document (Refer to Box.2.4)

It takes around 10 working days from the start till getting the TDP. The reasons why it takes so much time are as follows:

- Computerization of raw data: 2-3 days

Even though the items included in TDP are limited, as is stated above, investors are requested to fill out 11 pages of papers and submit them. This is because, in accordance with laws, the contents of 11 pages paper are to be held at the Department and to be open to everybody who wants to see them. This procedure is stipulated in Presidential Decrees No.3/1982 and No.1/1991. Submitted documents are transformed into computerized ones by the officer.

- Payment of fee to the bank and submittal of the receipt: 2 days

- Draw up TDP, check and issue the certificate: 5 days

Though the TDP to be issued is a very simple one and all information included in the

TDP is mainly from the Register at the Ministry of Justice and Human Rights as is shown below, the check is done in eight steps.

(Information to be included in the TDP)

- Name of Company
- Legal status
- Taxpayer No.
- Address & telephone
- Person in charge
- Main activities
- Approval No. of Ministry of Justice and Human Rights
- Approval for Changes in Deed of Company

Only the head of the Department has right to sign the TDP. The authority to sign is not delegated to subordinates. In case the head is out of office, no signature is made.

The above inefficient operation seems to not be limited to this case; it seems to be popular in other areas. If Indonesia improves the procedure, the impact on efficient operation may be very large. The following improvements are necessary and possible.

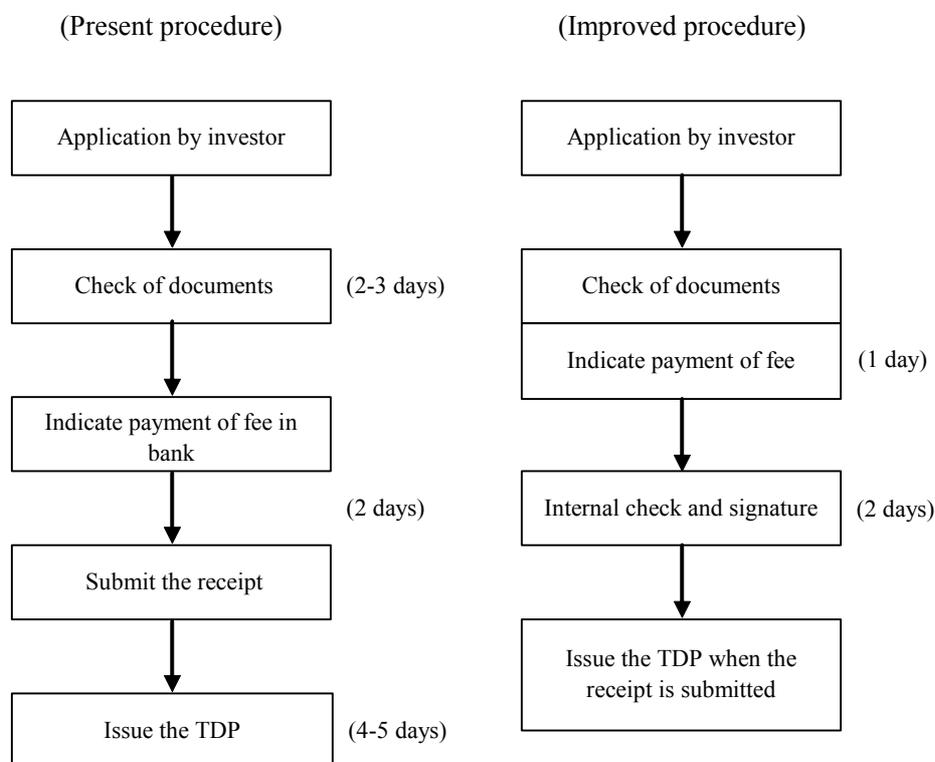
- Ask investors to submit computerized application forms with computerized draft of TDP
- Issue TDP in exchange for receipt of official payment fee
- Delegate to authorities the right to sign the document to subordinates

The department could trim the operation time by 4 days if the above improvements were made (Refer to Figure 2-13). In this regard, Medan's operational flow shown in Figure 2-14 and Box. 2.5 will provide a good example.

#### **Box. 2.4 Information Technology and Daily Operations**

Operation of TDP issue is executed in compliance with Government regulation stipulated in Presidential Decrees No.3/1982 and No.1/1991. Officers responsible for the operation conduct the job honestly as it is so stipulated. However, the operational procedure does not always conform to the current business customs because since 1983, the business environment has changed with the development of information technology. Operational procedures should be reviewed from time to time so as to ensure that they are fitted to the current situation. Otherwise, investors will not be satisfied with the operations. This kind of situation seems to prevail in various government offices. In private sectors, since competition is so severe, it could not happen. However, in public operations, since there is no competition, the situation tends to be overlooked. If it is necessary to do so, the above prevailing Presidential regulations should be revised so as to fit to the era of information technology development.

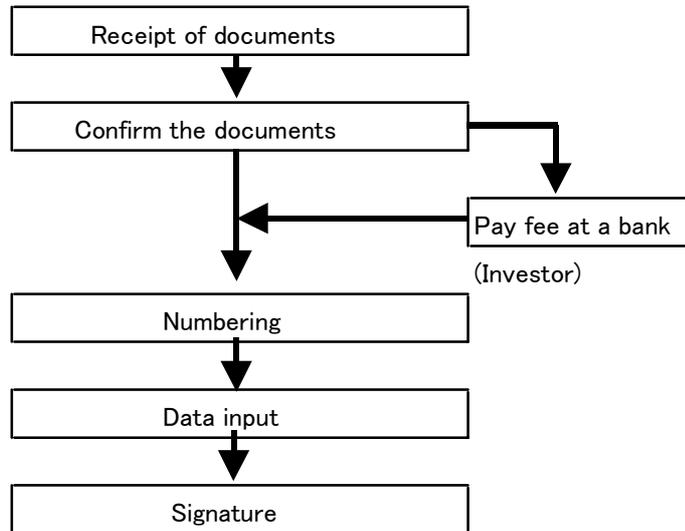
**Figure 2-13 Issuance of Business Operation Certificate (TDP) in South Jakarta**



**Box. 2.5 Issuing Process of TDP in Kota Medan**

Like the Department of Industry and Commerce in Jakarta, the Department of Industry and Commerce in Kota Medan issues TDPs in accordance with Presidential Decrees No.3/1982 and No.1 /1991. Therefore the procedure is basically the same between them. However, the duration needed in Kota Medan is only three days. The lower duration is partly due to the smaller number of issues compared to the number of cases in Jakarta. However, this became possible by making the process more efficient as follows. First, only four staff is involved. They are a registration officer, head of the section, director and the head of Department. Second, the head of Department delegates the task of checking to the director and he only signs the documents. Third, investors are able to pay the necessary fee at the Department office, therefore, they do not need to go to a bank to make such payment.(refer to Figure 2-14)

**Figure 2-14 Issuance of TDP in Medan**



Unlike the above case, East Jakarta local government issues TDP in more efficient way . If the complete documents are prepared, it takes only one- two days in issue of TDP. It should be noted that the check process is very short and this is a factor which makes it possible to reduce the total duration. However, it is also to be noted that the one-two days is only from the date when the officer receive the complete and correct data. In this regard, it happens that a notary public or a consultant, an agent of an investor, fails to prepare complete and correct documents and it takes totally 10 days to issue TDP as is shown in Case 3 of Table 2-43. The officer interviewed says that quality of investors' agents is not always high. They speculate and execute the process without confirmation. For example, instead of original certificates, they submit copied documents. Following table shows some examples on how many days it takes to issue TDP after the officer receives documents which are not proper. In these cases, the officer says, they receive the documents anyway and ask agents to bring proper documents later. The duration of issue of TDP is one-two days. One of important factors for making it possible for the issue of TDP in only one-two days is that investors pay fee for the issue at the bank locating in the same building of the office and come back to the office with the receipt for the next step.

**Table 2-43 Case of the Issuance of a Company Operation Certificate in East Jakarta Local Government**

Case	Submit documents	Receive proper documents	Issue of TDP
1	2006.6.16	2006.6.21	2006.6.21
2	2006.6.14	2006.6.20	2006.6.20
3	2006.6.12	2006.6.29	2006.6.30
4	2006.6.28	2006.6.30	2006.6.30
5	2006.6.9	2006.6.15	2006.6.15

Source: Department of Commerce and Industry, Kota East Jakarta

(7) Obtain permanent business license (IUT) from BKPM

Acquiring local permits and Minutes of Project Investigation issued after the confirmation of the entire operation by local government, the investor asks BKPM to issue a permanent business license. BKPM takes around ten working days to issue an IUT. IUT is a permanent business permit composed of four pages. The process takes currently around ten days as follows (Figure 2-15).

**Figure 2-15 Process for Issuance of a Permanent Business License (IUT)**

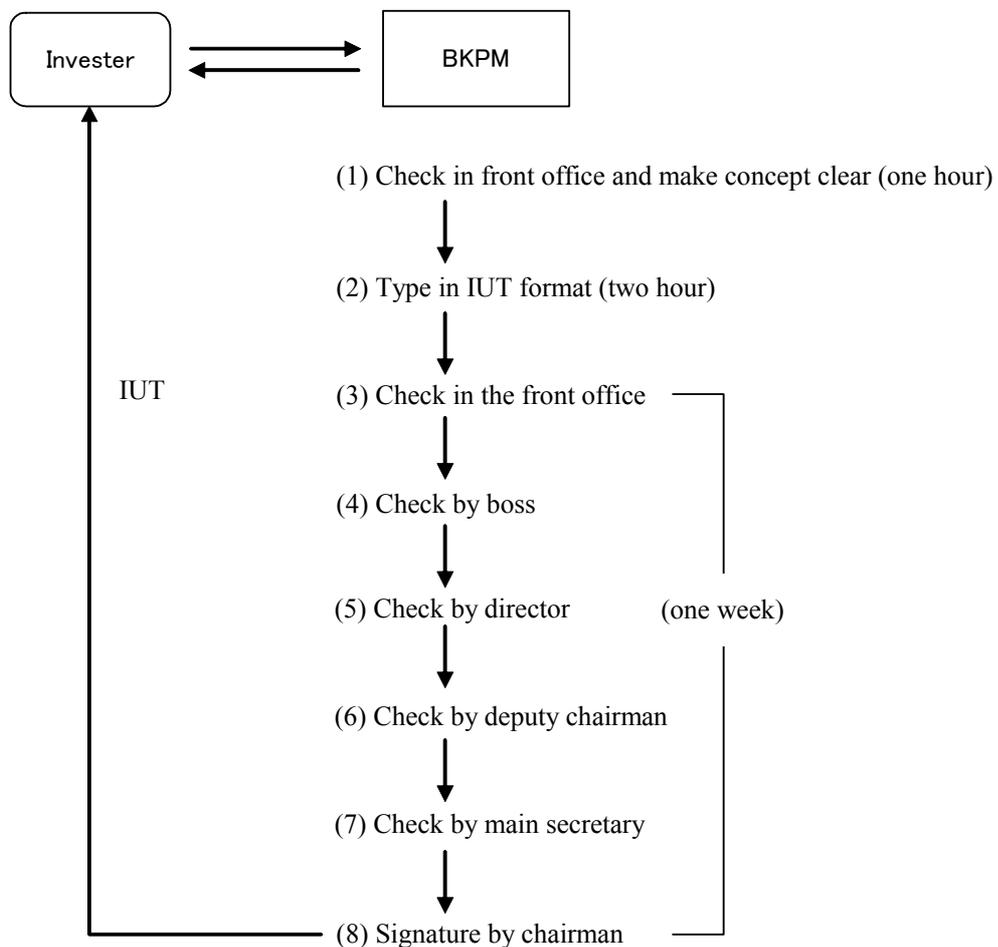


Table 2-44 shows the duration for operation from the receipt of whole and proper documents to issue of IUT for 2005. In almost 90% cases, IUT is issued within 14 working days. Average duration counts around 10 days. The maximum day is 139 days, while the minimum day is 2 days. Here again, looking at the situation by month, it is clear that the duration became more stable between 5 and 20 days after August, 2005. One of front officers at BKPM says that percentage share of investors who submit incorrect documents counts around 20%, a relatively large figure, though the most of mistakes is very minute. This is a reason why BKPM front office has to check the documents carefully. This implies how the documents made by other organizations are out of expectation for BKPM.

**Table 2-44 Duration for the Issuance of Permanent Company Operation Certificate (2005)**

	No .of case	Percentage distribution	(Jan.-July) No. of case	Percentage distribution	(Aug.-Dec.) No.of case	Percentage distribution
Within7 working days	412	37.9	242	35.9	170	41.1
8-14 days	534	49.0	302	44.8	232	42.7
15-21 days	97	8.9	85	12.6	12	16.2
22-28 days	15	1.4	15	2.2	-	
29 working days more	30	2.8	30	4.5	-	
Total	1,088	100	674	100	414	100
Average working days	10.4	-	11.5	-	8.4	
Standard deviation	9.1	-	11.1	-	2.8	

Source: Data are available from Bureau for Planning & Information of BKPM. Compiled by Miss Pipin assistant to JICA study team

### 2.3.5 Assessment of the Current Procedure

It is of interest that there can be heard different two evaluations of above procedure. One is “not so slow” and the other is “too slow.” The result of the above analysis on current procedure implies the following conclusion. First, as far as major actors are concerned, procedures within the organizations are streamlined. As far as institutional design is concerned, Indonesian procedures are not so inefficient. In the past several years, several reforms were realized and the procedure was streamlined. In this sense, at least, the World Bank’s study result seems to be a little out of date though it is necessary to discuss the matter with World Bank and confirm where recognition of the situation differs between the World Bank and us. Second, however, there are some actors whose process seems to be not so much streamlined. The process of acquiring local permits is one such example. This may be due to their not being serious in streamlining their operations. Their action principle seems different from BKPM’s. Third, procedures for registration at the Ministry of Justice and Human Rights is streamlined on the whole, but it is heard that it happens to still take much time, say two months. However, this may not be attributable to the Ministry of Justice and Human Rights but to lack of knowledge or ignorance

on the part of the notary public. Also, some blame should be assigned to investors. Cases that would match the last two are as follows:

- Investors fail to pay in the initial capital to their banking account, for a long time
- Notary public overlooks a mistake in the expected member of executives in a newly established company.
- Forgetting that a medical doctor in a public hospital is not entitled to become an executive, the notary public prepares a Deed of Company including the doctor as one of executives

In this sense, the human factor or error is a major reason. With respect to the quality of notaries, it is noted that notaries were given legal status under a law which was enacted in October 2004. In addition, it is said that FDI related work is concentrated in the hands of 10% of the notaries, who are very knowledgeable and have much experience, and therefore, it is rare that their quality becomes a main reason for the delay in procedures.

### **2.3.6 Factors Underlying the Current Time-Consuming Procedure**

Two factors could be suggested as underlying the consumption of time for procedures. One is an institutional factor. Due to inefficiency in the institutional framework, much time is required. Inefficient operational systems are such an example. This type of factor could be eliminated so long as the system is restructured so as to facilitate the operation smoothly..

Reportedly, the other is human factor, which is too tough to be eliminated. In this regard, following factors are often cited by parties concerned.

- Careless mistake or negligence or lack of understanding in procedures (investor and notaries public and other)
- Overlook related laws and regulations
- Lack of discipline in doing business

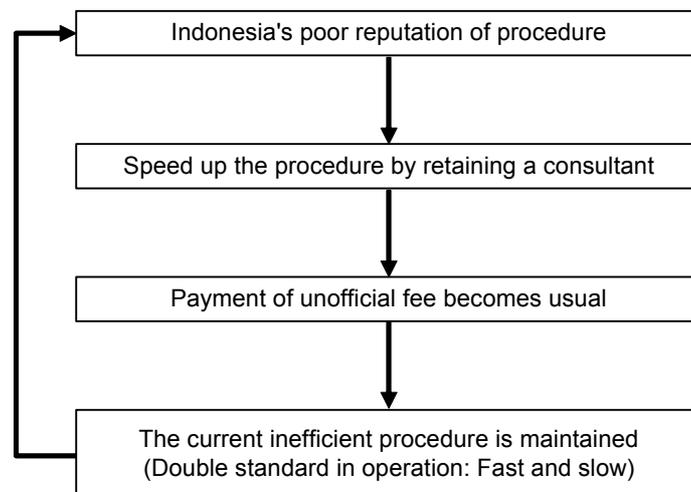
All of the above institutional and human factors becomes a source of “*Memakan Biaya (Indonesian cost)*”

Reportedly, the other is the human factor, which is too difficult to be eliminated. The typical factor here is that officials involved in the process intentionally keep the pace of operation slow. Their motivation for such behavior is to collection unofficial fees from investors. They ask investors for such payments to issue related papers or documents, when investors need to pick up them as soon as possible. The situation seems to be accelerated when work is done through agents. Investors generally hire agents for smoothing the procedures and to avoid complicated and time-consuming work in acquiring an investment license. Investors do not know details on how the procedures are going on and how long it takes and why, therefore, they leave these nuisance procedures to agents. As a result, investors become generous when asked to pay an unofficial fee as “Entertainment cost” if it will make it possible to speed up the

procedure. The agent or consultant can also confirm their necessity in this dealing. In other words, each, the investors, the agents and the government officers, is responsible for the current inefficient procedure. In this structure, in an economist's term, the agent or consultant plays a role of "rent seeker." It is essential to speed up reforms, which involve taking away these rents that have built up in the economic system. This is also one of the desirable measures to reduce the so-called high transaction cost.

The situation is summarized by Figure 2-16 and Box.2.6.

**Figure 2-16 A Source of Time-Consuming Procedures**



**Box. 2.6 A Malaysian case**

A Malaysian company invested in Indonesia to produce sewage related equipment near Jakarta. Hearing that investment approval procedure in Indonesia is a tough job and is so much time-consuming, the manager decided to retain a law firm and left every related work to them. However, it took so much time and money to obtain approval. He dose not know the reason why. Everything was in black box, though he could be out of any trouble, he says.

**2.3.7 Sources for Further Improvement**

The large variance in duration of the abovementioned procedures is a typical phenomenon observed in various areas in Indonesia. While procedures are very smoothly carried out in large sized investors or smart notaries public, those in small and medium sized investors or other notaries public are often stacked. As a result, even though average falls within a certain range,

variance becomes large. How to reduce the variance is a key issue for further improvement.

(1) Within BKPM

BKPM has two functions. One is to grant approval and permits. The philosophy lying behind this function is to observe whether investors obey laws and regulations. The other is to promote investment by investors. The philosophy lying behind this function is to extend to investors the best service possible related to their investments. In this sense, BKPM is a government institution as a regulator and, at the same time, a service industry, network industry and information industry.

From the above viewpoints, there are two fields for improvement for BKPM. One is to speed up the investment approval process. This would be is to make the process as efficient as possible. The other is to provide the best possible service to investors. This, for example, could mean providing a call center service for investors. Here, the first area is discussed.

Even though it is a tough task to eliminate the above human factors or errors, it is not so difficult to eliminate the inefficient factor, which comes from a deficiency in the institutional framework. Here, only the latter factor is discussed.

1) Improvement in issuance of Investment approval letter (SP) and Customs approval letters

Beyond this study report's mention of the investigation result above, there still remains room to improve or streamline the procedures.

The first source is duration for pre-processing of documents. Now that duration for SP issue is shortened, investors' concern is how to shorten the term for pre-processing of documents. Duration for SP issue is measured as the term from receipt of "complete and correct" documents till the issue of SP. Point is how long it takes to prepare the complete and correct documents. In Indonesia, it is often said that it takes substantial days. The long term is partly attributed to lack of business discipline on investors who do not try to prepare complete and correct documents, but partly to lack of transparency in the process. For the reason, investors fail to prepare the complete and correct documents. Even though they feel their documents are complete and correct, BKPM officers feel another way. In this respect, two aspects are cited. One aspect is lack of transparency in minimum capital as is stated in **2.2 Negative list**. The other aspect is flow chart which is requested to describe in SP application form. It is strongly advised for BKPM to tackle these two matters.

The second source is that since internal check time takes much time for operation, the time should be trimmed as much as possible. In other words, new efficient internal check system that fits to the IT era should be constructed. In addition, there is room for

streamlining the process by delegating signature of the IUT to lower echelon when the formal signer is for long days out of office

The third source is to streamline BKPM's operations. It is possible to shorten the operation time by introducing an on-line system for granting the SP; such a system would facilitate investors' input of the necessary data and sending it to BKPM through e-mail; these data are utilized in all successive processes. This scheme must be acknowledged to be valuable when it is considered that it facilitates avoidance of "person to person" contact, which is often recognized as a major source of corruption. This so-called e-procedure would help keep transactions transparent and accountable during a process which has tended to be graft-ridden. The new system would not only improve operational efficiency but also create added value for the BKPM's customers. The system is now under study in BKPM and if it is realized the duration for the application stage will be further shortened. The process for producing a central permit and IUT also can be streamlined using the on-line system. Second, so as to ensure that investors to submit necessary documents in appropriate manner, BKPM should guide them by preparing a detailed manual. The manual should include warnings on where investors tend to make mistakes in filling out the application forms. Since BKPM has engaged in appraisal of various investment proposals in the past, it will not be so difficult to prepare such the manual for investors.

With respect to streamlining of the operation within BKPM, a case for BKPM in Jakarta city is useful to refer to. One officer at the BKPM says that they issue SPs within five days. Since investment projects to be approved at the BKPM are concentrated in service sector which does not have a complicated production flow, there is no complicated factor encountered in judging whether the target sector is on the negative list or not, therefore, the application process goes smoothly. Even though it this a main reason why the approval procedure takes a shorter time in the BKPM than in BKPM, it seems that BKPM could streamline the procedure up to the same level, 5 days.

## 2) Improvement in issuance of permanent business license (IUT)

Another source of streamlining is to shorten the duration for process of IUT issuing. It seems that it is possible to shorten the current total duration of 10 days to 4-5 days by streamlining the process of check by back office and executives. In this connection, one of officers at BKPM expresses his opinion that, since the importance of issue of IUT has decreased under a change in interpretation of SP's function from "temporary" investment approval to "permanent" investment approval; it may be possible to replace IUT with the current investment report, which is to be submitted by investors. It is worthy to investigate the possibility in details for streamlining the whole process of investment approval.

### 3) Another areas

As is already stated, BKPM's investment approval procedure has been substantially streamlined in the past couple of years. However, there seems to be still wide difference in the duration for each process. Table 2-45 shows so-called variance. Except variance of SP, other variances seem to be still large. Interviews with officers involved in their operations revealed that following factors are related to the situation.

- Careless mistakes, negligence or lack of knowledge on investors, notaries public and other related organizations
- Complicated and sophisticated documentation which will often invite investors' misunderstanding
- Bureaucratic operation in BKPM which is out of date in IT era
- Lack of transparency

With respect to the first factor, it should be seriously taken into account that there exists various quality "divide" between parties concerned. It is urgent matter to bridge the difference in quality between them. For the other reasons, BKPM should take measures to avoid the cases by establishing new operation system, which is fitted to the development of IT. In this regard, it is advised to BKPM to analyze

**Table 2-45 Wide Variation in Duration for Investment Approval Procedure (Days)**

	Sample	Longest	Shortest	Average	Standard deviation
SP	1,465	43	1	8.6	4.42
Master list	155	56	3	18.9	9.96
IUT	1,088	95	2	10.4	9.01

The large variance, in terms of standard deviation, for duration of the above procedures is one of typical phenomena in various areas in Indonesia. While procedures are very smoothly carried out in large companies, those in small and medium companies are often stacked. As a result, even average is so-so, variance becomes large. It is a large issue how to reduce the variance. Capacity building for weak small and medium company is necessary.

### 4) Construct a performance measurement system

It is advisable that the authorities construct a new system under which management-level persons can get information on time spent at each stage of the process for each project. Thus, the time becomes a measure for evaluation of the efficiency of the performance of BKPM's operations. The concept of the system is as follows.

- Information covered:
  - Date of receipt of a proper application

- Date of issuing the SP
- Date of issuing each central government permit such as APIT, RPKTA/TA01, and Master List
- Date of receiving Minutes of Project Investigation /LKPM and
- Date of issuing a permanent business license (IUT)
- System:
  - Compiling the above data by project
  - Preparing tables for summarizing the above information
  - Reporting the above data and tables to top management
- Usage:
  - As one of the “Executive Information Systems”
  - Information for call centers

#### 5) Capacity building for both BKPM’s officers at front and back office

Under the current changes in Indonesia’s economic and industrial structure and investors’ business strategy followed by the former changes, capacity building for both front and back officers at BKPM is becoming necessary. Without enough knowledge about economy and business strategies, they can not handle daily operation in more efficient way. As is stated in **2.3.1** Changing Foreign Direct Investment Pattern, investors’ behavior is changing and if officers can not cope with the changes, it is difficult for them to achieve more efficient operation. This is a reason why a special capacity building for officers is necessary. Following is an example of the scheme.

- Purpose: By providing a chance to learn the recent changes in investors’ strategy and activity, let officers consider by themselves how to streamline current operation and reduce duration for issue of SP including time required for preparation of documents.
- Plan: BKPM sets an occasion of discussing the above changes among officers periodically and of proposing how to make their operation more efficient. Prior to discussion, information and planning section may prepare necessary documents and statistics which show how investors’ behavior is changing. BKPM also sets an opportunity for officers to listen to investors’ business and their strategy periodically. Discussion with investors will provide a good chance for both officers and investors to know what both thinks in investment approval procedure. Such a discussion meeting should be held once in a month at BKPM. In the meeting, at least one senior officer will attend and leads the discussion. Information obtained in the above meeting will be disseminated within BKPM. This information is especially useful for investment promotion because knowledge about investors’ business strategy really provides hints of investment promotion. Officers at investment promotion sector also attend the above meeting.
- Details: How to operate is shown below

- A leader for the capacity building is assigned from front officers
- The leader sets two kind of periodical meeting. One is internal discussion meeting and the other is meeting with investors.
- The internal meeting will be held once in a month with attendants from management, front and back office, information and planning section and investment promotion section. Main subject is recent trend of foreign direct investment, its major characteristics and problems faced in their daily operation. The meeting with investors will be held every month or once in two months with attendants of management, both front and back office, investment promotion section and information and planning section. Around ten investors are invited from main business sectors which cover not only manufacturing sector but also service sector. In the meeting, as is stated above, investors' opinion on Indonesia as investing country is heard as well as their complaints about BKPM's investment approval operation. It could happen that by chance, BKPM get some information on new investment plan from investors who attend the meeting.
- Final target is two folds, One is to streamline investment approval procedure. The other is that every front and back officer becomes an investment promoter. In other saying, they have two hats as a regulator and a investment promoter.
- Since the sustainability is far important, management people of BKPM secure budget necessary for continuous operation

(3) Within other organizations: Notaries public and Ministry of Justice and Human Rights

It could happen that owing to lack of knowledge and experience, the work performed by notaries may become a bottleneck for smooth operation in the Ministry of Justice and Human Rights. While investors should be duly careful to select a smart and knowledgeable notary public as their agent, it is also necessary for Association of Notary Publics to train their members.

As far as improvement in company registration process is concerned, as is already discussed before, major source for further improvement lies in the process that investors and notaries public prepare necessary and appropriate documents to submit the Ministry of Justice and Human Rights. The matter is beyond the Ministry's control. However, it does not mean that there is nothing to be improved by the Ministry. The Ministry should review the current process and revise the scheme so that investors and notaries public might not commit mistakes. The Ministry is advised to establish "Fool proof" system. In this regards, two areas are pointed. One is that the Ministry and notaries public should share the same information on negative list. In Indonesia, only negative list exists. However, it could happen that the list referred by the Ministry and notaries public is different because their interpretation is different. Both should execute their operation based on the exactly "same" information.

The other improvement area is to reduce or modify documents submitted to the Ministry. In this regards, two possibilities could be discussed. One is to abolish a document regarding an investor's domicile. The Ministry obliges investors to obtain a certificate of domicile for company registration. The certificate is provided by a local government office and it takes considerably a long time for an investor to obtain it. Since the domicile which an investor informs at the timing is not permanent but temporal one in most case, it could be substituted with notary public's address that will be retained by the investor for investment approval. If it is realized, the duration for preparing necessary documents for company registration could be streamlined to some extent. Considering it seems to be easy and practical to do so, it is recommended to investigate seriously the possibility.

The other area is payment of capitals. In Japan, by the recent revision of Business Corporation Law, in 2006, an investor can establish a company with only one yen. Such the policy was taken for promoting establishment of new companies as much as possible. Under the old company registration procedure, an investor was required to obtain a capital custody certificate which was issued by a financial institution. However, under the new Law, an investor is only required to certify the fact of payment of capital with their own voluntary ways such as showing the balance of banking account. In case the similar policy is followed in Indonesia, the duration of preparing documents for company registration will be shorted largely. The point is whether Indonesia can abolish the current minimum capital requirement clause, say Rp 20 million. In this regards, two factors should be mentioned. First, the economic situation in Indonesia differs largely from Japan's one. As one of methods to measure credibility of a company, amount of capital is still very important in Indonesia. Second, a company registration certificate is only one official document which is disclosed to a customer who hopes to do a business with the registered company. Considering these two, it seems to be too early not so easy for Indonesian government to introduce the similar system as in Japan. However, it is also recommended to study the possibility.

#### (4) Within local governments: Realization of "One roof service"

##### 1) Introduction

The other key source is to streamline the process in local governments who grant various local permits. The key is to revise their operation flow. By doing so, the idle time will be minimized and efficiency will be enhanced. The problem is that it is lacking of incentive for streamlining the process. Manpower is not in shortage. Investors or their agents are not so serious about the speedy operation. The local officers are engaged in another operation such as issuing construction permit for individual house and the percentage share of these operations is far large. Under such the environment, it is difficult to plant the local officer the motivation to search for efficiency.

A key is to establish one stop service under one roof office, at least one roof service system, within local government. Kabupaten Kudus and Kota Bandung have already established one as is already stated. However, the situation differs by local government. Kabupaten Bekasi has clear intention to establish one-roof service system, but due to budget constraint, the idea is not yet materialized. At this moment, investors have to visit various offices to obtain different permits from location permit, land utilization permit to construction permit. One of Dinas (department) in Kabupaten Bekasi issued around 250 location permits in 2005. The type of the permits covers for housing, FDI and domestic investment. The latter two counts only 15.

## 2) Concept of one roof, one door and one stop service

Three types of service are often discussed. They are one roof service, one door service and one stop service. Here, each service is defines as follows.

### ■ One roof service

All necessary permits are provided by offices which locate in a same building. Therefore, investors are not requested to go around various places to obtain various approvals or permit. However, investors are requested to submit necessary documents for getting one permit by visiting one office. If they want to get five types of permits, they have to visit five offices and submit documents and pick up permits one by one.

### ■ One door service

All necessary permits are provided at one door where investors first visit to submit necessary documents and to pick up these permits at the door. Therefore, they are not requested to go around various offices to submit documents and pick up permits. In this sense, one door service is more advanced than one roof service. By nature, one manager is delegated a power to sign whole permits

### ■ One stop service

The service is a different name of one roof or one door service. The name is given from a fact that in both service, investors are requested to visit only one place or building. In this sense, it is one stop service.

Realization of one roof or one door service is important for the following reasons.

- a) Most convenient to investors
- b) Time-saving to investors
- c) Low cost to investors
- d) Free from corruption

In case that each local permit is to be issued separately, such a system tends to become a source of corruption. In order to avoid such a risk, completed integrated service is indispensable.

3) Current situation on availability for one roof service

Concept of one roof service is not yet widely penetrated in Indonesia as is shown in Table 2-46. One of senior officers at BKPM quotes followings as its reasons. First, investment of both PMA and PMDA is quite few in some regions and local government has no chance to feel the necessity. Second, a head of local government sometimes dose not understand the advantage or convenience of integrated service to investors. Third, concept proposed by the President of Indonesia in Presidential Decree No.3, 2006 is not yet fully socialized. The BKPM officer stresses the importance of strong initiatives towards realization of the concept on mayors at Kabupaten or Kota

**Table 2-46 Spread of “One Roof Service” by Province**

Province	No. of Local government	No. of one roof service	Province	No. of Local government	No. of one roof service
East Kalimantan	13	0	West Java	25	n.a
South Kalimantan	13	0	Banten	6	n.a
West Kalimantan	12	0	Central Java	35	n.a
Central Kalimantan	14	0	North Sulawesi	9	n.a
Yogyakarta	5	0	Central Sulawesi	10	n.a
Jakarta	6	0	South Sulawesi	23	n.a
Nanggroe Aceh Darussalam/NAD	16	0	Gorontalo	5	n.a
Bengkulu	6	0	Sulawesi Tenggara	10	n.a
Lampung	10	0	East Java	5	0
Sumatera Utara	19	0	Jawa Timur	39	0
Riau	14	1	Bali	9	0
Jambi	10	0	West Nusa Tenggara	9	0
Kepulauan Riau	6	0	East Nusa Tenggara	15	0
Sumatera Barat	16	0	Maluku	8	0
Bangka Belitung/Babel	4	0	North Maluku	9	0
Sumatra Selatan	9	0	Papua	21	0
			West Irian Jaya	9	0

Source: BKPM

Table 2-47 shows some examples for current service. Needless to say, a case of Kabupaten Kudus is the most desirable. It is recommended for Minister of Home Affairs to set a standard service and extend supports to each local government for their realization of the standard service. In this relation, the toughest job is to persuade related sectors at local government to agree delegation of their authority to a new approval management

organization.

**Table 2-47 Type of Service Rendered**

Case	Example	Conditions	One door service	One roof service
Full-fledged	Kabupaten Kudus	(1) Investors are not requested to go around to submit necessary documents and to collect them (2) Investors show up themselves at a reception desk to submit and to collect documents (3) Special office handling all operation is set up	*	*
Undeveloped	Kabupaten Tangerang	(1) Each permit is provided by each related section	-	-
Half way	Kota Bandung	(1) Permit related office is gathered at one place Even though, investors have to visit to submit each documents and pick up them, it is done in a place	-	*
Undeveloped	Kota Medan	(1) Investors have to go around each different related government office to submit and collect documents (2) The offices are scattered	-	-

4) A recent new initiative by The Ministry of Home Affairs

An important regulation regarding “One door service” was issued in July 2006. It is Regulation of Minister of Home Affairs: No.24/2006 (July 2006) The Regulation relates the execution of one roof service in all local governments. The regulation consists of the followings.

■ Preface

■ Chapter 1: Definition

Article 11: One door integrated service means that all procedures from application to issue of permits are done and managed at one place.

■ Chapter 2: Purpose and Target

Article 2: Its purpose is to enhance quality of public service and to provide wide access for the public service

Article 3: Targets are realization of speedy, low cost, simple, transparent service

■ Chapter 3: Simplification of service

Article 4: Bupati and mayor are obliged to implement simplification of public service through one door service

■ Chapter 4: Implementing body

Article 5: Stipulated in current law and regulation

Article 6: Bupati and mayor delegate its signature to head of the service unit

■ Chapter 5: Procedure, Time , Cost

Article 11: Service will be completed within 15 working days after receipt of documents

■ Chapter 6: Human resources

■ Chapter 7: Disclosure of information

■ Chapter 8: Disposition of complaints

■ Chapter 9: Public's satisfaction

■ Chapter 10: Capacity building and supervision

Article 21: Minister of Home affairs and head of regional governments are responsible for capacity building

Article 22: Governor selects at least one kabupaten or kota as a sample area for development of one door integrated service

Article 23: Governor socializes bupati, mayor and public for smooth implementation of the one door integrated service

Article 25: Governor supervises the implementation on behalf of Minister of Home Affairs

■ Chapter 11: Cooperation

■ Chapter 12: Report

■ Chapter 13: Transition

Article 29: Each area is obliged to set an office for integrated one door service within one year

Article 11 of Chapter 5 is especially noted because it promises 15 working days for completion of one service operation after receipt of proper documents.

In order to realize the process, following five conditions are to be met. First, it is necessary to obtain understanding on the necessity of integrated service. In this regard, bupati or mayor's strong initiatives for reform are imperative. Without local government officers' understandings on how customer service is important to attract investment, it is impossible to root the concept. Second, capacity building for local government officers is necessary. Third, coordinating capacity of parties concerned is also required. It is because public servants tend to carry out their operation by themselves and without getting on the section's cooperation. Fourth, budget constraints are to be cleared. Fifth and lastly, it is indispensable to arrange plan for land utilization and construction as well as environmental restriction by zone area in advance and streamline duration for evaluation and check. In this sense, city planning is important.

The above Regulation obliges each local government to realize one roof service within one year. The target is not so easy to be cleared. Technical cooperation by donor countries may be necessary.

## **2.3.8 Reform at the Second Generation: “Integrated Service”**

### **(1) Introduction**

What is expected after the reform at the above first generation is the so-called integrated service. Here, “Integrated service” is defined as follows. It is to tie up various investment approval processes in one batch or one line under one authority as much as possible. Suppose that an investor has to visit five offices for obtaining five different documents for a license. In case these five offices are managed by different ministries or departments under different principles and they are located in different places, and in addition, the investor has to consume much time in obtaining the documents. If these documents are packed in only one document and license is provided with the document, the investor feels very convenient. The purpose is to enhance investors’ convenience by making the procedure short and inexpensive as much as possible among various parties concerned. Thus the service is exclusively designed for convenience to investors. From this view point, the best and desirable system is one under which investors could obtain all of approval and permits or licenses necessary for implementation of their investment. Therefore, as a matter of course, the service includes not only central government operation also local governments one. The key concept for the “Integrated service” is summarized as follows.

- A tracking system is established including the whole process from issue of the SP to issuance of local permits and the IUT
- One- door or one stop or one roof service is available for investment approval
- Integrated service covers not only central government permits but also local permits. However it dose not include promotion related services. Thus integrated services mean administrative ones on investment.
- Duration and cost for obtaining approvals , permits and licenses are minimized.

### **(2) Reasons why integrated service is necessary**

Every country is eager to attract FDI. Not only Indonesia but also countries, which at present are succeeding in attracting FDI such as Viet Nam and China, are stepping up their efforts to attract FDI. Under this environment, winners in this competition are those countries which are able to adjust themselves to the following environmental changes.

- Mounting importance of capability of providing services which customers need, not services which countries can provide
- Mounting importance of identification of customers’ needs
- Mounting importance of flexibility
- Mounting importance of speed
- Mounting importance of full utilization of information technology
- Mounting importance of speedy response to global standard

To achieve the adjustment, cooperation among different governmental organization is indispensable.

In the forthcoming New Investment Law, the Government refers to “Integrated Service”. Current investment approval procedure is carried out by different type of players. These players act on the basis of their different roles and functions, which are stipulated by each governing law and regulation. Therefore, the weight of investment approval operation in their total duties differs as is shown in Table 2-48. BKPM is specialized, but investment approval is only a small part of their business for the local government. The philosophy of their work is also different. Under this situation, it is hard to get these different organizations together. It is only going to be possible by a forging a deliberate linkage based on the common interest of these organizations.

**Table 2-48 Different Importance of Investment Approval Procedure by Institution**

Player	Weight of FDI related operation	Interest in FDI	Priority for FDI operation
BKPM	+++++	+++++	+++++
Notary public	++	+	-
The Ministry of Justice	++	+	-
Tax office	+	+	-
Bank	+	+	-
Municipal office	+	+	-
Local government	++	++	-
Department of Commerce at local government	+	+	-

Note: Evaluation by JICA study team

When integration is realized in the process of a new company’s registration, the time will be shortened because in this stage investors have to visit local municipal, bank, Ministry of Finance and the Department of Trade and Industry at the regional government to obtain the necessary documents for the registration. Once the process is integrated and the process is handled as one-roof service, the time of the registration will be drastically shortened.

### (3) Steps for realization of integrated service

Under the current situation that central government and regional government compete with each other over their role and function in management of permit administration for FDI, it is difficult to realize integrated service at once. It is recommended to adopt a step by step strategy. The steps consist of following four.

- First step: Streamline each process as much as possible (includes realization of one roof service at local governments)
- Second step: Harmonize basic documents used for investment approval procedure in

each actor

- Third step: Cooperate in a direction of realizing call-center
- Forth step: Consolidation of process through decentralization

Since the first step has already been explained in details, here the second and the third steps are discussed. The last and fourth stage is discussed in the next section

#### 1) Harmonize basic documents used for investment approval procedure in each actor

Now that each process has been streamlined to some extent, it is necessary to harmonize these independent processes on the same principles and same information. For example, both BKPM and Ministry of Justice and Human Rights refer to negative list in fulfilling their investment approval procedure. In this case if they interpret the list differently, their procedure become in a mess. It is advised to share “same” information and to proceed each function based on the same information. Coordination between both is imperative.

#### 2) Establish a call center in BKPM

It is proposed to establish a call center in BKPM and invite other key players cooperate in the management of the center by sending in necessary information on-line. The idea is as follows (Refer to Figure 2-17).

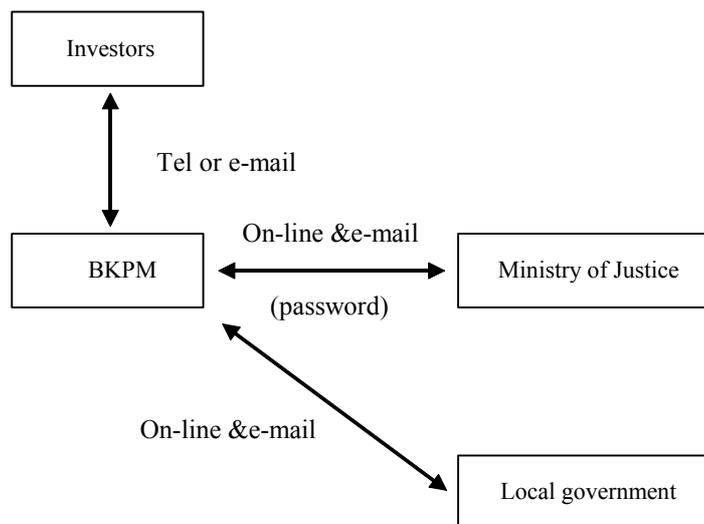
- BKPM establishes a call center dedicated to serving investors
- The function of the center is to provide information in response to investors’ inquiries on the timely processing of work on their project applications
- Source of information: BKPM, the Ministry of Justice and Human Rights, and Local government
- Technical aspect: service will be provided through BKPM’s website
- Information to be provided: To what extent the investment application procedure has advanced and where the procedure has stopped (if this is the case)
- Reference number for the inquiry: the SP number issued by BKPM

In this regard, BKPM has already established a form of a tracking system in March 2003. Investors can learn of or verify the status through accessing the website. The system facilitates the work of investors in tracking the current status of procedures. The areas covered are issuance of the SP, the Master list, and the IUT. Issuance of TA01, RPTK, IMTA and APIT documents is not included. The reason is lack of budget and not a technical one. Further, information on the SK is not covered. This is due to lack of budget funds and lack of coordination with the Ministry of Justice. Local permits are not included too because of lack of budget funds and lack of a system at the level of regional governments. An senior officer at Bureau for Planning & Information says that so long as the matter is well coordinated among BKPM, the Ministry of Justice, the Ministry of Manpower and regional governments, and the necessary budget funds are secured, it is not difficult for the current tracking system to be

expanded to encompass all stages of investment license related procedures

In future, e-process in investment application procedure should be introduced so that investors might be able to access to BKPM for investment application from their home countries. However, For the moment, the above mentioned establishment of call center should be given priority.

**Figure 2-17 Basic Concept of a Call Center**



With respect to communication, considering the distribution of FDI shown in Table 2-49, the following local governments will be given first priority. They are Jakarta Central Territory, West Java, Bali, and Banten..

**Table 2-49 Number of FDI Approvals by Area**

	2000	2001	2002	2003	2004	2005
Jakarta Central Territory	771	604	603	582	562	722
West Java	225	225	207	157	188	240
Bali	127	120	90	88	125	199
Banten	128	114	80	74	79	104
Others	348	213	258	337	272	383
Total	1,599	1,376	1,238	1,238	1,226	1,648

Source: BKPM

The above idea on a call center is only one step for integrated service. For rendering full-fledged service on investment approval procedure, consolidation of central government permit and local government permit is inevitable. However, it involves the arguments on centralization or decentralization of permits administration.

### 2.3.9 Centralization vs. Decentralization

#### (1) Definition of centralization and decentralization

It is not so easy to define the two concepts. Two different definitions are conceived. One is to define it from a view point of authorization of a deed, and the other is to define it from a viewpoint of place where the deed is carried out. The former is based on who has an authority to issue approval and permit, and the latter is where the approval and permit are issued. Taking an example, issue of customs approval letters is authorized to the Ministry of Finance even under a concept of “regional autonomy”, therefore, from a viewpoint of authorization, wherever it is issued in the central government or its regional office, current framework is centralization. It is because the power of issue is not delegated to regional government. However, if the issue is done not in central government office, say, Jakarta, but in its regional office, it could be considered as decentralization from a viewpoint of convenience for investors. It could be called as “Quasi-decentralization”. When the former definition is followed, as is shown below, only SP is a subject for discussion for future. It is because, by nature, custom approval letters and labor permits are by nature granted by central government or its delegation to related institutions (Table 2-50).

**Table 2-50 Centralization vs. Decentralization**

Case	Issue of approval or permit	Centralization	Decentralization
1	By central government itself	* (SP)	
2	By regional office of central government or BKPM	* (Master list)	
3	Delegated to a person in Rep. Office of central government or BKPM	* (Labor permit)	
4	By provincial or local government		* (SP)

#### (2) Three options

Concerning who should issue SP (may be IUT too), there are following three alternatives.

- Case1: Centralization and current system.
- Case2: Decentralization
  - Case 2-1: Regional government handles all of SP and IUT
  - Case 2-2: Local government handles SP and IUT
  - Case 2-3: All of three institutions, say BKPM, regional government and local government, have a chance to deal with SP and IUT. BKPM handles SP and IUT for national strategic projects. Regional government handles SP to IUT for projects, activity of which covers plural local governments. For projects that are related to only one local government, the local government handles everything, say Case 2-2. Criteria

of function sharing among the above institutions may be 1) strategic position of the project, 2) degree of spill-over effect of the project, and 3) investment amount of the project.

- Case3: Leave the selection of place for obtaining investment approval to investor's decision.

When Case 2&3 is selected, as a matter of fact, custom approval letters and work permits are to be issued by Ministry of Finance's and Ministry of Manpower's regional office.

The above is summarized in Table 2-51.

**Table 2-51 Summary Table for Options for Investment Approval Procedure**

Case	Type	SP	Master list	Work permits	Local permits	IUT	SK
Case 1 (currently)	Centralization	BKPM	BKPM	BKPM	Local government	BKPM	MOJ
Case 2							
2-1 (Central Java province and North Sumatra in the past)	Partial decentralization	Regional government	MOF's regional office	Ministry of Manpower(MOM)'s regional officet	Local government	Regional government	MOJ
2-2	Partial decentralization	Local government	MOF's regional office	MOM's regional office	Local government	Local government	MOJ
2-3	Partial decentralization	BKPM/ Regional government /local government depending on project type	BKPM/ MOF's regional office	BKPM / MOM's regional office	Regional government /local government depending on project type	Regional government /local government depending on project type	MOJ
Case 3 (Jakarta province, currently)	Investor's decision	BKPM or regional or local government	BKPM or MOF's regional office	BKPM or MOMs regional office	Local government	BKPM or regional or local government	MOJ

Footnote: MOJ: The Ministry of Justice

Among these options, which is the best? As far as one-roof service for investment approval is concerned, the current system centralized in BKPM seems to be better. Both of hard and soft infrastructures for achieving one-roof service have been already completed.

However, two problems remain to be solved. One is that the current system is far from being and” integrated service” including all aspects of service from investment approval to local permits. The other is that the duration for each procedure is generally longer than in the case when the procedure is done by the regional or local government. Interviewed regional and local government officers say that they can execute the same procedure as the central government but in a shorter time. How will investors evaluate this point?

Considering that the investment approval operation is to be followed by filing for and obtaining local government permits, it seems better to leave the operation to regional or local government as much as possible. The basic function of the central government or its agency is to determine the nation’s strategies and policies for FDI, and individual operation should be left to regional or local government. In this sense, Case 1 is not likely to be the best case. Case 2 seems to be better from a viewpoint of efficiency and readiness to provide the best service to investors. As for efficiency, investment approval operations are directly linked to local permit operations. As for readiness to provide the best service to investors, regional or local government feels it has an advantage in inviting investors to the regions concerned because it is obvious that the investment creates job opportunities in the region. Regional or local government naturally makes every effort to invite investment. Between Case 2-1 and Case 2-2 options, considering the following two factors, it seems better for regional governments to handle investment approval operations than local governments. First, it seems that number of foreign investment projects handled by each local government may be not so large and considering the efficiency aspect, it is not recommended to split a small pie among many local governments. Second, investment approval procedures include Customs approval letters and work permits, which originally have been matters handled by the central government, such as the Ministry of Finance and Ministry of Manpower, and authority is better delegated to regional governments than local governments in light of this. In this relation, it is conceivable that both the Ministry’s regional offices in capitol of Province handle the matter.

However, in realizing decentralization there are three points of concern. One is the regional or local government’s capability of handling the task. Is a regional or local government able to provide necessary services to investors at the same level (or at least the same level) that investors now enjoy? Considering the wide variation among regional or local governments’ capability, it may be difficult to start use of the same system at all local governments at the same time. The second is investors’ confidence in operations by regional or local governments. Since the investment approval procedure has been run by the central government for a long time, investors feel that the central government is accustomed to the operations and the investors are unlikely to want the operation done by regional or local governments. The third is efficiency. The volume of FDI varies by region. While FDI is concentrated in several provinces, other provinces have very little. However, if domestic

investment is included, a different picture appears. To make the operations in a provincial office easy, the Ministry of Labor can open its provincial office for providing work permits. At the same token, a special office for granting Customs approval letters can also be opened in the regional offices. In any event, it is essential for BKPM to extend technical support by granting investment approval authority to provincial officers. The final and fource is that, as is stated before, local governments are now required to realize one roof service for their local permits within one year. The task is a big one. Can they manage decentralization of investment approval procedure, while they are trying to do their best for realizing one roof service?

If the idea of decentralization is to be realized, how will investors react? This is a key point. In the case of FDI, investors' business generally is not confined to the area where the FDI is actually made in the sense of acquiring fixed assets. For example, even though FDI is made in Surabaya, the investor may well be targets planning on selling goods not only ion the Surabaya market but also the Indonesian market as a whole or even outside the country. In such a case the investor will try to get information in Jakarta, and therefore may select Jakarta as the place where the required investment approval procedures are followed.

Case 3 may be also realistic. However, how investors will react? In case of FDI, investor's business area is not confined to the area where FDI is realized. For example, even though FDI is realized in Surabaya, investor targets not only Surabaya market but also Indonesian market as a whole or even international market. Therefore, the investor will try to get information in Jakarta. Under such a situation, he may select Jakarta as a place where investment approval procedure is followed.. The only concern regarding Case 3 is that there is a possibility of producing confusion among investors.

### (3) A good reference of Batam Special Economic Zone

#### 1) Recent changes

Investment approval procedure for investment in Special Economic Zone is quite different from those in other areas. Basically, the procedure is fully quasi-decentralized. Every kind of procedure from SP, Master list, Working permit, local permits to IUT issued under one-roof service within the zone. Such simplicity and efficiency is one of the benefits to investors locating in the zone.

Before July 24, 2006, development of Batam special economic zone was managed by Batam Industrial Development Authority (BIDA). The authority received investment applications from investors and passed them to BKPM. BKPM handled them in the same way as other investment application in Jakarta. After July 25, 2006, however, the procedure completely changed as is shown in Table2-52.

**Table 2-52 Summary Table for Operation of Special Economic Zone In Batam**

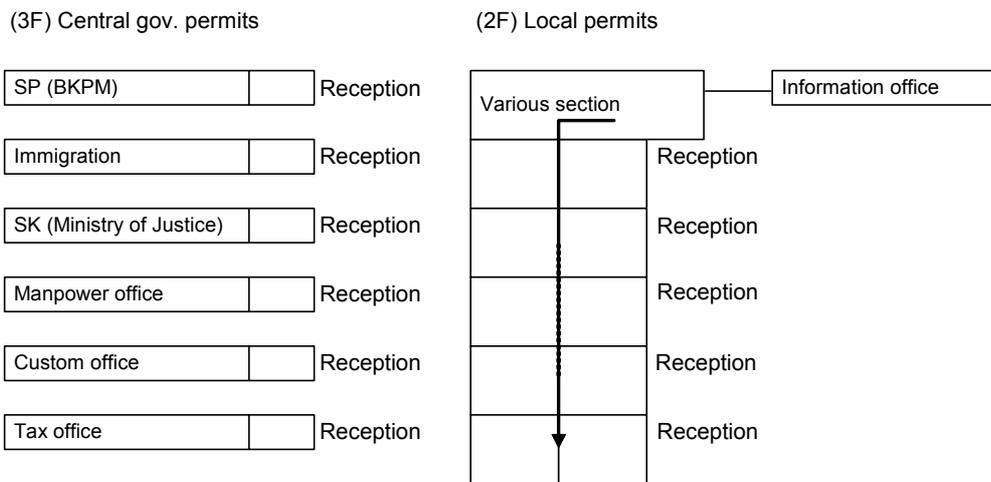
	Indonesia (Batam)	Viet Nam	Philippines	China (Shenzhen)
Legal framework	Framework Agreement Between The Government of The Republic of Indonesia and The Government of The republic of Singapore on Economic Cooperation in the Island of Batam, Bintan and Karimun Decision of Coordinating Minister for Economic Affairs (Kep-21/M. EKON/03/2006)		The Special Economic Zone Act of 1995	Free Trade Zones in Shenzhen
Authority for establishment	Unit of Integrated Capital Investment Service : Head of Public relation at Batam Authority		Philippine Economic Zone Authority (PEZA)- evaluation and recommendation Attached to Dept. of Trade and Industry Director general with the rank of a department under -secretary appointed by the President Three deputy directors: Board members: Director general, representatives of Dept, of Trade and Industry, Dept. of Finance, Dept. of Labor and Employment, Dept. of Interior and Local Government, National Economic Development Authority, Central bank	

			and investors	
Administration of each ECOZONE	Unit of Integrated Capital Investment Service	Management Board Head of Management Board is Vice Governor	Organized, administered, managed and operated by ECOZONE executive committee (1) PEZA board appoints administrator and deputy administrator ECOZONE advisory body: investor, regional and local government, labor union, PEZA	Administration of Shenzhen Free Trade Zones, a representative of Shenzhen municipal government
Operation within the ECOZONE	One roof service by UPPMT at Sumatra Promotion Center building Providers of services BKPM Ministry of Finance Ministry of Manpower Ministry of Justice Kota Batam government Batam authority	One roof service (one stop service) All related governmental offices staff are delegated in the management board	Development strategy of the ECOZONE:PEZA Survey of resources: PEZA Fiscal incentives: Presidential decree, National Internal Revenue Code Registration of business enterprises: PEZA PEZA establishes "One stop shop center" in the ECOZONE Government agencies that are involved in registering, licensing or issuing permits to investors assign their representatives to the ECOZONE	Consult with the free Trade Zones Service Center ↓ Check by the Economic Development Department ↓ Approval documents and license issued by the Administrative bureau (within 2 business days) ↓ Registers with the Shenzhen Industry and Commerce Administration (8 organizations)
Others	Integrated service except local permits will be supplied to investment in Bintan and Karimun, too			
Centralization or Decentralization	Quasai-decentralization	Quasai - decentralization	Quasai - decentralization	Decentralization

2) Current procedure

One roof service for both central and local permits is the biggest characteristics. Figure 2-18 shows the outline of both central and local permits offices. Investors can obtain every kind of permit by visiting central and local government office located in the same building of Sumatra Promotion Center. However, the service is not one door one, therefore, to obtain each permit, investors have to visit each office and submit necessary documents and pick up permit one by one.

**Figure 2-18 Office for Central and Local Permits at Batam SEZ**



Followings are a brief explanation for each operation.

■ Investment Approval Letter (SP)

While it takes about 7-8 days to get SP in Jakarta, it takes only 1-2 days in Batam, An officer in charge of the operation quotes the reasons for so speedy operation as few internal checks which are so many in Jakarta and as easy and simple check of negative list. Actually, the BKPM's Batam office handled ten investment projects in July 25 - Sept.4, 2006 and average time for the issuance of SP was 1.4 days. The Batam case shows that it is quite possible to streamline the process which is done in Jakarta.

■ Company registration (SK)

Regional office of Ministry of Justice issues SK. A senior officer says that the procedure is the same as in Jakarta, but duration for the operation is only 5 days, while it is two weeks in Jakarta. Here, procedure step is only 1 to 2, while it is 6 to 7 in Jakarta. Number of notary public counts 50 in Batam and Regional office of Ministry of Justice contacts with them for issue of SK. The office is delegated to issue SK, though check of the name is done through on-line system in Jakarta. Since the number is small, communication between the office and them is quite smooth. This is one of reasons why duration for procedure of SK issue is quite short compared in Jakarta, the senior officer says.

■ Local permits

The sections handle not only commercial investment projects but also individual non-commercial projects such as housing. After officers receive documents investment documents from investors and evaluate the investment projects, they recommend the approvals to technical advisers at local government office. When they get approval, they inform investors and provide permits. The process is followed one by one in line with a process. Total duration for investors to get permits depends on type of investment, but as for standard one, it takes around 70 days.

People working in the Center look like rather young and half of them are women. Reflecting it, the atmosphere at the work place is good and bright. This may be another reason why operation time is rather short. In addition, windows for operation are quite open, therefore, there seems no room for inducing corruption.

(4) Experiences in decentralization or quasi-decentralization

1) The case in BKPMMD in Central Java

BKPMMD in Jakarta has already been involved in investment approval procedures and so far there has not been any problem. BKPMMD in Semarang, the capital of Central Java, also had experience in handling the procedure in the past. Until a few years ago, the BKPMMD had issued not only the SP but also Customs approval letter under the support of the SUCOFINDO foreign workers employment permit and IUT. Only company registrations were executed through local notaries. The number of projects handled by them is shown in Table 2-53

**Table 2-53 Number of Project Handled by BKPMMD in Central Java**

Year	PMA (No)	(Amount, US\$ thousand)	PMDA(No)	(Amount,Rp million)
2000	56	598,371	34	2,451,203
2001	57	96,681	26	2,912.197
2002	44	91,765	14	1,541,259
2003	57	80,018	21	3,607,653
2004	46	3,086,867	17	5,608,617
2005	47	610,431	20	1,912,677
2006( Jan.-Jun.)	20	27,779	2	299,921

Source: BKPMMD, Central Java

2) The case in North Sumatra

The case in North Sumatra is informative in considering which way is better,

centralization or decentralization of investment approval operations. The province acquired experience in three different procedures in the past, as follows.

#### Between 1999-2002

Under the philosophy of regional autonomy, as stated in the Regional Autonomy Law No 22, 1999, the investment approval procedure was transferred to regional governments. As a result, BKPM became responsible for issuing SPs. In addition to SPs, the office also issued labor-related permits, Customs approval letters (Master list) and IUTs, though they needed SCOFIND's support for the Master list. SCOFINDO had its regional office in Medan. Company registrations were done through notaries.

#### Between 2001- August 2004

Considering that authority to issue a Customs approval letter by its nature is not to be transferred to regional governments, the Ministry of Finance returned the operation for Master list to the central government and delegated the operation to BKPM. As a result, BKPM issued the SP, labor-related permits and the IUT. Investors were requested to get Master list from BKPM.

#### From August 2004 to now

In April 2004, a new Presidential decree (No. 29, 2004) was issued to establish one-roof service for the investment approval procedure. In the decree, BKPM became a responsible organization executing one-roof service based upon the delegation of authority by the related ministers. All operations have come to be taken over by BKPM. To comply with the above Presidential Decree No. 29, 1999, it was stipulated that regional governments could delegate authority to grant approvals to BKPM.

### 3) The case in South Sulawesi

As BKPM in North Sumatra has done, BKPM in South Sulawesi also has experienced large changes in investment approval operations in the past five years.

Before 1999 when the regional autonomy policy was introduced, BKPM handled investment approvals only for PMDA projects, the investment cost of which did not exceed Rp 10 billion, while other projects were handled by BKPM in Jakarta. After the regional autonomy concept was introduced, BKPM began to handle the whole investment approval procedure as is indicated in Table 2-54, . BKPM began to issue related documents covering not only SP, APIT, IUT, but also the Master list and labor-related approvals such as RPTK and IKTA. As for the Master list, it has been handled under an understanding that the Ministry of Finance entrusted BKPM in Jakarta with the issuance and the BKPM delegated its operations to BKPM. BKPM handled the procedure with the cooperation of

SUCOFINDO in Macassar. On the other hand, as for labor-related approval, the labor office in the central government transferred its operations to the labor office in the province.

The officers in charge of the matter in the labor office were dispatched to BKPM. While the number of PMA projects numbered only around 5 a year, the number of PMDA projects was around 20 a year. Since August 2004, the investment approval operation was transferred to BKPM in Jakarta; therefore, the BKPM is not involved in the procedure any more. A booklet introducing the potential advantages for foreign direct investment in South Sulawesi was published as the 2005 edition in 2004. The booklet is still in use and is being distributed. In it is stated what kind of documents BKPM issues, as follows. This will be rewritten next year.

**Table 2-54 Issuance of Investment Approval Documents in South Sulawesi**

	Approval	Issuer
1	SP for PMA	BKPM
2	APIT	BKPM
3	RPTK	BKPM
4	TA01	BKPM
5	KITAS	Macassar immigration office
6	IKTA	BKPM
7	Master list	BKPM, SUCOFIND, Customs office in the Province
8	Location permit	Local government
9	Nuisance Act permit	Local government
10	Construction permit	BKPM
11	Land use title	BKPM
12	IUT	BKPM

Source: Standar Pelayanan Bisnis Investasi, Propinsi Sulawesi Selatan 2005

As to decentralization, one officer at BKPM says that he has no objection to transfer investment approval operations to the local government level, but, even in such a case, BKPM wants to be involved in approval of investment projects which cover plural local governments or investment cost of which is fairly large. The officer stressed the importance of coordination and cooperation between the regional government responsible for the overall development plan of the province and local government.

(5) Comparative study in other Asian countries

Judging which is desirable between centralization and decentralization for investment approval procedure, comparative study in other Asian countries was conducted.

1) Viet Nam: Partial decentralization

A salient feature of procedures for issuance of investment licenses is decentralization as is shown in Table 2-55. The prevailing government decree, “ Providing Detailed Regulations on the Implementation of the Law on Foreign Investment in Viet Nam,” issued July 31, 2000, stipulates as follows.

- An investment license shall be issued by the Ministry of Planning and Investment. However, this function is to be delegated to regional governments with the exception of Group A and B projects and specific projects in the table below.
- Authority to make decisions on investment projects differs by type of project as follows. It is noted that BOT, BTO and BT projects are classified as Group A projects.

**Table 2-55 Investment Approval Procedure in Viet Nam**

The Prime Minister	Ministry of Planning and Investment	Provincial People’s Committee
*Group A projects *At least 40 million US\$ projects in some sectors *Projects using at least 5 hectares of urban land or at least 50 hectares of land of other categories	*Group B projects	*Projects excluding the left two

(Note)

Group A projects:

- Infrastructure construction of industrial zones, export processing zones, high-tech zones, urban areas; BOT, BTO and BT projects
- Construction and operation of sea port and airports; operation of sea and air transportation
- Oil and gas
- Post and telecommunication services
- Culture; publishing, press; radio and television broadcasting, medical examination and treatment establishments; education and training; scientific research and production of medicines for human inspection
- Insurance, finance, auditing and inspection
- Exploration and exploitation of rare and precious natural resources
- Construction of residential houses for sale
- National defense and security projects

Group B projects

- Construction of national roads or railways
- Production of cement, metallurgy, electricity, sugar, alcohol, beer and cigarettes
- Manufacture and assembly of automobile and motorbike

There are two types of procedures. One is just registration and the other is accompanied with evaluation of projects before granting investment licenses. In accordance with the recent revision of the Investment Law, the procedure has been altered as follows, though detailed procedure is not yet announced (Table 2-56 and 57).

**Table 2-56 Process of Investment Approval under the Old Law in Viet Nam**

Procedure	Registration only	Evaluation necessary
Projects	<p>(1) Not belong to Group A</p> <p>(2) Not belong to the list of projects in respect of which environmental impact assessment reports must be prepared, and</p> <p>(3) Satisfy one of following conditions- export all their products, invest in an industrial zones, belong to manufacturing sector(invested capital of up to 5million US\$ and export ratio is more than 80%</p>	Other projects than listed left
Files	<p>(1) Application for license</p> <p>(2) Charter of company established</p> <p>(3) Documents verifying legal status and financial position</p>	<p>(1) Application for license</p> <p>(2) Charter of company established</p> <p>(3) Economic-technical explanatory statement</p> <p>(4) Documents verifying legal status and financial position</p> <p>(5) Documents relating to technology transfer, if any</p>
Aspects to be evaluated	None	<p>(1) Legal status and financial position</p> <p>(2) The socio-economic benefits</p> <p>(3) Applied technical and technological level, effective use of natural resources, the protection of environment</p> <p>(4) Appropriateness of land use</p>
Evaluation organization	None	<p>(1) Ministry of Planning and Investment (collecting opinions from related ministries, their branches and provincial people's committee)</p> <p>or</p> <p>(2) Provincial People's Committee (collecting opinions from related ministries and their branches)</p>
Approval	Within 15 working days from the date of receipt of proper documentation	<p>(1) In case evaluation is made by Ministry of Planning and Investment</p> <p>1) Group A projects: Within 45working days from the date of receipt of proper documentation</p> <p>2) Group B projects: Within 30 working days from the date of receipt of proper documentation</p> <p>3) Other projects: Within 18 working days from the date of receipt of proper documentation</p> <p>(2) In case evaluation is made by provincial</p>

Procedure	Registration only	Evaluation necessary
		People's Committee Within 48 working days from the date of receipt of proper documentation
License-issuing body	Provincial People's Committee	(1) Ministry of Planning and Investment or (2) Provincial People's Committee

**Table 2-57 Process of Investment Approval under the New Law in Viet Nam**

Type of project	1.	2	3	4
Article	46	47	48	49
Invested capital	Less than 300 billion VDN	More than 300 billion VDN	More than 300 billion VDN	Less than 300 billion VDN
Conditions for Investment	None	Yes	None	Yes
Issued certificate	Investment Certificate	Investment Certificate	Investment Certificate	Investment Certificate
Evaluation	Unnecessary	Necessary	Necessary	Necessary
Investment procedure	<ul style="list-style-type: none"> <li>■ Registration at Provincial State administrative body</li> <li>The body issues investment certificate</li> </ul>	<ul style="list-style-type: none"> <li>■ First, evaluation will be done. If the project clear the evaluation, investment certificate is provided.</li> <li>The Government shall provide regulations on the State body which has authority to evaluate investments and issue certificates</li> </ul>	<ul style="list-style-type: none"> <li>■ First, evaluation will be done. If the project clear the evaluation, investment certificate is provided.</li> <li>The Government shall provide regulations on the State body which has authority to evaluate investments and issue certificates</li> </ul>	<ul style="list-style-type: none"> <li>■ First, evaluation will be done. If the project clear the evaluation, investment certificate is provided.</li> <li>The Government shall provide regulations on the State body which has authority to evaluate investments and issue certificates</li> </ul>
Files to be submitted	<ul style="list-style-type: none"> <li>(1) Legal status of investor</li> <li>(2) Outline of project</li> <li>Invested capital</li> <li>(3) Report on financial ability</li> <li>(4) Land use requirements</li> <li>(5) Proposal for investment incentives, if</li> </ul>	<ul style="list-style-type: none"> <li>(1) Written request for issuance of investment certificate</li> <li>(2) Legal status of investor</li> <li>(3) Report on financial ability</li> <li>(4) Eco-technical explanatory statement</li> <li>(5) Charter of</li> </ul>	<ul style="list-style-type: none"> <li>(1)Written request for issuance of investment certificate</li> <li>(2) Legal status of investor</li> <li>(3) Report on financial ability</li> <li>(4) Eco-technical explanatory statement</li> <li>(5) Charter of</li> </ul>	<ul style="list-style-type: none"> <li>(1) Written request for issuance of investment certificate</li> <li>(2) Legal status of investor</li> <li>(3) Report on financial ability</li> <li>(4) Eco-technical explanatory statement</li> <li>(5) Charter of enterprise</li> </ul>

Type of project	1.	2	3	4
	any	enterprise	enterprise	
Time-limit for grant	<ul style="list-style-type: none"> <li>■ Within 15 working days from the date of receipt of proper documentation</li> </ul>	<ul style="list-style-type: none"> <li>■ The time limit for evaluation shall not exceed 30 working days from the date of receipt of proper documentation. The date could be extended up to 45 working days</li> </ul>	<ul style="list-style-type: none"> <li>■ The time limit for evaluation shall not exceed 30 working days from the date of receipt of proper documentation. The date could be extended up to 45 working days</li> </ul>	<ul style="list-style-type: none"> <li>■ The time limit for evaluation shall not exceed 30 working days from the date of receipt of proper documentation. The date could be extended up to 45 working days</li> </ul>

Source: Based on The New Investment Law

Under the new law which was into effect on July, 2006, every FDI project is processed by State government (regional government in Indonesia), regardless of necessity of evaluation and investment cost. In this sense, decentralization policy is adopted. However, the details are not yet announced on who is responsible for evaluation and how approval is issued.

#### Thailand

Unlike in Viet Nam, investment approval procedure in Thailand is centralized. Three types of application are available as follows (Table 2-58).

**Table 2-58 Investment Approval Procedure in Thailand**

Type	1: Investment with incentives by BOI	2. Investment without any incentive	3. Investment with incentives by IEAT
Organization for application	Board of Investment	Ministry of Commerce	Industrial Estate Authority of Thailand
Process	(1) Case 1: applied by the name of newly established company (2) Case 2: applied by the name of individual		
(1) Required time for obtaining license	(1) Case 1: 95 days (2) Case 2: 105-110 days	10-15 days	10-15 days
(2) Procedure	(1) Case 1: 1) Register at Ministry of Commerce (10 days) 2) Apply in BOI and approval (60 days) 3) Issue investment promotion certificate by BOI (20 days)	Register at Ministry of Commerce (10-15 days)	95-110 days

Type	1: Investment with incentives by BOI	2. Investment without any incentive	3. Investment with incentives by IEAT
	<p>4) Obtain permission to employ foreign workers and apply to tax exemption treatment for equipment and raw materials(BOI,15 days) Register land ownership and house, corporate tax payer and VAT and obtain permission of factory construction and operation (line ministries, 15 days)</p> <p>(2) Case 2:</p> <p>1) Apply incentives to BOI (60 days)</p> <p>2) Issue investment promotion certificate by BOI (20 days)</p> <p>3) Register the company at Ministry of Commerce (10days)</p> <p>4) Obtain other permit (15-20 days)</p>		
Reference	Other permit than BOI's permit can be obtained in 15-20 days when BOI provides its license		

In Thailand, the major concern is whether incentives are granted or not, therefore, in case investors do not expect any incentives, it is rather easy to obtain investment approval.

### The Philippines

Investment approval procedure differs by type of investment as is shown in the following Table2-59. Decentralization is characteristic. In case an investment dose not to need any incentive, approval procedure required is only registration.

**Table 2-59 Investment Approval Procedure in the Philippines**

Type of investment	Investment with incentive	Investment without incentive	Investment in special economic zone
Governing law	<ul style="list-style-type: none"> <li>■ The Omnibus Investments Code of 1987</li> </ul>	<ul style="list-style-type: none"> <li>■ Foreign Investments Act of 1991</li> <li>■ Implementing Rules &amp; Regulations</li> </ul>	<ul style="list-style-type: none"> <li>■ Special Economic Zone Act of 1995</li> </ul>
Approval and registration procedure	<ul style="list-style-type: none"> <li>■ Application ~</li> <li>■ Evaluation ~ Approval ~Registration</li> </ul>	<ul style="list-style-type: none"> <li>■ Registration only (required to submit complete documents)</li> </ul>	<ul style="list-style-type: none"> <li>■ Application ~</li> <li>■ Evaluation ~Approval ~ Registration</li> </ul>
Responsible organization for procedure	<ul style="list-style-type: none"> <li>■ Decentralization</li> <li>• The Board of Investments(attached to DTI):Adopt rules and regulations</li> <li>• BOI can delegate the process to DTI's regional office</li> </ul>	<ul style="list-style-type: none"> <li>■ Decentralization</li> <li>• Foreign corp., domestic corp. or partnership: SEC or its extension office</li> <li>• Single proprietorships: BTRCP or DTI or their provincial office</li> </ul>	<ul style="list-style-type: none"> <li>■ Decentralization</li> <li>• Philippine Economic Zone authority (PEZA)(attached to the DTI)</li> </ul>
Time required for approval and registration	20 days	15 days	No description
Incentives	<ul style="list-style-type: none"> <li>■ Income tax holiday</li> <li>■ Additional deduction for labor expenses</li> <li>■ Tax and duty exemption on imported capital equipment</li> <li>■ Tax credit on domestic capital equipment</li> <li>■ Exemption from contractor's tax</li> <li>■ Simplification of custom procedures</li> <li>■ Employment of foreign nationals</li> </ul>	None	Fiscal incentives
Negative list	<ul style="list-style-type: none"> <li>■ List A: Reserved to Philippine nationals: SME</li> <li>■ List B: regulated by law: defense-related activities, implications on public health and morals</li> </ul>	<ul style="list-style-type: none"> <li>■ List A: Reserved to Philippine nationals: SME</li> <li>■ List B: regulated by law: defense-related activities, implications on public health and morals</li> </ul>	
Other remarks	<ul style="list-style-type: none"> <li>■ Percentage share of foreign capital is limited up to 40% except the following</li> </ul>	<ul style="list-style-type: none"> <li>■ Scheme for "Pre Processing of Documents"</li> <li>■ Two kind of</li> </ul>	<ul style="list-style-type: none"> <li>■ Vested with the status of a separate customs territory</li> <li>■ One stop shop center</li> </ul>

Type of investment	Investment with incentive	Investment without incentive	Investment in special economic zone
	<p>cases</p> <p>(1) Pioneer project</p> <p>(2) Export ratio is more than 70%</p> <p>■ Evaluation criteria</p> <p>(1) Extent of ownership and control by the Philippine citizens</p> <p>(2) Economic rate of return</p> <p>(3) Measured capacity</p> <p>(4) Amount of foreign exchange earned</p> <p>(5) Extent to which labor, materials and other resources obtained from indigenous sources are utilized</p> <p>(6) Extent to which technological advanced are applied</p> <p>(7) Amount of equity</p>	<p>investment</p> <p>(1) For domestic market: 100% possible, but is required to increase the share of domestic corporation gradually</p> <p>(2) For export market: more than 60% of its products</p>	<p>(all appropriate government agencies assign their representatives to the ECOZONE to attend to investor's requirements)</p>

### China

Detailed investment approval procedure is shown in "Procedures of The People's Republic of China for The Registration and Administration of Chinese-Foreign Joint Ventures", 1980. An outline of this is as follows.

- 1) The Foreign Investment Commission of the People's Republic of China approves the joint ventures within three months after the investor submits the necessary documents.
- 2) Having received approval, the joint venture registers with the General Administration of Industry and Commerce of the People's Republic of China within one month. The documents investors are requested to submit are rather simple.
- 3) Registration is handled by administrative bureau for industry and commerce of the provinces, autonomous regions and municipalities directly under the central authority. In this sense, the procedure is decentralized.
- 4) General Administration for Industry and Commerce of the People's Republic of China issues a business license after an examination.

### (6) Desirable solution

Considering that

- It is necessary to disperse concentrated economic activities in Jakarta to regional areas for balanced economic growth of Indonesia,

- It is necessary to take harmonization with regional development into account,
- An important procedure of local permits follows after central permits
- Indonesia is not prepared for specific investment incentives which need evaluation for beneficiaries,
- With streamlining of investment approval procedure, it is not difficult for regional or local government to handle the operation,
- Investors enjoys more speedy investment approval procedure, decentralization seems to be desirable. However, if investment projects are categorized as national strategic ones or special projects for which special incentives are provided, investment approval procedure by central governments will be justified. As such projects, following ones are listed, though it is not limited to them.
- Food crops and plantation
- Forestry
- Fishery
- Oil & gas resources and minerals
- Infrastructure construction of industrial zones, export processing zones, highech zones, urban areas; BOT, BTO and BT projects
- Construction and operation of sea port and airports; operation of sea and air transportation
- Post and telecommunication services
- Cluster-oriented SEZ (Refer to Box. 2.7)

Current import duty incentives for capital goods and raw materials provided by Indonesian government will not be included in special incentives because it is standard one and is provided to every project which satisfies standard qualification.

In addition, how decentralization is properly rooted depends on local community's maturity on serenity. In case the community is obsessed in corruption, decentralization does not bear any fruit.

#### **Box.2.7 Development of a Salmon Cluster in Chile**

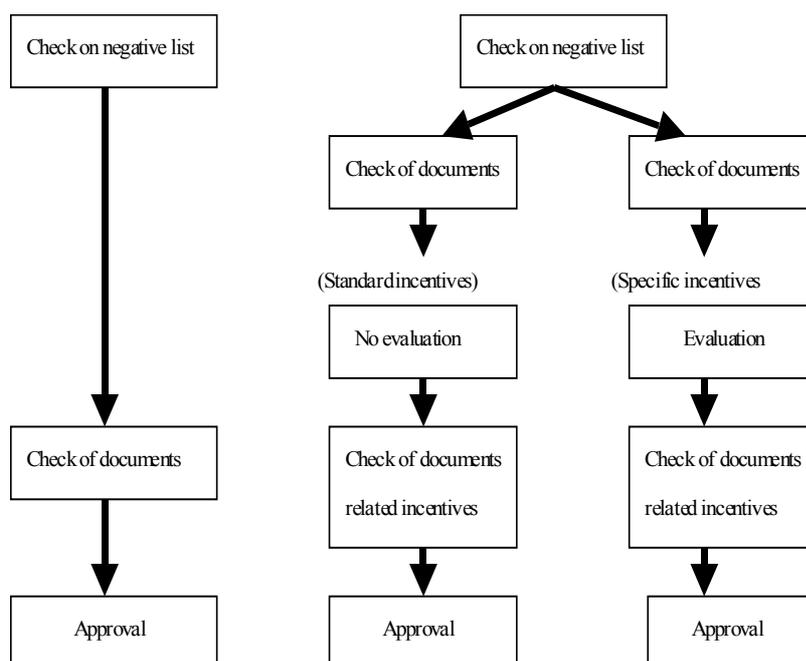
The cluster began to develop in the middle of 1980s in the 10th region of Chile. With the development, production volume of salmon expanded year by year and reached around 400 million tons in 2001 from only 2 million tons in 1987. The production share in the world market also increased from 2% in 1987 to 32% in 2001. Most of the current production is directed to the world market and it earned US\$964 million in 2001, thus being one of major exporting industry as well as copper concentrate. It is beyond our imagination how the salmon cluster is diversified, high technology oriented and involves various industrial sectors from fish cultivation, manufacturing to service sectors. Number of company engaged in the business counts 200 and their total employee is almost 41,000. Among 41,000, about 29,000 people are engaged in cultivation process and the rest 12,000 people work for manufacturing sectors such as processing for export and for service sectors such as net

workshops and transportation.

Competitive advantages are excellent water resources, availability of low cost feed of anchovy and long daytime. However, the most important key to success is institutional supports from Chilean government and academic circles such as university on introduction of appropriate regulation, productivity improvement and technological development, and human resources development. The cluster evolved in the three stages. In the first stage, a stage of collective learning by cultivators, several institutional buyers supported their business as a leading actor, mainly in finding international markets. In the second expansion stage, producers as main actors established cooperation networks among them and succeeded in securing scale merits. In the third and current stage, under globalization, international buyers consortiums, as main actors, maintain the industry's competitiveness and sustainability by placing suppliers' products in international market under competitive price. It is only a matter of salmon, however, the Chilean salmon cluster is so multinational, technology oriented and international business. Actually, the business goes beyond a cultivation of fish. In order to maintain their international competitiveness, the managers are taking a strategy of out sourcing and it gives a birth to many new service business.

Study of other countries' procedures as well as Indonesian procedures shows that the procedure should be like the following. There seems to be three types of procedures as is shown in Figure 2-19. The types differ according to whether incentives will be provided or not. Here, incentives include import duty incentives for capital goods and raw materials such as is provided in Indonesia. However, it is categorized as a standard incentive.

**Figure 2-19 Basic Investment Approval Procedure**



- |   |   |                                     |
|---|---|-------------------------------------|
| • Check of appropriateness of documents | • Check of appropriateness of documents | • Intensive evaluation              |
| • Decentralization is possible          | • Decentralization is possible          | • Centralization / Decentralization |
| • Less time-consuming                   | • Theoretically less time-consuming     | (In case of SEZ)                    |
|   |   | • Theoretically time-consuming      |

### 2.3.10 Future Prospect for BKPM's Investment Approval Operation

#### (1) What is BKPM?

BKPM has two different appearances, one of a regulator and the other of a promoter. It seems that both are contradictory, but it is not. Needless to say, BKPM's essential function is not to regulate but to promote investment. Then, how these two different functions are harmonized? The answer to the question is as follows. First, BKPM's main function is promotion. Second, however, as a nation's interest, it is natural for a government to regulate some areas for or types of foreign investment. Therefore, the government stipulates Negative list. Investors are required to check whether their investment is in the list or not in advance. However, it is not so easy for foreign investors to check it by themselves. Even if it is not impossible, it takes much time to do so. BKPM supports investors for the check, or in other words, BKPM checks it on behalf of investors. Considering as such, BKPM is fundamentally not a regulator but a facilitator of investment. Investment approval letter (SP) is actually a kind of passport provided to investors. Once investors obtain SP, they are entitled to access to various convenience related to investment approval procedure. Nature of custom approval letter is almost the same as that of investment approval letter. It is no doubt that BKPM evaluates whether investors are entitled to access to the incentive. In this sense, BKPM apparently faces investors as a regulator. However, again, it is considered that BKPM checks whether investors are eligible for the incentives determined by the government on behalf of investors for their convenience. BKPM's action is not for regulation but for facilitation for smooth investment.

While JICA study team visited Thailand to get information on how they process investment approval procedure, the team found that Board of Investment (BOI) in Thailand acts as a facilitator of investment. As well as BKPM, the organization checks the appropriateness of investment on behalf of investors. However, once it is cleared, BOI take investors to other organizations that issue another approval or permit. It is clearly a promotion function. If they are not promoters but only regulators, they will not take such a trouble to accompany investors.

#### (2) Fundamental changes in BKPM's missions and functions

Considering the situation concerning deregulation, e-process, and mounting pressure for

streamlining of operations on one hand and the movement toward decentralization on the other hand, there is a possibility that BKPM's investment approval business will become less important to BKPM. In this regard, the New Investment Law suggests the major functions of BKPM may be as follows. With respect to BKPM's functions, those as a promoter may be given more emphasis than to those as regulator.

=Article 16 (2)

The duties and functions of the government agency are

- To analyze and propose policy for capital investment;
- To compile norms, standards and procedures for investment activity;
- To empower regional investment, through private enterprise, state-owned enterprise or region-owned enterprise in developing potential capital investment opportunities;
- To compiling a map of Indonesian investment;
- To promote capital investment, including but not limited to potential investment opportunities in Indonesia
- To develop the capital investment business sector through investment empowering;
- To help in the resolution of obstacles faced by the business world in carrying out capital investment activity;
- To facilitate and coordinate domestic investors who carry out their capital investment activity outside the territory of Indonesia;
- To provide facilities for the implementation of capital investment..

The last one seems to indicate that BKPM still will deal with investment approval, but, it is clear that such activity is not BKPM's main business, though capacity building concerning decentralization for regional and local government is still one of the most important functions. Given these changes, it is necessary to develop a new business area or areas, preferably containing higher added value. Keywords that describe the desirable business for BKPM to undertake are as follows:

- Customer service oriented
- Business strategy oriented
- Information technology oriented
- Networking service

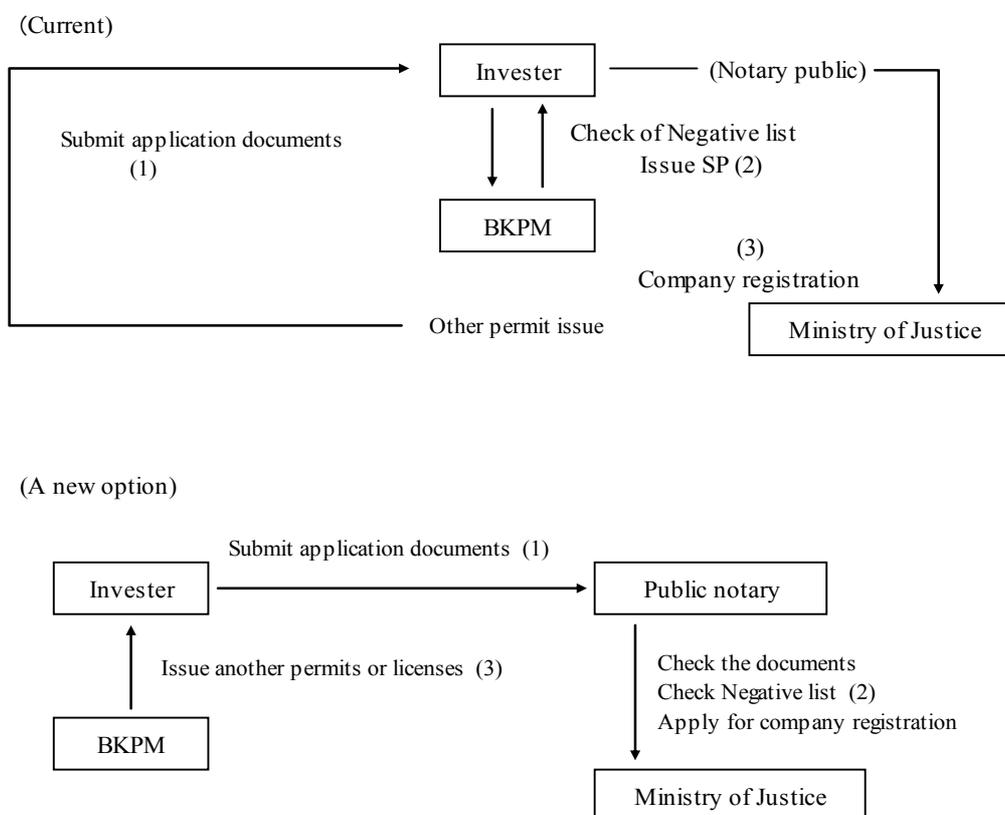
### (3) Integration of investment approval procedure and company registration

#### 1) A new scheme

In the same timing with the deliberation of New Investment Law, a new investment approval scheme is under consideration. The new scheme for investment approval procedure is not yet decided. However, reportedly, one of options is to integrate two process of

investment approval (SP) and company registration (SK) into one process as is shown in Figure 2-20. Under the change, SP is not issued any more. There is a possibility for notary public to become a key actor in checking negative list and apply new company's name to Ministry of Justice. After checking at the Ministry, it registers the new company. After the registration is carried out, BKPM will start its license operation such as issues of custom approval letters and work permit to investors. BKPM says that if this new scheme is introduced, it will issue automatically license for Master list so long as the documents are prepared correctly. It means that it could not happen for BKPM to impair registered company's status. This new scheme is shown below.

**Figure 2-20 Possible Changes in BKPM's Function**



## 2) Issues to be solved for realization

The main purpose of the above change is to trim time needed for obtaining central permits covering SP, SK, master list, work permit and so on. However, there are some issues to be cleared for realizing the target. First, it is necessary to develop a substitute of SP. SP has been an essential document for its holder to have a right to invest in Indonesia. So long as its holder shows the SP, he or she could ask parties concerned to proceed necessary actions for investment. When SP is abolished, what kind of document substitutes SP. Can SK substitute SP?. SK is a company registration certificate. Is this enough to ask local governments to issue

necessary local permits?. Second, in case a notary public becomes responsible for checking negative list as an initial contact person to investors, it is necessary to enhance their capability in checking negative list which is never done by notary public before. In addition, negative list should be set transparently as much as possible so that every notary public might judge easily whether an investment project falls under the list or not. Third, whether time could be trimmed solely depends on how to shorten the time for preparing necessary documents by both investors and notary public. The time is beyond control by Ministry of Justice. Fourth, with the change, there is a possibility that synergy between investment approval function and investment promotion becomes weak. Information necessary for development of efficient investment promotion is only available through investment approval proceeding, however, when both functions are separated, there is no security for it.

Besides the above issues, whether Indonesian government provide any special incentive provides or not in near future poses a large problem. If special incentive is provided, an evaluation process cuts in. The process should be done before company registration. Then who will conduct the evaluation—it is an issue.

### 3) Case in other Asian countries

While some issues to be solved for introduction of the above registration scheme instead of SP as is mentioned above, some countries already are involved in the similar scheme. JICA study team identified the scheme in Viet Nam, Thailand and the Philippines as was shown in Table 2-57, 2-58 & 2-59

First, in Viet Nam, in the first place investors are requested to take a procedure for investment registration at a provincial State administrative body for investment. If their investment projects do not need any evaluation, they will be provided investment certificate. The body checks negative list and confirm documents submitted correct and proper. In this sense, the administrative body performs two function of issuance of both SP and SK . Duration for issuance differs by whether the investment project is subject to evaluation or not. In case of evaluation being necessary, it takes much time than other case that dose not need evaluation. Because after evaluation, registration process starts,

Second, in Thailand, in case of investment without any incentive, by registering at Ministry of Commerce, an investor can invest. So it is simple. In case of investment with incentive from Board of Investment, there are two ways. One is to establish a company with registration at Ministry of Commerce and then to apply incentive license at BOI. In this case, there remains a risk that registered company is not entitled to obtain incentives. Other way is to get incentive from BOI and then to register the company at Ministry of Commerce.

Third, in the Philippines, in case of investment without incentives, investment is realized by registration. On the other hand, in case of investment with incentives, first, the investment project is evaluated whether it is entitled to get the incentives and then, if it is admitted, registration process starts.

Fourth, in China, as in Indonesia, Foreign Investment Commission of the People's Republic of China approves an investment project, and then the company is registered at General Administration of Industry and Commerce.

Summarizing the above cases, three facts are observed. First, registration scheme is possible. Second, however, in above cases, Ministry of Commerce or Investment board is involved in. There is no case for the third party such as notary public to be involved in. Third, in case that when investors expect special incentives, investment application and evaluation for eligibility of these special incentives are to be conducted prior to registration.

#### (4) Increased focus on promotional activities

What should BKPM do? First, BKPM should streamline the investment approval procedure as much as possible. By doing so, BKPM could gain the confidence of its customers. Also, BKPM could shift some of its human resources to more strategic and core areas. Second, BKPM can develop new business areas having added value that is larger than the investment approval business. Actually, the current investment approval business is low in value added. The following are some examples of areas with high value added. Most of them are related to promotion, not to approvals or permits.

- Customers service by laying tracking system
- Matching system by using networking
- Intensified research for customers
- Consulting service for potential investors
- Research and development of new schemes related to FDI to infrastructure
- Strengthen its engineering activities
- Host regular meeting among foreign investors, local partners and government
- Explore a new network through agreement between BKPM and influential foreign organizations, which are deeply involved in FDI
- Capacity building for regional or local governments in the area of investment approval operations
- Support regional or local governments in developing new investment schemes

The last item is support which regional governments strongly desire from BKPM. The Investment Controlling and Implementation Department at BKPM is engaged in follow-up of investors' investment and extends supports to investors. However, the department's activity is limited to the after-care of investments. In addition to the above supports, pre-investment

supports are expected

(5) Necessity of strengthening research activities

With respect to research activities, the following four areas should be given attention. The first is analysis of the wide difference between application of investment and realization of investment. As is shown in Table 2-60, there can be seen a wide difference between data given in applications and facts of the realization of investment. The difference may be attributed partly to technical reasons but partly to investor's changes in intention when actually making the investment. BKPM should carefully analyze the factors underlying the difference. It relates to efficiency in investment promotion. In this regard, it is to be noted that a similar phenomenon is confirmed in Thailand too.

**Table 2-60 Application of Investment and Its Realization:2000-2005**

Year	2000	2001	2002	2003	2004	2005
<b>Indonesia</b>						
No. of approvals	1,599	1,376	1,238	1,238	1,226	1,648
No. realized	638	453	435	570	544	909
Total amount Approved	16,014	15,210	9,955	14,278	10,415	13,679
Total amount realized (Million US\$)	9,877	3,484	3,085	5,450	4,601	8,914
<b>Thailand</b>						
No. of approvals	1,111	819	721	839	1,223	n.a
No. realized	625	612	626	251	279	n.a
Total amount Approved	279,192	226,200	162,500	283,820	600,900	n.a
Total amount realization (Million Baht)	304,895	267,800	203,700	74,600	83,000	n.a

Source: Indonesia: BKPM Thailand: BOI

The second is analysis on how many jobs are created by foreign direct investment every year. BKPM should be more serious about this subject, but it does not compile such data despite its importance. As far as capacity for job creation is concerned, the primary sector comes first. The tertiary sector's capacity is quite low as is shown in Table 2-27. The reason why the capacity for job creation by FDI is decreasing may be related to the increase in FDI in the tertiary sector whose capacity for job creation is weak. However, inflexible labor regulations may be another reason. Under the current Manpower Act, investors tend to invest in Indonesia in capital-intensive ventures rather than labor-intensive projects because trouble some labor problems is a deterrent. Comparing with capacity of job creation by means of domestic investment, as is shown in Table 2-28, FDI's capacity is inferior to that of domestic investment. This may be attributed to the fact that FDI is more capital intensive than is

domestic investment. In view of this it is desirable for Indonesia to identify strategic partners and invite them in promoting FDI. For an idea as to the qualification for strategic partners, reference can be made to Box 2.8.

**Box.2.8 Qualification for Strategic Partners in FDI**

1. Commitment to a long-term relation
2. Dedication to Indonesia's development
3. Contribution to the development of Indonesia's human capital
4. An innovative technology base
5. Competent management
6. Effective marketing strategy with experience in export business
7. Strong international competitiveness

The third is analysis of how past divestments year by year, and of the reason. Knowing the reason would enable BKPM to learn how to improve the investment climate. The fourth is analysis of the world-wide trend in foreign direct investment with attention given to the competitiveness of Indonesia's competitors. Based on such analysis, BKPM could prepare business strategies for attracting foreign direct investment to Indonesia.

BKPM is in the best position to know the world-wide tendency for foreign direct investment since it has a strong connection with investors. Through conversations with them, BKPM can obtain basic information that it can use to formulate strategies and design incentives for attracting foreign direct investment to Indonesia. In this regard, even though BKPM is in a position to be able to obtain raw data on foreign direct investment in Indonesia and is obtaining them daily, BKPM does not utilize this valuable data. It does not make any analysis of the data or derive any implication (Refer to Box.2.9)

What the BKPM is doing is only acting on requests from the managers in BKPM or their clients. They are making statistics on investment in Indonesia using data which are collected through daily operations such as issuance of investment approvals. In this sense, their activity is not an active one but passive one.

**Box.2.9 FDI's Power of Job Creation**

One of the economic benefits which FDI brings about is job creation. Recent statistics compiled by BKPM tell us that among industrial sectors, the primary sector's contribution is biggest in terms of number of employment opportunities per one FDI project. Tertiary sector's contribution is the least, and the secondary sector's contribution falls in between. As far as job creation is concerned, investment in the primary sector should be paid more attention. By industry, job creation by the textile sector is still large, while those by metal, machinery and electronics are weak.

(6) Weakening power of current fiscal incentive

While Indonesia does not provide any specific fiscal investment to foreign direct investment, it provides import duty incentives to investors. The number of beneficiaries and amounts of their investments in recent years are shown in Table 2-61. It is noted that only 10-20% of foreign investors are entitled to enjoy the incentives. There may be some room for improvement in this facility to enable more investors to be able to enjoy this type of incentive.. For the purpose, BKPM should be more serious about investors' business strategies and business models in Indonesia (Refer to Box. 2.10).

**Table 2-61 Trend in Approvals of Import Duty Incentives for FDI**

Year	Capital goods		Raw materials	
	No. of approvals	Investment (US\$ million )	No. of approvals	Investment (US\$ million )
2001	230	2,070	42	371
2002	183	1,452	35	472
2003	140	1,469	25	193
2004	101	1,540	11	245
2005	181	3,404	17	268

Source: BKPM “ Monthly Report” April.2006

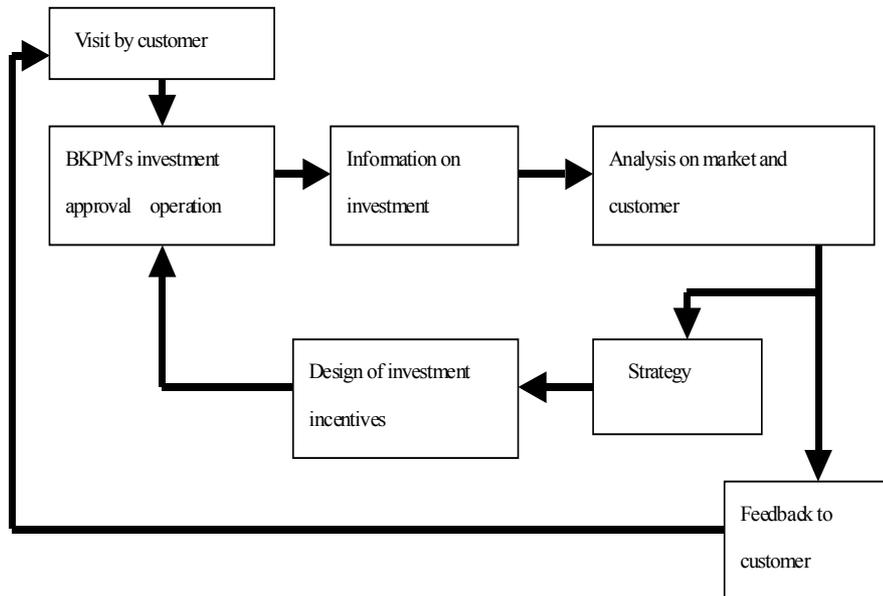
**Box.2.10 A Corporate Key: Understanding Corporate Business Strategies**

In their activities on behalf of promoting foreign direct investment, what promotion officers have to understand is global strategies of corporations. Corporations select site for investment by considering where products are produced and to where they are distributed. Preferences in selecting host countries change over time. Investment promoters are obliged to have deep insight into the changing world market and production costs in each competing country where products are produced. Since comprehensive, usable information on these subjects is scarce, BKPM is advised to collect such information through daily contact with the corporate sector. BKPM's investment license operations end in granting the licenses to investors, but promotion activity is where it all starts. By keeping in touch with corporate investment in Indonesia, BKPM could become familiar with how their clients are developing their strategies for the future. To organize a regular business meetings with people from the business world is one idea for continuous information gathering from clients on their business strategies.

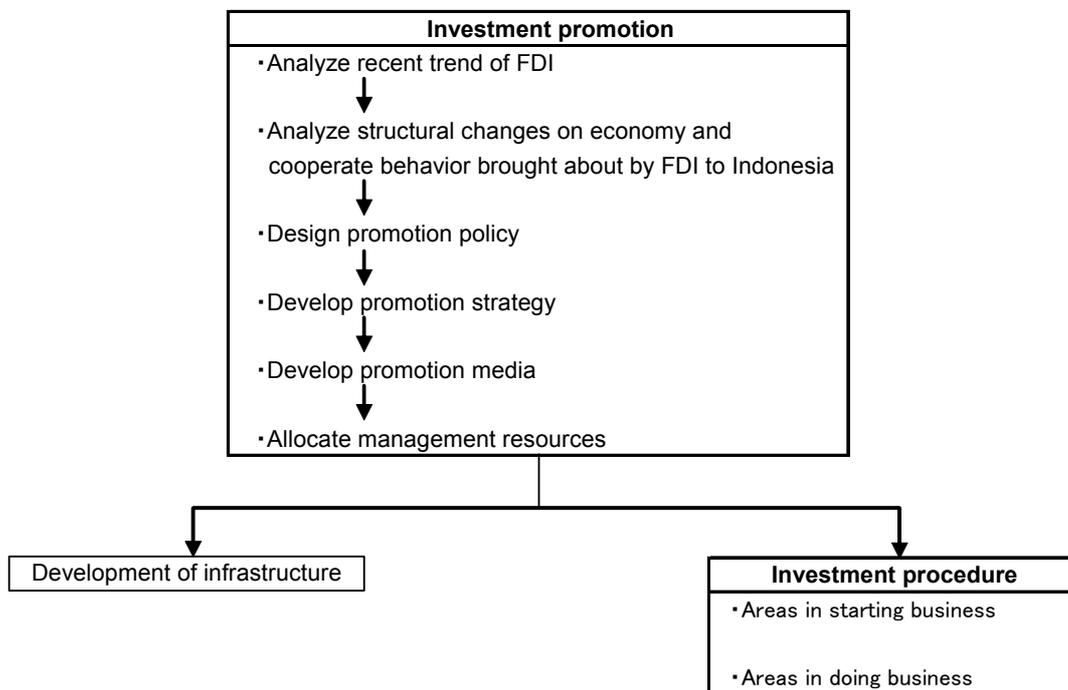
(7) Strategy for effective promotion of foreign direct investment

In order to formulate effective strategy to attract foreign direct investment, following basic research is indispensable (Figure 2-21 and 22).

**Figure 2-21 BKPM's Strategies for Attracting FDI**



**Figure 2-22 Improvement in Investment Climate**



1) Analysis on world-wide trend of FDI

First, what is occurring in FDI in recent years is analyzed. Which countries are FDI's

actors are studied through statistical analysis? Actors mean both host countries and invested countries. As one of recent changes, it is often pointed that China appeared in the FDI market as not only invested country but also host country of FDI. Following Table 2-62 and 2-63 shows an example of the analysis, though it is done for Latin American countries which have experienced substantial changes in FDI trend. The interesting fact is that relatively small countries have quite a different FDI patterns from large countries.

**Table 2-62 An Example of FDI Analysis for South America  
(Acumulated FDI in 1996-2004)(%)**

Country	Data	FDI sector	Major host country
Peru	1996-2004	Service (76) Manufacturing (15) Natural resource (10)	UK (30) USA (14) Netherlands (14) Spain (13)
Ecuador	1996-2005	Natural resource (81) Service (15) Manufacturing (4)	USA (28) Canada (24) Italy (6) Spain (5)
Colombia	1996-2004	Service (59) Natural resource (21) Manufacturing (19)	USA (23) Spain (18) Netherlands (10)
Bolivia	1996-2003	Natural resource (49) Service (43) Manufacturing (8)	USA (35) Argentine (10) Brazil (10) Italy (10)
Paraguay	1996-2003	—	USA (35) Argentine (11) Brazil (10) Netherland (10)
Venezuela	1996-2005	Service (40) Manufacturing (59) Natural resources (1)	USA (22) Spain (8) France (5)
Argentine	1996-2004	Natural resource (41) Service (29) Manufacturing (21) Others (9)	Spain (44) USA (18) France (8) Netherlands (5)
Brazil	1996-2005	Service (68) Manufacturing (28) Natural resources (4)	USA (22) Spain (14) Netherlands (14)
Chile	1996-2004	Service (63) Natural resource (26) Manufacturing (11)	Spain (30) USA (23) Canada (13)

Source: Economic Commission for Latin America and the Caribbean: ECLAC)

**Table 2-63 FDI by Sector in South America**

Country	FDI sector	Comments
Peru	Mining, Electricity, Gas, Water supply, Telecommunication, Finance	Economic infrastructure
Ecuador	Mining	
Colombia	Mining, Petroleum, Electricity, Gas, Water supply, Telecommunication, Finance, Chemical	Economic infrastructure, Chemical sector
Bolivia	Petroleum	
Paraguay	Food and beverage, Finance	
Venezuela	Mining, Finance, Machinery	
Argentina	Petroleum, Chemical, Food, Electricity, Gas, Water supply, Finance	
Brazil	Transport equipment, Chemical, Food, Electric machinery, Metal, Electricity, Gas, Water supply, Commerce, Transportation, Finance	Diversified
Chile	Mining, Food, Electricity, Gas, Water supply, Transportation, Telecommunication, Finance	Food

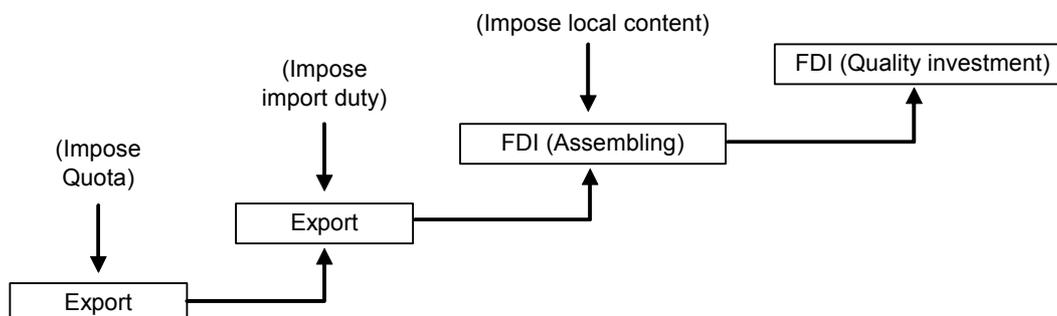
Source: UNCTAD Website

Second, the above tendency is studied by investment sector. With respect to sector, major actor was manufacturing in the past. However, nowadays, service industry and infrastructure industry began to attract FDI in almost all countries in the world.

Third, changes in investors' business strategy are analyzed. How their strategy has changed is shown in Figure 2-23. In the manufacturing sector, it was quite simple. Most of investors used to export their products to developing countries. However, these developing countries began to set import quota or high import duties in order to curb their imports and to protect local industries. On the other hand, these developing countries began to attract investment for local production of imported products. Thus, exporters changed their strategy from export to local production in developing countries and, for the purpose, began to invest. However, considering immature parts industry in developing countries, investors were compelled to export completely knock down products and assemble them to finished products there. Considering that this kind of local production does not create enough jobs, developing countries began to take a policy of local content. As the result, foreign investors were forced to produce some major and value added products locally. Meanwhile, with the economic development in developing countries, investors began to invest not only in the field of manufacturing sectors but also service and infrastructure sectors. Changes in investor's business strategy are taken place not only in investment sectors but also in business resources. For example, in the past, the biggest advantage in investing in developing countries used to be cheap labor. However, the situation is changing. They have begun to pay attention to management skills in developing countries, though it is still limited to some areas in some countries. Reportedly, US companies have begun to pay attention to outsourcing in IT industries and pharmaceutical industries in Asian countries. Actually, it tells us US

companies' FDI strategy is changing.

**Figure 2-23 Changes in Investment Strategies**



Fourth, based on the above analyses, investors' strategy in selecting countries and sectors for FDI is made clear.

2) The past performance of FDI to Indonesia

In the above world-wide changes in FDI, how FDI was in Indonesia is analyzed from various points of view. First, FDI to Indonesia is reviewed for the past 50 years focusing on the amount, host countries and sectors. Second, affects brought about FDI to Indonesia are analyzed on economic structure, industrial structure and trade structure. Third, as well, how corporate behavior has changed is analyzed. This analysis is important because changes in corporate behavior will invite another FDI to Indonesia. Analysis on corporate behavior is the most important subject.

Viet Nam is one of countries which have recently attracted large amount of FDI from Japan. Table 2-64 shows Japanese companies' strategy in investing in Vietnam which will provide Indonesia useful information for designing promotion strategy.

**Table 2-64 Japan's FDI in Viet Nam : Several Cases**

Investor's sector	Key concept	Business strategy
Sanitary ware	<ul style="list-style-type: none"> <li>■ Risk hedge against too much dependence on production in China</li> </ul>	<ul style="list-style-type: none"> <li>■ Produce near China and export the products to Chinese market</li> <li>■ Hold strong competitiveness in production cost against China</li> </ul>
Electronic parts	<ul style="list-style-type: none"> <li>■ Follow their customers' investment in Vietnam</li> </ul>	<ul style="list-style-type: none"> <li>■ Supply necessary parts to their customer advanced to Viet Nam with high speed</li> </ul>
Information technology service	<ul style="list-style-type: none"> <li>■ Export of service produced with information technology</li> </ul>	<ul style="list-style-type: none"> <li>■ Produce necessary service in Vietnam and export to Japan</li> </ul>

Investor's sector	Key concept	Business strategy
		<ul style="list-style-type: none"> <li>■ Utilize fully Viet Nam's low cost but excellent workers</li> </ul>
Chemical surface treatment service	<ul style="list-style-type: none"> <li>■ To serve Japan's investors in Viet Nam</li> </ul>	<ul style="list-style-type: none"> <li>■ Render their service to their customers which advanced from Japan in Viet Nam with low cost and at speed</li> </ul>
Special foodstuff	<ul style="list-style-type: none"> <li>■ To develop and export new products of which natural resource is available in Viet Nam</li> </ul>	<ul style="list-style-type: none"> <li>■ Develop natural resources which are not available in Japan</li> </ul>
Motor cycle	<ul style="list-style-type: none"> <li>■ To expand their market shares in developing Viet Nam</li> </ul>	<ul style="list-style-type: none"> <li>■ Additional investment in production capacity</li> <li>■ Strengthen both South and North Vietnamese production to capture their high market shares in both areas</li> </ul>
Wire harness	<ul style="list-style-type: none"> <li>■ To expand export base</li> </ul>	<ul style="list-style-type: none"> <li>■ Expand export of their products to China</li> <li>■ Expand Vietnamese factory's world-wide distribution capability</li> <li>■ Utilize fully Vietnamese low cost but excellent labor</li> </ul>
Stationary	<ul style="list-style-type: none"> <li>■ To bring new products in Vietnamese market where rapid expansion is expected</li> </ul>	<ul style="list-style-type: none"> <li>■ Pay attention to the potential of market growth</li> </ul>
Delivery service	<ul style="list-style-type: none"> <li>■ To provide various distribution service to Japanese customers including individuals</li> </ul>	<ul style="list-style-type: none"> <li>■ Serve to Japanese investors and their Japanese employees</li> </ul>
Printing materials	<ul style="list-style-type: none"> <li>■ To provide printing materials for commercial use to customers advanced to Indonesia</li> </ul>	<ul style="list-style-type: none"> <li>■ Serve to investor's customer</li> </ul>

Followings are some implications, which are derived from the above case, for BKPM's promotion activity.

- Pay attention to suppliers of products as well as of service to their customers which have already invested in Indonesia
- Pay attention to service areas for both investors and their employees
- Pay attention to investors' world wide business strategies and to let them incorporate Indonesian production base as one of world wide production network
- Pay attention to function sharing of investors between China and Indonesia
- Pay attention to Indonesian managers resources with low cost but good quality

### 3) Indonesia's competitiveness in attraction of FDI

Indonesia's competitiveness is made clear by analyzing its strength, weakness, opportunity and threat (SWOT). How to cope with the changes in investors' FDI strategy is

the main subject for analysis in this section. Areas for analysis are natural resources, human resources, management resources and location. Among them, management resources should be given a special attention.

#### 4) Indonesia's strategic areas for FDI

Based on the above analyses, BKPM could formulate strategic areas for FDI promotion. Areas cover industrial sectors, investors, investors' business strategies and business models and competitive resources.

#### 5) Design promotion policy

Investment promotion policy is designed. The policy includes priority sectors and areas and necessary incentives for investment promotion. Establishment of special economic zones is also important policy.

#### 6) Promotion strategies

With the FDI strategies for BKPM, it could identify promotion strategies including promotion measures and allocation of budget by investors.

### **2.3.11 Organizational Reform in BKPM**

#### (1) Establish a research section

Considering the increasing importance of research activity, BKPM is advised to reorganize a part of its structure. The current organization chart is shown in Figure 2-24. It seems that no research section is in the chart. It is recommended to set up a research section under an existing department or to establish a new department. In the former case, it would be wise to place it under the Department of Investment Development Climate because research activity would be strongly related to the current activity of the department. In the latter case, a new department will be established in parallel to the other five. The newly established research section will cooperate with existing foreign offices in collecting information on industrial and business trends, and foreign investors in each country.

In this connection, among the various functions in BKPM, a substantial percentage of total annual budget is allocated to the investment promotion section that has a 36% share in the 2006 budget. Therefore, it is advised to establish a system to evaluate, every year, the result of promotion activities

To supplement less experience in research activities at BKPM, it is recommended to establish collaboration with private sectors and universities. The collaboration will be

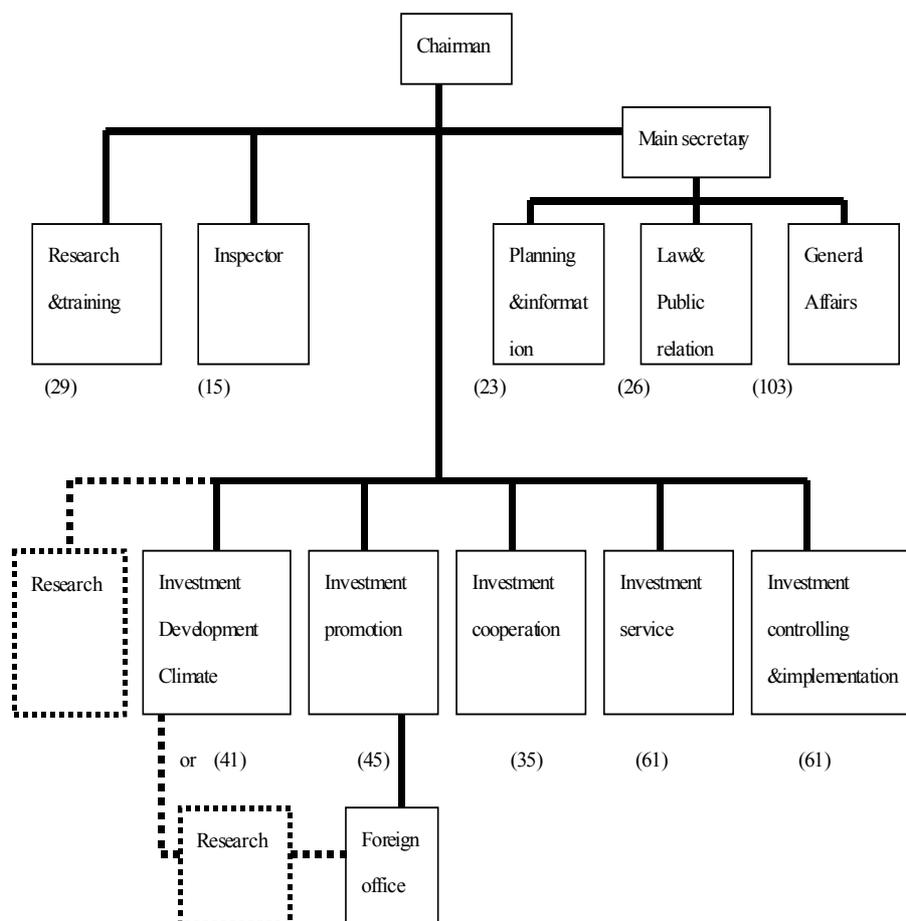
enhanced through the following measures.

- Exchange research staff in charge of research activities among BKPM, private sectors and universities
- Conduct joints research among BKPM, private sectors and universities
- Hold regular conference on foreign direct investment among BKPM, private sectors and universities. The name of conference is, for example, “ BKPM-University of Indonesia Conference”

Private sectors and universities include foreign entities.

Among various functions in BKPM, substantial percentage of total annual budget is allocated to investment promotion section with 36% share of 2006 budget. Therefore, it is advised to establish a system to evaluate the result of promotion activities every year.

**Figure 2-24 Organization Chart in BKPM (as of May 2006)**



Footnote: 1) Dotted line is proposed  
 2) Figure in the parenthesis shows the current number of staff

(2) Source of BKPM's advantages for research activities

BKPM is the only organization that is capable of collecting raw data on foreign direct investment in Indonesia. They include not only macro data on investment but also micro data for each investor. In this sense, these data are highly valuable for analysis of investment trends from various viewpoints. The organization of data held by BKPM is shown in Table 2-65.

**Table 2-65 Structure of FDI Data in BKPM**

Data	Investor total data	Reference	Corporate data	Reference
<b>No. of investment approval</b>				
By year	*		*	
By sector	*		*	Available for detailed classification
By location	*		*	
By country of origin	*		*	
<b>Amount of investment approval</b>				
By year	*		*	
By sector	*		*	Available for detailed classification
By location	*		*	
By country of origin	*		*	
<b>No. of realized investment</b>				
By year	*		*	
By sector	*		*	Available for detailed classification
By location	*		*	
By country of origin	*		*	
<b>Ranking of investment realization</b>	No. of projects, value and%			
By sector	*			
By location	*			
By country of origin	*			
<b>Realization of investment planning approval</b>	No. of projects, value and %			
By sector	*			
By location	*			
By country of origin	*			

Data	Investor total data	Reference	Corporate data	Reference
<b>Realization of manpower absorption</b>				
By sector	*	No. of projects and No. of workers	*	
By location	*	No. of projects and No. of workers	*	
<b>Employment absorption planning</b>				
By sector	*	No. of projects and No. of workers	*	
By location	*	No. of projects and No. of workers	*	
<b>Approvals of Import incentives</b>				
Capital goods	*	No. of projects and value by sector, by location and ranking	*	By value and location
Raw materials	*	No. of project sand value by sector, by location and ranking	*	By value and location
<b>Export oriented investment approval</b>				
By sector	*	No. of projects and value	*	Value and location
<b>Each investment</b>		Tendency could be understood through each analysis		
Name of foreign Investors			*	
Name of Indonesian Partners			*	
Shareholders			*	
Main line of business			*	
Location of the Project			*	
Annual production			*	Design capacity and production
Production capacity			*	
Annual sales			*	
Domestic sales			*	
Export			*	
Land area required			*	
Employment			*	By expatriates and Indonesians

Data	Investor total data	Reference	Corporate data	Reference
Total investment cost			*	
Source of fund and use of fund			*	
Debt-equity ratio			*	
Master list			*	Type of products imported
Technology used			*	Information obtained through equipment lay-out drawing or production process flow-chart
<b>Accumulated amount of investment</b>	*	By province and region (For 978-2005)		
<b>Managerial problems which investors face</b>			*	Report made by BKPM based on report from regional office
<b>Poor infrastructure</b>			(*)	
<b>Availability of raw Materials</b>			(*)	
<b>Finance</b>			(*)	

Based on the above data and additional information obtained through contact with investors, BKPM could conduct various analysis (Refer to Box.2.11). The following are some examples.

- Investors' global business strategies and importance of Indonesia as a part of production networks
- Investors' evaluation on the source of competitiveness for investment in Indonesia
- Investors' viewpoints on competitive sectors and locations for investment in Indonesia
- Investors' viewpoints on competitive business models in Indonesia
- FDI's capability to create exports
- Analysis on linkage between FDI and job creation, export and development in Indonesian industry
- Strategy for enhancing the capacity for job creation by foreign direct investment
- Effective deregulation of the negative list
- Effect of fiscal and non-fiscal incentives on FDI
- New incentives to investment which contribute to job creation

Among them, the most important and urgent topic is to identify business strategy of foreign investors in major countries such as Japan, Korea, Singapore, Thailand and China. Since the strategy will differ by country, it is necessary to adopt different promotion

strategies and techniques for each country (Refer to Box.2.12). Also, the last subject is worthy of study because, while fiscal incentives are strong support measures for attracting FDI, it is rather difficult to grasp to what extent they are effective. Currently, BKPM proposes fiscal incentives to the government only based on comparative studies for neighboring countries, however, such action is too weak to persuade the Ministry of Finance of the importance of fiscal incentives.

**Box.2.11 Organize a Regular Round Table-Meeting with Influential Businessmen**

Some ideas for a roundtable meeting: The meeting would be held once in a month or once in two months, with participation by influential persons who are engaged in business in Indonesia. Such a meeting could be utilized by BKPM to get various items of business information that will be useful in investment promotion activities. Businessmen would be selected from several representative industries such as the automobile, chemical, electronics, food and beverage, textile, general machinery, construction and service industry. The total number of businessman invited is to be up to 15. From BKPM, top management attends and chairs the meeting. The meeting will be held for one and half hours. In the first half hour a light meal will be served as lunch and the next hour will be spent for discussion on business topics. The topics will cover recent business trends by industry, investment trends and business strategies in Indonesia. BKPM will present recent trends in foreign investment to Indonesia. Once in two meetings, a Minister will be invited as a guest. The Minister will address some topics which are relevant to his or her responsibility. The important thing is that the members attend the meeting should be fixed.

**Box.2.12 Different Business Strategy by Country**

There seems to be two different types of investment strategy. One is the flying- geese type of investment and the other is the home-base type of investment strategy. The former has been followed by Korea, Viet Nam and China. They change production bases depending upon the competitiveness in the investment-target countries, moving from one country to another country. The shoemaking industry is one example and because of its nature, it is called a foot-loose industry. The latter is followed by Japan. Most Japanese investors invest in Indonesia on a long-term commitment base. It could happen that they change the nature of the products they make in Indonesia, but they will not transfer production bases from Indonesia to other countries. Investment in machinery, electric machinery and appliances and autos and auto parts industry fall under this category. As a natural course, the investment promotion strategy used for these two groups of countries may be different. For the former, promotion will be done focusing on Indonesia's competitiveness in terms of cheap labor cost, while for the latter, it will be done referring to the potential of the domestic market.

Results of the research activities by the research section will be utilized not only for promotion activity but also for determining what is to be on the negative list. Further, they will provide some hints on what kind of data and information should be included in application form for investment approval.

### 2.3.12 Conclusion

It is possible to streamline the current investment approval procedure more, if the following measures are taken.

- To fully utilize information technology
- To standardize operational processes
- To minimize bureaucratic operations by reducing internal checks
- To delegate authority to sign to a lower echelon
- To lessen the number of documents to be submitted
- To introduce an “ on-line system ” where it is possible
- To strengthen strategic thinking based on scientific research and analysis

However, the most important point is for every party concerned to cooperate with each other toward the common target of enhancing investors’ satisfaction so as to increase foreign direct investments in Indonesia. Who should take the initiative and leadership in the work of this cooperation building? It properly is BKPM. BKPM can function as a syndication manager for the work.

### 2.3.13 Outline of Proposed Action Plans

Table 2-66 shows outline of proposed action plans. Following is list of the plan.

1. Investment approval procedures
  - Set up a “ Pre-processing of documents ” section
  - Construct an on-line system for investment application submission via the Internet
  - Simplification of documents submitted for approval
  - Streamline internal check processes in issuance of the SPs for ML
  - Streamline internal check process in issuance of IUTs
  - Streamline internal check process in issuance of TDPs
  - Construct a full fledged on-line tracking system for the whole process
  - Trim the time to print the Gazette announcement of registration of the company
  - Trim the time for issuance of an investor’s domicile certificate
  - Establish a performance measurement system
  - Capacity building for local governments in their realization of “one roof service”
  - Capacity building for regional and local governments in case of development of decentralization
  - Assist local governments in standardizing their local permits operation
  - Set up a special project team within BKPM for materializing the above reforms
  - Set up a regular conference on SP issue among BKPM, Ministry of Justice and Association of Notary Public
  - Set up a regular conference on TDP issue among Department of Commerce at local government, Association of Notary Public and consultants

2. Reform of BKPM

- Redefine BKPM’s mission and major functions
- Strengthen BKPM’s planning and research function
- Establish collaboration with private sectors and universities including foreign entities.
- Propose organizational change in BKPM

3. Formulate detailed city plan

- Formulate land utilization plan by area
- Formulate construction permit standard by area
- Formulate environmental permit standard by area

**Table 2-66 Action Plans for Improvement of Investment Approval Procedure**

Plan	Contents	Effects	Responsible agencies
1. Investment approval procedure			
1.1 Set up a “ Pre-processing of documents” section	<ul style="list-style-type: none"> <li>■ For enhanced customer satisfaction, BKPM sets up an independent section to help investors in preparing proper application form. In the section, BKPM officer instructs how to fill the documents needed.</li> <li>■ For the purpose BKPM prepares detailed operation guidance pamphlet including illustration</li> <li>■ The most important items are highlighted as well as items which investors tend to commit mistakes</li> </ul>	<ul style="list-style-type: none"> <li>■ It will become possible to shorten pre-processing time</li> <li>■ It becomes possible to secure transparency in operation</li> </ul>	BKPM
1.2 Construct an on-line system for application of investment from customer’s site	<ul style="list-style-type: none"> <li>■ Potential investors can access BKPM for investment application though on-line from their home countries</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to shorten pre- processing time</li> <li>■ It becomes possible to secure transparency in operation</li> </ul>	BKPM
1.3 Simplification of documents submitted to obtain approval	<ul style="list-style-type: none"> <li>■ Make it clear what kind of information is needed in “ Flowchart of the production process and</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to shorten pre- processing time</li> </ul>	BKPM

Plan	Contents	Effects	Responsible agencies
	raw materials requirements for processing industries” (If details are necessary, it is possible to get the information at the procedure of custom approval letter issue		
1.4 Streamline internal check process in issue of SP for ML	<ul style="list-style-type: none"> <li>■ To reduce the number of checker</li> <li>■ To make it possible for lower echelon to sign documents</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to reduce the duration of SP issuance</li> <li>■ It becomes possible to lessen idle time for waiting signature</li> </ul>	BKPM
1.5 Streamline internal check process in issue of IUT	<ul style="list-style-type: none"> <li>■ To reduce the number of checker</li> <li>■ To make it possible for lower echelon to sign documents</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to reduce the duration of SP issuance</li> <li>■ It becomes possible to lessen idle time for waiting signature</li> </ul>	BKPM
1.6 Streamline internal check process in issue of TDP	<ul style="list-style-type: none"> <li>■ To reduce the number of checker</li> <li>■ To make it possible for lower echelon to sign documents</li> <li>■ To make it possible for an investor to pay fee at the related Department in stead of financial institution</li> <li>■ Case in Kota Medan could be referred to</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to reduce the duration of SP issuance</li> <li>■ It becomes possible to lessen idle time for waiting signature</li> </ul>	Local governments (Department of Commerce)
1.7 Construct full fledged on-line tracking system for whole process	<ul style="list-style-type: none"> <li>■ System through which investors can know the status of their project</li> <li>■ On-line system covers not only BKPM but also other organizations ranging from Ministry of Justice, Ministry of Manpower, and regional or local government who handles local permit for investment</li> </ul>	<ul style="list-style-type: none"> <li>■ It become possible for investors to know current situation of investment procedure</li> <li>■ Transparency of investment license procedure will be enhanced</li> </ul>	BKPM BAPENAS Ministry of Justice Ministry of Finance Ministry of Manpower Ministry of Trade Local governments (Department of Commerce)
1.8 Trim the time for issuance of an investor’s	<ul style="list-style-type: none"> <li>■ To admit an investor to refer a notary public ‘s</li> </ul>	<ul style="list-style-type: none"> <li>■ It become possible for shorten the time for SK</li> </ul>	Ministry of Justice Department of Commerce

Plan	Contents	Effects	Responsible agencies
domicile certificate	address as the investor's domicile in applying SK	issuance	at local government BKPM
1.8 Trim the time to print Gazette on registration of company	<ul style="list-style-type: none"> <li>■ To utilize soft copy as much as possible</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to obtain Gazette within one month in stead of two-three months</li> </ul>	Government publication office Ministry of Justice Notary public
1.9 Establish performance measurement system	<ul style="list-style-type: none"> <li>■ To grasp periodically the operation efficiency by calculating duration for operation</li> <li>■ The result is submit to management people for their evaluation of BKPM's performance</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to grasp BKPM's productivity</li> <li>■ It becomes possible to increase BKPM's efficiency</li> </ul>	BKPM
1.10 Capacity building for BKPM front and back officer	<ul style="list-style-type: none"> <li>■ Two kind of regular meetings will be held. One is for exchanges of opinions on what is happening in Investment in Indonesia and the other is for collection of information on investors' business strategy and their investment plan</li> <li>■ Through the meeting, both front and both officer can get idea on how to streamline their daily operation</li> <li>■ In addition, BKPM could obtain hints on how to promote investment through discussion with investors</li> </ul>	<ul style="list-style-type: none"> <li>■ Duration for investment approval procedure will be shortened</li> <li>■ Efficiency of investment promotion will be enhanced</li> </ul>	BKPM
1.11 capacity building for local governments in their materialization of "one roof service"	<ul style="list-style-type: none"> <li>■ BKPM will assists local governments to realize "one roof service"</li> <li>■ BKPM will extend following supports. First, current service is analyzed, second, best practice is studied, Third, considering</li> </ul>	<ul style="list-style-type: none"> <li>■ Local permits procedure will be streamlined</li> <li>■ Integrated service in investment approval procedure becomes feasible</li> </ul>	BKPM Ministry of Home Affairs Local governments

Plan	Contents	Effects	Responsible agencies
	different local conditions, what kind of service is possible is analyzed. Last, implementation plan is drawn up.		
1.12 Capacity building for regional and local governments in case of development of decentralization	<ul style="list-style-type: none"> <li>■ BKPM extends supports to regional and local governments for capacity building in issue of SP</li> <li>■ Support for standardization of local permits process (cooperation with Ministry of Home affairs)</li> <li>■ Support for realization of integrated service including one stop or one roof service and information network</li> <li>■ To hold related seminar in regional or local government planned by BKPM's Controlling and Implementation Dept.</li> </ul>	<ul style="list-style-type: none"> <li>■ Smooth operation will become possible</li> <li>■ Investors' satisfaction will be enhanced</li> </ul>	BKPM Ministry of Home Affairs Regional governments Local governments
1.13 Assist local governments in standardizing their local permits operation	<ul style="list-style-type: none"> <li>■ One door, One stop and One roof service will be introduced in every local government</li> <li>■ Operation will be equalized</li> <li>■ BKPM will extend not only technical assistance and capacity building but also financial support</li> <li>■ Develop standard operational manual</li> </ul>	<ul style="list-style-type: none"> <li>■ Local permits operation will be streamlined</li> <li>■ Investors satisfaction will be maximized</li> <li>■ Corruption will be reduced</li> </ul>	BKPM Provincial governments Local governments Ministry of Home Affairs
1.14 Set up a special project team within BKPM for materializing the above operational reforms	<ul style="list-style-type: none"> <li>■ The mission is to materialize the above reforms</li> <li>■ The project team member covers all of</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to speed up the reforms</li> <li>■ It becomes possible for all members at BKPM to share common</li> </ul>	BKPM

Plan	Contents	Effects	Responsible agencies
	<p>related sections</p> <ul style="list-style-type: none"> <li>■ Head of the team is assigned by Chairman of BKPM</li> <li>■ Chairman of BKPM fixes the target date for the reform</li> </ul>	<p>mission and philosophy of BKPM</p> <ul style="list-style-type: none"> <li>■ Investors' satisfaction will be enhanced</li> </ul>	
1.15 Set up a regular conference on SP issue among BKPM, Ministry of Justice and Notary Public	<ul style="list-style-type: none"> <li>■ The conference will be held for exchange of opinions on how to make their operation more efficient</li> <li>■ Both parties express frankly their troubles that they feel in their operation</li> </ul>	<ul style="list-style-type: none"> <li>■ Duration of SK Issuance will be reduced</li> </ul>	BKPM Ministry of Justice Notary Public
1.16 Set up a regular conference on TDP issue among Department of Commerce and Industry ,Notary Public and consultants	<ul style="list-style-type: none"> <li>■ The conference will be held for exchange of opinions on how to make their operation more efficient</li> <li>■ Both parties express frankly their troubles that they feel in their operation</li> </ul>	<ul style="list-style-type: none"> <li>■ Duration of TDP Issuance will be reduced</li> </ul>	Department of Commerce and Industry at local government Notary Public Consultant
1.17 Establish a collaboration with private sectors and universities including foreign entities.	<ul style="list-style-type: none"> <li>■ To supplement less experience in research activities at BKPM, it is recommended to establish a collaboration with private sectors and universities. The collaboration will be enhanced through the following measures.</li> </ul> <ol style="list-style-type: none"> <li>(1) Exchange research staff in charge of research activities among BKPM, private sectors and universities</li> <li>(2) Conduct joints research among BKPM, private sectors and universities</li> <li>(3) Hold regular conference on foreign</li> </ol>	<ul style="list-style-type: none"> <li>■ Research capability will be strengthened in rather short term</li> <li>■ Through contact with private sectors and universities, it is possible for BKPM to enlarge their scope of strategic thinking</li> </ul>	BKPM Private sectors Universities

Plan	Contents	Effects	Responsible agencies
	<p>direct investment among BKPM, private sectors and universities</p> <ul style="list-style-type: none"> <li>■ Private sectors and universities includes foreign entities.</li> </ul>		
<b>2. Reform of BKPM</b>			
2.1 Redefine BKPM's mission and major functions	<ul style="list-style-type: none"> <li>■ To obtain consensus on               <ol style="list-style-type: none"> <li>(1) Customer service oriented organization</li> <li>(2) Value added oriented organization</li> <li>(3) Knowledge industry</li> <li>(4) Information industry</li> <li>(5) Networking industry</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>■ To make it clear where BKPM should put its stress among various functions</li> </ul>	BKPM
2.2 Strengthen BKPM's planning and research function	<ul style="list-style-type: none"> <li>■ Planning function               <ol style="list-style-type: none"> <li>(1) Overall BKPM's strategy</li> <li>(2) Area and sector strategy</li> <li>(3) Incentive strategy</li> </ol> </li> <li>■ Research function               <ol style="list-style-type: none"> <li>(1) Subjects</li> <li>(2) Human resources                   <ol style="list-style-type: none"> <li>1) Cooperation with distinguished research institutes</li> <li>2) Cooperation with private sector</li> <li>3) Foreign organizations</li> </ol> </li> <li>(3) Organization</li> <li>(4) New cooperation scheme                   <ol style="list-style-type: none"> <li>1) Regular meeting with investors</li> </ol> </li> <li>(5) Competitiveness of BKPM's research function                   <ol style="list-style-type: none"> <li>1) Raw data on investment</li> <li>2) Regular contact with investors</li> <li>3) Research activity for strategic management</li> </ol> </li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to make a plan on effective promotion</li> <li>■ It becomes possible to conduct effective research for making strategy and effective incentives</li> <li>■ Management becomes transparent and accountable</li> </ul>	BKPM Research institutions in Indonesia and foreign countries
2.3 Propose organizational change in BKPM	<ul style="list-style-type: none"> <li>■ Set up newly a research section</li> </ul>	<ul style="list-style-type: none"> <li>■ Contribution in formulating BKPM's</li> </ul>	BKPM

Plan	Contents	Effects	Responsible agencies
	<ul style="list-style-type: none"> <li>■ Strengthen planning section</li> </ul>	strategies	
3. Formulate city plan by area			
3. 1. Formulate land utilization plan by area	<ul style="list-style-type: none"> <li>■ Set up legislations on land utilization by area</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to speed up evaluation on appropriateness of land utilization by an investment project</li> </ul>	Regional government Local government
3.2 Formulate construction standard by area	<ul style="list-style-type: none"> <li>■ Determine what kind of construction is allowed by area</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to speed up evaluation on appropriateness of construction of factory or service facility by an investment project</li> </ul>	Regional government Local governments
3.3 Formulate environmental standard by area	<ul style="list-style-type: none"> <li>■ Determine what kind of construction is allowed from a viewpoint of environment protection by area</li> </ul>	<ul style="list-style-type: none"> <li>■ It becomes possible to speed up evaluation on appropriateness of construction of factory or service facility from an viewpoint of environment protection by an investment project</li> </ul>	Regional government Local governments

As is shown in the above, action plans for investment approval procedure cover various fields from relatively minor ones to large and core ones. In addition, most of them are deeply inter linked with action plans proposed in the sections of New Investment Law and Negative list. Therefore, several important action plans which are to be urgently realized are integrated into one package. It is A prioritized plan: Three years plan for realizing “Integrated investment approval service”.

## 2.4 Manpower Policy

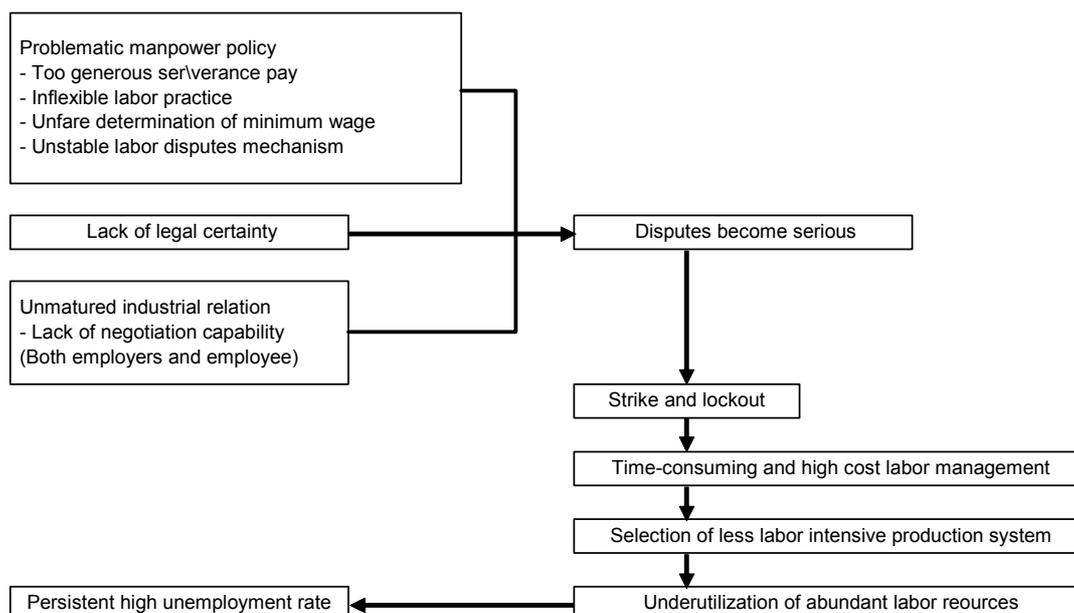
### 2.4.1 Indonesian Labor Problems

#### (1) Structure of the problems

Indonesia’s competitiveness is impaired by high economic cost as well as high social cost. The former is brought about by high cost of labor, which is attributable to high rate of wages and cost of regulations, while the latter is attributable to cost of unemployment and cost of regulations. This is a reason why manpower policy matters.

Indonesia's manufacturing sector, which is a main source of job creation, is said to be in the doldrums. This stagnancy is mostly due to high cost and labor problems. Notwithstanding Indonesia has abundant labor resources, such the resources are not fully utilized. It is because Indonesia has a unique structure of labor problems as is shown in the following Figure 2-25.

**Figure 2-25 Structure of Current Indonesian Labor Problems**



Under the situation of abundant labor resources, it is quite natural for investors to try to utilize these resources as much as possible when they invest in Indonesia. However, as was already stated in **2.3.10 Future Prospect for BKPM's Investment Approval Operation**, the foreign direct investment's capability for job creation seems to be dwindling. It is because, due to Indonesia's inflexible and too generous manpower policies to employees on one hand and due

to lack of legal certainty and immature industrial relations on the other hand, employers are inclined to select less labor intensive production or service system to avoid time-consuming and high cost labor management. Labor management is a considerable troublesome work in any country. It is not exception for investors' home country. The troublesomeness, however, will increase in case of labor management in foreign investment. It is quite natural for investors to pay high attention to labor management environment and select less troublesome country for their investment.

Reflecting the unfavorable labor management environment in Indonesia, as the following key employment and labor indicators in Table 2-67 show, trend in employment

performance is not well in Indonesia. Growth rate in employment is lower than one in labor force. Thus, unemployment rates are still on an increasing trend with all its economic growth.

**Table 2-67 Key Indicators for Employment and Labor Force**

Indicators \ Year	Year			Average growth rates(%)	
	1996-97	2000-01	2004-05	1996-97 to 2000-01	2001-01 to 2004-05
Working-age population(million)	133	143	155	1.7	2.0
Labor force				1.4	1.3
Employment by sector(% share)					
Agriculture	43	44	44	2.2	0.7
Manufacturing	13	13	12	1.9	-1.1
Other	45	42	44	-0.2	2.2
Total	100	100	100	1.1	1.1
Non-agricultural employment (% share)					
Formal	52	51	48	-0.2	-0.1
Informal	48	49	52	0.8	3.0
Total	100	100	100	0.3	1.4
Rates(%)					
Participation	68.8	67.2	65.2		
Employment	64.7	63.3	61.0	1.1	1.1
Unemployment					
On pre-2001 definition	4.8	5.8	6.5	6.4	4.1
On 2001 definition		8.1	10.1		

Source: Chris Manning and Kurnya Roesad “ Survey of Recent Developments ”, Bulletin of Indonesian Economic Studies ( World Bank)

In the forthcoming New Investment Law as well as the prevailing investment law, investors are allowed to employ foreign expertise in order to fulfill their business mission. On the other hand, it is also expected that investors prioritize the use of Indonesian manpower. Considering the main purpose of promoting FDI, which is to create job opportunities and to alleviate the chronic unemployment problem in Indonesia, such an expectation is clearly reasonable. However, it is also important for foreign investors to be able to maintain their competitiveness in order to survive under an era of global competition and to continue to employ local workers. As is shown in Table 2-68 below, the index for Indonesian labor productivity is increasing. However the growth rate is declining. To be more serious, the number of workers in the large and medium manufacturing sector is decreasing. It is said that the prevailing Manpower Act is relevant to this serious situation. Especially, schemes of

severance pay and minimum wages have been criticized.

**Table 2-68 Labor Productivity in Indonesia:1999-2003**

(Units:000Rp,%)

Year	Size of establishment	1999	2000	2001	2002	2003
Labor productivity	Large	48,698 (6.1)	58,111 (6.1)	64,552 (6.2)	75,923 (8.5)	81,990 (9.7)
	Medium	23,682 (3.0)	29,622 (3.1)	35,739 (3.4)	37,436 (4.2)	37,648 (4.4)
Efficiency (Input/Output)	Large	0.61	0.63	0.63	0.64	0.61
	Medium	0.60	0.60	0.60	0.71	0.64
Employment cost per output	Large	0.06	0.06	0.07	0.05	0.07
	Medium	0.08	0.08	0.13	0.05	0.07
Number of workers	Large & medium ('000)	4,234	4,366	4,382	4,364	4,273
	Growth(%)	2.69	3.13	0.37	-0.41	-2.13

Source: Central Bureau of Statistics "Industrial Indicator" 2003

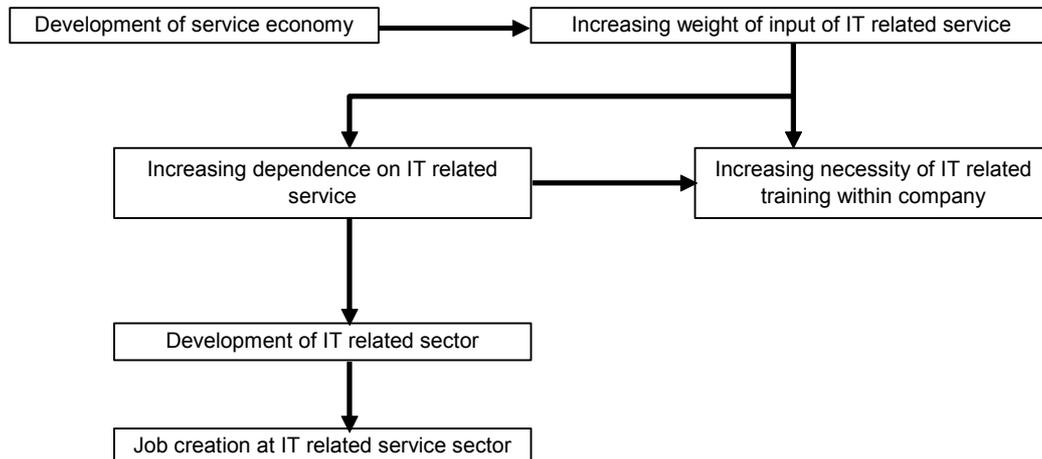
Footnote: figures in parenthesis are US\$'000 equivalent

(2) Background underlying the problems: Structural changes in Indonesian labor market

The current manpower policy does not necessarily take into consideration the changes in labor market which is taking place under the globalization of world economy and development of so called "service economy". First, manufacture experiences a change in its concept from "manu" facture to "brain" facture. Even in a traditional manufacturing sector, the portion of works to be done by traditional blue collar workers is decreasing. Blue collar workers are replaced by white collar workers whose works are operated by using computers. In this sense, most of "manu" facture is transforming to "brain" facture. It is becoming difficult to distinguish each other between blue collar and while collar work. Dichotomy between white collar and blue collar is becoming out of date. Second, with this change, even in manufacturing sector, an input ratio of service factor including research and development, design and inspection in total production cost is increasing. On the other hand, an input ratio of raw materials is decreasing. The phenomenon could be called as "transformation of manufacture to service" Third, as the result, education or training of "brain" facture for employees is becoming increasingly important. In most of companies, operation is done through computers and the computer systems become sophisticated every year. In order for employees to catch up the situation, they have to be timely trained. Fourth, reflecting these changes, type of employment becomes flexible. Non-regular employment such as outsourcing and contract-based employment increases. Needless to say, degree of the above changes differs by country. Pace of the changes seems to be slow in Indonesia than in developed countries such as Japan. However, it is no doubt that the changes are taking place and they

will accelerate. The above movement is summarized as an impact of development of service economy as following Figure 2-26.

**Figure 2-26 Impact of Development of Service Economy**

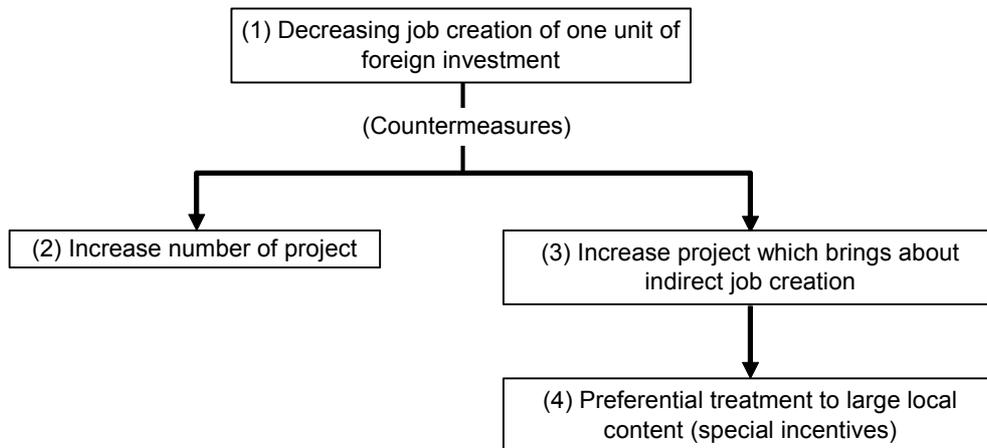


(3) Necessity of designing a new type of investment incentives for job creation

Considering that a main source of the above profound changes is development of IT, BKPM should become more serious about input ratio of IT in production or service when they evaluate investment proposal submitted by foreign investors. For the same reason, it is better for them to revise their check list of investment approval documents. Further, some incentives to sector which uses IT are to be considered for promotion of foreign direct investment to Indonesia. Whether an investment deserves such the incentives cannot be evaluated in advance, it should be so-called performance incentives.

With respect to incentives, it is also worthy to design new incentives for investment which utilizes local inputs in large quantity. The idea is illustrated in the Figure 2-27. Local content criteria used to be set as such that only investment which clears some level of local contents is given investment approval. However, here the concept is used as criteria for providing incentive. Again, the local input incentive should be performance one.

**Figure 2-27 Incentives for Local Inputs**



#### (4) Issues of manpower policy

The issue of manpower is two-fold. One aspect is the matter of securing foreign experts where Indonesian workers cannot replace foreign workers. In this aspect, the following is important

- Timely issue of work permits
- Issuance of work permits wherever it is clearly necessary
- Timely issue of business visas
- The other is to employ local workers without endangering their competitiveness while assuring employees' a decent standard of living.

Manpower policy should be arranged to meet these two requirements. In this aspect, among others, the following three considerations are important in formulating manpower policy

- Not to create over-protective working conditions
- Acceptance of flexibility in employment
- Development of capacity building of local workers

Reportedly, not only the Ministry of Manpower and Transmigration and the business world but also trade unions share the opinion that Indonesia needs FDI to accelerate economic growth in order to reduce unemployment, and, under the prevailing over-protective manpower policy, FDI will be discouraged from showing any interest in Indonesia. In order to expand FDI it is necessary to revise the current Manpower Act so that Indonesian companies regain confidence in their competitiveness on Indonesian business.

Indonesia's competitiveness is impaired by high economic cost as well as high social

cost. The former is brought about by the high cost of labor, which is attributable to the high level of wages and cost of complying with regulations, while the latter is attributable to cost of unemployment and cost of regulations. This is a reason why manpower policy matters.

#### **2.4.2 Basic Principles for Manpower Policy: Shift from Confrontation to Cooperation**

##### **(1) Contribution of FDI to development of the national economy**

The contribution of FDI to the development of the national economy is two-fold. One is the increase in the number of employees. The other is development of human resources. While the first one is usually stressed, the latter also should be seriously taken into consideration. FDI is executed on the basis of a global business strategy. The products made have to maintain not only price competitiveness but also quality competitiveness. Investors, to achieve this objective, make every effort to train Indonesian workers. The cost and time consumed for training is substantial. In this sense, investors invest their money not only in machinery and equipment but also human capital. Investment in human capital bear fruit only when long-term, favorable and reliable relation between employer and employees is established and maintained.

##### **(2) Increasing FDI's impacts on the national economy**

With the increase in FDI and in production, many companies come to be tied with each other. They are in the same boat. This means that once one of the links is broken, the negative impact can be a major problem not only for the companies concerned but also for the Indonesian national economy (Refer to Box 2.13). Such an occasion could happen when employer and employees are always adversaries and lack common interests. In order to avoid this kind of danger, it may be necessary for the government to adopt a flexible manpower policy and to leave the solution of problems to the company and its employees. The government should formulate a new Manpower Act taking these matters into consideration. In another words, the Government's intervention should be minimized. However, in order to solve labor problems arose between employers and employees in a smooth and smart way, it is necessary for both parties to keep always good communication on only daily operational matters but also corporate management.

### **Box.2.13 A Satellite Investment**

Around 30 years ago, an IT company, known worldwide, expanded to Indonesia, investing in a presence in Jakarta. Since then, the company expanded its operation year by year and grew to be one of the largest companies in Indonesia with almost 10,000 employees. With this development, vendors who supply related products and parts to the company opened their own operations near the company. The number of these vendors amounts to 30. The total number of employees at the magnet company and its vendors comes to around 30,000. Thus, a large satellite industry was born. The company introduced the so-called “Just in Time” system to its relations with these vendors. The system’s cycle is only two hours. Thus, the impact of stoppage of operation at the factory is very large. A long discontinuation will damage not only the company but also all of the satellite industry. Solution of labor problems in a smooth and smart way is only feasible when both an employer and employees keep always good communication on their business operation and corporate management. The management at the company bears deeply this in mind. One of managers says that both an employer and employees are in the same boat.

#### (3) Desirable basic principles for manpower policy

##### ■ A long term relationship principle

Sustainable corporate profits can be secured only when both an employer and employees cooperate each other based on a long term relationship. An employee is a laborer, but, at the same time, is a human capital. The necessity of such recognition becomes important under development of technology. Education and training become important to enhance employee’s productivity. In this sense, an employee is a “human capital” from every point of view. Manpower Act should strongly support this philosophy.

##### ■ A “ Win-Win ” principle

Considering the above, manpower policy should be constructed on the basis of cooperation between employer and employee, not confrontation between them. There is no winner or loser in this policy. Every party should be winner. Therefore it is necessary to solve labor issues in a manner mutual satisfactory to both employers and employees. This spirit of “win-win” should be explicitly described in the coming revision of the Manpower Act.

To realize the basic principle, first, employees have to cooperate for improvement of the company’s competitiveness and profits. However, next, employers have to reward the employees’ cooperation and efforts. In order to become confident in this type of cooperation, it is necessary for both employer and employee to make an agreement in writing. With the above strategy, it becomes possible that both employers and employees could evade the evil cycle of retaliation of dismissal and strike.

- A principle of emphasizing flexibility to changes in business environment  
Business environment is changing rapidly and if both employers and employees stick to a traditional way of thinking, they can not survive the business. The Government should be serious about the current changes taking place, too.
- A principle of attaching importance to time factor
- In current business world, time factor is becoming important for companies to survive global competition. When a labor dispute arises, it is necessary to solve the problem based on laws with speediness. For this, both an employer and employees have to observe relevant laws.

Table 2-69 shows how these principles affect solution of labor problems.

**Table 2-69 Vector for Solution of Labor Problems**

Principle Issue	A long term relationship	Win-win	Treat an employees as a human capital	Business environment	Time factor
Severance pay	---	Its components should be revised	Supplement by training and education scheme	Too generous provision should be revised	---
Outsourcing	Should be limited	Should be limited	Should be limited	Should be flexible	Should be flexible
Contract-based employment	Should be limited	Should be limited	Should be limited	Should be flexible	Should be flexible
Minimum wages	---	---	Its component should be revised	---	---
Labor disputes	---	Solution by both parties is desirable	---	---	Capacity building

### 2.4.3 Movement to rethink current Manpower Act

The basic labor law is the Manpower Act No 13, which was enacted in 2003. Even though it is a comprehensive law consisting of 193 articles, employers have negatively evaluated the Act complaining that the law is over-protective for employees. In particular employers advocated that articles concerning termination of employment, severance pay and outsourcing are over-protective for employees. Employers argue that under the current Act, they are not able to sustain their cost competitiveness relative to companies in other countries. The forthcoming manpower policy package is part of the government's larger strategy to improve the investment climate and address investor concerns about the labor situation. Reportedly, the revision of the Act covers the following areas (among others).

- Severance pay
- Minimum wages

- Labor contract
- Outsourcing
- Foreign expertise

#### 2.4.4 Termination of Employment and Severance Pay

*Keywords: Essence of severance pay, adverse impact of current scheme on growth and efficiency, mix of severance pay and other income supports, financial engineering for a new design of scheme*

(1) Severance pay: A symbol of inflexible labor practice

Summarizing Indonesian labor problems, it is said to be lack of flexibility in employment. Stipulation of severance pay is a symbol of such inflexibility. Recent comparative study on the flexibility of employment conducted by World Bank shows that Indonesia ranks the third inflexible country among twelve countries and its main factor lies in the large number of “Difficulty of Firing Index”. Severance pay is a major component of the index. The high cost of firing in Indonesia leads to the high index (Table 2-70).

**Table 2-70 Indices of Employment Flexibility**

Item Country	Hiring		Firing		Rigidity of Hours Index (0-100)	Average Index (0-100)
	Difficulty of Hiring Index (0-100)	Cost of Hiring (%of salary)	Difficulty of Firing Index (0-100)	Cost of Firing (weeks of wages)		
More restrictive (rigidity of employment index > 50)						
India	56	12	90	79	40	62
Cambodia	67	0	30	39	80	59
<b>Indonesia</b>	<b>61</b>	<b>10</b>	<b>70</b>	<b>145</b>	<b>40</b>	<b>57</b>
Brazil	67	27	20	165	80	57
Vietnam	44	17	70	98	40	51
Less restrictive (rigidity of employment index < 50)						
Korea	44	17	30	90	60	45
Philippines	56	9	40	90	40	45
China	11	30	40	90	40	30
Chile	33	3	20	51	20	24
Thailand	33	5	0	47	20	18
Malaysia	0	13	10	65	20	10
Singapore	0	13	0	4	0	0
Mean for all countries	39	40	35	38	13	80

Source: Chris Manning and Kurnya Roesad “ Survey of Recent Developments”, Bulletin of Indonesian Economic Studies ( World Bank)

(2) Essence of severance pay

Severance pay is made when dismissals and redundancies occur. Dr. Kirsten Sehnbruch, Professor at Center for Latin American Studies in University of California Berkeley, classifies reasons for dismissals and redundancies into two. One is just reasons and the other is unjust reasons. Generally speaking, severance pay is made only for unjust reasons.

- Just reasons:
  - end of contract
  - misconduct
  - retirement
  - voluntary resignation
- Unjust reasons:
  - downsizing (economic reasons)
  - redundancy (skill mismatch)
  - firm disclosure (bankruptcy)

Severance pay is widely recognized to have following four natures.

- A compensation for employees' inconvenience caused by sudden dismissal
- A "fine" that employers have to pay to employees for inconvenience of dismissals caused by unjust reasons on employers' side
- A kind of unemployment insurance
- A kind of income supports

Employees mean workers in formal sectors and those in informal sectors are not included. As Table 2-71 shows, among 95,177 thousand employees in Feb.2006 in Indonesia, only 25,972 thousand employees, around 37% of total employees, is covered for severance pay.

**Table 2-71 Number of Workers Who are Entitled to Receive Severance Pay:  
Regular Employee**

Employment status	No. of worker	Percentage distribution
Own account worker	18,301	19.2
Self employed assisted by family	20,632	21.7
Employer	2,813	3.0
Regular employee	25,972	37.2
Casual employee in agriculture	5,886	6.2
Casual employee not in agriculture	4,244	4.5
Unpaid worker	17,325	18.2
Total	95,177	100.0

Note: It is assumed that only regular employee is entitled to receive severance pay.

Source: BPS "Labor Force Situation in Indonesia" Feb.2006

### (3) Structure of severance pay

In the Manpower Act, termination of employment and severance pay are stipulated in Articles 156 to 172. When an employer terminates employment, he or she has to make three types of payment. They are Severance pay, Reward pay and Compensation pay. The total amount differs by the event causing termination and the duration an employee has served the company. Employers complain that the total amounts are too large. Further, they argue that it is rather difficult to terminate employees even though termination is due to wrongdoings by an employee. It is necessary to evaluate whether the current payment system is fair or not when it is compared with the cases in other countries.

Severance pay consists of three elements as follows.

#### ■ Retirement Pay

This payment is made when the employee is terminated, regardless of whether the termination is made on the basis of an employee's reason or an employer's reason, and other reasons such as death of the employee. In case of natural termination of definite-term employment, this payment is not made because the termination is based on law.

#### ■ Reward Pay

This payment is made on the basis of evaluation of the employee's contribution to the company. By its nature, payment is not made to employees whose service has been shorter than three years. The money will be paid even to employees who are not entitled to receive the retirement pay. The reason why the Manpower Act provided for this is that this payment, by nature, should be decided not by law but by free negotiation between employer and employee but if there is no regulation, employers cannot be expected to pay such money. In this sense, compulsive regulation is necessary when the weak position of employee is taken into account.

#### ■ Compensation Pay

This payment consists of three elements. One is pay for unpaid employee's right. Second is money paid for returning to the employee's native place after the employee is fired. The third is to secure the expected expenditure for housing and medical cost. This pay is stipulated to be 15% of total of the above retirement and reward pay.

### (4) Prevailing severance pay rates

With respect to the above retirement pay, in the year 1964 when the system was introduced, the four months of wages were at maximum. The rate was determined considering the employee's difficulty of finding the next job after termination of employment. However, since then, reflecting the labor market situation, the amount has been revised

several times, and it was fixed at the current level. The rate has been determined taking into consideration the necessity for employee and capacity to pay on employer's side. The employee's necessity reflects cost of living while he or she is looking for the next job.

Considering the nature of retirement pay, the payment is dependent on four factors as is shown in Table 2-72. The first is unemployment rate. If the rate is high, employee feels difficulty in finding next job after termination of current employment and requests large pay. The second is duration for job seeking after dismissal. If the duration is relatively short, employee may not request large amount of pay since he or she does not feel difficulty in finding next job. The third is corporate profits. If corporation enjoys high profits, employer can afford to pay large amount of retirement pay and becomes generous for large pay. The fourth is development of social insurance system. If the system is well developed, the payment is made by the system instead of employer. Therefore, the burden decreases for employer, though employer is requested to pay some contribution for the system.

**Table 2-72 Determinants of Severance Pay**

Factor	Elasticity to payment
Unemployment rate	Positive
Duration for job seeking after dismissal	Positive
Corporate profits	Positive
Social security system development	Negative

Note: Elasticity means that when a factor's value increases, the payment increases or decreases. For example, since the payment tends to increase when unemployment rate increases, the elasticity is positive. On the other hand, since the payment tends to decrease when social security system is well developed, the elasticity is negative.

The current pay rates are shown in Table 2-73. With respect to retirement pay, a cap is put on the payment. The pay increases in accordance with year of service, but, after 8 years of service, the pay rates become flat with nine months wages. The situation is the same for reward pay, but the pay rates become flat only after 24 years of service. Compensation pay is calculated as 15% of retirement pay plus reward pay.

**Table 2-73 Termination of Employment and Severance Pay**

Case	Reference articles	Retirement pay	Reward pay	Compensation pay
Dismissal	Art.156	Yes (*1)	Yes (*2)	Yes (*3)
Grave wrongdoings	Art.158	No	No	Yes
Guilty of crime	Art.160	No	Yes	Yes
Violations of provisions	Art.161	No	Yes	Yes
Resignation	Art.162	No	No	Yes

Case	Reference articles	Retirement pay	Reward pay	Compensation pay
Changes in the status of enterprise (workers are not willing to work)	Art.163 (1)	Yes	Yes	Yes
Changes in the status of enterprise (employers are not willing worker to work)	Art.163 (2)	Yes (two times)	Yes	Yes
Closure	Art.164	Yes	Yes	Yes
Closure by rationalization	Art.164(3)	Yes (two times)	Yes	Yes
Bankrupt	Art.165	Yes	Yes	Yes
Worker's death	Art.166	Yes (two times)	Yes	Yes
Enter pension age under pension program	Art.167	Yes / No	Yes / No	Yes / No
Absent from work for more 5 days without submitting a written explanation	Art.168	No	No	Yes
Worker makes a file for the settlement of industrial relations and terminate	Art.169 (2)	Yes (two times)	Yes	Yes
Worker makes a file for the settlement of industrial relations and terminate and employee is not guilty	Art.169 (3)	No	No	Yes
Ill for a long time	Art.172	Yes (two times)	Yes (two times)	Yes

(\*1)

Case	Year of service	Payment
a	Less than one year	One month wages
b	One year more but less than two years	Two month wages
c	Two years more but less than three years	Three month wages
d	Three years more but less than four years	Four month wages
e	Four years more but less than five years	Five month wages
f	Five years more but less than six years	Six month wages
g	Six years more but less than seven years	Seven month wages
h	Seven years more but less than eight years	Eight month wages
i	Eight years more	Nine month wages

(\*2)

Case	Year of service	Payment
a	Three years more but less than six years	Two month wages

b	Six years more but less than nine years	Three month wages
c	Nine years more but less than twelve years	Four month wages
d	Twelve years more but less than fifteen years	Five month wages
e	Fifteen years more but less than eighteen years	Six month wages
f	Eighteen years more but less than twenty one years	Seven month wages
g	Twenty one years more but less than twenty four years	Eight month wages
h	Twenty four years more	Ten month wages

Source: Manpower Act, No.13, 2003

(\*1)&(\*2)

(\* ) An employer shall not pay compensation if an employee has been terminated for one of the statutory causes provided that the employer indicated such cause in the termination notice. A written warning given to an employee who violated work regulations will now be valid for not more than one year from the date the employee committed the offense

(\*3)

-Annual leaves

-Costs or expenses for transporting the worker and family back to the point of hire

-Compensation for housing allowance, medical and health care: 15% of retirement and reward pay

-Others under the work agreement

(\*1)-(\*3): Changes in calculation shall be regulated with a Government Regulation

#### (5) Impacts on labor cost

Based on the past performance of dismissal and on the above schedule, it is calculated how the burdens of severance pay to employer is large as follows (Table 2-74). Even though the data is a little bit old since it is derived from the survey conducted in 1996 & 2000, it provides us several interesting information. First, turnover occurs in year of service for 2-5 and 5-10 years most frequently. However, the reason is not clear. Since severance pay scheme is influenced largely by structure of turnover, it is necessary to analyze the reason. Second, with respect to reason for dismiss, economic factor comes first with 63% followed by light wrongdoing with 31%. Voluntary and serious wrongdoings are few as reason for dismiss. Third, the average of severance pay is around 13% of total wages. However, actual cost ranges between 7-14%, an officer at APINDO says.

**Table 2-74 Average Severance Pay**

Year of service	Turn-over (%)	Reason for dismissal								Total % of salary
		Voluntary		Economic factor		Light wrongdoing		Serious wrongdoing		
		%	% of salary	%	% of salary	%	% of salary	%	% of salary	
Less than 1	11.7	0.0	1.63	7.8	17.25	3.9	9.25	0.0	1.63	1.7
1-less than 2	11.9	0.7	2.21	6.7	20.50	3.7	12.50	0.7	2.21	1.9
2-Less than 5	22.1	0.9	2.21	12.2	20.50	7.1	12.50	1.9	2.21	3.5
5-Less than 10	28.8	2.0	2.16	14.9	19.50	8.9	12.25	3.0	2.16	4.1
10-Less than 20	18.0	1.6	1.68	8.2	14.75	5.5	9.50	2.7	1.68	1.8
20-	7.5	0.8	1.24	3.4	10.25	2.1	7.00	1.2	1,24	0.5
Total	100.0	6.0		63.2		31.2		9.6		13.4

Source: Bahan presentasi LP3E FE UNPAD “ Indonesia’s Employment Protection Legislation. Swimming Against the Tide”

On the other hand, labor cost in total output is ranging from 3 to 13 % depending type of industry as is shown in Table 2-75. Average for large companies is around 7%. If the figure is used, annual cost for severance pay is theoretically 0.8% of output ( 7 %x 0.134). In case for medium scaled companies, the wage cost in total output increases to 20%, therefore, the burden of severance pay becomes large, say, 3% of output.

**Table 2-75 Employment Cost per Output : Large Manufacturing (2003)**

Industry	%	Industry	%
Fabricated metal products	7	Food and beverages	3
Machinery and equipments	8	Textiles	7
Electric machinery	8	Wearing apparels	13
Motor vehicles	6	Wood products	7
Chemical products	6	Total	7

Source: BPS Large and Medium Manufacturing Indicator 2003

According to a study on “Indonesia’s Employment Protection Legislation:

Swimming Against the Tide” conducted by Padjadjaran University on November 29, 2004, the high cost severance system brings about three unfavorable impact on labor market. High severance pay discourages employers to employ workers on permanent basis. It also hurts employment of younger workers and low educated workers, In the third, the system enhances problems of dualism and social exclusion in the labor market. Inflexible severance pay clause has adverse impact on the Indonesian labor market than as is expected (Refer to Box. 2.14 and 2.15)

**Box. 2.14 Negative Impact of Current Severance Pay Scheme on the Stability of Labor Market**

A company which is engaged in production of machinery equipments in Batam Special Economic Zone says that in order to mitigate the unfavorable impact of high severance pay on the company's profit, it employs a large number of employees except managers on contract-based employment. Since contract-based employment is allowed for only two years by Manpower Act, the company hires another employees on contract- base in every two years. Another companies follow the same policies, thus employees move from one company to another company in every two years. The company's president confesses that contract-based employment is not recommended as far as stability of employment is considered, but, considering the current high severance pay cost, it is unavoidable to follow the decision.

The above situation is seen in other countries such as India, too. "Severance Pay in Selected Asian Countries: A Survey" by Mukul G Asher and Pundarik Mukhopadhaya introduces the fact as follows.

*"A protective labor legislation has had adverse impact on growth and efficiency. Employers in India may react to these restrictive retrenchment laws by:*

- *using more contract, temporary and /or casual labor;*
- *expanding leasing in capacity of small firms;*
- *using more capital intensive and labor saving technology;*
- *shifting location of the industry to a state where labor is less organized;*
- *using the means of corruption / bribery to avoid legal consequences. "*

**Box. 2.15 Ironic Story Concerning Severance Pay**

A president director at a foreign company professes how current severance pay costs too much to a company. When a company faces financial difficulty, it tries to restructure the business line by downsizing its business. However, to downsize the business, they have to trim number of employee. They make severance pay to dismissed employees. Since the pay is so high, the company becomes almost bankrupt with the payment. It is too ironical.

(6) Movement to revise the severance pay clause in the Manpower Act, No.13, 2003

The current problem for the scheme is that employers have to pay 32.5 times of monthly wages at most when they lay off their workers. Further, they are obliged to pay the amount even to high salaried workers. One of the executives in APINDO, the employers' association in Indonesia, claims that under the current condition, an enterprise is bound to die. Actually, the company has to reserve a certain percent of expected severance pay as a liability. The burden is very heavy because the company has to do for all of its employees.

Corresponding to these criticisms from employers, reportedly the government is considering revision of these stipulations. The major points of the proposed revision are the following two. First, the payment amount is to be decreased for high-salary employees since the nature of the payment is to ensure maintenance of a standard of living while the employees are between jobs and lack a source of income. In other words, the severance pay system supplements the social security system. In order to improve the social security system, on the other hand, the contribution made by employers will be increased.

First, the payment amount is to be decreased for high salaried employees since nature of the payment is to secure their standard of living while they are out of job and lack source of income. In other words, the severance pay system supplements a part of social security system. In order to improve social security system, on the other hand, contribution by employers will be increased.

It is said that under the current scheme, high wage earners tends to quit their current jobs and to move to other companies in order to get large amounts of severance pay. This contracts the original concept of severance pay that secures employee's standard of living while he is out of job. Thus it is said that, in the new Manpower Act, only employees whose wage income is lower than some level will be titled to receive severance pay. It is reported that current severance pay will be altered as follows.

- Strikes, which endanger human lives (Art.139)
  - ↳ Strikes, which are staged without any written notice within 7 days prior
    - ↳ Illegal → Terminate employee without severance pay (Art. 142)
  
- Grave wrongdoings (Art.158)
  - ↳ Suspend employment → No obligation to pay wages
    - ↳ Verdict of guilty → Terminate
      - ↳ Compensation pay only
    - ↳ Verdict of not guilty → Repeal suspend
      - ↳ Pay wages and other compensation
  
- Violation of provisions of work agreement or regulations (Art.161)
  - ↳ Terminate after issuing three times warning letters
    - ↳ Reward and compensation pay
  
- Termination on employee's own will (Art.162)
  - ↳ Compensation pay
  
- Termination in the event of change in the status of the enterprise (Art.163)
  - ↳ Termination
    - ↳ Severance pay, reward and compensation pay (One time of usual pay)
  
- Termination owing to rationalization, Force Majeur and bankruptcy (Art.164&165)
  - ↳ Termination
    - ↳ Severance pay, reward and compensation pay (One time of usual pay)
  
- Termination owing to death (Art.166)
  - ↳ Termination
    - ↳ Severance pay (Two times) reward and compensation pay (One time )
  
- Termination owing to absence (Art.168)
  - ↳ Termination → Detachment money pay

Second, by allowing employers to introduce a new scheme of temporary layoffs of employees, they will be able to dismiss employees who are responsible for wrongdoings without paying salaries during the period that employers and employees dispute the legality of termination of employment.

Third, the payment amount is to be decreased for high salaried employees since nature of the payment is to secure their standard of living while they are out of job and lack source of income. In other words, the severance pay system supplements weak social security system. In

this regard, it is said that under the current scheme, high wage earner tends to quit the current job and to move to another company in order to get huge amount of severance pay. This contradicts the original concept of severance pay that secures employee's standard of living while he is out of job. Thus it is said that, in the new Manpower Act, only employees whose wage income is lower than some level are entitled to receive severance pay

(7) Necessity of developing social security system for unemployment

In case the above severance payment provision is simplified, improvement in the social security scheme is indispensable for protection of workers' livelihoods while they are out of work and have no source of income. If such a system is well developed, it becomes easy to terminate employment. The current situation, however, tells us that workers have no scheme for assuring unemployment security as is shown below (Tables 2-76). Only available schemes are provisions for compensation in the event of accidents or death during work, and the health care and pension fund. They comprise the Jamsostek Program. Therefore, in order to provide security against unemployment, it is necessary to develop a new unemployment security scheme, however, there is no movement seeking to accomplish this at this moment. This is because both employees and employers are against their contributing to the scheme. The point is whether employers are ready to provide 100% of the contribution for the scheme. Jamsostek officers do not favor any increase in the employers' contributions because they feel that the social security cost for employers is already so high, at 8-13% of wages

While employers welcome the above revision of the severance pay scheme, some of them comment that more importance is freedom to terminate employment. Under the current Manpower Act, it is possible for an employer to dismiss employees for the reason of wrongdoings on employee. However, due to deficiencies in procedures it is very difficult to actually do this.. This problem poses a more serious matter than severance pay conditions itself. Especially, they complain that it is very difficult to get permission from the Ministry of Labor. The process of dismissing employees should be streamlined. An alternative way to settle the problem of termination of employment as soon as possible may be to set up a new scheme of suspending employment until the dispute is settled. It is said that such the scheme is being considered in connection with revision of the Manpower Act.

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problem of termination of employment as soon as possible may be to set up a new scheme of suspending employment until the dispute is settled. It is said that such the scheme is being considered in connection with revision of the Manpower Act.

**Table 2-76 Social Security System in Indonesia**

	Contribution : percentage of wages	Contributor	Laws and regulations
Work accident	0.24-1.74%	Employer 100%	Employees Social Security Act No.3/1992 Government regulation No.14/1993
Death	0.3%	Employer 100%	Employees Social Security Act No.3/1992 Government regulation No.14/1993
Healthcare	For single workers 3% For married workers 6%	Employer 100%	Employees Social Security Act No.3/1992 Government regulation No.14/1993
Pension fund (Compulsive)	5.7%	Employee 2% Employer 3.7%	Employees Social Security Act No.3/1992 Government regulation No.14/1993
Total		Employee: 2% Employer: 7.2-11.8%	

Source: Jamsostek

(8) Comparative studies in other Asian countries

1) Viet Nam

Compared with Indonesia's case, Viet Nam's regulation is simple and amount of severance payment is small in terms of the number of months of wages. Also, there is no stipulation on reward and compensation pay (Table 2-77)

**Table 2-77 Severance Pay in Viet Nam**

Case of dismissal	Article	Severance Pay	Reference
■ Employee becomes unemployed due to organizational restructuring or technological changes	Article 17	Yes (Article 17)	One month's wages for each year of employment
■ Termination of trial job	Article 32	No compensation (in case that performance does not satisfy the agreed requirement) (Article 32)	If the work performed satisfies the agreed requirements, the employer must officially employ the employee
■ Termination of labor contract	Article 36	Yes (Article 42)	Half of one month's wage for each year of employment

Case of dismissal	Article	Severance Pay	Reference
			As to termination itself, necessary to get agreement with the executive committee of the trade union
■ Not perform repeatedly the work in accordance with the terms of labor contract	Article 38	Yes (Article 42)	Half of one month's wage for each year of employment As to termination itself, necessary to get agreement with the executive committee of the trade union
■ Employee commits an act of theft, embezzlement, disclosure of business or technology secrets Employee disciplined by extension of the period for wage increase or transfer to another position re-commits an offence	Article 85	No (Article 42)	As to termination itself, it is necessary to get agreement with the executive committee of the trade union
■ Employee suffers illness and remains unable to work after have received treatment for some period	Article 38	Yes (Article 42)	Half of one month's wage for each year of employment As to termination itself, necessary to get agreement with the executive committee of the trade union Period: twelve consecutive month for an indefinite term labor Six consecutive months for a definite term contract with a duration of twelve months to thirty six months Necessary to get agreement with the executive committee of the trade union
■ Dismissal due to natural Disaster, fire or another event of Force Majeure	Article 38	Yes(Article 42)	Half of one month's wage for each year of employment
■ Cease operation	Article 38	Yes(Article 42)	Half of one month's wage for each year of employment

## 2) Thailand

The basic laws governing labor relations in Thailand is the Labour Relations Act B.E.2518 (1975) and the Labour Protection Act B.E.2541 (A.D.1998). The former Act

composes of 162 sections. The main contents are as follows:

- Chapter 1: Agreement relating to conditions of employment (11 sections)
- Chapter 2: Settlement of labor disputes (13 sections)
- Chapter 3: Lock-Out and strike (3 sections)
- Chapter 4: Labor Relations Committee (8 sections)
- Chapter 5: Employees' Committee (9 sections)
- Chapter 6: Employers' Association (31 sectors)
- Chapter 7: Labor union (26 sections)
- Chapter 8: Employers' federation and labor federation ( 9 sections)
- Chapter 9: Unfair practices (7 sections)
- Chapter 10: Penalty provisions (33 sections)

On the other hand, the latter Act composes of 16 Chapters and Transitory Provisions with 166 sections. The main contents are as follows.

- Chapter 1: General Provisions (17 sections)
- Chapter 2: Employment of Labour in General (15 sections)
- Chapter 3: Employment of Women (6 sections)
- Chapter 4: Employment of Young workers (9 sections)
- Chapter 5: Wages, Overtime Pay, Holiday Pay and Holiday Overtime Pay (25 sections)
- Chapter 6: Wage Committee (14 sections)
- Chapter 7: Welfare (8 sections)
- Chapter 8: Occupational safety, Health and Environment (8 sections)
- Chapter 9: Supervision (8 sections)
- Chapter 10: Suspension from Work (2 sections)
- Chapter 11: Severance Pay (5 sections)
- Chapter 12: Lodgment and Consideration of Complaints (3 sections)
- Chapter 13: Employee Welfare Fund (13 sections)
- Chapter 14: Labour Inspectors (4 sections)
- Chapter 15: Delivery of Notices (1 section)
- Chapter 16: Penalties (15 sections)
- Transitory Provisions (7 sections)

In Thailand, it is not required to make severance pay to an employee whose employment has been terminated for any of the following reasons:

- Dishonest performance of his duties or the intentional commission of a criminal act against the employer
- Intentionally causing loss to the employer
- Performance of an act of gross negligence which results in severe loss to the employer
- Violation of the employer's work rules or regulations or orders which are both lawful and equitable

On the other hand, employers are requested to pay severance pay for the following cases shown in Table 2-78. Again, compared to Indonesia's case, the amount of severance pay is relatively small. Thailand's provision is unique in that while the severance pay increases along with the duration of service which employee rendered, a cap is put on the amount.

**Table 2-78 Severance Pay in Thailand.**

Case of dismissal	Section	Severance pay etc	Reference
<ul style="list-style-type: none"> <li>■ Termination of employment not due to commitment of wrong doings</li> </ul>	Section 67	Yes (Section 67)	Pay wages for annual holidays in the year of termination Other compensation
<ul style="list-style-type: none"> <li>■ Expiry of contract of employment</li> </ul>	Section 118	Yes (Section 118) For service of More than 125 days but less than one year: Wages for 30 days More than one year but less than three years: Wages for 90 days More than three years but less than six years: Wages for 180 days More than six years but less than ten years: Wages for 240 days(5) More than ten years: Wages for 300 days (Section 118)	Includes the case that employee does not work on the ground that the employer is unable to continue the undertaking
<ul style="list-style-type: none"> <li>■ Termination of employment for a definite period</li> </ul>	Section 118-paragraph 3	None(Section118)	
<ul style="list-style-type: none"> <li>■ Termination of employment under wrongdoings</li> <li>(1) Perform duty dishonestly or intentionally commit criminal offence against employer</li> <li>(2) Intentionally cause damage to employer</li> <li>(3) Cause serious damage to employer as a result of negligence</li> </ul>	Section 119	None (Section 119)	

Case of dismissal	Section	Severance pay etc	Reference
(4) Violate work rule or regulations or orders (5) Neglect duty without justifiable reason (6) Be imprisoned			
■ Termination of employment due to refusal of relocation of the place of business	Section 120	Yes (Section 120) Not less than 50% of the pay stipulated in Section 118	Employer shall notify the employee of not less than 30 days prior to the date of relocation (If employer fails to notify, he has to pay wages for 30 days)
■ Termination of employment due to reorganization of business	Sections 121 & 122	Yes (Section 121) The pay stipulated in Section 118 If the employee has worked more than 6 years, Special Severance pay of 15 days for each year shall be paid though total severance pay shall not exceed wages for 360 days (Section 122)	Employer shall notify the employee of not less than 60 days prior to the date of reorganization (If employer fails to notify, he has to pay wages for 60 days)

Source: Labour Protection Act B.E.2541 (A.D.1998)

### 3) The Philippines

In the Philippines, The Labor Code of The Philippines, Presidential Decree No.442, as Amended stipulates labor conditions which both employer and employee are to observe. The code composes of six books as follows. Provisions on severance pay are simple and amount of the payment is relatively small compared to the case in Indonesia as is shown in Table 2-79.

- Book One: Pre-employment
  - Recruitment and placement of workers
  - Employment of non-resident aliens
- Book Two: Human resources development program
  - National Manpower development program
  - Training and employment of special workers
- Book Three: Conditions of employment
  - Working conditions and rest periods
  - Wages
  - Working conditions for special groups of employees
- Book Four: Health, safety and social welfare benefits

- Medical, dental and occupational safety
- Employees' compensation and state insurance fund
- Medicare
- Adult education
- Book Five: Labor relations
  - Policy and definitions
  - National labor relations commission
  - Bureau of labor relations
  - Labor organizations
  - Coverage
  - Unfair labor practices
  - Collective bargaining and administration of agreements
  - Grievance machinery and voluntary arbitration
  - Strikes and lockout and foreign involvement in trade union activities
  - Special provisions
- Book Six: Post employment
  - Termination of employment
  - Retirement from the service
- Book Seven: Transitory and final provisions
  - Penal provisions and liabilities
  - Prescription of offenses and claims
  - Transitory and final provisions

**Table 2-79 Severance Pay in the Philippines**

Case of dismissal	Section	Severance Pay etc	Reference
■ Unjust dismissal	Art. 279	None	Invalid Employee shall be entitled to reinstatement Compensation shall be paid
■ Wrongdoings (a) Serious misconduct or willful disobedience (b) Gross and habitual neglect of duties (c) Fraud or willful breach (d) Commission of a crime	Art. 283	None	Employer can dismiss
■ Dismiss due to the installation of labor-saving devices or redundancy Closure of establishment and reduction of personnel	Art. 283	Yes: One month pay or one-half month pay for every year of service,	It is necessary to inform workers and the Ministry of Labor and Employment at least one month before the intended date

Case of dismissal	Section	Severance Pay etc	Reference
		whichever higher	
■ Dismiss due to retrenchment to prevent losses and closure of establishment or undertaking not due to serious business losses	Art. 283	Yes: One month pay or one-half month pay for every year of service, whichever higher	It is necessary to inform workers and the Ministry of Labor and Employment at least one month before the intended date
■ Disease as ground for termination	Art. 284	Yes: One month pay or one-half month pay for every year of service, whichever higher	Only in case that continuous employment is prohibited by law or is prejudicial to employee's health
■ Termination by employee	Art. 285	None	
■ Retirement from the service upon reaching the retirement age	Art. 287	Yes: the age of 60 years or more but not beyond 65 years—one-half month salary for every year service	Retirement benefits The service should be at least five years

Source: Labor Code , Book six

#### 4) China

(Labor law in China)

The legal structure in China is unique. There are three layers. The first one is a nation-wide law and the second one is region -wide law. The third one is regulation which is only applicable to foreign companies operating in China.

Taking labor law as an example, with respect to joint-ventures, the nation-wide basic law is “Provisions of The People’s Republic of China for Labor Management in Chinese-Foreign Joint Ventures.” The provisions consist of only 16 articles and are very simple. Basically the provisions are for solution of labor problems. The basic philosophy is to leave the solution to the labor contract between employer and employee. In this sense, the government does not intervene. On the other hand, region-wide law differs by region. For example, Shenzhen Special Economic Zone has its own regulations. It is “Regulations of Shenzhen Special Economic Zone on Laborers”. It consists of eight chapters and 55 articles as follows.

Chapter 1: General Provisions (9 articles)

Chapter 2: Qualifications and Producers of Laborer Recruitment (9 articles)

Chapter 3: Labor Contracts (13 articles)

Chapter 4: Working Time and Vacation (4 articles)

Chapter 5: Labor Payment and Social Insurance (7 articles)

Chapter 6: Occupational Safety and Health (5 articles)

Chapter 7: Labor Supervision and Settlement of Labor Dispute (5 articles)

Chapter 8: Supplementary Provisions (3 articles)

The third one is regulation named “Regulations on Labor Management in Foreign Companies” It consists of 36 articles and stipulates basic requirements.

(Termination of employment and severance pay)

In China too, it is possible for an employer to dismiss an employee. This is provided for in the above nation-wide Regulation on Labor Article 4. However, employers have to give compensation to the employees. The amount is not fixed by the Regulations and is to be determined in accordance with provisions of the labor contract. Thus, there is no governmental regulation on the amount.

The regulations of Shenzhen stipulate that compensation is to be paid by the employer for termination of employment is as follows.

Article 25 : The standard of paying the economic indemnity shall be calculated based on a laborer’s continuous service life in certain unit: one monthly-wage shall be paid to the laborer, if his service life expires one year: the sum of economic indemnity shall not exceed total amount of twelve monthly –wage.

“Regulations on Labor Management in Foreign Companies” stipulates severance pay in Article 19 as follows. Severance pay consists of two pays. One is pay that covers the cost of living and the other covers pay for medical expenses. The former pay is one month’s wage for each year of service, while the latter pay is 3 months of wages for employees whose service life is less than 5 years and 6 months of wages for employee whose service life is more than 5 years.

##### 5) Other related studies

In addition, results of several other studies are available. Among them, “Severance Pay in Selected Asian Countries: A Survey” provides us an overall picture on the current situation of severance pay. The survey has been conducted for six countries in Asia. The are India, Malaysia, Philippines, Singapore, Sri Lanka and Thailand. The result shows diversity in the philosophy, design features, implementation efficiency of severance pay. Following Table 2-80 summarizes the result.

**Table 2-80 Comparison Table for Severance Pay in Six Asian Countries**

Country	India	Malaysia	Philippines	Singapore	Sri Lanka	Thailand
Legislative framework						
• Coverage	Only formal private sector	Only formal private sector	Only formal private sector	Only formal private sector	Only formal private sector	Only formal private sector
• Payment	Mandatory	Mandatory	Mandatory	Non mandatory	Mandatory	Mandatory
Amount						
• 9 month service	12 days	8 days	1 month	12 days	1.7 months	1 month
• 4 years service	2 months	2months	2 months	4 months	9 months	6 months
• 20 years service	10 months	13.5 months	10 months	20 months	46 months	10 months
Payment						
• Method	Lump sum	Lump sum	Lump sum	Lump sum	Lump sum	Lump sum
Financing						
• Responsibility	Employer	Employer	Employer	Employer	Employer	Employer
• Tax exempt	No	No	Yes	No	Unknown	No
Other income support system	---	---	Social risk pooling arrangements	---	Consider to introduce unemployment insurance system	Plan to introduce unemployment benefit fund
Implementation						
• Enforcement	Weak	---	Concern about weakness	---	Quite weak	Concern about weakness
• Transaction cost	High	---	Relatively high	Low	High	Relatively high

Source: Made from Mukul G Asher and Pundarik Mukhopadhaya ““ Severance Pay in Selected Asian Countries: A Survey”

#### 6) Summary of comparison between Indonesia and other Asian countries

Since each country has its own system based on different labor practices, it is difficult to conclude which country is favorable to employees and which country is favorable to employers, but it seems that as far as severance pay including reward pay is concerned, Indonesia’s system is more favorable to employees than in other countries.

Even though the amount of Indonesia’s severance pay is larger than that of other countries it is not easy to say definitely what level is appropriate to Indonesia. Considering that the pay is a kind of social security safety net for unemployed workers, the level should depend on how many days a worker has to wait to find next job. If the duration is short, the worker should be satisfied with relatively small amount of pay. On the other hand, if a worker who became unemployed has to wait so many days until he or she finds the next job, they need more severance pay. Data on the duration for this is not available in Indonesia. However,

related data as available is shown in Table 2-81. These data tells us that the number of new job seekers far exceeds the number of new job finders. As a result, the number of people looking for jobs tends to increase. If the calculation is correct, it takes about 37 months until all unemployed men can find their next job, while it takes 100 months for all unemployed women to do so. That is, results vary by gender and also by age.. By age and gender, it takes 28 months for a 20-29 years old man, while it is 71months for the same age bracket's women. Reading from Table 2-82, generally speaking, it is rather easy for both men and women in the 30-44 age bracket to find a job than those in the 20-29 age bracket.

**Table 2-81 Number of New Job Seeker and New Job Finder by Age Group in East Jakarta**

Data for	All age bracket	Men	Women	Total
May 2005	No. of job seeker(1)	26,365	24,302	50,667
	Job finder(2)	605	678	1,283
	(1)/(2)	36	36	36
May 2006	No. of job seeker(1)	30,589	29,462	60,045
	Job finder(2)	555	285	840
	(1)/(2)	37	103	71
May 2006 (20-29 years)	No. of job seeker(1)	11,921	14,123	26,044
	Job finder(2)	425	200	625
	(1)/(2)	28	71	42

Source: Labor office at Kota East Jakarta

**Table 2-82 Changes in the Duration of Waiting for a New Job : 20-29 Years and 30-44 Years**

Year & month	Men		Women		Total	
	20-29 years	30-44 years	20-29 years	30-44 years	20-29 years	30-44 years
May 2005	55	16	47	12	51	14
Jun.	63	18	53	8	58	11
Jul.	40	14	27	6	32	10
Aug.	19	10	22	6	20	8
Sept.	14	7	17	6	15	7
Oct.	44	16	31	10	43	13
Nov.	61	28	47	18	53	23
Dec.	6	29	31	29	9	24
Jan. 2006	7	2	8	1	7	2
Feb.	14	16	55	10	22	13
Mar.	23	19	47	10	32	14
Apr.	27	22	57	10	33	15

Source: Labor office at Kota East Jakarta

The duration for being able to find the next job is largely influenced by the job market, that can be measured by the unemployment rate. In this regard, Table 2-83 shows unemployment rate in relevant countries including Indonesia. The rate is quite low in both Thailand and Viet Nam, while it is high in both Indonesia and the Philippines. In fact, it is not unreasonable that the number of months of severance pay is larger in Indonesia than in Thailand and Viet Nam. However, it is not easy to say definitely that the current Indonesian severance pay is matched to the unemployment rate. What could be said is that, in order to minimize the severance pay, the Indonesian government has to make efforts for improving social security for unemployed workers and enhancing labor mobility by establishing a government system for matching employers with manpower requirements and workers who are seeking employment.

In designing a new formula, the following factors should be taken into account.

- 1) Availability of social security for unemployed workers
- 2) Job opportunity different by age and sex
- 3) Duration unemployed people have to wait until they can find next job

For the above second and third factors, it is necessary to grasp statistics on real situation of duration for finding next job by age and gender.

**Table 2-83 Unemployment Rate in Asian Countries(%)**

Country	Year	Percentage
Indonesia	2002	9.1
Thailand	2004	1.5
Viet Nam	2004	2.1
The Philippines	2004	10.9

Source: ILO

Table 2-84 compares severance pay by type of unjust reason among five countries including Indonesia.

**Table 2-84 Comparison of Severance Pay between Indonesia and Other Asian Countries**

Case	Term of service	<b>Indonesia</b>	Viet Nam	Thailand	The Philippines	China (Shenzhen Special Economic Zone)	China ( Foreign Companies)
Closure due to continual loss	5 years	<b>8months</b>	5 months	3 months	2.5 months	5 months	11 months
	10 years	<b>15 months</b>	10 months	10 months	5 months	10 months	16 months
	15 years	<b>17 months</b>	15 months	10 months	7.5 months	12 months	21 months
	20 years	<b>18 months</b>	20 months	10 months	10 months	12 months	26 months
Closure for rationalization	5 years	<b>16 months</b>	5 months	6 months	2.5months	5 months	11 months
	10 years	<b>25 months</b>	10 months	12 months	5 months	10 months	16 months
	15 years	<b>28 months</b>	15 months	12 months	7.5 months	12 months	21 months
	20 years	<b>29 months</b>	20 months	12 months	10 month	12 months	26 months

Indonesian's pay is higher than other countries as is shown above, however, in order to compare actual effective cost for employer, it is necessary to take difference in wage level into account. For example, suppose that severance pay in Indonesia is 20 months of wage, while it is 10 months of wage in Thailand. It is clear that cost to employers is double for Indonesia compared to Thailand. However, when Thailand's wage level is double of Indonesia's one, the actual severance pay is the same between Indonesia and Thailand. Therefore, severance pay in the above table should be adjusted by the difference in minimum wage level. The result is shown in Table 2-85. Indonesia's severance pay is still high.

**Table 2-85 Severance Pay Adjusted by Difference in Minimum Wages**

Year of service	Indonesia	Viet Nam	Thailand	The Philippines
5 years	16 months	3 months	9 months	5 months
10 years	25 months	6 months	17 months	11 months
15 years	28 months	9 months	17 months	16 months
20 years	29 months	12 months	17 months	21 months

Footnote: Case for closure for rationalization

(9) Design future severance pay scheme

1) Basic understandings on essence of the pay

To employers, the less severance pay, the better. On the other hand, to employees, the more pay, the better. Considering a serious conflict of interest between both parties, for solution of the pay problem, it is necessary to propose fair and reasonable pay rates which will be agreed upon by them. Otherwise, both employers and employees do not reach so-called win-win solution.

In order to get a fair and reasonable solution, it is necessary to deliberate once again the concept and characteristics of severance pay. The pay is fundamentally a temporary one which is caused by an irregular event. For the reason, employers have to pay some money to employees for their inconvenience caused by dismissal. The inconvenience is two fold. One is that employees are suddenly dismissed against their expectation that they could enjoy rights to work at a company. The other is that they suddenly lose means of earning money for sustaining their daily life. The dismissed employees try to find next jobs, but it takes some time for them to find job opportunities. Employers have to compensate employees for these two inconveniences.

The first compensation should be, by nature, a single rate, while the latter should reflect each employee's cost of living. Determinants of cost of living are two of reasonable monthly

wages for each employee and duration for which should be spent to find next job. For example, it is assumed that an employee who earns Rp 10 million per month is dismissed for company's economic reason. He has to begin to find out next job. If it takes six months to find the job, he has to spend Rp 60 million for sustaining his family. However, he has no way to get such an amount of money. It is to be covered by severance pay. The issue is how long it takes for him to find the next job. Generally speaking, an elder employee has rich job experience, therefore, he or she does not find so much difficulty in finding the next job. On the other hand, for younger employees, it is not so easy to find out next job because their experiences are few and competition on finding a new job is comparatively tough, therefore, duration until finding next job tends to become large compared to elder employees. The above duration may not be different between an employees who has served for, say 10 years, and 15 years. If it is true, the duration is set as flat from some years on in other saying, a cap should be laid on the duration.

With respect to the structures, other countries not only in Asia but also in Latin America share common ones. They are,

The severance pay is made only for "unjust reasons "

The amount is different by type of unjust reason.

The amount is generally related to the period of time that an employee worked for a company.

The longer, the larger.

The concept is a kind of unemployment insurance. In other sayings, It is provided to workers while they are looking for a new job.

## 2) Proposed structure

Considering that

- Severance pay is a kind of social securities for unemployed people,
- Severance pay is a safety net to poor people,
- The months for the pay should be determined based on how many months unemployed workers have to wait until they can find next job,

the pay rates should be set as follows.

- (a) Severance pay should consist of two components of retirement pay and compensation pay. It should not include reward pay. This payment should be separately determined under individual labor contract between an employer and an employee. By nature of severance pay, retirement pay rate by year of service should be basically more flat than reward pay.
- (b) Severance pay differs by type of termination of employment. An example is shown in the below table (Table 2-86)
- (c) The severance pay should be determined taking into account how many months it takes for an employee to find next job after dismissal. The duration may differ the

- employee's job experience. In this sense, it is not always fair and reasonable to consider that the longer years served in the previous working place, the more the months for severance pay. A cap is laid in severance pay as is seen in Thailand
- (d) In order to fix a fair and reasonable pay rates, the Government should try to collect market information on the above duration for finding next job after dismissal.

Based on the above consideration, one example of revised scheme is drawn as follows.

<b>One example of a new severance scheme</b>	
<b>1. Retirement pay: simplify to three rates</b>	
<b>Less than one year' service</b>	<b>one month</b>
<b>One-five years' service</b>	<b>three months</b>
<b>More than five years</b>	<b>six months</b>
<b>2. Reward pay: the rates is determined by labor agreement between an employer and employees</b>	
<b>The government obliges both parties to conclude the agreement prior to employment</b>	
<b>3. Compensation pay : 15% of retirement pay</b>	

### 3) Another considerations

Considering that severance pay is one of income supports for employees, it is advised for the government to include the following scheme as one of the pays, even though it is not a pay in a real sense. This implies that severance pay system shifts its weight gradually from monetary term pay only to non-monetary benefits such as supports of job training to employees. In order to develop a special scheme consisting of traditional severance pay and other income supports, research and development of financial engineering for the scheme becomes necessary.

- Job training support which makes it possible for employees to find next job after dismissal
- Job search support which assists dismissed employees in finding next job
- Personal saving support which provides employees incentives for saving with special interest and some contribution from employers

If the above schemes are developed, the pressure on severance pay will be mitigated. Under the current situation that the above schemes are not observed, severance pay in monetary term becomes only one target for discussion. This situation is not favorable.

**Table 2-86 Proposed Structure of Severance Pay**

Amount of severance pay Reason	None	Small	Medium	Large
<b>Just reasons</b>				
Grave wrongdoings	*			
Guilty of crime	*			
Violations of provisions	*			
Absent from work	*			
Voluntary resignation	*			
End of contract	*			
Worker's death		*		
Ill for a long time			*	
<b>Unjust reasons</b>				
Changes in status of enterprise (workers are not willing to work)		*		
Changes in status of enterprise (employers are not willing worker to work)			*	
Closure			*	
Bankrupt			*	
Downsizing				*
Redundancy (skill mismatch)				*
Closure by rationalization				*

(10) Another option: Transition to a social security scheme

1) A trade union's proposal

Current severance pay scheme in Indonesia is obviously too protective for employees when it is compared with other Asian countries. If the current situation persists, labor cost tends to become high and it endangers Indonesian competitiveness vis-a-vie other Asian countries competitiveness in world market. In addition, current scheme impairs stable labor market and produces non-regular employment such as outsourcing and contract-based employment. To employees too, to secure stable labor market is more valuable than to enjoy current severance pay scheme, if they are requested to select one between them. If reward pay determined by year of service is separately given within a framework of employer-employee agreement, stable and long term employment will bring a benefit to employees.

Even though, it becomes clear that the current severance pay should be revised, it is difficult to point precisely which level is reasonable and fair. It is because basic data and information is not available on duration until an employee can find next job once he or she is fired. In this regard, it is urgent to strengthen research function on labor matters.

Current severance pay system is a part of substitute for unemployment social security which is underdeveloped. As a result, the pay becomes large. Thus, development of unemployment social security system is another option for solution of current too generous severance pay for employees. In this regard, one of the most influential trade unions, whose member counts 1.7 million workers, proposes to replace the current severance pay scheme with a social security scheme. The president speculates that if contribution for social security by employers is increased from current 11.7% to 18%, and contribution by employees is increased from 2% to 3%, it is possible to reduce severance pay to zero. The trade union prefers this scheme. Reportedly, the government has begun to study such the possibility. With a respect to a concern that increase in employers' contribution may impair their competitiveness in world market, one of trade unions insists that the increase is reasonable considering current low level of contribution on pension fund compared with high contribution in other countries (Table 2-87).

**Table 2-87 Comparison of Contribution for Pension Fund (%)**

Country	Employer	Employee	Total
Singapore	20.00	13.00	33.00
Malaysia	12.00	11.00	23.00
Philippines	5.04	3.36	8.40
India	12.00	12.00	24.00
<b>Indonesia</b>	<b>3.70</b>	<b>2.00</b>	<b>5.70</b>
Nepal	10.00	10.00	20.00
Tanzania	10.00	10.00	20.00
Uganda	10.00	5.00	15.00
Papua New Guinea	5.00	5.00	10.00
Kenya	5.00	5.00	10.00
Sri Lanka	12.00	8.00	20.00

Source: JAMSOSTEK

The above mentioned trade union's proposal of replacing severance pay with social security has some issues to be solved as follows:

- Coverage of the severance pay

Current severance pay in Indonesia includes reward pay. The pay is not matching the philosophy of social security. Therefore, the pay may not be covered by social security scheme. Actually, JAMSOSTEK is reluctant to include the pay in the social security

scheme. However, on the other hand, considering that it is difficult to bind employers to pay reward pay under usual labor agreement between an employer and employees, employees may persist to include the pay in the social security scheme.

- Coverage of an employee

Ideally, not only regular employees but also outsourcing and contract-based employees are to be covered. In this case, however, since many issues are involved in such as collection of contribution, the scheme will become more complicated.

- Type of security

Two schemes are considered. One is saving type and the other is risk pooling type or insurance type. In the latter case, it is difficult to decide which organizations are allowed to join in the scheme. It is because depending on the quality of organizations, the risk differs.

- Contribution rate for both employers and employees

The rate is crucial and both feel the less, the better. The rate should be determined taking into consideration various kind of factors such as tax exemption for employers' contribution and for interest on savings at JAMSOSTEK's fund management.

- Sustainability of the scheme

The scheme becomes sustainable only when both employers and employees contribute to the scheme as is scheduled. The above trade union says that only 20% of employers pay severance pay at this moment and fears moral hazard by some employers.

## 2) Several options for reform of severance pay

Following Table2-88 shows several options for reform of severance pay. Case 1 is a minor revision of the current scheme. Case 2 is a change to a social security scheme and Case 3 is a reform by mix of the current scheme and a social security scheme. Among these cases, JAMSOSTEK insists that in case of transition to social security, only retirement pay is to be transferred to social security because other two of reward and compensation pay are not fit to the nature of social security.

**Table 2-88 Alternative Schemes**

Alternative scheme	Case	Contents	Issues to be solved
1. Maintain current scheme	1-(1) Only rates are modified	(1) Revise current rates to fair and reasonable ones	(1) Determine fair and reasonable rates (2) Financial engineering for design of a new scheme is necessary
	1-(2) Separate "reward pay"	(1) Revise current rates to fair and reasonable ones for severance pay and compensation pay	(1) Get consensus from employees (2) Financial engineering for design of a new scheme

Alternative scheme	Case	Contents	Issues to be solved
		(2) Reward pay is made based on labor agreement between an employer and employees	is necessary
2. Change to social security scheme	2-(1) Saving type of social security scheme	(1) Abolish current scheme and change to social security scheme, un-employment benefit scheme	(1) Too much time-consuming process (2) Financial engineering for design a new scheme is necessary (3) There is no example in other country
	2-(2) Insurance type of social security scheme	(1) Replace the current scheme with security scheme (2) Wide variety of scheme	(1) Too much time-consuming process Financial engineering for design a new scheme is necessary Risk analysis in important (4) There is no example in other country
3. Mix current scheme and social security scheme	3-(1) Reward pay is separated and paid upon agreement between an employer and employees	(1) Only retirement pay is transferred to social security scheme	(1) Financial engineering for design of a social security scheme is necessary
	3-(2) Maintaining current system basically, part of reward pay is transferred to pension	(1) Reward pay is paid by pension, while retirement pay and compensation pay are lump sum	(1) Financial engineering for design of a new pension scheme is necessary

### 3) Possibility of transition to social security system

Setting some conditions, the possibility is investigated. The conditions are as follows:

- It is presumed that all of retirement pay, reward pay and compensation pay are transited to social security scheme as one package
- Annual wage for an employee is set as Rp 15 million in the first year
- The annual wage will increase by 5% per annum
- The interest rate is 5% per annum
- Contribution by both an employer and employees is set at 7% and 2% respectively.
- Type of social security is not risk pooling one but saving type

The result of the calculation is summarized in the Table 2-89.

**Table 2-89 Transition to Social Security Scheme**

Year of service	Current severance pay	Social security scheme by increased contribution
5 years	16 months	12 months
10 years	25 months	15 months
15 years	28 months	21 months
20 years	29 months	22 months

4) Issues to be studied further in details

In transition of current severance pay scheme to a social security scheme, there are several issues to be studied. Followings are some examples.

■ Type of pay to be covered

Should reward and compensation be included or not? In this regard, JAMSOSTEK's stance is clear and they believe that only retirement pay should be covered by nature of social security

■ Employee to be covered

Should outsourcing and contract-based employee be covered or not? Without doubt, it should

■ Characteristic of the scheme

Should the scheme be insurance type or savings type? Ideally, it should be insurance type.

5) Establish a neutral research institution for the above study

It is not so easy to alter social security scheme once it is settled, therefore, it is recommended to establish a neutral research institution for the study. The mission is to conduct basic research on labor market situation and institutional framework, to conduct case studies in other countries and to conduct financial engineering on risk pooling scheme, cash flow analysis, and risk hedge scheme. Needless to say, JAMSOSTEK should be deeply involved in the operation of the new research institution.

## **2.4.5 Outsourcing**

(1) Towards more flexibility

Amid mounting pressure of competition and the effects of development of new information technology, business organizations feel a necessity of adopting more flexible types of employment. They are, primarily, outsourcing and contract-based employment. There is an immediate need to make labor regulations more conducive to business. The Government should revise the prevailing Manpower Act so that employers might be able to

accommodate their practices to the new surroundings.

(2) Increasing demand for outsourcing

Employers has felt the necessity of outsourcing for the following two reasons. One is that employers can trim labor cost by adopting outsourcing. The labor cost per an employee in outsourcing may be less than that in normal employment because employer does not need to pay bonus and allowances such as severance pay, though, on the other hand, he or she has to pay management fee to outsourcing companies in addition to wages to employees. The other is that employer can avoid onerous labor management. Labor management is very tough work in every country, much less in foreign country. In addition, however, another factor has recently begun to appear. Employer feels its necessity from a viewpoint of business strategy. Employer tends to concentrate their human resources on more strategic areas and to leave other areas to outsourcing. Details in this context will be stated later.

(3) Prevailing regulations and their problems

Under the prevailing Manpower Act, it is allowed to use outsourcing as follows.

Article 65:

- (1) The subcontracting of part of work to another enterprise shall be performed under a written agreement of contract for work
- (2) Work that may be subcontracted as mentioned under subsection (1) must meet the following requirements:
  - a) The work can be done separately from the main activity
  - b) The work is to be undertaken under either a direct or an indirect order from the party commissioning the work;
  - c) The work is an entirely auxiliary activity of the enterprise; and
  - d) The work does not directly inhibit the production process
- (3) (Abridged)
- (4) The protection and working conditions provided to workers / laborers at the other enterprise as mentioned under subsection (2) shall at least the same as the same as the protection and working conditions provided at the enterprise that commissions the contract or in accordance with the prevailing laws and regulations

Article 66: Workers / laborers from labor suppliers must not be utilized by employers to carry out their enterprises' main activities that are directly related to production process except for auxiliary service activities or activities that are indirectly related to production process

- If the job is related to the entrepreneur's core business activities or activities directly connected with production process, the entrepreneur is only allowed to employ workers / laborers under an employment work agreement for a specific time and or under a work agreement for an unspecified time and / or under a work agreement for

an unspecified time.

- What is meant by auxiliary service activities or activities indirectly related to production process are activities outside of the core business of the enterprise. (cleaning service, the provision of catering service • • • )

Business world feels that the above regulation is too rigid and out of date. There are three problems. The first is that outsourcing is allowed only for “non-core business” . The second is that the definition of “non-core business” is too vague and lacks legal certainty. The third is that the current regulation does not match the changing business environment. So long as the government sticks to the current regulation, there is a possibility that Indonesian enterprises lost their competitiveness in both cost and flexible supply of products and services.

#### (4) Current situation of the outsourcing industry

Under the above stipulations, enterprises currently outsource only limited jobs such as cleaning services and security services. Some companies interviewed quote example of outsourcing jobs as follows.

- Security service
- Reception service
- Driver
- Food preparation work in canteen
- Line worker

One of outsourcing providers interviewed describes the current situation as follows. They provide their services, deploying their 1,000 persons, to around ten customers, that mainly are financial institutions. Under the current regulation, their service is directed mainly to service sector such as banks. However, they say that, even though the Manpower Act puts some restriction on the service areas where an outsourcing company can have access, they do not feel any inconvenience because the service industry’s job is by nature very flexible and most of its jobs can be inferred to be non-core business.

Another company interviewed feels that demand for outsourcing is very strong. The company cites several reasons for the strong demand. First, amid the prevailing global and world-wide production system, customers face more fluctuation in demand than before. They have to cope with this fluctuation in production too. Outsourcing is one of the ways to facilitate responding to the fluctuation. Second, they are still annoyed with the unstable quality of labor. While they choose their employees with full care, they face the necessity of dismissing some of employees for their poor performance. Dismissal of an employee, however, is not easy under the current Manpower Act, therefore, they rely on a flexible

employment system, that is outsourcing. Third, outsourcing cost is cheaper than ordinary and normal employment cost. Fourth, they do not want to be involved in the tough work of sorting out labor problems. Summing up, employers feel a great risk of continuing to employ workers for a long term.

As is stated above, employers' attitude toward outsourcing is fundamentally a kind of risk hedge. However, a new wave has begun to appear. The wave is that employers utilize the scheme as their new business strategy, if they are allowed to do so. One example is outsourcing for inspection work in manufacturing lines. In this case, the sponsored company takes over the whole process of inspection of products for their customer. Another example is a more strategic one, where a company relies on outsourcing for some specific business activity such as human resources development and information technology development. The company in this instance follows such a strategy not only to minimize labor cost as much as possible, but also to redistribute their limited resources to their strong areas through "Selection and Concentration." The movement has just started and is not yet widespread. However, there will be a possibility that these types of outsourcing become more popular in Indonesia. In these cases, the kinds of employees required are not operators but professional staff. Whether this tendency gains momentum or not depends on how far the companies can recruit highly qualified workers. For this reason, some outsourcing companies are engaged in capacity building for workers in addition to conducting ordinary outsourcing business.

#### (5) Comparative study in other Asian countries

##### (Viet Nam)

There is no provision on outsourcing in Viet Nam's Labour Code, though there are detailed provisions for contract-based employment. No regulation on a sector or area where outsourcing is allowed is not found.

##### (Thailand)

There is no regulation on outsourcing in Thailand. However, there is a description on employment for a definite period in the Labour Protection Act B.E.2541 (A.D.1998). The Act allows employers to take on employees for a specific project which is not their normal business or trade and requires a definite date to commence and end the work, or for work which is occasional with a definite ending or completion, or for work which is seasonal and the employment is made during the season. Also the Act says that such work shall be completed within a period not to exceed two years (Section 118). It seems that Indonesia takes a more flexible stance toward definite period work contracts, as is stated later.

##### (The Philippines)

There is no regulation on outsourcing in the Philippines

(China)

In China too, it is possible for employer to dismiss employees based on Regulation on Labor Article 4. However, the employer has to give compensation to such employees. The amount is determined in accordance with provisions of the labor contract. Thus, there is no governmental regulation on the amount.

#### (6) Future prospect

Considering the changes in business models and strategies taking place in Indonesian business society, however, the current Indonesian framework seems to be out of date. A more flexible framework seems necessary for the following two reasons. One is a necessity to strengthen cost competitiveness. In order to enhance their competitiveness, employers are serious to reduce operation cost by outsourcing of part of their operations anywhere such an opportunity exists. The other is an operational one. With respect to the provision in the prevailing Act, it is rather difficult to separate “core business” from “non-core business.” Reportedly, in the coming revised Manpower Act, the scope for outsourcing will be enlarged from “a certain job” to “any kind of job” in Article 59. If this is realized, the decision on which job is suitable to outsourcing is left to the employer. In this regard, one of the entrepreneurs interviewed stresses that, if it is allowed to do so, he will change all employment from current normal employment to outsourcing employment. He quotes storage operations, packaging operations and even main manufacturing operation as future outsourcing areas. “There is no area for which outsourcing is impossible,” he says

In this regard, following outsourcing services are becoming popular in Indonesia. Most of them are related information industry.

- Call center outsourcing
- Software development
- Application maintenance
- Software testing
- Web development
- Data processing
- Search engine services
- IT consulting
- Customer support
- Technical support
- Financial outsourcing
- Website design services
- Database development
- E-commerce outsourcing

- Wireless services
- Networking services
- Billing services

The other is operational one. With respect to the provision in the prevailing Act, it is rather difficult to divide “core business” from “non-core business”. Reportedly, in the coming revised Manpower Act, the scope for outsourcing will be enlarged from “a certain job” to “any kind of job” in Article 59. If it is realized, the judgment on which job is suitable to outsourcing is left to employer, not to the government officer. In this regards, one of entrepreneurs stresses that, if it is allowed to do so, he will change all employment from current normal employment to outsourcing employment. He quotes storage operation, packaging operation and even main manufacturing operation as outsourcing areas in future. “There is no area for which outsourcing is impossible”, he says. In this regard, following outsourcing services are welcome by

In designing a new institutional framework for outsourcing, changes in business strategies taking place under global competition and development of information technology should be taken into account. In order to enhance price competitiveness on one hand and maintain flexibility on the other hand, business organizations tend to follow the strategy of selection and concentration of their business and operation. As a result, the corporation will concentrate on some specific areas and leave other areas to outsourcing. This strategy is necessary for the corporation to succeed in business growth and expansion. If the corporation succeeds in the business expansion, the scale of its work force requirement necessarily will also expand. Thus, such a strategy is positively assessed. As far as outsourcing has the above characteristics, the Indonesian government should promote it rather than regulate it. For the same reason, when regulators use the word “non-core,” it should be understood that it means “strategically’ non-core,” and not for minor and unsophisticated works such as reception desk tasks or routine security patrols.

As is stated above, employers’ attitude toward outsourcing is fundamentally a kind of risk hedge. However, a new wave has begun to appear. The wave is that employers utilize the scheme as their new business strategy, if it is allowed to do so. Pointing some examples, it is outsourcing for inspection work in manufacturing line. In this case, outsourcing company takes up a whole inspection process of products for their customer. Another one is more strategic one, and a company relies on some specific business activity such as human resources development and information technology development on outsourcing. The company follows such a strategy not only to minimize labor cost, but also redistributes their limited human resources to their strong areas through “Selection and Concentration” strategy. The movement has just started and is not yet spread in Indonesia. However, there will be a possibility that these types of outsourcing become more popular. Strategy of “selection and

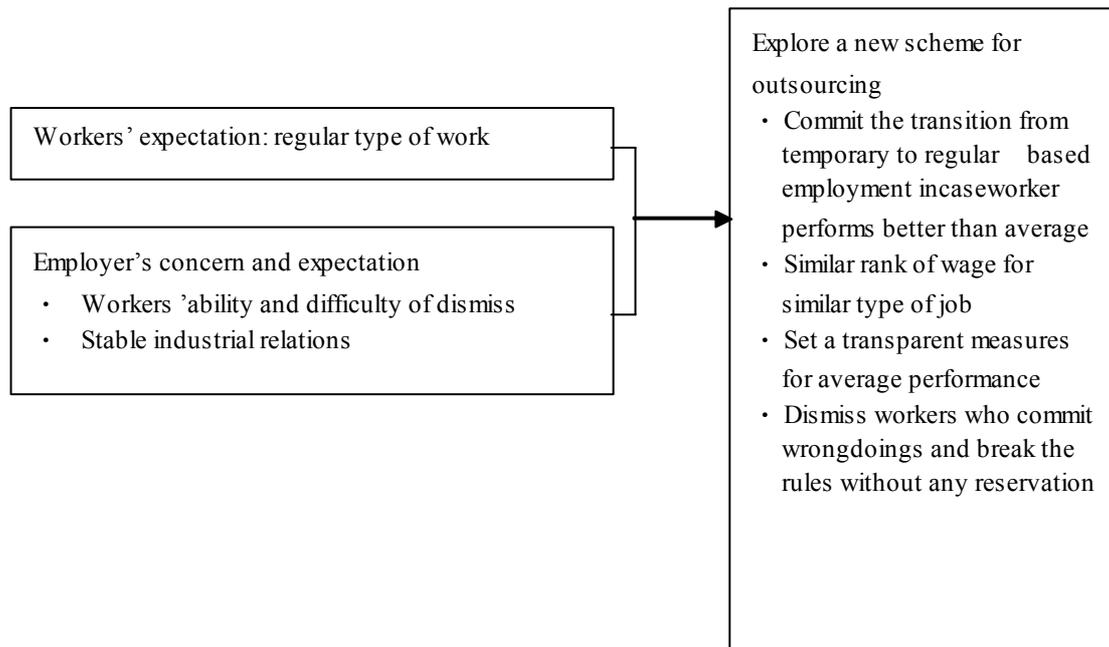
concentration” is necessary for corporation to succeed in business growth and expansion. If the corporation succeeds in the business expansion, their employment will also expand. Thus, such a strategy is positively assessed. As far as outsourcing has the above characteristics, Indonesian government should promote it rather than regulate. For the same reason, when regulators use the wording of “non-core”, it should be understood that it means “strategically” non-core” not for minute and unsophisticated works such as reception or security operation. Whether this tendency gets momentum or not depends on two factors. One is how far the company can recruit highly qualified workers. For this reason, some outsourcing company is engaged in capacity building for workers in addition to ordinary outsourcing business. The other is, needless to say, deregulation on outsourcing by the government

Usually, an employer will make a contract with a manpower supply company for dispatching of manpower. On the basis of the contract the manpower supply company dispatches workers. Fees usually consist of payment to a worker, say the wages, plus a management fee, therefore, the total cost to the employer is not so different from the cost burdened by employer for normal employment Flexibility in using outsourcing to obtain not employees but workers is more convenient, but is not so inexpensive. For that reason one company speculates that even if the potential areas are expanded by the revision of Manpower Act, the area suitable for outsourcing may not widen for the company.

Even though employers are comfortable with the above revision, negative comments are heard as follows. First, outsourcing could affect workers’ productivity and loyalty. Second, the revisions to the current law will affect the industrial relations system, which now sees employers and workers as partners. Third, there will also be no room for the two sides to reach collective labor agreements where they establish their own rights and obligations.

The most important is what the employee feels and wishes. It is said that they expect long term and regular work employment. In Japan, some employees prefer outsourcing type of employment for the reason that it provides them with more free time. However, in Indonesia, most employees want to work on a regular employment base. It is necessary to strike a balance between the employer’s need and the employee’s expectation. The solution is, as is shown in Figure 2-28, that so long as the employee’s performance is not lower than average, the employer should change the method of obtaining labor from outsourcing to regular based employment. With this regulation, employees will make an effort to have the option of being transferred from outsourcing based employment to regular one. Sustainable and long-term employment is beneficial to the employer, too, it should be noted.

**Figure 2-28 A New Scheme for “Outsourcing”**



Finally, the advantages and disadvantages of deregulation of outsourcing is summarized in Table 2-90.

**Table 2-90 Deregulation of Outsourcing**

	To employers	To outsourcing companies	To employees
Advantage	<ul style="list-style-type: none"> <li>■ Flexibility in recruit of employee</li> <li>■ Strategic thinking in manpower security (whenever necessary, necessary number of worker)</li> </ul>	<ul style="list-style-type: none"> <li>■ Enlarged business chance</li> </ul>	<ul style="list-style-type: none"> <li>■ Possibility of getting various experience</li> </ul>
Disadvantage	<ul style="list-style-type: none"> <li>■ Training is necessary</li> </ul>	<ul style="list-style-type: none"> <li>■</li> </ul>	<ul style="list-style-type: none"> <li>■ Unsecured job opportunity</li> <li>■ Unfavorable working condition such as payment</li> </ul>
Problem solution	<ul style="list-style-type: none"> <li>■ Similar rank of wage for similar type of job</li> </ul>	<ul style="list-style-type: none"> <li>■ Fair working contract with employee</li> </ul>	<ul style="list-style-type: none"> <li>■ Similar rank of wage for similar type of job</li> </ul>

(7) Conclusion

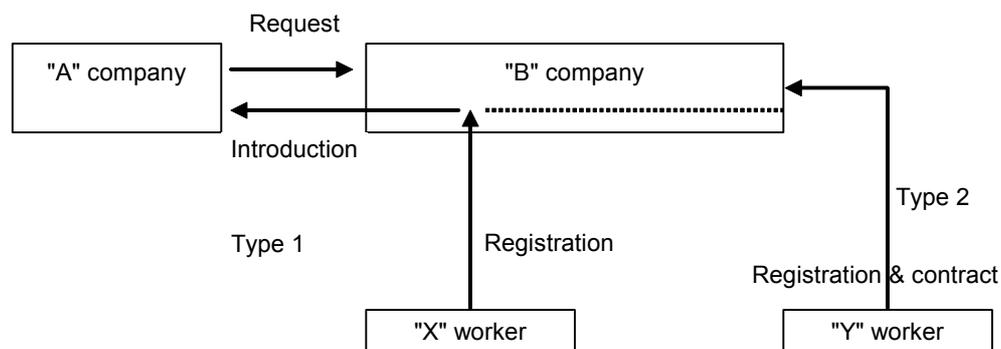
Outsourcing is a sophisticated management strategy and goes beyond the simple motivation of cost reduction for companies who struggle to hold strong competitiveness.

Therefore, regulation should be minimized. However, the principle of “similar pay for a similar job” should be strictly observed. At the same time it is expected that the outsourcing industry, by adopting smart business strategies, will grow in Indonesia. If the industry grows, people working in the industry will tend to be more content and will find it easier to get challenging jobs. The importance is not to regulate in the sense of repressing but to foster an excellent outsourcing industry. The negative image planted on outsourcing will be wiped out when outsourcing business becomes more professional. The importance is not to regulate the industry but to foster it to the excellent intelligent industry. On the other hand, it is also necessary to regulate outsourcing industry in such a way that people regularly working under the industry are treated as not temporary but regularly employees within the industry. Basic conditions for excellent outsourcing company are as follows.

- Develop new business models
- High profits and salaries
- Treat employees under regular employment
- Attach importance to education and training for employees
- Make severance pay

Following Figure 2-29 shows a new type of outsourcing business. Type 1 is a traditional outsourcing business and type 2 is a case for excellent outsourcing company which is described above.

**Figure 2-29 A New Type of Outsourcing Business**



Considering that outsourcing becomes one of strategic employment, the Government is advised to establish a neutral labor issue research institution under collaboration with employers’ association, labor unions and academic circles. The major function of the institution is to conduct basic analysis on changing labor market and, based on the analysis, to provide information necessary for the Government to formulate manpower policy fitted to the changes in labor market.

## **2.4.6 Contract-based Employment**

### **(1) Current situation in Indonesia**

Contract-based work is a scheme under which employer makes a personal contract with employee for a fixed term. This type of employment differs from those of outsourcing in two aspects. One is that contract-based workers are usually staff, while workers for outsourcing are operators. The other is that due to the first difference in nature, contract-based workers have a possibility to be hired as regular employees after some time has passed.

There are three reasons why employers adopt contract-based employment. The first is easy adjustment to seasonal changes in production levels. Every production has seasonality, more or less. In order to cope with this situation and to minimize production cost, it is necessary to utilize contract-based employment. The larger the export ratio of products manufactured in Indonesia, the stronger the seasonality of production, a manager in an information industry points out. The second is that compared with regular employment, contract-based employment is inexpensive because the wages for contract-based employees are lower than those for regular employees and are usually not required to pay bonus and severance pay. The situation is true as is shown in Table 2-91 which shows Japanese case, though the Japanese case illustrates the difference in wages between regular employment and part-time employment. The third reason is that employers are not always confident in workers' reliability. Needless to say, employers recruit good quality employees as much as possible and they train them after employment. However, even with all of their efforts, it could happen that the number of employed workers comes to be beyond the company's expected requirement. In this case, if, employers could easily lay off employees, they may recruit them on regular base. However, in Indonesia, it is very difficult to lay off employees once they are recruited. Very naturally, employers are alert when it comes to recruiting employees on regular base.

**Table 2-91 Difference in Wages between Regular Employment and Part-time Employment (Japan)**

(Yen/hour)

Year	Man		Woman	
	Regular	Part-time	Regular	Part-time
1990	2,358	1,085	1,256	768
2002	2,598	1,020	1,706	929
2005	2,566	1,099	1,655	972

Note: Reasons for non-regular type of employment: Labor cost reduction (52.3%), seasonal adjustment (38.8%), Utilization of elder people (26.9%) (plural answer is allowed) (2005, Ministry of Labor and Welfare)

Source: Ministry of Labor and Welfare “Basic Survey on Nation’s Life”

The prevailing Manpower Act No.13, 2003 allows employers to hire workers on a temporary basis as follows.

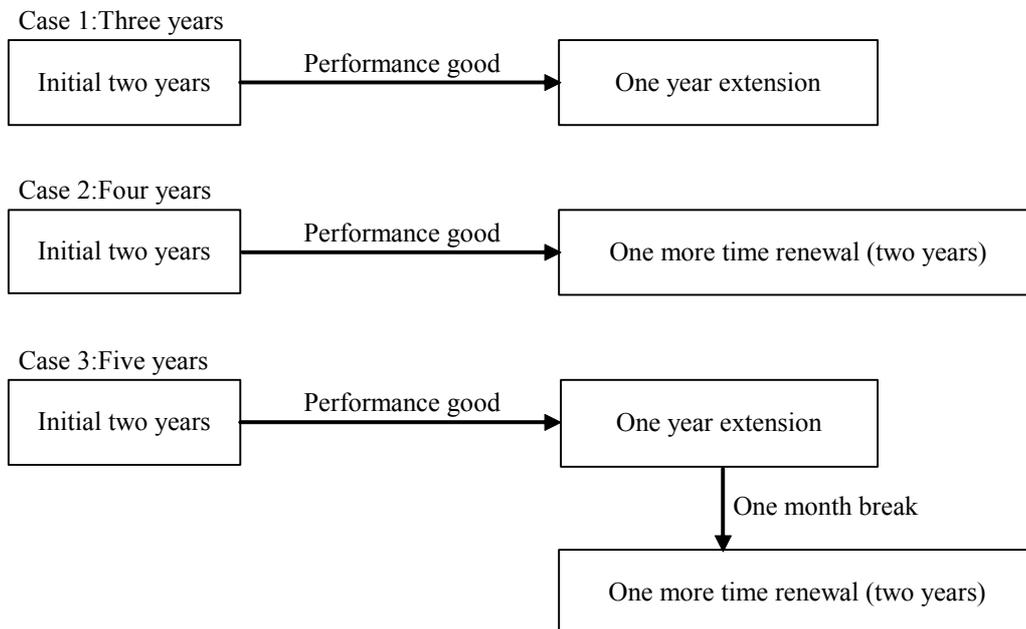
Article 59: A work agreement for a specified time can only be made for a certain job, which, because of the type and nature of the job, will be finished in a specified time, that is:

- a) Work to be performed and completed at once or work which is temporary by nature;
- b) Work whose completion is estimated time which is not too long and no longer than three years;
- c) Seasonal work; or
- d) Work that is related to a new product, a new activity or an additional product that is still in the experimental stage or try-out phase

The necessity of contract-based employment is mounting in the areas in which production varies by season. However, there is restriction on both the business area and term, when contract-based employment is allowed in Indonesia. There are two types of contract. One is for employment for a short term, six months. In this case, extension of another six months is allowed. Therefore, at longest, employer can hire a contract worker for one year. The employer is not allowed to employ a contract worker beyond one year and is not allowed to employ him or her again even two or three years later. The other is by a long-term contract. In this type of contract, there are three cases as is shown in Figure 2-30. The total duration is at longest five years, though a condition of “one month break after three years’ service” has to be cleared.

Reportedly, in the coming revision of the Manpower Act, the term for the above long-term contract will be extended from three years to five years. Contract-based employees who continue to work more than five years on contract will become permanent employees. Also, any kind of business area will become open to contact-based employment.

**Figure 2-30 Current Contract-Based Employment**



(2) Comparative study in other Asian countries

(Viet Nam)

Viet Nam's Labour Code, which was enacted in June 1994 and amended in April 2002, allow the following three forms of labor contract (Article 27).

- a) An indefinite term labor contract
- b) A definite term labor contract: twelve months to thirty-six months
- c) A labor contract for a specific or seasonal job: less than twelve months

In case of the above b) and c), when the contract expires and the employee continues to work in the same place, the two parties, the employer and the employee, shall enter into a new labor contract within a period of thirty days from the date of expiry of the contract. If no new labor contract is entered into, the signed contract shall become an indefinite term labor contract. Where the two parties enter into a new labor contract, which has a definite term, they may only do so for one additional term. If the employee continues to work beyond the additional term, an indefinite term labor contract must be entered into.

The two parties are prohibited from signing specific or seasonal job labor contracts for a term of less than twelve months in respect of a job that is regular and has a duration of twelve months or more, except in the case of the temporary replacement of an employee who has taken leave of absence for specific reasons such as pregnancy.

Article 32 stipulates the case for probation as follows. The wage of the employee during

probation must be at least 70% of the wage for the relevant rank of the job. The trial period shall not exceed sixty days in respect of works, which require specialized or highly technical skills, or thirty days in respect of other works.

(Thailand)

There is no any regulation on contract-based employment

(The Philippines)

The Labor Code divides employment only into two types. One is “regular” and the other is “casual ”. An employment arrangement is deemed to be regular where the employee has been engaged to perform activities which are usually necessary or desirable in the usual business or trade of the employer (Article 280). On the other hand, an employment is deemed to be casual if it is fixed for a specific project or undertaking the completion or termination of which has been determined at the time of the engagement of the employee or where the work or service to be performed at the time of the engagement of the employee or where the work or service to be performed is seasonal in nature and the employment is for the duration of the season (Article 280). There is no any regulation on outsourcing or contract-based employment.

(China)

There is no any regulation on contract-based employment

(3) Summary of “Outsourcing” and “ Contract-based employment ” and comparison with other countries

Basically, there is no regulation for these two type of employment in other countries than Indonesia as is shown in Table 2-92.

**Table 2-92 Comparison of “ Outsourcing ” and “ Contract-based Employment “**

		Indonesia	Viet Nam	Thailand	Philippines	China
Outsourcing	Areas where outsourcing is allowed	<ul style="list-style-type: none"> <li>• <b>Separate from the main activity</b></li> <li>• <b>Auxiliary activity</b></li> <li>• <b>Not directly inhibit the production process</b></li> <li>• <b>Non-core business</b></li> </ul>	No regulation	No regulation	No regulation	No regulation

Contract-based employment	Area where contract-based employment is allowed	<ul style="list-style-type: none"> <li>• <b>Temporary by nature</b></li> <li>• <b>No longer than three years</b></li> <li>• <b>Seasonal work</b></li> <li>• <b>Related to new product and new activity</b></li> </ul>	Specific or seasonal job	No regulation	No regulation	No regulation
	Duration	<ul style="list-style-type: none"> <li>• <b>At longest three years in an initial stage</b></li> </ul>	At longest three years	No regulation	No regulation	No regulation

(4) Future prospect

It is necessary to secure flexibility in contract-based employment while paying attention to adverse effects that are or may be caused by deregulation, as follows (Table 2-93).

**Table 2-93 Deregulation on Contract-based Employment**

	To employers	To employees
Advantage	<ul style="list-style-type: none"> <li>• To be able to avert risk of employing low quality of manpower</li> <li>• Flexibility in recruit</li> </ul>	<ul style="list-style-type: none"> <li>• Opportunity to work in various place and obtain various experiences</li> <li>• Flexibility</li> </ul>
Disadvantage	<ul style="list-style-type: none"> <li>• Time-consuming recruit process</li> </ul>	<ul style="list-style-type: none"> <li>• Instability</li> </ul>
Problem solution	<ul style="list-style-type: none"> <li>• If there is no special reason not to do so, employers have to convert the employment to regular one when employees request it.</li> <li>• Similar rank of wage for similar type of job</li> <li>• Set limitation on repetition</li> </ul>	<ul style="list-style-type: none"> <li>• To establish system of evaluating fairly their diversified experience</li> </ul>

(5) Conclusion

It may be useful to deregulate the term for contract-based employment. However, it is necessary to enforce an obligation on employers that once the term of contract-based work expires and an employee has no special reason to be dismissed, the employer has to employ him or her on regular base after the contract expiry date. Contract-based employment is obviously inferior to regular employment in securing the stability of labor market. For facilitating the transition of contract-based employment to regular based employment,

following two countermeasures are to be considered. One is a reform of current severance pay scheme which is too generous to employees. The other is security of fair and speedy work of labor disputes settlement mechanism.

#### **2.4.7 Business Visa**

##### (1) Background

Currently two types of business visa are available. One is working visa and the other is general business visa. The general business visa is issued to a businessperson, who enters Indonesia for doing business, in his or her country in advance. Here “business” excludes business activities, which involve taking up employment or acquiring money for payments of services. In Indonesia, every kind of work at factory is regarded as such an activity, even though it is only temporary one. Therefore, for fulfilling the work, it is required for a businessperson to obtain the working visa.

Even though the procedure for getting working visa has been streamlined and the duration for the procedure has been shortened as was stated in 2.3 Improvement of Investment Approval Procedure 2.3.4 Current Procedure (5), it still takes at least around two weeks. When a businessperson has much time to get working visa in his or her country in advance, he or she follows it. However, it could happen that a businessperson has to get urgently such a working visa. Such a case happens in the following occasions:

- A quality control staff at the head office is suddenly called on by Indonesian factory to settle a quality problem
- A mechanical engineer at the head office is suddenly summoned by the Indonesian factory to solve a mechanical trouble at short notice.
- A factory worker in the company’s home country factory is suddenly summoned by the Indonesian factory to replace broken parts in the factory with the parts, which are only available from the home country.

Fortunately, in Indonesia, Visa on Arrival (VOA) is available. The visa is issued for a person who enters Indonesia as a tourist when he or she arrives in Indonesia. In order to solve the problem represented by the difficulty in getting a working visa when the need arises to make an urgent working visit to Indonesia, it is recommended the following be adopted. A new type of work visa for short term is introduced in VOA

There are two types of work at factory. One is work could be done by local workers and the other is work which cannot be handled by local workers. The former is daily work. The latter is specific and high technological work. However, Manpower Act dose not distinguish

the difference of both and expects that all work at factory is to be basically performed by local workers. As the result, the Act expects strict measures are to be taken for providing working permit to foreign workers. If this idea is strictly followed, even sophisticated repairing work of machinery, for example, is to be done by local workers at factory. However, since local workers cannot handle the matter, foreign entrepreneurs invite staff from their home countries even though it is very expensive to do so. It is because time factor is very important for management. If Indonesia sticks to this “out of dated” work concept, Indonesian enterprise will lost its competitiveness.

In order to solve the inconvenience, it is recommended to introduce a new type of work visa for short term in VOA. In this regard, Thailand case stated below is to be noted. In this regard, in Indonesia too, similar visa was issued in Batam SEZ in the past. The urgent visa was provided to foreign workers visiting Batam, a special economic area, for urgent matters. However, when Visa on Arrival (VOA) was introduced all over Indonesia, the scheme was abolished.

## (2) Case in other Asian countries

### 1) The case in Thailand

The Alien Occupation Law, adopted in 1973, requires all aliens working in Thailand to obtain a Work Permit prior to starting work in the country. However, the Alien Employment Act does provide special treatment in the case of “Necessary and urgent work” as follows. The Thailand’s One Stop Service Center for Visa and Work Permit is informative. In Thailand, for necessary and urgent work of a period not longer than 15 days, applicants can get a visa and work permit for the work by submitting the following written documents signed by the alien and endorsed by the employer. When the Director-General or his designee accepts the documents, the alien is allowed to work temporally in Thailand without a work permit.

- Two application forms
- A passport
- A copy of the affidavit of the jurisdictional person issued by Department of Business Development not longer than 6 months
- A letter of permission from the governmental authority concerned, if any

The following works are mandated to be the necessary and urgent works for which work period not longer than fifteen days is authorized

- 1) Administrative and educational works
  - Conference, discussion, seminar or business invitation works
  - Temporary internal audit
  - Special lecture and educational works

- Aviation superintendent work
- 2) Technical work
  - Inspection, follow-up and technical solution works
  - Meeting work on machinery installation and technique
  - Aircraft engineering work, aircraft mechanical work
  - Machine repairing or installing work
  - Petroleum technical work
  - Machinery demonstrative or testing work
  - Technical training and seminar work
  - Movie making work
- 3) Overseas recruitment work
  - Worker screening work
  - Skill testing work
- 4) Miscellaneous work
  - Purchasing work
  - Tour liaison
- 5) Works which the Director-General or the officer authorized by the Director-General shall deem appropriate to accept special notifications upon interim necessity

The application form is simple as is shown in Box.2.16

(Office of Foreign Workers Administration, Department of Employment in Thailand”  
Work Permit Handbook”)

**Box 2.16 Application Form for Urgent Duty**

Written at  
Date    Month    Year •

**Subject:** Informing of Urgent Duty

**To:** Director General / Entrusted by the Director General of Department of Employment

I (Mr./Mrs./Miss) • • last name first \_\_\_\_\_ Nationality: \_\_\_\_\_ Age: \_\_\_\_\_ years  
holding passport no. • • • in used at \_\_\_\_\_

Arrived in Thailand on date • • month • • year • •

will work in the position of \_\_\_\_\_, Period: • • • day

From date \_\_\_\_\_ to date \_\_\_\_\_

Vicinity of work: \_\_\_\_\_

Name of company employer • • • • •

Address: \_\_\_\_\_ lane • • • st

Tumbon • • • • Umphur/district • • • • Changwat

Tel • • • • •

I certify that the above information is true

Signature    \_\_\_\_\_    informer  
Signature    \_\_\_\_\_    employer  
   seal of company  
date • • • month • • • year • • • •

## 2) The case in Viet Nam

In Viet Nam, even though the entry is for business purposes, it is not requested that a visitor obtains visa and work permit if the stay is within 15 days.

## (3) Conclusion

It is difficult to find out an ultimate solution for this problem. Following is one of solutions which will convince both the Ministry of Manpower and investors.

- The visa is temporarily issued as one of “Visa on Arrival” for a “special work” which can not be foreseen in advance
- It is valid up to 15 days
- Applicants are requested to prepare “Application Form for Urgent Duty” in advance
- The application is signed by both informer and employer
- To prevent its abuse, immigration office keeps the record
- Applicant is requested to pay additional fee as a kind of “fine” for inconvenience on Indonesian government

### **2.4.8 Minimum Wages**

#### (1) Current situation in Indonesia

The Indonesian Manpower Act stipulates minimum wages under Article 88-90. It is determined as follows and is periodically reported in publications.

First, the level is determined based on what is needed for decent living by taking into account productivity and economic growth (Article.88, subsection [4]). Second, the minimum wages consists of Provincial or district/city-based minimum wages and Provincial or district/city-based sectoral minimum wages. Third, Governors determine minimum wages taking into consideration recommendations from Provincial Wages Councils and/or District Heads/Mayors.

Except East Java and Central Java, which do not employ the minimum wages system, thirty-one provinces determined minimum wages for the year of 2006 as in the following Table 2-94. There is a wide difference among provinces from Rp 447,000 per month in West Java to Rp 822,000 in Papua

**Table 2-94 Minimum Wages by Province (Rp1,000)**

Province	Wages	Province	Wages	Province	Wages
Ache	750	Jakarta	819	South Kalimantan	629
North Sumatra	737	Banten	661	Central Kalimantan	634
West Sumatra	650	Central Java	-	East Kalimantan	684
Riau	637	Jyokujakarta	460	Maluku	575
Riau islands	750	East Java	-	North Maluku	528
Jambi	563	Lampung	505	Gorontalo	527
Bangka Belitung	640	Bali	510	North Sulawesi	713
South Sumatra	604	West Nusa Tenggara	550	South East Sulawesi	573
Bengkulu	516	East Nusa Tenggara	550	Central Sulawesi	675
West Java	447	West Kalimantan	512	South Sulawesi	612
West Sulawesi	612	West Irian Jaya	822	Papua	822

Source: Ministry of Manpower and Transmigration

Comparing Indonesian minimum wages with those in other Asian countries, as is shown in Table 2-95, they are less than in Thailand and the Philippines but more than in Vietnam.

**Table 2-95 Minimum Wages per Month in Other Countries ( 2005)**

	City	US\$
Indonesia	Jakarta	89
Vietnam	Hanoi	55
Thailand	Bangkok	127
The Philippines	Manila	188

Source: Internet

The present system has a defect in its determination procedure and definition of minimum wages. The level is determined by a tripartite agreement among employers, trade unions and the government. Trade unions do not always represent labor, because a trade union could be organized when ten people get together, even though they are not employees.

With respect to the definition of minimum wages, Article 88 of the Manpower Act states that in order to enable the worker to earn a living that is decent from the viewpoint of humanitarian standards, the Government shall establish a wages policy that protects the worker or /labor. However, there is no direct relation between “decency” and minimum wages. The “minimum” wages should be precisely defined. The amount should be settled according to the precise definition. In this connection, the process for determination of the minimum wages also should be improved in accordance with the revision of the definition. In

this regard, a minimum wages is not always determined by economic factors as political factors sometimes are important. That is seen often in rural areas. Actually, the minimum wages has increased at a higher pace than real GDP and real average wage, a recent report, “Wage and Employment Effects of Minimum Wage Policy in the Indonesian Urban Labor Market”, by SMERU says. The report also shows that the impact of minimum wages on employment is negative. The only exception is for employment of white-collar workers (Table2-96). This means that introduction of a minimum wages and raising of the minimum wage without economic reasons deprives workers of job openings and the impact is not evenly felt among workers. The workers in relatively weak positions suffer from the impact.

**Table 2-96 Impact of Introduction of Minimum Wages on Employment**

- Elasticity of increase in minimum wages on increase in employment-

All workers	-0.112**	Educated	-0.017	Full-time	-0.086*
Male	-0.065	Less educated	-0.196**	Part-time	-0.264*
Female	-0.307**	White-collar	1.000*		
Adult	-0.066	Blue-collar	-0.140		
Youth	-0.307**				

Note:\*\*is significant at 1% level, \* is significant at 5% level

Source: SMERU “Wage and Employment Effects of Minimum Wage Policy in the Indonesian Urban Labor Market”

When result of the above analysis is considered, minimum wages should be designed under the following thought. First, the minimum wages are to be set so as to cover the daily cost of living. The cost of living does not include cost related to the investment cost such as housing cost. Second, the minimum wages are to be set to cover the living cost for all members of household. Thus, the level is to be decided on standard size of the household. Third, in order to have a fair and reasonable minimum wages scheme, it is necessary to satisfy not only employees but also employers.

## (2) Comparative study in other Asian countries

### 1) The case in Thailand

In January 1998, the new Thai Labor Law, Labour Protection Act B.E. 2541, took effect. In the new law, the structure of the Wage Committee was revised and its powers were extended. Under the Act, there are two wage rates.

The standard minimum wage rates fixed by the Wage Committee; and

The specific minimum wage rates fixed by the Wage Committee for specific activities or businesses or specific areas or provinces that shall not be less than the standard minimum rates.

The Alien Employment Act in Thailand corresponds to the Manpower Act in Indonesia

Minimum wages are set by the Wage Committee. The minimum pay varies by region depending on cost of living, business capability, labour productivity, economic and social conditions.

## 2) The case in Viet Nam

Article 56 in the Labour Code stipulates the minimum wage as follows:

### Article 56

The minimum wage is set on the basis of the cost of living of an employee who is employed in the most basic job with normal working conditions, and includes remuneration for the work performed and additional amount for contribution towards saving.

In Viet Nam, the government determines a general minimum wage for each region, and a minimum wage for each industry in consultation with the Viet Nam General Confederation of Labour and representatives of employers.

The Vietnamese government issued a decree dated January 6, 2006 regulating minimum wages for Vietnamese employees working for foreign direct investment enterprises, foreign agencies, organizations, international organizations and foreign individuals in Viet Nam as follows:

- 870,000VND per month applied to enterprises in district of Hanoi
- 790,000VND per month applied to enterprises in suburban districts of Hanoi and other large cities
- 710,000VND per month applied to enterprises in the rest of the country

## 3) The case in the Philippines

The Regional Tripartite Wages and Productivity Boards establish the minimum wage by region and industry. Each Regional Board is composed of the Regional Director of the Department of Labor and Employment as chairman, the regional Directors of the National Economic and Development Authority and the Department of Trade and Industry as vice-chairmen and two members each from workers<sup>7</sup> and employers' sectors. In the performance of its wage-determining functions, the Regional Board conducts public hearings and / consultations with interested parties. Standards or/criteria for minimum wage fixing are as follows.

- The demand for living wages;
- Wage adjustment vis-à-vis the consumer price index;
- The cost of living and changes or increases therein;
- The needs of workers and their families;
- The need to induce industries to invest in the countryside;

- Improvements in standards of living;
- The prevailing wage levels;
- Fair return of the capital invested and capacity to pay of employers;
- Effects on employment generation and family income; and
- The equitable distribution of income and wealth along the imperatives of economic and social development

#### **2.4.9 Industrial Disputes Settlement Procedure**

##### (1) Importance of strong and efficient labor disputes settlement mechanism

Labor dispute is one of the most troublesome headaches to foreign investors. It is not exaggeration to say that labor dispute tends to lead easily an investment enterprise to bankruptcy. An efficient and strong labor dispute settlement mechanism is important for the following two reasons. One is that with such a mechanism being available, investors, especially foreign investors, feel it safe to promote their business because they can expect to solve any dispute at relatively low cost and with much saving of time. The other is that if such a mechanism is available, investors do not need to rely on outsourcing and contract-based employment. If there is no efficient and strong mechanism, investors tend to hedge their risks of time-consuming labor dispute solution by enlarging the scale of their outsourcing and contract-based employment. Therefore arranging for a strong and efficient mechanism for labor dispute settlement is beneficial not only to investors but also to employees.

##### (2) Newly developed scheme in Indonesia

###### 1) Procedure

Labor disputes have remained a serious concern for businessmen in Indonesia, because there rarely is a win-win solution to such disputes. In a move expected to bring a quick end to labor disputes, the government installed a new mechanism.

The Industrial Dispute Settlement Law (Law No.2/2004) was enacted in Jan.2006. The law is a substitute for Minister of Manpower Decree No.22/1957 and No.24/1964.

In the past, when an industrial dispute arose, the parties concerned made efforts to settle the dispute through negotiations and mediation aimed at reaching a consensus and, if the negotiations failed to reach a consensus, it meant use of procedures for the settlement of industrial relations disputes that are regulated by law. Under the new law, all of disputes are to be settled through the newly established Labor Court. The new scheme provides faster, fairer and cost-free resolution of disputes, with a process of negotiations and mediation

before a case can be brought before the court. It replaces the government-sanctioned Regional and Central Committees for Settlements of Industrial Disputes, whose procedures and decisions were established in 1957.

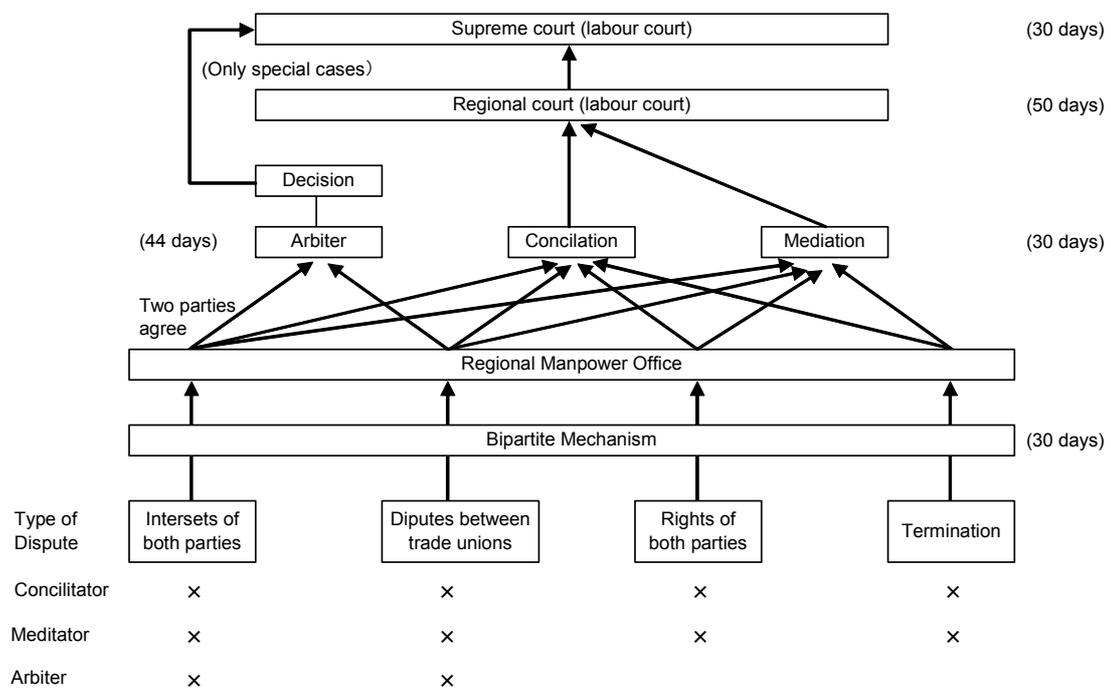
The new law consists of nine chapters and 105 articles. In the first chapter, it defines the industrial disputes as follows.

- Dispute between an entrepreneur and labor union within a company
- Dispute on termination of employment
- Dispute on interests of the entrepreneur and employee
- Dispute on rights of the entrepreneur and employee
- Dispute on a coalition between the entrepreneur and/or trade union and employee and/or labor union

Under the new law, workers and employers have legal certainty as to when their dispute will be settled. Legal certainty is what investors most need in doing business in Indonesia. Industrial disputes will be handled through bipartite negotiation, mediation, conciliation and, if needed, arbitration or the special court over the designated 140-day period.(Figure 2-31). Thee new mechanism is designed on the basis of basic four principles of speedy solution, accurate judgment, same standard, and low cost operation

**Figure 2-31 A New Labor Disputes Settlement Mechanism**

**Dispute Settlement Mechanism**



The new procedure is as follows. According to the mechanism, every dispute will be settled within 140 days.

- The dispute is solved through a bilateral negotiation mechanism between the entrepreneur and employee within 30 days. If bilateral negotiations fail twice, it is inferred that the dispute is not settled. The result is reported to the labor office of the local government of Kabupaten or Kota.
- If the dispute is not settled, mediation or conciliation will start. The labor office at Kabupaten or Kota suggests both parties to choose the next action, mediation or conciliation. However, the office suggests conciliation be tried first because mediation is done by the government and the office wants to avoid monopolization of the activities by the government, If both parties want the government to take part, then mediation at the initiative of the government will start. Mediation or conciliation will be held for 30 days at length. If the dispute is not settled and both entrepreneur and employee agree to arbitration, they go to an arbitrator (Refer to Box. 2.17).
- If the dispute is not settled by mediation or conciliation, it is brought to the labor court in the region. The court judges the dispute within 50 days. Arbitration will be held within 44 days and the conflict will be settled. In the case of arbitration, there is no chance to reach court except in special cases such when the decision is made beyond authority of the arbitrator responsible in employment/manpower

If the dispute is not fixed, it finally is brought to the Supreme Court and the court settles the case within 30 days.

Only public servants having some qualification are entitled to be in the position of mediator while conciliators and arbitrators are private persons who have some specific qualification. The number of judges in courts is 159 as of May 2006. Mediators are stationed in each Province and their number is 693, while the number of conciliators and of arbitrators nation-wide is 106 and 26 respectively. In Indonesia, around 12,000 labor disputes arise every year. Among them around 70% of them are solved by bipartite negotiation. Therefore the remaining 4,000 disputes are to be solved through the new mechanism.

Since the speedy settlement of labor disputes is an extremely important issue to entrepreneurs, if this new system smoothly works, it will serve to enhance good industrial relations.

## 2) A key to successful settlement

When the scheme works as planned, the settlement will be speeded up. In this regard, however, some expressions of concern are also to be heard. Dr. Asep Suryahadi at SMERU Research Institute is one of specialists in this area who expresses such concern. The new

labor disputes settlement system works only when employees become real one partner of the settlement process. However, it is said that it is very difficult because most of employees do not know what is negotiation and how to do it. Employees do not know manpower act and labor contract. Most of them have never read any labor contract. On employers' side too, some of them cannot read Indonesian version labor contract and cannot speak Indonesian language when they are foreigners. Communication with employees is very difficult. In addition, employees want to negotiate with only top management people, not second class managers. On the other hand, top management will not appear before them. Therefore, negotiation itself dose not start. Under such the situation, it seems very difficult for both parties to get to negotiating tables.

Considering the situation, it is necessary for some neutral organizations to facilitate the negotiations. So far in some cases, NGOs support employees, but unfortunately they are not always welcomed by employers because they are not in a neutral position and they are even agitators. Under the current settlement system, conciliator or mediator seems to be in a good position for such facilitation even though the stage is premature one prior to negotiation. Their function is just to teach employees what negotiation is and how to proceed it. Another issue is how to secure necessary number of arbitrator, conciliator and mediator. Considering the possibility of increase in labor disputes, in case that enough number of staff is not secured, even though the duration for each settlement is streamlined, it takes much time to settle because it is impossible to start the settlement itself.

**Box.2.17 Recent Performance for Labor Disputes Settlement in  
Jakarta Capitol Territory**

An officer at the Jakarta regional labor office stated that in a recent one month period, about 30 disputes were brought to the regional labor office. The Parties concerned could select conciliation or mediation as the means for solution, but, all of them selected mediation rather than conciliation. The main reason is that while mediation will be carried out by a government officer, conciliation will be done by private individual who is not known by both parties. Around 90% of the 30 disputes is related to termination of employment. Disputes brought by employers and employees each accounted for 50%. Among the disputes, 50% of them were not solved by mediation and went to regional court

3) The case in Kota East Java

In the past five months from January 2006, 49 cases were brought in for settlement. All of them was handled by mediators. Most of them were settled at the level of mediation. By type of disputes, most of them were disputes over dismissal. It is reported the number of disputes brought to mediation has shown a decrease. This is because both employer and employee became serious about voluntary solutions in order to avoid a solution in court as

much as possible.

#### 4) The case in Central Java Province

An officer at a provincial labor office stated that the number of disputes reported is fewer than expected as is shown in Table 2-97. This is clear from the fact that while until last year, as Table 2-98 shows, a large number of cases were reported, the figure in the past five months of this year is few. This is not because labor disputes decreased but because, due to realization of regional autonomy, local government is not requested to report the cases to Provincial government. Provincial government is no longer in a position to be able to obtain exact data and information on the matter. Also, Provincial offices do not know how labor disputes are solved. Such a situation seems to be serious because not only the Provincial government but also the Central government cannot collect information necessary for formulating strategy and plan for revision of the Manpower Act.

**Table 2-97 Reported Labor Disputes in Central Java Province : 2006**

Year 2006	Dispute other than dismiss and strike		Dismissal		Strike		
	Case	No. of involved employee	Case	No. of involved employee	Case	No. of involved employee	Lost work hours
Jan.	2	7	27	148	-	-	-
Feb.	6	43	6	6	3	1,422	18,786
Mar.	7	34	10	95	1	178	1,246
Apr.	2	1	6	14	-	-	-
May	3	31	8	61	1	250	5,250
Total	20	116	57	324	5	1,850	25,282

Source: Labor & transmigration office, Central Java Province

**Table 2-98 Labor Disputes in Central Java Province : 2000-2005**

Year	Disputes other than dismiss and strike		Dismissed				Strike		
			Individual		Collective				
	Case	No. of involved employee	Case	No. of involved employee	Case	No. of individual employee	Case	No. of involved employee	Lost work hours
2000	16	7,743	293	429	14	962	102	46,396	698,510
2001	83	10,132	881	4,713	41	2,503	61	12,602	286,480
2002	15	5,773	534	353	30	4,899	23	8,970	184,933
2003	93	2,932	1,187	9,781	35	3,408	53	15,639	357,017
2004	121	5,018	523	1,147	61	12,186	17	3,374	37,920

2005	24	3,605	407	620	33	9,583	22	13,475	68,523
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Source: Labor & transmigration office, Central Java Province

#### 5) The case in North Sumatra Province

One mediator in the North Sumatra provincial government labor office stated that cases that came to labor disputes settlement counts totaled 60-70 in the past six months compared with 551 cases in 2005. Most of them are related to dismissals. Among 60-70 cases, those that went to court for settlement are only six. The mediator says that cases where a settlement process is requested are showing a decline in number compared with the past as is shown in Table 2-99. With respect to the reason, the mediator speculates that, under the new settlement scheme, the final decision will be made by a court and it is felt troublesome by both for employer and employee, so both try to settle the disputes between them as much as possible. In this relation, it is said that large companies tend to solve labor disputes between employer and employee by themselves before applying the new scheme.

**Table 2-99 Labor Disputes in North Sumatra Province : 2001-2005**

Year	Disputes other than over dismiss	Dismissal	
	No. of case	No. of case	No. of involved employee
2001	8	400	472
2002	10	450	483
2003	9	450	487
2004	10	650	731
2005	11	540	814

Source: Labor & transmigration office, North Sumatra Province

#### 6) The case in South Sulawesi Province

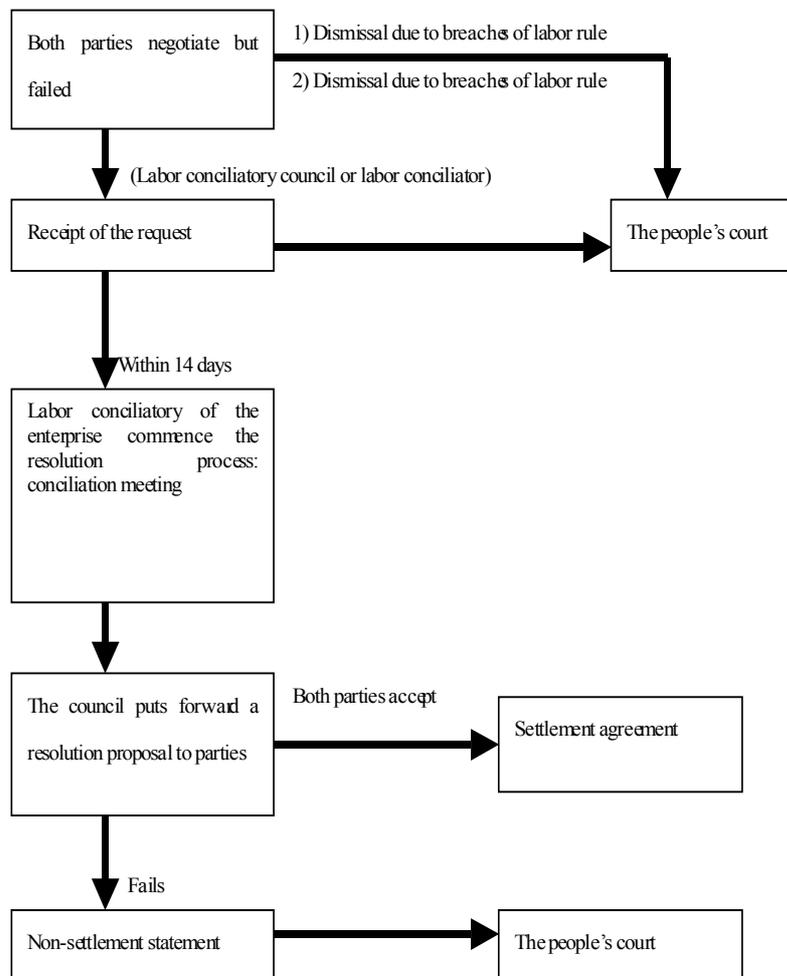
There exist around 12,000 enterprises in South Sulawesi Province. In the past couple of years, labor disputes that needed mediation for solution amounted to around 60 cases a year. Since January 2006 when the new labor disputes settlement law was introduced, only special cases that need the Provincial government's involvement are reported and their number is, up to June 2006, only 10. However, it does not mean that labor disputes settlements are decreasing. Most of them are handled at the local government level and are not reported to the Provincial government. Most labor disputes are related to dismissal. While dismissal occurs because of employees' wrongdoings in the Province, some of the dismissal are deeply related to business difficulties that force the employers to trim the number of their employees. One of the officers in the Provincial labor office said that the new settlement scheme has been successful so far.

(3) Comparative study in other Asian countries

1) The procedure in Viet Nam

The Labour Code of the Socialist Republic of Viet Nam stipulates the procedure for individual labor dispute settlement as follows. In Viet Nam, there exist two bodies and organizations having authority to settle individual labor disputes. One is the labor conciliatory council of an enterprise, or a labor conciliator of the body in charge of State administration of labor of the district, town, and provincial city. The other is The People's Court. Principally, the resolution shall be made by the conciliator first, but if it fails, the People's Court must resolve the issue. However, depending on the dispute, the People's Court will come first (Figure 2-32).

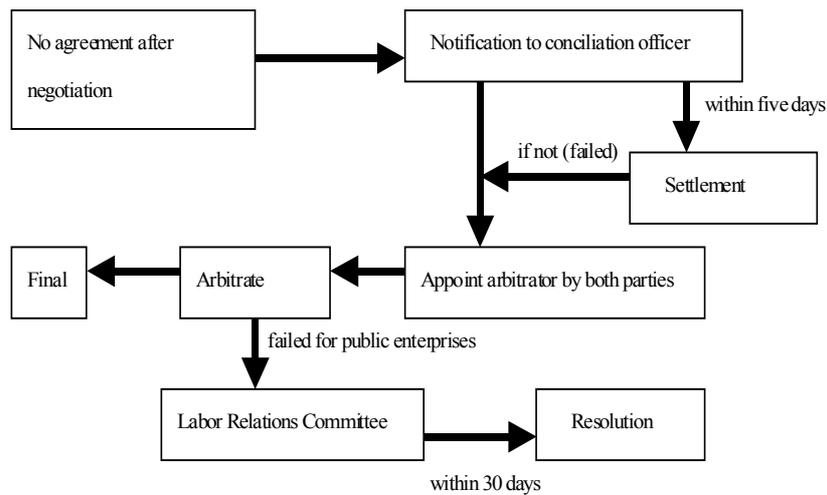
**Figure 2-32 The Case in Viet Nam**



## 2) The procedure in Thailand

In Thailand, firstly, the conciliation officer tries to solve the dispute. If he cannot settle it, he appoints arbitrators and they will solve the disputes. In the cases when of public enterprises are involved, the Minister of Labor suggests that the Labor Relations Committee resolve the matters (Figure 2-33).

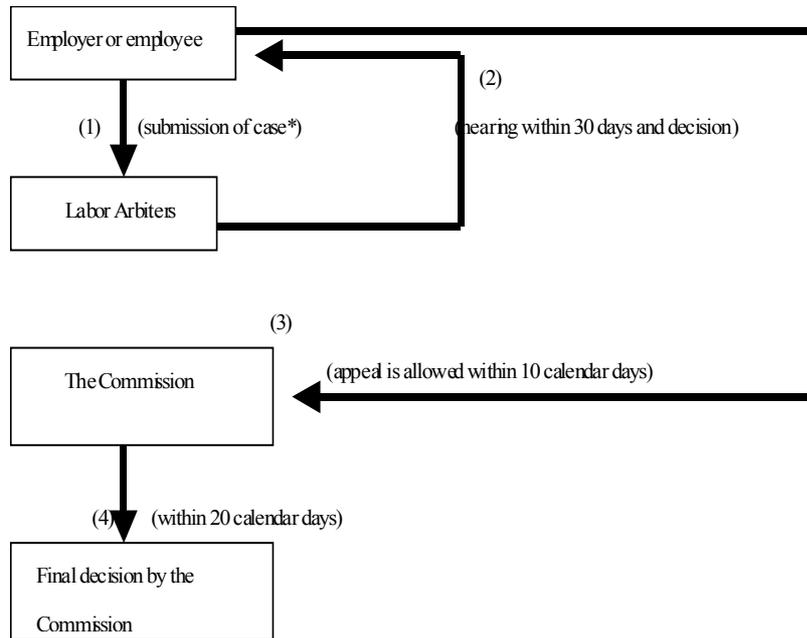
**Figure 2-33 The Case in Thailand**



## 3) The procedure in the Philippines

The procedure is rather simple. When the employer and employee cannot settle labor dispute, labor arbitrators help to solve the dispute. However, if such efforts do not bear fruits, the National Labor Relations Commission, attached to the Department of Labor and Employment, settles the dispute (Figure 2-34). The Commission is composed of a Chairman and 14 members. The 14 members are five each from workers and employers and four from public sector.

**Figure 2-34 The Case in the Philippines**



\*Unfair labor practice cases, termination disputes, working conditions, damages arising from labor relations, questions involving the legality of strikes and lock out, etc

#### 4) Comparison between Indonesia and other Asian countries

While the process is almost similar, as is shown in Table 2-100, the process in both Indonesia and Viet Nam is unique in that the final decision will be made by a court.

**Table 2-100 Solution Process of Labor Disputes**

	Indonesia	Viet Nam	Thailand	The Philippines
Characteristics	Final decision is made in labor court	Final decision is made in The People's court	Final decision is made at arbitrate	Final decision is made at the Government-initiated Commission
Procedure	(1) Bipartite mechanism ↓ (2) Conciliation or mediation ↓ (3) Regional court ↓ (4) Supreme court	(1) Bipartite mechanism ↓ (2) Conciliation ↓ (3) The People's court	(1) Bipartite mechanism ↓ (2) Conciliation officer ↓ (3) Arbitrate	(1) Bipartite mechanism ↓ (2) Labor arbiter ↓ (3) The Commission
Longest term for final decision	(1)-(4): 140 days	(2)-(3): Information is not available	(2)-(3): Information is not available	(2)-(3): 60 days

**(4) Conclusion**

Since the new system started in January 2006, almost six months have passed. Reviewing the past, it is concluded that the system is working well. Most of cases brought in were related to dismissals. The largest effect seems to have been that both employers and employees began to negotiate sincerely to solve labor disputes between them in order to avoid the new court system.

For the mechanism being firmly established, following two measures are important. One is to make both employer and employee understood the advantage of the mechanism and to recommend them to use the mechanism. The other is to collect and analyze settlement cases as much as possible for the purpose of securing legal stability and reliability of the system.

**2.4.10 Employment of Foreign Workers**

**(1) Current situation in Indonesia**

Under the Manpower Act, an employer is allowed to employ a foreign worker for certain positions and for a certain period of time only. A certain positions mean jobs, for which an Indonesian worker cannot replace a foreign worker. In this sense, foreign workers are

required to have special knowledge, skill and expertise. Employers are obliged to train Indonesian workers so as to replace them by Indonesian worker. This is a reason why the employment of foreign worker has a time horizon.

When employers employ foreign workers, they are obliged to pay a special fee of compensation for each foreign worker (Article 47(1)). The obligation is intended to support efforts to increase the quality of Indonesian human resources. Employer who hires foreign workers and pay compensation feel doubt about whether the money is actually spent for development of Indonesian human resources. In the forthcoming new Manpower Act, there is a possibility of discussing whether executives and Komisaris members should be excluded from being counted as foreign expertise. They are not requested to get work permits and there is no requirement to pay the above compensation. This is because of the simple reason that they are not workers but entrepreneurs.

## (2) Comparative study in other Asian countries: The case in Thailand

Thai's Royal Decree Stipulating Work in Occupations and Professions Prohibited to Aliens B.E.2522 (1979) specifies which occupation is closed to foreigners. Unlike the Indonesian case, the specification is clear as follows, for example. The total number is 38 as of year 2000

- Labor work
- Front-shop sale
- Supervising, auditing or giving service in accountancy
- Brokerage or agency, except brokerage or agency in international trading
- Engineering profession in civil engineering
- Architecture profession
- Guide or tour conductor
- Providing legal services or engaging in legal work

### **2.4.11 Capacity Building for Local Workers**

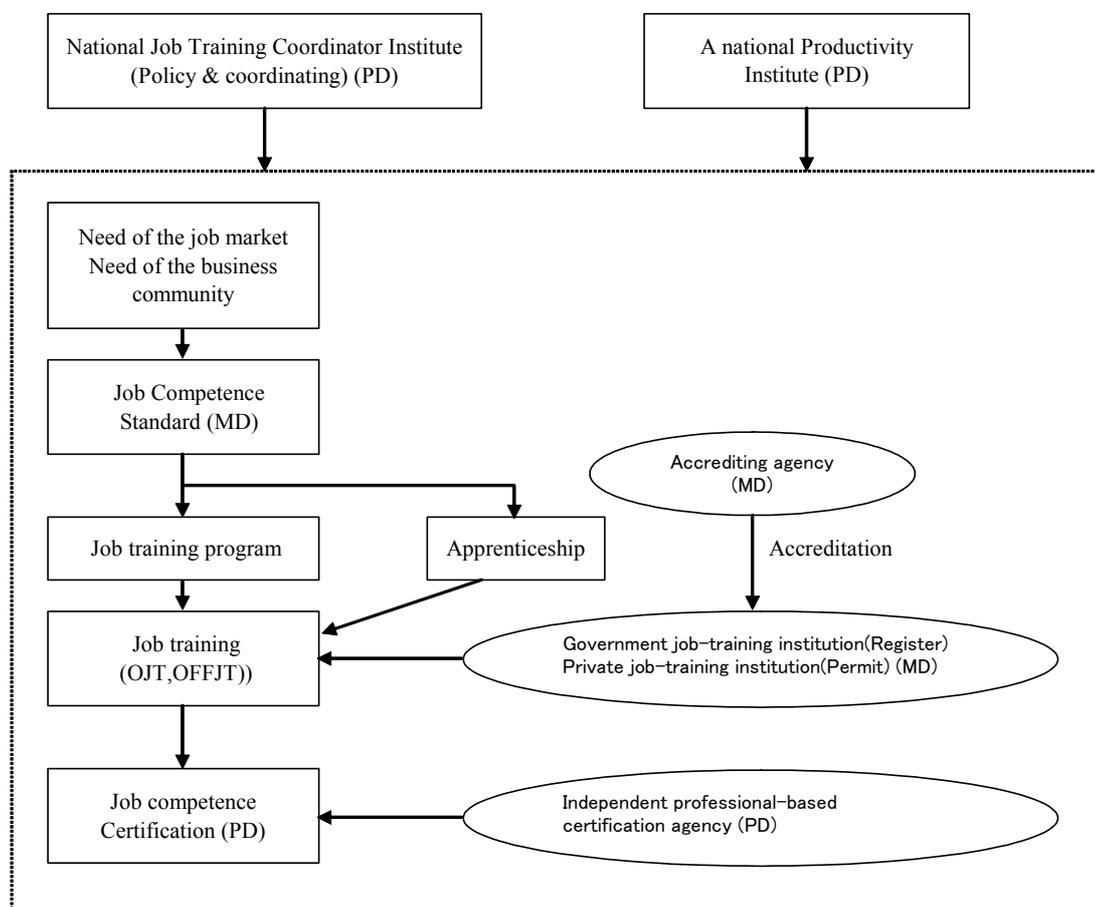
While the government allows foreign capital to employ foreign workers under some conditions as mentioned above, it advocates the necessity to train local workers so as to replace foreign workers as much as possible. In this regard, the Manpower Act stipulates how to train local workers and how to share responsibility between foreign capital and the government (in Article 13-30). The fund for the efforts is obtained by collecting payments from foreign capital. Also, the Act stipulates to lay Ministerial Decision for that purpose. However, they have not been materialized.

Since the matter is very important for foreign worker's policy, the corresponding strategy

and plan should be formulated as soon as possible. What is done or not done will have a great impact on foreign direct investment. The problem seems to be, more or less, common to every developing country such as Thailand and Viet Nam. Many things could be learned from the comparative study of these countries.

The “National Job Training System” has been developed and has just begun to function. shall be regulated with a Government Regulation. The outline is shown in Figure 2-35. One accreditation agency has been established

**Figure 2-35 National Job Training System in Indonesia**



#### 2.4.12 Outline of Proposed Action Plans

1. Introduction of a new and special work permit
2. Severance pay
  - Revise “ Severance pay ” articles in Manpower Act
  - Statistical analysis on duration required for employees who are fired to find out the next job after dismiss by age group

3. Type of employment

- Deregulation on outsourcing
- Deregulation on contract-based employment
- Foster strategic outsourcing industry

4. Labor disputes settlement

- Capacity building for new labor disputes settlement
- Secure the stability and reliability of the law enforcement on labor disputes settlement

5. Develop a new model determining minimum wages

6. Establish a government-sponsored labor issue research institute

**Table 2-101 Action Plans for Improvement of Manpower Policy**

Plan	Contents	Effects	Responsible agencies
1.Introduction of a new and special work permit	<ul style="list-style-type: none"> <li>● Work permit for“ Necessary and urgent work”</li> <li>● Referred to Thai’s design, characteristics of which are issued for necessary and urgent work visit and limited for 15 days</li> </ul>	<ul style="list-style-type: none"> <li>● It becomes easy for technical officers to visit factory for settling technical problems at short notice from their home countries</li> </ul>	Ministry of Manpower and Transmigration
2. Severance pay			
2.1 Revise “Severance pay” articles in Manpower Act	<ul style="list-style-type: none"> <li>● Determination of pay at fair and reasonable level</li> <li>● Main factor for determination is duration and transaction cost for employee fired to get the next job as well as the cost of living while he or she gets the new job</li> <li>● To obtain data on the above duration and transaction cost</li> </ul>	<ul style="list-style-type: none"> <li>● Cost down in labor cost becomes feasible</li> <li>● JOB opportunity for unemployment workers will expand</li> </ul>	Ministry of Manpower and Transmigration
2.2 Statistical analysis on duration required for employees who are fired to find out the next job after dismiss by age group	<ul style="list-style-type: none"> <li>● Duration by age group</li> <li>● Collection of statistical data through tie up with “Hello-work” system</li> </ul>	<ul style="list-style-type: none"> <li>● It becomes possible to set a fair and reasonable severance pay structure</li> </ul>	Ministry of Manpower and Transmigration
2.3 Financial engineering for a new design of severance pay scheme	<ul style="list-style-type: none"> <li>● Develop a reasonable and fair scheme which consists of traditional severance party and other income supports</li> </ul>	<ul style="list-style-type: none"> <li>● It becomes possible to have a more flexible severance pay scheme</li> <li>● Severance pay by employers becomes more flexible</li> </ul>	Ministry of Manpower and Transmigration
3. Type of employment			

Plan	Contents	Effects	Responsible agencies
3.1 Deregulation on outsourcing	<ul style="list-style-type: none"> <li>Delete the wording of “non-core” from the article in the law</li> </ul>	<ul style="list-style-type: none"> <li>Corporation’s competitiveness will be strengthened</li> <li>Expansion of foreign direct investment is expected</li> </ul>	Ministry of Manpower and Transmigration
3.2 Deregulation on contract-based employment	<ul style="list-style-type: none"> <li>Allowable duration is extended from current four years to five years</li> </ul>	<ul style="list-style-type: none"> <li>Corporation’s competitiveness will be strengthened</li> <li>Expansion of foreign direct investment is expected</li> </ul>	Ministry of Manpower and Transmigration
3.3 Foster strategic outsourcing industry	<ul style="list-style-type: none"> <li>Establish a new type strategic outsourcing company</li> <li>The government supports the industry</li> <li>“A new type”: strategic company whose employees are professional and highly educated in business</li> </ul>	<ul style="list-style-type: none"> <li>It becomes possible to wipe out negative image on workers in outsourcing business</li> </ul> <p>Deregulation on outsourcing employment becomes easy</p>	Ministry of Manpower and Transmigration Ministry of Industry

Among them, the following plan is given a high priority because in order to solve the above mentioned various labor problems, it is necessary to analyze precisely the current situation and the source of problems, and to find out solutions. Otherwise, both employee and employer end in insisting their own opinions. What can sort out discrepancy between both opinions is only a fair and rational discussion based on objective research and analysis.

## 2.5 Current Condition of Indonesian Tax System

The history of a modern tax code of Indonesia is comparatively new. It was enforced in 1984. This is because it was typical "Oil dependence and Foreign aid dependence nation" that rely on 50 to 65 percent of national revenue from oil or gas related income and income from state own enterprises. When grant aid from the foreign country was added, it reached 80% from 65 of the entire national incomes. The condition continued until 1980's. During the period, amount of national expenditure was a little; therefore, revenue was not so important for the government. The establishment of the new taxation business system was needed at the beginning of the 1980's, since the government noticed that for the depression of the crude oil price and estimated oil deposits of Indonesia was being 20 another years. And then, the government examined an American style tax system to establish a new tax system which assures economic development and boosting of economic scale. Afterwards, revenue becomes seven or more times bigger by breaking away from oil dependence policy during the decade

starting 1986 until 1995/96. Also, share of tax revenue in national income become 70 to 80 percent.

**Table 2-102 Annual Revenue Transition of Government**

(unit: 1 Billion Rupiah, %)

	00	01	02	03	04	05	06(budget)*	
							amount	
M. Revenue (share of GDP)	205.335 21.1%	301.078 20.5%	298.605 16.0%	341.396 16.8%	407.836 18.0%	495.444 18.2%	625.237 20.6%	
Tax revenue (share of GDP)	115.913 11.9	185.541 12.6	210.087 11.3	242.048 11.9	280.874 12.4	346.834 12.7	416.313 13.7	
Domestic tax	108.885	175.974	199.512	230.933	268.132	331.595	399.322	13.1
Income tax	57.073	94.576	101.873	115.016	134.899	175.380	210.714	6.9
VAT	35.232	55.957	65.153	77.082	87.556	101.295	128.308	4.2
Commodity tax	11.287	17.394	23.189	26.277	29.173	33.256	36.520	1.2
Tariff	7.028	9.567	10.575	11.115	12.742	15.239	16.992	0.6
Import duty	6.697	9.026	10.344	10.885	12.444	14.921	16.573	0.5
Non-tax revenue (Share of GDP)	89.442 9.2	115.059 7.8	88.440 4.7	98.880 4.9	126.684 5.6	147.315 5.4	205.292 6.8	
Natural resources	76.290	85.672	64.755	67.510	91.389	110.391	151.642	5.0
Crude oil	50.953	58.950	47.686	42.969	63.060	72.805	110.138	3.6
Gas	15.708	22.091	12.325	18.533	22.199	30.933	36.097	1.2
Profit from state owned company	4.018	8.837	9.760	12.617	9.818	12.777	23.278	0.8
Foreign aid	--	478	78	468	278	1.296	3.632	0.1

(Remark 1) Fiscal year : April to March until 99/2000, April to December in 2000. January to December since 2001 or later

(Remark 2) Data in 2005 was provisional (announce in Jan. 2006), data in 2006 shows budget

(Source) Ministry of Finance, Bank Indonesia

The government is making big effort to increase tax revenue by improving tax levying efficiency since the revenue becomes lifeline for Indonesian government. These efforts for tax levying seem effective because it grew by 10 percent in average even after the economic crises while the growth of GDP being 4 to 5 percent during the year. However, Indonesian government is aiming to improve a ratio of tax revenue to GDP up to 13.7% in fiscal year 2006, whereas the ratio in 2005 being 12.7%.

The revenue ratio of Indonesia is smaller than that of Asian nations in the vicinity compared with the scale of GDP.

**Table 2-103 The Revenue Ratio Comparison**

	Indonesia (2005 )	Thailand (2003)	Philippine (2004)	Vietnam (2003)	China (2005)
Revenue Ratio (%)	70.0	89.1	86.0	77.1	91.6
GDP Ratio (%)	12.7	15.2	12.7	18.6	15.1

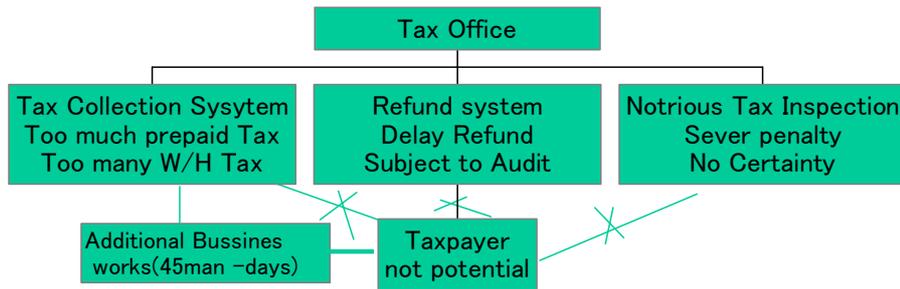
Source: JICA Study Team

Therefore, Tax authority wishes to increase the revenue more. On the other hand, private economic group expect “FDI fascinating tax system”, “low tax ratio than neighboring Asian countries” and “abridgment of tax inspector's powers”. Cross expectations between the private business group and tax authority now become the background of taxation business trouble and causes the tax revision to be delayed.

For example tax system in Indonesia makes taxpayer be apt to excess tax payment, such as many items of withholding prepaid income tax and monthly prepaid income tax etc. The Indonesian spirit “collect tax for the tax payer who can afford pay “is so notorious that potential foreign investor could not invest Indonesia willingly.

And once paid, it is difficult to refund the overpayment tax. If claim refund, it must subject to notorious tax audit. The worst case the taxpayer, who claimed refund, will be force to pay bigger amount in back taxes. So foreign taxpayers in Indonesia, who are probable target on tax, cannot pay tax willingly but protect not to pay tax. Foreign taxpayers in Indonesia fall, that is to say, in a vicious spiral stacked. Getting this information from the foreign investor, who already invested in Indonesia, the some potential foreign investors are apt to shrink to invest Indonesia and invest other countries. There are now many alternatives of same or better condition to invest with Indonesia in Asia, such as Thailand, Vietnam, Philippines etc. Therefore this vicious spiral must be cut somewhere at a certain time as soon as possible. I think the best point to cut is tax refund system. If overpaid tax refunded smoothly, the vicious spiral stacked would start to move properly. Almost all the foreign taxpayers whom I met for this study confirmed if the refund system in Indonesia was improved there would be no problem regarding prepaid tax.

**Figure 2-36 A Vicious Spiral of Taxation**



Source: JICA Study Team

As for the taxation system of Indonesia is simple as it pass through law → government ordinance → minister' s decision → business notice by tax bureau, and supported by steady law system. On the other hand, a lot of vague points are left to the tax authorities. And there have been no arranged records of precedents, therefore the criteria for judgment lean too much on tax officers so they have big powers on disputes regarding taxation. It can be said that the factor of the taxation business trouble is in understanding shortage between the tax collector and the taxpayer devoting to the collection of taxes system and collection of taxes that values the cash flow of the government sector in excess.

Problem of Indonesian taxation system which was pointed out by foreign investors as the most serious is discussed below. It is necessary to adopt measure of the improvement at once if these problems are clarified by the comparison with neighboring countries.

### 2.5.1 Negative Effects

#### (1) Tax advance payment system

Advance installment payment system on income tax : The payment in the previous year is paid 100% by installments (12 times a year). It seems that it is the maximum in neighboring countries 12 times of the prepayment, and the complexity of the business and number of the frequency become also a burden to taxpayers

It is ideal that no prepaid income tax system theoretically, but considering the inefficient collecting-tax system in Indonesia, it is impossible to complete the condition at once. I propose that the number of tax returns must be reduced to 2 ~ 4 times at the first place. It supposes to give taxpayers another benefit that is to reduce the clerical work. In the result of UI study 2005, it takes 8 men days per month to fill the monthly return documents regarding PPH25.

**Table 2-104 Comparison of the number of installments of prepaid tax**

	Indonesia	Thailand	Philippine	Vietnam	China
Number of Payment	12 Times	2 Times	4 Times	4 Times	4 Times

Source: JICA Study Team

Advance payment income tax for import goods: Prepayment income tax that the importer pays at each import (Only Indonesia adopts the prepayment of the income tax at each import). This maybe comes from the notion that “A firm intended to import goods from abroad usually has to have profit, so pays first the Income tax as the part of the profit at the time of import.” But this notion has not been acceptable for foreign investors now. Moreover, in comparison with other neighboring companies, there isn’t any other country to apply such tax.

- Too many items withholding prepaid income tax: The target is wide, and almost all the service sectors are included, both from domestic and overseas. In the case of prepaid income tax, it causes the taxpayer to burden additional work that is 6 man days per month.

**Table 2-105 Comparison of Items of withholding tax**

Indonesia	Thailand	Philippines	Vietnam & China
Payment to Resident (PPH23) <ul style="list-style-type: none"> <li>• Total amount</li> <li>• Estimate Net Income *</li> </ul>	Payment to Resident and Non-resident	Payment to Resident and Non-resident <ul style="list-style-type: none"> <li>• Expanded Withholding Tax system</li> </ul>	Payment to Resident and Non-resident Remittance to abroad taxpayer must Withhold the Tax according to the content of remittance
Payment to Non-resident (PPH26) <ul style="list-style-type: none"> <li>• Total amount</li> <li>• Estimate Net Income*</li> </ul>			
Total 45 Items *Total 31 Items	Total 21 items	Total 28 items	N.A

\* means same as prepaid tax

Source: JICA Study Team

- Fiscal tax : When the residents leave the country, they are obliged to pay Fiscal tax (In case by air Rp1,000,000-, in case by sea Rp,500,000-, in case by land Rp250,000-). This tax is treated as a part of prepaid personal income tax. If an employer pays this

tax for an employee's business trip the amount is treated as the employer's prepaid income tax.

But if they claimed a refund of this tax, it is also subject to tax inspection. If not finished with the inspection, the refund won't perform. When the refund claimed as a part of income tax at the same time of the refund of PPH22, PPH23, or overpaid PPH25, there might be no problem. But as for the individual tax, if the individual wants to take the refund procedure for itself, it is difficult. Because the individual must prepare all the documents the tax office required, and if there is a tax inspection the taxpayer will incur many losses, such as negotiation losses, etc. Therefore, there are many foreign companies treat the tax as a cost instead of a refund, to avoid vexatiousness. There is not any other neighboring country to apply the same tax.

(2) Length of VAT of refund period

According to the regulations, the duration to get refund approval is as follows from when the value added tax is claimed.

**Table 2-106 Comparison of Duration of VAT refund**

	Indonesia	Thailand	Philippine	Vietnam	China
Duration of VAT Refund	From 5 Month to 1 year There is a big difference between big companies and small and medium scale companies	0.5 Years	2 Years	1 Month	1 Month

Source: JICA Study Team

- 1) Refund claim- by a specific, competent taxpayer: It is within one month .
- 2) Refund claim- in those who deliver it through "VAT collector" or exporters excepting the above-mentioned payer (payers are allowed 7 days): It is within two months.
- 3) Refund claim- by other payment of taxes: It is within six months.
- 4) It is necessary to do a refund (approval and negation) decision within 12 months in case of when tax authorities investigate the taxation business about the tax in the complete range.  
Excluding the above-mentioned 1), it is necessary to review the result of a taxation investigation about the refund claim other than before the repayment money is paid.  
Generally, it takes about one year or so to refund . Only a limited number of big enterprises which adopt the "Modern Tax Administration System "that the tax bureau promotes enjoys the regular refund.

This refund system on VAT causes many loses to taxpayers, as follows.

- 1) For taxpayers, who export 100% of their products the output VAT cannot be incurred, but only the input VAT always incurred. Therefore, the output VAT must be refunded every month (or year). Taking the procedure VAT means financial loss because of raising funds,

interest loss, time loss, and negotiation loss because of the tax audit.

This situation causes less competitiveness of export-oriented companies.

- 2) According to the regulations in Indonesia, when a taxpayer pays a royalty to an overseas company, if the taxpayer should not pay input VAT instead of the overseas company, the VAT paid could not be subject to refund. It means if a taxpayer pays a royalty at US\$100-, he will finance US\$110.0. When a taxpayer pays withholding income tax on PPH26, the payment cannot influence the cash-flow directly. Because the taxpayer reduces the amount of tax-and-pay. But in case of VAT, it will refund in future, but it influences cash-flow.
- 3) In case of the commission received, which cannot add value in Indonesia, there is no clear regulation about the case, therefore the taxpayer usually treats it with the commission received of the miscellaneous income account. But the tax officer brings some matters on VAT.
- 4) The company newly invested is incurred by the current VAT refund system. Because such company usually has much more input VAT of initial purchase, including machinery, land, and buildings. It becomes an obstacle to inviting new potential investors.
- 5) PDKB (Pengusaha di Kawasan Berikat ; Bonded factory) must pay VAT for the services, although VAT is exempted from the materials or goods moving through customs. But it is natural that the operation of the business should be done not only the transaction of goods or materials, but also the many services, such as repair, subcontract processing, audit of accounts, royalty , consulting, etc. It is ludicrous that  
The PDKB system is established in order to introduce export-oriented industries. But these VAT payments give less competitive power to the export-oriented industries.

The VAT refund system is maybe employed in neighboring countries as well. Therefore, it is better to compare the duration of VAT refund procedures with neighboring countries for improvement. Peraturan Direktur Pajak Nomor Per -122/PJ/2006 concerning amendment of the overpaid VAT refund system issued on August 16, 2006. The content of which not so changed from before. But it is stipulated that overpaid VAT should be refunded within 2 month from the receipt of the claim. But there are still terms and conditions regarding severe penalties and post audits. I hope this time the tax authority in Indonesia should refund the VAT regularly and properly according to this new regulation. If not, Indonesia adds to the shame and is sure to be abandoned by the foreign positive investors.

- (3) The business load concerning the taxation is large
  - 1) The income tax: Obligation of 12 times-advance-payment-system a year is more frequent than neighboring countries are. The object of the withholding tax is too wide, and the issue clerical works of the withholding tax are borne.
  - 2) Value added tax: Formalism that doesn't admit error in writing, such as FAKTUR PAJAK (Tax Invoice)

3) The audit and criminal investigation: The indication of the result of the survey is imperfect. Vague regulations in the tax code are almost relied upon by the judgment of the tax authority. The trouble between the tax collector and the taxpayer devoted to collection of taxes is not endured.

(4) A substance labor cost increase

It is a cause for an existing investor to make the company operation in Indonesia difficult.

- 1) There are a lot of losses, not worship insertion items, of the corporation tax.
- 2) Almost all welfare expenses are the losses, not worship insertions.  
Load size of the manager and the engineer has been sent by the foreign investor.
- 3) Temporary payment levy item of value added tax. Value added tax of the cost considered to be a final consumption will be charged as cost 100%. This system increases the cost for semi-products.

(5) Notorious tax audit system

The reason of the notorious tax audit comes from Indonesia as follows.

- 1) The legal structure regarding taxation in Indonesia is almost good. But the writing style is so equivocal that there could be much gray-gray area.
- 2) The tax auditors show very large variation in each opinion.

If there is a clear criteria for judgment, the dispute can be settled by mutual content. But in Indonesia this is the tax administration, that as I said before, the tax officials, who have an overwhelming power of criteria for judgment act as if he were a rulebook. In this situation, almost all taxpayers think the unofficial negotiation is a far more rational solution than official, considering the financial and time burden, which is unwilling and unreasonable, costed by the proper tax return. The solution of this matter is as follows:

- Start to prepare the record-book of precedents dividing into every case by case. And the record book is enabled to be used practically by tax officials.
- Re-educate tax officials so as not to be in variation regarding the level or consciousness of tax inspections. In another words, ensuring the operation standard.

(6) Investment incentives

Neighboring countries have a clear industrial policy and the incentive system, but Indonesia does not. Incentives are important for investors when they evaluate the viability of investment. Therefore, it is necessary for Indonesia to prepare any incentives as fascinating as what Thailand and Vietnam offer. They are the present rival when the investor does F/S of the investment other than China.

Regarding the investment incentive, I propose one idea regarding a fiscal incentive to Indonesia. That is the post-performance incentive system. The prevailing investment fiscal incentive in ASEAN is applied only to introduce the foreign investment. So they value the investment project and give the fiscal incentive before the investment. They cannot value the result of the project. Considering the current severe competition among the neighboring countries regarding investment incentives and the financial situation of Indonesia, it is a good idea not to involve this competition. So the fiscal incentive for pre-investment is controlled only to one or two industries which Indonesia wants to introduce. And the investor who has performed the good performance, such as acceleration of employment, increase of the rate of local procurement, technical transfer, acquisition of foreign currency, etc., should be given the fiscal incentive from the Indonesian government. The other neighboring countries have not yet applied this system. And the pre-investment incentive system has a defect that if the investor cannot perform the original plan it is difficult to cancel the incentive. The Indonesian government shrinks to introduce fiscal incentives, because it would reduce the tax revenue. But I hope they will think falling income is temporary, but foreign investment which is introduced by the incentive will increase. So there is a possibility to get the more-tax revenue than the falling income.

(7) The Bonded Area system out of date

To achieving the competitive edge for the cost of the export industry, many countries apply the bonded system. Indonesia also has the system, and can establish a bonded factory/warehouse.

The law on the bonded system in Indonesia is based on the ministry decree dated June 26, 1997, No.291/KMK/1997, and the implementation regulation of the decision of the Director general of tax office dated July 25 ,1997, KEP-63/BC/1997. These laws changed the concept of EPTE (bonded factory) and EPZ (bonded Area) to PKB (administrator of bonded area) and PDKB (business operator/factory in bonded Area). That is, PKB is an administrator, and PDKB is a business operator. As for the bonded warehouse, the concept is the same. PGB (Administrator of bonded warehouse) is an administrator, and PPGB (warehouse operator in bonded area) is an operator.

There are many complaints from foreign investors, because the bonded system in Indonesia cannot catch up with the modern transaction of trade, and not achieve the competitive edge for the cost of the export industry.

- 1) PDKB must pay VAT for services.
- 2) The goods which buy in domestically cannot bring in PPGB.
- 3) The transfer between PPGBs is prohibited.

But the frontier of the bonded area of Batam Island in Indonesia is starting to improve the system to settle those problems. I think on the basis of the success of the Batam Island case the new system on the bonded area will prevail all over the Indonesia area in the near future.

(8) The computerization of the taxation

Because the tax code is vague, the judgment of taxation is being left by tax authorities. Moreover, there are no arranged records of precedents. Therefore, the taxation business trouble occurs easily, and the solution is negotiated on among the taxpayer and tax collectors. Both of them are going to aim to get a win-win resolution. It is necessary to avoid manual procedures by the tax officer. Computerization and/or introduction of an E-payment system into the taxation procedure could be the one measure to solve these conflictions.

The tax bureau of Indonesia is promoting to introduce the “Modern Tax Administration System,” which includes an E-Payment system into the tax levying. However, it is still only introduced in a part of the tax office in Indonesia, and only the big companies enjoy the merits.

**2.5.2 Customs**

About the custom in Indonesia, I also regret to say it is so notorious that foreign positive investors couldn’t invest in Indonesia willingly. I myself think it is surprising that the improvement which customs had been performed for this 10 year is great. But the speed of improvement regarding customs in the neighboring competed countries, such as Thailand and Vietnam, is so quick that Indonesia could not catch up with them. Therefore, Indonesia must improve the customs system as soon as possible. Analyzing complaints from foreign investors found they are also categorized into three categories. That is:

1. Late import goods release

**Table 2-107 Comparison of days to release import goods**

	Indonesia	Thailand	Philippines	Vietnam	China
Number of days to release the import goods	5.5 days	1or2 days	7 days	2 days	N.A

Source: JICA Study Team

To see the above result, it is true the duration of the customs clearance in Indonesia is a little longer than any other neighboring countries except the Philippines. But considering that

the Philippines is now on alert of Terrorism, and that it takes more time than usual, it seems to be almost the same with Indonesia. It means Indonesia must improve, to make the import goods released fast. I think it is good idea that the authority should declare the target the same as the “One-day-Clearance” in Thailand.

## 2. Unfairness and Non-transparency

It has been said that the most effective way to avoid the above matters, typically such as informal payment, is the introduction of an electronic system into the customs clearance system. It is because almost all believe that to limit the human interaction between importers and custom officials is to limit informal payments. But in Indonesia, despite their introduction of the electric system in customs clearance, there are still the human interactions and some sectors which cannot use this system efficiently. I think it is because there are two reasons, as follows:

The first is ; there is no law on the implementation of electric transactions, such as digital signatures, electric documents, etc.

In customs clearance procedures in Indonesia, EDI (Electric Data Interchange) for imports has been introduced since 1997. The introduction of EDI was supposed to clear the import goods without interaction with customer officers. But I found in this study that despite the adoption of EDI, many importers still claimed that every import shipment, even in the green lane, require face-to-face meetings with customs officials, to submit the hard-copy documents. Theoretically speaking, EDIs do not require any face-to-face meetings with a custom official, so the informal payment should be close to zero. If the means of informal payment and the frequency of meetings with customs officials for the green lane are not zero, then it must be some problem with EDI in Indonesia. From the JICA study in 2005, which noted that “human

The second is the system doesn't connect with the other government agencies' database.

In this study I have an opportunity to hold a meeting with APJP (Asosiasi Perusahaan Jalir Prioritas), members of which consist of the companies of the Priority lanes. Almost all the member companies reported they could clear customs for one day (Average: 8 hours). But one chemical company reported that it takes 7 days. Hiring in details from the company, I found it is because the company must get some approvals from other government agencies, such as POM, MOC, and MOI. EDI at present in Indonesia does not yet connect with other agencies' database. So the company goes to the agencies to get approvals and bring each of them to the customs office.

I think it takes much time for Indonesia to introduce the single-window system completely at once, which Indonesia is going to apply together with

So the first step to improve the EDI system efficiently and easily is the linkage to other government agencies' databases and the preparation of the implementation law regarding electric transactions. I think this makes the time of releasing import goods shortened, and make the customs procedure in Indonesia more fair and transparent than now.

### 3. Notorious Post audit

It is clear that the quicker release for import goods, the more important the Post-audit.

But, sorry to say, the Post-audit system in Indonesia is so notorious that foreign positive investors could not invest in Indonesia positively. The reasons are the same as the notorious TAX audit, which I have already mentioned in this report. But one thing to note regarding this matter in Indonesia is too long the duration of documents-keeping. In comparison with other neighboring countries, it is true that the duration in Indonesia is longer.

**Table 2-108 Comparison of Custom Document Storage Period**

	Indonesia	Thailand	Philippines	Vietnam	China
Duration for Documents-keeping	10 years	10 years (5years)*	3 years	5 years	N.A.

\*Thailand is discussing submitting the bill of the amendment at the Diet.

It is difficult for foreign investors to accommodate the audit regarding the matters of 10 years before. Because the account officer at that time may be changed, and that the document to be keep is too spacious, and some documents/data may be lost.

According to the customs law in Indonesia, the custom is authorized to post audit 2 years back. There is no clear regulation as to the duration of the document regarding Customs clearance. But the customs office has insisted on 10 years' duration. I would like propose the two-year duration should be clearly stipulated in accordance with the law.

## 2.6 Investment Promotion and Implementing Organization

### 2.6.1 Current Condition of Investment Promotion in Indonesia

Nation level investment promotion is currently being carried out by BKPM.

#### (1) Organization structure for investment promotion.

Deputi Bidang Promosi Penanaman Modal is in charge of promotion activity

There are 3 divisions in charge of investment promotion

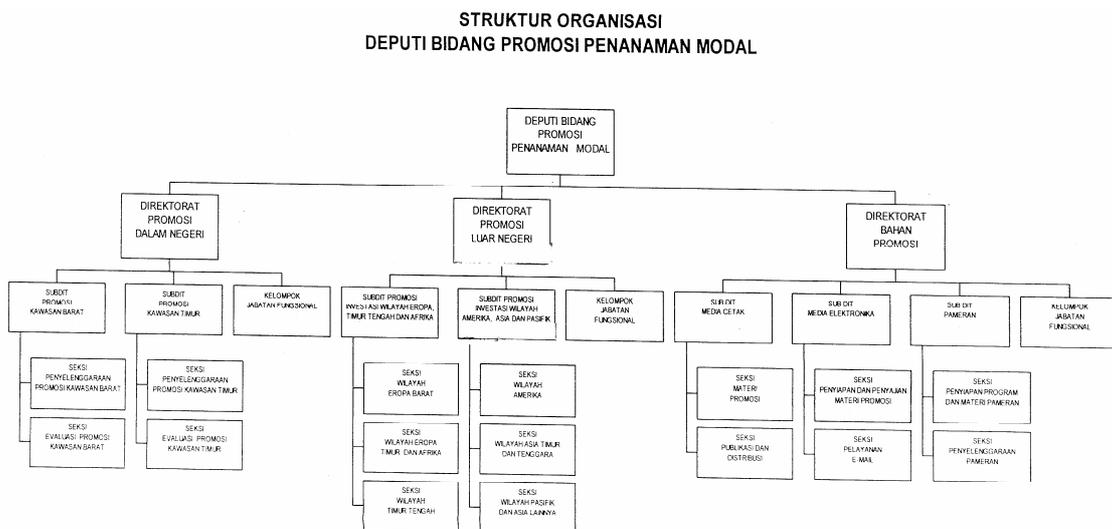
- 1) Directorate of Domestic Investment Promotion
- 2) Directorate of Foreign Investment Promotion
- 3) Directorate of Media Promotion

Activities for foreign direct investment promotion are carried out by Directorate of Foreign Investment Promotion, which have 2 sub-divisions.

One is Sub-division of Investment Promotion for Europe, Middle East & Africa which is in charge of promotion in Europe, Middle East & Africa area and the other is Sub-division of Investment Promotion for America, Asia & Oceania, which is in charge of promotion in America, Asia & Oceania area

Directorate of Media Promotion is in charge of development and maintenance of promotion materials such as publications, brochures, and Internet web-site and preparation work of overseas exhibitions.

**Figure 2-37 Organization of Investment Promotion at BKPM**



In addition, there are 6 overseas liaison offices in Tokyo (Japan), Taipei (Taiwan), Melbourne (Australia), London (United Kingdom), Amsterdam (Netherlands) and Los Angeles (U.S.A.) which are operated by BKPM and in charge of promotion activities in their countries.

Furthermore, provincial level investment promotion is carried out by regional BKPM (total 33) established in each province. The promotion tool such as brochures and leaflet are prepared by each BKPM by their own budget including maintenance of their own Internet web-site

(2) Promotion Activities:

The following promotion activities are carried out by BKPM both within the country and out of the country.

Some of those programs are organized by other ministries and other government agencies (such as Ministry of Tourism, NAFED etc.) to which BKPM participates under mutual agreement. Also in some of those programs, regional BKPMD participates jointly or partially.

1) Promotion activities within the country

■ Business gathering:

- Business meeting with BKPM, local government and business community held in 8 provinces in 2005

■ Indonesian Investment Expo:

- Exposition held annually at Semarang and Bali in 2005 to invite domestic and foreign investors

2) Promotion activities carried out in overseas (out of the country)

■ Overseas promotion by BKPM headquarters:

- Individual approaching to potential investor/business community under business trip base held at 48 times in 2005 at 35 cities in the world

■ Overseas promotion by overseas liaison offices:

- Promotion activities carried out by overseas liaison offices in Tokyo (Japan), Taipei (Taiwan), Melbourne (Australia), London (United Kingdom), Amsterdam (Netherlands) and Los Angeles (U.S.A.)

■ Receiving foreign investment missions:

- Received 11 missions from India, Russia, Japan, Switzerland, Turkey, Taiwan, Germany, Australia and Singapore

■ Tie up with overseas organizations:

- Following up of MoU in investment promotion with overseas governmental/non governmental organizations of 6 countries.

■ Exhibitions (held in overseas and/or within the country)

- Holding/Participating exhibitions at 12 cities in overseas countries and 5 cities in Indonesia

■ Media promotion activities

- Developing/updating brochures & CDs for investment promotion material  
- Maintaining official Internet website

## 2.6.2 Comparison of Investment Promotion Activities Among Neighboring Countries

The followings are result of comparative study with the neighboring countries, each country is also aggressively promoting foreign direct investment into their country, which gave us many hints how to enhance investment promotion.

### (1) Organization structure for investment promotion

The following table shows the organizational structure of investment promotion of each country.

Obviously, there are two types of organizational structure, such as;

#### 1) Centralized system into one organization, such like Thailand and Philippines.

In both Thailand and Philippines, Board of Investments (BOI) is in charge of every kind of promotion activity representing the country, including promotion of region level on behalf of local government.

#### 2) On the contrary, China has different system such like, decentralized system.

In China, investment promotion is carried out by each municipal government by their own policy and strategy. Each promotion activities are being carried out by their own way and tools under their own budget. The central government role is only giving the guidance for promotion and not intervened to municipal government activities, unless otherwise incongruent with central government policies and guidance.

**Table 2-109 Organizational Structure of Investment Promotion**

	Competent Authority of Investment promotion	Promotion Organization (Nation-level)	Promotion Organization (Region-level)
INDONESIA	Office of President (BKPM)	BKPM Other ministries etc	BKPM
THAILAND	Office of Board of Investments (OBOI)	Board of Investments (BOI)	BOI
PHILIPPINES	Department of Trade & Industry	Board of Investments (BOI)	BOI, PEZA, SMBA, CDC
VIETNAM	Ministry of Planning and Investment (MPI),	MPI, Foreign Investment Agency (FIA)	People's committee (DPI)
CHINA	Ministry of Commerce	China Council for the Promotion of International Trade (CCPIT)	Municipal Government

Source: JICA Study Team

### Comparison result

In Indonesia, there are some differences in organizational structure from other countries.

- 1) BKPM is now engaged in nation-level promotion, however, BKPM is not fully empowered to carry out every kind of promotion activities (since some of ministries are currently carrying out promotion activities concerning certain kind of businesses under their own policy and strategy, which is beyond control of BKPM)
- 2) Region-level promotion is carried out by BKPM in each region; however, the quality and quantity of their activities are varied very much by each province by province, due to their capacity. BKPM is unable to control such BKPM's activities because each BKPM belongs to each provincial government.

#### (2) Investment policy and strategy

The following table shows which organization takes responsibility to establish nation level investment policy and strategy and prioritized business categories and/or restricted business categories to let investors know about nation's policy and strategy.

Through the course of comparative study of neighboring countries it is learnt that every country has established their own investment policy and prioritized and restricted business categories to let all parties concerned know what categories of business are welcomed or restricted in their countries.

**Table 2-110 Promotion Policy / Prioritized Business Categories**

	Promotion policy (made by)	Prioritized business categories	Restricted business categories
INDONESIA	(BKPM/other ministries)	(BKPM/other ministries)	Negative List
THAILAND	Board of Investments (BOI)	BOI Decree	Negative List attached to Foreign Business Act
PHILIPPINES	Board of Investments (BOI)	Investment Priorities Plan	Negative List
VIETNAM	Ministry of Planning and Investment	Decree of law; List of encouraged investment project	Negative List
CHINA	Municipal Government. (under the guidance of Ministry of Commerce)	Catalogue for guidance of Foreign Investment	Catalogue for guidance of Foreign Investment

Source: JICA Study Team

### Thailand

Board of Investments (BOI) is sole governmental organization responsible for both planning and implementation of investment promotion. Under the Investment Promotion Act, BOI established and announced “Investment Promotion Policies” and criteria of promotion activities which are eligible for receiving incentives. The types, sizes and conditions of business activities eligible for promotion are announced together with the list of sector by sector.

Furthermore, in order to promote regional development of country, BOI divided country into 3 investment zones based on economic factors, such as level of income and availability of infrastructure, and designated zone 3 areas as “Investment Promotion Zones” in where some preferential treatment is granted.

On the contrary, restricted business categories are listed in the attachment of the “Foreign Business Act” as negative list and revised once a year.

### Philippines

In Philippine, “Investment Priority Plan (IPP)” is prepared by the Board of Investments (BOI) and issued annually in the name of the President as a government policy for investment promotion. The IPP indicates a list of promoted areas of investments eligible for incentives in consultation with related government agencies and private sector.

On the contrary, “Foreign Investment Negative List” is issued under the Foreign Investment Act to indicate a list of investment areas reserved to Philippine nationals, in other words, those that are restricted/prohibited to foreign investment. The Foreign Investment Negative List shall be amended once every two years.

### Vietnam

Country’s basic policy of foreign investment is regulated in the Law on Foreign Investment in Vietnam and the prioritized and/or restricted business categories/areas are also regulated by the decree of the Law.

Investment promotion has been started since 2005 by establishing “Investment Promotion Center” in Ha Noi, Ho chi minh and Da Nang by the Ministry of Planning and Investment and still under developing stage.

### China

In China, Ministry of Commerce of the Central government is responsible for formulating national policy for foreign investment in view of nation based economic development. Ministry of commerce has set up and given notice of basic framework to each municipal government in the form of laws, regulations and guidance.

Basic policy for inviting foreign investment is regulated in the “Provisions on Guiding the Orientation of Foreign Investment (Feb.11, 2002)” and “Catalogue for the Guidance of Foreign Investment Industries (Apr.1, 2002)” which were set up by the central government.

The industries to be encouraged, restricted and prohibited by foreign investment are designated in this regulation and guidance,

Under these regulation and guidance, each municipal government has set up their own policy for investment promotion, such as encouraged industries to be invited or industries to be restricted under their policies in considering their location, advantages and weaknesses and development plan.

In that sense, detailed promotion policies and strategy is actually formulated by each municipal government and much depended on own discretion of each municipal government.

For example, Shenzhen City, China's first special economic zone, have their own development plan and strategy to encourage foreign investment to build a hi-tech city, modern logistic hub, regional finance center and a high cultural and ecological city after over 20 years of development experience of the special economic zone.

#### Comparison result

With reference to the investment policy and strategy, compared with other neighboring countries, Indonesia has some disadvantages to appeal potential investors

There is no clear policy and strategy to invite foreign investment to the country, which shall be guidance or strong message for foreign investor to easily identify which sector of business is prioritized to make an investment in Indonesia both nation-level and region-level

### (3) Incentives

The following table 2-105 shows what incentives are currently offered to attract foreign direct investment among the neighboring countries

**Table 2-111 Incentives offered to foreign investors**

	Fiscal Incentives	Non-fiscal incentives
INDONESIA	Fiscal and non fiscal incentives are basically not introduced now, except • import duty exemption /reduction treaty (final custom duty become 5%)	(None)
THAILAND	(Basic incentives offered by BOI) Tax-based incentives include exemption or reduction of import duties on machinery and raw materials, and corporate income tax exemptions.	(Basic incentives offered by BOI) Non-tax incentives include permission to bring in foreign workers, own land and take or remit foreign currency abroad.
PHILIPPINES	(Basic incentives offered by BOI) - <u>Income tax holiday</u> - <u>Exemption from taxes and duties on imported spare parts</u> - <u>Exemption from wharfage dues and export tax, duty, impost and fees</u> - <u>Tax exemption on breeding stocks and genetic materials</u> - <u>Tax credits</u> - <u>Additional deductions from taxable income</u>	(Basic incentives offered by BOI) -Employment of foreign nationals -Simplification of customs procedures for the importation of equipment, spare parts, raw materials and supplies and exports of processed products. -The privilege to operate a bonded manufacturing/trading warehouse
VIETNAM	-Exemption/reduction of corporate income tax - <u>Exemption from duties on imported materials</u>	N.A.
CHINA	(EXAMPLE in case of Guangdong Province) I. Exemption or Reduction of Enterprise Income Tax The income tax of foreign invested enterprises is basically 30%, however, The income tax of the following foreign invested enterprises shall be levied at the rate of 15%: - Foreign-invested enterprises located in special economic zones and foreign invested enterprises located in economic and technological development zones; - Foreign Invested enterprises deemed to be high-tech and new-tech enterprises located in areas	Not specified but offered by each municipal government under their discretion

	Fiscal Incentives	Non-fiscal incentives
	<p>determined to be high and new tech development zones by the State Council;</p> <ul style="list-style-type: none"> <li>- The foreign invested enterprises located in the free Trade Zones that are engaged in the processing of export-oriented products.</li> </ul> <p>Since Guangdong Province can enjoy the preferential policy granted to the coastal economic open areas, all the foreign-invested enterprises in the province (except the above-mentioned enterprises) will enjoy a 24% enterprise income tax. For Foreign-invested enterprises with over-10-year-term of operation, starting from the first year of profit making, their income tax for the first year and the second year shall be exempted and that for the third to fifth year shall be slashed by 50%.</p> <p>The local income tax of a foreign-invested enterprise shall be calculated based upon the taxable amount of income at the rate of 3% and tax exemption or reduction shall be granted</p> <p>II. Exemption or Reduction of Tariff, Value-added Tax, Consumption Tax</p>	

Source: Web-site of each organization and summarized by JICA Study Team

### Thailand

Board of Investments (BOI) is responsible for both planning and implementation of investment incentives.

The BOI appoints 142 industrial sectors as the investment priority sectors under the decree.

Investment priority industries are subject to receive incentives (Agriculture/agrotechny, technology/human resource development business, public service business, environment protection business, industry of special objective)

Such businesses as trade and investment support office, R & D, Regional generalization headquarters, technology renovation and promotion business are subject to incentives

The BOI offers two kinds of incentives to promoted projects, regardless of location:

Tax-based incentives include exemption or reduction of import duties on machinery and raw materials, and corporate income tax exemptions.

Non-tax incentives include permission to bring in foreign workers, own land and take or

remit foreign currency abroad.

In addition, BOI divides the whole country into three investment zones, and gives special preferential treatment (fiscal and non-fiscal incentives) on investment each zone by zone.

### Philippines

In order to encourage foreign investment, the following preferential treatments are prepared by BOI, PEZA(Philippine Economic Zone Authority), SMBC (Subic Bay Metropolitan Authority) and CDC (Clark Development Corporation).

The followings are basic incentives for BOI registered enterprise

<Fiscal incentives>

- (a) Income Tax Holiday
- (b) Exemption from Taxes and Duties on Imported Spare Parts
- (c) Exemption from Wharf age Dues and Export Tax, Duty, Impost and Fees
- (d) Tax Exemption on Breeding Stocks and Genetic Materials
- (e) Tax Credits
- (f) Additional Deductions from Taxable Income.

<Non-Fiscal Incentives>

- (a) Employment of Foreign Nationals
- (b) Simplification of customs procedures for the importation of equipment, spare parts, raw materials and supplies and exports of processed products.
- (c) The privilege to operate a bonded manufacturing/trading warehouse subject to Customs rules and regulations.

On the contrary, PEZA, SBMA and CDC are offering their own incentives to the investor who invested PEZA's export processing zone or other special economic zone.

The followings are Incentives for PEZA registered enterprises

<Incentives for Ecozones and IT parks/building locators>

- (a) Income Tax Holiday (ITH) or Exemption from Corporate Income Tax for four years, extendable to a maximum of eight years;
- (b) After the ITH period, the option to pay a special 5% Tax on Gross Income, in lieu of all national and local taxes
- (c) Exemption from duties and taxes on imported capital equipment, spare parts, supplies, raw materials.
- (d) Domestic sales allowance equivalent to 30% of total sales
- (e) Exemption from wharf age dues and export taxes, imposts and fees
- (f) Permanent resident status for foreign investors and immediate family members
- (g) Employment of foreign nationals
- (h) Simplified import and export procedures
- (i) Other incentives under Executive Order 226 (Omnibus Investment Code of 1987),

as may be determined by the PEZA Board

### Viet Nam

In Viet Nam, the Ministry of Investment Planning approves the incentives for foreign investment in considering the opinion from other ministries and People's Committee of the region.

The major incentives currently offered are;

- 1) Reduction of corporate income tax, such as 10%, 15%, or 20% is applied for the 10 to 15 years after starting business for the business sectors listed in the prioritized sectors.
- 2) Exemption of import duties in specific sector (machinery and equipment which are imported as a capital assets, construction materials which are not manufactured in Vietnam; raw materials used for BOT project and "special investment priority project" or raw materials used for production at economically under developed region, raw materials and spare parts used for the production of export orient products or raw materials and parts for machinery/electric and electronics devices production.

### China

In order to encourage foreign investment, the following preferential treatments are prepared as incentives by the relevant municipal government with approval of the central government.

- (1) Preferential taxation
- (2) Preferential treatment for investment to specified regions
- (3) Preferential treatment for investment to the specified projects
- (4) Preferential treatment in the bonded zone/special economic zones

For the investments to the mid-west regions, some additional preferential treatments are prepared for investment area and conditions of establishment.

For the investment to the emphasized projects to be encouraged, such as energy, transportation, special treatments for minimizing business risks are prepared

Preferential taxation are introduced for the investment to the special economic zones (SEZ: 4 zones in all china including Shenzhen), the economics and technological development zones (54 zones in all China) and the hi-tech industry development zones approved by the central government.

In free trade zones (FTZ: 15 zones in all China) and export processing zones, enterprises can go through, process and store imported goods without paying custom duties and taxes.

These incentives are able to enjoy after obtaining approval of foreign investment, registration of enterprise and relevant business licenses.

The above-mentioned incentives are regulated and officially announced to public and supposedly, there is no other incentive. However, in order to encourage foreign investment, many invisible incentives are actually offered to foreign investor by municipality under their own discretion.

(For example, in the case of Auto City project in Huado District of Guangzhou city, Huado district government has invested to not only industrial area but also residential and recreation facilities to attract foreign investor who is considering to invest to this project area.)

#### Comparison result

It is learnt that most of neighboring countries have prepared certain level of fiscal and non fiscal incentives to attract foreign direct investment into their countries, whereas there is little incentives offered by Indonesian government.

It might be necessary to study what kind of incentives may be necessary to attract foreign investor in order to compete against neighboring countries.

#### (4) Promotion Activities

The following table 2-106 shows what sort of promotion activities currently carried out targeting foreign investors among the neighboring countries

**Table 2-112 Promotion Activities targeting foreign investor**

	Promotion Activities
INDONESIA	<Within the county> - Investment Exposition <Out-of-the-country> - Fair /Exhibitions - Overseas liaison office (6 cities)
THAILAND	<Within the county> - Investment Information Service Center - Introduction industrial subcontracting - One stop service center for visa and work permit - ASEAN supporting industry database - Investment matchmaking service - Investment facilitation service by foreign expert - Investment Support Center by Investment Club Association <Out-of-the-country> -Fair/ Exhibitions - Overseas liaison office (7 cities)
PHILIPPINES	<Within the county> Information assistance to local and foreign investor -Timely investment advice and facilitation regarding investor's business transactions

	Promotion Activities
	<ul style="list-style-type: none"> <li>-Assistance in the selection of ideal investment location</li> <li>-Joint Venture Matching Services</li> <li>- Investment advice and facilitation for Small and Medium Entrepreneur (SMEs)</li> <li>- Business linkages with public and private sector</li> <li>- Evaluation and supervision of investment applications</li> <li>- Training on Investment Promotion</li> <li>- Seminar on Investment Networking for Local Executives</li> <li>- Facilitation of Environmental Clearance Certificate and advocacy for environment-related projects Seminar on Investment Networking for Local Executives</li> <li>- Investment briefings, inbound and outbound missions, seminars and conferences</li> <li>- After-sales service through the Investment Promotion Network (IPN)</li> <li>- Entrepreneurial assistance to Overseas Filipino Workers</li> <li>&lt;Out-of-the-country&gt;</li> <li>- Fair/ Exhibitions</li> <li>- Overseas liaison office (4 countries)</li> </ul>
VIETNAM	<ul style="list-style-type: none"> <li>&lt;Within the county&gt;</li> <li>- Investment Promotion Center</li> <li>&lt;Out-of-the-country&gt;</li> <li>(through commercial attach)</li> </ul>
CHINA	<ul style="list-style-type: none"> <li>&lt;Within the county: Case of Guang Dong Province&gt;</li> <li>(1)Information dissemination on investment opportunities</li> <li>- Investment Seminar/workshop (both in domestic and overseas)</li> <li>- Fair and exhibition (both in domestic and overseas)</li> <li>-Information provision through association/club of investors</li> <li>- Information provision through web site</li> <li>(2) Consultation service</li> <li>Some municipal governments now try to offer consultation services to investors in order to facilitate investment procedures more smoothly.</li> <li>- Providing supplier/ purchaser information is also performed in the course of data providing services</li> <li>(3) Investors association or club</li> <li>There are some associations established by those members of foreign investor, which is aggressively act as bride between investor and regional government to deliver investors opinions/complaints as well as deliver the government policy and regulatory information</li> <li>(4)e-investment</li> <li>The central government maintains official web-site “Invest in China” to provide necessary information about foreign investment in English and other language.</li> <li>Each municipal government also maintains their own web site to not only provide necessary information but also build their image up.</li> <li>&lt;Out-of-the-country&gt;</li> <li>(Carried out by each municipal government)</li> </ul>

Source: Web-site of each organization and summarized by JICA Study Team

### Comparison result

Although promotion activity itself is similar with those neighboring countries, each country is making considerable effort to attract investors' interest into their country aggressively and developed many kind of services to keep investor's attention and facilitate their investment by their own way.

On the other hand, compared with other neighboring country Indonesian promotion activity seems to be not so informative and also not as investor-friendly as a whole.

### **2.6.3 Current Issues of Investment Promotion of Indonesia**

In viewing of the current condition and comparative study of neighboring countries, there may be some issues about investment promotion activities currently carried here in Indonesia.

#### (1) Issues of organizational structure;

Although promotion activities are currently carried out by BKPM and other related organizations, it seems that every activity have been carried out in inconsistent way and no coordination from the investor's point of view. That gives little favorable impact to foreign investor but gives rise to confusion to investor to which organization they have to contact with.

One reason why is there is no player who take the strong leadership in doing investment promotion by making coordination between the competent ministries concerned since BKPM is not fully empowered to make planning and to control country-level promotion.

Besides, region-level promotion is rather weaker than that of BKPM and not systematically conducted to appeal foreign investor because there is much different in capability in doing investment promotion by each province by province.

It might be necessary to review the current organizational structure in doing investment promotion more effectively and efficiently both in nation level and region level

#### (2) Issues of investment promotion policy

From the investor's point of view, there is no clear guidance for investors to identify,  
- which sector of business is welcomed / prioritized to make an investment in Indonesia  
- what condition is needed to comply with both nation-level and region-level  
Furthermore, there is little fiscal incentive to attract foreign investor.

It might be necessary to make clearer and transparent investment promotion policy and strategy as a message of nation's policy to appeal foreign investors.

In this connection it might be also necessary to make more intensive research and analysis in order to make clear investment policy

- Which sector of industries shall be a leading sector now and in the future
- Which sector of industries is needed to bolster country' economic growth
- What is the trend of inflow investment in the past and in future outlook

Furthermore, it might be also necessary to study what kind of incentives may be necessary to attract foreign investor in order to compete against neighboring countries since most of other competitors have prepared certain level of fiscal and non fiscal incentives.

### (3) Issues of promotion activities

From the point of view of foreign investors, current promotion activities are not so informative and attractive. In other word, promotion itself is not effectively conducted to the potential investors who have interest in investment into Indonesia.

In order to make promotion activity more effectively and efficiently it might be necessary to study how to identify the targeting potential investors and how to make more strategic approach to those potential investor both nation-level and region-level. That is to say how to make planning to achieve such objective.

Besides, to make promotion activities more effective and efficient, it is also essential to strengthening promotion function, such as resources to be utilized.

It might be necessary to strengthen promotion function, such as preparation of necessary manpower (including capacity building of promotion staff), promotion tool as well as financial background.

### (4) Issue of enhancement of services for investor

In addition to promotion activities the effort to keep investors interest shall be also important.

From the point of view of foreign investors, there are not so attractive services currently offered to foreign investor compared with other countries.

In order to keep good relations with foreign investors and facilitate their actual investment into the country, it might be necessary to develop and maintain more informative and investor-friendly services.

## 2.6.4 Outline of proposed action plan

In view of the above current condition of investment promotion activities in Indonesia and result of comparative study of neighboring countries, it seems necessary to strengthen the promotion function not only organizationally and procedurally so as that promote foreign direct investment to this country more effective and effectively.

“*Investment Promotion*” shall be regarded as one of marketing activity, therefore, key of activity shall be

<What> *deliver appropriate message* (about investment policy, government intention, necessary information, etc)

<To whom> *to potential investor* who have interest in investment

<when/where> *in timely manner / in right occasion*

In this regards, it is suggested to take the following actions for more effective promotion.

### (1) Item 1: Strengthening research function on investment promotion

In order to make investment promotion more effectively and efficiently, it is essential to set up well-defined policy as message to potential investors as well as to make more clear strategy of promotion by setting target to achieve.

For this purpose, research and analysis shall be indispensable to identify the targeting potential investors because target shall be set according to the promotion policy and strategy. In this sense it is necessary to strengthen research function to make necessary research and analysis such as;

- Which sector of industries shall be a leading sector now and in the future
- Which sector of industries is needed to bolster country’s economic growth
- What is the trend of inflow investment in the past and in future outlook

which aims to make the following output as basic data to help preparing necessary promotion policy and strategy ;

- Updated list of potential investor (by industry, by country)
- Analysis report of inflow investment in the past and future outlook
- Analysis report of investor movement (by country)

In order to achieve those missions it is recommended

- Enhancing research function both BKPM and other institution.
- Making necessary research & analysis and report to the competent department for policy/strategy and target setting.
- Collaboration with each researching entities is to be made as well as collaboration

with other institutions Bappenas, Ministry of Trade, Ministry of Industry

(2) Item 2: Making well defined policy / strategy of investment promotion

As previously mentioned, it is necessary for both Indonesian related organization in charge of investment promotion and foreign investor to understand well what is nation's policy and strategy. In this sense, well defined policy and strategy shall be necessary to deliver to potential investor as message of nation's policy and strategy of investment promotion, such as;

- Which sector of businesses/industries is given priority
- Which area of country is eager to welcome
- What shall be provided for investor (as "incentives")
- What (& how) is restricted to invest (as "negative list")

In this regard, it is suggested to take following actions accordingly

- 1) Examine the result of research and analysis on in-flow investment outlook and national policy /development plan
- 2) Establish investment promotion policy /strategy what and how to attract potential investor.
- 3) Formulate well defined investment priorities plan as well as negative list as nation's message to potential investor
- 4) In addition, necessity of effective incentives shall also be studied from the view point of attracting investors

In order to do so, BKPM shall play initiative role with collaboration of other competent ministries and related organizations (such as Bappenas, Ministry of Trade, Ministry of Industry etc.) to formulate nation-level promotion policy as well as region level promotion policy with collaboration of regional government.

In this connection BKPM shall reform organizational structure to enhance planning and coordination function

(3) Item 3: Strengthening promotion function

It is also necessary for the promotion organization (both BKPM and BKPMMD) to strengthen the promotion function such as organizational, personnel and budgeted in order to carry out promotion activity effectively and efficiently.

In order to do so, the following matters shall be considered,

- 1) Strengthening organization structure

- 2) Capacity building of promotion staff
- 3) Securing necessary budget
- 4) Collaboration of related organization both within the country and out-of-the country.

(4) Item 4: Provide more effective information service to potential investor

It is necessary for the promotion organization (both BKPM and BKPMMD) to upgrade or develop more effective tool of information service to provide appropriate message / information in timely manner. (Both method of delivery and contents)

In order to do so, the following matters shall be considered,

- 1) Review and upgrade or unify the entire promotion tool, such as, publication and brochure, more informative and investor-friendly (both nation-level and region-level)
- 2) More effective use of internet web-site
- 3) Establish more close linkage on web-site with other ministries, organization related to investment promotion.

(5) Item 5: Provide appropriate service to investor

Compared with other competitor countries, it is necessary to enhance or develop some kind of service to attract and keep good relationship with investor who is going to make investment by establishing permanent office, plant, shop.

The following services shall be studied to develop or upgrade for this purpose

- Facilitation service for investor to get license / permit from competent authority /local government.
- Enhance consultation services to provide necessary assistance.
- i.e.: Help desk, Investment adviser, temporarily (short term) rental office, etc

(6) Item 6: Keep more close contact with foreign investor

Keeping good relationship with existing foreign investors is essential to attract new investor since they will be good advertising media for potential investor

The following matters shall be considered so as to keep more close contact with foreign investors and to know the investor's needs and movement

- Conduct periodical business meeting with influential investors
- Conduct periodical survey (questionnaire) to identify their needs and to watch movement
- Discovering and introducing "Success Story" as good example of investment in this country

## 2.7 Current Condition of Infrastructure

### 2.7.1 Outlook of Infrastructure in Indonesia

Infrastructure has a crucial role in the economic development of developing countries. It stimulates economic development by contributing to improving business environment. Infrastructure is also one of primary factors to promote private investment. MIGA (2002)<sup>1</sup> shows that reliability and quality of infrastructure and utilities is ranked the fourth location factors influencing new site selection, following market access, stable social and political environment, and ease of doing business. Table 2-113 shows location factors of infrastructure. Reliability and quality of infrastructure is followed by cost of utilities and roads. Understandably, manufacturers are more concerned with infrastructure issues than service companies.

**Table 2-113 Location Factor (Infrastructure)**

	Reliability and Quality of Infra	Cost of Utilities	Roads	Air Service	Ports
Manufacturing	60	37	34	27	30
Services	37	16	16	19	3

Source: MIGA(2002)

Indonesia has invested too little in infrastructure. After the financial crisis in 1997, the government of Indonesia has been forced to scale down its budgets, and due to that, has not been able to invest sufficiently in infrastructure. Table 2-114 reveals the trend of the government investment to infrastructure projects. The government spending in 2004 reached at only 1.0% of GDP, while that in 1994 was 3.9%. The actual value in 2004 is one fifth of the spending in 1994.

**Table 2-114 Government and Private Investment into Infrastructure**

	1994	2002	2004
US\$ bn	7.8	1.6	2.2
% of GDP	3.9%	0.9%	1.0%

Source: The World Bank

Even after 2004, the government spending into infrastructure has remained in lower level.

<sup>1</sup> MIGA (2002), *Foreign Direct Investment Survey*.

The government's investment into fixed asset<sup>2</sup> was Rp. 40,386 billion in 2004, while slightly decreasing to Rp. 37,001 billion in 2005. According to the budget bill in 2007, the government planned spending into infrastructure in 2007 is around Rp.33,800 billion only. In terms of GDP share, even in 2004, the amount was only 6.8% of current GDP<sup>3</sup>.

The Coordinating Ministry for Economic Affairs presented the Infrastructure Demand and Source of Funds for 2005 – 2009 as shown in Table 2.7-2. According to that, Indonesia needs to US\$145 billion in investment in infrastructure between year 2005 to 2009, but the government can afford only 17% of this. In addition, it is said that the country needs US\$200 billion annually for infrastructure investment in order to realize the 6% annual rate of economic growth as targeted by President Susilo Bambang Yudhoyono. Available state budget resources for capital expenditures in infrastructure, however, are estimated as US\$4 billion per year.

Given the limited budget space, it is crucial for Indonesia to invite private investment into infrastructure projects. As Table 2-115 reveals, Indonesia requires US\$ 90 billion for 2005-2009, US\$ 18 billion per year on average. The government announced 91 projects as investment targets for private sector on the Infrastructure Summit in 2005. Along with this estimation, No project, however, has reached to exchange a sign between the government and private parties.

**Table 2-115 Infrastructure Demand 2005 -2009**

US\$ 4 bn	Aceh reconstruction demand (World Bank 2005)		
US\$ 145 bn	US\$ 25 bn	National State Budget	
	US\$ 30 bn	Domestic Funding Sources (incl. National Banks)	
	US\$ 90 bn	US\$ 10 bn	Multilateral and bilateral donors
		US\$ 22.5 bn	Private Sector – Batch 1 (91 Projects published in 2005)
US\$ 57.5 bn		Private Sector – Next Batch	

Source: Bappenas

Infrastructure in Indonesia is less developed than neighboring countries such as China, Thailand, the Philippines, and Viet Nam as Table 2-116 shows.

<sup>2</sup> The fixed asset expenditure is regarded as broader definition of infrastructure, containing land, equipment, buildings, roads, irrigation, construction asset and others.

<sup>3</sup> Because we are using the figure of fixed asset investment, the GDP ratio is different from that in Table 2.7-2.

**Table 2-116 Infrastructure Indicators in 2005**

Indicators	Indonesia	China	Thailand	Philippines	Vietnam
GNI per capita, Atlas method (current US\$)	1,140	1,290	2,540	1,170	550
Access to electricity (% of population)	53	99	82	87	76
Electric power consumption (kwh per capita)	411	987	1,626	459	374
Improved water source (% of population with access)	78	77	85	85	73
Improved sanitation facilities (% of population with access)	52	44	99	73	41
Total telephone subscribers per 100 inhabitants	18	49	3	44	18

Source: The World Bank

In the following section, we will further study electric power sector, roads and toll roads, and water supply sectors to understand the features and problems of these sectors.

### **2.7.1.1 Electric power sector**

#### (1) Electric power in Indonesia

##### 1) Present Condition

The national electric power system is categorized into two groups; the Jawa-Madura-Bali system and Sumatra system, and the others. The former group is well developed and connected with each other by high-voltage lines. On the other hand, the others are less developed than the former without any linkages with each others.

Electric power supply has failed to meet the demand in many areas. The electricity consumption abruptly increased at 11% in 2000, following 6.7% in 2001. The growth was mainly attributed to household sector. After experiencing weak growth in 2002 and 2003, it suddenly increased again in 2004.

**Table 2-117 Electricity sales**

	(GWh)				
Group	2000	2001	2002	2003	2004
Household	30.564	33.34	33.994	35.753	38.588
Business	10.576	11.4	11.845	13.224	15.258
Industry	34.013	35.59	36.831	36.497	40.324
General	4.012	4.192	4.419	4.967	5.927
Total	79.165	84.52	87.089	90.441	100.097
Growth rate (%)	11,0	6,7	3,9	3,8	10,7

Source: PLN

**Table 2-118 Composition of Electricity Sales**

Group	2000	2001	2002	2003	2004
Household	38.6%	39.4%	39.0%	39.5%	38.6%
Business	13.4%	13.5%	13.6%	14.6%	13.4%
Industry	43.0%	42.1%	42.3%	40.4%	43.0%
General	5.1%	5.0%	5.1%	5.5%	5.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: PLN

Electricity production of PLN and its power purchase are shown in Table 2.7-7. Due to a lack of ability, PLN can not meet the increasing demand by its own production without purchasing power from IPPs. The amount of electricity purchase has been increased sharply. In 2004, it reached 24 GWh, occupying 20% of total production.

**Table 2-119 Electricity Production of PLN**

	(GWh)				
Group	2000	2001	2002	2003	2004
Own Production	83.503	87.635	88.068	90.046	93.113
growth rate(%)		4.9	0.5	2.2	3.4
Purchase of Electricity	9.135	13.299	19.067	20.549	23.978
growth rate(%)		45.6	43.4	7.8	16.7
Generator Rental	687	720	1.225	2.435	3.154
Total Production	93.325	101.654	108.36	113.03	120.244

Source: PLN

The power production of PLN heavily relies on petroleum fuel and coal as Table 2-120 shows. The high dependence on petroleum fuel has caused serious problem in PLN's financial position. Indonesia has been net oil importer since 2004, and thus the petroleum fuel price is fragile to international oil price and exchange rate. Amid the upward trend of oil price as well as the government decision to reduce the oil subsidy in 2005, the cost of petroleum fuel has weighted down the PLN's financial position.

**Table 2-120 Power Productions by Energy Type**

	2000	2001	2002	2003	2004
Petroleum Fuel	21	22	28	29	35
Non Petroleum Fuels:					
- Hydropower	11	12	10	9	10
- Coal	35	34	33	35	33
-Geothermal Power	3	3	4	3	3
- Natural Gas	30	29	26	23	18

Source: PLN

## 2) Development plan

It should be necessary to install at least 89.7 GW additional power capacities by 2026 to fulfill increasing power consumption. PLN estimates that power demand would increase by 9.2% annually on average for the next twenty years and, as a result, power consumption would reach at 450TWh. The details are provided in Table 2.7- 9. According to estimation by PLN, Indonesia needs US\$ 90.4 billion in investment in electricity generation, US\$ 8.7 billion in that in electricity transmission and transformation, and US\$ 5.1 billion in that in electric power distribution in order to realize the plan of enhancing power supply capacities. PLN emphasizes the necessity of private participation into the projects concerned, while estimating that the amount of funds can be financed by the government or PLN with the support of bilateral and multilateral loans.

**Table 2-121 Investment Demand between 2006 to 2026**

in US\$ million

<b>Installment</b>	<b>Jawa-Madura-Bali</b>	<b>Others</b>	<b>Total</b>
Electric power generation	61,091	29,300	90,391
Electricity transmission grid	1,329	6,332	7,661
Electricity transformation Station	750	330	1,080
Total*)	2,079	6,662	8,741
Middle-voltage grid	1,764.6	521.3	2,285.9
Low-voltage grid	741.2	294.5	1,035.7
Transformer for electricity distribution	1,493.8	282	1,775.8
Total*)	3,999.6	1,097.8	5,097.4

Note: \*) The period of transmission and distribution are between 2006 and 2015.

Source: RUKN 2006

The government plans to increase the share of coal in order to minimize the costs of electric power generation. The share is expected to achieve 71% of total by 2010, and thereby the share of petroleum fuel will decrease to 2% accordingly as Table 2-122 reveals.

**Table 2-122 Power Production Plan by Energy Type**

(%)

	2006	2007	2008	2009	2010
Petroleum Fuel	24	15	6	2	2
Non Petroleum Fuels:					
- Hydropower	9	9	6	8	8
- Coal	42	47	60	70	71
-Geothermal Power	5	6	6	6	7
- Natural Gas	19	24	20	14	12

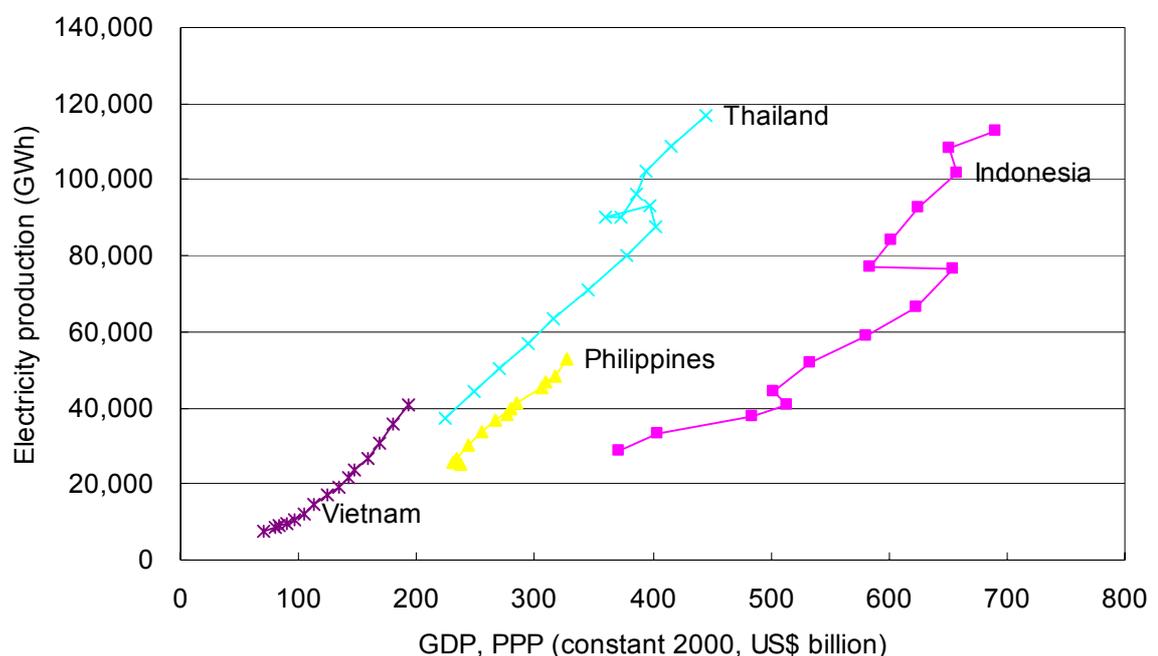
Source: RUKN 2006

## (2) Comparison to neighboring countries

Indonesia is a relatively large electricity producer and consumer in absolute terms compared to nearby countries except China. Considering its economic size, however, the figures for Indonesia are relatively smaller than the other countries. In 2003, the amount of production reached at 112,926 GWh, which was larger than that in Viet Nam and Philippines

and slightly lower than that in Thailand (116,983 GWh). When we compare the electricity production in relation to the scale of the economy, however, in Indonesia it is relatively small. Figure 2-38 shows the relation between economic scale and the amount of electricity produced in each country. Note the figure for the GDP of Thailand in 2003, US\$446 billion, which is almost the same amount of the GDP of Indonesia in 1991. The amount of electricity production of Indonesia at the GDP level is extremely lower than that of Thailand. The same trend can be observed in the comparisons between Indonesia and Philippines and Viet Nam.

**Figure 2-38 Economic Scale and Electricity Production**



Note: we omit China from this comparison because the amount of GDP and electricity production is too huge to compare with the rest of the countries.

Source: The World Bank

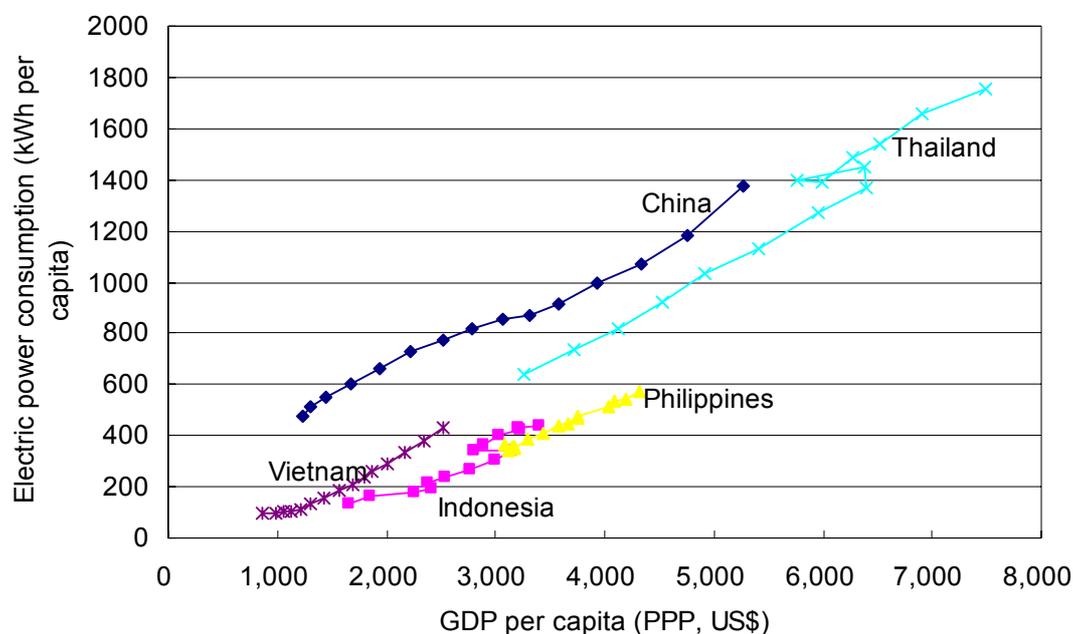
The amount of electric power consumed by Indonesia is larger than that of the Philippines and Viet Nam, while smaller than that of China and Thailand as Table 2-123 reveals. When we take into account income level, GDP per capita, the consumption level of Indonesia is even smaller than in the Philippines as well as in Viet Nam. Figure 2-39 indicates the relationship between GDP per capita and the amount of electric power consumption per capita in each country. It is clear that, comparing at the same level of GDP per capita, the amount of electric power consumption per capita in Indonesia is smaller than that in Viet Nam and almost same as Philippines.

**Table 2-123 Electric Power Consumption**

	1999	2000	2001	2002	2003
China	1,140,000	1,250,000	1,360,000	1,520,000	1,780,000
Indonesia	74,600	82,600	88,200	90,700	94,500
Philippines	35,200	38,900	41,300	42,500	46,100
Thailand	84,600	91,200	95,600	104,000	111,000
Vietnam	20,000	22,900	26,400	30,800	35,200

Source: The World Bank

**Figure 2-39 GDP per Capita and Electricity Power Consumption per Capita**



Source: The World Bank

(3) Law and regulatory framework

1) Law and regulations

The prevailing law and regulations related to the electric power sector are:

- Law No. 15/1985 on Electricity Business
- Government Regulation No.3/2005 amendment for the Government Regulation No. 10/1989 on utilizing and supplying of electricity
- Ministry of Energy and Mineral Resource (MEMR) Regulation No. 01/2006 replacing MEMR Regulation No. 09/2005 concerning electricity power purchasing procedure and/or transmission wheeling charge

The law No.15/1985 deals with (i) the foundation and objectives of the development of the electric power sector, (ii) energy sources for electricity, (iii) general planning of the electric power sector, (iv) electric power business operations, (vi) supply and utilization of electricity, and so on. According to the law, the electric power business is executed by the State and carried out by a state-owned company holding electricity business authority, which is PT. Perusahaan Listrik Negara (PLN). In addition, the holders of power generation business permits are allowed to supply electricity except to individuals. No private entities, however, have been granted the permit.

In 2002, the Government enacted law No. 20/2002 on Electricity which allowed the private sector to participate not only in generation, but also transmission, distribution, and retailing, so as to introduce competition in the electricity sector. This was expected to pave the way to shift from the current single seller model (monopolistic PLN) to a multiple seller model. But the law was annulled by Constitutional Court in 2004 as being unconstitutional.

## 2) Related government organizations

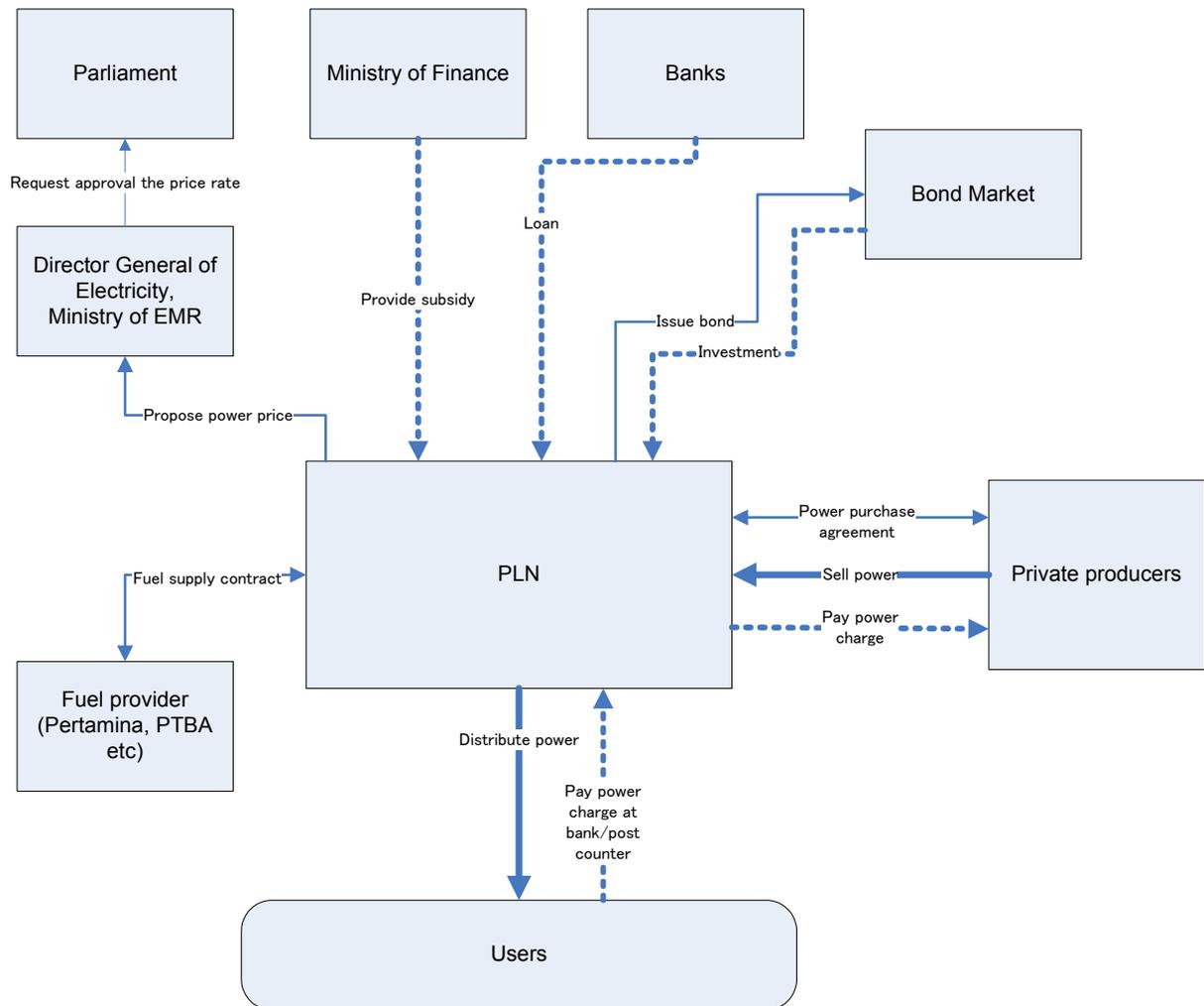
The main regulatory institution in the electricity sector is the Directorate General of Electricity and Energy Utilization (DGLPE) under the Ministry of Energy and Mineral Resources. The responsibilities of the DGLPE are to formulate and to implement policies for electricity utilization. The ministry has responsibility to grant Electricity Business Licenses to cooperatives and other business entities, which enable them to supply electric power.

The electricity supply business is the domain of the state-owned enterprise PT. Perusahaan Listrik Negara (PLN). It is fully owned by the Government and a monopolistic entity in the energy sector. Established in 1961, it was transited to being a state-owned limited liability company from being a state-owned public company in 1994.

## 3) Sector structure

Figure 2-40 describes the structure and key players of the electricity sector in Indonesia. Due to monopolistic activities of PLN, independent power producers have to sell the power they generate to PLN.

**Figure 2-40 Structure of the Power Sector**



The central issue facing the sector is the weak financial position of PLN. It has operated at a net loss every year as Table 2-124 reveals. The government provides a subsidy to make up the deficit every year. For example, in 2004, PLN made a profit at Rp.2,562 billion, although it should have gone into the red without the government subsidy, Rp.3,469 billion. Despite the government’s financial support, PLN had a net loss in 2004. One reason behind this weak financial situation is the increasing cost of fuel. In Table 2-124, it is shown that the cost of fuel in the total cost of generation reached Rp. 24,491 billion in 2004, almost 41% of the total expenses. If PLN had authority to adjust the power price according to raising fuel costs, then it could improve its financial position. The price of electricity supplied by PLN, however, is determined by Parliament, that acts on a proposal from the Ministry of Energy and Mineral Resources. The price has not been changed since 2003. PLN had proposed to increase electricity tariffs by 12.5% in 2006 after the government decided to reduce the amount of subsidy to oil producers in October 2005. According to internal financial reports, PLN’s operating costs have jumped by Rp. 14 trillion in 2005 due to fuel price hikes. The

proposal was finally rejected, and instead of that the government decided to provide a higher subsidy to PLN.

**Table 2-124 Profit/Loss Account of PLN**

(In millions of rupiah)					
Items	2004	2003	2002	2001	2000
<b>Total Income</b>	<b>62,273,062</b>	<b>54,430,778</b>	<b>62,273,062</b>	<b>35,359,958</b>	<b>22,566,663</b>
Electricity Revenue	58,232,002	49,809,637	58,232,002	28,275,983	22,139,883
Other Revenue	4,041,060	4,621,141	4,041,060	7,083,975	426,780
<b>Total Expenses</b>	<b>59,710,767</b>	<b>58,586,498</b>	<b>59,710,767</b>	<b>32,710,378</b>	<b>27,215,821</b>
Electricity Purchased	11,970,811	10,837,796	11,970,811	8,717,141	9,395,365
Cost of Generators	33,796,203	31,384,807	33,796,203	18,006,083	13,444,380
Materials Expenses	3,508,272	3,463,610	3,508,272	1,789,559	1,031,249
Other Expenses	10,435,481	12,900,285	10,435,481	4,197,595	3,344,827
<b>(Loss)/Profit</b>	<b>2,562,295</b>	<b>(4,155,720)</b>	<b>2,562,295</b>	<b>2,649,580</b>	<b>(4,649,158)</b>
Other Net					
Non-Operating Income	(1,117,606)	(2,040,885)	(1,117,606)	(2,793,808)	(19,331,236)
(Expenses)					
<b>Profit/(Loss) before</b>	<b>1,444,689</b>	<b>(6,196,605)</b>	<b>1,444,689</b>	<b>(144,228)</b>	<b>(23,980,394)</b>
<b>Deferred Tax</b>					
Deferred Tax Expense	(3,184,503)	(1,388,881)	(3,184,503)	(356,261)	(620,975)
Loss before	(1,739,814)	(7,585,486)	(1,739,814)	(500,489)	(24,601,369)
Extraordinary Profit					
Account					
Extraordinary Profit	(281,551)	1,685,404	(281,551)	183,394	-
Account					
<b>Net Profit (Loss)</b>	<b>(2,021,365)</b>	<b>(5,900,082)</b>	<b>(2,021,365)</b>	<b>(317,095)</b>	<b>(24,611,369)</b>

Source: PLN annual report

#### (4) Issues and recommendations

##### 1) Issues

The primary issue in the electric power sectors is a lack of government guarantee. In the current regulatory framework, there are no government guarantee schemes which can mitigate the credit risk of PLN. The government established a risk sharing mechanism for demand risk, although it can not apply to the projects based on purchase agreement such as electric power generation projects. A lack of government guarantee is serious for investors because of the weak financial position of PLN. It has operated at a net loss as Table 2-124 reveals. The Government provides subsidy to fill a deficit every year. For example, in 2002.714, PLN made a profit at Rp.2, 562 billion, although it should have gone into the red without the Government subsidy, Rp.3, 469 billion. Despite of the Government financial support, PLN was in a net loss in 2004. One reason behind of this weak financial situation is

the increasing costs of fuel. In table 2.71, cost of fuel composes the cost of generation, reaching 24,491 billion in 2004, almost 41% of the total expenses. If PLN had authority to adjust the power price according to raising fuel costs, then it could improve its financial position. The price of electricity supplied by PLN, however, is determined by parliament upon a proposal from the Ministry of Energy and Mineral Resources. The price has not been changed since 2003. PLN had proposed to increase electricity tariffs by 12.5% in 2006 after the Government decided to reduce the amount of subsidy to oil products in October 2005. According to internal financial reports, PLN's operating costs have jumped by RP. 14 trillion in 2005 due to fuel price hikes. The proposal was finally rejected, and instead of that the Government decided to provide more subsidies to PLN.

To mitigate the risk contingent to power plant projects, additional risk sharing mechanism which is applicable for electric power sector should be introduced. This will be discussed in 2.7.4.2.

### 2.7.1.2 Toll roads

#### (1) Roads and toll roads in Indonesia

##### 1) Present condition

In 2004, the total length of road (excluding toll road) is 348km. The National road occupies only 10%, 35km, while Kabupaten Road is dominant as 69%, 241km, as Table 2-125 reveals. The condition of National Road is better than Provincial Road and Kabupaten Road. The National Road in good and fair condition achieves 81%, while that of Provincial Road and Kabupaten Road are 52% and 43% respectively. The length of Toll Road is 606km and its condition is good.

**Table 2-125 Length of road and condition (2004)**

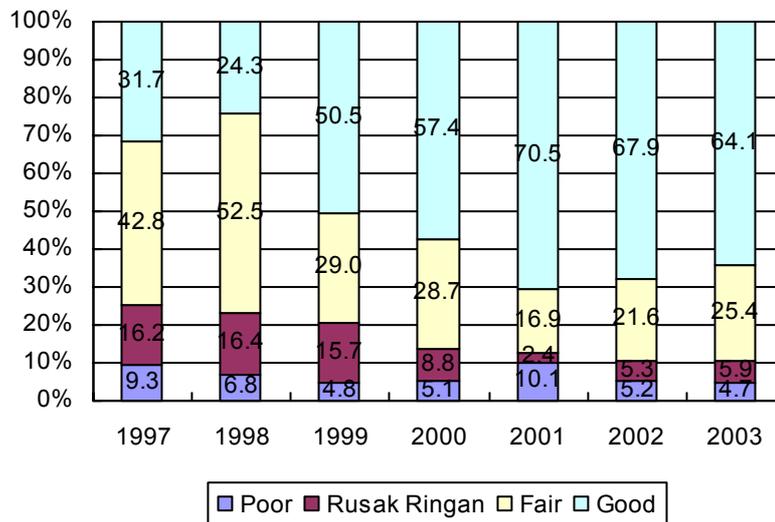
	Length (km)	Condition			
		Good	Fair	Poor	Bad
National Road	34.6	37.4	44.0	7.7	10.9
Provincial Road	46.5	27.5	35.3	4.4	22.7
Kabupaten Road	240.9	17.0	26.4	21.9	34.7
Kota Road	25.5	9.0	87.0	4.0	0.0
<b>Total</b>	<b>347.6</b>	<b>20.0</b>	<b>33.7</b>	<b>18.2</b>	<b>28.1</b>
Toll Road	606.0	100.0	0.0	0.0	0.0

Note: The figures of national road are for 2004 as the forecast based on IRMS 2003. And the figures of other road are for 2003 as the actual figures based on IRMS 2003.

Source: Bappenas (2005)

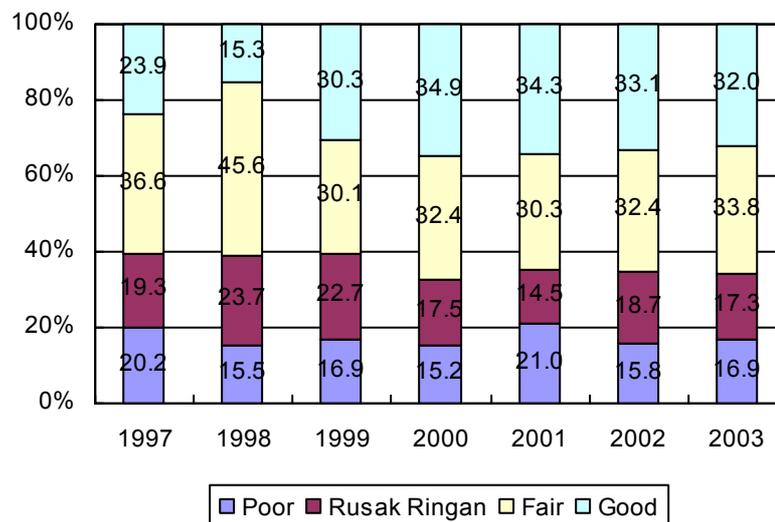
While the condition of National Road has been improved since 1998 as Figure 2-41 shows, those of Provincial Road and Kabupaten Road have not shown remarkable changes. The condition of Kabupaten Road is even getting worse.

**Figure 2-41 Condition of National Road 1998-2003**



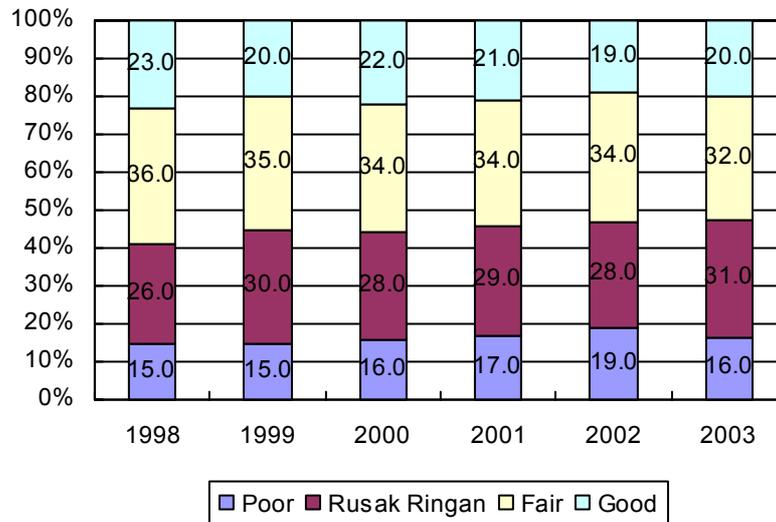
Source: Bappenas (2005)

**Figure 2-42 Condition of Provincial Road 1997-2003**



Source: Bappenas (2005)

**Figure 2-43 Condition of Kabupaten Road 1998-2003**



Source: Bappenas (2005)

The deteriorated local road dose cause negative impacts on business activities. The joint study of JBIC and LPEM-FEUI (Lembaga Penyelidikan Ekonomi dan Masyarakat Fakultas Ekonomi Universitas Indonesia) shows that the truck transportation cost, which accounts for around 50% of total, is the largest component of logistic cost. They raise the improper condition of local roads as one factor of the high truck transportation cost. Since local roads provides connection between main roads and industrial estates, the deteriorated local roads causes unnecessary traffic jam and thereby push up the transportation costs<sup>4</sup>. This implies that improvement of local road condition is necessary not only for the context of basic human needs, but also to improve business and investment environment in Indonesia.

## 2) Development plan

According to the National Medium-Term Development Plan 2004-2009, the government is planning to construct roads and toll roads between 2004 to 2009 as shown in Table 2.7- 14.

<sup>4</sup> JBIC (2005)

**Table 2-126 Construction Plan of Roads and Toll Roads**

Roads and Toll Roads	Length
Primary Artery Roads	12,321km
Provincial Roads	2,390 km
Toll Roads (Total)	1,593km
Toll Roads in the Jabotabek Area	257.5km
Surabaya-Madura Bridge	5.4km
Cikampek-Purawakarta-Padalarang Toll Road	40km
Trans Java Hi-Grade Toll Road	1,290km

Source: NMTDP 2004-2009

(2) Road sector compared to neighboring countries

The total length of the road network in 2002 is 36,8362km according to the World Bank. Table 2-127 and Table 2-128 show comparisons of total road network and proportions of paved roads in Indonesia and its neighboring countries. The road network in relation to population indicates accessibility to the road network. The table suggests that the road network of Indonesia is not less developed comparing to the other three countries. That figure, however, is much smaller than Malaysia (3.1% in 2001) and India (3.6% in 2001), which are not included in the table.

**Table 2-127 Roads, Total Network (Km/1000 people)**

	1998	1999	2000	2001	2002
China	1.03	1.08	1.11	1.34	1.38
Indonesia	1.77	1.75	1.73	1.73	1.74
Philippines	2.73	2.67	2.64	2.58	2.53
Thailand	1.08	1.07	0.95	-	-
Vietnam	1.22	1.20	-	-	-

Source: The World Bank

The proportion of the network which has been paved indicates the quality of the road infrastructure, because the cost of operating vehicles on a paved surface is much lower than on an unpaved surface<sup>5</sup>. According to the table, the figure for Indonesia is greater than that of the Philippines and Viet Nam, while lower than that of Thailand. It should be noted that Malaysia (77.9% in 2001) and India (63.3% in 2001) have much higher paved road ratios than Indonesia does.

<sup>5</sup> The World Bank (2003), *An Averting Infrastructure Crisis*, The World Bank Office Jakarta.

**Table 2-128 Paved Road Ratio (% of total roads)**

	1999	2000	2001	2002
Indonesia	57.1	57.1	58.9	58
Philippines	20	21	21	9.5
Thailand	97.5	98.5	..	..

Source: The World Bank

### (3) Laws and regulatory framework

#### 1) Law and regulations

The prevailing law and regulations related to Road sector are:

- Law No.38/2004 concerning Road
- Government Regulation No.15/2005 as an implementing regulation of Law No.38/2004

According to Law No.38/2004, the toll tariff is calculated based on the affordability of the road user, the extent of the profit generated from the vehicle operational cost and feasibility of investment. The initial toll tariff should be the one which the successful bidder has proposed. Evaluation and adjustment of the toll tariff should be carried out once every two years and adjusted for inflation. Adjusted tolls are proposed by the private operator and decided by the Minister of Public Works, and BPJT recommends any adjustment of the toll to the Minister. If the Minister rejects the adjustment, the Ministry will compensate the operator for loss incurred by the rejection, although the detail mechanism of the compensation has not been disclosed yet. The Ministry of Public Works will publish within this year.

#### 2) Relevant organizations

The Director General of Road Development under the Ministry of Public Works is responsible for formulating and implementing policies on road development. The governmental authority comprises the operation of the national roads, while it is the authorities of provincial governments and regency governments to operate provincial roads and regency and rural roads respectively.

The Toll Road Regulatory Body (BPJT), which was established based on the Government Regulation No. 15/2005, has authority to regulate, operate and supervise toll roads. Before this, PT. Jasa Marga, a state-owned enterprise<sup>6</sup>, was responsible for regulating and operating toll roads. The duties include also providing recommendations on the initial tariff on toll roads and its adjustment. Law No. 38/2004 on Roads stipulates.

<sup>6</sup> As of June, PT Jasa Marga is fully owned by the government, while it plans to issue IPO in . This will herald its privatization.

(3) Sector structure

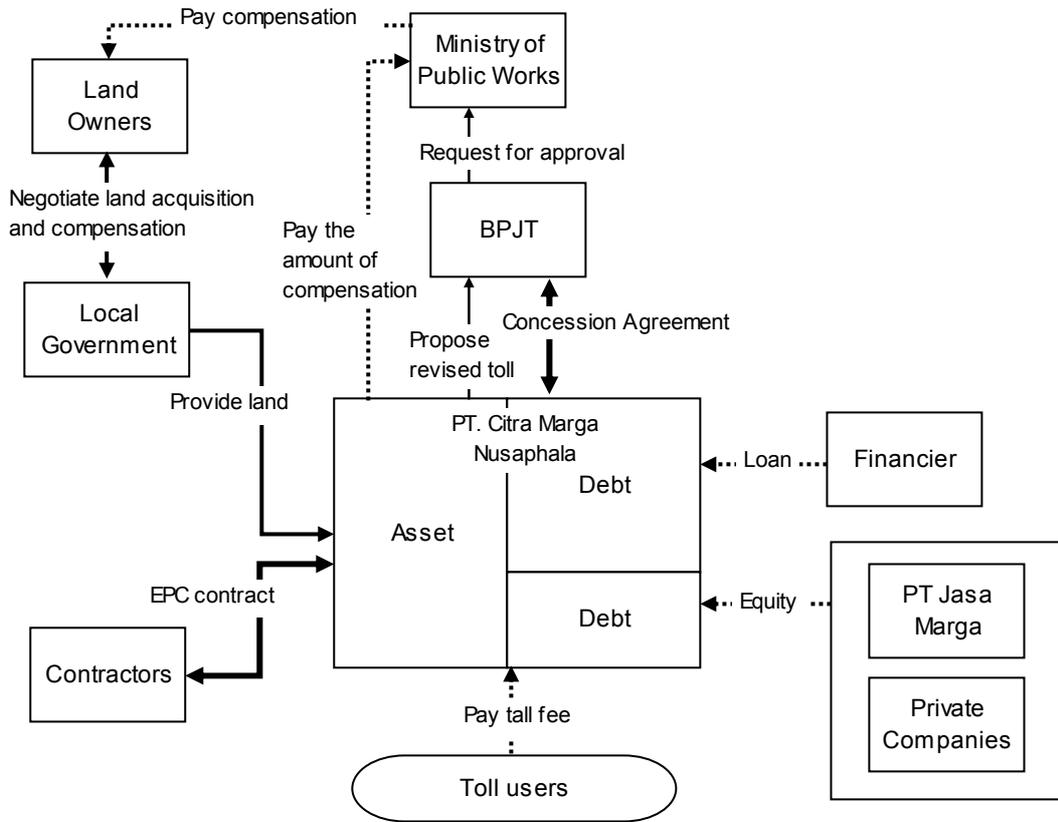
Currently, three types of operators are possible: (a) 100% owned by PT Jasa Marga; (b) joint ventures between Jasa Marga and private companies; and (c) 100% owned by private companies. But, no type (c) operator yet exists. The figure below shows the joint venture case of PT Jasa Marga and private companies. As Table 2-129 shows, Jasa Marka occupies almost 70% of the total length of toll roads in 2000. The participation of Jasa Marga to the SPC has the purpose of providing a guarantee to banks. There are SPCs in which foreign private companies participated. None of them, however, joined the SPCs from the construction phase, avoiding taking on any land acquisition risks. They all joined the SPCs after completion of the construction operations.

**Table 2-129 Share of Jasa Marga and Joint Venture in 2000**

Operator	Jasa Marga	Joint Venture	Total length
	(Km)	(Km)	(Km)
Java	319.85	153.97	473.82
Other area	34.4	6.95	41.35
Total	354.25	160.92	515.17

Figure 2-44 shows a joint venture operator, PT. Citra Marga Nusaphala Persada (CMNP) and its subsidiary operator, PT. Citra Marga Surabaya (CMS).

**Figure 2-44 Joint Ventures in the Toll Road Sector**



a) Concession agreement

BPJT, as regulator of toll roads, signs a concession agreement with SPC ( in this case, CMPN as well as CMS).

b) Land acquisition

Land acquisition is implemented by a committee organized under the concerned local government and composed of the concerned local governments and National Land Agency. The committee carries out activities related to land acquisition including setting the amount of compensation. The compensation is disbursed by the Ministry of Public Works, while it is the responsibility of the SPC to prepare the amount.

c) Construction and operation including tariff collection

The SPC took responsibility for construction, operation, and maintenance of the toll roads before the Presidential Decree No. 67 of 2005 was issued. The decree allows the government to let the private sector construct, operate, and maintain infrastructure only if it is feasible to them. If not, the government has to implement the project with its own budget<sup>7</sup>.

<sup>7</sup> The Government considers implementing a toll road project in Tanjung Priok in a different scheme. In the scheme, the Government will construct the toll road and contract out the operation and management to private sector.

d) Revision of tolls

Their responsibility is to monitor the projects as well as to adjust tolls once every two years in response to a proposal from the operator. The tariff is arranged by the following formula stipulated in the Government Regulation No.15 of 2005 (Article 68):

$$\text{Newtariff} = \text{Old tariff}(1 + P) \quad \text{where } P = \text{rate of inflation.}$$

The final approval is issued by the Public Works Minister, acting upon the recommendation of BPJT.

(4) Financial structure of toll road operator

To understand the toll road operation business, we would like to study the financial structure of PT. Citra Marga Nusaphala Persada (CMNP). CMNP was established in 1987 as a joint venture operator between PT. Jasa Marga and private sector. Its current shareholders as of May 2006 are:

**Table 2-130 Stockholders of CMNP**

Stockholders	Stock	Ownership
Public	1,073,604,480	53.68
PT Jasa Marga (Persero)	355,760,000	17.79
PT Sinarmas Sekuritas	213,000,000	10.65
UBS AG Singapores/a Heffernan	144,053,920	7.20
Remington Gold Limited	104,548,000	5.23
Ivan Daniar Sumampow	102,672,000	5.13
Cooperative	6,361,600	0.32
<b>Total</b>	<b>2,000,000,000</b>	<b>100.00</b>

Source: CMNP financial report

Table 2-131 shows profit loss account of CMNP in 2005. The major revenue source is toll revenues which accounts for almost 99% of total revenues. The operating expenses are composed of two items, toll service expenses and general and administrative expenses. Table 2-132 shows more detail structure of the toll service expenses. The dominant expense source is depreciation which occupies 45% of total toll service expenses.

**Table 2-131 Profit Loss Account of CMNP**

Items	2005
<b>Revenues</b>	
Toll revenues	435,068,253,081
Rent revenues	2,571,255,286
Total Revenues	437,639,508,367
<b>Operating expenses</b>	
Toll service expenses	154,389,873,871
General and administrative expenses	106,065,072,866
Total operating expenses	260,454,946,737
<b>Income from operations</b>	<b>177,184,561,630</b>
Other income net	(50,435,272,115)
Equity in net losses of associated companies	31,827,238
<b>Income before income tax</b>	<b>126,781,116,753</b>
Income tax expenses	(47,275,705,945)
Income before minority interests in net loss of consolidated subsidiaries	79,505,410,808
Minority interests in net loss of consolidated subsidiaries	1,518,347,115
<b>Net income</b>	<b>81,023,757,923</b>

Source: CMNP financial report

**Table 2-132 Toll service expenses**

Items	2005
<b>Toll service expenses</b>	
Depreciation	69,344,323,313
Personnel expenses	27,563,150,330
Amortization	9,091,932,706
Land and building tax expenses	6,034,348,630
Lease and insurance expenses	2,044,198,669
Consultant fee	1,936,292,178
Maintenance expenses	1,452,739,260
Printing and binding	1,122,834,146
Others	1,698,293,422
<b>Sub total</b>	<b>120,288,112,654</b>

Items	2005
<b>General and administrative expenses</b>	
Personnel expenses	10,157,156,630
Utility costs	1,980,239,728
Lease and insurance expenses	1,829,849,425
Other expenses	2,703,570,163
<b>Sub total</b>	<b>16,670,815,946</b>
<b>Maintenance expenses for fixed assets</b>	
Personnel expenses	8,967,537,514
Maintenance costs	6,505,472,517
Others	1,957,935,240
<b>Sub total</b>	<b>17,430,945,271</b>
<b>Toll service expenses</b>	<b>154,389,873,871</b>

Source: CMNP financial report

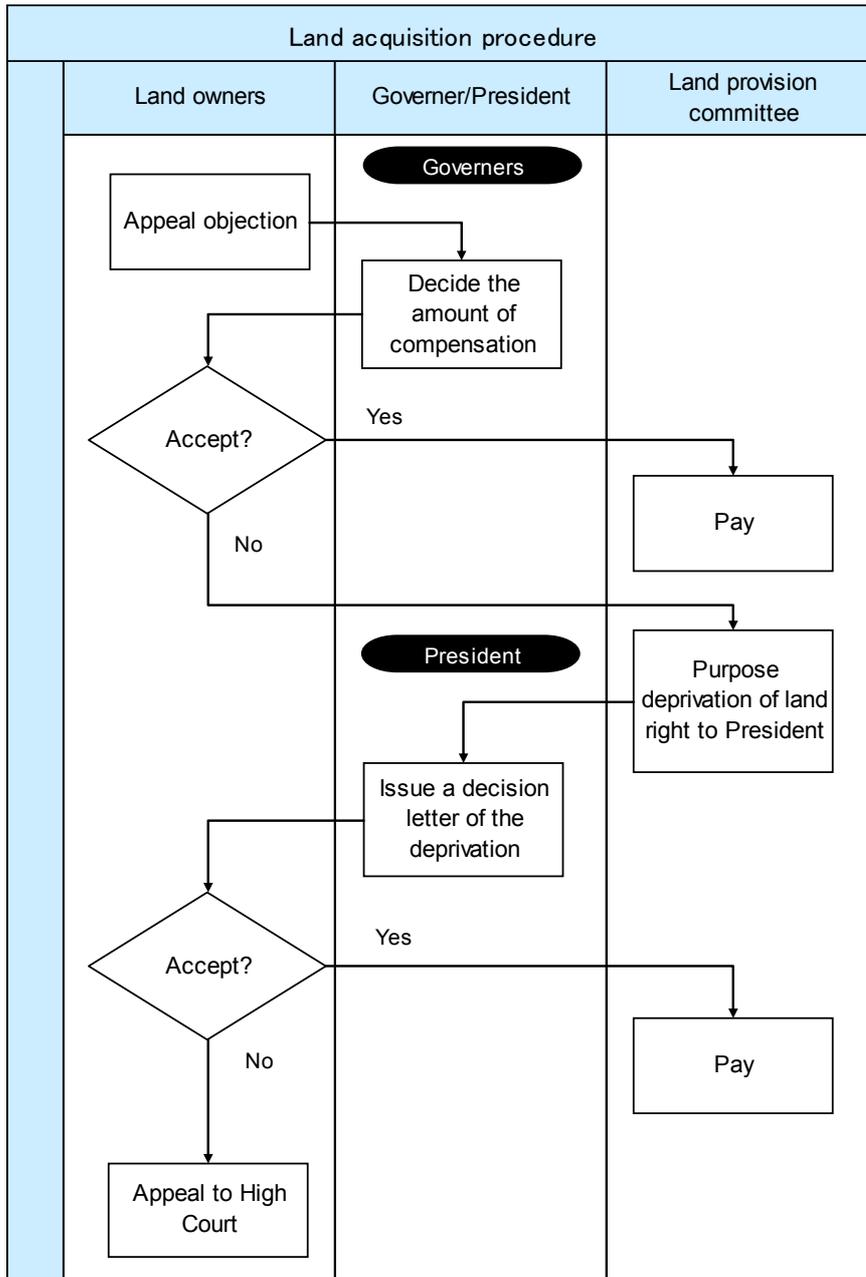
Because the toll road sector has been opened for private operator since 1989, the current operators seem to enjoy relatively stable business.

#### (5) Issues

Despite introduction of the new regulations on land acquisition in 2005, land acquisition still remains the biggest obstacle for investors. There are several factors of the land acquisition problems.

The first is a lack of administrative instruction for the newly introduced regulation related to land provision, Presidential Regulation No. 65 of 2006. Due to this, the administrative instruction for the old regulation No.65 of 1993 is still in effective. The new administrative instruction in conformity to the Presidential Regulation No.65 of 2006 should be introduced immediately.

**Figure 2-45 Land Acquisition Procedures**



The second is the level of compensation to be offered by a local government. The problem is that the value is derived based on NJPO (tax object sale value which is always much lower than the market value. According to Presidential Regulation No.65 of 2006, a land provision committee organized by the local government concerned is responsible to offer and negotiate the amount of compensation with land owners. The negotiation is often stalled due to the insufficient amount of compensation offered. And it takes a long time to solve this conflict. Figure 2-45 shows the procedure of land acquisition. If the two parties do not reach a consensus, the land owner can appeal the local government's governor an objection. Upon the

petition, the governor makes its decision on the amount. If the land owner, however, does not accept the amount, the committee may send a proposal to the President to request deprivation of the land owner's right to the land. In case where the land owner is still unwilling to accept the amount, he/she can request for appeal to the High Court for the determination of the compensation. Such a prolonged conflict causes additional financial burdens to private operators.

The third is unmanaged land registration system. There may be several land owners in one land. In such a case, the land provision committee has to file a proposal of deprivation of land right to the president. As mentioned above, this takes a lot of time to solve the problem.

### 2.7.1.3 Water supply sector

#### (1) Water supply sector

##### 1) Present Condition

As of 2003, 477 PDAMs (drinking water regional company) deliver water in respective areas. According to the World Bank, water distribution in urban areas and rural areas are carried out the actors described in the following Table 2-133. In urban areas, PDAM is the largest water supplier, accounting for 50%. In rural areas, however, the share decreases to 8%, while self supply is the largest source of water supply. When we contemplate distribution side, the share of PDAM is much smaller in both urban and rural areas than water supply.

**Table 2-133 Water Distribution in Urban Areas and Rural Areas**

Supplier	Supply		Distributor	Distribution	
	Urban	Rural		Urban	Rural
PDAM	50%	8%	PDAM	35%	5%
			Non PDAM*1	15%	3%
Alternative Supply	8%	2-4%	Alternative Supply*2	8%	2-4%
Self Supply	40-42%	88%	Community supply	1-2%	33%
			Household supply	40%	55%

\*1: Non PDAM includes commercial on-selling, reselling, tanker supply, donor-founded community networks

\*2: Alternative includes developer initiatives, Aqua providers, distribution of extracted water, network or transported)

Source: The World Bank

## 2) Development plan

According to the National medium-Term Development Plan 2004-2009, the development of drinking water aims at the increased coverage of pipelined drinking water to reach 40% at the national level by the end of 2009, more specifically to reach 66 % in urban areas and 30 % in rural areas.

## (3) Legal and regulatory framework

### 1) Laws and regulations

The prevailing law and regulations related to the water sector are:

- Law No. 7/2004 concerning Water Resources
- Law No. 16/2005 concerning the Development of Drinking Water Supply System

Law No.7/2004 replaced Law No.11/1974 which is mainly concerned with irrigation, and describes the construction of infrastructure and facilities related to water. Law No. 7/2004 stipulates that drinking water supply systems (SPAM) should be developed to fulfill the need of raw water for household drinking water. The SPAM is defined as an integral unit of physical and non-physical system of the drinking water infrastructure and facilities.

### 2) Relevant organizations

The key central government organization in the development of SPAM is the Directorate General of Water Resource under the Ministry of Public Works. The Directorate has responsibilities in the formulation and the implementation policies of the water resources field. The Director General of Water Supply is responsible for water supply.

According to the Law No.7/2004, it is a central government responsibility to manage the water resources in the trans-provincial river areas, transnational river areas, and nationally strategic rivers, while it is a regency or municipal government responsibility to manage water resource in their respective area. The role of provincial governments is to manage water resources in the trans-regency or municipal river areas.

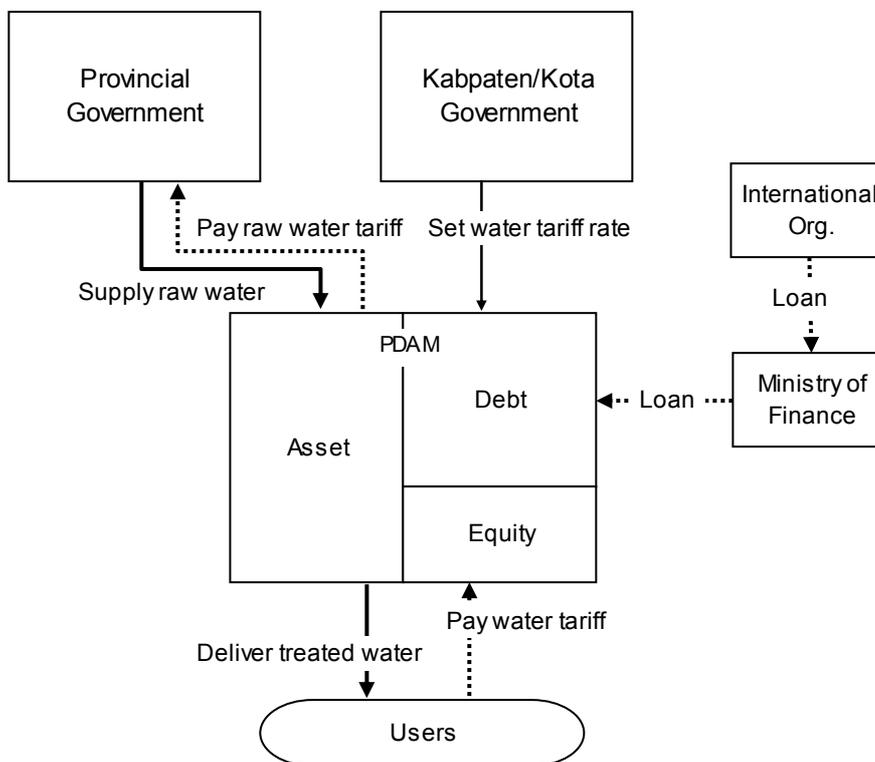
Law No. 7/2004 stipulates that the development of drinking water supply systems (SPAM) should be carried out by the State-owned company (BUMN) or the regional administration-owned companies (BUMD).

## (4) Sector structure

Figure 2-46 shows the main players in the water supply sector. As we described earlier, PDAM, which are owned by regency/municipal governments, are the main water suppliers especially in urban areas, the owner, a regency or municipal government, provides budgetary

assistant to the PDAM and often request dividends in turn. PDAM has no authority to set water tariff. The Kabupaten or Kota government to which the PDAM belongs makes the decision as to whether to change the water tariff, acting on requests from the PDAM.

**Figure 2-46 Structure of the Water Supply Sector**



PDAM responsibilities are to distribute water to users, maintain water purification facilities, and invest in new equipment. Water users can pay their user charges at a bank or post office, or a so-called service unit of PDAM. If a customer has not paid for the month, the PDAM will issue a remind letter. PDAM will stop supplying water to the customer if he/she does not pay the charges due after three remind letters.

As we have seen in Table 2-133, PDAM is not sole water supplier for local residents. It faces competition with self water supply from underground water, mineral water providers, and illegal water reseller.

There are 25 PPP operations in water supply sector in Indonesia, and most of private operators are to supply water to PDAM instead of direct supply to end user.

In the following part, some cases of PPP operations are examined.

## 1) Case of PDAM Kabupaten Tangerang

PDAM Kabupaten Tangerang has signed three concession agreements with private operators for water treatment plants Serpong, Cikokol, and Kalawachi.

Serpong: The plant was constructed with financing by the World Bank and French Government, in 1995. Due to lack of the required skills, however, the PDAM failed to operate the facilities. In 1997, the PDAM decided to make an operation agreement with PT. Cisdane which is a joint venture between a French company Degremont and an Indonesian company Traya and had been in charge of the engineering part in constructing the plant. The contract period is 15 years and the obligation of the operator is just to operate and maintain the plants. Their revenues are the treated water supply tariff paid by the PDAM which is reviewed once a year based on the tariff formula provided in the Box. 80% of the water produced by the plant goes to Jakarta, and 20% goes to Tangerang.

Cikokol: The plant had been constructed in 1989 and operated by the PDAM until 2003. Because of financing difficulties caused by the Asian currency crisis, it became difficult for the PDAM to continue operating it alone. Then, in 2004, the PDAM decided to contract out the operation of the plants to PT. Tirta Kenchana Caraya Mandiri which is a joint venture between an Australian firm and an Indonesian firm. It is a rehabilitation-operation-transfer contract. The operator is responsible to expand the capacity from current level 1000 l/s to 1500l/s by 2007.

### Water Tariff Formula

The PDAM, as required by its contracts, purchases treated water from private operators to distribute to end users. The tariff to be paid to private operators is derived using the following formula, which is stipulated in the contract.

$$P_i = F_n + R_n \times Q$$

where  $F_n$  is monthly fixed payment in n period,  $R_n$  is the average water selling price during n period, and  $Q$  is the amount of water supplied during n period. The  $F_n$  and  $R_n$  are also variables derived by the following formulas.

$$F_n = FO_{n-1} \times \left( 0.12 \times \frac{E_n}{E_{n-1}} + 0.37 \times \frac{X_n}{X_{n-1}} + 0.51 \times \frac{C_n}{C_0} \right) + \frac{1}{12} P_{i-1} \times (B_n - 1)$$

where  $FO_{n-1}$  is actual operation payment disbursed in n-1 period,  $C_n$  is the consumer price index of Indonesia in n period,  $E_n$  is average electricity tariff in period n,  $X_n$  is rupia dollar rate announced by the Bank of Indonesia in November in n period or the rate when it changes by 15%, and  $B_n = BIOR_n / BIOR_{n-1}$  where  $BIOR_n$  is the Bank rate.

$$R_n = R_{n-1} \times \left( 0.48 \times \frac{E_n}{E_{n-1}} + 0.46 \times \frac{K_n}{K_{n-1}} + 0.06 \times \frac{C_n}{C_0} \right)$$

where  $K_n$  is the cost of chemicals in period n.

Then, inserting the formulas of  $F_n$  and  $R_n$  with replacing  $FO_{n-1}$  and  $R_{n-1}$  as  $A$  and  $B$  respectively, we obtain the following function:

$$P_i = \frac{E_n}{E_{n-1}} (0.12A + 0.48B) + \frac{C_n}{C_{n-1}} (0.51A + 0.06B) + \frac{X_n}{X_{n-1}} 0.37A + \frac{K_n}{K_{n-1}} 0.06B + \frac{1}{12} P_{i-1} \times (B_n - 1)$$

where  $A$  stands for  $FO_{n-1}$  and  $B$  does for  $R_{n-1}$ . As this function suggest that the water tariff to be paid to private operators varies mainly according to the electricity tariff, consumer price index and exchange rate. The electricity tariff has not been changed since year of 2003. Thereby, between year of 2004 to 2006, the water tariff is a function of the consumer price index and exchange rate only.

Neither of the two private operators was required to construct equipment. As a BOT contract scheme, PT. Tirta Lyonnaise Medan provides an example of a BOT contract scheme in the water supply sector in Indonesia. The outline of the project is as follows:

Project:	To construct and operate 500L/s water plant in Belumai, Tanjung Morawa to supply to Medan. The concessionaire is required to construct in three phases consisting of two 200L/s modules and one 100L/s modules, a 5.7km 660 diameter transmission line, a raw water intake and two 500 m <sup>3</sup> supply reservoirs.
Total Project Cost:	US\$ 4.5million
Project scheme:	BOT
Concession period:	25 years (staring from 2001)

PT. Tirta Lyonnaise Medan (TLM) is a joint venture between PDAM Tirtandi and Suez. PDAM Tirtanadi contributes 15% of total equity in the form of land, while Suez supplies 85%. The debt-equity ratio is 60:40. In the beginning of the project, TLM procured the necessary finance from Suez in a US\$ denominated loan. As the figure shows, however, TLM refinanced the hard currency loan in local currency loan in 2006. Niaga Bank offered a local currency denominated loan equivalent to 80% of the total hard currency loan, and thereby, TLM paid back the amount to Suez. The Bank will provide even the balance, 20%, if TLM does not get into financial trouble within one year.

Table 2-136 shows the share of each item of TLM's profit and loss statement. The revenue completely relies on water tariff payment from PDAM Tirtanadi. Because the PDAM is also a shareholder of TLM, it should also be in PDAM's interest to pay the tariff according to the contracted amount. The tariff rate is reviewed once in six months by using the tariff formula. On the expense side, the largest item is the charge for electricity used.

**Figure 2-47 Private Operators in the Water Supply Sector**

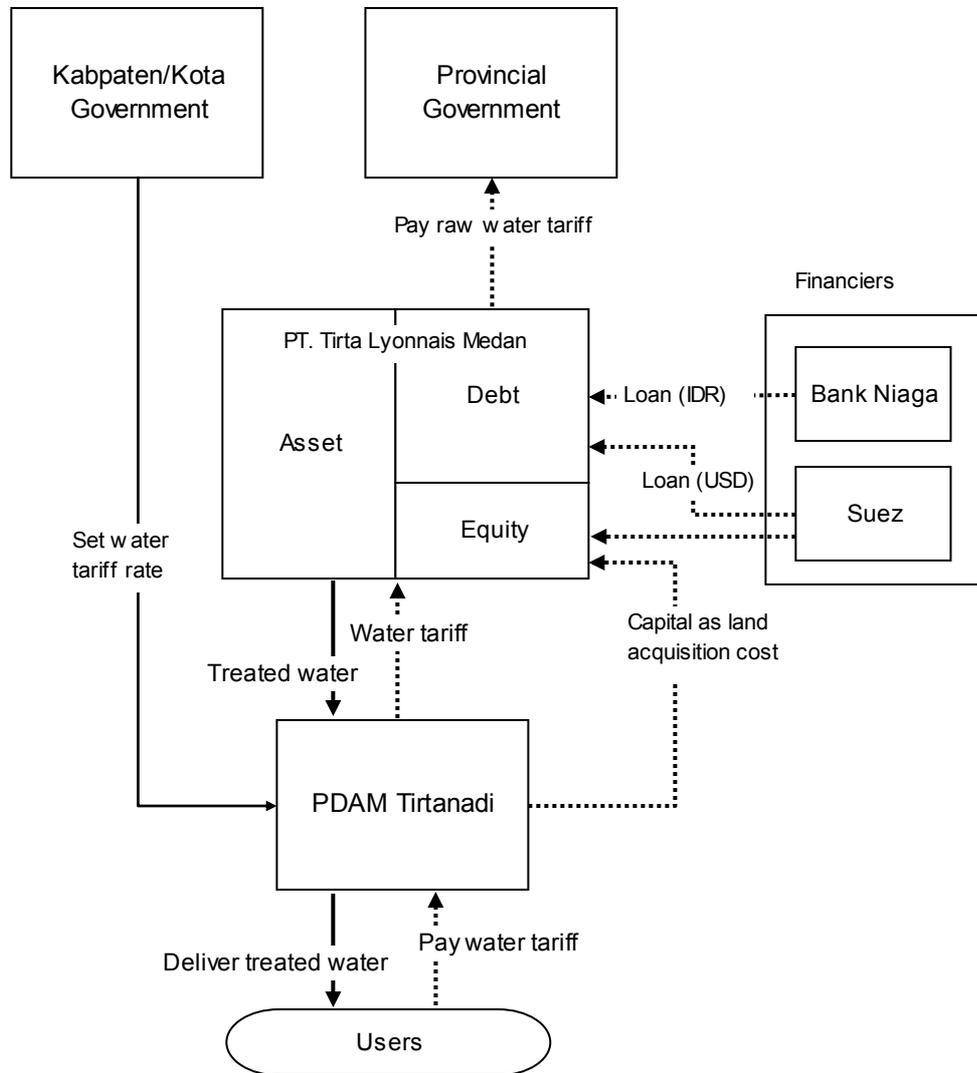


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**Table 2-134 Profit/Loss Statement Summary**

	Items	Share
<b>Income</b>	<b>Tariff revenue from PDAM</b>	<b>100%</b>
<b>Expenses</b>	Raw water expenses (Rp.10/m <sup>3</sup> )	12%
	Operational costs	
	Manpower	12%
	Chemical	11%
	Electricity power	20%
	Maintenance	3%
	Interest rate	12%
	Depreciation	21%
	<b>Total</b>	<b>79%</b>
	Others (office expenses such as phone, tax, etc.)	21%
	<b>Grand Total</b>	<b>100%</b>

Source: Compiled by Study Team

#### (4) Financial structure of PDAM

The financial position of PDAMs is crucial to realize sustainable business of private operators, because water tariff payment from PDAM is sole revenue source for them under the water supply contract. In this section, we examine the financial position of PDAM Tirtanadi (Medan) as a case study.

##### 1) Profit and loss statement

Table 2-134 is the profit and loss statement of PDAM Tirtanadi. User charges are the major income source -- accounting for almost 90% of total expenses. The water tariff rate imposed to users is determined by the province or municipal government as stipulated in the law no. 16/2005. In the expense side, the largest expense source is water purchased cost from private operators, while raw water purchased cost is marginal, only 1%. The unit cost is only Rp.21/m<sup>3</sup> for public users and Rp.60/m<sup>3</sup> which is determined by the central government. The dominant cost item is transmission and distribution expenses which share to operating expense is around 40%<sup>8</sup>.

<sup>8</sup> This is not the common trend for PDAMs. For example, the largest expense of PDAM Tangeang is water purchase payment to private operators.

**Table 2-135 Profit and loss statement of PDAM Tirtanadi**

	2005	2004	2003	2002	2001
<b>Revenues</b>	<b>208,110</b>	<b>199,962</b>	<b>188,198</b>	<b>135,890</b>	<b>126,478</b>
Water supply revenues	185,908	179,487	171,166	121,326	113,971
Waste water revenues	1,922	1,866	1,785	1,255	1,137
Non water revenues	20,280	18,609	15,247	13,309	11,370
<b>Operating expenses</b>	<b>115,194</b>	<b>108,469</b>	<b>100,996</b>	<b>74,375</b>	<b>64,356</b>
Water resource expenses	31,300	25,935	23,548	12,192	6,717
Water treatment expenses	35,094	33,067	30,238	25,029	19,028
Transmission and distribution	44,886	45,241	42,707	34,259	34,180
Waste water expenses	3,914	4,226	4,503	2,895	4,431
<b>Gross Profit</b>	<b>92,916</b>	<b>91,493</b>	<b>87,202</b>	<b>61,515</b>	<b>62,122</b>
General and administration	86,325	83,368	79,048	56,704	57,734
<b>Income from Operations</b>	<b>6,591</b>	<b>8,125</b>	<b>8,154</b>	<b>4,811</b>	<b>4,388</b>
Other income (net)	1,146	622	992	642	1,005
Other income	1,176	914	1,021	667	1,027
Other expenses	29	292	29	25	22
<b>Current profit</b>	<b>7,737</b>	<b>8,747</b>	<b>9,146</b>	<b>5,453</b>	<b>5,393</b>
Income before tax	7,737	8,747	9,146	5,453	5,393
Income tax	3,143	3,144	3,188	2,016	2,041
<b>Net income</b>	<b>4,594</b>	<b>5,603</b>	<b>5,958</b>	<b>3,437</b>	<b>3,352</b>

Source: PDAM Tirtanadi

## 2) Balance sheet

Table 2-136 shows the balance sheet of the PDAM. In the asset side, the tangible fixed asset (net), which is composed of installations of water purification plants, vehicles, and office buildings, occupies more than 80% of total asset. In the liability side, the long term liabilities to the government and international organizations are dominate, and the PDAM does not have debt to banks. This means that they have no financial resource except borrowings from government or international organization. Their financial resource is less diversified.

## 3) Financial indexes

Table 2-137 shows the financial indexes of PDAM Titanadi. Its financial status is very weak. Capital adequacy ratio is small, while the debt equity ratio indicates highly dependence on debt. Their profit ratio remains very lower level at 3 to 4%.

**Table 2-136 Balance sheet of PDAM Tirtanadi**

	2005	2004	2003	2002	2001
<b>Current Asset</b>	<b>33,207</b>	<b>29,530</b>	<b>25,589</b>	<b>21,009</b>	<b>18,347</b>
Cash/bank deposit	7,829	6,273	3,106	5,671	3,404
Account receivable	9,801	7,499	11,495	8,971	9,597
Short term investment	7,636	8,636	6,136	1,217	1,000
Inventory	6,215	5,172	3,415	3,054	2,781
Others	1,726	1,950	1,437	2,096	1,565
<b>Non Current Asset</b>	<b>227,674</b>	<b>196,010</b>	<b>169,100</b>	<b>165,865</b>	<b>168,703</b>
Intangible fixed asset	110	110	110	0	0
Tangible fixed asset	176,923	151,829	149,792	151,885	151,092
Other non current asset	50,641	44,071	19,198	13,980	17,611
<b>Total Asset</b>	<b>260,881</b>	<b>225,540</b>	<b>194,689</b>	<b>186,874</b>	<b>187,050</b>
Current Liability	67,379	50,657	38,724	22,544	21,029
Acceptance payable	23,058	17,967	14,725	1,723	1,630
Short term liabilities	7,228	7,226	8,029	11,417	11,653
Other current liabilities	37,093	25,464	15,970	9,404	7,746
<b>Long term liability</b>	<b>62,982</b>	<b>60,934</b>	<b>49,596</b>	<b>57,280</b>	<b>66,481</b>
<b>Fixed Liability</b>	<b>25,560</b>	<b>20,834</b>	<b>16,550</b>	<b>21,799</b>	<b>15,795</b>
<b>Equity</b>	<b>104,962</b>	<b>93,116</b>	<b>89,820</b>	<b>85,252</b>	<b>83,745</b>
Capital and reserve	100,367	87,251	83,861	81,631	80,393
Retained earnings	4,595	5,865	5,959	3,621	3,352
<b>Total of Liability and Equity</b>	<b>260,883</b>	<b>225,541</b>	<b>194,690</b>	<b>186,875</b>	<b>187,050</b>

Source: PDAM Tirtanadi

**Table 2-137 Financial Indexes**

	2005	2004	2003	2002	2001
ROA	1.76	2.48	3.06	1.84	1.79
ROE	4.38	6.02	6.63	4.03	4
Profit ratio	3.17	4.06	4.33	3.54	3.47
Capital Adequacy Ratio	40.23	41.29	46.13	45.62	44.77
Debt Equity Ratio	0.67	0.73	0.64	0.81	0.93
Growth Rate of Total Revenue	4.07	6.25	38.49	7.44	-
Growth Rate of Income from Operations	-18.87	-0.36	69.57	9.6	

Source: Compiled by JICA Study Team

## (5) Issues

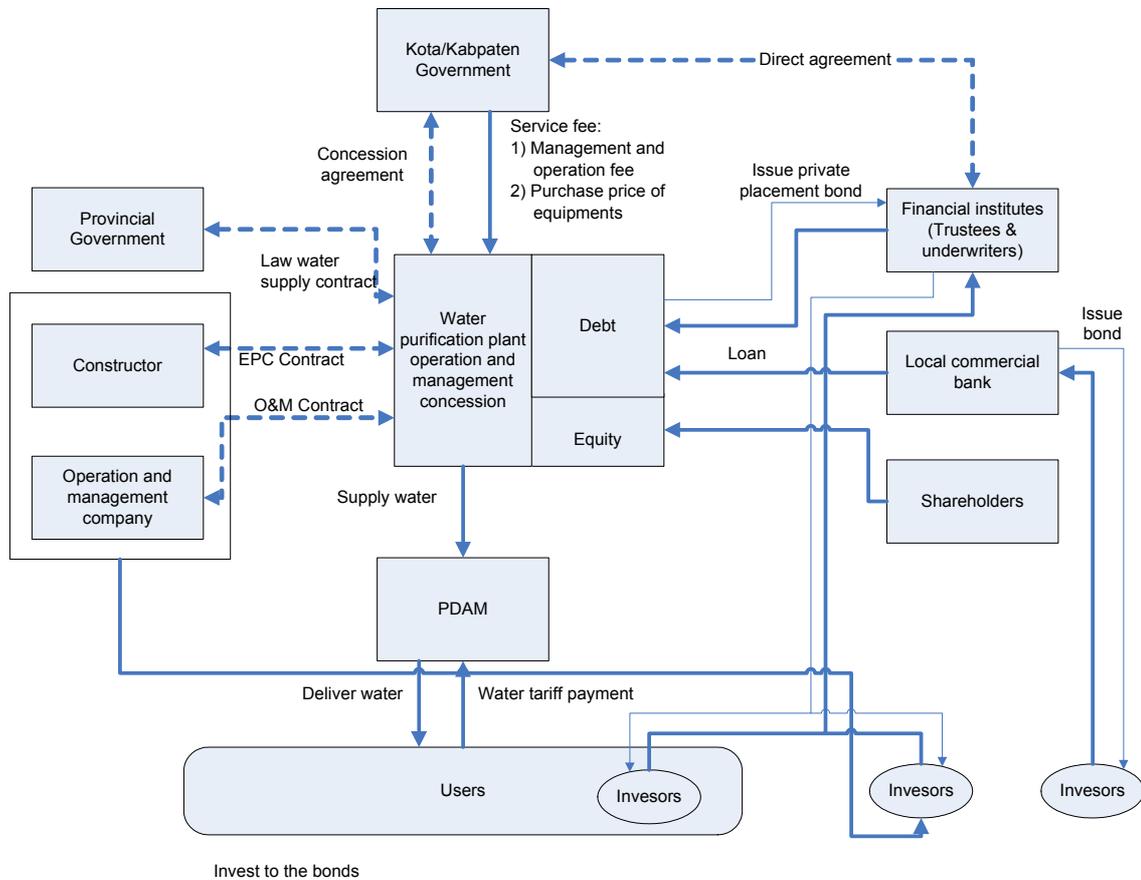
The primary issue is the weak financial position of PDAM. Under the current regulation, a private operator can choose a contract to supply treated water either to end users or to PDAM. In the former case, the main revenues of the operator are tariffs collected from end user. The local governments wish to invite such type of investment, because they believe that private operators can manage water supply business more efficient than PDAMs (and this should be true). Private parties, however, tend to prefer the latter approach, because their revenue in the former case would be directly affected to market fluctuations and water tariff rate which is often determined politically. In the latter case, the PDAM's payment is the biggest revenue source of the private operators. This implies if PDAM were insolvent, the private operator would face financial difficulties or at worst go bankrupt.

To improve the PDAMs' financial position, the government may take two steps. The first step is to accelerate their debt repayment and to enhance its effectiveness so as to be bankable. The second step is to introduce alternative financial scheme other than multilateral loans. One idea is to introduce bond financing scheme with establishing a public development bank which will handle bonds issued by PDAMs. Because each PDAM is too small to attract investors in nation wide, a public development bank which will be financed by issuing public bonds will soak up PDAMs bond or give loans.

The introducing bond financing scheme is expected to contribute also to the development of bond market which will lead more financial options not only to PDAMs but also private operators in water supply sector. The following is one example of bond financing scheme in water sector.

The figure shows a model scheme of bond financing water supply project.

**Figure 2-48 Model Scheme of Bond Financing Water Supply Project**



Project structure

Providing service; i.e. supplying water to PDAM and receiving water charge payment from PDAM

PPP modality

BTO (Build- Transfer-Operate): The SPC transfers the ownership to the local government and operates during the contract period.

Financing scheme

Capital structure		Financier/investors
Debt	Loan for the construction	Local banks
	Private placement bond (refinancing to the loan)	Investors (local banks, constructor, O&M company, and local corporate)
Equity		Project sponsors

The SPC procures the debt portfolio firstly loan from the local banks, especially for

financing construction of the facilities. Then, in the operational phases, the loan debt is supposed to be refinanced by issuing bond. Here, we assume to issue private placement bond, instead of public offering bond. This is because, given the less developed bond market in Indonesia, public offering bonds issued by the SPC in regional area are less likely to attract enough number of investors to sell all offered bonds. The Private placement bonds can not be traded in the exchange market, but it can trade between the specified concerned parties. Thus, we assume that the private placement bonds will be easier financial measures to procure necessary amount of funds than private offering bonds.

#### Revenue of the SPC

Service fee payment from the local government, which is composed of:

- Operation and management fee of the water purification plant; and
- Purchase price of the facilities constructed.

#### **2.7.1.4 Summary of each sector**

Items		Toll Road	Water supply	Power sector
1. Responsible government agency		BPJT(Central government)	PDAM or Kabupaten/Kota government	PLN
2. Financial structure	1) Major revenue sources	Toll tariff collection	a) Water tariff payment from PMDA b) Water tariff payment from end-user	Power tariff payment from PLN
	2) major cost sources		Electricity tariff	
3. Competitor		Non toll road. Not much competition	a) Underground water usage b) Unauthorized second distribution of water supplied	No competition
4. Risk	1) Demand risk	High (elasticity of demand to economic fluctuation is high)	Low (It may be affected indirectly by demand risk through PDAM)	Low (IPP does not face end user demand fluctuation directly)
	2) Default Risk of payers	Law (payers are toll road users)	High (Default of PDAM)	High (Default of PLN)
	3) Risks related land	High (delay in acquiring land)	Law	High (Land acquisition may be responsible for private sectors)

Items	Toll Road	Water supply	Power sector
4) Tariff (for end users) revision risks	High	Law (the risk of amending tariff subject to PDAM may be high)	High
5) Factor of pressuring costs	Inflation	Power tariff, inflation	Oil price, exchange rate, infraction

Source: Compiled by Study Team

## 2.7.2 Overall framework of PPP

### 2.7.2.1 PPP and risks

In general, there are six types of approach to PPP. Among them, service contract, management contract as well as lease contract is less risky than concession contract, BOT, and divestiture, since the private sector (contractor) does not take on commercial risk. The duties of the private sector in the former contract are just to provide services to the consigner; e.g., providing management services for a government owned facility.

**Table 2-138 PPP Approach**

Approach	Asset Ownership	Operation & Maintenance	Capital Investment	Commercial Risk	Contract Duration
Service Contract	Public	Public/Private	Public	Public	1-2 years
Management contract	Public	Private	Public	Public	3-5 years
Lease	Public	Private	Public	Shared	8-15 years
Concession	Public	Private	Private	Private	25-30 years
BOT	Public and private	Private	Private	Private	2-30 years
Divestiture	Private or Public and Private	Private	Private	Private	Indefinite or limited by license

Source:(<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/EXTINFNETWORK/0,,contentMDK:20535877~menuPK:489896~pagePK:64159605~piPK:64157667~theSitePK:489890,00.html>)

Private investors in Indonesia especially in the electric power sector express the following risk as their main concerns:

- government guarantees for borrowing of IPPs

- government guarantees of long-term power purchase agreement
- power purchase contract denominated in foreign currency
- tariff setting system
- responsibility for land acquisition
- exemption of tax related to import
- stable fuel supply for power plant construction by IPPs
- abolition of minimum 5% local capital requirement

### **2.7.2.2 PPP framework**

The Government of Indonesia has worked to introduce new policy schemes to mitigate those risks taken on by the private sector. The notable policies introduced in 2005 are:

- Presidential Regulation No. 67 of 2005 concerning Cooperation between the Government and the Business Entities in the Provision of Infrastructure
- President Regulation No. 36 of 2005
- Ministerial Regulation No. 39/2006.

In November 2005, the Government of Indonesia promulgated Presidential Regulation No. 67 of 2005 concerning Cooperation between the Government and the Business Entities in the Provision of Infrastructure. This regulation is a milestone in promoting PPP to infrastructure in Indonesia by providing a framework for implementing PPP projects on a clear, more transparent and accountable basis.

#### **(1) Objective of PPP**

The regulation prescribes the objective in undertaking PPP projects, such as:

- meeting the financial requirement in providing the infrastructure;
- improving the quantity, quality and efficiency of the service;
- improving the quality of management and maintenance in the provision of infrastructure; and
- encouraging the utilization of the principle of users paying for the services that they receive.

In general, the law or regulation on PPP covers various sectors that it should stipulate the relations with the existing laws and regulations in the relevant sectors. Even though Regulation No.67 of 2005 contains a provision concerning this matter, it fails to clarify how to harmonize with the prevailing legislations.

#### **(2) Intended types of infrastructure and identification of the project**

The regulation prescribes the types of infrastructure which can be operated in

conjunction with a business entity<sup>9</sup>, such as (Article 4):

- transportation infrastructure;
- road infrastructure;
- infrastructure for the distribution of water;
- infrastructure for drinking water;
- waste water infrastructure;
- telecommunication infrastructure;
- electrical power infrastructure; and
- oil and natural gas infrastructure.

This list covers all sectors, and the regulation does not have any negative lists. This may suggest that the Government intends to open up all infrastructure sectors for PPP project to. In the meantime, the regulation does not provide either specific criteria of a project to be executed by PPP nor does it define applicable schemes such as BOT, BTO, or BOO.

The regulation gives two means of executing PPP in infrastructure operation, namely a cooperation agreement or operational permit (Article 5). The cooperation agreement is the framework to carry out a PPP project which is on the list of priority projects of the relevant government, while the operational permit is that for a PPP project which is proposed by a business entity.

In the framework of the cooperation agreement, the relevant ministry or local government should identify the projects while taking into account the matter of conformity with the national or regional mid-term development plan, interconnection with other infrastructure sectors and regional areas, and cost analysis and social benefit. Each proposed project for PPP are accompanied by (Article 7):

- a pre-feasibility study;
- cooperation scheme plan;
- project financing plan and the source of fund thereof; and
- cooperation proposal plan comprising the schedule, process and method of evaluation.

Referring to the information, the government agency should identify the projects. After the identification procedure, the relevant ministry or local government is obliged to give priority to the projects and open them for the public, although the regulation does not provide the bases of the prioritization and the way to open them to the public.

The identification of the projects may be initiated not only by a government organization but also by a business entity. This is the framework of the operational permit. A business entity is allowed to propose a project which is not on the government priority project list, to the relevant ministry or local government (Article 10). The technical ministry or local

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<sup>9</sup> Business entity includes a limited liability firm, a state owned enterprise, a regionally owned enterprise, and a cooperative

government shall evaluate the proposed project. If it meets the feasibility requirement, the project should be advanced to the stage of a public tender (Article 12).

(3) Procurement procedure of a business entity (concessionaire)

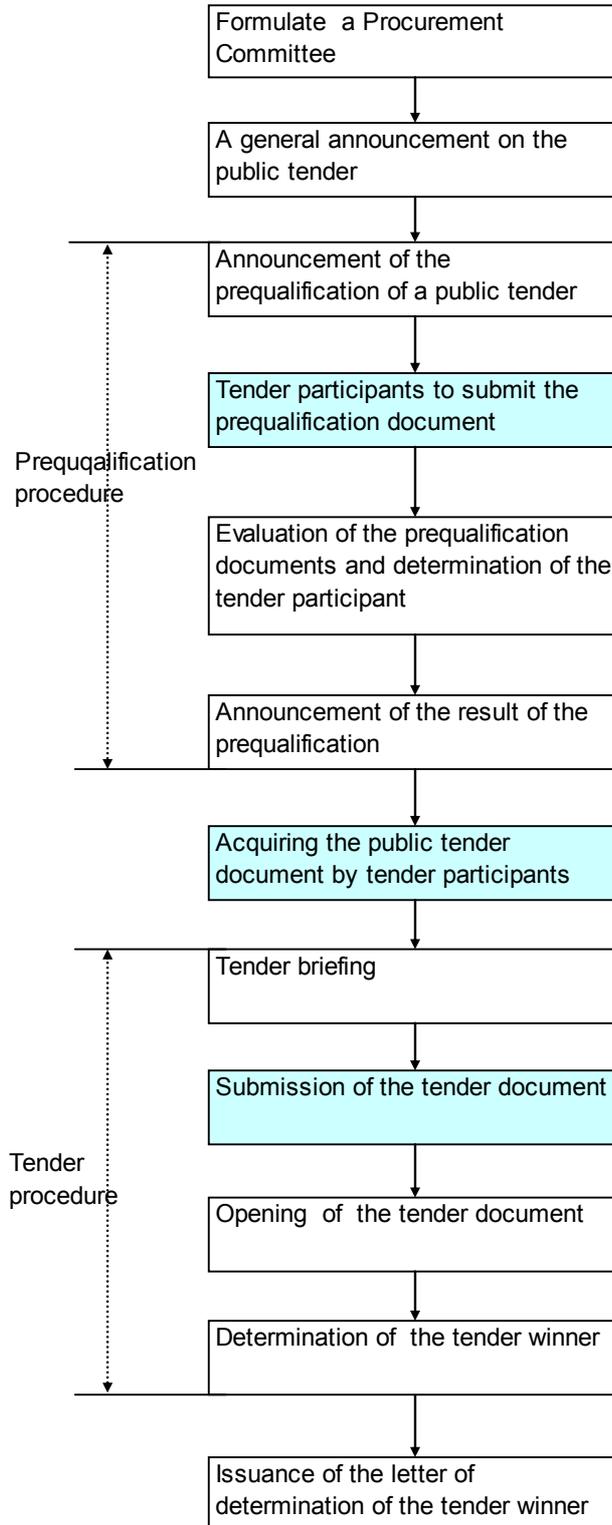
According to regulations, the business entity procurement procedure in both the framework of the cooperation agreement and the operational permit are carried out by means of a public tender. But, it provides details of the procedure only for the framework of the cooperation agreement, and mentions that the procedure to tender the operational permit is regulated by the relevant government authorities. It should be noted that, before adoption of Law No. 67/2005, it was not necessary to carry out a public tender for infrastructure projects with PPP. Indeed, the concession agreement for the water supply in Jakarta was given to two private companies in 1998 without a public tender. The concession agreement aimed at stimulating more private financial inflow into the sector, although it has created discord between the Jakarta Water Supply Regulatory Body and the two private concessionaires.

In general, the selection of a concessionaire takes either of the two following procedures:  
a) single-stage procedure which selects a concessionaire by a one-time proposal and bid; and,  
b) multiple-stage procedure by several times of proposals and bids, generally two-stage<sup>10</sup>.  
Indonesia uses the single-stage procedure as Figure 2-49 shows.

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<sup>10</sup> UNCITRAL (United Nations Commission on International Trade Law) recommends taking the two-stage procedure in its guideline on private financed infrastructure projects (p.75).

**Figure 2-49 Procurement Procedure**



It is mainly composed of two parts; one is for prequalification and another is for the tender. The responsible body for conducting procurement is a procurement committee which

should be organized by the line ministry or regional government which is responsible for the procurement.

(4) Risk management and government support

According to regulations, the Ministry of Finance (or Regional Finance Management Task Unit when the regional government provides supports) carries out risk control and management of PPP projects. The key responsibilities in doing this are:

- approving or rejecting the proposed offering of government support to the business entities; and
- determining criteria for approval or denial of support for projects that are being offered by the central government.

As the entity to be concerned with the execution of those activities, the risk management committee on infrastructure provision has been established in the Ministry of Finance based on Minister of Finance Decree 518/2005. In addition, it is the National Committee for Policy on Acceleration of Provision of Infrastructure (KKPPI) which is single window body for government support. The details of the organization are provided in the following section.

In May 19, the Ministry of Finance issued Ministerial Regulation No. 38/PMK.01/2006 on Implementation Instructions for the Control and Management of Infrastructure Provision Risks. In the regulation, the Ministry stipulates the risks to be covered by the regulation and types of government support to be provided. According to the regulation, the government has identified three types of risk and types of government support for each risk:

1) Political risks

Definition: Political risks contain seizure of assets belonging to private operators by the government, legal changes, restrictions on currency exchange and remittance.

Government support: The Government will sign a contract to offer a guarantee

2) Project performance risks

Definition: Project performance risks contain location risk and operation risk.

Government support:

a) Location risk:

- delays in land acquisition may be compensated by extension of the concession period and/or by other means approved by the Minister of Finance
- increases in land price may be compensated by extension of the concession period,

by bearing a percentage of the excess price as agreed with the Business Enterprise, and/or by other means approved by the Minister of Finance;

b) Operational risk, in the event that:

- delays in declaring commencement of commercial operation, delays in tariff adjustment, cancellation of a tariff adjustment or the setting of an initial tariff lower than that agreed may be compensated by extension of the Concession period and/or by other means approved by the Minister of Finance;
- changes in the specification of outputs outside of those already agreed by the Minister/Head of Institution which cause financial loss for the Business Enterprise may be given compensation based on recalculation of the cost of production;

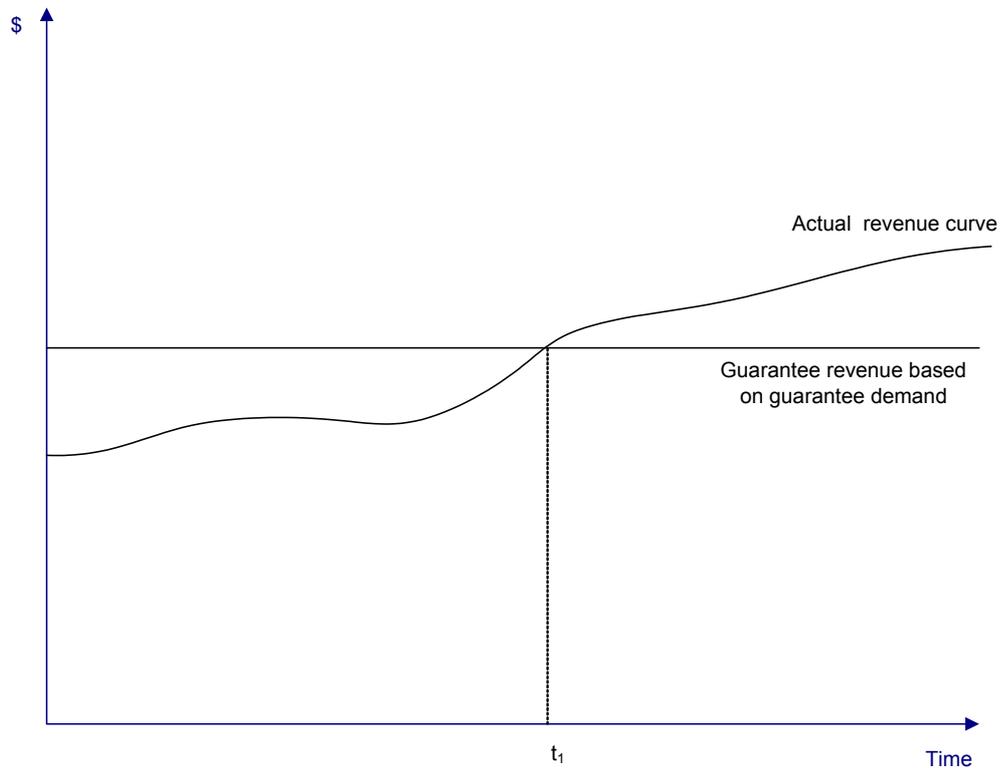
3) Demand risks

Definition: Demand risk is defined as that triggered by an actual demand level which is lower than the contracted level.

Government support: When actual revenues are lower than the minimum total revenues guaranteed by the government as a result of total demand for the goods/services produced by the project being less than the total demand on which the agreement was based, financial and/or other forms of compensation may be approved. On the other hand, when actual revenues are higher than the minimum total revenues guaranteed by government as a result of total demand for the goods/services produced by the project being higher than the total demand on which the agreement was based, the government may obtain financial benefit from the excess receipts. According to the Ministry of Finance, more precisely to say, the government will start negotiation with the private operator how the government will obtain financial benefit as return for the compensation granted.

The figurative explanation is provided in Figure 2-50.

**Figure 2-50 Demand guarantee scheme**



Considering those schemes, the risks involved in PPP projects would be shared as shown in Table 2-139. The table is based on a draft concession agreement in a toll road project. The table shows political risk, project performance risk, market (demand) risk, default risk, and force majeure. All political risks would be shared by both parties as the regulation No. 38/2006 stipulates. Not all project performance risks, however, are shared by public and private. The regulation promises to provide support only for site risks and changes in output specification. The rest of the risks should be covered by the private side. Market (demand) risks would be shared by the two parties, although it is not clear how to identify the link between those risk items and actual demand level. Even though the regulation does not mention default risk and force majeure, this draft concession agreement specifies that they should be shared by the two parties.

Private investors reallocate risks, which they have to take, by methods such as use of contract of the nature such as of an EPC (Engineering, Procurement, and Construction) contract for design and construction risk, and an O&M (Operation & Management) contract for operation and management risk. But, some risks are still left to private investors. For example, a private sector company is exposed to market risk such as that of a general economic downturn, inflation, or competition risks -- risks that cannot be controlled by private sector's efforts. Furthermore, tariff adjustment is also a serious risk for private investors.

**Table 2-139 Risks and Risk Takers**

	Risk	Risk taker
Political risk	Seizure of operator's asset by government	Public/Private
	Risk of a change in laws and regulation	Public/Private
	Conversion restriction and prohibition to Repatriate	Public/Private
Project performance risk	Site Risk – Land Acquisition; – Increasing of Land Price; – Environmental issues.	Public/Private Public/Private Private
	Design, Construction and Commissioning Risk – Design; – Construction; – Commissioning.	Private Private Private
	Operational Risk – Approval to Operate; – Tariff Adjustment; – Input – Maintenance and Renovation; – Changes in output specification outside agreed specification range; – Operator Failure; – Technical Obsolescence	Private Public/Private Private Private Public/Private Private Private
Market (demand) risk	General economic downturn;	Public/Private
	Competition	Public/Private
	Demographic Change	Public/Private
	Inflation	Public/Private
Default risk		Public/Private
Force Majeure		Public/Private

### **2.7.2.3 Procedure of offering government support to PPP infrastructure development**

#### (1) KKPPPI

The National Committee on Policy and Acceleration of Infrastructure Development (KKPPI) was established in 2001 under Presidential Decree No. 81 of 2001. Considering the importance of PPP to infrastructure and necessary improvement of the framework, the

Government promulgated Presidential Decree No. 42 of 2005 to make KKPPI the primary institution to promote PPP. According to the decree, the main responsibilities of the KKPPI are

- Formulation of the coordination strategies to accelerate infrastructure provision
- Coordination of the integration of planning and programs and monitor the implementation of policies
- Formulation of the implementation of public service obligation (PSO) in the acceleration of infrastructure provision
- Determine the efforts required to solve various issues relating to infrastructure provision

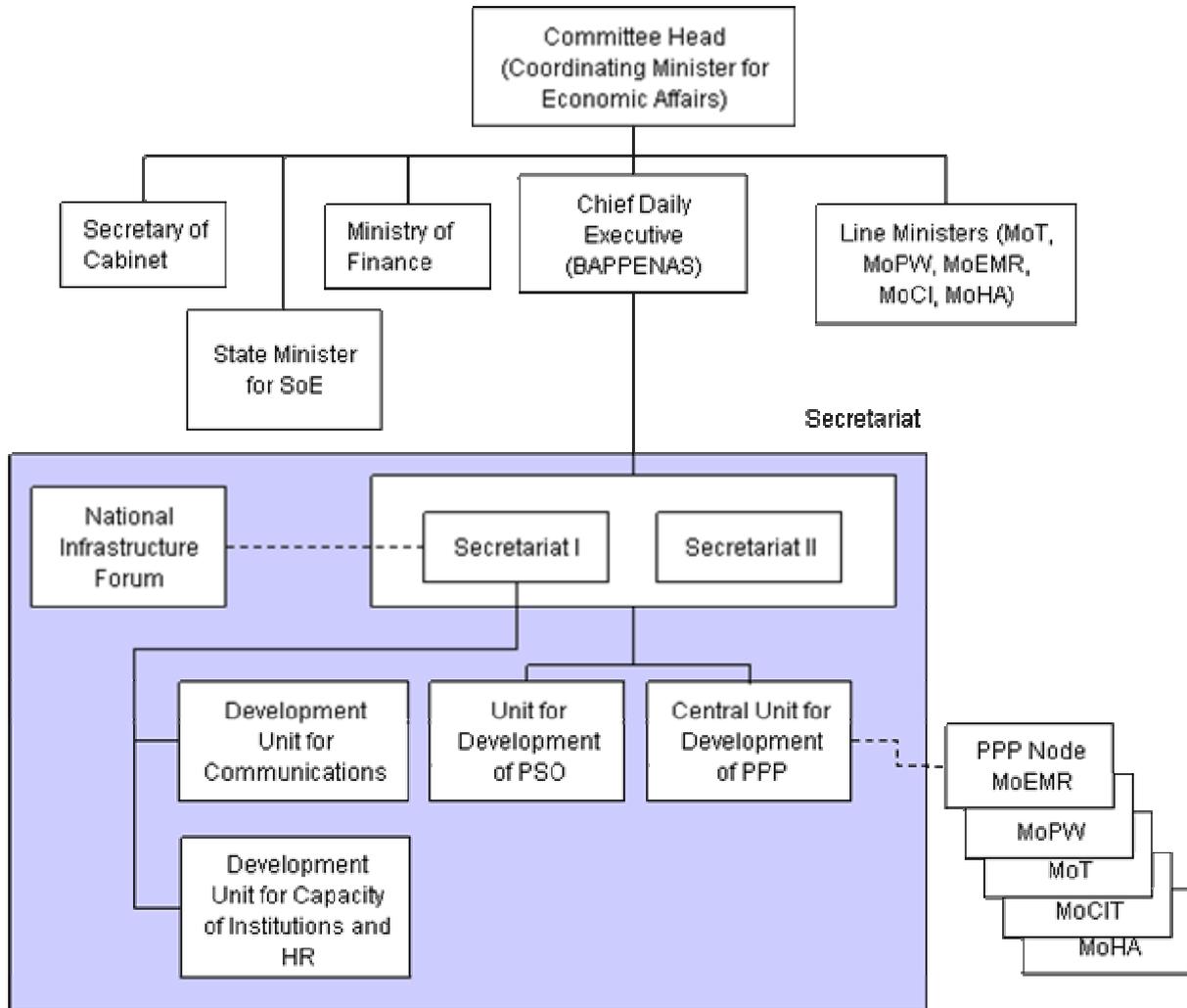
In order to formulate arrangements for the coordination in integrating infrastructure project processes, KKPPI will establish a network with line ministries and regional/local governments. Figure 2-33 shows the organizational chart of KKPPI. It should be noted that, as of February 2006, the organization established is KKPPI and secretary, but still not the management. The Government is preparing a decree to establish the actual management function of KKPPI operations.

As the Presidential Regulation No.42 of 2005 and Decision of the Coordinating Minister for Economic Affairs No. KEP-01/M.EKN/05/2006 stipulates, the Committee Head is Coordinating Minister for Economic Affairs, and the Daily Executive Head is the Chief of Bappenas. The members are:

- Minister of Home Affairs
- Minister of Finance
- Minister of Energy and Mineral Resources
- Minister of Public Works
- Minister of Transportation
- Minister Communication and Information Technology
- State Minister for State-Owned Enterprises, and
- State/Cabinet Secretary

The Committee Secretariat is head by Secretary I (Deputy of the Coordinating Minister of Economic Affairs in Coordinating Fiscal Decentralization and Economy and Infrastructure Development) and Secretary II (Deputy of Bappenas in Facilities and Infrastructure). The duties of Secretary I is to coordinate stakeholders, to monitor policy implementation and to conduct legal studies, while those of Secretary II are to supervise implementation of Work Groups.

**Figure 2-51 Organization Structure of KKPI**



Within the Committee Secretariat, there are four units which implement the duties of the Committee Secretariat.

1) Unit for Development for Public Service Obligation (PSO)

The duties are:

- To develop PSO policies and strategies as well as subsidy schemes;
- To carry out cross sector coordination to facilitate the implementation of PSO projects and subsidized projects; and
- To conduct monitoring over the implementation of PSO policies and strategies.

2) Central Unit for Development of PPP

The duties are:

- To conduct evaluation on implementation on cooperation of PPP projects and development of policies and capacities of the related institutions through

cooperation between the Government and Business Enterprises;

- To conduct evaluation on and coordination of implementation of PPP projects, working with the PPP nodes in the respective line Ministries and local governments;
- To develop policies on PPP capacity and institutionalization of PPP; and
- To operate mechanism/facilities to finance technical assistance to the PPP nodes in the respective line Ministries and local governments.

### 3) Development Unit for Communications

The duties are:

- To communicate, disseminate information, build understanding and socializing Government strategies and policies in relation to acceleration of infrastructure development and participation of business enterprises in the provision of infrastructure, to the related Government institutions and stakeholders; and
- To strive for and facilitate public consultation and other activities to support the duties mentioned in the above section.

### 4) Development Unit for Capacity of Institutions and Human Resources

The duties are:

- To develop capacity and expertise of institutions in cooperation of Public Private Partnership projects;
- To improve knowledge and expertise of stakeholders, mainly Regulatory Bodies and Government institutions responsible for the provision of infrastructure;
- To prepare development programs for institutions providing infrastructure in an overall manner in accordance with needs;
- To prepare programs for improvement of knowledge and skills for human resources involved in the implementation of infrastructure development programs;
- To carry out education and training programs supporting the development of institutions and human resources for the infrastructure sector; and
- To conduct identification, gathering, maintenance and processing of information and know-how as learning material from experiences in implementation of projects providing infrastructure.

## (2) Procedure of granting government support

The procedure of granting government support described in Figure 2-34 is stipulated in Ministerial Regulation No.39/2006 and Regulation of the Coordinating Minister for Economic Affairs No.Per-04/M.Mekon/06/2006. First, a line ministry is required to submit a proposal for government support to KKPPI. The proposal should contain following documents:

- a. Feasibility study;

- b. bid documents which at least contain the following:
  - i) form of partnership;
  - ii) financing plan for the PPP projects and source of funding thereof;
  - iii) plan for partnership offer including schedule, process, and evaluation method;
- c. documents that contain detailed description concerning proposal for government support, accompanied by analysis on preventive acts that need to be conducted in the context of reducing the emergence of Government financial obligation (contingent liabilities) as an impact of implementation of the Partnership Agreement; and
- d. documents derived from results of public consultancy.

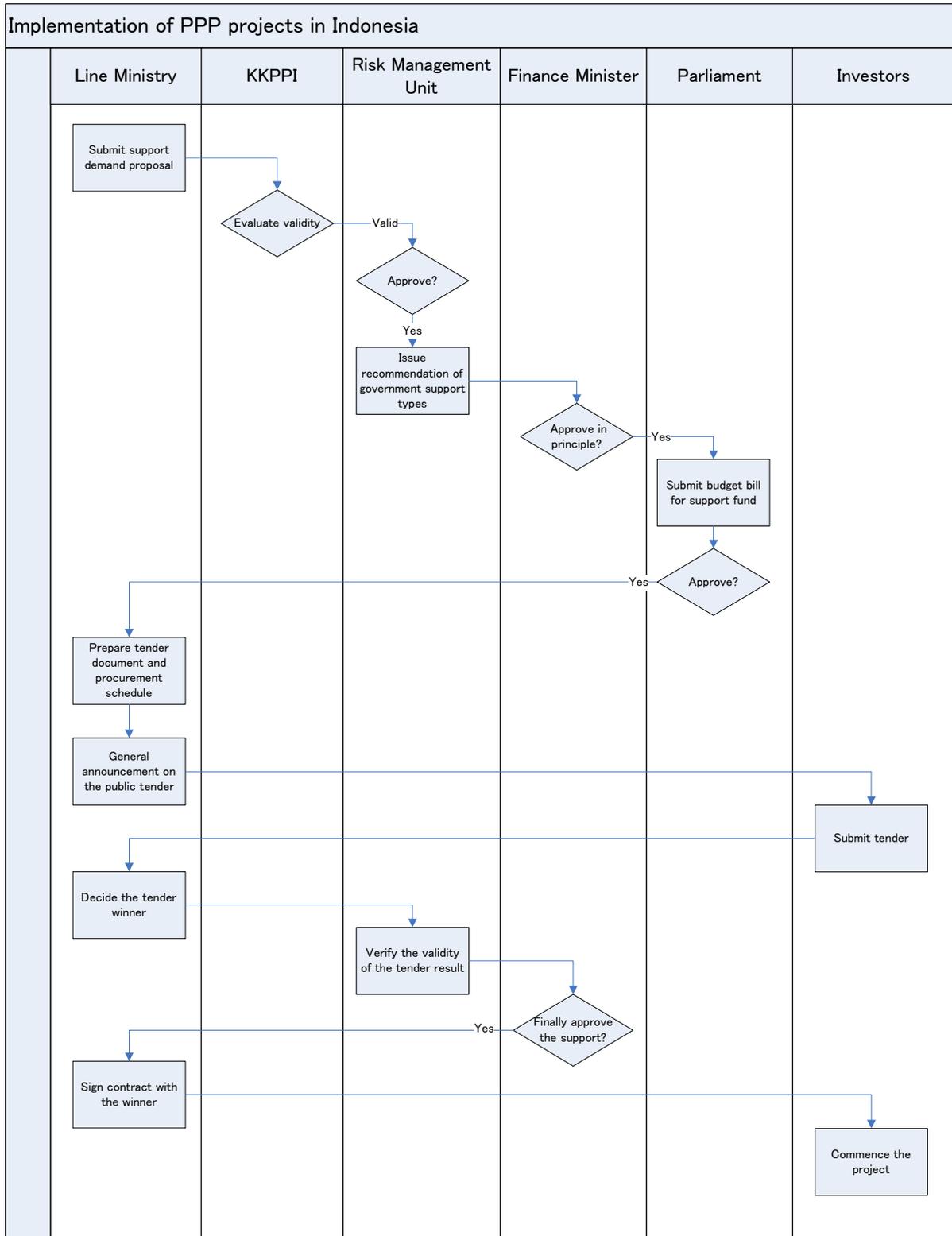
When the proposal is submitted, the Secretariat examines the completeness of documents, and then the Central Unit for Development of PPP conducts evaluation on the feasibility of proposals to have government support and the sequence of priorities, submitting recommendations to the Committee of KKPPI. In determining the sequence of priorities, the Central Unit for Development of PPP considers:

- a. analysis on benefits, economic and social costs;
- b. harmonization and/or integration between sectors; and
- c. range of government support applied for.

The Regulation of the Coordinating Minister for Economic Affairs No.Per-04/M.Mekon/06/2006 stipulates the following criteria as the base of the evaluation:

- a. accordance with the laws of the Republic of Indonesia;
- b. accordance with the national med-term development plan;
- c. accordance with the sector strategic plans;
- d. competitiveness;
- e. land availability;
- f. preparedness of project concept;
- g. accordance with regional spatial layout plan;
- h. preparedness in control over environmental impact;
- i. clarification on form of cooperation;
- j. completeness of bid documents;

**Figure 2-52 Procedure of Granting Government Support**



- k. economic and social benefits and costs;
- l. clarification on risk overcoming

- m. clarification concerning form and amount of requested government support; and
- n. project feasibility.

Based on the recommendation, the Committee determines the PPP projects which are eligible to obtain government support, and submits that list of priority projects to the Minister of Finance. Upon the submission, the Risk Management Unit of the Ministry of Finance assesses the projects based on the same principle applied to KKPPI's evaluation as well as budget space. If it finally approves the projects, it issues an in-principle approval and submits a recommendation on feasible types of government support to the Finance Minister. Only those projects which obtain approvals from the ministry are eligible to go to the tender process with government support. The line ministry is required to submit results of the tender to Ministry of Finance. The ministry conducts its evaluation as to whether the tender process has been conducted properly. After issuance of final approval from the Ministry, the line ministry and the winning bidder sign the contract.

#### **2.7.2.4 Comparison of PPP framework among neighboring countries**

In this section, we briefly compare the PPP framework of Indonesia and other neighboring countries. Table 2-140 provides comparisons of Indonesia, Viet Nam and the Philippines<sup>11</sup>.

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<sup>11</sup> We did not include Thailand and China in this table. Thailand introduced Regulation of the Office of the Price Minister on the Undertaking of Public Mega-Project for Country Development in February 2006. The Government, with this new regulation, intended to no longer adopt BOT and BOO schemes and issues any government supports. Instead of them, it aimed at introducing a mechanism that private bidders propose how to carry out a project, including a financial scheme as well as technical skills. Following the resignation of Prime Minister Mr. Thaksin, this new project scheme has been postponed until new prime minister would be appointed. As of May 2006, Thailand has not made their decision on new prime minister, and thus we do not know the government's policy toward PPP to infrastructure development. Regarding China, they have not opened infrastructure project to private investors. Because of those reasons, we omitted the two countries from the table.

**Table 2-140 Comparison among Indonesia, Viet Nam, and the Philippines**

Items		Indonesia	Vietnam	Philippines
PPP related law		Presidential Regulation 67/2005	Degree No.62 dated 15/8/1998	BOT Law (R.A. 6957 as amended by R.A. No.7718)
PPP related agency		KKPPI	Ministry of Planning and Investment and Prime Minister	ICC NEDA Board BOT Center
Type of infrastructure	Electricity	✓	✓	✓
	Transportation	✓	✓	✓
	Road	✓		✓
	Water supply	✓	✓	✓
	Waste treatment	✓	✓	
	Telecommunication	✓		✓
	Oil and natural gas	✓		
	Others		Other areas as determined by the Prime Minister	Education and health infra, industrial and tourism estates, government building
JV restriction	JV restriction	Yes (minimum 5%)	No	No
Incentive for BOT project	Tax exemption	Not specified in law	✓	✓
	Import duties	Not specified in law	✓	✓
Selection process of investors		See flow chart	See flow chart	See flow chart
Government support		✓	Not specified	✓

(1) PPP related law and agencies

1) PPP related law

All three countries have enacted law or regulations to promote PPP to infrastructure. The law in Indonesia does not stipulate applicable schemes of PPP, while those in Viet Nam and the Philippines do. BOT law in the Philippines provides for nine types of PPP scheme such as:

- Build-transfer (BT)
- Build-lease-and transfer (BLT)

- Build-operate-transfer (BOT)
- Build-own-and-operate (BOO)
- Build-transfer-and operate (BTO)
- Contract-add-and operate (CAO)
- Develop-operate-and transfer (DOT)
- Rehabilitate-operate-and transfer (ROT)
- Rehabilitate-own and operate (ROO)

In addition to the above scheme, there are four other modalities:

- Service Contract (1-2 years) to secure assistance on specific task.
- Management Contract (5-8 years) to manage operates and maintains government assets.
- Lease Agreement (8-15 years) to lease a government asset at a fixed leased rate.
- Concession Agreement (20-30 years) to manage operates, maintain and invest in government assets.

## 2) Approving agency

### Indonesia

If the project is not subject to any government support, the head of respective Ministry or local government are responsible for approval. If the implementation agency expects to have government support for the project, the Risk Management Unit of Ministry of Finance makes decision to grant such facilities.

### The Philippines

The approving agencies differ from the costs and types of projects as Table 2-141 shows. The national government agencies are responsible for the national projects, while the local governments for the local projects. For the national projects, the primary approving agency is ICC referring Investment Coordination Committee of the National Economic and Development Authority (NEDA) Board. According to the table, the approving agency is NEDA board for projects costing more than Php 300 million. Projects undertaken through BOO scheme or through scheme other than those defined under the law required Presidential approval.

**Table 2-141 Approving Agency of the Philippines**

Project	Costs	Approving agency
National projects	Up to Php 300million	ICC
	More than Php 300million	NEDA Board for approval upon the recommendation of ICC
Local projects	Up to Php 20 million	Municipal Development Council
	Php 20 million to Php 50million	Provincial Development Council
	Up to Php 50 million	City Development Council
	Php 50 million to Php 200 million	Regional Development Council
	More than Php 200 million	ICC

Viet Nam

In Viet Nam, it is the President who has an authority to approve infrastructure projects financed, constructed, and operated by private sector as figure 2-36 reveals. Even, the signer of such project contracts is also the President.

3) PPP promotion agency

Indonesia and the Philippines have organization dedicated to promoting PPP to infrastructure, KKPPI and BOT center respectively, while Viet Nam does not. The roles of BOT center are:

- Project Monitoring and Facilitation
- Project Development
- Marketing and Promotion of the BOT/PSP Program
- Policy Advocacy.

The responsibilities of KKPPI, on the other hand, are:

- Formulate the coordination strategies to accelerate infrastructure provision
- Coordinate the integration of planning and programs and monitor the implementation of policies
- Formulate the implementation of public service obligation (PSO) in the acceleration of infrastructure provision
- Determine efforts required to solve various issues relating to infrastructure provision

Both agencies plays roles as the monitoring, facilitating, and coordinating of PPP projects, while not are providing technical services to each project such as drafting or negotiating concession agreement.

### **Private Infrastructure Investment Center of Korea (PICKO)**

PICKO is the organization such as BOT center and KKPPi to support to support all the administrative procedures in private sector participation in infrastructure investment in Korea. PICKO have two distinctive functions.

- (1) Conducting feasibility studies for unsolicited projects
- (2) Acting as a one-stop service center for private investment in infrastructure facilities in investment consulting, marketing, etc especially for foreign investors.

### (2) Types of infrastructure

The type of infrastructure applicable to PPP projects are defined in respective law. That in the Philippines covers wider area than that in Indonesia and Viet Nam, which includes:

- Education and health infrastructure;
- Land reclamation, dredging and other related development facilities;
- Industrial and tourism estates or townships, including related infrastructure facilities and utilities;
- Government buildings, housing projects;
- Markets, slaughterhouses, and related facilities;
- Warehouses and post-harvest facilities; and
- Public fish ports and fishponds, including storage and processing facilities.

Because partnership between public and private can be feasible to various projects, it is not necessary to confine the coverage within conventional infrastructure projects such as toll road, power plant, water supply, and so on.

### (3) JV restriction

In Indonesia, foreign participants in infrastructure projects must organize a joint venture with local firms, which minimum share should be 5%. In Viet Nam and the Philippines, there are no such restrictions. The R.A. No. 7718 of Philippine says that any individual, partnership, corporation of firm, whether local or foreign, including joint venture or consortia of local, foreign or local and foreign firms can participate in PPP infrastructure projects

(4) Incentive for BOT projects

**Table 2-142 Incentives for BOT Projects**

More Php 1.0 billion and registration with the BOI	Incentives provided under the Omnibus Investment Code
Less than Php 1.0 billion and registration with the BOI	Incentives provided for under the Omnibus Investment Code subject to inclusion of the project activity or sector in the current Investment Priorities Plan (IPP) of BOI.
Incentives stipulated by other existing laws	E.g. incentives provided under: -P.D. 535 (1974) "Tourism Incentives Program of 1974"; -R.A. 7156 "Mini-Hydroelectric Power Incentives Act"
Incentives provided by local government units	Additional tax incentives, exemptions, or relieves, subject to the provisions of the Local Government Code (LGC) of 1991 and other pertinent laws.

(5) Selection process of private participants

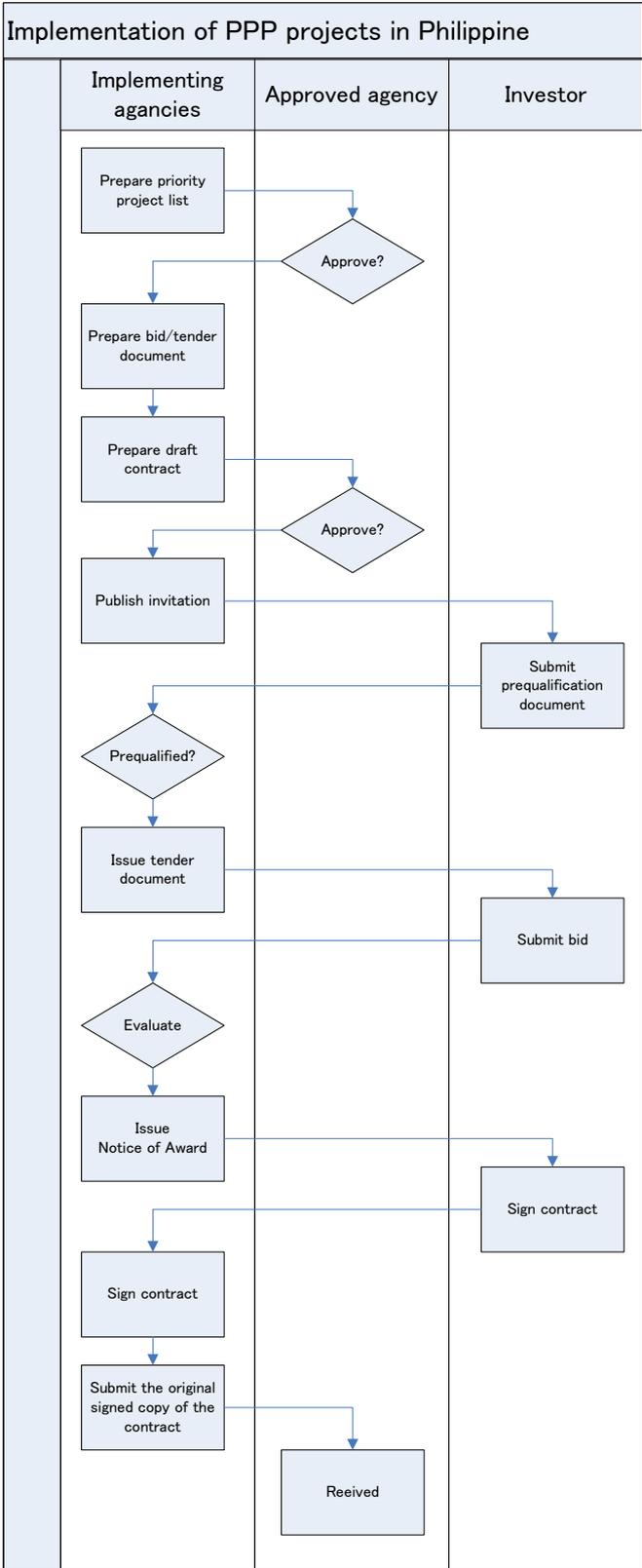
The Philippines

Figure 2-53 shows the approval procedure for the private sector entity who is to construct, operate and maintain infrastructure. The government implementing agency is responsible to conduct the selection. First, concerned government agencies including local governments have to identify priority projects which will be financed, constructed, operated and maintained by the private sector. Those priority projects should be approved by the appropriate approving agency.

Viet Nam

In Viet Nam, it is the President who has an authority to approve infrastructure projects financed, constructed, and operated by private sector as Figure 2-54 reveals. And the signer of such project contracts is also the President.

**Figure 2-53 Procedure of Implementing PPP Projects in the Philippines**





(5) Government Support

The BOT law in the Philippines defines seven types of government support, but there is no specific stipulation on government support.

**Table 2-143 Government Support in the Philippines**

a) Cost sharing	Government bears a portion of capital expenses associated with the establishment of an infrastructure development facility, which should not exceed fifty percent (50%) of the Project Cost. Such government share may be financed from direct government appropriations and/or from Official Development Assistance (ODA) of foreign government or institutions.
b) Credit Enhancements	Government extends direct and indirect support to a development facility by the Project Proponent and/or Agency/LGU concerned, the provision of which is contingent upon the occurrence of certain events and/or risks, as stipulated in the contract.
c) Direct Government Subsidy	This refers to an agreement whereby the Government to pay for or shoulder a portion of the Project Cost or the expenses and costs in operating or maintaining the project;
d) Direct Government Equity	This refers to the subscription by the Government of shares of stock or other securities convertible to shares of stock of the project company
e) Performance Undertaking	This refers to an undertaking of a department, bureau, office, commission, authority, agency, GOCC, or LGU in assuming responsibility for the performance of the responsible agency's obligations under the contractual arrangement.
f) Legal Assistance	This refers to the extension of representation by government lawyers to a Project Proponent
g) Security Assistance	This refers to the deployment of government security forces in the vicinity of the project site to provide security

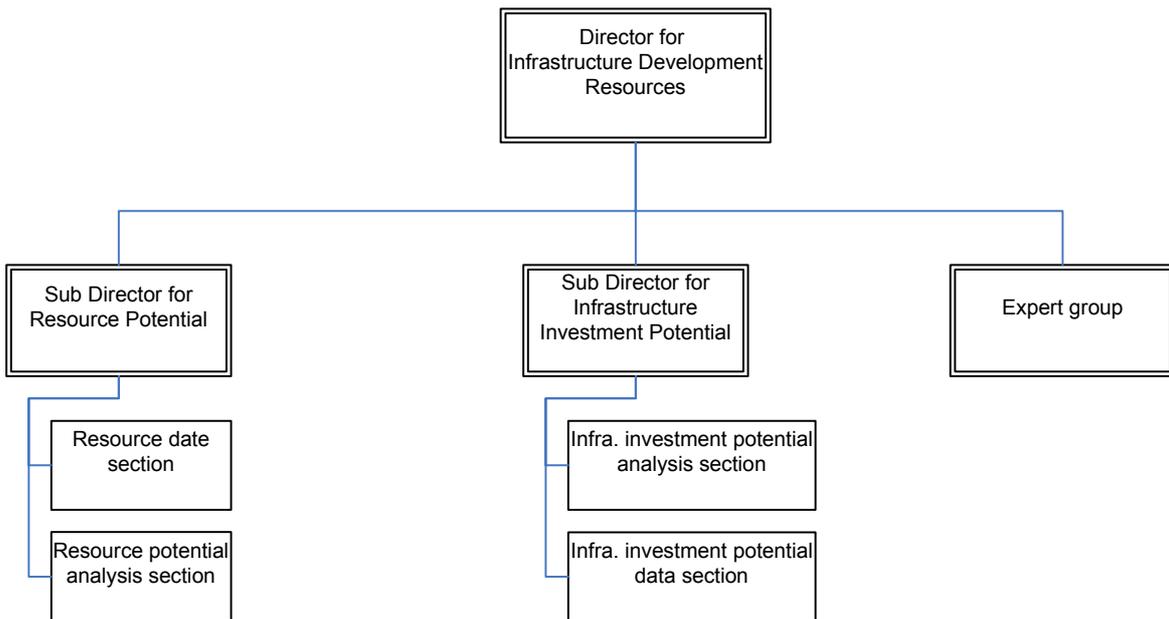
### **2.7.3 Promotion of Infrastructure project and BKPM**

#### **2.7.3.1 Function and roles of BKPM in the infrastructure sector**

In BKPM, no single organization has responsibility for promoting private sector

investment in infrastructure projects. One directorate collects and analyzes infrastructure related information, that is, the Director for Infrastructure Development Resources under the Deputy Chairman for Investment Development Climate. Their organization structure is shown in the Figure 2-55. Each section is composed of one section chief and two section staff except expert group which contains no staff. The total number of staff including the director is 15.

**Figure 2-55 Organization structure of Directorate of Infrastructure Development Resources of BPM**



The Section of Infrastructure Investment Potential Analysis Section is responsible for planning programs conducted by the other sections. They create the TOR to subcontract the planned programs to private companies or consultants.

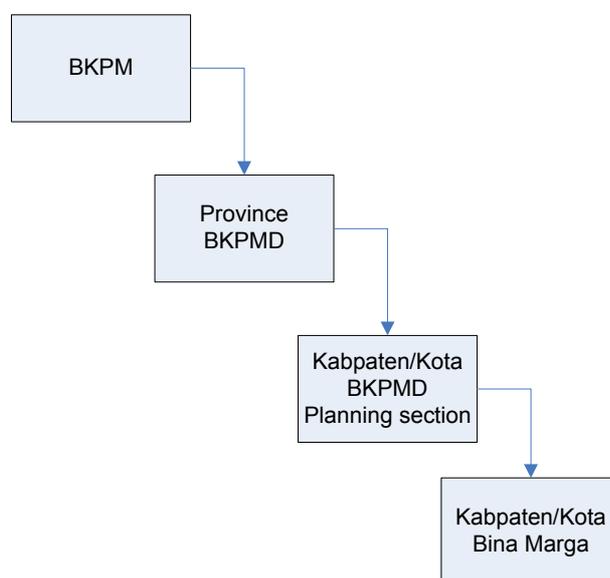
The Sub Directorate for Infrastructure Investment Potential is the key organization in infrastructure related information. The Section of Infrastructure Investment Potential Data is in charge of collecting data on infrastructure related to investment. It collects infrastructure related information and publishes a Directory of Regional Investment Facilities and Infrastructure for each province. The main contents of the publication are:

- Transportation Infrastructure
- Supporting Infrastructure
- Supporting Facilities
- Tourism Facilities
- Developing Plan of Investment Facilities and Infrastructure

These comprise information on available infrastructure and the tariff rates. The purpose of the publication is to disseminate information on infrastructure for potential investors.

The section gathers required information through BKPM in the Kabupaten/Kota. The flow in gathering infrastructure related data in each province is as described in Figure 2-38 . First, BKPM, the Section of Infrastructure Investment Potential Data requests the Province BKPM to gather data, which then asks Kabupaten/Kota BKPM to provide requested data. The planning section of Kabupaten/Kota BKPM requests to Kabupaten/Kota Binamarga to gather necessary data and information.

**Figure 2-56 Flow of Collecting Infrastructure Related Information**



BKPM also implement its own promotion activities including those in the infrastructure field.

BKPM and BKPM have not approached infrastructure as an investment opportunity. They have regarded it as one of investment climates for investors. Therefore, their way of promoting infrastructure is just to focus on the current situation of infrastructure facilities. Despite the current government efforts to lure foreign investors into infrastructure project, BKPM has not taken any steps toward positive involvement into the field, except by publishing Infrastructure Project 2005 which covers potential infrastructure projects as investment opportunities.

## 2.7.4 Issues and recommendations

### 2.7.4.1 PPP regulation

#### (1) PPP modality

Provision on feasible PPP modality is necessary. The Presidential Regulation No. 67 of 2005 governs the type and form of PPP, although lacking of the modality of PPP such as BOT, BOO and so on to be applicable.

##### Recommendation

To show clear rule of PPP scheme, the applicable modalities of PPP in Indonesia should be mentioned in a regulation.

#### (2) Type of infrastructure:

The PPP scheme should be applicable to wider types. The types of infrastructure covered under the Presidential Regulation No.67 of 2005 are confined to conventional sectors such as transportation, road, water, telecommunication, power and oil and natural gas. PPP scheme, however, can be introduced much wider sector. For example, as we observed in the Philippines, their law governs the coverage not only those sectors, but also government building, education and health infrastructure, and so on.

##### Recommendation

Considering the other counters' cases such as the Philippines and Japan, the type of infrastructure should include also government building and housing projects, education and health infrastructure, tourism related infrastructure.

#### (3) Unsolicited projects:

The detail procedure and criteria for evaluation of unsolicited projects should be defined. The Presidential Regulation No. 67 of 2005 allows unsolicited projects as projects based on the initiatives of the business entity. The regulation provides brief framework and procedure for the implementation. However, the detail provisions on the tender procedure and criteria for evaluation have not been regulated yet. In executing those projects, the government will be able to incorporate private knowledge and skills more than in doing projects that identified by public sector. And, thereby, this provision is significant to create competitive PPP framework.

##### Recommendation

Unsolicited project's provision should be regulated.

## 2.7.4.2 Risk sharing mechanism

### (1) Project performance risks

More detail provisions are necessary for the project performance risk sharing mechanism. The Finance Ministerial Regulation (38/PMK.01/2006) stipulates availability of compensation for performance risk. For example, in case where the tariff adjustment is delayed or cancelled, the government will provide compensation by extension of the concession period or by other means. Extension of the concession period, however, will not be supportive mechanism for private operators. No matter how long the concession period extended, the private operators have to payback the debt to banks from their resources, tariff revenues, within a contracted period. If the proposed tariff adjustment is cancelled, the operator will have to endure increasing costs without increasing tariff to be collected from users. And thereby it is obvious to decrease the resources to payback to the lenders. Because the provision does not specify “other means”, private investors can not have confidence that the government will support them.

#### Recommendation

The government should introduce cost sharing mechanism between the government and operators in case where the government rejects the proposed tariff adjustment or the private operator incur loss due to delays of the adjustment.

### (2) Demand risk

The mechanism of demand risk implicitly aims at toll road projects, and thus an additional provision should be necessary to mitigate the risks of the projects such as electric power project and water supply project. The demand risk mechanism is to allow the government to bear compensation to a private operator if its revenues become lower than that of contracted one due to the lower actual demand than the guaranteed level. To specify the actual demand level to an exact project is possible in toll road project, but neither electric power project nor water supply project because the private operators only supply electricity or water to PLN or a PDAM respectively which distribute to end users. And thereby, the private operator agrees not on demand level but tariff level to be paid by PLN or PDAM. This means that the revenue of the private operator is not varied upon demand, but PLN's or PDAM's financial position and tariff rate to be agreed with PLN or PDAM.

#### Recommendation

The government should modify the scheme so as to make it applicable also to PLN or PDAM. In case of water supply sector, the government may disburse subsidy to PDAM when the revenue goes down as a result of total demand for the water supplied by the PDAM being

less than the total demand on which was agreed between the two parties. Because the private operator's revenue depends on the water tariff payment by PDAM, the declining revenue of the PDAM will severely affect to its payment to the private operator. The proposed scheme will mitigate such risk.

#### **2.7.4.3 PPP promotion: One stop service center especially for foreign investors**

In the current policy framework, investors have to talk directly to respective Ministries or local governments on PPP projects. Some organizations have enough knowledge and experiences to cope with inquiries from private investors, but the others, especially local governments, lack adequate capacities. There is no organization who provides PPP related investment consulting service or technical advisory service in the context of policy framework of Indonesia. This may cause physical and mental obstacles to potential foreign investors. To mitigate such impediments, we believe one-stop service center should be established to promote PPP projects to foreign investors. Currently KKPPPI does exist as sole agency to facilitate and monitor PPP projects, although it does not have enough capacities to deal with individual inquiries from investors.

##### Recommendation

One idea is to enhance the capacity of BKPM to enable it to handle inquires on PPP project related to investors. The details of this plan will be discussed in the section of Action Plan.

#### **2.7.4.4 Infrastructure Policy Package: All planed policies should be completed within 2006**

The PPP framework is still under development, and the development will be completed by the end of this year. Given the current status, it is difficult to evaluate the current policy framework of PPP because it is still not in operation.

The Infrastructure Policy Package of 2006 shows policy plans to increase private participation in infrastructure provision as shown in the following table. All action plans and planned outputs are indispensable to promote PPP projects, and thus should be completed within the planned time framework. Out of 18 planned outputs, however, only five have been completed. The Government proclaims that the new PPP policy will be applied from 2007. If it fails, investors may loose their interests on investment into infrastructure projects.

**Table 2-144 Infrastructure Policy Package of 2006 for Cross Sectors  
Strategic Policy**

Action Plan	Output	Completion Period
a. Develop a national policy framework for infrastructure provision.	Indonesian Infrastructure Road Map for PPP.	Mar, 2006
b. Replace Presidential Decree 7/1998 to create	Operational Giddiness Manual for PPP.	Mar, 2006
	Coordinating Minister for Economic Affairs Decree on readiness criteria for the prioritization of projects.	Completed. PER-03/M.EKON/06/2006
	Coordinating Minister for Economic Affairs Decree on the procedure and mechanisms for PPP projects.	Completed PER-04/M.EKON/06/2006?
	Operational Guidelines Manual for PPP in infrastructure provision by sector.	May, 2006
	Template model agreements for the implementation of PPP projects.	May, 2006
c. Improve coordination among government's institutions to accelerate infrastructure provision by strengthening the role of KKPPI	Coordinating Minister for Economic Affairs Decree on the standard operating procedures in KKPPI.	Completed? KEP-01/M.EKON/05/2006
d. Improve the capacity of contracting agency in the preparation of PPP projects.	Policy paper on the establishment of a Project Development Facility (PDF).	Sep, 2006
e. Establishment a PPP Center in the KKPPI	Coordinating Minister for Economic Affairs Decree on the establishment of the PPP Center.	Apr, 2006
	Toolkit for PPP implementation.	Jun, 2006
	Monitoring system for PPP implementation.	Mar, 2006
f. Establish a PPP Node in the ministry	Criteria for PPP project proposals submission.	May, 2006
	Minister of Public Works Decree on the establishment of a PPP Node in the Ministry.	May, 2006
	Minister of Transportation Decree on the establishment of a PPP Node in the Ministry.	May, 2006

Action Plan	Output	Completion Period
	Minister of Energy and Mineral Resources Decree on the establishment of a PPP Node in the Ministry.	May, 2006
g. Establish a Risk Management Unit to evaluate PPP projects requiring government support.	Minister of Finance Decree on risk allocation framework for infrastructure provision.	Completed No. 38/PMK.01/2006
	Establishment of Risk Management Unit.	Completed
h. Establish CIIF	Work plan and agenda.	Mar, 2006

#### 2.7.4.5 Capacity building of local government

Local governments are required to enhance its capacity of managing PPP project. Many infrastructure sectors are under the authorities of local governments, including water supply and waste water management, transportation within the municipalities (e.g. city bus service or monorail), and local road development. For example, the potential infrastructure projects list of 2005 contains 24 water supply related projects which are under the authorities of respective local governments. Provincial governments are also required to submit their project proposals to the Ministry which select the projects to be carried out with PPP scheme. The capacities of the local governments, thereby, are crucial for introducing PPP scheme thought the country. Even though the government has introduced several policies on risk sharing mechanism, local governments' understanding on risk sharing and PPP scheme is limited. Some of them still stick to conventional concept of PPP that the central government would extend financial support in case of financial difficulties of operators. They also lack knowledge and skills on feasibility studies, preparation of tender documents and concession agreements, as well as negotiation skills.