

INVESTMENT CLIMATE REFORM IN INDONESIA: A PROGRESS REPORT

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***Workshop on Improving Indonesia's Investment Climate:
Reform Experiences from the Region***

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Outline

- Why do we need reform in investment climate?
- A Quick Survey on Indonesia's position in investment climate.
 - Doing Business 2006 Results
 - CMEA - LPEM-World Bank- the Nederland Government Survey Results
- Investment Climate Reform: Plan and Progress
- Next Reform Agenda
- Conclusion and How to make effective implementation.

Growth and Unemployment as the main motivation for reforms

Table 2.1: Growth accounting

	Growth in output per worker	Contribution to growth of:		
		Physical capital	Human capital	TFP
Indonesia				
1961-03	2.9	1.7	0.5	0.6
1967-80	5.0	2.0	0.5	2.4
1981-97	3.8	2.5	0.5	0.8
1998-99	-8.8	0.9	0.5	-10.0
2000-03	2.1	0.4	0.4	1.2
Comparator economies 1961-03*				
East Asia (5)	3.6	1.9	0.5	1.2
Korea	4.7	2.7	0.7	1.3
Malaysia	3.6	2.2	0.6	0.8
Philippines	1.0	0.8	0.4	-0.2
Thailand	4.1	2.3	0.4	1.4
OECD	2.4	1.0	0.4	1.0
All developing	1.4	0.8	0.3	0.3

Source: Bosworth and Collins (2003) and World Bank staff estimates. * Simple averages for comparator groups. OECD and All Developing are 1961-00.

Grafik 14: Jumlah Penganggur dan Penciptaan Lapangan Kerja Baru, 2001-2005

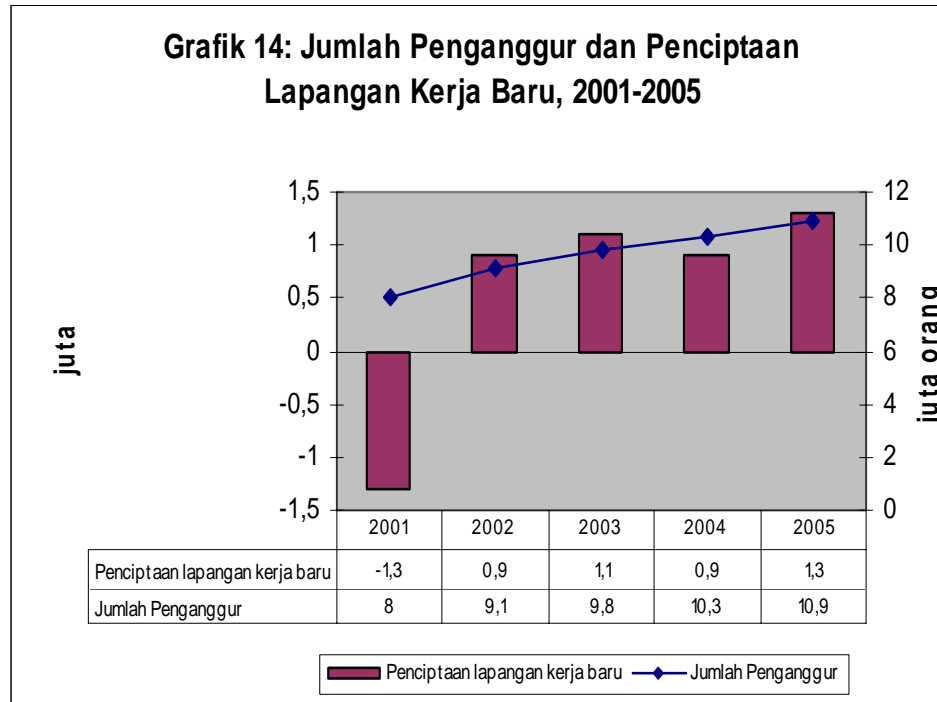
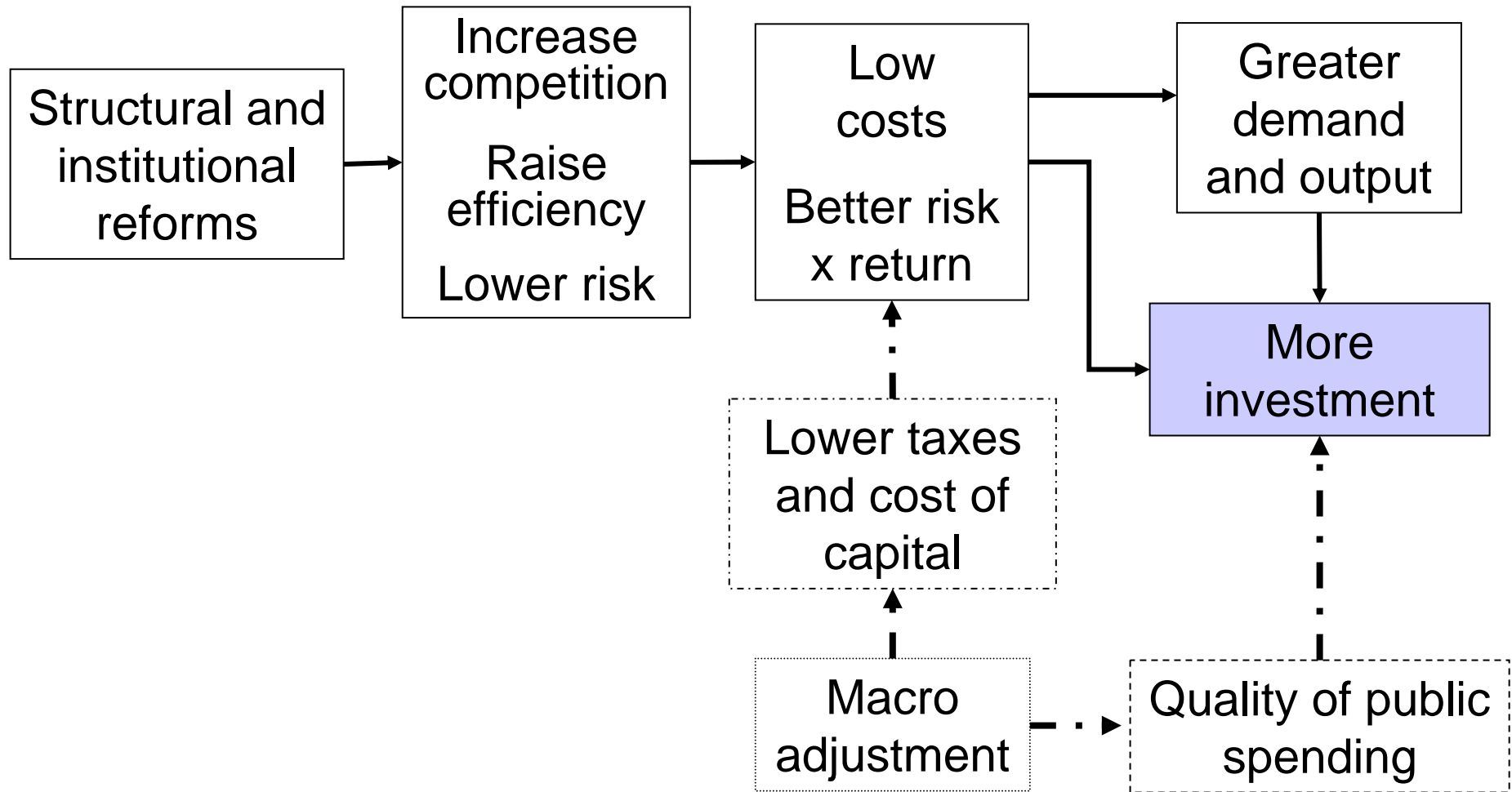


Table above shows TFP is in declining trend while Graph above show number unemployed tends to rise. At the same time, number employment creation in formal sectors dropped sharply

The 1990s reforms

- Explanations for growth deceleration
 - Political transition
 - Deep financial crisis
 - Returning back to protecting regime
 - Big bang decentralization
 - State's inability to invest in infrastructure due to fiscal constraint
- Goal:
 - Resume growth by attracting private investment and fostering TFP growth through increased competition, private ownership and constraints on policy discretion.

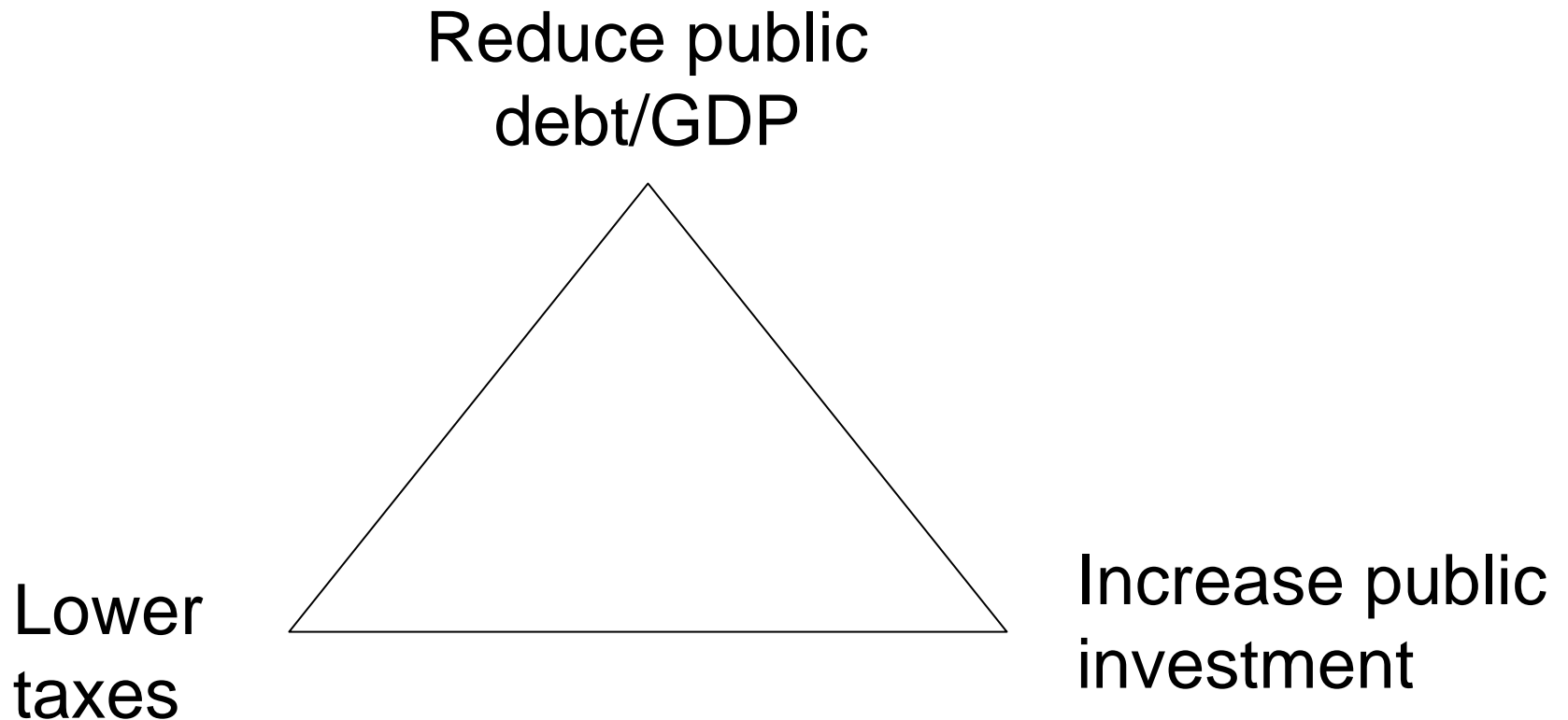
Improving investment climate



A reform agenda

- Fiscal policy trilema
- Trade liberalization
- Financial sector reform
- Informality: tax, labor and business regulation
- Jurisdictional risk

Fiscal policy trilema

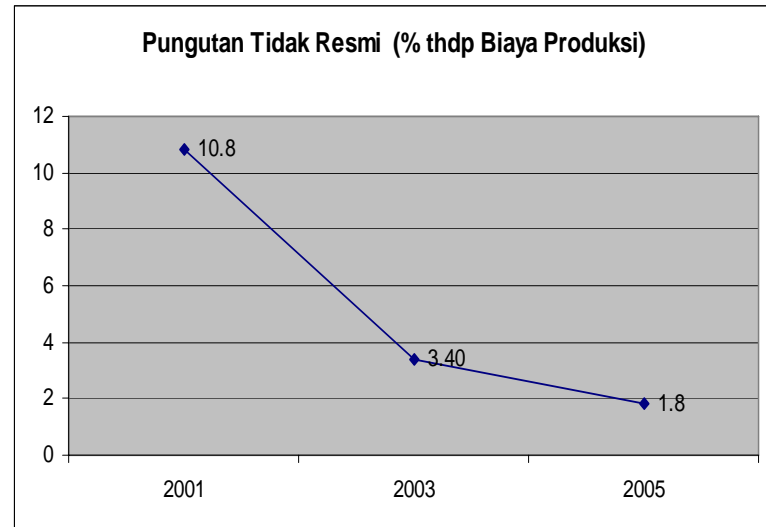


Fiscal reform

- Reduce public debt / GDP ratio:
 - Sustain a high primary surplus
 - Lower the cost of debt
- Restructure public spending to accommodate rise in public sector investment
- Reduce tax burden
 - Social security reform
- Develop a medium-term fiscal framework that lowers political risk
- Most of them have been achieved and further reforms are underway.

Monitoring Results from LPEM-WB Survey

- ❖ Two indicators of corruption dropped sharply.
- ❖ Bribes to government officials as share of production costs fell from 10.8% in 2001 to just 1.8% in the current survey (3.4% in the 2003 ICA).
- ❖ At the same time, percent of senior management time spent dealing with government officials dropped from 12.8% in the 2001 survey to just 4.9% berkurang.



Two possible explanations :

- 1. Improvement in anti-corruption efforts.*
- 2. A more competitive environment among regions to provide a better environment and efficient in public sector*

Monitoring Results from LPEM-WB Survey

- Number of days for setting up a business in Indonesia is about 80 days not 151 days as reported in Doing Business Survey 2006.
- But that survey found a huge variation faced the companies when dealing with BKPM.

Table 5
Average Days* to Establish a PT. Company

	Activities	Notary Survey LPEM (2005)	Law Firms Interview (World Bank 2005)	Institution/ Entity
1	Obtain clearance for the company name from the Ministry of Law (MoL); obtain the standard form of the company deed from MoL	2	7	Ministry of Law
2	Founders draw up the deed of establishment (articles of association) and sign it in front of a notary.	2	7	Notary
3	Obtain a certificate of domicile from the local municipality	4	10	Local sub-municipality office (kelurahan)
4	Obtain a taxpayer registration number (NPWP) and taxable entrepreneur identification number (NPPKP)	6	14	Local Tax Office
5	Open a bank account and deposit the initial issued capital in the name of the proposed company	4	4	Bank
6	Pay to the State Treasury the non-tax state revenue (PNBP) fees for legal services pursuant to the Decree of the Minister of Law No. M.OI-UM.01.06/1993	1	1	Ministry of Law
7	Arrange for the notary to apply for the publication of the articles of association of the company in the supplement to the State Gazette from the State Printing Press, get payment receipt	1	2	Notary office
8	Submit physical documents to the Ministry of Law	1	75	Ministry of Law
9	Issuance of the SK approving the deed of establishment by the Minister of Law	14		Ministry of Law
10	Register with the Company Register at the Local Trade Office and obtain the Company Registration Certificate (TDP)	9	15	Local Trade Office (Dinas Perdagangan)
11	Apply for the business trading license (Surat Izin Usaha Perdagangan or SIUP)	11	14	Local Trade Office (Dinas Perdagangan)
12	Register with Ministry of Manpower	1	1	Ministry of Manpower
13	Apply for workers social security (Jamsostek) program	1	1	PT. Jamsostek
Total Time in Working Days		57		
Total Time in Calendar Days		80	151	

*Notes: The notaries are answering in terms of working days, whereas the law firms are answering to in terms of calendar days

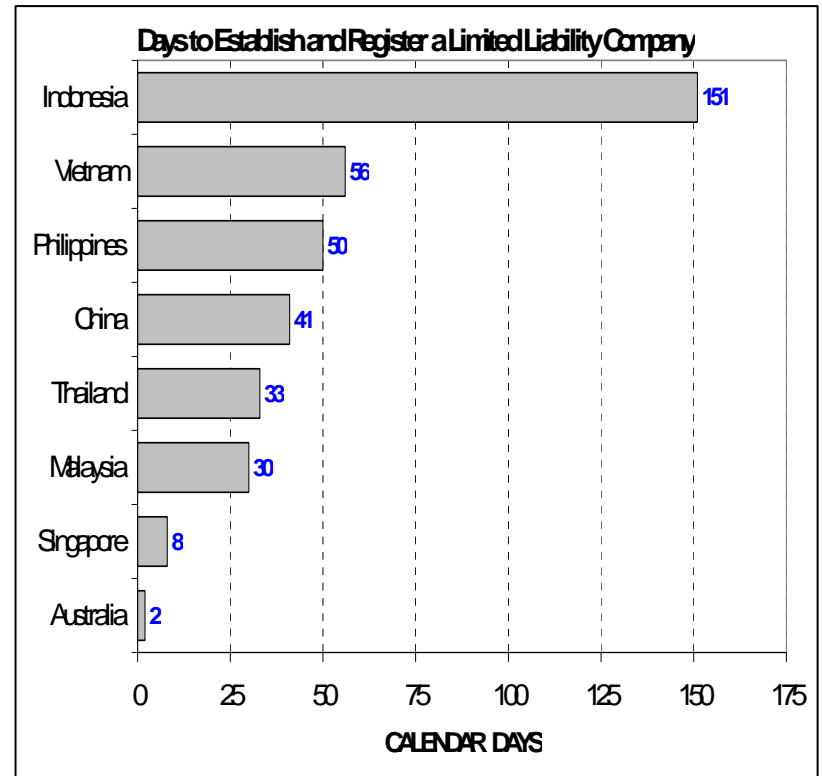
... but 80 days to start a business is still too long

Table 4

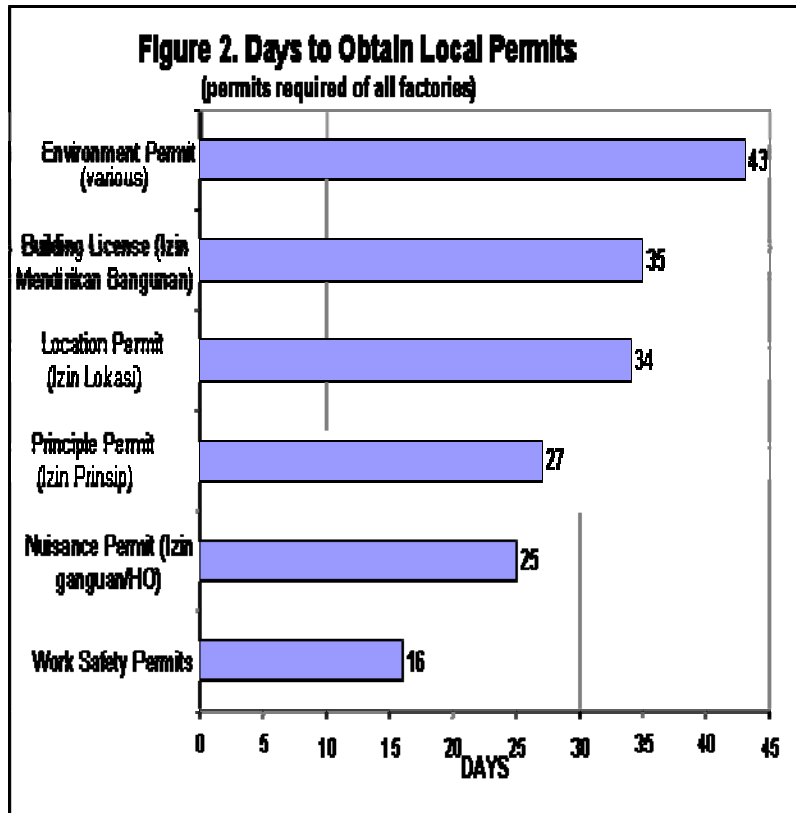
BKPM Approval Process: Time Required (Working Days) and Frequency of Not Acceptance Application (Times)

No	BKPM Approval Process	Average	Min	Max	Median
1	How much time to collect all of the information and documents required for first submission of an application to BKPM?	24 days	1 day	120 days	5 days
2	If first application is not accepted, how much time to gather any additional information or documents to satisfy BKPM?	12 days	1 day	60 days	5 days
3	How many times was the application not accepted by BKPM on the grounds that it was not complete and correct?	3 times	1 time	10 times	2 times
4	How much time to collect all of the information and documents required for final submission of an application to BKPM (documents accepted as complete and correct by BKPM)	24 days	2 days	60 days	16 days
5	How much time to issue the approval letter (SP) after documents accepted as complete and correct by BKPM	34 days	1 day	120 days	20 days
	Total Time required to have SP (Approval Letter of BKPM) = row 4 + row 5	58 days	3 days	180 days	36 days

Note: 1 week = 5 working days, 1 month = 20 working days



... new investment law is not enough



- to a certain sector, other regulations are required.
- Regulatory reforms can be done and needed in both central and local governments

Need to focus on micro sector reforms

- ❖ Regional Regulations are still problems and sources of policy uncertainties and distortions
- ❖ Tax administration problems: new draft of tax packages are far from satisfactory and tend to be counterproductive.
- ❖ Infrastructure: lack of supply and quality
- ❖ Time to start a business is very long and variance is large.
 - ❖ Small and medium businesses are the losers
- ❖ Tax refund still takes long time and in practices require “informal payment” to disburse it.
- ❖ Labor regulations become less flexible make entry and exit cost increased significantly.
- ❖ No clear vision over the future state owned enterprises
- ❖ SME Development action plan need to be elaborated further .

... survey results also reveal a lot of effort are needed to improve investment climate in all fronts

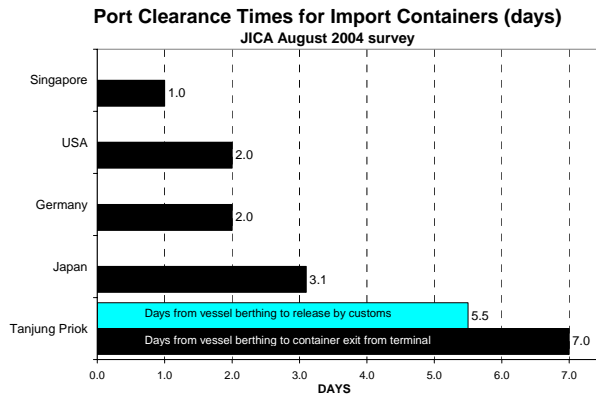


Table 16
Average Time to Obtain Utility Connection (in days)

Types of Utilities	2005 LPEM/WB Survey	2003 ICA Survey (WB/ADB)
Electricity (PLN)	24	15
Telephone (Telkom)	16	27
Water (PDAM)	17	13

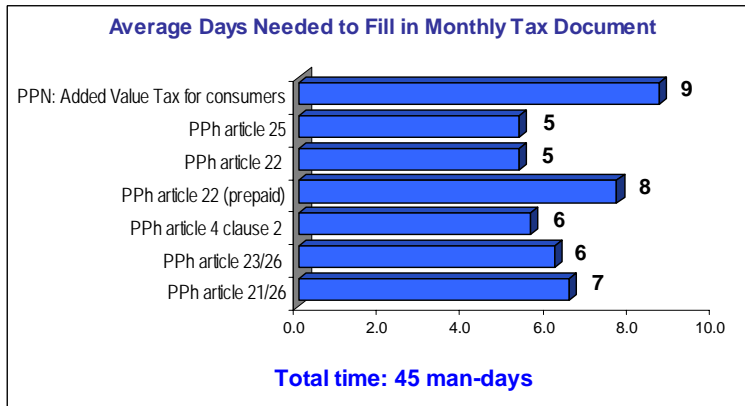


Table 11
Respondents Reporting VAT Return Negotiation and Extra Payments
According to Firm Size

Firm Size (workers)	Yes		No		N
<100	6	50.0%	6	50.0%	6
100 to <500	58	55.8%	46	44.2%	104
500 to 1000	23	60.5%	15	39.5%	38
>1000	30	57.7%	22	42.3%	52
All Firms	114	57.0%	86	43.0%	200

Action Program

A. Solving regional regulation problems

- ❖ Central government exercises the power to abolish contra productive local government regulation:
 - From 2001-Oct 05 : 469 Perdas have been cancelled and about 170 of them abolished between Okt 04-05
- ❖ Amendment Law No.34/2000:
 - Changing the concept from open list to closed list
 - Exercise General Allocation Fund as tool to impose discipline to regional government if :
 - They do not report new Perda to Central Government
 - Still exercise a Perda that has been cancelled by central government.
 - Implement a perda without central government approval.
- ❖ Improving Perda Monitoring System by Ministry of Finance and Ministry of Home Affair
- ❖ Propose new incentives for encouraging region

Launching a new packages of investment law and regulation

- Investment Law Objectives:

1. Increasing the quality and number of Investment
2. Reducing cost of doing business in Indonesia.

Several Highlights of the Investment Law Draft:

- Equal treatment for Domestic and Foreign Investors.
 - Simplifying Procedure for Registration & Licensing
 - Repositioning the role of Investment Board (BKPM) as an investment promotion and facilitation agency.
 - Clear and Transparent Negative List.
- Target of 30 days for setting up business in Indonesia can be achieved through other improvement in government regulation.
 - As part investment packages, GOI also will prepare serial packages of deregulation.

Fiscal Incentives: Tax and Custom

1. Tax Reduction:

- Company tax rate reduction from 30% to 28% in 2007. Beyond 2007 there would be a reduction of 1 % annually to achieve the new tax rate of 25% in 2010.
- Individual tax rate reduction from the maximum of 35% to 33 % in 2007 and achieved a new maximum tax rate of 30% in 2010.

2. Simplifying Procedures of Tax & Custom, and also Tax refund

3. Equal Treatment for tax payer and officer

4. Government will discuss further improvements on tax law draft with the parliament to meet business sector demand

Non-Fiscal Incentives

- Improving Coordination Mechanism for Export and Investment by empowering National Committee on Export Promotion and Investment (PEPI)
 - President SBY will chair PEPI
- Empowering Domestic Industries and SMEs.
 - Action plan for SMEs Development is on the final stages

Labor Market Reform

The Objective of Labor Market Reform: “To create more flexible labor market”

Major Focusses on Labor Market Reform:

1. Reduction on the cost of severance Payment.
2. More flexible when all sectors are allowed to employ contract workers, with extendable period of contract
3. Flexible rule for outsourcing
4. Minimum wage would be discussed between two parties involved and must not be determined by the government.
5. New draft on labor law is being prepared and now has been discussed at the inter-ministrial level.

Infrastructure

Empowerment of National Committee on Infrastructure (KPPI) by providing the Committee with an authority to make a decision on behalf of the technical departments-the decision is transparent and discussed by Ministers

Progress on Regulatory Reform, including:

- Government Regulations on Toll Road, Clean Water, Electricity and Land Consolidation.
- A Revision on Presidential Instruction 7/1998 (Public –Private Partnership on Infrastructure) including:
 1. More opportunity for public & private partnership on infrastructure investment.
 2. Flexibility in infrastructure project tenders, with good governance practices.

The work of Infrastructure Reform in progress:

- Tendering process is undergoing for seaport, airport and railway

Infrastructure Summit will be held in February 2006.

Conclusion

- Surveys shows some improvements in investment climates during the SBY-JK administration.
- But there are gaps between political will (for improvement in investment gap) and implementation.
- Need “hands in” policy to improve investment climate in both central government and local government.
 - Government transfer will be a good candidate for policy tool since about 70 % of local government revenues from General Transfer (DAU)