



**THE CRITICAL EVALUATION OF INVESTMENT LAWS  
AS A TOOL OF PROGRESS WITHIN ASEAN  
The case of Indonesia<sup>1</sup>**

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**INTRODUCTION**

This paper is an attempt to overview the investment law regime of Indonesia with a view to assessing its relevancy to the ever changing environment of business and politics in Indonesia. The issue being touched here is whether investment laws play the role of a tool of progress in the Indonesian context and to what extent it facilitates Indonesia's economic relationship with the rest of ASEAN countries under the aegis of regional economic cooperation that might lead to probable regional economic integration.

**CURRENT DEVELOPMENT IN BRIEF**

The parliamentary and presidential elections were just over and the euphoria of democracy has been evolving in the Indonesian society building up to a much higher expectation of the people towards better governing rules and regulations that affect their life. During the entire process of political campaign to win the votes of the people, the politicians and the presidential candidates have offered numerous promises of policy actions to give better services and enhance the fulfilment of people's rights of better living conditions and more reliance on mobilizing self-generating resources to meet economic and financial needs of the nation. This means that the management of the Indonesian economy will be more oriented towards enhancing and improving the self-reliance on own ability and capability in providing jobs and business creation efforts. Such new approach is imminent given the size of the country's market and the natural and human resources readily available to meet this macro goal. The cited constitutional premise for this new viable policy direction is provided by the 1945 Indonesian Constitution.

Despite the political promises to take new direction in the management of the Indonesian economy for the next five years, the presidential candidates barely touched on

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the very nature of the open market economy Indonesia is still applying. The Indonesian economy is still market driven and that the country's monetary system still works on the free foreign exchange regime. Both regulatory regime and macroeconomic policies have been in place for the open market economy to function in Indonesia. On the other hand, during the presidential political campaigns, the public at large has expressed their sentiment that the current management of the Indonesia economy should be geared towards more incentives to domestic economic players and the country's natural resources should be primarily managed by domestic economic players, including state owned enterprises with the sole utilization objectives to secure the benefit goes to the Indonesian people at large. However, the new administration under the President elect that is also an incumbent will likely continue managing the economy under the current direction.

The review of the Indonesian investment law is made against the above-mentioned background with a view to having a better understanding as to the future direction of investment policy to be adopted in future along the lines of the evolving new directions of the economic management of the country.

## **THE BRIEF ENCOUNTER ON INDONESIAN ECONOMY IN THE PAST FIVE YEARS**

### **Empirical Achievements<sup>3</sup>**

Indonesia has a market-based economy in which the government plays a significant role through its 139 state-owned enterprises and administering prices on several basic goods, including fuel, rice, and electricity. In the aftermath of the 1997-98 economic crises, Indonesia experienced a negative GDP growth of 13.1% and unemployment rose to 15-20%. To cope with this problem, the government took custody of a significant portion of private sector assets via debt restructuring, but subsequently sold most of these assets, averaging a 29% return. Indonesia has since recovered, albeit slower than some of its neighbours, by recapitalizing its banking sector, improving oversight of capital markets, and taking steps to stimulate growth and investment, particularly in infrastructure. GDP growth has steadily risen this decade, achieving real growth of 6.3% in 2007 and 6.1% growth in 2008. While the government has reduced its 2009 growth forecast to 4.2%-4.7% given reduced global demand, the consensus forecast is for growth of 3.5%. This means that the Indonesian economy is market driven and that the role of the government has been to provide policy direction and support facilities.

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<sup>3</sup> Some statistics presented in this section are derived from official publications of Bank Indonesia and Indonesian Statistics Office.



In reaction to global financial turmoil and economic slowdown in late 2008, the government moved quickly to improve liquidity, secure alternative financing to fund an expansionary budget and secure passage of a fiscal stimulus program worth more than \$6 billion. Key actions to stabilize financial markets included increasing the deposit insurance guarantee twenty fold, to IDR 2 billion (about U.S. \$174,000); reducing bank reserve requirements; and introducing new foreign exchange regulations requiring documentation for foreign exchange purchases exceeding U.S. \$100,000/month. As a G-20 member, Indonesia has taken an active role in the G-20 coordinated response to the global economic crisis.

The government's basic economic policy has been to implement a "pro-growth, pro-poor, pro-employment" economic program<sup>4</sup>. The Medium Term Plan has been focused on four broad objectives: creating a safe and peaceful Indonesia; creating a just and democratic Indonesia; creating a prosperous Indonesia; and establishing a stable macroeconomic framework for development<sup>5</sup>. The administration has met the targeted average growth of 6.6% from 2004 to 2008 to reduce unemployment and poverty significantly, thereby Indonesia's overall macroeconomic picture is stable. In 2008, domestic consumption continued to account for the largest portion of GDP, at 61%, followed by investment at 27.7%, government consumption at 8.4%, and net exports at 0.6%.

Following a significant run-up in global energy prices in 2007/2008, the Indonesian Government raised fuel prices by an average of 29% on May 24, 2008 in an effort to reduce its fuel subsidy burden. Fuel subsidies had been projected to reach Rp 265 trillion (\$29.4 billion) in 2008, or 5.9% of GDP. The fuel price hikes, along with rising food prices, led consumer price inflation to a peak of 12.1% in September 2008. To help its citizens cope with higher fuel and food prices, the Indonesian Government implemented a direct cash compensation package for low-income families through February 2009 and an extra range of benefits including an expanded subsidized rice program and additional subsidies aimed at increasing food production. Subsequent declines in oil and gas prices allowed the government to reduce the prices for subsidized diesel and gasoline. As of March 2009, gasoline was selling for market rates but was subject to a subsidized price cap in the event of an increase in prices.

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<sup>4</sup> President Yudhoyono Administration has focused on working on these policies that have shown good results during 2004-2009. The political agenda for the second term of his administration will continue implementing these policies.

<sup>5</sup> See BAPPENAS (the National Planning Agency of Indonesia), 2005



The above-mentioned achievements have been contributed by investments, domestic and foreign. Foreign direct investment (FDI) and short term capital market investment have contributed to the resiliency of the Indonesian economy in facing the last global economic crisis. The progress of realized investment from 1990 to February 2009 as reported by the Indonesian Investment Board support this statement<sup>6</sup>. In 1990 the realized foreign direct investment (FDI) magnitude was in the area of USD 706 million whereas in 2008, the figure has been tremendously increased to USD 14,871.4 million with 239 projects, while in January – February 2009, realized FDI has already reached 29 projects with the value of USD 1,970.9 million. The influx of capital to the Indonesian economy has contributed to the stable GDP growth as mentioned above and the investment multiplier effect has impacted Indonesia in all facets of people's life. It is therefore concluded beyond reasonable doubt that investments have indeed been playing the important role as tools of progress in Indonesia.

The future is now rest upon the new administration to capitalize these achievements and that the political promises of more say in particularly utilizing the natural resources in the hands of domestic and semi government players should be carefully adhered. The people at large have shown their inclination to review the very basic constitutional tenets of the Indonesian economy.

### **Trade Policy Objectives**

The above-mentioned achievements have been the results of consistent implementation of the Indonesian trade and investment policy objectives. Since the inception of the Indonesian economic regime that centers on market economy in early seventy, Indonesia's main general and sector-specific trade policy goals and priorities have been to improve its business climate and regional competitiveness; attract greater foreign and domestic investment, especially in infrastructure and export sectors; and generate high-quality job growth needed for sustained economic development. To this end, the authorities maintain that Indonesia should reassert itself in bilateral, regional, and multilateral trade forums and negotiations, with the aim of expanding international markets and supporting global efforts to liberalize trade while protecting Indonesia's economic interests and maximizing the potential benefits for national welfare. Along these lines, the Government continues pursuing a triple-track strategy of international trade negotiations, as neighboring

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<sup>6</sup> See Badan Koordinasi Penanaman Modal (BKPM), 2009, viewed at <http://www.bkpm.go.id>



countries have done. This comprises the multilateral track under the auspices of the WTO; the regional track, which focuses on ASEAN and ASEAN+1 regional agreements; as well as negotiation of a bilateral trade agreement with Japan. Indonesia is also studying the potential benefits and costs of a free-trade area with other potential partners. In pursuing this strategy, Indonesia is keen to ensure that the negotiations are consistent on all avenues and do not lead to agreements that are different in structure, commitments, rules of origin, and other aspects of rules and standards. Inconsistency would increase the cost of doing business and erode the benefits of the agreements. Indonesia therefore realizes that it needs to review its laws and regulations that affect the implementation of the open market policy under the aegis of international cooperation and arrangement. Streamlining foreign and domestic investment laws is therefore a necessity.

#### **The Investment Law 25/2007**

To further boost the Indonesian economy for the next decades, the Indonesian administration enacts the new Investment Law No. 25/2007. Under the aegis of market economy, the highlights of the new investment law are outlined below.

#### **Basic Policy Investment (Article 4):**

The Government decides basic policy investment with the objectives to stimulate direct investments in all economic sectors thereby improve the competitiveness of the national economy. In order to achieve this goal, the Government is responsible to (i) provide equal treatments to all investors, domestic and national in nature, (ii) secure legal and business certainty for investment from its inception, implementation down to its termination in accordance with the law. In so doing the government open the opportunities for micro & small business, medium size business and cooperatives to prosper and grow.

#### **Investment Entity (Article 5):**

Investment in general may take the form of personal undertaking and legal entity. However, foreign investment is mandated by the law to be in the form of a limited liability company with domicile in Indonesia. Should the investment be in the form of a limited liability company, both domestic and foreign investors must have shares in the company or buy the company shares.

#### **Assurances to investors given by the law (Articles 6 to 9):**

1. The law requires the government to provide equal treatment to both domestic and foreign investments. To this effect, the law repeals the Foreign Investment law (Law No 1/1967 and Law No. 11/1970) and Domestic Investment law (Law No.

6/1968 and Law No. 12/1970). It means no more distinction between the domestic investment and that of foreign investment. This treatment does not apply to a specific investment based on bilateral agreement between Indonesia and other foreign country;

2. The government shall not nationalize foreign investment, nor take over the investment except otherwise sanctioned by the law. Should the government nationalize or take over the investment, the investors must be given adequate compensation based on market price and should the government and the concerned investors do not reach any agreement, such agreement should be obtained through arbitration.
3. The investor may assign his assets to the other investor.
4. Foreign investors may repatriate and transfer all kinds of proceeds of his investment in foreign exchange. Such as capital investment, dividends, bank interest and other related earnings.
5. The government may apply rules and regulation for all transfer and repatriation activities such as taxes as appropriate, reporting requirements, as well as the protection of creditor and the state interest. To this effect, the government and by the sanction of the court may request that bank or other financial institution to hold the transfer if all the legal responsibility of the investor have not been met. The financial institution is mandated by the law to obey such request.

#### **Manpower and Industrial Relation Dispute Settlement (Article 10 & 11)**

The investor is required by the law to employ Indonesian manpower in its investment implementation with the exception of expertise that is not available in Indonesia. The investor is required by the law to gradually improve the competency of the Indonesian employee through training and technology transfer.

Should there be any dispute involving manpower such dispute must be settled amicably by consensus first by the investor and the employee. If amicable settlement could not be reached, the dispute is handled through the tripartite arrangement involving the investor, employee and work-force organization and the industrial relation court proceeding.

**Business Opportunity (Article 12)**

All kinds of business opportunity are open for investment, except those business declared closed by the government on the basis of public policy criteria. The government shall from time to time issue the conditions that qualify for public policy.

**Investor's Rights, Obligation and Responsibility (Article 14, 15, 16 and 17)**

The coverage of investor's rights include legal protection on his property rights, ease of obtaining information and other administrative services in relation to his investment business, and of obtaining facilities as mandated by the law.

On the other hand, the investor is obligated to: (i) exercise the principles of good corporate governance in running his investment business, (ii) comply with the corporate social responsibility, (iii) meet with investment reporting requirement, (iv) respect the local cultural tradition and values, and (v) abide by all rules and regulations of the country.

The investor is responsible for the sustainability of the investment to secure the going concern of the investment business as well as to abide by all pertinent rules and regulation in conducting his business investment. If the investment business is in the area of non renewable natural resources, the investor is required to set aside gradually certain funds to finance the environment reclamation and rehabilitation.

**Investment Facilities (Articles 18 through 24)**

The government provides certain facilities to investors for new investment, expanded investment, pioneering investment and investment that works in partnership with small business. For new investment, the facilities cover tax exemption for certain specified period, reduction in corporate income tax for certain specified period, exemption or reduction of import duties and levies for capital goods and raw materials. Additional tax facilities are given to (i) investment in remote and backward region of the country, (ii) investment for innovation and technology transfer, (iii) investment that requires massive manpower in significant numbers, (iv) investment in public infrastructure development, (vi) investment in partnership with small business.

In the area of land use and property rights, the law grants land cultivation titles of up to 95 years which is a significant improvement to the old 35 years. Building rights is now 80 years (used to be 30 years), and land use right is now 75 years instead of 25 years. The law requires however that the investment must meet certain conditions, i.e. long gestation period and greatly contributes to strengthening economic competitiveness.



The law explicitly offers easier immigration procedures for obtaining residence permits and multiple entry visas. For example, a two year residence permit will be automatically issued to foreign investors that may be upgraded to a permanent residence permit after four consecutive years of stay in Indonesia.

### **Better Administration (Articles 25 through 30)**

The law clearly states that the government, central and regional, is administratively responsible to provide investors with one stop licensing and service centre. It means the government must be serious about expediting investment licensing by continuously streamlining cumbersome procedures and reassess the merit of the permits needed to start up investment ventures. Better coordination among regulatory agencies in both central and regional government is required by the law. All kinds of regulatory regimes and policies in the regions must be streamlined with the requirement of the law. The authority on this matter rests upon the central government to oversight the implementation of the law.

### **Dispute Settlement**

The law provides the legal ground for the settlement of dispute between the government and the investors through arbitration if the amicable settlement could not be reached. The rules of conciliation are based on arbitration law. If the dispute arises between the government and the foreign investor, the dispute settlement is sought through international arbitration.

In a nutshell, the Investment Law 25/2007 covers 14 important areas that provide security, certainty and predictability of doing investment in Indonesia. These areas are briefly mentioned below:<sup>7</sup>

1. Freedom to Invest: investors enjoy freedom to invest in any sector of the economy except in small number of activities which are listed on “Negative List”, no restriction as to the size of the investment, the source of fund and the market of the products produced.
2. Simple company formation: Investors may choose any form of business entity as vehicle for their investment.
3. Taxes and duties: continue to assess tax and duties to facilitate investment by providing tax incentives on investment in certain sectors of the economy.

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Source: BKPM (The Indonesian Investment Coordinating Board) Investment Policy Statement, 2009.



4. Availability of Foreign Exchange: maintain the free foreign exchange regime in Indonesia monetary system.
5. Access to local funding: secure the easy access to local funding.
6. Labour Practices: facilitate the residency permits for expatriate personnel of the investors.
7. General infrastructure: the government strife to build the infrastructure as prerequisite to doing investment.
8. Availability of Land: Ensure that the land titles are given as per requirement of the investment life.
9. Encouragement of investment in SME business ventures: the government will continue simplifying regulatory and policy environment, removing obstacles to securing access to raw materials, removing tax related impediments and improving access to credit. Subcontracting and partnership arrangement between SMEs and big business enterprises are fully encouraged.
10. Investment Promotion: formation of public and private partnership in promoting and facilitating investment in Indonesia.
11. Investment Services: Establish one stop service system throughout Indonesia to facilitate investment.
12. Investment Protection: Indonesia joins Multilateral Investment Guarantee Agency (MIGA) and actively pursuing bilateral agreements with trading partner countries to secure the protection of investors' assets.
13. Double Taxation Relief: Avoid double taxation and prevent tax evasion through international treaties.
14. Arbitration: Facilitate the appropriate forum for settling disputes.

### **ASEAN CONCOURSE**

Having the largest economy, population and territory by significant margins within ASEAN, Indonesia has been instrumental in formulating and implementing the ASEAN Framework Agreement on enhancing economic cooperation, signed in 1992. This Agreement established the Common Effective Preferential Tariff (CEPT)<sup>8</sup> Scheme, which aimed to achieve an ASEAN Free Trade Area (AFTA). Tariff reduction/elimination under

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<sup>8</sup> Under the CEPT it was agreed that tariffs on goods subject to tariff reductions would be reduced to 0-5% by 2002 for the founding members plus Brunei (ASEAN-6), by 2006 for Viet Nam, by 2008 for Laos and Myanmar, and by 2010 for Cambodia.



the AFTA is granted on a reciprocal basis and local-content requirements apply.<sup>9</sup> The process of reducing tariffs, which began in 1993, is almost complete.<sup>10</sup>

ASEAN is also working to remove non-tariff barriers to intra-ASEAN trade; harmonize customs nomenclature, valuation and procedures; harmonize product standards and regulatory requirements; and improve rules of origin under the CEPT. With regard to the work programme on the elimination of non-tariff barriers by 1 January 2008 (First Package), 1 January 2009 (Second Package) and 1 January 2010 (Third Package), the authorities state that Indonesia has submitted updates on its NTM list together with the relevant supporting legislation. Indonesia will harmonize its customs nomenclature under the HS 2007 by 1 January 2007. As to the rules of origin under the CEPT, ASEAN is focussing on finalizing the Product Specific Rules (PSRs) for products under the Priority Integration Sectors (PIS) and the text of CEPT-ROO and its Operational Certificate Procedures (OCP). From these policy actions, Indonesia has been consistent in adjusting its economic and trading policies to the content of ASEAN agreements.

In the area of services, the ASEAN Framework Agreement on Services, signed in 1995, provides guidance for services liberalization over and above WTO commitments, and promotes cooperation among service suppliers in ASEAN. To date, ASEAN has completed several packages of services liberalization covering construction, telecommunications, business services, financial services, air and maritime transport, and tourism. This involves preferential access for other ASEAN member states in the establishment of services entities and employment of professionals. Under the priority integration approach, tourism, healthcare, and air travel are scheduled to be liberalized by 2010. ASEAN countries are currently working on expanding negotiations to cover all sectors and all modes of supply.

All those agreements require investments. The ASEAN Investment Area Agreement, signed in 1998, is aimed at facilitating the free flow of direct investment, technology, and skilled professionals. The agreement covers manufacturing, agriculture, fisheries, forestry, and mining as well as services activities related to these sectors. The agreement is also aimed at increasing intra-ASEAN investment and FDI, promoting the

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<sup>9</sup> A product is eligible for a tariff concession if at least 40% of its content originates from any ASEAN member state; the 40% local content refers to both single and cumulative content.

<sup>10</sup> ASEAN-6 members have fully complied, by including 98.9% of the products into the CEPT, of which 99.6% at a rate between 0-5percent. Indonesia has reduced tariffs on 11,034 tariff lines to 5% or less for products of ASEAN origin. Under the terms of AFTA, Indonesia applies three lower tiers, of 0%, 2.5% and 5%, for all goods imports from ASEAN members that meet the AFTA rules of origin requirements. According to the authorities, Indonesia does not have any products in the temporary exclusion list.



economic integration of ASEAN, and jointly promoting ASEAN as an attractive region for FDI.

ASEAN is also seeking to enhance regional economic integration through the establishment of the ASEAN Economic Community (AEC) – a single market providing for the free flow of goods, services, skilled labour and capital – by 2020. Member countries have identified 11 priority sectors: agri-based products; air travel; automotive products; electronics; fisheries; healthcare; rubber-based products; information/communications technology sector (products and services) related to e-commerce; textiles and apparel; tourism; and wood-based products. In 2004, they signed a Framework Agreement for the Integration of Priority Sectors to accelerate their integration across members. In 2003, the priority sectors accounted for more than 50% of intra-ASEAN trade.

ASEAN countries share common trait, which is market driven economy. All countries' resources are being utilized following the principles of open market economy and that the respective government economic policy is geared towards facilitating the private sector market to work in an efficient and productive manner. Almost all countries except Singapore have similar export products, where the degree of each country's economic resiliency rests upon its human and natural resources. Joint efforts to better equip themselves on advanced technology and to mobilize all resources at hands will be a primary uniting factor for realizing an economic integration in the region. There are ample opportunities for the ASEAN governments to establish common economic platform that may be enforced to be the basis for future economic integration such as that of Europe.

To this effect, ASEAN Law Association may contribute the works for building commonality of investment laws in ASEAN. Hence, investment laws become the tool of progress for the region. All ASEAN countries should now focus on further harmonizing their respective laws including relevant regulatory regimes of investment in order that all pertinent regional agreements on a number of economic cooperation as described previously be smooth sailing in their implementation.

## **CONCLUSION AND RECOMMENDATION**

Law number 25/2007 is a clear effort to streamline Indonesia's regulatory regimes with the rest of the world under the aegis of the World Trade Organization (WTO). Being member of WTO, Indonesia is mandated to be part of the world's system. This law is seen as the catalyst for the Indonesian economy to be part of the world's economy. Since Indonesia adopts the system of a market driven economy whereby the intervention of the government is limited to public policy domain, it remains to be seen whether the course to



be taken in the Investment Law 25/2007 is consistent with the principles of market economy. Some elements in the Indonesian society consider law 25/2007 as too liberal if not a ticket to sell out Indonesia to foreigners. This sentiment is definitely wrong and it is the duties of the government and the investors *per se* to prove that Indonesia is the beneficiary of the investment benefits produced by the effective and efficient interactions of investors in the level-playing field of the market economy. Indonesia is part of the global economy. The investment paradigm for the future is to balance economic openness to the rest of the world with the interest of the Indonesian people for better living condition. The Indonesian Investment Law is an effort to provide legal certainty and predictability for both domestic and foreign investment to play their roles in the Indonesian economy through open and just market mechanism. It now rests upon Indonesia and its business players to meet the challenges and the new administration should reposition itself towards more active role of a facilitator and regulator to safeguard the economic interest of the people at large.

Within ASEAN, Indonesia will continue play the leadership role given the size of its economy, territory and population. Following the principles of market economy adopted by all member countries, ASEAN must joint force in establishing the supporting laws and regulatory regimes in different areas of economic activities that provide legal certainty and predictability for the efficient and productive business undertaking to function.

The ALA National Committee of Indonesia opines that it is now timely for ALA to decide on undertaking the initiative to lay ground for further harmonization of investment laws and the related investment regulatory regimes within ASEAN. The ALA National Committee of Indonesia proposes the following action programs to be adopted and subsequently implements:

1. The first step is be to establish a working group to study all regional economic agreements and cooperation in order to determine basic rules that provide legal ground for such activities.
2. The second step is to compile and study all ASEAN member countries' investment laws and their relevant regulatory regimes with the objective to establish common traits of investment laws and regimes for further harmonization.
3. The third step is to formulate new and comprehensive investment law model for ASEAN.

