

Indonesia: An Overview of the Legal Framework for Foreign Direct Investment

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Abstract

Law Number 1 of 1967, on Foreign Investment law (FIL), formally established the legal framework for Foreign Direct Investment (FDI) in Indonesia, and was the first following independence in 1945. The FIL is primarily patterned — amongst other things — to pursue the transformation of potential economic resources into real economic strength and to attract capital, expertise and technological inflow. Today, in modern Indonesia, several laws/regulations have been promulgated and implemented to augment the ambitious drive to attract FDI. However, the legal framework for FDI and the administration of justice are perceived as weak and inadequate; moreover, the Asian financial crisis (June 1997) heightened this concern. Since then, investor confidence has eroded significantly and substantial exodus of existing foreign investments was registered in 1998/99. The Government of Indonesia (GOI) has responded by reorienting its FDI legislative policies and initiating reforms in its legal system. To restore investor confidence, the need to put in place a clear and coherent FDI legal framework, underpinned by a transparent and an independent judiciary, is crucial now more than ever before. This paper examines the legal aspects of FDI in Indonesia and, within that context, the emerging legislative policy trends.

I. Background

The availability of vast, highly diversified natural resources, a huge potential domestic market, a competitive and productive labour force, and a market-oriented economic policy, amongst other factors, have attracted Foreign Direct Investment (FDI)¹ inflows to Indonesia. In the 1960s and 1970s, FDI in Indonesia was concentrated in the petroleum sector² (oil and natural gas); however, in the 1980s and 1990s — via a combination of deregulation, market liberalisation and a series of fiscal incentives — FDI was enticed into other sectors of the economy. Since then, the Government of Indonesia's (GOI) main economic policy has been to foster FDI in the broad-based manufacturing sector and to invigorate an export-oriented and diversified economy.

In the early 1990s, Indonesia enjoyed a spectacular economic growth rate of an average of 8%. Between 1967/68 to April 1996, accumulated approved FDI reached US\$154.1billion.³ Unfortunately, the high rate of economic growth was not sustained. The onset of the Asian financial crisis (December 1997) highlighted serious flaws in Indonesia's financial sector, public institutions, and corporate governance, amongst others. Consequently, the national economy weakened — and FDI, trade, and finance withered. Foreign entities divested a

cumulative amount of US\$356million and US\$3,270million in 1998 and 1999, respectively (UNCTAD 2000: 286).

Arguably, the Asian financial crisis indeed rekindled the fundamental aspects and importance of ‘good governance’ and ‘rule of law’. It has also staged the era for *Reformasi* (reform) and *Indonesia Baru* (New Indonesia), which now poses new challenges and opportunities. Since 1998, the GOI has adopted various means to attract FDI — including the streamlining of licensing procedures, granting generous incentives, and removing or minimizing existing impediments to FDI. In today’s investment climate in Indonesia, foreign investors are seeking a more transparent legal system with modern commercial laws/regulations, rule-based commercial transactions, and an efficient and independent judiciary.

Many queries remain. How will the recent Law on Regional Government⁴ No. 22/1999 (Regional Autonomy Law — RAL) and the Law on Fiscal Balance Law⁵ No. 25/1999 (Fiscal Balance Law — FBL) affect the existing foreign entities? Also, what are its implications for foreign entities in contemplation of investing in Indonesia? What are the fiscal implications? Will the ‘legal sanctity’ in the existing investment contracts, executed by the central GOI, be valid and enforceable? This paper will attempt to find the answers. In doing so, it further surveys the existing FDI-legal framework (it is not the intention of the writer to analyze in detail the substantive and procedural laws related to the same).

The paper is organised as follows: Section II describes the legal system of Indonesia; this is followed by Section III, which briefly discusses the role of law in economic development. Section IV then examines the various legal aspects of FDI in Indonesia, before Section V concludes the paper.

II. The Legal System of Indonesia

In order to fully understand the underlying legal processes and the policies from which they derive, it is necessary to attain some familiarity with the overarching legal system of Indonesia. This section seeks to provide this background by outlining several salient aspects that pertain to the legal structure, including its historical basis, the Constitution, as well as fundamental laws and institutions.

Legal History

Historically, given the various ethnic, social, religious and cultural groups existing in the Indonesian archipelago, laws were administered predominantly along the path of *adat law*⁶ (customary law) and *syariah law* (Islamic law). The Dutch colonization, beginning in the late

16th century, introduced the civil law system to Indonesia and a ‘pluralistic legal system’, whereby laws were administered along population groups. In essence, the natives were governed by the prevailing *adat law* and *syariah law* (Islamic law), and correspondingly the Europeans and foreign Orientals were governed by Dutch law.

Independence

Following independence, the colonial laws inherited from the Dutch remained. To date, Indonesia by and large embraces a pluralistic legal system, as opposed to a uniform legal system. The main sources of the law include *adat law*, *syariah law*, and Dutch colonial law and statutes. Certain aspects of private law have achieved uniformity and it is foreseeable that, with the on-going globalisation trend and Indonesia positioning itself more visibly on the international commercial platform, this would be an emerging legislative trend. Presently, the following laws have been uniformalized — Land law (Basic Agrarian Law 1960), Company law (Limited Liability Law 1995 No. 1), and Labour law.

By virtue of Section II of the Transitional Provisions of the Constitution 1945 (*Undang Undang Dasar 1945*), all existing laws/regulations at the time of independence (1945) are to remain valid and applicable — unless and until they are replaced constitutionally by statutory enactment.⁷ Most importantly, the colonial laws must at all times meet the requirement of a prevailing ‘statutory proviso’ — Government Regulation No. 2 (10 October 1945) — which stipulates that pre-independence laws/regulations are only valid insofar as they do not contradict the spirit of the Constitution.

Constitution: the Pancasila Republic

The Indonesia Constitution (*Undang Undang Dasar 1945*, UUD 45),⁸ being the ‘supreme law’, enshrines the *Pancasila* ideology — or the basic state philosophy, which embraces five basic principles:

Every Indonesian citizen should: believe in the existence of God the Almighty; strive to achieve a just and civilised humanity; maintain Indonesian unity; adhere to democracy which is guided by inspirational wisdom in consultation and representation; and strive to achieve social justice for all the people of Indonesia.

Theoretically all laws emanate from *Pancasila* principles and similarly all aspects of society — politics, economics and social ordering — are premised on the same. Authors such as Himawan (1997), Lindsey (1999), and Goodpaster (1999) argue that, paradoxically, the *Pancasila* principles are mere rhetoric emphases and were manipulated by the executive

(former President, Sukarno and Soeharto) in order to empower themselves and to subjugate the judiciary under their control.

Laws and Institutions

The People's Consultative Assembly (*Majelis Permusyawarata Rakyat*, or MPR) — whose foundation rests on the *Pancasila* principle: “adhering to democracy which is guided by inspirational wisdom in consultation and representation” — is the highest political and consultative assembly, and is also the custodian of the constitution. The House of Representatives (*Dewan Perwakilan Rakyat*, or DPR), promulgates the primary laws (*Undang-Undang*) and (in theory) supervises the actions of the President. The laws promulgated by the DPR tend to be concise and thus are supplemented by the executives' (president and ministers) promulgation of further implementing regulations (secondary legislation) via government regulations, presidential decrees/instructions, and ministerial decisions.⁹ The laws promulgated by the MPR are the highest laws, followed by DPR laws, secondary legislation, and judicial case law. However, due to the inherent ‘civil law system’ in Indonesia, judicial case law is merely ‘persuasive’, as opposed to binding. UUD 45 empowers the president, as head of the executive, with a myriad of responsibilities and powers.¹⁰ In this respect, the President, amongst other things: may promulgate law, together with parliament (Article 5); is the supreme commander of the armed forces (Article 10); may declare martial law (Article 12); may pardon criminals and political convicts (Article 14); and shall appoint ambassadors, consuls and ministers (Article 13 and 17).

The Dutch civil code (*Burgerlijk Wetboek, Kitab Undang Undang Hukum Perdata*) and commercial code (*Wetboek van Koophandel, Kitab Undang Undang Hukum Dagang*) of 1848 are the main governing commercial laws applicable to foreign entities.¹¹ Furthermore, government sources indicate that 400 pieces of colonial law remain applicable, to-date.¹² It is important to keep in mind that substantial aspects of the civil and commercial codes, as well as several other colonial laws, are yet to be amended, modified or repealed to keep pace with and augment modern business dynamics. Hence, to date the inherited Dutch colonial law remains largely outdated and obscure.

By virtue of Government Regulation No. 2 of 1945 (as indicated earlier), the Courts of Indonesia have had shown instances of repealing colonial laws that are seen as unconstitutional (see Gautama 1995: 18-24). However, would outdated and obscure laws not infringe upon the spirit of the UDD 45? Gautama (1995: 26) thus advocates ‘judicial activism’ in reforming the current substantive laws:

This function of the Courts in their case by case decisions are, in my opinion, far more important in the process of law reform, than what has been achieved through the issuance of new regulations by the legislature.

In concert, the Chief Justice of Canada, the Honourable Beverley McLachlin (2000: 330), emphatically endorses:

As we enter the twenty-first century, we are embracing a new conception of democracy, one that does not exclude judicial action, but includes it. The fact is incontrovertible; we can only achieve a free and democratic society through the aegis of a strong legislative power combined with a strong independent judiciary.

The civil courts are structured in a three-tier formation: District Courts; High Courts; and the Supreme Court — a fairly simple structure for the world's fourth most populous country! The District Courts are the courts of first instance, and hearing is presided by three judges, with appeals hereof proceeding to the High Courts (which do not possess original jurisdiction). The Supreme Court is the final Court of Appeal and has original and exclusive jurisdiction over all civil and criminal matters.

Of late, spurred by the onset of the financial crisis, the administration of justice has come under severe criticism. Politicization, inefficiencies, corruption, collusion, and the lack of independence thwart the workings of the judiciary (discussed below). *Business Asia* (18 September 2000), reported:

In an Asia-wide survey of expatriate businessmen conducted by the Political and Economic Risk Consultancy (PERC), Indonesia's legal system was rated Asia's worst, with systemic weakness and corruption cited as the main reasons. Court rulings are routinely sold to the highest bidders and there is evidence of bias against foreign companies in dispute with local actors...notably, among career judge nominees most failed the screening on grounds of 'moral integrity', with their views of how best to deal with thank you gifts from grateful parties following favorable verdicts proving to be a particular stumbling block.

III. Role of Law and Legal Institutions in Economic Development

Perception of law and legal institutions

‘Rule of law’ and ‘law based behaviour’ are alienated concepts in Indonesia, or at least this has been the case during the Sukarno (1945-67) and Soeharto (1967-98) regimes. During the Sukarno (guided democracy) era, the development of law was basically suppressed. As Lindsey (1999: 13) observes:

The legislative process was effectively replaced by executive instruction and legal legitimacy lay in ideology as defined by the President rather than in written statute or a formal jurisprudence. This, combined with executive intervention in the judicial process and a culture of contempt for the rule of law, led to widespread legal uncertainty and the collapse of the legal process.

Similarly, Soeharto’s (New Order) regime, although seen to be advocating *Negara Hukum* (rule of law) outwardly, continued with the anti-legalism stance, whereby the judiciary was basically politicized (Fitzpatrick 1999: 75). In essence, it was not the norm to apply the law to engineer social and economic ordering. In this context, the Courts in Indonesia, to date, have neglected and/or failed to cultivate a ‘jurisprudence culture’. If this is the case, how then did Indonesia — prior to the economic setback resulting from the onset of Asian financial crisis — achieve such an impressive economic growth in trade, investment, finance, and production? To this Goodpaster (1999: 22- 23) asserts:

Indonesia created its phenomenal success without the use of rule of law (at least in the complete western sense of that term). It succeeded through political centralisation aimed at the integration and stability of an extremely heterogeneous, potentially fractious state, and through economic liberalisation aimed at economic growth. Political control, and patronage (which included corruption and bribery) as a method of governance, kept the country together while moving it forward; and economic growth provided the real benefits essential to maintaining citizens’ allegiance... [r]ule of persons and authority, patronage as a method of securing loyalty and control and tight control of interest groups and potentially competing power centers — not rule of law — have been normative in Indonesia. The system is a patrimonial system of vertically structured patron-client relationships.... After a certain point, however, patronage and control of intermediate groups create a seriously distorted incentive structure; and lead to major economic inefficiencies by creating a political market for income shifting and redistribution services or excess rent seeking.... The sense now, however, is that the existing method of governance has run its course and is not as successful as it once was, and that Indonesia now needs to turn to new methods of governance.

Further, he surmises (30):

Presently, most foreign investment has fled Indonesia. While it was there, however, there were important, unanswered questions as to how much foreign investment, and what sectors, Indonesia lost because of its legal, judicial and other decision-making systems. Now I suppose the appropriate question is: what specific changes in Indonesia’s legal, judicial and administrative decision-making systems are necessary to help restore foreign investor confidence?

Whether the present era of *reformasi* will change or abide by the former worrisome trend (Soeharto regime) remains to be seen.

Importance of law and rule based transaction

Increasingly, empirical evidence proves that efficient law and legal institutions promote and sustain economic activities.¹³ To this end, both create an ascertainable ‘structure of expectations’. Certainly the law does not eradicate all eventualities and/or uncertainties, but it substantially reduces business risks. What is the purpose of the law in the context of economic development? First, the law conceptualizes and underpins the rights, obligations and liabilities of all business parties. Second, business parties are able to pursue their commercial transactions with a reasonable degree of certainty and predictability. Third, the law provides legal recourse and due process. Fourth — and most importantly — it promotes and sustains business confidence. Conversely, an inefficient legal system would, amongst other things, increase transactions costs and in the long term reduce private accumulation and investment. North (1990: 67/68) observes:

When we compare the cost of transacting in a third world country with that in advanced industrial economy, the costs per exchange in the former are much greater — sometimes no exchange occurs because costs are high. The institutional structure in the third world lacks the formal structure (and enforcement) that underpins efficient markets... the institutional framework plays a major role in the performance of an economy... it is critical key to the relative success of economies, both cross-sectionally as well as through time.

It can be argued that Indonesia, in the 21st century, would be compelled to embrace the application of rule of law and rule-based commercial transactions. This is for several reasons. First, the Asian crisis highlighted the pervasiveness of ill practices such as corruption, collusion and nepotism (KKN), especially at the governmental level, as well as the dire lack of accountability and transparency in the conduct of affairs. There are now strong calls from the people of Indonesia and the international community urging the GOI to democratize and embrace good governance — consequently, this would entail policies being articulated by enforceable written laws. Second, the patronage system that was tacitly used by the then-President Soeharto has run its course. Investors may henceforth not be able to enlist ‘informal protection’ from the ruling élites. Legal certainty is therefore the only protection. Third, in the advent of globalization — and as Indonesia engages and commits itself to regional and international frameworks (WTO, ASEAN, and APEC) (all of which to a greater or lesser extent incorporate rule-based behaviour) — the influence of law will be unavoidable, if not inevitable.

Recent developments

In all fairness, there are presently some aspects of the legal system that have been reformed or are in the process of reformation. To this end, the Law on the Judiciary (No. 35 of 1999) now empowers the Supreme Court to carry out the various administrative and regulatory functions that were previously undertaken by the now (renamed) Ministry of Law and Legislation. New, substantive laws, such as the bankruptcy law, intellectual property law and the arbitration law, have been enacted. Efforts have also been made to appoint or replace Supreme Court judges based on the criteria of meritocracy. It is envisaged that the new laws on governance (UU No. 28/1999 and No. 31/1999) — designed to combat corruption, collusion and nepotism — would deter and eliminate the said ill practices.

However, such reformatory works are not entirely satisfactory. For example, the application of the new Bankruptcy law is worrisome. Indeed, the former Attorney-General, Marzuki Darusman, commented that the “[j]udicial system is an embarrassment — the recent decisions rendered on bankruptcy, corruption and administrative malfeasance cases have been heavily criticized”. Further, Pompe (1999: 73) has cautioned that “[t]here is a pervasive sense in Indonesia that the judiciary has grossly failed to, let alone support, the political changes initiated by Reformasi”.

I would surmise that, given the existence of a weak legal system in Indonesia for the past three decades — wherein the law and judiciary were considered to be either a threat or insignificant — the success of the reformation of laws and legal institutions would, at best, be incremental and, at worst, be fragmented or even completely fail to materialize.

IV. Legal Aspects of FDI

Legislative Policy

In principle, FDI concerns two sets of legal issues: on one hand, those relating to undertaking the investment in the first place, and on the other, those relating to the investment once it is made. How does Indonesia address these two concerns? The legislative policies addressing FDI are enshrined in Law Number 1 of 1967 on Foreign Investment (as amended by Law Number 11 of 1970) (FIL) (see Annex I).

The main body of the FIL consists of 31 articles — essentially, it propounds the GOI’s legislative policies towards the following: licensing; general incentives; sectors closed or restricted for FDI; domicile of foreign entities; manpower; fiscal concessions; use of land; capital transaction and repatriation; investment duration; nationalisation and compensation.¹⁴ In addition to the FIL, foreign entities are subject to sectoral policies, applied by the corresponding ministries — such as that stipulated in Law No. 5/1984 on industry, Law No.

5/1967 on forestry, and Law No. 12/1992 on agriculture. Notably, the FIL attempts to balance the development goals as well as national identity of Indonesia with the aspirations, business strategies, and needs of foreign entities.

Although Indonesia's economic policy is to be receptive towards FDI, its view is that FDI should not to be overly relied upon; as such, the long term goal is to achieve self reliance and be a global player in its own right.¹⁵ Thus, FDI is accorded a supplementary or complementary role to fill the demographic investment scarcity, with the hope that it will not be permanent. It is important to appreciate and understand this stance taken by the GOI, as it accounts for the existence and shaping of the future legal framework for FDI. As Gautama (1997) puts it, "FDI should be looked at as a complementary means for the acceleration of the country's economic development".

What is the GOI's present stance towards FDI, particularly in the aftermath of the financial crisis? President Megawati Sukarnoputri, upon assuming office, has firmly endorsed the importance of FDI for Indonesia's overall economic development. There is a clear recognition from the GOI that FDI is crucial in order to usher in the much needed capital, technology and skills to invigorate the 'slumbering' economy. To this end: the investment approval procedure has been streamlined, the negative list revised, a privatization programme initiated, and incentives enhanced. At first glance, the vast commercial opportunities available in privatizing the various state-owned enterprises (SOEs) appear overwhelming. However, since the initial inception of the 'masterplan for the reform of SOEs' (1998), nothing positive has been developed. In fact, there are constantly mixed signals coming from the GOI. Difficulties in ascertaining the valuation of the SOEs, nationalistic sentiments, and the dilemma in attracting buyers in an uncertain political and economic environment seemed to have dampened the transition.

On or about December 2001, the State Minister, Laksamana Sukardi, reiterated that one-fifth of the GOI's stakes in SOEs would be divested in due course (*Straits Times*, 15/12/2001). From the legal perspective, a macro-legal environment conducive to private participation is intrinsic for successful divestiture. It is extremely crucial that the laws are set right in order to translate policy into action. Divestiture is nothing else than the transfer of property or ownership from one person to another. In this context, property law is of the utmost importance. Property rights cover a range of legal rights over assets, including the right to use the concerned assets and to dispose them through sale or other means. Proper sequencing of regulatory reforms is thus highly crucial. In order to determine the price that they are willing to pay, investors need to know what regulatory regime the company will be

operating. Clear laws/regulations and supporting institutions must be put in place to establish a 'level playing field'.

In a broader context (as noted earlier), as of recent, new substantive laws have been promulgated (bankruptcy law and intellectual property law), and the judiciary itself is slated for reformation. Would all these measures restore investor confidence? It might, if the said changes and reforms are clearly defined and undertaken systematically, decisively and consistently. These must furthermore be underpinned by transparency and accountability. However, observers reckon that if the prevailing social and economic uncertainties continue for too long, in all likelihood foreign investors will ultimately stay away from Indonesia (*Jakarta Post*, 22/11/2000; *The Economist*, 29/7/2000; *The Straits Times*, 30/1/2001).

Licensing procedure

In a similar way to most developing countries, the GOI fosters and controls FDI through licensing. The Investment Coordinating Board (*Badan Koordinasi Peranaman Modal* or BKPM),¹⁶ established in 1973 (Presidential Decree No. 20/1973), is the government institution that administers the FIL. It is a central body that screens investment applications, grants licenses/permits, and offers incentives. In addition, similar regional investment bodies (BKPMMD) co-exist in the respective provinces and is headed by a chairman, who is subordinate and responsible to the provincial governor (see Annex II).

The BKPM is the first 'port of call' for all foreign investors contemplating investments in the permissible investment sectors — with the exception of petroleum (oil and natural gas)/general mining and forestry, whereby the Ministry of Mines and Energy and the Ministry of Forestry, respectively, process the initial application approvals and thereafter the BKPM supervises the implementation and production stages. Furthermore, the Ministry of Finance handles and regulates all foreign investments in the financial sector. Generally, all aspects of financial activities — including banking, insurance, leasing, consumer credits, factoring, money brokering, and venture capital — are open to foreign participation, but in consortium with local participants.

At the time of writing, it should be noted that the licensing application procedure has been substantially simplified and streamlined.¹⁷ This was done in line with the GOI's initiative to minimize/eradicate bureaucratic high handedness and red tape (see Annex III). From an investor viewpoint, simplifying and streamlining the FDI application procedure would enhance transparency and substantially reduce or eliminate transactions costs. However, with the Regional Autonomy Law (RAL) now in force, it seems like the 'BKPM/BKPMMD framework' may not be applicable and this casts a long shadow on its legal standing (as discussed below).

Essentially, the RAL empowers the regencies and municipalities, amongst other things, to administer governance of ‘capital investments’ within their respective regions.

At the time of writing, a corresponding BKPM-type framework has yet to be established in the regencies and municipalities, if any. The BKPM is a ‘statutory creature’ of the central government — how, then, would it be conceptualised and functional in the level II regions (districts and municipalities)? It is discernable that a BKMP-type framework established in all the respective districts and municipalities would be an extremely costly matter and would be administratively and logistically mind-boggling. Understandably, this legal dichotomy is causing much concern to potential and existing investors (*Straits Times*, 2/1/2001). Although the RAL technically empowers the regional governments to foster and control FDI in their respective regions, neither it nor any other implementing regulations provide the legal mechanism to do so (as discussed below). This is a serious concern.

Restrictions and Limitations

At the time when the FIL was promulgated (1967), Indonesia adopted a relatively cautious attitude towards FDI. In the mid-1960s and 1970s, several of the economic sectors were completely closed to foreign participation. However, since the 1980s and 1990s through to the present time, several of the previously closed sectors have been liberalized and opened to FDI. As similar to most host countries’ security policies, Indonesia is closed to sectors that provide “vital formation in national defence, among others, the production of arms, ammunition, explosive, and war equipment” (FIL, Article 6 para 2).

By virtue of Presidential Decree No. 96 dated 20/07/2000 (as amended by Presidential Decree No. 118 dated 16 August 2000), a new ‘negative list’ for investment prohibits foreign participation in the following sectors: radio, television broadcasting, printing, logging activities in natural forests, public transportation (taxi and bus services), inter-island shipping services, and trade and supporting services (except for large-scale retail services such as malls, supermarkets, departmental stores, as well as large distributors/wholesalers and restaurant operations).¹⁸ Furthermore, medium- and large-scale foreign entities may participate only through joint ventures (20% equity) with domestic small-scale entities — and even so, they are limited to 26 sectors.¹⁹ In addition, 33 sectors are solely reserved for domestic small-scale entities²⁰ — which clearly demonstrates the importance given to cultivation and promotion of ‘home-grown’ businesses.

It should be noted that an emerging economic policy for the GOI is to promote local entrepreneurship in partnership with foreign entities — in this regard, joint venture agreements would play a pivotal role in crystallizing the rights, obligations and liabilities of all parties.

Thus, it is conceivable that more contractual agreements would proliferate between foreign and local entities. The contractual principles, as encapsulated by the prevailing *adat* law, are primarily meant to serve the needs of a closed, rural community, not engage in the complexities of world commerce. Similarly, the contractual principles enshrined in the Dutch civil code tend to be obscure and outdated. Needless to say, the crux of business dealings and faith rest on the availability of modern and pro-business contractual law. The GOI should reenact a pro-business, uniform contract law, which would lay the foundation for an exuberant business community. The governing contract law is the cornerstone of the legal framework for a market economy regulating the way in which property rights are transferred. Little wonder, the reference to the ‘sanctity of contracts’ is a popular one in a modern legal system.

Foreign participation through a joint venture agreement with a domestic entity is mandatory for sectors that are considered to be of ‘public importance’. These include: the construction and management of ports; the production, transmission and distribution of electric power to the public; shipping; telecommunications; air transportation; the development and management of drinking water; the public railway system; the development of atomic energy generation; and mass media. Further, and most importantly, at least, 5% of the capital equity of the aforesaid sectors must be owned by an Indonesian concern (Article 6 of Government Regulation No. 20/1994). In general, the said sectors are owned and managed by the SOEs. In light of the GOI’s present, ambitious policy to embark on the privatization of the SOEs, it is likely that in the near term these sectors could be wholly or substantially owned by foreign entities.²¹ Arguably, the said Article 6 of Government Regulation No. 20/1994 is technically in contravention of the TRIMs and the AIA initiatives — in the context of deprivation of ‘national treatment’ (as discussed below).

Theoretically, a foreign entity can be wholly owned. However, by virtue of Article 7, para 1 (Government Regulation 20/94), the foreign entity (PMA) must divest part of its shares to a domestic entity (the process of ‘*Indonesianisasi*’) within a maximum period of 15 years after commencement of commercial operation, either by way of direct ownership or through the domestic stock exchange. Reportedly, the BKPM does not strictly enforce the divestiture requirement. Alternatively, the said law is circumvented by the existing foreign entities through venturing into new projects, and thereby a new ‘countdown period’ would commence as of the start of commercial operations of these new projects. From a moot point of view, the divestiture requirement also contravenes the principle of ‘national treatment’, as enshrined in the TRIMs and AIA frameworks (full implementation of the principle of national treatment begins in 2010).

Article 33 of the Indonesian Constitution stipulates that “[a]ll natural resources in the soil and the waters of the country are under the jurisdiction of the state and shall be used for the greatest benefit and welfare of the people”. The mineral development policy is premised on the principle that all minerals are part of the nation’s wealth. However, by virtue of Law No. 11 of 1967 on the Provision of Mining, foreign participation is permissible under certain circumstances.²² FDI in the mining sector is effected either through ‘production sharing contracts’ or ‘work contracts’ with the GOI (Article 8 of the FIL). In accordance to Book III of the Civil Code, to establish a valid and legally enforceable contract, the following elements must be satisfied: the willing consent of the parties; the capacity to contract; and the existence of certainty and legality in the subject matter. Typically, the said contracts impose on the foreign parties the need to conduct all stages of the operation — including general prospecting, exploration, refining and processing, transport and marketing of the mineral products. Furthermore, foreign parties are obliged to meet all financial burdens/expenses — which includes taxes, dead rent, royalties, compensations to resettled indigenous people, VAT, land and building taxes, and withholding taxes. In addition, there is an on-going onerous obligation to keep the relevant authorities informed of all activities through submission of quarterly and annual reports. Notably, Law No. 11 of 1967 takes great pains in emphasizing the legal aspects of obligations and liabilities of foreign investors. Basically, it is a protectionist legislation and imposes hefty criminal sanctions against non-compliance of statutory obligations. The RAL, in addition, is causing more confusion and creating a precarious situation with regard to the mining sectors (this is discussed below under Regional Autonomy Law).

Foreign participation in outright forest concession is not permissible. However, foreign entities may participate as operating contractors for domestic logging companies under contract-of-work agreements. In the recent Law No. 41 of 1999 on Forestry, exploration and exploitation of natural resources is prohibited within a ‘protected forest area’. On the face of it, this law will apply *even if* the ‘protected’ status is conferred subsequent to the issuance of the contract of work. In March 1997, *PT Citra Palu Minerals* secured a contract of work to exploit gold mining in the Palu mayoralty, central Sulawesi, and it thereafter commenced drilling works in September 1998. Unfortunately, the drilling activity had to be suspended in June 1999, as the mining area concern was designated as a protected forest area (in January 1999). Needless to say, this new law could further erode investor confidence. First, it makes the mining sector extremely risky and uncertain. Secondly, it may frustrate the principle of ‘validity of property rights’, as established by other prevailing laws and regulations. As this is relatively a new law, the scope and extent of its application remains to be seen. Logically, one way to prevent or mitigate the ‘harshness’ of this law is through the implementation of an

integrated and cohesive working methodology between all relevant ministry departments and institutions.

Similarly, the infrastructure sector (telecommunications, roads, ports, water and electricity supplies, etc.) is owned by the SOEs and foreign participation is permissible on a contractual basis, as opposed to outright ownership. SOEs, being public bodies, are governed by public law. Reportedly, to pursue a civil lawsuit against a SOE in the event of a conflict and/or breach of contract is an arduous task, let alone the enforcement of a judgement against one, which can be virtually impossible.

Foreign entities are restricted from sourcing funds in the domestic financial sector for payments towards loans and equity capital requirements. However, working capital may be raised from domestic financial institutions. Banking Law No. 7/1997, as amended by Law No. 10/1998, essentially restructures the banking sector.²³ To this effect, the Bank of Indonesia issued a ruling, dated 14/5/99, which now allows for up to 99% foreign ownership of local banks (this was previously 49%). Furthermore, foreign banks may operate branches in Indonesia without conditions being attached, although such banks must be highly capitalized and internationally reputable.

Land rights and ownership have been a vexing matter since independence. Foreign investors' entitlement to land rights and usage are largely restricted. The land law, based on the Basic Agrarian Law No. 5 of 1960 (BAL) and the Presidential Decree No. 23 of 1980, are both administrated by the Ministry of Land Affairs. All rights in land, whether formerly based on western law or *adat* law, were converted into a single system of new rights based on *adat* law, albeit an *adat* law modified by modern principles introduced in the BAL. The uncertainties surrounding land rights are attributed to: a lack of a proper registration system, poor geographical demarcation, the rich diversity of the local population adhering to different sets of customary rules, and high-handed bureaucratic intervention. Fitzpatrick (1999: 75) observes:

First, unitary law in Indonesia's pluralist environment does not have uniform legal consequences but in fact has a highly discriminatory application. Secondly, a number of normative justifications for compulsory land acquisition exist independently of, and override the provisions of statutory law. Thirdly, incorporating universal *adat* principles into western-style law has not succeeded in creating postcolonial national law but has been perverted by the state to justify ad hoc bureaucratic domination of land administration. Fourthly, the relationship between formal state law and local practice is now so intertwined, and characterized to such an extent by the hegemony of state law and practice, that the traditional paradigm of dualism is no longer an accurate basis for analysis of Indonesian law.

The Basic Agrarian Law in essence only permits 3 types of land rights out of 11 for foreign investors (Govt Ordinance No 40 of 1996). The right of building (*hak guna bangunan*

or HGB) allows the construction and ownership of buildings. This lease is valid for 30 years and is further extendable for another 20 years. In addition, the HGB may be used as collateral for loan applications. The right to use (*Hak Pakai* or HP) allows usage of land for a specific purpose (they do not convey sub-surface, air, water, or mineral rights), and the title may not be mortgaged. The right of cultivation (*Hak Guna Usaha* or HGU) entitles the bearer to use state-owned land for the purposes of agriculture, fishing and ranching for a period of 30 years. Traditionally, the HGU may only be held by an Indonesian legal entity however, the Indonesian partner in a joint venture company may convey the interest of the land to the joint venture company. The HGU may be used as collateral for the purposes of a corporate loan.

In recent times, a number of foreign entities — such as *PT Newmont Minhasa Raya*, *PT Kelian Equatorial Mining*, and *PT Exxon Mobil* — have reportedly encountered land disputes with the local residents and authorities. Now, with the RAL and FAL in effect, more contentions and confrontations can be anticipated. The *Tempo Weekly* (5/3/2001) reported, “[t]he spirit of autonomy is giving rise to confusion, fights for authority and conflicts”. Further, the chief of the *Lampung* provincial legislature, Srie Atidah, commented that “there are now more than 300 cases of land disputes all from the Suharto era, when a lot of people were forced to evacuate their land and were given very little compensation” (*Straits Times*, 2/2/2001). Suffice to say that economic losses caused by such political and social uncertainties can be substantial — and at the same time, investor confidence is eroded. There is an urgent need to clearly define, in a legislative context, the scope and extent of the regional authorities’ powers in land matters.

Saad (17:2001), in a study, found that *kapupaten* (district) Deli Serdang, amongst others, was in outright violation of Presidential Decree No. 10 of 2001 — if this type of situation goes unabated, the laws itself would — ironically — pose as a ‘villainous agent’. I would argue that there is now an urgent need to address land disputes in a pragmatic and transparent manner. To this end, specialized institutions need to be established to address land disputes efficiently and promptly. In 1964, the “Land Reform Courts” (Undang-Undang No. 21 Tahun 1964) were established with a view to resolve land disputes promptly and fairly, under the guidance of a panel of judges consisting of judicial and non-judicial appointments. However, to date, these courts have not been put into operation. In the interests of expediting land dispute resolution, these ought to be activated, since land rights are a fundamental component of property rights. Without the ownership of the land on which a factory is built, for example, the foreign entity will encounter a high degree of insecurity about the future policies of the GOI and would also be unable to use the land as security. The latter will certainly affect the commercial entity’s ability to raise corporate finance.

The Regional Autonomy Law (RAL)

The RAL 1999 and FBL 1999 were promulgated to pattern in the political, economic and social paradigm shift in Indonesia, particularly since the onset of the financial crisis. The RAL seeks to decentralize and democratize the governance structure and correspondingly, the FBL seeks to allocate equitable revenue sharing with the outer regions of Java. In the context of FDI, the following features of the RAL are noteworthy:

- The Central government is fully responsible for conduct of matters relating to foreign affairs, defence and security, administration of justice, religion and further, shall coordinate the policies on national planning and macro national development control, financial balance fund, state administration and state economic institutional systems, human resources development, natural resources utilization, strategic high technology, conservation and national standardization (Article 7 of the RAL);
- Regencies and municipalities shall be responsible for the administration of the public works, health, education, culture, agriculture, communication, industry and trade, capital investment, environment, land affairs, and cooperative/manpower affairs (Article 11 of the RAL);
- The provinces are responsible for economic activities that cross the borders of regencies and municipalities, and shall also assume responsibilities for all activities that cannot be undertaken by the respective regencies and municipalities (Article 9 of the RAL);
- The central government shall grant principal business permits for the petroleum sector (oil and gas), electricity exploration, and investment in strategic high technology (Article 2, para 3 of the Govt Reg No.25 of 2000);
- Provinces shall cooperate with the regencies and municipalities in the field of capital investments (Article 3, para 7 of the Govt Reg No. 25 of 2000);
- Disputes between regencies and municipalities shall be resolved by the central government through deliberation, and in the event of a deadlock, the matter shall be referred to the Supreme Court (Article 89 of the Govt Reg No. 25 of 2000); and
- The central government may cancel regional regulations or decisions of a regional head that contravene public interests or higher regulations and/or other regulations (Article 114 of the Govt Reg No. 25 of 2000).

How would the RAL affect foreign entities currently contemplating the possibility of investing in Indonesia, as well as existing investments? Presently, non-mining sectors are under the purview of the BKPM/BKPMMD. Conversely, investments in the mining sector are undertaken in collaboration with the relevant ministries and/or SOEs.

Under Article 11 of the RAL, the districts and municipalities shall foster and control ‘capital investments’ within their respective areas. Similarly, in areas of inter-regencies and municipalities, the province concerned shall assume the said task. At the time of writing, it was noted that the necessary ‘implementing regulations’ that would facilitate the letter and intentions of the RAL were yet to be promulgated. Evidently, this is creating a legal lacuna. By virtue of Article 3 para 2(7) of the Govt Reg No. 25 of 2000, the provinces are obliged to cooperate with the concerned regencies and municipalities with regard to capital investments.

However, the said regulation fails to conceptualize the notion of ‘co-operation’ in a legal context.

Therefore, it seems that the BKPM/D, at the provincial level, should conduct the initial screening and subsequently approve all ‘non-mining’ sectoral FDI applications, through consultation and cooperation with the respective regencies and municipalities. Can a regency and municipality’s “People’s Representative Assembly” (DPRD or local parliament)²⁴ promulgate the relevant rules and regulations, seeking to conceptualize an ‘investment procedure’ framework? If the answer is ‘yes’, each province, district and municipal will have different sets of regulations to foster and control FDI — with possibly dreadful consequences. Arguably, the DPR, having enacted the RAL, should also promulgate the necessary implementing regulations through the executive mechanism. Furthermore, since the BKPM/BKPM/D originates from the FIL, which is a statutory creature of the central parliament (DPR), any attempt to abrogate the functional role of the said BKPM/BKPM/D via regulations promulgating from the DPRD would arguably tantamount to an *ultra virus* (illegal) act. This notion is further reinforced by the recent MPR decree 111/2000.²⁵ In short, the DPRD may not promulgate laws that contravene the primary laws and secondary regulations promulgated by the DPR and the executive, respectively. Hence, from the legal perspective, the *status quo* in the non-mining sector — even after the RAL comes into effect — largely remains.

Confusion and uncertainties prevail over the mining sectors.²⁶ Effectively, Article 10 of the RAL cedes the management of natural resources to the regions, but Govt Reg 25 No. of 2000 seems to do just the reverse. Article 2, para 3(3) of Govt Reg No. 25 of 2000 enumerates that ‘principal business permits’ for oil, gas, and electricity shall be granted by the central government. Basically, as regards the petroleum sector, the Govt Reg No. 25 of 2000 attempts to maintain the ‘status quo’ that prevailed prior to the RAL coming into effect.

What about investments in the non-petroleum mining sector (general mining)? Although the central government retains the power to decide “policies on natural resources utilization” (Article 7, para 2 of the RAL), the management of it *per se* is ceded to the regions (Article 10 para 1 of the RAL). Here, once again I would argue that — in the absence of any implementing regulations from the executive — all approvals and permits ought to be issued by the Ministry of Mining and Energy, as enunciated in the Law No. 11 of 1967 on Provision of Mining. Under Article 3 para 5(3) of the Govt Reg No. 25 of 2000, the provinces shall grant ‘core business permits’ connected to exploration and exploitation for the general cross mining areas between the regencies and municipalities. Yet, even if the regencies or municipalities are to issue the relevant permits, who or whom has the authority to do so? Is it the mayor, the regent, or the regional secretariat? To date, the prevailing laws and regulations are completely

silent on these pertinent issues. What is more disturbing is the fact that Law No. 11 of 1967 and the RAL are literally at odds with each other. This situation warrants immediate redress — indeed, it calls for a clear legislative guidance.

Can the regencies and municipalities unilaterally annul or repudiate any of the existing investment licenses and contract-of-work agreements? Understandably, this has been a paramount concern for foreign investors since the RAL came into effect. Under Article 8 of the Govt Reg No. 25 of 2000, “licensing and cooperation agreements of the Government with third parties, based on the Government’s authority prior to the determination of this Government regulation, are declared valid up to completion of the licensing agreements”.

Certainly, the RAL and Govt Reg No. 25 of 2000 are causing a legal quagmire. On the one hand, the RAL seems rather comprehensive and generous in empowering the regions to take charge of various economic activities. On the other hand, Govt Reg No. 25 of 2000 seems to divert the said powers back to the central and provincial government. Bell²⁷ (2001:20-21) laments:

This provision is not intended to allow the Central Government to amend the Regional Autonomy Law through regulations because if it were so intended, one would need much clearer language. Therefore, the regulation should elaborate on the details of the Law, but should not take exception to it. This principle is reiterated in the Decision of the MPR on Sources of Law, which stated that legislation of a lower order (government regulations for example) may not contradict legislation of a higher order (a law for example). The Central Government adopted the main regulations, the Regional Autonomy Regulation, on May 6, 2000. I am not sure, however, that these regulations simply fill in the details. At times, these regulations appear to be a list of the powers the ministries refuse to transfer to the regions notwithstanding the clear wording of the Regional Autonomy Law. In certain places, the Central government appears to be trying to undo through the regulations what the law tries to do.

Ironically, the RAL has compounded the legal uncertainties surrounding FDI.²⁸ BKPM’s deputy for services and facilitation, Mr. Yusan, commented that “[i]nvestors were more concerned with the creation of legal certainty in the country than the bombings” (*Jakarta Post*, 22/11/2000). The GOI maintains that “standard regulations and procedures for all regencies/municipalities shall be promulgated” (*Jakarta Post*, 11/08/2000). This begs the question: where and when? The RAL, whether for the good or bad, is apparently stimulating “nationalistic sentiment and belonging” among the regencies and municipalities (*The Straits Times*, 24/05/2001). The *Jakarta Post/Asia News Network* (5/03/2001) reported that the “State Minister for Women Empowerment, Khofifah Indor Parawansa, said that decentralization has led to exclusiveness and egoism”. An oil sector executive added, “[t]here is so much uncertainty that the best thing to do is to maintain a positive yet neutral relationship with every level of government *bupati*, governor, or national players” (*The Straits Times*, 20/04/2001).

Are existing foreign entities in a dilemma? *PT Newmont Minahasa Raya* — which operates a gold mine in North Sulawesi — was compelled, on or about October 2000, to shut down its operation when the locals took over its production facilities due to land disputes. Furthermore, the company was involved in an acrimonious tax dispute with the local authority earlier this year. *PT Kelian Equatorial Mining* (owned by the Australian based *Rio Tinto*), operating a gold mine in East Kalimantan, suspended its operation in April 2000, amidst protests and disputes over land claims by the locals. Reportedly, a spokesman for *Rio Tinto* described the conflicts as the “worst” the company had faced since it began operations in 1992, and described the situation as “reform euphoria” (*Business Asia*, 10/07/2000). *PT Exxon Mobil*, located in North Aceh, has constantly encountered aggressive confrontations with the locals over land claims (in addition to threats by CAM). *PT Caltex Pacific Indonesia*, has — in recent months — repeatedly endured labour disputes and land rights claims in Riau.

Modus Operandi

What kind of corporate vehicle is required for a foreign entity? Article 3 of the FIL states: “An enterprise as intended by Article 2, which is operated wholly or for the greater part in Indonesia as a separate unit, must be a legal entity organised under Indonesia Law and have its domicile in Indonesia”. On 8 March 1996, the new Indonesian limited liability company law — Law No. 1 of 1995 (Undang Undang Tentang Perseroan Terbatas or UUPT) came into force, while the prior company law, based on the Dutch East Indies Commercial Code (Articles 35-56), was wholly repealed.²⁹ The elucidation of UUPT states that “with the new regulations, it is anticipated that the limited company may turn into a pillar of national economic development based on brotherhood and the principles of economic democracy as a manifestation of Pancasila and the constitution of 1945”.

Foreign entities are required to register as a limited company — *Perseroan Terbatas* (PT) — and either as a private or public company. Foreign companies established within the framework of the FIL (*Penanaman Modal Asing* or PMA) are, in principle, entitled to all the incentives provided by the FIL. Incorporation is effected by the submission of the notarized ‘Deed of Establishment’, containing the Article of Association (which encapsulates the conceptual and functional role of the corporate entity), as subscribed by at least two persons, to the Ministry of Justice. Upon approval of the Ministry of Justice, the same shall be registered with the Company’s Registry and published in the state gazette.³⁰

It is important to note that the UUPT requires all PTs to have a minimum authorised capital of 20 million rupiah, of which at least 25% must be subscribed. In addition, 50 % of the said subscribed capital must be paid up at the time of submitting documents to the Ministry of

Justice. Thereafter, the remaining 50% must be paid upon the PT receiving official approval from the Ministry of Justice. Apparently, the Ministry of Justice does enforce the paid-up capital requirement strictly (Tabalujan: 905). A foreign entity wishing to operate as a public listed company must be domiciled in Indonesia, fully registered with BAPEPAM (the capital market regulatory agency), and satisfy certain statutory requirements (see Annex IV).

How is corporate governance observed? Conceptually, the UUPT encompasses provisions for checks and balances, particularly to safeguard the interests of shareholders, creditors, and the public at large. The PT attains legal status only at the time of approval of the Deed of Establishment by the Ministry of Justice. In the interim, all acts of the shareholders (subscribers) in the interest of the company are ‘personal’, unless the acts in question are subsequently ratified by the company (Article 7 of the UUPT). Furthermore, directors remain liable for the acts of the company until the statutory registration and notification (as noted earlier) are fulfilled (Article 23 of the UUPT). This can be rather confusing — where exactly does the legal shield of ‘separate legal entity’ begin?

The corporate concept of ‘limited liability’ for shareholders is not absolute. Shareholders concerned can be ‘personally liable’ in the event of: (a) involvement in unlawful acts conducted by the company; (b) directly or indirectly using assets of the company for which as a result the assets become insufficient to pay the company’s debts; and (c) for causing loss to the company by acting in bad faith.

The UUPT views any form of ‘reduction of capital’ in a corporate entity as a ‘self-serving’ exercise and hence takes great pains in limiting its application. The reduction of issued capital must be approved by shareholders’ resolution. In the event of a 50% or larger reduction of the capital, the directors must also report the reduction to the Courts and publish the information in the state gazette. Finally, if a company’s loss amounts to 75% against its issued capital, the company in question is automatically dissolved.

All PTs are required to have an annual general meeting of shareholders — in general, shareholders’ resolutions are by deliberation, with a view to reach consensus (*musyawarah untuk mutakat*). However, if an agreement is not reachable, then the matter is resolved by voting. The UUPT requires that, at all times, books and records be maintained by the company, in order to ascertain its financial position. Furthermore, all accounting reports (balance sheets and profit and loss statements) must be filed with the Registrar of the PTs within 6 months of the end of the financial year.

How are minority shareholders’ rights protected? A minority shareholder (personal or entity) may dispose of his/its shares to the company — at a fair price — if he/it is in disagreement with certain actions of the corporate entity. Such actions include: amendments to

the Article of Association; dispositions of all or a substantial proportion of the company's assets; and either a merger, consolidation, or acquisition of the company (Article 55 of the UUPT). In addition, the Courts are empowered to investigate matters wherein the directors and commissioners are alleged to have acted unlawfully and in a manner that is detrimental to the company's shareholders or third parties. However, it seems that the powers of the Courts here are limited to an investigative (fact finding), rather than adjudicative, function (Article 110-114 UUPT). A shareholder may also seek compensation for damages suffered from the acts of the company which are deemed "unfair and without proper grounds", resulting from resolutions of the board of directors or commissioners and general meeting of shareholders (Article 54, para 2 of the UUPT).

The UUPT adopts a 2-tier management structure — comprising the board of directors (*direksi*) and the board of commissioners (*dewan komisaris*). The former manages and represents (*mewakili*) the company and the latter supervises (*mengawasi*) the directors.³¹ It is now mandatory for all PTs to ordain a board of commissioners (Article 94 UUPT). Most importantly, the office of commissioners assists in enhancing the elements of impartiality and independence in the corporate culture.

Directors and Commissioners hold fiduciary duties towards the company and shall be jointly and/or severally liable when erroneous company annual accounts and/or information causes losses to all parties (Article 60 UUPT). In addition, each director and commissioner may be personally liable for any erroneous or negligent acts committed in the discharge of his responsibilities (Article 98 UUPT). To a large extent, the UUPT superficially underpins corporate governance. Suffice to say that the stipulation of laws is one thing, and the vigorous implementation and enforcement of the laws is quite another. There are no available data to determine the number of prosecutions initiated by the Registrar of Companies or other relevant authorities against PTs that have contravened the UUPT in one way or another. There are also no data on actions taken against directors and commissioners in breach of fiduciary duties.

If conceptualized and harnessed correctly, corporate governance could fundamentally underpin transparency and accountability. In this context, ill practices such as corruption, collusion and nepotism, which are known to be pervasive in Indonesia, can be put to 'check' — to a certain extent at least — if the relevant regulatory body/bodies undertake their enforcement duties swiftly and diligently. Taken in this light, therefore, the enactment of the UUPT is encouraging. However, in furtherance to this, more effective rules, regulations and laws are needed to shore up the capital market (securities), and more insolvency procedures are needed to create a level playing field (transparency).³² Emulating transparency through stringent disclosure requirements and the exercise of due diligence that is premised on international best

practices is the main thrust that can be used to promote and sustain investor confidence. Arguably, in Indonesia's context, there might be prominent vested interests in protecting the *status quo* — however, the pressure exerted by foreign investors for a convergence in the regulatory structure can be equally overwhelming, as capital markets play a pivotal role in the economy.

Mergers and Acquisitions (M&As)

Cross-border M&As became an important mode of entry in developing Asia. Cross-boarder M&As in South East and South East Asia reached an annual average of \$20 billion during 1997-1999, compared to an average of \$7 billion during the pre-crisis years of 1994-1996. Two types of cross-boarder M&As can be distinguished: acquisitions of local firms by new foreign investors and acquisitions of shares in existing joint-ventures by the foreign joint venture partners (Zhan and Ozawa 2000). The first was encouraged by the low prices of firms when translated into foreign currencies, the new openness to M&As and the favourable long-term prospects of the crisis-affected countries. The second took place either through acquiring more equity from a domestic partner or through buying new shares, motivated by changes in the law or the prevent a joint-venture from collapse (World Investment Report, UNCTAD 2000).

The Govt Reg No. 20/1994, as noted earlier, was promulgated (amongst other things) in order to liberalize FDI entry and, most importantly, to facilitate FDI entry to Indonesia through M&As as opposed to traditional 'greenfield' investments. In this respect, the following types of M&As are recognised by Article 8 and 9 of the Govt Reg No. 20 of 1994:

- (a) A foreign investment entity (PMA) both established in the context of joint venture as well as direct foreign investment already in commercial production as set forth in its permanent business license may establish a new company. The said newly established company shall have the following status:
 - As a foreign investment (PMA) company, if there are new foreign citizens and/or legal entities among the aforesaid joint-venture participants; or
 - As a domestic investment (PMDN) company, if 100% of the shares are owned by a foreign (PMA) company, or the shareholders consist of Indonesian legal entities and citizens.
- (b) Joint-venture foreign investment (PMA) companies already in commercial production as set forth in their permanent business license may purchase the shares of an established company incorporated as a limited liability company through direct ownership and/or the domestic capital market.³³ Purchase of shares through direct ownership:
 - May only be allowed if the field of business of the company invested is open to PMA.

- The status of the company the shares of which are to be purchased is identical to the capital investment company at the time of its establishment.
- (c) Foreign legal entities and existing PMAs may purchase shares of existing companies incorporated as limited liability companies by virtue of Indonesian laws, through direct ownership and/or the domestic capital market. Share purchase through direct ownership:
- Shall only be allowed if the fields of business of companies the shares of which are to be purchased are open to foreign investments (PMAs) at the time of purchase.
 - The amount of Indonesian participant shares in the company acquired shall not be less than 5% out of the total amount of shares paid up and subscribed.
 - Such shares purchases shall be conducted in the context of salvaging and improving the company concerned with the intention: to continue development in the construction stage; to convert loan capital into share capital; to increase marketing of production; to increase exports; and to apply new technology.

In addition, the UPPT (Part VII, Article 102-109), now regulates the ‘governance’ aspect of M&As. Prior to the UPPT, the Dutch commercial codes did not specifically address the same — therefore M&As were virtually existing in a legal vacuum. The UPPT has, to a certain extent, redressed the precarious situation (see Annex V). However, similar to other types of commercial laws, the credibility of the M&A law hinges on its strict enforcement.

The much-awaited Anti-Monopoly and the Unfair Competition Law (Law No. 5/1999) came into effect on 1/2/2000. Essentially this law prohibits corporate entities from holding more than a 50% share of the domestic market. Furthermore, the law prohibits 2 or 3 companies holding 75% of the market between them. In principle, the said new law seeks to prevent monopolistic and oligopolistic practices, price fixing, trusts, and cartels. Contravention of the law would entail a maximum fine of Rp100 billion and/or 6 months imprisonment (if the company executive(s) is/are found guilty). However, a company that increases its share through ‘efficient operations’ and does not wilfully block new entrants into any specific market is not in contravention of the said law. However, the law falls short of defining the notion of ‘efficient operations’. It is hoped that implementing regulations would redress this concern.

The efficacy of the Anti-Monopoly and Unfair Competition Law rests very much on the implementing regulations and political will to embrace the law in its entirety. In this sense, it could be argued that, technically, the present activities of the several SOEs are infringing the said law. It remains to be seen, however, whether the spirit and letter of the law would be strictly adhered to. The Business Cooperation Supervisory Commission³⁴ was set up as regulators of the new law. Critics have warned that politicization of the said commission would frustrate the application of the law and have therefore advocated a high degree of

independence in its formation and functional aspects. In spite of the prevailing laws, the GOI has the ‘all-encompassing’ power to disallow any M&A that is perceived as detrimental to the ‘public interest’ (Presidential Decree 15/sk/1994).

Seemingly, this decree is an opaque regulation, which leaves much administrative discretion in interpretation to individual officials. It is important that the government bodies act in a transparent manner and account for its dealings and decisions. Theoretical discussions and empirical evidence (apparently limited in scope) both suggest that competition law will not deter FDI and, indeed, may encourage it (APEC 1999). Non-discrimination between the private and public sector is an essential component of competition law, and particularly so in the context of divestiture.

Following the onset of the financial crisis, a number of financially distressed domestic companies were acquired by foreign entities. However, the present political uncertainty and the rampant social unrest have indeed, dampened M&As activity, significantly. Empirical evidence (UNCTAD 2000) suggests that efficient capital markets display a strong correlation to churning healthy M&As activity. Hence, a highly regulated market is perceived as ‘anti-M&A’. Conversely, a liberalized market, adhering to prudential supervision, tends to attract M&A (subject to the soundness of the prevailing fundamentals). From the regulatory perspective — in order to deter wrongful practices such as insider trading, market rigging and manipulation — there must be specific and detailed laws addressing such practices. Here again, it is crucial that the relevant authorities implement and enforce the laws strictly. Furthermore, to promote and sustain business integrity and ethics, the concept of ‘fiduciary duties’, ‘due diligence’ and ‘confidentiality’ must be expounded and invoked (in a legal context). By and large, the present law (Capital Market Law) governing the secondary market is not entirely satisfactory. It remains obscure and ineffective, in part due to the lack of implementing regulations, coupled with institutional incompetence and/or failures.

Performance Requirements, Labour and the Environment

Decree No. 223/1995 of the Minister of Finance stipulated either lower or zero import duties on manufacturing parts in the automotive industry — which was tacitly linked to the usage of local content. However, as of August 1999, with the introduction of a flat rate import duty of 15% for all imported materials in the automobile industry, the said decree No. 223/1995 was repealed. To date, the GOI does not impose any form of local content requirement — a fundamental obligation under the TRIMs framework. To demonstrate the coherence of this policy it would be prudent to prescribe it within a legislative context.

Article 26 of the FIL stipulates that “[f]oreign capital enterprises are obliged to manage and control their enterprises in accordance with the principles of good business administration without harming the interests of the State”. Since the onset of the financial crisis in 1997, environmental matters have taken the centrestage in Indonesia. The law on environmental management, Law No. 23 of 1997, now sets the main environmental legislative policies. The Environment Impact Management Agency (BAPEDAL) is responsible for the development and implementation of national policies and progress of environmental management. However, there are several sectoral laws that individually deal with environmental issues and thereby cause much confusion as to what are the actual legislative policies. Furthermore, institutional irregularities and lack of co-ordination between all governmental ministries escalate the problem (Tan: 1998). Observers have constantly criticized Indonesia for its laxity on environmental governance. Most empirical studies suggest that FDI will not necessarily flow in to take advantage of lower environmental standards — and efforts by national governments to compete for FDI by embarking on lower environmental standards are unlikely to be very successful in the longer term. However, excessive regulatory burden on new enterprises for the clearing up of past contamination, or uncertainty about the future liabilities, may possibly deter FDI (OECD: December 1997).

By virtue of Article 11 of the RAL, the regencies and municipalities are empowered to administer environmental matters in their respective areas, albeit with the central government deciding the ‘macro policy’ on environment management. Would this mean that each regency and municipality could adopt its own environmental regulations and rules? This dilemma is now a major concern for foreign investors.³⁵ Apparently, there seems to be an on-going mistrust between the locals and the foreign investors — the locals constantly accuse the foreign entities of irresponsible environmental behaviour (for example, see the recent incidents involving *PT Newport Minahasa Raya*, *PT Kelian Equatorial Mining* and *PT Freeport Indonesia* — EIU 2001: 18).

On the other hand, foreign investors allege that the relevant authorities are shoddy when applying and enforcing environmental laws with regard to domestic entities. Be that as it may, the challenge now is to put in place clear and well-defined environmental laws and enabling institutions; and implementing and enforcing the said law consistently and justly in a coordinated manner. Mere ‘command and control’ type of laws and regulations will not suffice. Indonesia ought to engage the resources of foreign entities in order to enhance its environmental regime. Thus, the GOI ought to collaborate with the private sector in promoting and safeguarding environment protection. Indonesia might demonstrate its earnestness by incorporating key international environment conventions into its national law and, most

importantly, by adhering to them strictly. Under the Jakarta Declaration on Economic and Development (18/09/97), Indonesia, together with its ASEAN counterparts, agreed to take all measures necessary to protect and safeguard the environment. Subsequently, at the sixth ASEAN Summit in Vietnam (December 1998), another declaration was issued — and this was ensued by the promulgation of the ‘15 objectives’ for environmental cooperation and adoption of a ‘strategic plan of action’ (see ASEAN website). However, as is similar to other prevailing ASEAN initiatives, these declarations should not be over-emphasized, as they are legally non-binding.

As a general rule, a foreign entity may appoint the management of its own entity (Article 9 of the FIL). However, a foreign enterprise is only allowed to employ foreign workers in ‘managerial and expert personnel’ positions, which cannot as yet be fielded by Indonesians (Article 11 of the FIL). In addition, foreign entities are required to conduct and/or provide regular and systematic training and educational facilities for Indonesians with a view to gradually replace foreign employees with Indonesians (Article 12 of the FIL). Evidently, the national policy is to make available all types of employment to Indonesians, and foreign employment is therefore only viewed as a substitute. The logic of such a policy is questionable.

How is the labour law designed? Since the fall of the Suharto era, the notion ‘empowerment of the labour force’ has resurfaced. The recent Manpower Law (25/1997) recognizes workers’ rights to strike, but also concurrently applies several restrictions.³⁶ Reportedly, employees, human rights groups and NGOs have opposed the said law; furthermore, the law has yet to be implemented. It is believed that the present ‘Bill on Manpower Development and Protection’, which is yet to be enacted as well in the DPR (parliament), will replace the said Law No. 25/1997. The draft law comprehensively addresses issues such as: work contracts/collective bargaining agreements, minimum wage determination, minimum employment age, work hours/conditions, protection of women workers, layoffs, strikes and lockouts, training facilities, regulation of employment services and employment of expatriates, and — most importantly — the imposition of sanctions for violation of labour standards. Furthermore, the ‘Bill on Industrial Dispute Resolution’ seeks to establish a ‘labour court’ within the regular court system that would arbitrate, mediate and adjudicate in all aspects of labour disputes. In addition, the said bill requires ‘strikes and lockouts’ to be held in abeyance until all mediation and conciliatory efforts are fully exhausted. Presently, compulsory mediation is applicable to all labour disputes.

Indonesia has hitherto ratified several key labour conventions, namely: the Right of Assembly and Collective Negotiation (1956); Right of Equal wages for Men and Women

(1957); and the Convention on Forced Labour, Freedom of Association and Protection of the Rights of Association (1998). Incorporating international labor conventions is the right direction to adopt — it assumes international best practice. Furthermore, given the wide potential of the said two bills in parliament, the present GOI policy commitment to improve labor welfare, and the present ‘era of *reformasi*’, it is likely that in the medium term, the situation surrounding the treatment of labour would improve.

Non-Fiscal Incentives

The FIL allows foreign entities to transfer/repatriate funds out of and in to Indonesia without any form of restrictions. Even in the worst of times during the crisis (1997-1998), the GOI did not abrogate from this legal obligation. Although ‘reporting requirements’ for fund transfers out of Indonesia has been made more stringent, as of to date, there are no capital controls — much to the relief of the existing investors.

There are strictly no foreign exchange controls. In addition, transfers of funds (incoming/outgoing) are not restricted. However, the Bank of Indonesia (the central bank) must be routinely informed of all foreign equity, loan capital, and transfers of funds. The Foreign Exchange Law No. 24/1999, which was implemented in April 2000, requires the compulsory reporting of all foreign exchange transactions above US\$10,000. As a general rule, there are restrictions on the transfer of foreign entity capital (equity) while the foreign entity is benefiting from the prevailing relief and incentives (Article 20 of the FIL). Foreign entities may transfer funds at the prevailing exchange rate on the following transactions:

- Net profits after deduction of the relevant taxes and fulfillment of other financial obligations;
- Proceeds for depreciation of fixed assets related to plant machinery and equipment;
- Costs of foreign personnel assigned to the enterprise and for Indonesians employees training abroad;
- Compensation in the case of nationalization;
- Payment of principal and interests on foreign loans; and
- Proceeds from the sale of shares to Indonesian parties.

In terms of nationalization and compensation, the FIL provides a statutory guarantee that the GOI will not undertake a total nationalization and/or revocation of ownership (rights of control and management of the foreign entities), except when it is in the ‘public interest’ to do so (Article 21 of the FIL). In the event of nationalization, the GOI is legally obliged to provide the necessary compensation — all affected parties shall agree upon the amount, type and method of payment in accordance to valid principles of international law. However, if an

amicable agreement is not attainable, the affected parties may resort to an arbitration tribunal with a view of fully abiding by its ruling. To date, there have been no incidents of any acts of nationalization of a foreign entity.

Indonesia has entered into Investment Guarantee Agreements with a number of countries. In principle, these guarantees include compensation in the case of nationalization, damage or loss caused by war, revolution or insurrection, or payments in the case of non-convertibility of the currency. Indonesia is also a signatory to the Multilateral Investment Guarantee Agreement (MIGA), which provides investor protection against political risks.

Indonesia also designates certain areas as 'Industrial Zones'. Although Article 4 of the Govt Reg. 20/94 enumerates that business activity of FDI may be located "throughout the territory of Indonesia", it also states that where regions are designated as 'bonded zones' or 'industrial estates',³⁷ FDI ought to be located thereat. Presently, there are 66 industrial estates over 17 provinces of Indonesia — 39 of which are located in West Java (*Indonesia Bizwatch*: July 2000).

Govt Reg No. 33 of 1996 and No. 42 of 1999, in regard to 'bonding stockpiling areas', stipulates that all production ports of entry for export purposes shall be designated as bonded zones (KBs) (the Minister of Finance via issuance of decrees may designate KBs).³⁸ As a general rule, foreign entities seeking to benefit from 'duty-free'-type of incentives must commit to export substantial amount of their production. To this effect, the BKPM routinely seeks 'export plans' envisaging at least 80% by value of production being targeted for exports. In the 1990s, the GOI — in a bid to promote development in the remote regions of Indonesia — designated several 'Economic Development Zones' (KAPET). Essentially, apart from its inherent bonded zone status, the KAPET also provides a number of tax incentives (see Annex VI). Clearly, the policy rationale for creating the KB is to promote export-oriented industries. However, the present KB licensing procedure is overly cumbersome and is in need of reformation. Three areas can be singled out for possible reform. First, the application procedure must be kept simple and transparent. Second, bureaucratic high-handedness needs to be curtailed. Third, there is a dire need to co-ordinate the national industry related incentives with that of the regional.

Fiscal Incentives

Whether fiscal incentives are a necessary instrument within the legal framework for attracting foreign investment has been a protracted issue for decades. The generally assessed conclusion is that tax incentives have only marginal importance in promoting investments, although many industrial countries including the United States grant tax incentives to foreign or out-of-state investors. In reviewing the past years since 1984 in

Indonesia, it is difficult to correlate any loss of investment with the cessation of fiscal incentives in 1984 (except for tax write-offs introduced in 1989). The shortfall in investments in Indonesia appears to have been in general attributed to the difficulty of doing business there, such as administrative problems and divestment policies. (Tang: 161)

Prior to 1984, the GOI provided various fiscal incentives such as: tax holidays, investment allowances, dividend tax exemption and accelerated depreciation to foreign investors. Until 1983, the policy direction has been to promote FDI via offering generous fiscal incentives. However, after 1983, the GOI made a drastic policy reversal. The taxation law of 1984 essentially ceased the availability of all the said fiscal incentives as from 1/1/1984. Why the policy reversal, especially when at the material time (1980s), other ASEAN countries were generous with their offerings of fiscal incentives?

Subsequently, in 1994, another dramatic policy shift materialized. In this case, to a certain extent, the fiscal incentives that existed prior to 1984 were reintroduced. In particular, the Tax Law of 1984, as amended in 1992 and 1994, provides fiscal incentives to “priority sectors and certain locations” (remote areas) in the following ways: accelerated depreciation and amortization; loss carried forward up to 10 consecutive years; and reduction of income tax as encapsulated in Article 26 of Law No. 7/1983 and Law No. 10 of 1994.

Furthermore, pursuant to the said amended tax law, Govt Reg No. 45 of 1996 purports to accord specific sectors, including capital goods, manufacturing, agribusiness, infrastructure, sea/air transport, engineering, and professional personal training with tax holidays on a case-by-case basis. In a way the said tax incentives were introduced as a policy instrument for romping investment into the priority sectors and the underdeveloped regions of Indonesia. However, all implementing legislation (secondary) to fulfil the full intention and letter of the Tax Law No. 1984 are as yet to materialize (other than the said Govt Reg No. 45 of 1996). It is generally felt that the concept of ‘priority industries’ is ill defined. Arguably, due to lack of the relevant implementing regulations, the tax law of 1984 partly remains as a ‘dead letter’.

Were there any ‘incentive-oriented’ policy responses during the financial crisis? Indeed, under the then-President B.J. Habibie (1999), via Presidential Decree 7/1999, the tax-holiday scheme was re-introduced. However, as of to date, the said decree is as yet to be fully implemented (it is believed that Decree 7/1999 would eventually replace the tax-holiday provided by Govt Reg 45/1996). Reportedly (EIU 2001), the Govt Reg 45/1996 and Presidential Decree 7/1999 are confusing and inconsistent — which in the near term may not go down well with investors.

With a view to demonstrate ASEAN solidarity and rejuvenate the FDI climate in the region in the midst of the Asian crisis, the Hanoi Declaration of 1998 was executed by all

ASEAN member states and, within its ambit, the ‘Statement on Bold Measures’ was adopted in December 1998. To this end, Indonesia agreed to extend “additional special privileges to qualified ASEAN and non-ASEAN investors in the manufacturing sector, for applications received from 1/1/1999 to 31/12/2000 and approved thereafter” (Paragraph 6). The privileges included: a minimum three year corporate income tax exemption or a 30% corporate investment tax allowance; 100% foreign equity ownership; duty-free imports of capital goods; domestic market access; a minimum industrial land and leasehold period of 30 years; employment of foreign personnel; and speedy customs clearance. Furthermore, Indonesia offered 100% foreign equity ownership in the wholesale, retail, manufacturing sectors, and to certain aspects of the banking sector.

All new BKPM-PMA investment projects approved within the framework of the FIL, together with existing PMA companies expanding their projects to produce similar products with a view of 30% expansion or diversification of their products, are entitled to exemption/relief from import duty and levies. This is applicable to two areas: first, on the importation of capital goods, namely, machinery, equipment, spare parts and auxiliary equipment; and second, on the importation of raw materials for the usage for two production years (accumulated production time).

As alluded earlier, one of the key economic policies of the GOI, particularly since the mid-1980s, is to encourage the export-oriented manufacturing sector. To this end, various ‘export-related’ incentives have been introduced, and these include: (a) restitution (drawback) of import duty and surcharge on the importation of goods and materials used to manufacture the exported products; (b) exemption from VAT and sales tax on luxury goods and materials purchased domestically, to be used in the manufacturing of the exported goods; and (c) no restrictions on import of raw materials required for production even if such materials are available in the domestic market. Given the huge potential market size of Indonesia (with a population of 225 million), it is evident that foreign entities would wish to penetrate the domestic market. Prior to 1998, it was impossible to do so directly. Now, the Government Regulation of 1998 allows foreign entities to sell their own products directly to other corporate entities in Indonesia who use these products as capital equipment, spares or for raw materials in their production process. Moreover, they may also distribute their own finished products within Indonesia through a foreign owned distributor or wholesaler.

Taxation

Presently, from the legal perspective, the taxation regime — in light of the RAL and FBL — appears to be increasingly confusing and unclear. The pressing question is: will the RAL and

FBL tempt 'over-zealous' local taxation? Regrettably, as of to-date, there is no clear answer to this question. Although the RAL and FBL purports to empower the regions to exercise fiscal management, all relevant regulations addressing the scope and extent of the said power are yet to be promulgated. The Tax Law of 1983, as amended by Law No. 19/94, basically governs the present tax structure (corporate, personal and others). Essentially, the Tax Law of 1983 introduced a uniform tax law and thereby repealed the tax law that was inherited from the Netherlands Indies government. The primary policy objective of the Tax Law of 1993, as narrated in the preamble, is to "achieve a taxation system characterized by simplicity, equity and consistent interpretation and administration". The revised Tax Law 1994 embodies the legislative policies, and amongst other things, it seeks to: lower the corporate and personal income tax; widen the application of the VAT and luxury tax; and impose a withholding tax on all types of work, whether performed in or out of Indonesia.

Since 1997, the GOI has had tightened its fiscal policy in order to increase its revenue collection (to an extent, this is an important aspect that was attached as conditionalities to the IMF loan, amongst others). In 1998, the GOI's decision to impose a VAT in Batam invoked widespread discontent within the foreign business community, especially investors from Singapore, whose business interests are reported to be 70% of the 370 foreign entities in Batam (*Straits Times*: 5/1/2000). Subsequently, the GOI made a fiscal policy reversal — on or about 5/1/2000, the imposition of the VAT was removed. In the recent years, the GOI has constantly reiterated its intention to implement and strictly enforce the tax law. To this end, several 'taxation rulings' have been amended. The General Tax Provisions and Procedures imposes criminal sanctions against the false and/or incomplete returns and tendering of information that could result in losses to the state, amongst others. The former Co-ordinating Minister of Economy, Rizal Ramli, reiterated: that "the government from now on will take strong action against tax crime... the government of Indonesia reckons that tax revenues in the amount of Rp 130 trillion could have been lost over the past 10 years due to inadequate collection efforts and low tax compliance" (*Jakarta Post*: 23/11/2000).

In terms of personal taxes, the income tax is evaluated solely based on residency. Article 2 of the Income Tax Law (1994) defines a 'resident' as: "Any individual present in Indonesia for more than 183 days in any twelve month period or any individual present in Indonesia during a tax year and intending to reside in Indonesia". A resident taxpayer is subject to tax on his total worldwide income. 'Non-residents' are subject to tax on income derived from Indonesian sources (a withholding tax of 20% on income, interest, dividends, etc.). Under Article 4 of the Tax Law 1994, taxable³⁹ income includes: wages, salary, commissions, bonuses, pensions, interest, dividends, and annuities, among others. As part of

the overall fiscal policy, the GOI provides tax credits and attempts to prevent double taxation — as the Chief of the Tax Office for Foreign Institutions of Industries, John Hutagol, commented: “in case an expatriate is treated a resident taxpayer his or her world wide income shall be reported in the tax return, and tax paid offshore on the world wide income can be credited against the Indonesian income.... We have a method for avoiding double taxation and what we adopt here is ordinary tax credit per country limitation” (*Jakarta Post*: 11/01/2000).

As regards corporate taxation, all resident companies in Indonesia are subject to the corporate tax (including worldwide incomes). From the legal perspective, any organisation in the form of a company, corporation, partnership or cooperative established or domiciled in Indonesia, whether incorporated or unincorporated, having limited or unlimited liability, shall be deemed a ‘resident entity’ (Tax Law 1994). Also, a ‘non-resident’ company is subject to tax when in receipt of ‘Indonesian-source’ income.

The Tax law stipulates that all resident establishments are liable to tax on profits accrued from its ‘business activities and properties’ — ‘business activities’ being broadly defined. The corporate income tax rate is aligned as follows: 10% for the first Rp25 million; 15% for Rp25-50 million; and 30% for Rp 50 million and above (see Annex VII). In general, companies with revenues from the following activities are subject to a fixed income tax: construction — 2%; consulting — 4%; and real estate — 6%. Furthermore, foreign mining companies operating under a ‘contract of work’ and ‘production sharing contracts’ in the general mining sector and the oil/gas sector, respectively, are subject to corporate taxes as envisaged in their contractual agreements (which tends to replicate the prevailing tax law). Is there a capital gains tax? Presently, none exist in a definitive form. In essence, capital gains are intrinsically treated as mere income.

The GOI has thus far executed tax treaties with several countries (about 50 countries) with a view to reducing the single-based withholding tax of 20%. Basically, tax treaties facilitate the contextualization of fiscal rights and obligations with a fair degree of certainty and predictability. Therefore, the GOI should vigorously pursue such agreements with more sovereign nations. Generally, the said tax treaties tend to replicate the ‘OECD model’, wherein withholding taxes are apportioned into 0%, 5%, 10% and 15%. Reportedly, due to institutional inefficiency and overly cumbersome rules, claims made under the respective tax treaties tend to be frustrated (1996 circular from the Director-General of taxation).

There are several other taxes applied by the GOI. The VAT is applied at a flat rate of 10% and is imposed on manufacture, import and/or distribution of goods, and most services rendered (exports are exempted from VAT). In addition, the import or delivery of luxury goods (for example, passenger vehicles and electronic goods) attracts a luxury sales tax in the range of

10% to 75%. In recent years, the amount and number of items subject to the luxury sales tax were increased considerably. The *Straits Times* (12/4/2001) reported: “Indonesia stands to lose millions of dollars in potential investments as tax changes affecting luxury goods are forcing some international firms to rethink their expansion plans in this country... the problem is that higher prices resulting from the luxury tax hike have created a smaller market for high-end items — electronics, cars, and computers among them”. As noted earlier, in accordance with the GOI’s present stance of seeking to increase its ‘revenue collection’, a decree was promulgated in 1998 that imposes a VAT and luxury sales tax on Batam island. Although the said decree does not affect the foreign entities directly (the incentives available under the ‘bonded zone and industrial estate’ scheme remains intact, yet foreign investors resisted it. Their concern was that the imposition of the said taxes would indirectly increase their transactions costs in a ‘roundabout’ manner.

Article 82 of the RAL further stipulates: “Regional taxes and retributions shall be regulated with laws. And the stipulations of tariff and the procedures for regional taxes and retributions collection shall be stipulated with regional regulation in accordance with laws and regulations”. Conversely, Article 83 of the RAL allows the districts and municipalities to grant fiscal and non-fiscal incentives on their own accord.

Will the RAL and FIL stimulate ‘over-zealous’ local taxation? Could there be duplication of taxation within the national (Law No. 10/94) and the regional framework? Presently, these are the common queries of foreign investors, amongst others. By virtue of Law No. 34 of 2000, pursuant to the FBL, local governments now have a greater authority to levy taxes and fees than they had previously. The original law (Law No. 18 of 1997) limited provincial governments to three kinds of taxes (motor vehicles, changes to title on motor vehicles, and motor vehicle fuel). Districts and municipalities were restricted to six kinds of taxes (hotels, restaurants, entertainment, advertisements, street lightening, mining of non-strategies minerals, and surface and ground water usage). The new law allows the districts and municipalities to create new taxes and levies in furtherance to the said law.

It is conceivable that regional governments may use their newfound authority to impose a wide range of taxes and levies, which consequently may have a negative impact on FDI. Reportedly, anecdotal evidence suggests that regional governments are promulgating fiscal regulations that can be detrimental to commerce and investment (Saad: 2001; Usman: 2001). In fact, the Ministry of Finance has admitted that many recent local regulations are in violation of the national laws (*Jakarta Post*: 21/11/2001). The paramount concerns are: how onerous are the new taxes and levies going to be? Will the central government promptly intervene in cases of ‘inequitable taxes’? Could ‘double-taxation’ proliferate within the

districts and municipalities? Regrettably, the present taxation laws/regulations does not generally nor specifically address such issues; it therefore further exacerbates the element of legal uncertainty on the investment environment. “A deepening political paralysis in Jakarta has led to demands from Indonesia’s regional governments, including Yogyakarta’s, for more tax revenues and greater financial independence” (*The Straits Times*: 2/5/2001).

There does not appear to be any strong empirical basis that would support the use of tax incentives as a means of attracting FDI. However, there is a prevailing theoretical notion that the higher the risk undertaken by investors — whether political, economic, or legal — the higher the anticipated corresponding returns (profits). Indonesia’s present investment climate poses visible risks and uncertainties. To this end, it is crucial that — at least from a regulatory perspective — the taxation regime sets out clear taxation laws that are applied in a transparent and uniform manner. The immediate concern is for the fiscal implication of the RAL and FBL. More pointedly, in the light of the on-going regional autonomy policy, it is imperative that the national fiscal policies are calibrated in clear legislative text. Contradictions and discrepancies between the national and regional milieu would engender erosion of investor confidence as well as foster legal uncertainty. Suffice to say that matters particularly concerning investors are the overall fiscal pressures on enterprises and the predictability of tax administration and enforcement.

Intellectual Property Rights (IPRs)

Braga (1999:32) narrates:

Evidence based on surveys of multinational corporations from Germany, Japan and the United States shows that intellectual property protection does affect FDI decisions. The impact, however, varies across industries: again, pharmaceutical and chemical firms seem to be more sensitive to the host-country’s IPRs regime. Moreover, the quality of a country’s IPRs regime is just one of the many variables determining the overall investment climate of the country from the perspective of foreign investors.

In 1997, the GOI made substantial changes to the IPR framework, both conceptually and functionally, in order to abide by the Agreement on Trade-related Aspects of Intellectual Property Rights Agreement (TRIPs).⁴⁰ To this end, the following laws were promulgated: Law No. 12 of 1997 (copyright), Law No. 13 of 1997 (patents), and Law No. 14 of 1997 (trademarks). Presently, these said laws are slated for further amendments and/or modifications. Furthermore, five international conventions on IPR were fully incorporated into the national law. Guatama (1997) comments: “[a]ll these changes and joining of conventions in the field of intellectual property rights are evidence of Indonesia’s willingness to join the

family of nations within the framework of the World Trade Organization which was adhered to by Indonesia with Law No. 7 of 1994”.

The promulgation of the new IPR laws are in line with the ‘development strategy’ to embrace the trend of globalization, as envisaged under the ‘Guidelines of the Overall Development Plan’ (*Garis — Garis Besar Haluan Negara* (GBHN) (MPR No. 11/MPR/1993). It should be noted that the US Trade Office, as of May 2000, placed Indonesia on the ‘watch list’⁴¹ category with regard to IPR regimes. Prior to this, Indonesia was placed on the notorious ‘special 301 priority watch list’ — facing possible sanctions under S.301 of the Omnibus Trade and Competitiveness Law (this group of countries were perceived to have unsatisfactory IPR regimes). This move is a clear ‘endorsement’ of the new IPR laws. The rest of this subsection will address in turn the issues of copyrights, trademarks, patents, and international conventions in the context of Indonesia’s IPR regime.

The present law on copyright is governed by the Copyright law of 1982, as amended by Law No. 7/87, and further revised by Law No. 12/1997. In essence, the said law entitles the copyright holder to the ‘exclusive right’ to publish and reproduce his work, or license another person to do so (Article 2). In addition, registration is not required to warrant copyright protection, as a rebuttable presumption of ownership is made. ‘Work’ herein relates to the “creations in the fields of science, art and literature” — to this end, it includes books, written work and most importantly, computer software programs (Article 11). A pertinent question is: are foreign copyrights protected? ‘Creations’ by non-Indonesians will have inherent copyright protection if they are made and published in Indonesia. Under Article 48a of the Copyright Law, all creations of foreigners shall be protected — if their respective sovereign states have concluded Bilateral Copyright Agreements with Indonesia and/or is a party to a Multilateral Copyright Agreement of which Indonesia is a signatory.

Clearly, one of the major concerns with regard to copyright is compulsory licensing. Compulsory licensing is permissible when it is considered necessary for the benefit of ‘national interest’ (*kepentingan nasional*). For instance, a foreign book may be translated into *Bahasa Indonesia*, in the interest of promoting education. Furthermore, parts of a creative work may be cited for the purposes of “education, scientific research, reports, reviews and court proceedings, amongst others” (Article 15). The legislative policy here strives to balance commercial needs and public interest; it is therefore important to maintain the balance in a fair and equitable manner.

The Law No. 12 of 1997, working in tandem with the Berne convention, extended the copyright protection period as follows: works are granted copyrights for the lifetime of the

author and 50 years thereafter; and computer software and broadcast programs are protected for 50 years from the date of registration.

As for trademarks, the new Law No. 14 of 1997 amends certain aspects of the original Trademark Law of No. 1992 and, most importantly, it seeks to comply with the TRIPs framework. Essentially, trademark protection is sought via the ‘active constitutive system’ (by registration) as opposed to the ‘declarative system’. Under Article 3 of Law No. 19/92, “the right on mark is the exclusive right, granted by the state to the owner of a mark, registered in the general Register of Trademarks”. Hence, a trademark will only have legal validity when duly registered. The rightful owner of a trademark must, at all times, ‘act in good faith’ (*beritikad baik*). In the landmark Supreme Court decision made regarding the ‘Tancho case’ (Decision No. 677/sip/1972 of 13/12/92), it was held that ‘good faith’ with regard to ownership and use of the trademark is a crucial “prerequisite for ensuring legal protection”. In this case, a local Indonesian entrepreneur, one Wong A Kiong, trading under the name of the ‘Tokyo Osaka Company’, had registered the trademark ‘tancho’ — related to cosmetic products at the Jakarta Trademark Office. Although he succeeded in registering the said trademark, the Supreme Court subsequently annulled the registration based on the finding that the said Wong A Kiong had, at all times, failed to act in good faith. In particular, he had intentionally chosen to use the name ‘tancho’ despite having known that the name/label is associated with *Tancho Kabuashiki Kaisha (Tancho Co Ltd)* — a foreign entity in Indonesia.⁴²

Article 1 of the Trademark Law No. 19/92 recognizes the following as registrable marks (*merk dagang*): brands/labels of goods that are commercial products; service marks used for commercial activities; and collective marks used as brands for goods and services. In order to be registrable, a mark must fulfil certain criteria. First, the mark/label must be ‘sufficiently distinctive’ (Article 5); and second, it shall not contravene good moral and public policy. However, registration will be refused if a mark/label is in principal or on the whole similar to that owned by others (it should not confuse the general public). Is a licensing agreement of trademarks valid and registrable? The Supreme Court decision of the ‘*Gold bond*’ (Gallaher case) endorsed the ‘legal validity’ of licensing agreements of trademarks within the scope of Article 44 of the TML of 92. Insofar, as such agreements do not contain provisions that are contrary to the public good and/or economic progress of Indonesia, and is in addition executed in ‘good faith’.

Significantly, the new law introduces the concepts of ‘geographical indicators’ and ‘applications of origin’, in accordance to the TRIPs. ‘Geographical indications’ are indications that identify goods as originating in the territory of a TRIPs member or a region or locality thereof, where the quality, reputation or other characteristics of the goods are essentially

derived from that geographical origin or quantity, including the nature, human factor or a combination of these two factors (Article 22). In this regard, the GOI must provide the legal means to protect registrants of geographical indications. Moreover, it is necessary to prevent: (a) the use of any means in the designation or presentation of a good that indicates or suggests that the good in question originates in a geographical area other than the true place of origin in manner which misleads the public as to the geographical origin of the good; and (b) any use which constitutes an act of unfair competition within the meaning of Article 10bis of the Paris Convention (1967). However, registration of geographical indications will be refused if the trademark is contrary to good morals and public policy, or capable of misleading the public concerning the feature, quality, or origin of production or its use. Certainly, investors would welcome this aspect of the law, although its efficacy squarely depends on its implementation.

The new law also enumerates the principle of ‘honest trade practices’ and ‘good faith’, and to this extent, seeks to strengthen the protection of well known trademarks; hence, the protection is not limited to similar goods and services, but *also extends to non-similar goods*. In the Supreme Court decision of the “*Gucci case*” (Supreme Court No. 3485/Pdt/1992 of 4/9/1995), it was held:

[T]he Paris Convention requires also from its members to give the same treatment in protecting owners of well-known trademarks whatever their origin; that the trademark ‘Gucci’ is a trademark which is widely known, crossing national boundaries of its origin, because it has good reputation, regionally as well as internationally, and therefore Gucci is to be classified as belonging to the group of well-known marks; that because Gucci is grouped as a well-known trademark, in this country it has to receive same protection as in its country of origin, Italy, that since Indonesia itself is a member and joined the ratification of the Paris Convention, even ‘without reservation’, the provisions of this convention should be fully complied with.

Patents are defined, according to Law No. 6 of 1989 (as amended by Law No. 13 of 1997), as “a special right granted by the state to an inventor for the results of his invention in the field of technology to personally implement his inventions by himself or to authorise another person to implement it” (Article 1 of Law No. 6 of 89). Article 2 further defines ‘inventions’ as “the activity of solving a certain problem in the field of technology, either in the form of a production process or product or an improvement and enhancement of a production process or product”. In addition, the ‘invention’ must be new, contain an inventive step, and be industrially applicable (Articles 2, 3, and 5). Gautama (1997) observes that “unlike the old Act which stipulates that an invention is regarded as not being new because it is not yet made public, under this new Act the novelty characteristics are base on the result of an evaluation that at the time an application for a patent is accepted, the invention is not part of the previous one or the one that has already existed (Article 3)”.

A registered patent holder may exercise the ‘exclusive right’ to use the patent commercially by himself or license the same to a third party (the patented product may be sold, rented, supplied for sale, or rented to deliver the patented products). In line with the TRIPs framework, a patent right owner may prohibit imports of products, which purports to infringe his ‘proprietary rights’ (Article 21). However, such importation is permissible if, firstly, it assists in improving the overall welfare of Indonesia and, secondly, the patented product is yet to be produced in Indonesia. The new Law No. 14 of 1997 extends the protection period of patents from 14 to 20 years. Finally, simple/utility model patents (*paten sederhana*) now have a protection period of 10 years. To some extent, the Law No. 13 of 1997 has widened the registrable list — for example, chemical production processes aimed at producing food and drinks for consumption by men or animals, as well as new varieties of plants, animals or cultivation processes, are now patentable.

Can compulsory licensing be invoked? Failure to implement a registered patent may allow a third party to use and implement the patent. To do so, in accordance to Articles 81-87, a private person or corporate entity must seek the approval of the Courts. Provided that 36 months has lapsed since the date of patent registration, and the patent holder concerned has failed to commercially exploit and implement the patented product, Courts may issue the appropriate “Order of Court”. In doing so, the Court must convince itself that: the applicant is financially viable; is capable of implementing the patent commercially; and the product would, by and large, benefit Indonesian society. In addition, under Articles 104-108 of Law No. 13/97, the GOI may undertake the implementation of a patent that is deemed as “very important for the defense of the security of the state”. Potentially, this provision of the law could be widely interpreted.

Apart from the substantive law, what is crucial is the legal and institutional ability to provide immediate redress in the event of a third party IPR infringement (such as in cases of passing off, imitation, or piracy). In Indonesia, a civil action can be instituted to claim damages for (economic) losses suffered due to an act of infringement. It should be noted that the Courts may, if warranted, issue a preliminary ‘Injunction Order’ to prevent further alleged violation of IPRs while the necessary investigations and/or trial is proceeding. Most certainly, this is an important component in the enforcement of IPRs. In addition, the new Law No. 13/97 (Article 123a) — in line with the TRIPs (Article 34) — has reversed the burden of proof in civil patent infringement cases (therefore the onus is on the defendant to prove that he is not infringing the patent in question). This is a noteworthy change, as satisfying evidential burden has been a major hurdle in patent infringement cases. Notwithstanding, the civil action the infringer may

also be indicted in the criminal Courts and, if found guilty, can be sentenced to up to 7 years imprisonment and/or fined up to a maximum of Rp 100 million.

Indonesia has, as of 2002, ratified several IPRs international conventions. Under Presidential Decree No. 24 of 1979, Indonesia ratified the Paris Convention (with reservation to Articles 1 to 12, which consists of substantive provisions related to patents and trademarks). Presidential Decree No. 15 of 1997 has now withdrawn the said reservation and adopts the convention in its entirety. The Patent Cooperation Treaty (PCT) was adopted in 1970 with reservation to Article 59 (which allows disputes to be adjudicated before the ICJ). Similarly, Decree No. 16 of 1967 has withdrawn the reservation and adopts the convention in its entirety. The PCT would facilitate the filing of applications for the protection of inventions in any contracting state; these are treated as ‘international applications’ under the treaty (the treaty is administered by the World Intellectual Property Organization (WIPO), of which Indonesia is a member). The Trademark treaty, as administered by WIPO, was fully adopted via Presidential Decree No. 17 of 1997.

Although Indonesia withdrew from the Berne Convention in 1958 — due to the then perceived ‘impracticalities’ it could have had created — as a member of the WTO it is committed to the TRIPs framework (which in turn embraces the Berne Convention). Therefore it has re-adopted the same, via Presidential Decree No. 18 of 1997. Another issue of note is related to copyright matters — Presidential Decree No. 19 of 1997 now fully adopts the WIPO Copyright Treaty.

It should also be noted that, in recent years, three other IPR instrument-related laws were enacted in the DPR — industrial design, integrated-circuit space design, and trade confidentiality, all of which are integral for the continued innovation and development of the manufacturing and electronic sectors, and for facilitation of technology transfer. As noted earlier, the 1997 IPR laws (copyright, patent and trademark) are slated for further amendments and/or modifications. All indicators show that the GOI is committed to reform the IPR regime, in line with international best practice. The promulgation of the 1997 laws is a significant step towards achieving this goal. The accession to the several international conventions itself is a noteworthy accomplishment. Still, much of the legislative details of the new IPRs laws are left to implementing regulations. Typically, this allows wide latitude in ‘administrative discretion’ in interpretation, implementation and enforcement. To operationalize the new IPR laws, it is crucial that all the relevant implementing regulations are promulgated in a timely manner, and within the ‘intent and letter’ of the primary law. For instance, on the notion of ‘compulsory licensing’, it is extremely crucial that the implementing regulations set out the exact details of

the scope and extent of its application. Compulsory licensing has the potential to infringe proprietary rights — therefore, foreign entities would naturally be wary of its implications.

It should be noted that, at present, the relevant institutions and the judiciary neither possess the efficiency nor the dynamism to implement and enforce the IPRs laws strictly. Reportedly, the Intellectual Property Rights Office is swamped with a huge backlog of IPR applications and the staff thereat lack the necessary technical knowledge that is essential to understand IPRs (EIU 2001). Fundamentally, in the context of IPRs, time is of the essence. Hence, in the event of an IPR infringement by a third party, it is crucial that the law and the relevant institutions are harnessed promptly and effectively to curb the infringement. Suffice to say that any economic loss suffered in such a situation can be substantial. In addition, business goodwill will be tarnished. Empirical studies show that developed countries such as the U.S., the U.K. and Germany have in place efficient institutions and civil courts that implement and enforce IPR laws swiftly and strictly — as such, they are able to maintain investor confidence and attract FDI (Braga 1999). Indonesia hitherto has been largely averse towards doing so. This stance must change.

Globalization and the advent of information and communications and technology (ICT) pose fresh challenges to the IPR regime. First, there is a need to conceptualize an effective and credible enforcement mechanism. Second, public awareness of IPRs must be transmitted through education, mass media, and other mass communications media. Third, the law must mould together with the economic imperatives in order to avoid a ‘legal vacuum’. Fourth, and most important, the civil courts must play a pivotal role in enforcing IPRs laws and regulations consistently and strictly. In this regard, it is essential that judges acquaint themselves thoroughly with the rudimentary principles governing intellectual property instruments. It is discernible that the incorporation of the TRIPs framework and the major IPR conventions (as mentioned above) would provide fresh impetus to the IPR regime in Indonesia. Although the TRIPs Agreement lays the foundation towards a higher standard of protection of IPRs on a global scale, it leaves its signatories with some flexibility in designing national IPR regimes. The performance of a country’s court system is an essential part of any legal system framework for business activity. Needless to say, potential investors will be interested in the competence and independence of the Court system, as well as its accessibility and efficiency. It remains to be seen how, in daily legal practice, all these new laws and conventions for the international protection of IPRs will be applied by the Indonesian Courts and the relevant institutions.

Administration of Justice/Dispute Settlement

The FIL provides for ‘arbitration’ under the auspices of the Convention for Settlement of Investment Disputes (ICSID), in the event of a legal dispute arising between an investor and the GOI (the convention was ratified by Law No. 5 of 1968). Gautama (1995: 431-437) is of the view that in the context of Indonesia *per se*, dispute resolution under the ICSID framework can be a “lengthy and expensive affair” — he cites the long-drawn dispute of the AMCO case (*Case No ARB 81/1 as AMCO v Indonesia*). This case commenced on or about 27/2/1981 and reached its finality in 1992. In the 12-year period the case went through the stages of annulment, various re-submissions, and multiple re-findings. It is worth noting that, at all material times, the Supreme Court of Indonesia — via application of the exclusive power of ‘cessation’ — interfered extensively in the case. Ideally, this should not to be the case. Arguably, the availability of the ICSID dispute mechanism will, at the very least, maintain some degree of investor confidence — foreign investors will have the benefit of a third party adjudicating a dispute matter with the GOI, if any.

Principles and rules governing commercial arbitration are encapsulated in the First Title of Book 111 of the Code of Civil Procedure (CCP). Certain aspects of this law were amended in the recent Arbitration Law No. 30 1999. However, it does not overhaul the existing arbitration framework, which is considered partly archaic. How is an ‘arbitration clause’ interpreted? In the case of *Ahju Forestry Company Ltd v PT Balapan Raya* (Supreme Court case no. 2924K/sip/1981), involving a legal dispute between a Korean company and its Indonesian partner, the District Court and the High Court assumed competency and jurisdiction in the matter — notwithstanding the fact that an arbitration clause existed in the relevant contractual documents of the two companies. On appeal, the Supreme Court overruled the said District Court and High Court decisions and upheld the legal validity of the existing arbitration clause and pronounced that the Courts in Indonesia are bound by such arbitration clauses in a contractual agreement. Similarly, in the case of *PT Metropolitan Timber v PT Gupki Trading Company* (no. 2225k /sip/1976), the Supreme Court once again strictly applied the validity of an arbitration clause. However, there are also reportedly instances (quite a few) when the Courts outrightly refused adherence to arbitration clauses in the contractual agreements.

The *Badan Arbitrase Nasional Indonesia* (BANI) — operating under its own set of rules and procedures — essentially administers the domestic arbitration framework.⁴³ In accordance to Article 634 of the CCP, all arbitration awards must be registered with the District Courts. Subsequently, an arbitration award is only enforceable when an order for enforcement (*exequator*) is obtained from the District Court. As a preliminary exercise, before granting an execution order, the District Court will take pains in satisfying itself that the arbitration

procedure and/or award did not infringe any public policies at all material times. As a general rule, an arbitration ruling and award is final and binding, but can be set aside under certain circumstances (Article 642, CCP) (see Annex VIII).

It is fair to say that the above-mentioned Article 642 of the CCP has a wide ambit and, correspondingly, any ‘factual findings’ could also be broadly interpreted. In short, it allows ample opportunities for the Civil Courts’ intervention — in which case the purpose of domestic arbitration is defeated and becomes questionable. In practice, foreign entities tend to seek arbitration outside Indonesia (for example, in the ICC in Paris, the London Arbitration Center, or Arbitration Centre in Singapore). There is apparently some degree of doubt surrounding the credibility and efficiency of BANI. Green (1999: 298-299), in his study of the foreign investors’ perception of the BANI, noted the certain issues that might question the legitimacy of BANI (see Annex IX).

Next, the crucial question is: are foreign arbitration awards enforceable in Indonesia? As a general rule, in tandem with international practice, Indonesian Courts do not recognize and enforce foreign arbitration awards — unless there are existing treaties at the bilateral, regional or multilateral level facilitating such recognition and enforcement. To this end, Indonesia acceded to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards on 7/10/81, via Presidential Decree 34 of 1981. Initially, it appeared as if the Courts of Indonesia were reluctant to abide by the said convention.

In 1984 the Supreme Court held that in accordance with Indonesian practice, it would still be necessary for the Government to promulgate implementing regulations. And those regulations should be observed both when a request to enforce a foreign award should be made to a District Court or when such request should be made directly to the Supreme Court for a determination as to whether the award is contrary to Indonesian public policy.

Gautama (1995:479) argues against the Court’s ruling and asserts that the Presidential Decree No. 34 of 1981 has the inherent legitimacy to ‘jump start’ the said convention. In addition, it can be argued that the Court’s ruling seems to contravene Article 111 of the convention, which stipulates:

[E]ach contracting state shall recognise arbitral awards as binding and enforce them in accordance with the rules of procedure in the territory where the award is relied upon, under conditions laid down in the following article. There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards.

The ‘legal uncertainty’ prevailing over the convention was eventually suppressed by the promulgation of Supreme Court Regulation No. 1 of 1990. Still, it is unfortunate that it

took nine years to finally embrace the convention; even so, the following conditions must be fulfilled:⁴⁴

- A tribunal in a country must render the award, which is a party to a bilateral or multilateral convention with Indonesia concerning the reciprocal recognition and enforcement of foreign arbitral awards;
- The award must relate to a cause of action that would fall within the scope of commercial law, as the term understood in Indonesia law; and
- The award must not contravene Indonesia law and public order or public policy.

There is a clear recognition today that formal adjudication (civil litigation) is not the most pragmatic and practical way to resolve commercial disputes. In this context, Alternative Dispute Resolutions (ADR) — in the form of arbitration, negotiation and mediation, amongst others — are being pursued actively, particularly in the developed countries. Suffice to say that ADR tends to be procedurally less formal, more inexpensive, and generally allows greater flexibility in dealing with a matter under dispute. Given the general perception of the judiciary as ‘weak and inefficient’, it is pertinent that Indonesia makes every effort to develop and promote the ADR mechanism. For a start, arbitration, as a means of dispute resolution, ought to be actively encouraged. In this context, the present rules and procedures should be redefined to enhance transparency and accountability. Most importantly, the Courts must strictly validate arbitration clauses and awards.

Civil Jurisdiction

To date, the basic court structure and procedures are still governed by Dutch colonial law (the *Herziene Indonesisch Reglement*), which many have argued is “obscure” and may not support the “modernity and dynamism of the present era of globalization” (Pompe: 1999). In general, all civil cases are commenced in the District Courts (*Pengadilan Negeri*). Thereafter, appeals from the District Courts are heard in the High Courts (*Pengadilan Tinggi*). Finally, the Supreme Court (*Mahkamah Agung*) is the highest Court in Indonesia and therefore is deemed to have ‘exclusive jurisdiction’ over all matters (both civil and criminal). In practice, at least three judges preside over a Court hearing (Law No. 15 of 1965), and the judges are obliged to attempt conciliation amongst the parties — which underscores the *pancasila* ideology.

The Constitution (1945) does not categorically stipulate that there is to be an ‘independent’ judiciary. The elucidation of the law states that “[j]udicial authority is an independent authority, in the sense that it is beyond the influence of the government” — a broad and vague notion. Theoretically, the judiciary is independent (Article 4 (3) of the Law on Judicial Power, and MPR No. 11/MPR/1978). However, in practice the judicial structure is

part of the government — judges are civil servants (Article 14 of Law on General Courts), members of the Public Servants Corps of the Republic of Indonesia (KOPRI). Under Article 5 of Law No. 2 of 1986, the Minister of Justice is responsible for the “organization, administrative and financial supervision” of the Courts. Hence, the Minister of Justice shall not interfere in court proceedings. It can be argued that a strict distinction between ‘court’ and ‘non-court’ proceedings may not be visibly clear at all times. Lev (1978: 55-56) maintains:

Indonesian judges... conceive themselves as *pegawati negeri* (civil servants), officials, and as such, members of a bureaucratic class to which high status has always attached. One implication of the role of *pegawati negeri* is that it is patrimonially associated with political leaders, to whose will it must always be responsive. It is this as much as anything else that underlies the issue of judicial independence. Whatever the daily effects of the Ministry’s responsibility, it is symbolically important as a reminder of the judiciary’s conceptually limited authority and the direction of its loyalties.

Are foreign civil judgements recognized and enforceable in Indonesia? Article 436 of the Regulation on Civil Procedure stipulates: “foreign judgments (commercial matters) may not be executed in the territory of Indonesia except under Article 724 of the Commercial Code and other legislative instruments” (Article 724 pertains to the ‘general average’ as related to Admiralty Law). Reportedly, the Courts in Indonesia are prepared to recognize and enforce constitutive and/or declaratory decrees, insofar as they do not contravene public policies. Therefore, in all other circumstances, a foreign judgement essentially must be retried in the Courts of Indonesia. At best, a foreign judgment may be adduced as *prima facie* evidence; even then, it is solely the Courts’ prerogative to either accept or reject the evidence.

How do legal advisers to foreign investors perceive the judiciary mechanism? In a study conducted by Taylor (1999: 288), lawyers opined the following weaknesses in the judiciary:

- Judges are not trained to a level where they can comprehend foreign investment documentation in English and are not comfortable with international transactions;
- To foreign clients, it appears that the courts are biased in favour of the Indonesian party;
- Foreign clients believe that judges may be corrupted through bribery; and
- Decisions made by courts in commercial cases are not consistent.

In addition, Butt (1999:247) surmises:

In several recent cases, the court has been prepared to thwart the effect of its own decisions by ‘recommending’ that they not be implemented. This, combined with allegations that corruption, collusion and government interference are prevalent during the judicial decision-making process, has prompted much of Indonesian society to lose any remaining faith in courts they have been reluctant to use for many years.... To be truly independent, the judiciary must not only hand down impartial decisions. It must

also be able to enforce its decision. If judicial decisions are treated with contempt, the *negara hukum* (rule of law) cannot exist.

It should be noted that even the Supreme Court, on several occasions, was prepared to deviate from its own decisions due to non-judicial interference. To this end, the Supreme Court judges — by usage of *surat sakti* (informal letters) — have tacitly prevented the District Courts from following a former Supreme Court decision (albeit the fact the said decisions were not judicially overruled). Further, the backlogs of cases are exerting immense pressure on the legal system and confidence in the judiciary is virtually non-existent (Pompe: 63-66).

The lack of legal certainty — accentuated by the inherent corrupt judiciary, laxity of court procedures and rules, and out-dated substantive laws, amongst others — are now paramount concerns for foreign investors. Will the present era of *reformasi* reinvent the beleaguered judiciary? The Law on the Judiciary (No. 35/1999) apparently seeks to transfer much of the administrative power and autonomy to the judiciary, which was formerly held by the Ministry of Justice. As noted earlier, a number of Supreme Court judges have been replaced and the newly appointed judges were apparently appointed based on their merit and competence. At the time of writing, the controversial *Manulife case* purports to reveal the many shortcomings of the legal system: political intervention, slackness, and, most importantly, the lack of transparency. The former Attorney-General, Marzuki Darusman, commented: “concerted efforts are not being made to redress this [*Manulife Case*] and several similar cases that were brought to our attention recently... this case has brought our law enforcement system into disrepute and reinforced the adverse perception of our legal system” (*Jakarta Post*: 25/4/2001).

In terms of administrative justice, by virtue of Law No. 5 of 1986 on Administrative Justice, one may, through the Courts, challenge bureaucratic decision making practices that are in breach of the principles of administrative law. This is truly an unexpected legislative development — considering the fact that the then-President Soeharto had repeatedly shielded the executive mechanism from ‘judicial whipping’. The grounds for judicial review of an administrative decision are as follows (Article: 53 (2)):

- The decision under challenge conflicts with the operative law;
- The administrative body or official, in making the decision under challenge, used their authority for a purpose other than that for which it was granted; and
- The administrative body or official, after taking into account all the interests affected by the decision, should not have made, or failed to make, that decision.

It would be fair to say that — for the first time — a mechanism providing checks and balances on the executive has been attempted. Whether this is achievable depends upon three related factors (Quinn 1999):

- The extent to which the Administrative Courts are willing to enforce the provisions of the Law on Administrative Justice and allow the challenge of government decisions;
- The ability of the Courts to capture public confidence, and present the court system as a viable avenue for the protection of individual interests against the improper or illegitimate exercise of the power of the state; and
- The willingness of the bureaucracy to obey Court orders in the absence of any compelling enforcement mechanisms.

Reportedly — since the establishment of the Administrative Courts in 1991 — these courts have protected a range of interests. However, others have argued that it is effectively a ‘toothless tiger’, and enforcing Court orders against the relevant government agencies seem to be an on-going problem. It remains to be seen if the *reformasi* era will place administrative justice in the forefront.

An Outline of Bilateral, Regional and Multilateral Commitments

This subsection examines, in turn, the various bilateral, regional, and multilateral commitments that the GOI maintains with regard to FDI.

As of 1/1/2000, the GOI has had executed bilateral investment treaties (BIT) with 52 countries (UNCTAD 2000). Although the FIL (as discussed earlier) sets out the national FDI-framework, BITs are essentially country specific, and hence place the perspective on the rights, obligations and liabilities of Indonesia with a foreign investor country in a crystallized manner. The basic provisions of such treaties deal with most favoured nation status; national treatment; fair and equitable treatment; adequate and effective compensation; and a dispute resolution mechanism, among others (see Sornarajah 1994). To uphold legal certainty, it is crucial that the provisions of a BIT conforms with the national FDI laws — in this regard, the national FDI laws should exhibit a high degree of consistency and clarity.

Regional commitments typically involve ASEAN. In order to reaffirm the importance of sustaining economic growth and development in all member states through joint efforts in liberalizing trade and promoting intra-ASEAN trade and investment flows — as enshrined in the Framework Agreement on Enhancing ASEAN Economic Cooperation signed in Singapore on 28/6/1992 — the GOI effected the ASEAN Investment Agreement (AIA)⁴⁵ on 7/10/98.

Pursuant to the AIA, Indonesia shall (Article 4): (a) accord national treatment (admission, establishment, acquisition, expansion) to all ASEAN member states investors by

2010 and to all other nations by 2020; (b) allow entry to all economic sectors by 2010 or 2020 for ASEAN and non-ASEAN countries, respectively; (c) with immediate effect confer most favoured nation treatment to all ASEAN members; and (d) accommodate free flow of capital, skilled labor, professional and technology from member states. However, the GOI may abrogate from its obligations under the AIA framework in the following circumstances: (a) in the economic sectors under the temporary or sensitive lists (Article 7(3)); (b) in order to protect and safeguard its national security, public morals, laws and regulations and fiscal structure (Article 13); (c) in the case of provisional emergency safeguard measures taken to avert serious injury and threat (Article 14); and (d) when confronted with a serious balance of payments and external financial difficulties or threat thereof (Article 15).

In the event of invoking any of the above-mentioned article provisions, Indonesia shall notify its intention to the other ASEAN member states in a timely manner (Protocol on Notification Procedures, which, to an extent, is similar to that of the WTO framework). Furthermore, all disputes arising from the AIA framework shall be resolved in accordance to the Protocol on Dispute Settlement Mechanism for ASEAN, dated 20/11/1996. In essence, the said protocol seeks to resolve disputes in an informal manner — through consultation, conciliation and/or mediation. To prevent dilatory tactics, the said protocol prescribes a time framework of 290 days to settle a dispute (Article 10).

Broadly, from the regulatory perspective, the AIA in effect subjects each member state's legal framework for investment to scrutiny. Under Article 5, paragraph 5(b) of the AIA, Indonesia is to “[u]ndertake appropriate measures to ensure transparency and consistency in the application and interpretation of their laws, regulations and administrative procedures in order to create and maintain a predictable investment regime in ASEAN”. In addition, Indonesia is to inform the AIA council, on a regular, basis of all existing laws, regulations, administrative guidelines, and international agreements relating to investment (Article 11), subject to elements of confidentiality (Article 11 para 3). It is conceivable that if this functional aspect of the AIA is harnessed diligently, it could, to some extent, facilitate harmonization of the legal framework for investment within ASEAN. Ultimately, this would create legal certainty and shore up investor confidence in the region. In a broader context, however, the success of the AIA largely hinges on the effectiveness of its institutional framework (the AIA council) and, most importantly, the ‘political will’ of the member states to implement the necessary measures. The question to be asked is therefore: “To be or not to be?”

Indonesia became a member of the World Trade Organization on 1/1/1995 and therefore is obliged to comply with the Trade Related Investment Measures (TRIMs) (one of the agreements negotiated and concluded in the Uruguay rounds). The TRIMs recognize that

certain measures imposed by the governments in connection with investments have had restrictive and distortionary effects on trade. To this end, it prohibits Indonesia from applying any forms of trade-related investment measures that are inconsistent with Articles (iii) (national treatment) and (xi) (quantitative restrictions) of the General Agreement on Tariffs and Trade (GATT) which relate to imports. An implication of the TRIMs is that the GOI can be brought before the WTO 'Dispute Resolutions Mechanism' in the event of any breach of its obligations under the treaty.

V. Concluding Remarks

Broadly, 'legal certainty' would encompass issues such as: (a) dynamic and efficient substantive laws clearly stating the rights, obligations, and liabilities of all business parties; (b) rule-based business transactions; (c) procedural law providing prompt and inexpensive means to the courts; (d) an institutional framework that supports business development and sustainability; (e) strict adherence to the principles of 'rule of law' and 'supremacy of the law'; and — most importantly — (f) an efficient and independent judiciary. Regrettably, all the aforesaid are presently lacking in Indonesia. There is an urgent need to undertake reformatory works in the judiciary and the lawmaking process. The legal reforms should be considered as an integral part of the continuing and sustainable process of socio-political democratization. As Professor Muladi, the former Attorney-General, and Justice of the Supreme Court of Indonesia, puts it (Muladi 2001, p. 3):

In connection with those basic conditions, the nature of the reforms movement should be interpreted as an organized and systematic effort of the Indonesia people to actualize the core values or indices of democracy which had been manipulated and distorted during the Suharto regime.

Evidently, the commercial laws — as inherited from the Dutch — are archaic. The fundamental components of commercial law — such as contract law, security law, and agency law — do not lend support for modern, international business transactions. The DPR's reluctance and slowness in enacting modern, uniform and universal laws have already been noted. There is an urgent need to reinvent the legislature's stance. In this legislature process, a balance between idealism and pragmatism is important. The law should not be too ambitious, or it may not be effectively implemented; in which case, the law would merely be rhetoric rather than binding norm. However, most importantly for a nation that seeks to achieve sustainable economic development, the law cannot merely endorse existing practices — it must continue to strive for superior economic efficiency.

It is impractical and unreasonable to expect the DPR — given its sheer magnitude in size and the overly cumbersome legislative process — to enact modern commercial laws in the short term. Laws need to be enacted in a consistent and piecemeal manner. I would argue that the Courts in Indonesia should play a ‘proactive’ role in the development and progression of the law. Under Government Regulation No. 2, dated 10/10/1945, the Courts may refuse to apply the relevant colonial Dutch laws so long as they contradict the spirit of the Constitution. The *Pancasila* principles — as embodied in the Constitution — seek to mould a progressive and modern Indonesia; thus, in this respect, the judicial Courts of Indonesia have the golden opportunity to make laws that facilitate and develop modern business practices. Partly, this is necessary, as total reliance on the DPR to promulgate modern laws would entail a long, drawn-out process. Considering the present situation, Indonesia simply cannot afford the luxury of procrastination if it desires to regain its coherence and confidence as a nation and a global player. However, in exercising its powers, the Courts must themselves be subject in obedience and subordination to the supremacy of Parliament and the Constitution.

Primary laws are noted for their brevity in content — the filling in of implementing details are often left for secondary legislation. It is not surprising to find a plethora of secondary legislation (decrees, regulations, directives, and so on) addressing a particular (primary) law enacted by the DPR. Presently, there also exists secondary legislation whereby the scope of its applicability and validity is not entirely clear. These are also characterized by the custom, in Indonesian legislation, of superimposing one new law on the body of existing laws regulating the same subject — rendering the whole structure opaque if one reads only one or two documents. This precarious situation needs immediate redress.

First, it would be preferable if the primary law addresses the substantive ingredients with a reasonable amount of detail, and furthermore explicitly states the scope and extent of the corresponding secondary legislation, if any. Second, amendments, modifications and repeals of the existing laws must be clearly stated and gazetted. Third, and most importantly, the Administrative Courts must play a pivotal role in ascertaining that secondary legislation — *as per* promulgated by the executive — is within the ambit of corresponding primary laws. In sum, the substantive laws must endeavor to provide the elements of ‘certainty’ and ‘predictability’ in the conduct of business transactions (rights, obligations and liabilities).

Presently, the RAL and FBL are certainly causing a legal quagmire. Apart from the autonomy regulations contradicting the RAL, other laws — such as the mining law and basic agrarian law, amongst others — are also inconsistent with the same. There is an urgent need to coordinate all laws and regulations in a pragmatic manner. Suggestions to effect these could include: a detailing of regulations and decrees addressing the licensing procedures; more

integrated coordination between the BKPM/BKPMMD and all other relevant ministries and government agencies; increased certainty in the implementation of the fiscal laws and policies; increased certainty in land rights and environmental matters; and increased certainty in regional jurisdictions. On this final point, what is of concern is the need to clarify the extent and scope to which regional governments can foster and control FDI within their respective jurisdictions.

It is a widely known fact that corruption, collusion and nepotism (KKN) are pervasive in Indonesia (*Jakarta Post*: 15/5/2001). It has been noted that Law No. 28/99 and Law No. 31/99 were promulgated to combat such ill-practices, but as of to-date, the GOI has been criticized for its slackness in enforcing the said law. The Supreme Court has reportedly annulled the regulation setting forth the creation of a joint investigating team (JIT), which was to investigate complaints of corruption in the Courts. The motive behind this action is questionable and suspicious — “certainly the court’s ruling and government inaction raised barely a ripple of indignation from the public or media, inured to such perceived inconsistencies” (*Jakarta Post*: 14/5/2001). Indonesia Corruption Watch claims that only 5 of 41 Supreme Court justices it investigated “cannot be bought” (*Jakarta Post*: 14/5/2001).

It is crucial that the judiciary is wholly reformed. Suffice to say that corruption in general is a deadly and virulent disease — as such, corrupt practices in the judiciary are made even more despicable. When the keepers of law and order are infested with ‘tainted blood’ — what faith and trust can the business community and society at large possibly behold? In the event that the judiciary fails to reinvent itself for the better, then by all accounts one can say that the ‘*Reformasi* era’ has tacitly re-endorsed the revival of the ‘Suharto era’, at least in the judiciary. Certainly, this would substantially undermine investor confidence. Furthermore, Indonesia runs the risk of being marginalized as a nation.

Today, in Indonesia, the legal system is witnessing a paradigm shift — a shift that requires major adjustments at all levels. Hence, strong political commitment is essential not only to push through a legislative reform package but also to ensure its effective implementation. Therefore, reforming the macro-legal environment implies not only new laws and regulations fostering FDI, but also institutions and administrative personnel to support, implement and enforce such laws and regulations. The task is to find the proper balance between various competing objectives and to determine the proper instruments to achieve those objectives. Some basic principles, which can be considered fundamental components of a macro-legal environment for FDI, include:

- Publicity of the rule of law, which enables all concerned parties to have access to the laws they have to abide by;

- Clarity and certainty of the legal framework, which allows such parties to understand which laws are applicable to their situation, and what their specific meaning is;
- Predictability in the application of the rule of law, which reduces the risks linked to changing interpretation, implementation or enforcement of the laws;
- Stability of the legal, political and policy frameworks, which provides investors assurances that the GOI will not unilaterally and unfavorably change the basic conditions underlying their investment decisions; and
- Fairness, possibility of legal recourse, and due process, with access to independent judiciary and dispute settlement mechanism; and

In sum, what is required is a nation governed by the rule of law.

NOTES

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1. The International Monetary Fund defines ‘direct investment’ as “investment in enterprises located in one country by effectively controlled by residents of another country”; generally, for statistical purposes, equity investments of 10% or more are considered direct investments.
 2. In the 1960s and mid-1970s Indonesia, dominated as a major oil producer, but endured an economic crisis in the 1970s due to huge plunge in oil prices. The petroleum sector contribution to the economy has declined from its peak in the early 1980s, when it accounted for 80% of export earning and two-thirds of government revenues — see INDIO (May 1996).
 3. Correspondingly accumulated approvals for domestic investments totalled Rp 422.4 trillion — see INDIO (May 1996).
 4. Undang-Undang No. 22, 1999 Tentang Pemerintah Daerah (7 Mei 1999).
 5. Undang-Undang No. 25, 1999 Tentang Perimbangan Keuangan Antara Pemerintah dan Daerah (19 Mei 1999).
 6. A practice that is followed in a particular locality in such circumstances that it is to be accepted as part of the law of that locality.
 7. The BHPN (Badan Pembinaan Hukum Nasional) is the government agency ordained with the task of reviewing all colonial laws/ regulations to ensure that they are in line with democratic principles.
 8. The UUD45 consists of 37 articles and 4 transitory rules. Its ideologue and concepts were laid by the founding fathers of Indonesia (Muhammad Yamin, Supomo, Sukarno and Hatta).
 9. It is common to see secondary legislation not conforming to the ‘spirit and letter’ of the primary laws whereupon it derives its source — invariably, this creates inconsistencies and uncertainties of the law.
 10. Since the fall of Suharto, there have been strong calls from political observers to fully democratize the institution of the ‘presidency’ (elected by the people). For a succinct

- descriptive analysis of the various government institutions, see Himawan (1997: 239-246).
11. Generally, natives engaged in a contractual relationship with foreign entities embrace the Dutch codes by voluntary submission — contractual principles are contained in Book 111 of the Civil Code. The *adat* law does not possess the dynamism to support complex commercial agreements; see Gautama (1995:74).
 12. Technically, the 400 inherited colonial laws are to be replaced in piecemeal manner during the Second Long Term Development Plan (1993-2118). Himawan (1997:243) is unconvinced and states: “[a]t present rate of about nine pieces of legislation being produced annually, it is highly questionable whether the DPR can discharge its main function of passing legislation and overcome the existing paucity of substantive law”.
 13. De Soto, in his research with respect to Peru, found overwhelming evidence that an inefficient legal system: reduced investment; led to a stagnation of growth of big and efficient enterprises; limited usage of properties as collateral; and led to stagnation resulting from the lack of a system for transferring and organizing property rights, among others (De Soto 1989).
 14. The FIL is noted for its brevity in content — like other primary statutes (*undang-undang*), it is supplemented by implementing regulations, which are promulgated via ministerial and presidential decrees.
 15. The GOI’s economic management philosophy and objectives are laid out in a series of five-year developments plans, called Repelitas. These began the financial year 1969/70. Repelita VI commenced in April 1994 and will continue until April 1999. The end of Repelita V marked the conclusion of the government’s first 25-year long-term development plan. The fundamental objectives of Repelita VI, and the second 25-year long plan development program, are to advance and consolidate national self-reliance and to boost further economic growth, creating a prosperous and equitable society.
 16. A vice-chairman — together with deputies for planning, promotion, evaluation and permits, guidance and implementation — assists the chairman, who is also the Minister of Investment. The BKPM administers the FIL and grants foreign investment approvals and licensing (it is authorized to issue various supplementary licenses and permits on behalf of 13 ministries). However, FDI in the bonded zones are considered by the BKPM, through submission of applications via the respective bonded zone authority.
 17. Application for an investment approval to the BKPM/ BKPMMD would entail submission of the following documents: model 1 (PMA); power of attorney; Articles of Association of both foreign and Indonesian entities in the case of a joint venture; and a detailed description of the production process in the form of a flowchart, block diagram, or other technical form. Level I and level II regions are the provinces and the districts/municipalities, respectively.
 18. Presidential Decree No. 96/2000 effectively banned foreign participation in the multimedia sector and reduced foreign equity participation in the telecommunication and airlines sectors to 49%, which caused much unhappiness amongst the foreign investors. However, the GOI changed its policy within months, and — via Presidential Decree 118/2000 — removed both the said restrictions.
 19. The GOI is clearly embarking on a policy to protect and promote the domestic small-scale businesses.
 20. These would include different aspects of: agriculture, livestock, fishery, food and beverage industry, processing and canning of fruits, processing of spices, palm essence industry, rice milling and threshing, copra industry, sugar industry, silk yarn spinning industry, wood carving industry, downstream of paper production, rubber goods for usage, agricultural machinery industry, fluid machinery industry, bicycle industry, silver handicrafts industry, mining, retailer, wholesaler, trading services and others,

- restaurant, construction for building very simple houses, medical services, and electricity supporting services.
21. In order to attract private sector investment, including FDI, the GOI gave its support to a new investment approach through a variation of the build-operate-transfer or BOT model. This type of scheme is also known as the joint operating scheme (*Kerja Sama Operasi* or KSO) scheme.
 22. The GOI allows foreign participation in mining sector, if it serves the ‘public interest’ and does not contravene the principles of *Pancasila*. For investment purposes, the minerals are divided into 3 categories: (a) strategic minerals — oil, tin, nickel, uranium and other radioactive minerals, coal, cobalt, and asphalt; (b) vital minerals — gold, silver, lead, zinc, copper, bauxite, manganese and iron; and (c) others — primarily industrial minerals including limestone, clay, sulfur and gypsum.
 23. Law No. 10 of 98, dated 10/11/98, was promulgated to strengthen the governance on banking practice of foreign and domestic financial institutions. Further, the Central Bank power of prudential supervision was enhanced. As part of the on going reforms in the beleaguered financial sector, the Indonesian Bank Restructuring Agency (IBRA) (a government agency), was established to assist in the operation of all problematic banks, and thereby several state and commercial banks were put under its supervision.
 24. The DPRD is the regional legislative body found in the provinces, regencies/municipalities. See chapter (v) of the RAL regarding its conceptual and functional roles embracing modern democratic principles.
 25. The recent MPR Decree (Ketetapan MPR 111/2000) concerning the Origin of Law and the Hierarchical Order of Legislative Rules stipulates (in Article 4) that a legislation of a lower level shall not contradict and/or contravene a legislation of a higher level.
 26. Decisions relating to contractual agreements in the petroleum (oil and gas) and mining sectors were held in abeyance until 2001 (when the RAL came into force).
 27. For a refreshing legal analysis of the RAL, see Bell (2001). As the RAL is a relatively new law, there has not been much written analysis of it as yet.
 28. See *The Straits Times* dated 1/1/2001, 2/1/2001, 3/1/2001, 4/1/2001, 6/1/2001, and 5/3/2001.
 29. Gautama (1997: 129) commented: “[t]he new PT law has now become positive law... [i]t was the result of a long procedure and efforts to reform the old provision concerning limited liability companies, as contained in Article 36 to 56 of the Commercial Code. These articles had long since been left to be no longer fitting into the current world economic structure, which has shown remarkable development, nationally as well as internationally”. The UPPT came into force in March 1992 and therefore technically all corporate entities should now be in compliance with the UPPT.
 30. Thereafter incorporation, any fundamental amendments to the Articles of Association shall only be permissible after prior approval from the Ministry of Justice — all other simple amendments need only be registered with the Registrar of Companies (Article 15 of UPPT). Creditors may object an amendment to the Article of Association providing for reduction of capital (Article 19 of UPPT).
 31. By virtue of Article 79 of UPPT, a company director or commissioner must be an individual whom: is not a bankrupt; was never responsible for a company driven to bankruptcy; has not committed a criminal act causing financial loss to a company; and has legal capacity.
 32. The Bankruptcy law of 1999 replaced the old law dating back to 1905. Some critics have argued that it is not comprehensive and is inadequate to support modern business dynamics.
 33. In 1976, the GOI established the Capital Market Operation Board (BAPEPAM) and a state owned company to operate and promote the capital market (PT Danareksa). BAPEPAM now possesses only a regulatory and supervisory role; the stock market is

- run by private agencies licensed by the Minister of Finance. Under the UPPT, a merger (*penggabungan*) is when a company becomes part of another existing company; consolidation (*peleburan*) refers to a transaction in which two companies dissolve themselves to form a new company; and acquisition (*pengambilalihan*) refers to company or individual taking over a company through a purchase of the latter's shares.
34. Reportedly, as at January 2001, the Business Competition Supervisory Commission has commenced investigating complaints of alleged monopolistic practices of the following entities: PT Inti Boga Sejahtera, PT Indofood Sukses Makmur, PT Bogasari Flour Mills, PT Aqua Golden Mississippi, PT Unilever Indonesia, PT Sntos Jaya Abadi, PT Asahimas Flat Glass and Pertamina. See Indonesia BizWatch, TDB, January 2001.
 35. In an attempt to redress the lack of coordination within the government ministries and institutions, the Ministry of Agriculture and Forestry was formed in August 2000, in order to oversee environmental policies and enforcement of the relevant laws.
 36. In the year 2000 a number of labour disputes erupted — in June, 150 workers at PT Kaltim Prima coal went on strike, and the 30-day strike reportedly led to economic losses of about \$232,000 per day. In April, PT Kelian Equatorial mining was forced to stop operations in order to resolve labour disputes, among others. PT Sony Electronics endured labour unrest practically throughout the year. Also, sporadic labour unrest was reported in several provinces and districts (EIU 2001: 46).
 37. The prices of land and the estates' facilities are the major determinants of land sales. The occupancy rate in Batam Industrial park used to be fairly high; however, after the May riot and the uncertainty regarding the imposition of VAT, a few companies have chosen to relocate. See Indonesia Bizwatch (TDB 2000). (An industrial estate is 'self-contained' — wherein facilities such as water, electricity, sewage system, telephones, postal services, and housing are readily available. These tend to be located near ports and provide good transportation facilities).
 38. Seven bonded zones have been established — Jakarta, Batam island, Ujung Pandang (South Sulawesi), Pasuruan (East Java), Semarang (Central Java), Bekasi and Bogor (West Java). (KBs are building places or areas with certain borders in which industry activities for the processing, design, engineering, sorting, initial/final inspection, and packaging of goods and imported materials — or goods and materials originating from other Indonesian customs areas — are conducted. Products are mainly exported (BKPM). To obtain a license to operate in a KB, a foreign entity must fulfil the following: adduce evidence of ownership or control of a building, place or area with clear borders situated in a industrial zone; possess an industrial license and other licenses required by the related technical offices; subject itself to an environment impact analysis; and register as a taxable entrepreneur (PKP).
 39. 'Deemed income' is predetermined for foreigners working in the petroleum and mining industries as follows: general managers — \$11,275 per month; managers — \$9,350 per month; supervisors and tool-pushers — \$5,830 per month; assistant tool-pushers — \$4,510 per month; and crew members — \$3,245 per month. Presently, the personal tax stratum consists of 3 tax brackets — 10% on the first Rp25 million; 15% on Rp25-50 million; and 30% on income exceeding Rp50 million. The tax law allows the following deductibles: basic exemption (Rp 2.88 million); spouse and each dependent (maximum of 3; Rp 1.44 million); 5% of gross earned income, with a maximum of Rp108, 000 per month (Rp 1.3 million a year) for occupational expenses; 5% of gross income, with a maximum of Rp 36,000 per month (Rp 432,000 per year) for pension costs.
 40. The TRIPs is one of the pillars of the new multilateral trade order under the WTO. Essentially, it requires its signatories to apply the principles of 'most-favoured nation' and 'national treatment' to intellectual property protection. It also sets minimum standards of protection with respect to all forms of intellectual property: copyright,

- trademark, patents, service marks, geographical indications, industrial designs, layout designs of integrated circuits, and trade secrets. See Braga (1996)
41. Reportedly, the GOI notified the WTO in December 2000 that it was unable to fully conform to the TRIPs framework by January 2001.
 42. Another landmark case in the similar context is the 'NIKE' case (Decision No. 220 PK/Perd/1986).
 43. The BANI was established in 1997 under the auspices of the Indonesian Chamber of Commerce and Industry (KADIN). Its panel of arbitrators consists of retired justices of the Supreme Court, law academics, experts in finance, and other prominent persons. Perhaps to built its credibility and image, it ought to have foreign arbitrators in its panel.
 44. To enforce a foreign arbitral award in Indonesia, the applicant must obtain a writ of execution from the Supreme Court by registering an application with the office of the Registrar of the Central Jakarta District Court.
 45. For a illuminating essay on the AIA framework, see Freeman (2000:80-114).

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Appendix I

The preamble of the FIL succinctly states the overall economic policies of Indonesia, and within that context, the role and purpose of FDI. It enumerates the following:

- a. That, throughout the territory of this country, as a blessing of God, potential economic resources are found abundantly which have not yet been transformed into real economic strength because of among other things, a lack of capital, experience and technology.
- b. That Pancasila is the spiritual basis for the development of the Indonesian economic system and should always be reflected in economic policy.
- c. That economic development requires the transformation of potential economic resources into real economic strengths through investment, utilization of technology, expansion of knowledge, improvement of skills, and increases in organizational and managerial ability.
- d. That efforts to overcome economic decline and further develop our economic potential should be based on the capabilities and capacities of the Indonesian people themselves.
- e. That nevertheless this principle of relying on our own capability and capacity should not lead to a reluctance to make use of foreign capital, technology and skills, so long as these are truly devoted to serving the economic interests of the people without causing dependence on foreign countries.
- f. That foreign capital should be utilized to maximum advantage in order to accelerate the economic development of Indonesia, as well as utilized in other fields and sectors, where Indonesian capital for the time being is not yet being employed.
- g. That it is imperative to devise clear regulations in order to fill the need for capital for national development, as well as to avoid uncertainty on the part of foreign investors.

Appendix II

The functional role of the BKPM is clearly enshrined in the Presidential Decree No. 25/1991, as amended by Presidential Decree No. 114/1998 (28/07/1998), which stipulates that the BKPM is to (Article 3):

- a. Formulate investment policies and convey them to the President to obtain his approval;
- b. Coordinate investment planning, both sectorally and regionally, and synchronizing the said planning into an integrated plan in the framework of Law No. 1/1967 and Law No. 6/1968 and in the framework of the regulation beyond the law on investments;
- c. Draw up periodically a list of business sectors for investment as a guideline for the development on investment sectors with account being taken of the opinions and materials conveyed by relevant ministers/government agencies and Regional Investment Coordinating Agencies;
- d. Present the said list of business sectors for investment referred to in (c) to the President in order that they may be stipulated in a presidential decree;
- e. Spearhead the said investment activities in regions in conformity with the policies of development;
- f. Carry out assessment and development activities in framework of providing the broadest information on investment projects;
- g. Establish communication and carry out promotions and provide information on investment projects;
- h. Evaluate applications for investments in accordance with the prevailing policies and stipulations on investments;
- i. Submit results of assessment/evaluation of applications for foreign investment value of over US\$100,000,000.00 (one hundred million) to the president in order to obtain his decree;
- j. Approve foreign investments with an investments value of up to US\$100,000,000.00 (one hundred million) and approval of domestic investments on behalf the Government of the Indonesia;
- k. Issue, on behalf of the minister fostering the business sectors for investment concerned in the framework of the enforcement of Law No. 1/1967 and Law No. 6/1968, licenses and implementation decisions on investments in accordance with the delegation of authority from the Minister concerned;
- l. Undertake fostering and counselling and provide guidelines on problem solving in order that the implementation of investment projects may run smoothly; and
- m. Undertake supervision over implementation of investment projects already approved by the government in cooperation with Regional Investment Coordinating Agencies (BKPM) and relevant ministries/government institutions so that it shall be in with prevailing licensing and laws and impose sanctions in the case of deviation.

Appendix III

The salient features of the BKPM/BKPMMD framework are as follows:

- BKPM or BKPMMD shall approve FDI value of less than US\$100 million and correspondingly the president shall approve investment value of US\$100 million and above;
- Application for investment license can also be submitted through the respective countries Indonesian consulates.
- Upon obtaining the initial investment approval, foreign entities have a year to sought all necessary implementing licenses/permits and to begin commercial production (previously, a three-year period was allowed);
- BKPM and BKPMMD may issue further implementation licenses/permits — approval for granting faculty for the import of capital goods, raw materials and supporting materials, limited importer identification number (APIT), expatriate worker utilization plan (RPTK), and permanent business license (IUT);
- The regencies and municipalities (level-11 region) are to issue permits pertaining to location, building, and disturbance building use rights — previously, such permits were issued by the provinces (level-1); and
- A permanent business license (*Ijin Usaha Teap* or IUP) shall be issued, once commercial production commences.

Appendix IV

Statutory requirements for a foreign entity wishing to operate as a public listed company in Indonesia are as follows:

- A registration statement as a public company declared effective by BAPEPAM for a public offering;
- A financial statement audited by a public accountant registered with BAPEPAM, with an unqualified opinion as sound for the most recent financial year;
- A minimum of 1 million shares to be listed;
- A minimum of 200 shareholders, whether individual or institutional, with each shareholder having a minimum of one trading unit;
- All fully paid shares must be listed provided this does not conflict with regulations governing the percentage of shares owned by foreigners;
- Be found and in operation for a minimum of 3 years;
- An operational income and net profit for the 2 most recent financial years; and
- A minimum total assets of Rp20 billion, minimum shareholders' equity of Rp7.5 billion, and minimum paid up capital of Rp 2 billion, and market capitalization of Rp 4 billion.

Appendix V

The salient features of M&As, as encapsulated in the UUPT, are as follows:

- The Board of Directors of all concerned companies must draw out a merger, acquisition or consolidation plan.
- The said plan must stipulate, among other things, the underlying reasons for the contemplated transaction, the method of conversion of shareholding, the new Articles of Association, the annual accounts of all companies involved for the last 3 years, as well as disclose all other relevant information.
- The M&As must be approved by a resolution of shareholders of all concerned companies, with a 75% majority.
- The ‘contemplated M&A’ must be published in 2 daily newspapers at least 14 days before the general meetings.
- Most importantly, the contemplated M&A must be approved by the Ministry of Justice.
- At all times, the ‘paramount interest’ of the company’s minority shareholders, creditors and employees, as well as the interest of the public and ‘healthy competition’, must be adhered to.

Appendix VI

Foreign entities located in the bonded zones (KB) are entitled to the following incentives (BKPM: 2001):

- Exemption from import duty, import surcharge, excise, income tax under article 22, VAT and sales tax on luxury goods on the importation of capital goods and equipment including raw materials for the production process;
- Exemption of VAT and sales tax on luxury goods on the delivery of products for further processing from bonded zones to their subcontractors outside the bonded zones;
- Allowed to divert their products amounted to ¼ of their export (in terms of volume) to the Indonesia customs areas, through normal procedure including payment of custom duties;
- Allowed to lend own machinery and equipment to their subcontractors located outside bonded zones for no longer than 2 years in order to further process their own products; and
- Allowed the sale of scrap or waste materials to the Indonesian customs area as long as it contains at the highest tolerance of 5% of the amount of the material used in the production process.

Further, foreign entities located within the KAPET (mentioned earlier) are entitled to the following incentives:

- Accelerated and/or amortization of assets;
- Income tax exemption under Article 22 of the Income Tax Law for the import of capital goods, materials and other equipment directly related to production activities;
- Loss compensation as from the subsequent tax year consecutively up to 10 years;
- Article 26 of the Income Tax Law deductions on dividend, in the amount of 50% from the amount otherwise payable;
- Deductions as cost of production for local regional development and expansion, directly related to business activities, the functions of which may be calculated as employee income; and
- Exemption from VAT and sales tax on luxury goods imposed on entrepreneurs in KAPET for domestic purchases and/or imports of capital goods and other equipment, import of taxable goods for further processing.

Appendix VII

Under the said Tax Law 1994, the following are construed as ‘deductibles’:

- Assets depreciation using either straight line or declining-balance method;

| Asset (non-building) | Reducing Balance | Straight line |
|---|------------------|---------------|
| Class 1-depreciable property (4 years) | 50% | 25% |
| Class 2-depreciable property (8 years) | 25% | 12.5% |
| Class 3-depreciable property (16 years) | 12.5% | 6.25% |
| Class 4-depreciable property (20 years) | 10% | 5% |
| Asset (building) | | |
| Permanent (20 years) | 5% | |
| Non-permanent (10 years) | 10% | |

- Wages, fees, interest, rent, royalties, travel expenses, doubtful debts, insurance premiums, administration costs and levies.
- Establishment costs and capital expansion costs can be amortized 50% using the reducing balance method (special rules apply for the mining and oil/gas sectors – Article 11(2) of Tax Law No. 10/94.
- Business losses may be carried forward to 5 years (Mining and priority sectors) or 10 years (investment in remote areas).

Appendix VIII

Exemptions from *Badan Arbitrase Nasional Indonesia* (BANI) arbitration rulings under Article 642, CCP, include:

- The decision is rendered beyond the limits of the agreement;
- The decision is given by virtue of an agreement which is void or which has expired;
- The decision is given by a number of arbitrators who were not competent to decide in the absence of the others;
- Subjects have been decided upon which were not claimed or the award had allowed more than what was claimed;
- The award contains controversial dispositions;
- Arbitrators have omitted to decide upon one or more subjects which according to the agreement were submitted to their direction;
- The arbitrators have infringed procedural formalities which have to be followed on penalty of nullity;
- Documents have been decided upon which the decision had been rendered, are acknowledged to be false or have been declared false;
- After the decision has been rendered, decisive documents which had been retained by one of the parties are recovered; and
- When decision was based upon fraud or guile, committed during the hearings is later on discovered.

Appendix IX

Issues that could question the legitimacy of the BANI, as highlighted by Green (1999: 298-299), include:

- (a) Most lawyers recommend that their clients include an arbitration clause when contracting with an Indonesian party. They also recommend that arbitration take place outside Indonesia, usually under either United Nations Commission on International Trade Law (UNCITRAL), or the ICC rules. They do *not* recommend arbitration in Indonesia using BANI facilitates.
- (b) Reasons for recommending that arbitration take place outside Indonesia include: familiarity with, and the convenience and neutrality of, such a forum; lack of confidence in the Indonesian legal system; and a lack of information on the procedural rules for arbitration in Indonesia.
- (c) Reasons for not recommending BANI include unfamiliarity with, and concerns as to the adequacy of, its facilities; a general uncertainty about BANI; and a perception that it is unreliable.
- (d) The reasons for choosing dispute resolutions process not connected with Indonesia are as outlined at (b) and (c). Additional reasons include preference for a recognised arbitration centre, and client familiarity with other rules and fora.
- (e) All respondents listed informal methods of dealing with disputes that they had been involved with.
- (f) Of the formal mechanisms for dispute resolution, litigation was mentioned as a potential method of resolving a dispute. One respondent referred to an occasion where litigation was employed by the other side, and another did not discount its use if other means did not achieve the desired result.
- (g) Australian lawyers had negligible direct or indirect experience of arbitration by BANI.
- (h) No clear consensus emerged from the survey as to why BANI is under-utilized as a dispute resolution centre. Some of the possible reasons put forward included BANI's low profile; the lack of readily available information about BANI; and a general lack of confidence in, and a negative perception of, the Indonesia legal system.
- (i) Most respondents felt unable to comment on BANI's neutrality and efficiency, or on the commercial acumen of its decisions and staff.
- (j) Most respondents, again because of lack of direct experience, were not prepared to comment on whether Indonesian courts enforced BANI awards, or intervened in BANI proceedings.
- (k) There appears to be no widespread awareness of the relationship between KADIN and BANI. The few comments that were made on this subject indicate that the effect of any relationship between BANI and KADIN would diminish the perception of BANI's independence.
- (l) The consensus among respondents was that there is insufficient information available on BANI's services. There was a strong call for information on BANI's rules, its panel of arbitrators, and its success in resolving disputes.

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