Growth of Foreign Investment in Indonesia and Encountering Problems

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I. Introduction

Despite the 1998's monetary crisis, Indonesian economic growth has moved toward a positive trend. Nevertheless, the annual relative growth, since then, is lower than other neighbor countries which was hit by the similar crisis such as South Korean, Thailand, and even lower compared to our relative growth back in 1980's to middle of 1990's. It has come to known that there are two major obstacles to barricade the recovery of Indonesian economic process over the past few years. First, slower rate of business recovery particularly from the most hit companies, big companies, and second, investment activities has not been fully utilized including foreign investments although the New Governance Era (Orde Baru) confirmed that foreign direct investments are the most significant factors to boost economic growth rate. The foregoing technology development, product diversification as well as relative export growth rate are among the most obvious results due to the existence of foreign direct investments in Indonesia.

To sum up, many interrelated factors today are all added to prevent Indonesian businesses and investments recovery to progress according to plan. Ranging from issues frequently mentioned in mass media such as security, law uncertainty to poor infrastructure situation. In addition, compared to fellow Asian countries such as China and India that has not played any significant role in regional or global economic domain during the Orde Baru Era, Indonesian competitive advantages has been deteriorated even further.

Therefore, learning from the matters previously explained, the main topic to be discussed in this paper is a complex business environment which in turn stated that investment policies applied should cover all aspects of business area. In other word, no matter how excellent the policy is prepared, the effectiveness of ones' policy will depend on factors other than those within the investment policy framework since they will be influential in ones decision making in entering business world in Indonesia.

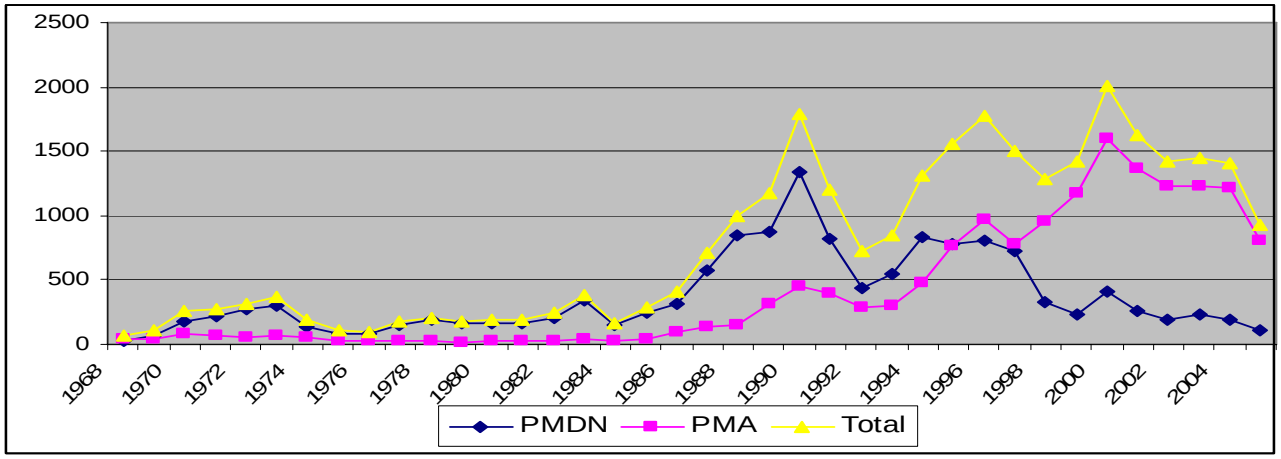
II. The Growth of Foreign Direct Investments (FDI) in Indonesia

Figure 1 stated that following the crisis in 1998, the total numbers of new foreign direct investments had an opportunity to increase slightly, at least based on the approval data from BKPM (Investment Coordinating Board). However, later than the year of 2000, the number began to decrease and the chart shown a declining trend ever since. Yet, an interesting part of the figure is that the number of new foreign direct investments on annual basis has gone beyond the total numbers of domestic investment, since 1998. In other words, following the crisis

period, the role of foreign direct investments have been far more significant than domestic investments in improving domestic investment directly as well as the national economic growth.

Nonetheless, judging from the net value (incoming and outgoing investment flow), the condition after the crisis was rather disappointing although there was some improvement in 2004 (Table 1). Numerous factors is found to be the main issues of foreign investments to withdraw simultaneously from Indonesia and created gloomy investment climate afterward. Those factors were not merely bound to politic and social stability but also infrastructure platform, labor related issues, government policy which was directly or indirectly influencing the net profit over long term risk cost of investment activities, and so forth. The more foreign investments withdrawn from Indonesia are actually saying that Indonesia was not attractive enough for investment acts compared to other countries.

Figure 1: The Growth of Approved FDI and Domestic Investment, 1967-2005



Source: Investment Coordinating Board (BKPM)
* PMDN: Domestic Investment; PMA: Foreign Investment

Table 1. Net Value of FDI in Indonesia, 1990-2004 (in million US$)

Year	Value
1990	1.093
1991	1.482
1992	1.777
1993	2.004
1994	2.109
1995	4.346
1996	6.194
1997	4.667
1998	- 356
1999	-2.745
2000	-4.550
2001	-2.978
2002	145
2003	-597
2004	423

Note: The value of FDI including privatization of State Owned Companies (BUMN) to foreign party, and banking restructuring particularly selling bank assets to foreign investors.
Source; Bank Indonesia: Indonesian Financial Statistic, several issues until Feb.2005.

III. Indonesian Attractiveness for FDI[1]

Lack of Indonesia's ability to encourage FDI was even more noticeable in comparison to the increase FDI in other countries. In ASEAN region, for example, Indonesia was the only country suffered a negative flow of FDI since 1998's crisis; although the negative value shown an increment trend since 2000 (Table 2). This was with regard to a healthier politic climate compared to the period of 1998-1999 and started to gain foreign investors' confidence to create some investment in Indonesia.

Table 2: The Growth of FDI in ASEAN, 1991-2002 (in million US$)

Country	1991-1996 (average)	1998	1999	2000	2001*	2002*
Indonesia	3,0	-0,4	-2,7	-4,5	-3,3	-1,5
Malaysia	5,4	2,7	3,9	3,8	0,6	3,2
Filipina	1,2	1,7	1,7	1,3	1,0	1,1
Thailand	1,9	7,5	6,1	3,3	3,8	1,1
Singapore	6,9	7,6	13,2	12,5	10,9	7,7
Brunei	0,2	0,6	0,7	0,5	0,5	1,0
Cambodia	0,1	0,2	0,2	0,1	0,1	0,05
Laos	0,05	0,05	0,05	0,03	0,02	0,02
Myanmar	0,3	0,7	0,3	0,2	0,2	0,1
Vietnam	1,2	1,7	0,2	1,3	1,3	1,2

*Note: * = different value to that in Table 1, probably due to different calculation method between two different sources.*

Source: UNCTAD (2003)

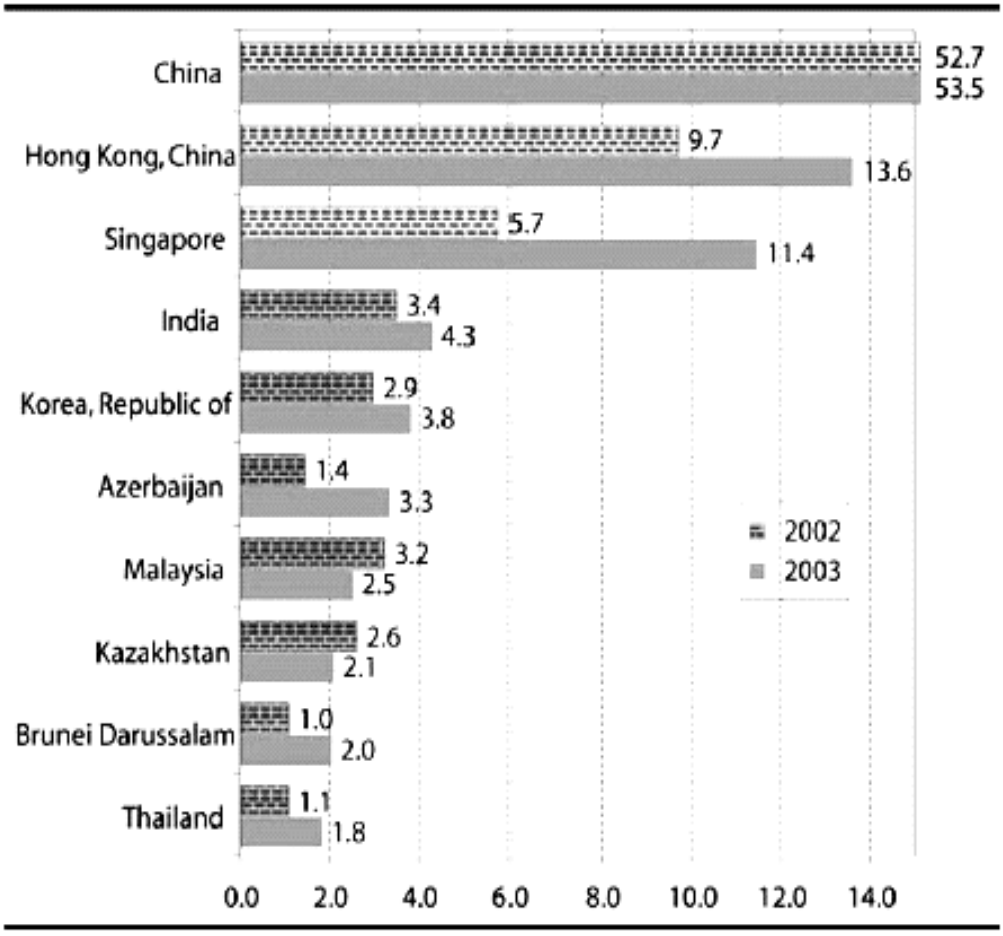
Other comparison factors could be found in Figure 2 that pointed out ten (10) big countries as FDI recipients in Asia and Pacific area. It was very clear, that China (including Hong Kong) was the major recipient, meaning that the investment competitiveness of that country was the highest within the region. Many factors attributed to China's attractiveness for foreign investment, among other things politic and social stability, well-maintained economic policy to support business activities, well-equipped laborers compared to those in Indonesia, and stable infrastructure condition. It was only Singapore, Malaysia and Thailand, within the ASEAN group, also included in this Top 10 category, which concluded the fact Singapore was the highest to attract FDI. An intriguing part from the figure was that China and India, which is considered as a newcomer in regional trading activities and highly potential to become the superpower countries in global economy, were also the significant countries for FDI. If this situation remain the same in years ahead, then undoubtedly those 2 countries will become the new emerged superpower in global economy, at the same time will be a potential threat for Indonesian export continuity to ASEAN region or even globally.

UNCTAD had created three (3) indexes which can be applied in measuring country's attractiveness for FDI. First, the Transnationality Index that is used measure transnationality degree of FDI recipient country. Basic thought behind this index is quite simple, for example, if there is more multi/transnational companies in country A compared in B then the degree of transnationality of country A is higher than B. In detail, this particular index

[1] Most of this writing is based solely to the annual report of UNCTAD concerning investment development in the world, especially reports in 2003 and 2004.

can be based into four (4) ratios; the inflow of FDI to fix gross capital; FDI inflow to gross domestic product (GDP); added value of multinational companies to GDP, and working opportunity of multinational companies to those in recipient country.

Figure 2. Asia and Pacific; 10 Major FDI Recipient Countries, 2002 and 2003 (in million US$)



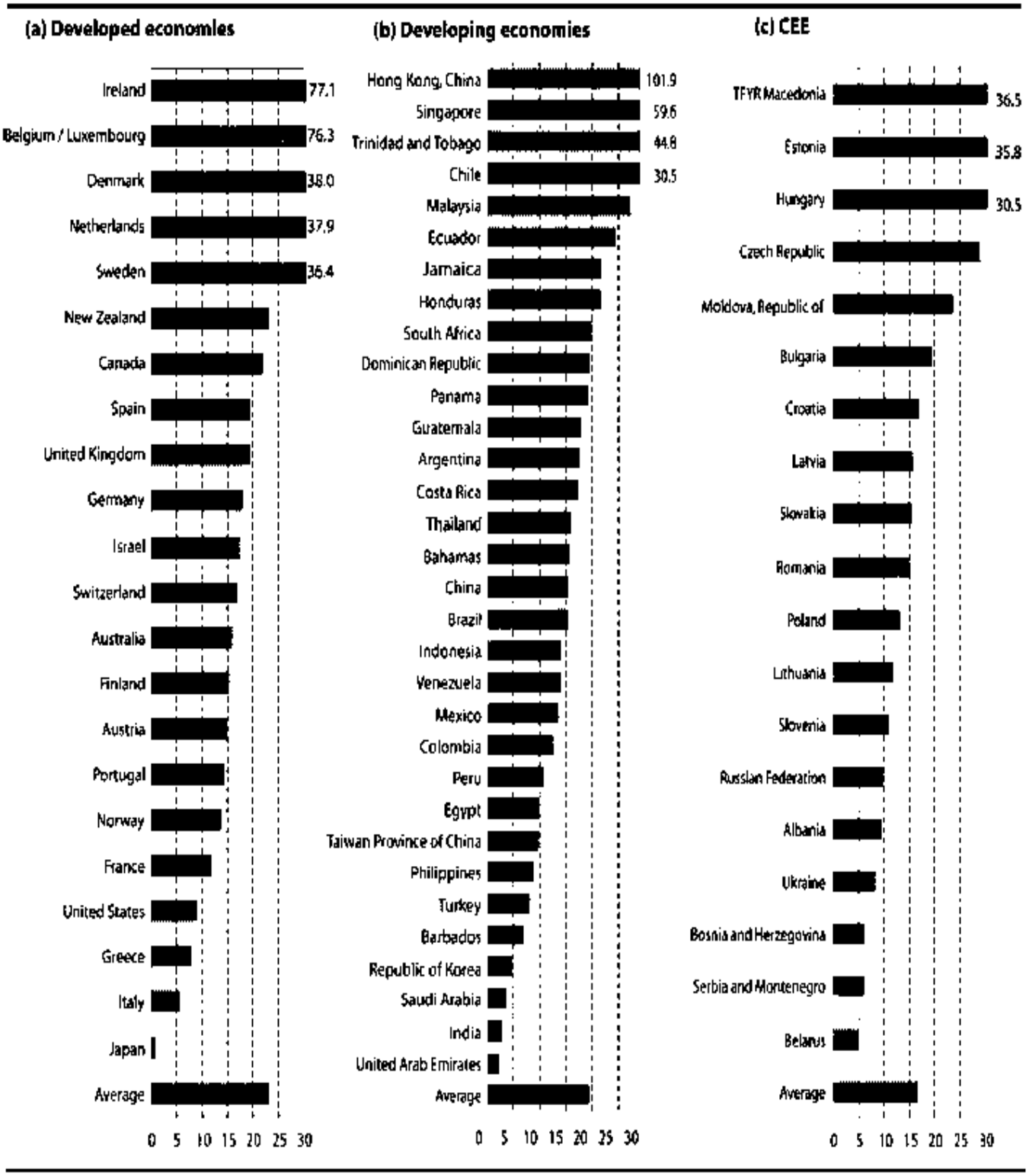
Note; dots between numbers are semicolons in Indonesia
Source: UNCTAD (2004)

According to UNCTAD annual report regarding the world investment growth in 2004, Figure 3 defined such indexes from several countries in the world (including in its observation sample) into three groups that is developed economies, developing economies, and transitional countries (CEE) such as those in East Europe. It can be seen that Hong Kong (China) gained the biggest index value, followed by Ireland, Belgium and Luxembourg.

The second index called Inward FDI Performance Index. This particular index is used to measure the total amount of FDI inflow to recipient country. It creates country rating/chart according to the total amount of FDI received by recipient country relatively towards its economy scale and calculated as the ratio of recipient country's contribution in global FDI inflow to its contribution in global GDP. If the value is higher than one (1) then the country attracts higher FDI within proportional level to its economic scale. Lower than one stated that

such country received lower amount of FDI whereas negative value pointed that foreign investors withdrawn their capital within certain period of given time. In conclusion, higher index value of one country compared to others meaning that the first mentioned country has higher competitive edge to win FDI.

Figure 3: Transnationality Index of FDI Recipient Countries, 2001



Source: UNCTAD (2004)

The result of index calculation taken from 140 countries for the year of 2001 – 2003 shown in UNCTAD report in 2004 can be evaluated in Table 3. It was clear that merely 3 countries from South East Asian region that is positioned in that table, Brunei Darussalam, Singapore and Hong Kong (China). Indonesia was in the lowest rank next to Suriname.

Table 3. Economic Rating based on Inward FDI Performance Index, 2001-2003

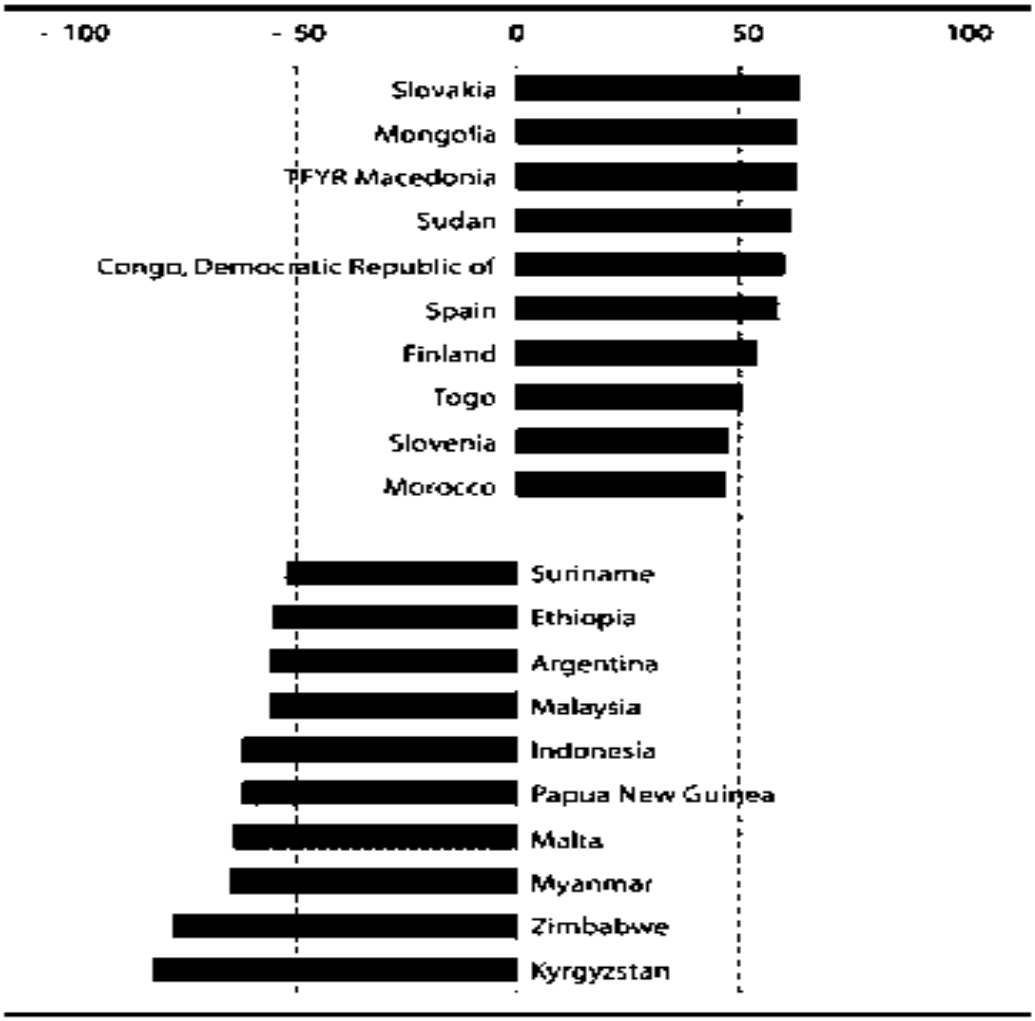
1	Belgium and Luxembourg	36	Spain	71	Portugal	106	Paraguay
2	Brunei Darussalam	37	China	72	Venezuela	107	Niger
3	Azerbaijan	38	Dominican Republic	73	Ukraine	108	Norway
4	Ireland	39	Viet Nam	74	Congo, Democratic Republic of	109	Malawi
5	Angola	40	Denmark	75	Malaysia	110	Turkey
6	Singapore	41	Latvia	76	Zambia	111	Ethiopia
7	Gambia	42	Sweden	77	South Africa	112	United States
8	Kazakhstan	43	Finland	78	Austria	113	Uzbekistan
9	Hong Kong, China	44	Albania	79	Australia	114	India
10	Estonia	45	Panama	80	Papua New Guinea	115	Kyrgyzstan
11	Bolivia	46	Brazil	81	Malta	116	Libyan Arab Jamahiriya
12	Slovakia	47	United Republic of Tanzania	82	Tajikistan	117	Taiwan Province of China
13	Czech Republic	48	Costa Rica	83	United Kingdom	118	Argentina
14	Trinidad and Tobago	49	Switzerland	84	Jordan	119	Russian Federation
15	Mongolia	50	France	85	Myanmar	120	Korea, Republic of
16	Netherlands	51	Bahrain	86	Uruguay	121	Syrian Arab Republic
17	Nicaragua	52	Mali	87	Thailand	122	Sierra Leone
18	Namibia	53	Slovenia	88	El Salvador	123	Egypt
19	Croatia	54	Togo	89	Iceland	124	Yemen
20	Jamaica	55	Lithuania	90	Lebanon	125	Guinea
21	Bulgaria	56	Bahamas	91	Algeria	126	Oman
22	Congo	57	Botswana	92	Benin	127	Greece
23	Mozambique	58	Tunisia	93	Cameroon	128	Rwanda
24	Cyprus	59	Honduras	94	Ghana	129	Kenya
25	Moldova, Republic of	60	Israel	95	Gabon	130	Nepal
26	Guyana	61	Mexico	96	Philippines	131	Burkina Faso
27	Georgia	62	Romania	97	Pakistan	132	Japan
28	Ecuador	63	Peru	98	Italy	133	Bangladesh
29	Sudan	64	Colombia	99	Belarus	134	Haiti
30	Armenia	65	New Zealand	100	Guatemala	135	Zimbabwe
31	TFYR Macedonia	66	Côte d'Ivoire	101	United Arab Emirates	136	Iran, Islamic Republic of
32	Morocco	67	Qatar	102	Germany	137	Kuwait
33	Hungary	68	Poland	103	Senegal	138	Saudi Arabia
34	Chile	69	Nigeria	104	Sri Lanka	139	Indonesia
35	Uganda	70	Canada	105	Madagascar	140	Suriname

Source: UNCTAD (2004).

By comparing the index within two certain periods, we could decide which country is moving toward a better position, and the ones going to the opposite direction. Further, comparing the period of 1996-1998 with 2001 and

2004, Figure 4 might explained 2 groups of country that is number of countries with higher improved position and others with the worst position during that certain period of time. The first group may be called the first winner whereas the latter are the most defeated countries in terms of competitive edge to attract FDI inflow. Surprisingly enough, Indonesia is included in the second economic category where at the same token none other ASEAN countries positioned in the same group. This was due to the crisis back in 1998 resulting in a declining trend of FDI inflow to these countries compare to the rest of the world.

. **Figure 4: The First Winners and The Most Defeated Economies in terms of FDI Inflow 1996-1998 to 2001-2003 (changes in rating)**



Source: UNCTAD (2004)

If the second index related to actual/real performance then the third one representing the potential of a country to invite FDI called Inward FDI Potential Index. Many factors contributed to the country's potential to encourage FDI starting from the scope of domestic market, availability of raw materials, human resources condition until the capability of that country in developing technology.

Results of this index indicating the top 25 economies in the period of 1988-2002 as it is shown in Table 4. United Stated remain in the higher position but Singapore positioned in the fourth rank while Indonesia with its

potential richness in raw materials and human resources not to mention wide domestic market with total population of over 200 million people, was not in that top 25.

Table 4. Top 25 Rank Based on Inward FDI Potential Index, 1988-2002

Economy	1988-1990	1996-1998	2000-2002
United States	1	1	1
Norway	4	3	2
United Kingdom	3	5	3
Singapore	12	2	4
Canada	2	4	5
Belgium and Luxembourg	10	8	6
Ireland	24	18	7
Qatar	22	20	8
Germany	7	6	9
Sweden	5	7	10
Netherlands	9	9	11
Hong Kong, China	17	14	12
Finland	8	13	13
France	6	10	14
Iceland	15	19	15
Japan	13	12	16
United Arab Emirates	29	11	17
Korea, Republic of	20	21	18
Denmark	16	16	19
Switzerland	11	17	20
Taiwan Province of China	21	24	21
Australia	14	15	22
Israel	27	25	23
Austria	19	22	24
Spain	25	26	25

Source: UNCTAD (2004).

Last but definitely not the least is in the form of matrix developed by UNCTAD in its annual report of 2004. They made four economy groups of around 140 economies to be the focus of the observation based on performance index and potential index to attract FDI. As it is shown in Table 5, these 4 groups indicated as follows; high performance index-high potential index, high performance index-low potential index; and low performance index-low potential index. Clearly, economies within the first group were the most interesting country for foreign investors. Prior to the crisis period in 1997/1998, Indonesia was actually included in this group along with China (Hong Kong) and most of the ASEAN countries except Vietnam. However, right after the crisis, Vietnam in turns took Indonesia's position and Indonesia was excluded from the picture. Yet, other ASEAN countries such as Singapore, Malaysia, Brunei Darussalam and China were able to maintain their positions.

Table 5. Matrix of Performance and Potential FDI Inflow, 1988-1990, 1993-1995, 2000-2002

	High FDI performance	Low FDI performance
	2000-2002	
	Front-runners	**Below potential**
High FDI potential	Bahamas, Belgium and Luxembourg, Botswana, Brazil, Brunei Darussalam, Bulgaria, Canada, Chile, China, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominican Republic, Estonia, Finland, France, Germany, Guyana, Hong Kong (China), Hungary, Ireland, Israel, Jordan, Latvia, Lithuania, Malaysia, Malta, Mexico, Mongolia, the Netherlands, New Zealand, Panama, Poland, Portugal, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Trinidad and Tobago, United Kingdom, Viet Nam.	Australia, Austria, Bahrain, Belarus, Egypt, Greece, Iceland, Islamic Republic of Iran, Italy, Japan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Norway, Oman, Philippines, Qatar, Republic of Korea, Russian Federation, Saudi Arabia, South Africa, Taiwan Province of China, Thailand, United Arab Emirates, United States.
	Above potential	**Under-performers**
Low FDI potential	Albania, Angola, Armenia, Azerbaijan, Bolivia, Colombia, Congo, Ecuador, Gambia, Georgia, Honduras, Jamaica, Kazakhstan, Mali, Morocco, Mozambique, Namibia, Nicaragua, Republic of Moldova, Sudan, TFYR Macedonia, Togo, Tunisia, Uganda, United Republic of Tanzania.	Algeria, Argentina, Bangladesh, Benin, Burkina Faso, Cameroon, Côte d'Ivoire, Democratic Republic of the Congo, El Salvador, Ethiopia, Gabon, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, Kyrgyzstan, Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Romania, Rwanda, Senegal, Sierra Leone, Sri Lanka, Suriname, Syrian Arab Republic, Tajikistan, Turkey, Ukraine, Uruguay, Uzbekistan, Venezuela, Yemen, Zambia, Zimbabwe.
	1993-1995	
	Front-runners	**Below potential**
High FDI potential	Argentina, Australia, Bahamas, Bahrain, Belgium and Luxembourg, Brunei Darussalam, Canada, Chile, China, Costa Rica, Czech Republic, Denmark, Dominican Republic, Estonia, France, Guyana, Hong Kong (China), Hungary, Indonesia, Ireland, Jamaica, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Panama, Papua New Guinea, Poland, Qatar, Republic of Moldova, Singapore, Slovakia, Spain, Sweden, United Kingdom.	Austria, Botswana, Bulgaria, Cyprus, El Salvador, Finland, Germany, Greece, Iceland, Islamic Republic of Iran, Israel, Italy, Japan, Jordan, Kuwait, Libyan Arab Jamahiriya, Oman, Portugal, Republic of Korea, Russian Federation, Saudi Arabia, Slovenia, South Africa, Suriname, Switzerland, Taiwan Province of China, Thailand, Ukraine, United Arab Emirates, United States, Uruguay, Uzbekistan, Venezuela.
	Above potential	**Under-performers**
Low FDI potential	Albania, Angola, Azerbaijan, Bolivia, Colombia, Congo, Côte d'Ivoire, Ecuador, Egypt, Gambia, Ghana, Honduras, Kazakhstan, Kyrgyzstan, Latvia, Mali, Morocco, Mozambique, Myanmar, Namibia, Nicaragua, Nigeria, Paraguay, Peru, Philippines, Tajikistan, Trinidad and Tobago, Tunisia, Uganda, United Republic of Tanzania, Viet Nam, Yemen, Zambia.	Algeria, Armenia, Bangladesh, Belarus, Benin, Brazil, Burkina Faso, Cameroon, Croatia, Democratic Republic of the Congo, Ethiopia, Gabon, Georgia, Guatemala, Guinea, Haiti, India, Kenya, Lebanon, Lithuania, Madagascar, Malawi, Mongolia, Nepal, Niger, Pakistan, Romania, Rwanda, Senegal, Sierra Leone, Sri Lanka, Sudan, Syrian Arab Republic, TFYR Macedonia, Togo, Turkey, Zimbabwe.
	1988-1990	
	Front-runners	**Below potential**
High FDI potential	Australia, Bahrain, Belgium and Luxembourg, Botswana, Canada, Chile, China, Colombia, Costa Rica, Cyprus, Denmark, France, Greece, Hong Kong (China), Indonesia, Ireland, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Norway, Oman, Portugal, Singapore, Spain, Sweden, Switzerland, Taiwan Province of China, Thailand, Trinidad and Tobago, United Kingdom, United States, Venezuela.	Algeria, Austria, Bahamas, Brazil, Brunei Darussalam, Finland, Germany, Hungary, Iceland, Islamic Republic of Iran, Israel, Italy, Japan, Kuwait, Libyan Arab Jamahiriya, Panama, Poland, Qatar, Republic of Korea, Saudi Arabia, South Africa, Suriname, United Arab Emirates, Uruguay.
	Above potential	**Under-performers**
Low FDI potential	Argentina, Benin, Bolivia, Dominican Republic, Ecuador, Egypt, Gabon, Gambia, Guatemala, Guyana, Honduras, Jamaica, Malawi, Myanmar, Niger, Nigeria, Papua New Guinea, Paraguay, Philippines, Sierra Leone, Syrian Arab Republic, Togo, Tunisia, Viet Nam, Zambia.	Angola, Bangladesh, Burkina Faso, Cameroon, Côte d'Ivoire, Congo, Democratic Republic of the Congo, El Salvador, Ethiopia, Ghana, Guinea, Haiti, India, Jordan, Kenya, Lebanon, Madagascar, Mali, Morocco, Mozambique, Namibia, Nepal, Nicaragua, Pakistan, Peru, Rwanda, Senegal, Sri Lanka, Sudan, Turkey, Uganda, United Republic of Tanzania, Yemen, Zimbabwe.

Source: UNCTAD 2004

IV. Determinants Factors

Investments or a decision of foreign investors to invest in one country mainly depend on several factors which is very influential, directly or indirectly. In the framework of macro economy, these factors may be grouped into two category which is demand factors that will affected market demand side, and supply factors which will influenced the investment from the side of production.

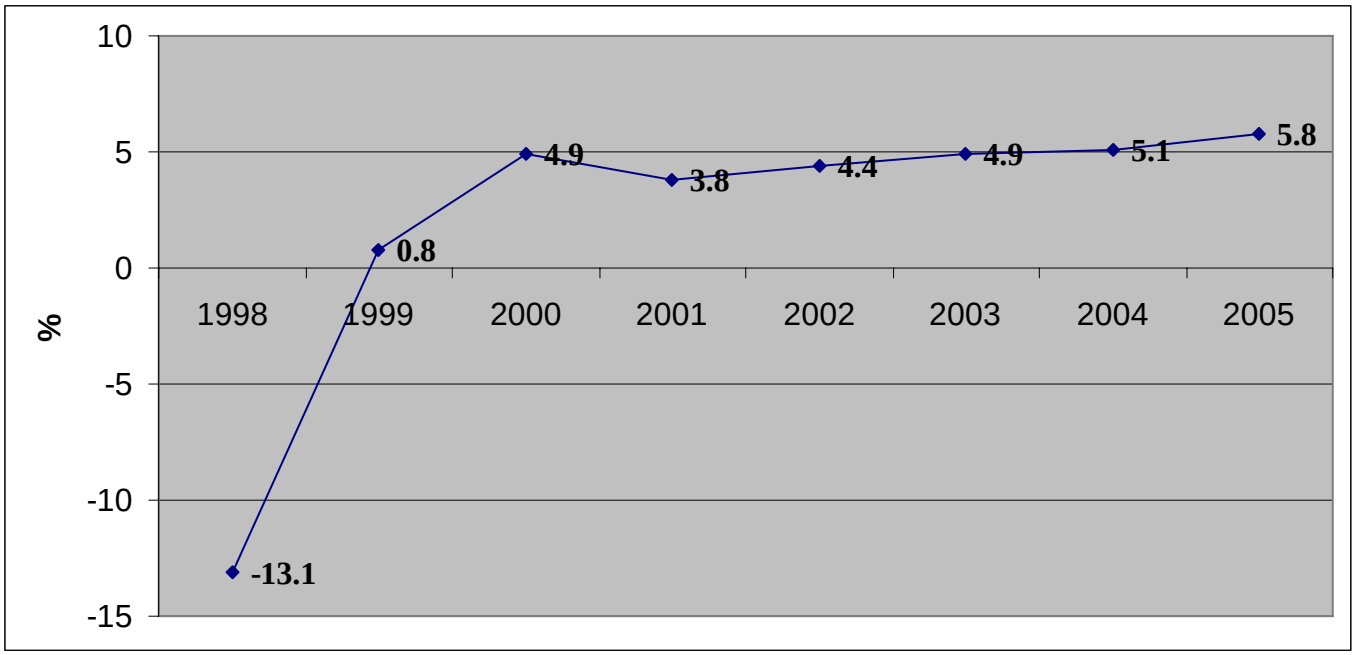
IV.1. Demand Side

From the demand standpoint, there are two main factors namely the total population (based on age structure) and real income per capita. These 2 factors work head to head in determining the scope of market potential that will also contributed to the potential income of an investor. The total population in Indonesia is clearly a major to the market potential. However, it will be a disadvantage if the average income per person or consumer buying potential in Indonesia is relatively insignificant. Therefore, the ability to bounce back from the crisis to produce higher GDP per capita, at least at similar level of those in Orde Baru Era, becomes a crucial consideration for foreign investors.

Figure 5 shows that the growth of GDP in Indonesia following the crisis up until the year 2005. We can see that Indonesia was indeed in the middle of recovery which was indicated by a positive trend of GDP growth since 1999 but in a slower pace. Compared to other ASEAN countries, which was hit by similar crisis, Indonesia was in the worst position. Based on the report of Asian Development Bank in 2002 (ADB 2002), Thailand which was severely hit by the similar crisis as in Indonesia, was able to boost its GDP growth to 4.4% in 1999. At the same token, the growth of Indonesia's economy was merely 0.9% (0.8% according to Central Statistic Bureau/BPS). What is interesting though, Vietnam was at its best in escalating its economic growth within the region. During 1999, this country enjoyed around 4.7% growth, which was higher than the average growth of ASEAN region of 3.8%; and in 2002 was estimated to be increased by 7.1%. Two years later, the growth increased to 7.3% and 7.7% subsequently. Further, Philippines whose suffered the similar crisis merely enjoyed 1.8% economic growth in 2001 yet three years later the growth increased up to 6.1% in 2004. As it was in Malaysia, the country gained an increment growth of 7.1% in 2004 where it was only 0.3% in 2001 (Figure 6).

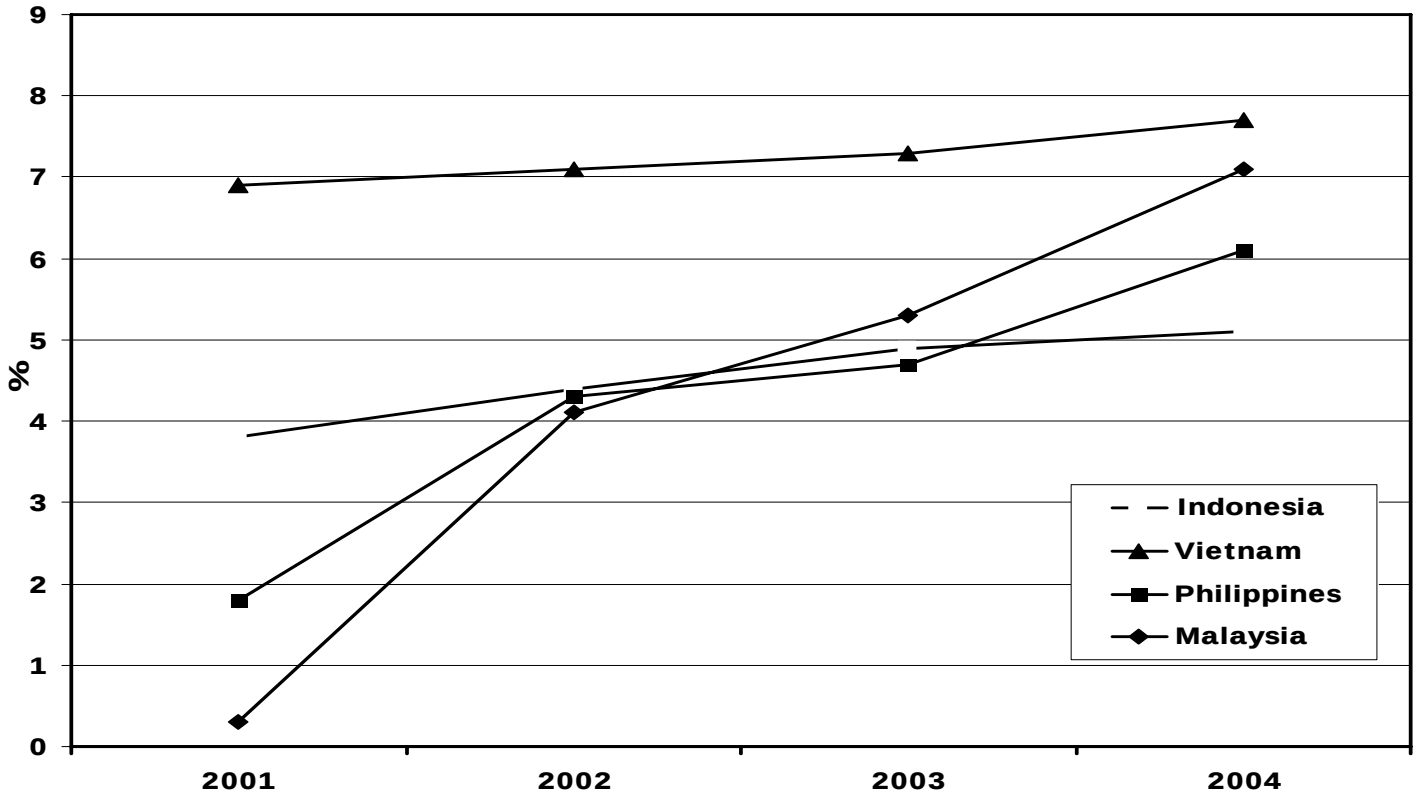
Table 6 further explained the development of Indonesia's real income per capita. Due to the crisis, Indonesia's income per capita had declined drastically and is not able to bounce back to little over 1000 US$ as it was in 1997. Thus, from investor's point of view, consumer demand in Indonesia remained low and became one crucial aspect to be considered in determining investment activities.

Figure 5. GDP Growth in Indonesia, 1998-2005 (%y-o-y)



Note; dots between numbers is semicolon in Indonesian terms.
Sources; Central Statistic Bureau and Bank Indonesia

Figure 6. GDP Growth of Several Countries in South East Asia (%)



Source : ADB (database)

Table 6. GDP per Capita (Nominal) in Several ASEAN Countries, China and Japan

Countries	Currency	Period							
		1980	1990	1995	2000	2001	2002	2003	2004
Brunei Darussalam	(B$)	-	(25.685,0)	(25.737,0)	(22.910,0)	(22.482,0)	(22.452,0)	(23.615,0)*	(24.500,0)**
	US$	-	14.171,03	18.157,89	13.288,86	12.547,86	12.538,81	13.544,708	14.495,33*
Cambodia	(Thousand Riel)	-	-	(722,47)	(1.053,23)	(1.081,16)	(1.136,57)	(1.163,44)	-
	US$	-	-	294,79	274,22	276,07	290,53	292,81	-
Indonesia	(Thousand Rp)	(308,13)	(1.174,87)	(2.304,60)	(5.979,01)	(6.761,51)	(7.417,51)	(8.125,77)	-
	US$	491,43	637,55	1.024,91	709,94	658,96	796,62	947,38	-
Laos	(Thousand Kip)	-	(147,61)	(304,99)	(2.588,83)	(2.907,78)	(3.325,50)	(3.587,81)	-
	US$	-	208,57	379,01	328,21	324,73	330,69	339,46	-
Malaysia	(Ringgit)	(3.891,09)	(6.579,06)	(10.926,96)	(14.922,39)	(14.236,02)	(15.086,52)	(16.142,51)	-
	US$	1.787,45	2.432,28	4.363,11	3.926,95	3.746,32	3.970,14	4.248,03	-
Myanmar	(Kyat)	(1.147,71)	(3.749,78)	(13.715,79)	(53.696,53)	(73.619,75)	(115.153,63)	(155.922,73)	-
	US$	-	-	-	-	-	-	-	-
Filipina	(Thousand Peso)	(5,04)	(17,52)	(27,87)	(44,31)	(47,07)	(50,39)	(53,75)	-
	US$	671,48	720,71	1.083,67	1.002,67	923,08	976,46	991,62	-
Singapore	(S$)	(10.411,20)	(22.007,95)	(34.184,77)	(39.716,92)	(37.580,0)	(37.814,35)	(37.443,53)	-
	US$	4.862,32	12.142,32	24.117,94	23.037,65	20.974,49	21.118,26	21.492,10	-
Thailand	(Thousand Baht)	(14,18)	(39,10)	(72,39)	(80,81)	(83,40)	(87,57)	(94,39)	-
	US$	692,53	1.528,35	2.905,40	2.014,51	1.877,11	2.038,42	2.275,23	-
Vietnam	(Thousand Dong)	-	(633,47)	(3.142,39)	(5.651,98)	(6.076,96)	(6.673,67)	(7.538,01)	-
	US$	-	97,72	284,69	398,93	412,70	436.76	486,01	-
China	(Yuan)	(456,88)	(1.585,74)	(4.798,34)	(7.007,29)	(7.571,90)	(8.122,02)	(8.963,20)	-
	US$	304,91	331,52	574,56	846,44	914,80	981,28	1.082,90	-
Japan	(Thousand Yen)	(2.082,31)	(3.578,84)	(3.960,48)	(4.026,31)	(3.974,60)	(3.908,66)	(3.899,89)	-
	US$	9.183,70	24.717,44)	42.105,94	37.360,20	32.704,66	31.172,02	33.640,04	-

*Note: * = temporary numbers*
*** = estimated numbers*
Source: ASEAN-Japan Centre (2005) (IMF data except for Brunei Darussalam)

IV.2. Supply Side

IV.2.1. Environmental Analysis

Business Environment

Investment activities which are part of business entities evolve within a highly dynamic and complex environment. Therefore, government efforts to encourage foreign investment over the past few years will be in vain if the following issues are not taken into account; business environment for investment purposes, and a larger scale of economic development to create some ”game rules” for business activities as a whole which will determined how the business as well as market respond to such condition. Environment, in which business may be well-operated can be divided into two categories that are direct environment and larger environment (Figure 7). Larger environment is the one that will influence a business act indirectly and consisting of components as follows; macro economy (trading policy, industrial policy, financial policy as well as tax and monetary policies), politics and government at the national as well as local level (for instance the scope of policy making, stability and security), services granted by the government (such as educational and health, infrastructure, utility and security services, external aspects (such as global trading, consumer trend and attitude toward business act), and climate to natural environment (such as raw materials, weather condition and peasant cycle)

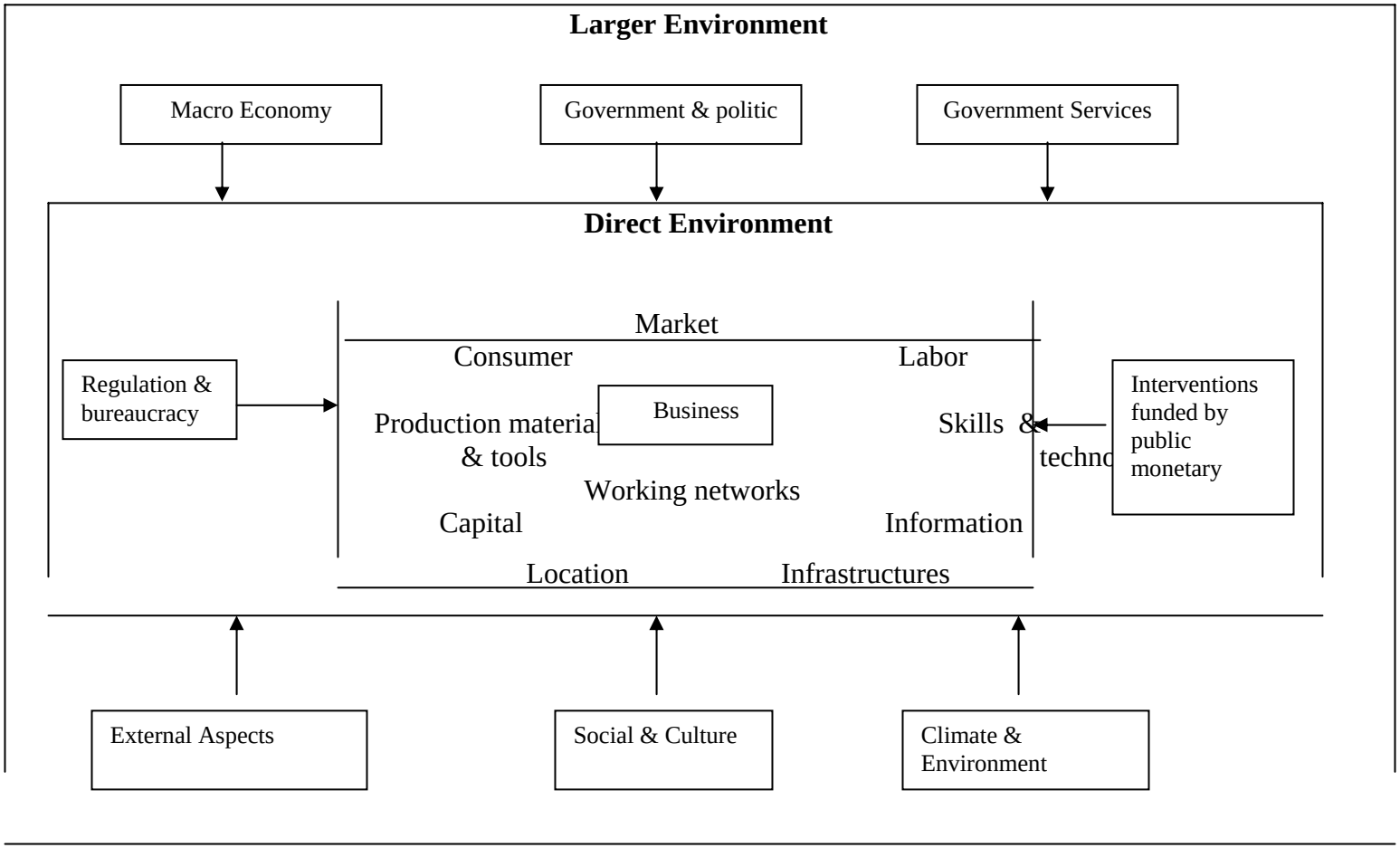
On the other hand, direct environment is those directly influenced to business activities as a whole that is, market (such as consumer, labor, capability and technology, production materials and tools, location infrastructures, capital and working network), bureaucracy and regulation (such as institutions, rules, tax tariff and system, license and permission, process and product standard, and consumer and environment protections), and interventions funded by public monetary (such as financial services for business act).[2]

The impact of all the above toward investment policy is that the policy will not reach its effectiveness level if not supported by policies other than those in business environment. For example, on one side, the government wishes to increase domestic investment by granting tax incentives for new companies or companies expected to expand its production capacities, where on the other side, the government issued trading policy to eliminate import tax of certain products which in facts those in favor of prospective investors. Other examples, though number of incentives has been given to investors, the investment will not necessarily increase particularly those foreign investments in the area of footloose based industries such as electronics and textiles will not chose Indonesia to be its activities based as long as the infrastructure condition is not stable, or the capability of its human resources are still below the relative average of neighbor countries.

In the light of technology development within liberal trading free concepts, competitive advantages factors become far more important compared to comparative advantages factors in affecting investment mobilization across countries.

[2] Factors in direct environment are also the significant components in the well-known “diamond” concepts from Porter (1998a,b) which is highly influential to country’s competitiveness.

Figure 7: Business World in Direct and Larger Environment



Public Institutions

Investments development is also influenced by public institutions, or in other word public institutions is an important factor to the business world. Based on the report by WEF (2005), Table 7 represent relative position by several indicators from public institutions in Indonesian that draw major attention from prospective investors. From the table, most of the indicators indicated a poor Indonesian economic condition. For example, in terms of independent judicial from political influenced ranging from government members (ministries and president), political figures, community as well as companies, Indonesian rank declined from 58 to 68, although the declining rate is smaller following the increased total sample amount in the country. In terms of a legit framework for business player to deal with any business conflict and to refuse any legality of government acts or rules, Indonesian position fell from 51 to 73. Moreover, property rights and intellectual rights protection which is crucial for investment development, were also indicated a poor performance.

Table 7: Indonesian Position In Several Indicators related to Public Institution in *The Global Competitiveness Report 2004-2005* and *2005-2006*

Indicators	Rank	
	2004-2005 (104 countries)	2005-2006 (117 countries)
Judicial Independence	58	68
Efficiency of legal frame work	51	73
Property rights	67	88
Intellectual rights protection	47	68
Deficit in government spending	25	40
Burden from central government	15	45
Bureaucracy Level	85	48
Tax level and effectiveness	27	24
Irregular/Illegal payment in export-import	75	106
Irregular/Illegal payment in using public utility	70	94
Irregular/ Illegal tax disbursement	76	104
Irregular/illegal act public contract	46	84
Irregular/illegal act in judicial decision	69	99

Source: WEF (2004, 2005).

In terms of wasting government spending that whether the government provides primary products and services to business worlds which are not available in the market including basic infrastructure, Indonesia's position based on the above table is also worsened. Further, in terms of burden that has to be suffered by business player as a result of government regulations related to administration standards to be fulfilled by them such as reporting, permission and so forth, Indonesia was actually in a better position compared to other 104 countries. These differences indicating that wider distortion in domestic market mainly caused by regulations of central government.

Indonesia's bureaucracy level was at its lower position which indicating that bureaucracy efficiency in Indonesia was very low and mainly contributed to a poor business climate in Indonesia. Other factors also gives part in terms of incentives or disincentives attributed to the need of conducting business is tax, and for that matter Indonesia ranked in a better position which means tax was not the source of distortion to the business climate.

In the area to unrecorded extra payment or bribery act related to export-import activities, and the irresponsible to use public utilities, Indonesia's ranked in poor level as well, and it should be the one factor that must be

eliminated to gain effectiveness from government regulations which is bound to support the recovery of business activities process and thus improve the investment climate in Indonesia. For some countries, perhaps, which was already long invested in Indonesia and familiar to Indonesian customs in conducting business, such conditions might not be serious matter as to barricade their future investment in domestic market. However, middle scale companies emerged from new countries, such condition might appear uneasy for them to gain potential profit in making some investment in Indonesia.

Far more interesting issue is as if Indonesia's position in public institutions compared to other ASEAN countries as represented in Table 8. From several indicators in the table, Indonesia's position was relatively poor if not worst. This is saying that public institutions in Indonesia were not conducive for business/investment climate compare to other ASEAN countries. Malaysia and Singapore on the other hand positioned as the higher rank, while Singapore ranked the number 1 position in all mentioned indicators within ASEAN region. Even in the last indicators, Singapore ranked the highest from all 104 surveyed countries. Meaning that Singapore has been the most attractive country for investors.

Macro Environment

Figure 7 above stated that business activities are influenced by two environments according to their nature, direct and indirectly, or the later also defined as larger environment. Such environment including macro economic environment consisted of many factors ranging from banking conditions, monetary market improvement, tax system to government regulations inflicting business world.

Table 9 below representing Indonesia's rank position over a number of macro economic environment indicators taken from *the Global Competitiveness Report* for the period of 2004-2005 and 2005-2006. As a result of those years observations, it is evidenced that is not the major problem in business world where Indonesia ranked in 7 position, while for other indicators, Indonesia's condition remain poor even poorer in 2005-2006, such as the improvement in monetary market and banking condition.

Next, Figure 8 indicating scoring and position of ASEAN countries included in the sample of *The Global Competitiveness Report 2005-2006* Macro Economic Environment Indicators. Similar to other indicators applied beforehand, Singapore remained the highest among 117 countries surveyed. Meanwhile, Indonesia positioned in 64 ranks with a score of 3.89. Though, it was not the lowest rank among ASEAN countries yet in terms of macro economic environment Indonesia condition is in bad shape.

Table 8: Indonesian Position for Public Institution in ASEAN based on *The Global Competitiveness Report 2005-2006* (104 countries)and *2005-2006* (117 countries)

	Judicial Independent		Efficiency in Legal Framework		Property Rights		Deficit in Government Spending		Partiality in decision making of government members		Bureaucracy Level		Effectiveness of law decision making institutions		Trustworthy toward policeman services		Business cost toward corruption	
	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B
Malaysia	31	20	21	16	32	23	11	2	30	11	76	106	6	5	24	37	38	22
Indonesia	58	68	51	73	67	88	25	40	24	30	85	48	29	52	66	78	72	69
Thailand	44	40	35	36	41	43	16	17	50	39	99	92	36	24	48	46	48	43
Philippines	74	85	85	91	74	64	90	100	90	98	54	86	86	93	99	96	96	96
Singapore	24	19	14	8	12	6	1	1	7	3	16	15	1	1	2	1	10	5
Vietnam	59	63	61	64	66	61	68	52	55	70	91	64	43	40	40	42	73	79

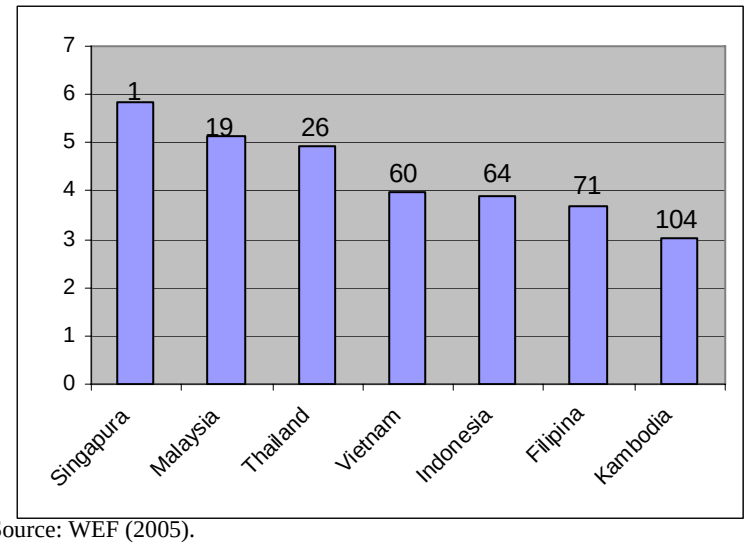
Note : A = 2004-2005; B = 2005-2006
Source: WEF (2004, 2005).

Table 9. Relative Position of Indonesia in Macro Economic Environment in the *Global Competitiveness Report 2004-2005* and *2005-2006*

Indicators	Rank	
	2004-2005 (104 countries)	2005-2006 (117 countries)
Advanced monetary market	40	70
Banking condition	83	109
Availability of venture capital	20	57
Credit access	64	70
Access to local stock market	65	51
Stock trading regulation	70	-*
Effectiveness of bankruptcy constitutions	53	-
Trading obstacles	65	58
Cost of importing tools/machineries	52	-
Business impact from domestic trading obstacles	69	-
Business impact from foreign trading obstacles	20	-
Business impact from tax procedures	51	-
Business impact from rules of foreign Investment (FDI)	86	66
Tax costs	7	7
Efficiency of tax procedures	37	-
Transparency of tax regime	44	-
Organized efforts to improve competitive edge	27	-
Country credit level	-	75

Note : * = several questions asked in 2005-2006 were not repeated in 2004-2005 survey.
Source: WEF (2004, 2005).

Figure 8: ASEAN Countries Score and Position in Macro Economic Environment Index in *the Global Competitiveness Report 2005-2006*



Source: WEF (2005).

IV.2.2 Technology and Human Resources

It is certain that investment climate is crucial to attract foreign investment and there are number of factors called hard factors that are extremely important to invite foreign capital investment that is technology skill and quality of human resources (HR). These factors are interrelated and due to the rapid growth of knowledge and technology plus the need of standardization related to environment and consumer safety, technology skills and quality human resources in one country will be taken into account by prospective investors before doing so.

In terms of technology, many indicators may be applied as to foresee the differences in technology skills between countries. Among other things is export product/item based on its contained technology as it is shown in Table 10, the position of Indonesia was in number 12 from 20 ranks of high technology whereas China ranked the highest.

Table 10: Position (P) of Top 20 ASEAN Countries with Rapid Growth of The Largest Market Segment Based on Technology Category, 1985-2000

P	All Category	P	HR Based	P	Non-HR based	Technology Based					
						P	HT (high)	P	MT(midl)	P	LT(low)
1	China	3	China	1	China	1	China	1	China	1	China
3	Korea S.	4	Korea S.	3	Malaysia	2	Malaysia	4	Korea S.	4	Indonesia
5	Malaysia	5	India	5	Thailand	3	Taiwan	6	Taiwan	5	Thailand
7	Thailand	7	Thailand	6	Korea S.	4	Korea S.	7	Malaysia	6	Malaysia
8	Taiwan	8	Indonesia	7	Singapore	5	Singapore	8	Thailand	9	India
9	Singapore	10	Japan	8	Filipina	7	Filipina	10	Indonesia	11	Vietnam
11	Filipina	16	Hong Kong	9	Indonesia	8	Thailand	14	Singapore	12	Bangladesh
13	Vietnam			10	Taiwan	12	Indonesia	17	India	15	Pakistan
14	India			16	India					17	Sri Lanka
				18	Vietnam						
				20	Bangladesh						

Source: UNCTAD (2002)

The ability to further enhance technology and quality of human resources are significant in winning the competition since they are the determinants factors to productivity and efficiency. As an illustration, a lack of technology skills in Indonesia might be described in Table 11 which indicating the differences in working productivity between 100% local owned companies and foreign companies (at least with some share of foreign companies). We see that, combining all industrial groups, the average labor working productivity in companies with foreign minority shares, majority shares and 90%-100% shares (multinational companies), each 338%-745%, 436%-594% and 164%-542% higher than pure local-owned companies. Negatives differences stated that labor working productivity in local-owned companies are higher than foreign companies, yet it was rarely occurred.

Table 11. Differences in Labor Working Productivity in foreign companies and local-owned companies in Manufacturer Industry (average % per added value period per labor)

Ownership	1975-85	1986-91	1992-94	1995-97	1998-99	2000-2001
Manufacturer (all industry)						
Foreign dominated	542	351	164	375	401	281
Foreign majority	594	533	487	501	562	436
Foreign minority	388	499	650	745	707	468
Food						
Foreign dominated	505	508	322	448	677	347
Foreign majority	608	394	445	441	398	382
Foreign minority	183	437	226	283	394	289
Textile						
Foreign dominated	230	156	78	108	247	124
Foreign majority	442	474	313	366	412	218
Foreign minority	168	139	281	266	175	113
Clothes						
Foreign dominated	-78	-10	83	108	158	662
Foreign majority	-36	58	102	163	368	132
Foreign minority	-36	-20	107	134	167	78
Shoes (the like)						
Foreign dominated	202	80	83	67	138	95
Foreign majority	288	245	14	80	172	183

Foreign minority	-	26	-2	4	38	50
Chemical						
Foreign dominated	190	270	214	325	381	168
Foreign majority	295	271	465	379	524	246
Foreign minority	375	392	334	345	555	147
Synthetic rubber						
Foreign dominated	134	181	106	152	104	178
Foreign majority	161	104	80	198	193	193
Foreign minority	42	303	99	24	18	-6
Plastic						
Foreign dominated	24	1	125	2 076	418	232
Foreign majority	1 431	387	185	221	310	234
Foreign Minority	650	680	145	322	195	167
Metal						
Foreign dominated	1 534	344	148	149	264	121
Foreign majority	394	402	728	553	1 166	816
Foreign Minority	182	280	513	238	487	242
Electricity & precision machine						
Foreign dominated	146	-32	119	90	229	109
Foreign majority	355	271	83	146	86	41
Foreign minority	324	277	135	77	56	44
Transportation Machinery						
Foreign dominated	-	-	-54	450	161	225
Foreign majority	228	288	257	281	214	121
Foreign minority	139	527	283	360	509	832
Others						
Foreign dominated	938	410	200	265	454	246
Foreign majority	743	786	561	591	487	395
Foreign minority	334	410	1 406	1 705	1 294	664

Source: Table 5 of Takii and Ramstetter (2005).

Low level of technology skills and human resources quality in Indonesia might be observed from lower performance and/or its competitiveness. Report from UNCTAD (2004) shown that among ASEAN-4 (Indonesia, Thailand, Singapore and Malaysia), Indonesia's ranked measured by *Competitive Industrial Performance Index* was by far the lowest while Singapore maintain the highest rank even in the world ranks (Table 12). This index is calculated based on indexes of manufacturer added value per capita, manufacturer export per capita, industrialization intensity and the quality of exported manufacturer.

Table 12: *Competitive Industrial Performance Index*

Countries	1980		1990		2000	
	Ranks	Score	Ranks	Score	Ranks	Score
South ASEAN						
Bangladesh	49	0,201	57	0,192	56	0,203
India	38	0,243	36	0,262	40	0,275
Nepal	88	0,072	72	0,145	69	0,161
Pakistan	53	0,192	47	0,219	49	0,235
Sri Lanka	78	0,107	79	0,131	62	0,192
South East ASEAN						
Singapore	2	0,683	1	0,772	1	0,833
Malaysia	40	0,240	24	0,368	15	0,492
Thailand	47	0,213	34	0,281	23	0,386
Indonesia	75	0,119	57	0,199	38	0,292

Source: UNIDO (2004)..

In other illustration, survey result conducted by WEF in *The Global Competitiveness Report 2005-2006* according to businessman opinion surveyed and secondary data analysis (national) indicated that based on Technology Index (TI), Indonesia's ranked in 66 out of 117 countries. One significant measure of TI is called Innovation Index (II), and Indonesia ranked in 80 in terms of II.S. For TI, Singapore is the only country to reach top 10 and ranked 13 related to II. Obviously, Singapore is considered the core player in terms of creating advance innovation. WEF report also stated that among top 25 countries in innovation terms, Singapore ranked at 10 with total number of patents received out of 1 million residents of 104.4 (where United States was the highest).

At the readiness level in technology at hand, WEF report also stated that Indonesia was at ranked 67 with the score of 3.4 below the average of 3.7. The highest as United States with score of 6.5, while Singapore at the rank 7 with 6.0 score. Score=1 indicating that the said countries was far below other countries whereas score=7 might be considered as the world leader in technology development.

Next table, Table 13 will show several indicators to define relative position of Indonesia in its companies' readiness in terms of technology. In general, Indonesia's condition was not in a better shape, as such it was not able to encourage foreign investments particularly manufacturer of products contained middle to upper technology level to open their factories in Indonesia

Table 13. Indonesian Relative Position in terms of Technology Readiness of Local Companies In general, based on *The Global Competitiveness Report 2004-2005* and *2005-2006*.

Indicators	Ranking	
	2004-2005 (total 104 countries)	2005-2006 (total 117 countries)
Level of absorbing technology in company	85	82
Capacity to create innovation	28	47
Advanced production process	45	73

Source: WEF (2004, 2005).

Technology capability in one country is totally depending upon its human resources quality while the said quality is influenced by the quality of its educational system. It is admitted that educational system is critical factor for long terms country's development and today's educational system in Indonesia remained unsupported to the quality of human resources needed by domestic as well as global market. Central Statistic Bureau date indicating that up until today most of Indonesian laborer is merely in the level of elementary school and many of them were not even passed that level. Indonesia is also considered as the smallest countries compared to other countries even smaller total populations in terms of government spending for education and research and development activities (R&D) either as a part of GDP or State Income Budget (APBN)

Report from WEF in *the Global Competitiveness Report 2004-2005* and *2005-2006* stated that Indonesia's rank related to educational and technology development was relatively low. In Table 14, we can see that during 2004-2005 Indonesia was at the 35 rank related to the quality of educational system (whether

the system was applicable to meet country's standard) and rank 46 for the quality of public school (whether the quality of one country is similar to the best quality in the world), and Indonesian position for this indicator lowered to 56 in 2005-2006. The interesting issue of this part was that related to the number of children attending the primary school enrollment, where the condition of Indonesia was not that bad. It was also realized that as a result of government policy concerning the obligation to fulfill primary school, Indonesia succeeding increased the number of children attending that level. However, in terms of higher level of education, Indonesia suffered a poor condition and will be worsened if comparing to the study results between 2004-2005 and 2005-2006. It is undeniable that higher level of labor education is most needed as the competitive edge to attract foreign investments. Today, with the rapid growth of technology produced cheaper transportations cost and the emerged existence of footloose industry using synthetic materials not to mention government efforts to increase investment, foreign investments, might not be succeed if the human resources educational level is still lower than before.

Table 14: Relative Position Of Indonesia in Education and Technology Development in *the Global Competitiveness Report 2004-2005* and *2005-2006*

Indicators	Ranking	
	2004-2005	2005-2006
Quality of educational system	35	56
Quality of public schools	48	66
Quality of mathematic and science education	57	55
Dispersing of qualified health services	36	-*
Level (based on secondary data in 2001, or availability data in years follows)		
-primary enrollment		
-secondary enrollment)	23	22
-tertiary enrollment	81	90
Technology readiness	74	83
	57	67

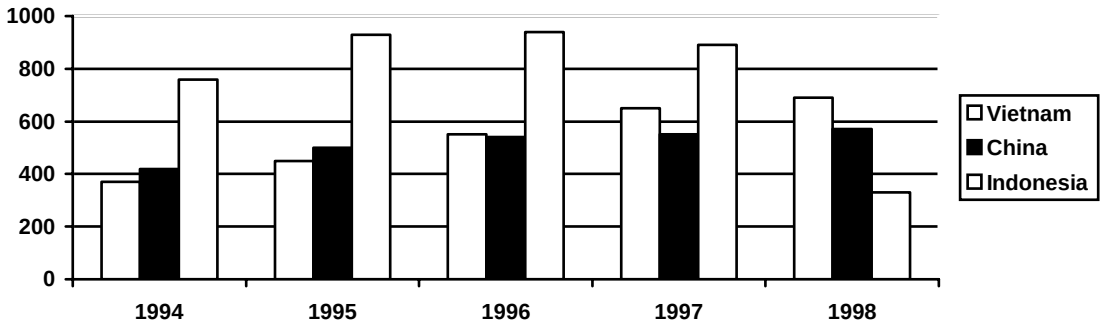
Note: see table 9.*
Source: WEF (2004, 2005).

IV.2.3 Labor Costs.

It is often said that China surpassed Indonesia in terms of its competitive edge in terms of and rate of wage in particular. Data from UNIDO pointed out that the average annual wage per labor (in US$) in Indonesia was higher than those in China (Vietnam as the new competitor next to China), with exception in 1998 since the depreciation of rupiah value against US dollar (Figure 9) . Combination of these factors had created a strong pressure to the price of China exported products as such the country gain its competitive edge related to price competition.

As a whole, well-educated human resources (not merely technician but also management skills) and rapid growth of technology which will increase productivity and lower structure of production costs, added by China involvement in WTO, it can be predicted that the growth rate of China market segment in global market in the following years will continue to move at an even rapid way. If that prediction becomes reality, it is possible that Indonesia's exported products will eventually vanished from market such as Japan, US or Europe, and in the world.

Figure 9: Annual Average Rate of Wage per Labor in Indonesia, China and Vietnam, 1994-1998



Source: UNIDO & MPL (1999).

IV.2.4 Infrastructures

Worst infrastructures condition in Indonesia has also played an important role in lessening the attractiveness for foreign investment and footloose industries which is not heavily depended upon local natural resources. For this type of industry , the only factor available to encourage foreign investment is the scope of domestic market (defined by the combination of total number of residents and the rate of real income per capita). Nonetheless, if changes are not made related to the poor infrastructures condition then foreign investors or multinational companies will choose other countries as the centre of its operation such as Malaysia, Singapore or Vietnam, and exporting the product to Indonesia.

A report from World Bank in 2005 indicated poor infrastructures performance in Indonesia, and even worst in ASEAN region. As it is shown in Table 15, in terms of fix telephone network, Indonesia was in the lowest position among 12 ASEAN countries. The same happened in electricity where Indonesia was at the bottom 2 position. In general, from the infrastructures perspectives, Indonesia is the most unattractive country for investments.

Table 15. Infrastructures Performance in ASEAN

Indicators	Indonesia (2000)	Ranking in ASEAN
Electrification rate (%)	53	11 from 12 country
Fix telephone network (%)	4	12 from 12 country
Number of mobile phone requested (%)	6	9 from 12 country
Access to clean sanitation (%)	55	7 from 11 country
Access to clean water (%)	78	7 from 11 country
Public road network(km per 1000 residents)	1,7	8 from 12 country

Source: World Bank (2005b).

Report from WEF (2004,2005) stated a similar trend. From Table 16, the quality of infrastructures in general for the year 2004-2005, Indonesia ranked in 44 out of 104 countries included in the sample, and further worsened in to the level of 66 out of 117 countries in 2005-2006 period. Figure 10 representing Indonesian position compared to other ASEAN countries in terms of the quality as a whole. In terms of the

infrastructures quality based on its type, Indonesia condition also poor even worst for example the quality of telephone/fax and telephone networks per 1000 residents.

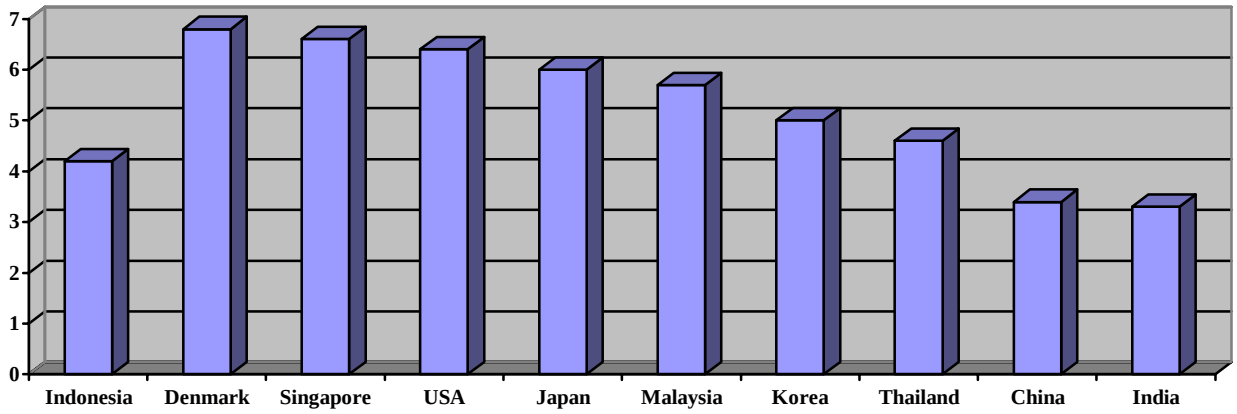
Table 16. Indonesia's Position in Infrastructures Quality in *the Global Competitiveness Report 2004-2005* and *2005-2006*

Indicators	Ranking	
	2004-2005	2005-2006
General quality	44	66
Public road development	28	52
The quality of port	40	71
The quality of air transportation	61	70
Electric Supply	68	84
Post Office efficiency	57	69
The quality of telephone/fax	85	90
Telephone network per1000 residents (data, 2003)	86	96

Source: WEF (2004, 2005).

A further study from World Bank in 2004 concerning various problems including high cost in conducting business in many countries in the world stated that generally in several developing countries in order to obtain one telephone line, and to go through custom-house, or to register new business needed more time with higher costs compared to those in developed countries.

Figure 10. Ranks of Indonesian and Other ASEAN countries in General Quality of Infrastructures In *The Global Competitiveness Report 2005-2006.*



Source: WEF (2005).

V. Investment Policy

Early March 2006, Indonesian Government issued a new package of investment policies thru the Presidential Instruction Number 3 year 2006. The package contained programs matrix along with several action, the target, time limit, as well as those in charge to execute each components. The program include an effort to strengthened investment services institutions and harmonized central and district regulations, customhouse and tariff, taxes, laborers as well as small and middle scale business and cooperation. One of the government actions toward the improvement of investment climate is to simplified the process needed in starting new

business and obtain working permit. The expected outcome from such action is to cut the time needed gradually from 150 days to 30 days. This can be done by delegating authority to the Law Enforcement in District Office and Human Rights Centre. Taxes issue in the new package has also been introduced to finalize three constitutions that are General Taxation Regulation, Income Tax Constitutions and Value Added Taxes. Any revision related to the general regulation of taxation was also be constructed in the package. The policy related to import duties and tariff in order to improved backlog services has also been set up in the package. It is related to the increased number of companies entered through green line, those with faster services with a little amount of investigation.

Now, the question is will the new package is properly made to reach the expected target? According to World Bank Report in 2005a regarding investment climate, it stated that in creating an investments climate we one need a n investment policy related to three following issues; costs, risks, and limitation of level of competition in which the government will hold the strongest influenced (Table 17). If the government influenced thru policy or actions toward the three aspects is negative, for instance high business/investment costs then the policies has eliminate the opportunity for new business to grow or expanding production capacity, meaning eliminate the possibility to increase investments.

As it shown in Table 17, government policies and actions that would have direct or indirect effect on investment costs starting from corruption, public services, import duties policy, bureaucracy in working permit administration, monetary policy that affected the rate of inflation and interest rate until government spending of developing and improving infrastructures. The influence of all the above matters toward certain investment costs varied according to type or sector of economy and financial condition of a company to make an investment. As for multinational companies that accustomed to use external sources for its capital, the instability of interest rate in the country probably would not be any problem. Or, for foreign companies conducting business in a country with little dependencies toward importing raw materials, then the import duties tariff might not be the problem as well.

Certainly, an investment policy could be effective depend on the harmony between investment policy and other economic policies and together create politic and social stability. Meaning that coordination between government institutions is the main condition to move toward a better future.

Table 17. Influential Government Policy and Actions toward Investment Decision

3 factors affecting investment decisions	Factors creating opportunity and incentive for investments	
	Strong government Influence	Weak Government Influence
Costs	Corruption Taxation system Import &export duties Subsidy Bureaucracy & regulation burden Infrastructures Public Services Financial aspect performance Interest rate Labor market regulations	Market price of raw materials Scope of input & output market Scale of economy related to certain technology

Risks	Credibility of anticipated policy Macro economic stability Property rights Enforcement toward contracts/deals Withdrawal of property rights for public interest.	Reaction of consumer & competitor External surprises Natural disaster The strength of supplier
Competition Limitation	Limitation regulation of entry & exit, Competition law & Policy Functioning the financial aspect & infrastructures	Market measures & length between input & output market Economic Scale in certain activities

Source: Table 1.1 in World Bank (2005a) with slight modification.

VI. Major Problems in Investment: Several Survey Results.

It is said may times that business climate including investment is the crucial factor to boost economic growth. Therefore, it is also clear that a profitable business climate is one thing that has to exist in Indonesia so that the expected growth of 6% in 2006, and higher in the coming years as well as increasing working opportunity and decreasing level of poverty may be pursued continuously.

In other words, business climate will reflects number of factors related to certain location in creating opportunity and incentives for businessman/companies to conduct their business properly. Further, a conducive business climate is the condition in which ones could operate his business with a minimum rate of costs and risks to reach a long term profit as high as possible (Stern, 2002) . For example, several studies indicated that as a result of improvement taken in investment climate during 1980's and 1990's which lowered the investments costs and risks drastically, then the investments in private sectors as a part of GDP has increased to over 200% in Chine and India.[3]

In a report produced by World Bank (World Bank, 2005a) related to business climate, stated that there were number of factors should be considered to improved investment climate, among other things the macro economy stability and lower rate of corruption. The report also explained survey results concerning business climate implemented by World Bank which covered over 26.000 companies in 53 countries, including Indonesia. Even though existed barriers differ among countries but the survey result in general indicated the importance of risks related to the policy, including uncertainty in policy and macro economic stability.

Though some differences occurred in creating ranking method toward investment/business risks, the survey results was supported by annual survey related to competitiveness of a nation applied by *The World Economic Forum* (WEF), and the result was shown in the annual report namely, *The Global Competitiveness Report.* As can be observed in Figure 11, based on the respondents percentage, it turned out that 3 major problem preventing business/investments to grow is inefficient bureaucracy, poor infrastructures, and tax regulation. Similar conclusion also stated in that World Bank Report (World Bank 2005a) that inefficient bureaucracy has been the major obstacles in business growth, in terms of real

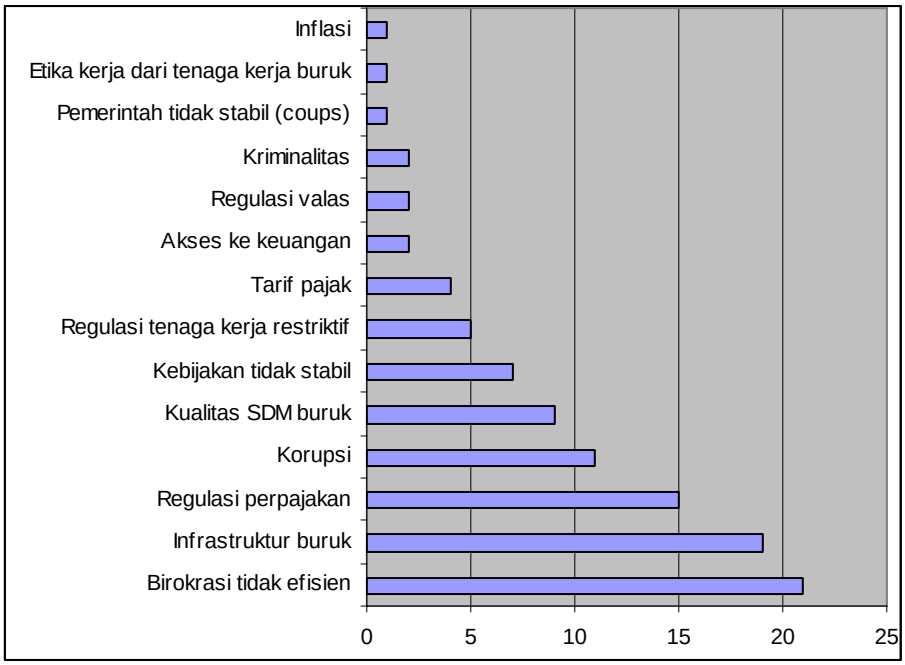
[3] For India case, see for example Aghion & friends (2003), Ahluwalia (2002), Rodrik and Subramanian (2004), and World Bank (2005a); for China cases, see Chen and Wang (2001), Qian (2003), Young (2000), and World Bank (2005a).

conditions that is the costs that has to be disbursed by businessman, as well as in terms of alternative costs form that is the time wasted in obtaining working permit.

A survey result from JETRO concerning the major problem preventing the growth of business or investments in several ASEAN countries described a rather different picture. Table 18 explained that for Indonesia (ID), major problems are the high rate of labor wage followed by complicated taxation system. In Malaysia (M) and Singapore, the similar problem has also been the case for much business man. In Thailand (Th), major problem is a complicated trading procedure, whereas in Philippines (F), Vietnam (V), and India (In) poor infrastructures condition has been the major problem.

Further, report from World Bank (2005) pointed out that Indonesia is the most expensive country in terms of costs as well as number of days in conducting some business. As shown in Table 19, a business man will need around 151 days to administer all business permits, and a minimum required costs and capital of 130.7% and 125.6% subsequently, from an income per capita in Indonesia. Number of permits and total days required in Indonesia is best described in Figure 12 from Research Institution of the University of Indonesia.

Figure 11: Major Business Problems in *The Global Competitiveness Report 2005-2006.*



Note : factors include inflation rate, poor working ethic, and unstable government, and criminal rate, access of fund, labor regulation, foreign exchange regulation, tax tariff, unstable policy, poor human resources, corruption, taxation regulation, poor infrastructures, and inefficient bureaucracy.

Source: WEF (20050.

Table 18: Major Investment Problems (%)

Problems	Th	M	S	ID	F	V	In
Poor infrastructures conditions	15,6	23,6	3,1	54,7	75,5	63,8	72,2
Uncertain & unclear policy	9,5	16,5	6,3	67,7	47,9	61,3	14,8
Complicated taxation system	46,3	11,0	12,5	72,0	20,9	40,0	55,6
Complicated trading procedures	62,8	33,9	21,4	67,6	37,1	56,8	58,5
Increasing level of wages	41,6	52,1	54,0	86,4	36,5	29,5	55,7
Laborer issue such as strike and so on..	7,1	6,6	1,1	37,0	25,7	11,5	26,6

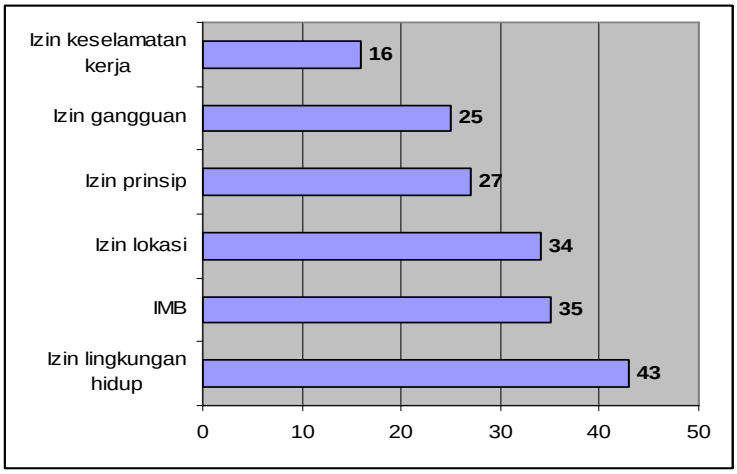
Source: Jetro (taken from Kompas, 2006).

Table 19: Indicators to Favor Business Operation in Several Countries

Country	Total procedures	Total days	Costs*	Minimum capital*
Bangladesh	8	35	91,0	0,0
Cambodia	11	94	480,1	394,0
China	12	41	14,5	1.104,2
Hong Kong	5	11	3,4	0,0
India	11	89	49,5	0,0
Indonesia	12	151	130,7	125,6
South Korea	12	22	17,7	332,0
Laos	9	198	18,5	28,5
Malaysia	9	30	25,1	0,0
Filipina	11	50	19,5	2,2
Singapore	7	8	1,2	0,0
Sri Lanka	8	50	10,7	0,0
Taiwan	8	48	6,3	224,7
Thailand	8	33	6,7	0,0
Vietnam	11	56	28,6	0,0

Note:* = as a percentage of income per capita
Source: World Bank (2005), taken from urwanto (2006).

Figure 12: Total days to obtain Working Permit in Indonesia



Note: working permit including work safety permit, distortion permit, principal permit, location permit, and environmental permit.
Source: LPEM-FEUI 2005, taken from Purwanto (2006).

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