Indonesia

* Indonesia grew an estimated 6.1% and 6.4% in 2010 and 2011, respectively. With a population of 234.4 million and a GDP of $1 trillion, Indonesia is the 16th largest economy in the world. Their per capita income of $4,700 is ranked 156 out of 227 countries by the CIA World Factbook.
* The government made economic advances under the first administration of President Yudhoyono (2004-09), introducing significant reforms in the financial sector, including tax and customs reforms, the use of Treasury bills, and capital market development and supervision.
* The government has promoted fiscally conservative policies, resulting in a debt to GDP ratio of less than 25%, a small current account surplus, a fiscal deficit below 2%, and historically low rates of inflation. Fitch and Moody's upgraded Indonesia's credit rating to investment grade in December 2011. Indonesia still struggles with poverty and unemployment, inadequate infrastructure, corruption, a complex regulatory environment, and unequal resource distribution among regions. The government in 2012 faces the ongoing challenge of improving Indonesia's insufficient infrastructure to remove impediments to economic growth, labor unrest over wages, and reducing its fuel subsidy program in the face of rising oil prices.
* Foreign investment is publically welcomed, but practically discouraged by inconsistencies in codes and enforcement. Corruption is pervasive, resulting in a corruption perception score of 3 out of a high of 10, with 7 out of 10 respondents reporting paying bribes. The overall global competitiveness score is 4.38 out of 7, ranking Indonesia 115 out of 227 in the world, according to Transparency International.
* Indonesia’s trade weighted tariff is 3.1%, but many non-tariff trade barriers exist, earning it a score of 73.9/100 in trade freedom, but only 35/100 in investment freedom on the Heritage Foundation’s Index of Economic Freedom. This is due in large part to the fact that the financial markets are not fully developed and the four dominant commercial banks are state-owned.
* The Indonesian labor market is rigid and imposes costs on both initiating and terminating employment. Despite procedural streamlines, staring a business requires more than the world average of 7 days and 30 procedures. Coupled with an inefficient regulatory process merits Indonesia a labor freedom index of 52.1 and a business freedom index of 54.6 on a scale of 100.
* Rule of law is the weakest of Indonesia’s four pillars supporting the free market according to the Economic Freedom Index. Its judicial system is not fully independent, it is subject to political pressure and its rulings are arbitrary and inconsistent.
* The Heritage Foundation ranks Indonesia in the lowest third of the countries of the world in the protection of property rights, with a score of 30 out of 100, as enforcement is arbitrary and inconsistent with sub-par protection of intellectual property rights. Additionally the market for pirated goods is growing and corruption is prevalent, resulting in a control of corruption score of -0.727 out of a possible 2.5 by Transparency International.

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**In Race to Attract Investment, Indonesia Needs Rule of Law**
**By Andrew White**, The Jakarta Post, April 20, 2012

As a representative of US business interests in Indonesia, I am often asked about the most important criteria for any investor. I respond with three words: rule of law.

Of course rule of law means many things to different people. For companies looking to invest millions or perhaps even billions of dollars, it means equal, fair treatment under a legal system that is transparent. Prevailing laws and regulations cannot be applied arbitrarily. Above all, rule of law means that contracts are sacrosanct. Investors will think twice if there are serious doubts that contracts will be honored and agreed legal frameworks will be observed.

Having just returned to Indonesia from a period living abroad, I am staggered by the incredible progress that Indonesia has made in just a few short years. From cementing democratic principles and institutions to freeing up its economy to capture investment, and the economic growth and jobs that go with it, Indonesia has made remarkable strides.

A large portion of my time is increasingly spent meeting with companies and investors, many of whom are looking seriously at Indonesia for the first time as a place to expand their business or invest their money. These investors are attracted by Indonesia’s wealth of natural resources, its young and growing population, steady economic growth and its recent debt upgrade by rating agencies. The government’s master plan to accelerate and expand the economy, which has created a road map for continued growth, along with anticipated reforms in the banking and financial sectors, are also encouraging.

…An issue of troubling concern to investors is the lack of proper enforcement of contracts. This concern is echoed by the World Bank, which, in its Ease of Doing Business Index, ranks Indonesia 156 out of 183 countries in the area of contract enforcement.

Harvard Kennedy School’s Ash Center closely examines the rule of law in Indonesia in its report “From Reformasi to Institutional Transformation: A Strategic Assessment of Indonesia’s Prospects for Growth, Equity and Democratic Governance.” The report concludes “that local business interests have routinely used corrupt courts to extract concessions from foreign companies,” and it goes on to state that “the legal system — courts, prosecutors, police, lawyers — must uphold the law and the rights of citizens without bias.”

…The oil and gas sector is the most tightly regulated business sector in Indonesia and with good reason, given that oil and gas revenues provide around 30 percent of the state’s revenue. Under the current agreed PSC legal framework, any dispute over projects and costs is resolved by government auditors and there exists an established arbitration process. If there is a genuine case to answer here, why is the established regulatory and legal framework being bypassed arbitrarily?

In another move that has raised eyebrows in the investment community, operators in the mining and energy sector in Indonesia are also now facing the prospect of unilateral and arbitrary moves to rewrite their contract terms, previously agreed in good faith. As investors we respect the sovereign right of the government to make the laws and regulations. However, contracts allow for the changing of terms under mutual agreement and it is often the case that solutions can be found to accommodate the goals of the host country and the investor through dialogue and mediation.

Indonesia is in a global competition for investment. Legal and judicial uncertainty is a key risk factor in determining where capital investment will go. If Indonesia is serious about attracting foreign investment to continue its remarkable growth story it cannot ignore these challenges.

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