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INDONESIA

SELECTED ISSUES OF INDUSTRIAL DEVELOPMENT  
AND TRADE STRATEGY

ANNEX 3

INDUSTRIAL LICENSING

July 15, 1981

East Asia and Pacific Regional Office

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CURRENCY EQUIVALENTS

Currency: Rupiah (Rp)

US\$1	=	Rp 625 (November 1978)
Rp 1	=	US cents 1.6
Rp 1,000,000	=	US\$1,600

PRINCIPAL ABBREVIATIONS AND ACRONYMS USED

BAPPENAS	Government Planning Agency
BAPINDO	State-Owned Development Bank
BKPM	Badan Koordinasi Penanaman Modal (Investment Coordinating Board), also ICB
BPS	Biro Pusat Statistek (Central Bureau of Statistics), also CBS
CBS	Central Bureau of Statistics
GOI	Government of Indonesia
IDFC	Indonesian Development Finance Corporation
KIK	Kredit Investasi Kecil (Small-Scale Investment Credit Program)
KMKP	Kredit Modal Kerja Penanaman (Working Capital Credit Program)
NAFED	National Agency for Export Development
PDFCI	Private Development Finance Corporation of Indonesia
PLN	State Electricity Corporation
PMA	Penanaman Modal Asing (Foreign Investment Projects)
PMDN	Penanaman Modal Dalam Negeri (Domestic Investment Projects)

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INDONESIA

SELECTED ISSUES OF INDUSTRIAL DEVELOPMENT AND TRADE STRATEGY

INDUSTRIAL LICENSING IN INDONESIA

1. INTRODUCTION

1.01 This annex provides a detailed discussion of the regulatory mechanism and industrial licensing arrangements in Indonesia. Some of the licenses needed by manufacturers are issued through the Department of Industry, but the majority must be obtained from numerous other agencies, such as the Investment Coordinating Board (BKPM), both at a national and local level; the scope of this annex, therefore, extends well beyond a discussion of licensing within the Department of Industry. There are six main sections. First, the main licenses which must be obtained are described in Chapter 2. Second, the official justification for licensing in the different areas are discussed in Chapter 3 so that the precise objectives which licensing is believed to achieve are clear. Next, the criteria for the allocation of licenses are briefly outlined. Fourth, details are given in Chapter 5 of the licensing system in operation; it is shown that, in practice, procedures are complex and time-consuming. In the next section (Chapter 6), some of the economic implications of licensing in Indonesia are discussed. Finally, Chapter 7 presents, in detail, specific policy recommendations.

2. THE LICENSING SYSTEM

General Points

2.01 There are three points which need to be borne in mind when analyzing the licensing system in Indonesia. First, it is useful to think of manufacturing firms as falling into three broad institutional categories: the BKPM sector; the BRO sector; and the unlicensed sector. These will be discussed in more detail below. There are, unfortunately, no estimates of the number of firms or employees falling into these groups, although the bulk of the large, medium and small firms in Indonesia (of which there were over 55,00 in 1974/75) would fall into the first two categories, while almost all of the cottage establishments (of which there were about 1,200,000 in 1974/75) would fall into the third grouping.<sup>/1</sup> The BKPM sector

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<sup>/1</sup> Cottage establishments, which are usually unlicensed, will generally be excluded from the discussion in this Annex.

covers those firms which have applied for licenses through the Investment Coordinating Board, the BKPM; all manufacturing firms, no matter how small, with any degree of foreign equity whatsoever must obtain approval for their operations in this way. Domestically owned firms, on the other hand, may opt to apply for taxation and investment incentives from the Government, in which case they must apply through the BKPM, or alternatively, they may simply register under the BRO provisions which is administratively easier, but which does not provide for any concessional facilities. Finally, there is a large but unknown number of small and cottage firms which are unlicensed, although according to a strict interpretation of the law they should at least be registered with local government departments.

2.02 Second, as this division suggests, the licensing system is not uniform for the different types of firms. On one hand, there are specific licensing requirements relating to production, which vary by product and by region, for firms which register through the BKPM or under the BRO provisions; in addition, firms must obtain a number of other licenses, which adds to the complexity of the procedures. On the other hand, there are many licenses of various sorts (external and internal trade, pollution, domestic road and sea transportation, classification and packaging of products, and so on) which, in principle, apply to all industrial enterprises although, in practice, cottage establishments tend to be ignored. It will be convenient, then, in the following sections to consider the licensing system under three headings: (a) the BKPM system; (b) the BRO provisions; and (c) other regulations.

2.03 Third, the Indonesian legal system is largely derived from the Dutch system under which broad enabling legislation passed by Parliament allows for numerous clarifying regulations to be issued by ministers or officials appointed to implement broad policy. In Indonesia, the result is that rules and regulations governing industrial policy in general, and licensing conditions in particular, can be variously found in the following sources:

- (a) The Broad Outline of National Policy statement (Garis-garis Besar Haluan Negara). This statement, formulated every five years, lays down broad guidelines for the conduct of policy in particular areas including industrial development;
- (b) Laws (Undang-undang) passed since Independence, and laws passed during the Colonial period, such as the Bedrijfsreglementarings Ordonnantie 1934, (known as the BRO). These are often couched in broad terms and generally provide ministers and officials with wide powers of interpretation;
- (c) Government Regulations (Peraturan Pemerintah). These are usually issued by the President of Indonesia, and have a status approaching that of laws;

- (d) Presidential Decisions (Keputusan Presiden). These are also issued by the President.
- (e) Ministerial Decisions (Surat Keputusan Menteri). All Ministers issue ministerial decisions, usually on a fairly frequent basis, governing matters within their field of responsibility; the main ministers who issue decisions on matters closely affecting industrial licensing are those responsible for industry, trade and finance, although decisions in the areas of agriculture, health and monetary policy (credit allocation and trade) are also important.
- (f) Director Generals' Decisions (Surat Keputusan Direktur Jenderal). Director Generals within the departments involved in industrial policy listed in the previous category are empowered to issue decisions; these, in practice, often contain a substantial element of policy.
- (g) Various other documents issued by the central government. There are several other legal forms in which central government decisions affecting licenses granted to manufacturers are issued from time to time: internal communications within government departments, such as telexed messages to regional Customs and Trade offices changing external trading regulations; communications issued by ministers and by the central bank, Bank Indonesia, usually in the form of circular letters (surat edaran), and official rulings laid down in letters issued by senior Taxation Office official. The publicity given to decisions of this sort varies; for example, rulings made on test cases by Taxation Officials may be sent to only the manufacturing firm involved, or they may be circulated in a mimeographed form to a number of selected firms, or they may be given a wider distribution through business news-sheets, or even published in one or several newspapers.

2.04 Regional officials also have the authority to issue regulations. The main ones are:

- (a) Governors' Decisions (Keputusan Gubernur Kepala Daerah). These decisions only have authority within any one province, and, in principle, may not contradict any decisions of higher legal standing, such as Ministerial Decisions.
- (b) Regional Bureau Heads' Decisions (Keputusan Kepala Dinas). On matters which have not been spelt out in detail in regulations issued from Jakarta, regional officials can set out precise guidelines; for example, regional officials may specify what documents must be supplied in support of the application for a license unless the requirements have been explicitly and fully specified in directions from Jakarta.

2.05 It is apparent from the length of the list of possible sources of instructions on licensing that a number of officials are empowered to act with varying degrees of authority throughout Indonesia.<sup>/1</sup> Also there is no well-organized and generally recognized system of making public all of the various directives issued; the legal status of one directive relative to others is not always clear and, therefore, conflicts may arise; and although regional officials, in principle, may not issue decisions which contradict instructions from higher officers, in practice, some of these officials take rather wide powers upon themselves and issue rather generous "clarifications" of policy. In many cases, letters of approval from regional officers or even neighborhood officials must be obtained before a more substantive license can be obtained. These letters of approval, therefore, take on the character of a license. To facilitate the discussion, the definition of an industrial license suggested by Guisinger will be used:<sup>/2</sup>

"The term 'licensing' ... refers to all discretionary controls on private industrial investment (excluding controls such as import quotas). While most developing countries 'license' industrial firms in this sense of the term, they do not necessarily use that phrase. Some countries refer to industrial franchises as 'entry agreements'. In others, laws are passed to give the government considerable latitude to grant and withhold incentives and privileges, a power that has the same effect as licensing though it does not carry the name ... all of these discretionary controls are grouped under the general rubric of licensing."

#### The BKPM System

2.06 An Indonesian Investment Board was originally established in the 1960s, with branches for both foreign and domestic investment, to implement the new laws on investment in these areas which came into effect in 1967

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<sup>/1</sup> This is the position for "substantial" decisions affecting licensing; naturally for the very large number of trivial matters which licensing effects, such as whether a particular form has been filled out correctly or not, a very much larger number of officials are in a position to exercise their discretion.

<sup>/2</sup> Stephen E. Guisinger, "Direct Controls in the Private Sector", in John Cody, Helen Hughes and David Wall, Policies for Industrial Progress in Developing Countries, Oxford University Press, New York, 1980, p. 190. Note that licensing in Indonesia extends to public sector enterprises as well.

and 1968 respectively./<sup>1</sup> The Investment Coordinating Board (BKPM), as it is now called, went through several reorganizations during the 1970s, the most recent of which has reportedly led to a marked improvement in the efficiency with which applications for investment approvals are handled./<sup>2</sup> One important aspect of the changes announced in 1977 was the release of BKPM's list of priority industries (the Daftar Skala Prioritas, or DSP) which had previously been unpublished.

2.07 During 1978 and 1979 much effort was made within the BKPM to streamline investment procedures, and the overall situation from the investor's point of view now seems to be much improved compared with the situation only three years ago./<sup>3</sup> Recent changes which affect the licensing system are apparent in two areas: the Investment Priority List and procedure. Although much scope for improvement remains, 1978 was indeed a watershed year for the Investment Board.

#### The Investment Priority List (DSP)

2.08 In February 1980 a revised DSP was published./<sup>4</sup> It contained the first major changes since the List was originally issued three years earlier. It is now planned to revise the DSP every six months. The DSP is formally issued by BKPM, but is decided upon in a coordinating committee, where all

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<sup>1</sup> The laws were Law No. 1, 1967, on Foreign Investment, and Law No. 6, 1968, on Domestic Investment respectively. These important new laws laid down the basis for the Soeharto government's policies towards the provision of incentives for industrial development and have, with modifications and additions, remained in effect ever since. Details of these laws, and more recent amending legislation, are contained in Investment Law and Regulation, issued by the Investment Coordinating Board, BKPM, Jakarta, August 1979.

<sup>2</sup> The reforms on late 1977 which strengthened the BKPM and which were instrumental in speeding up the processing of applications are discussed in the previous Bank survey of the Indonesian industrial sector, see Problems and Prospects for Industrial Development in Indonesia, Vol. 1, May 25, 1978, Report No. 1647-IND, pp. 42-46.

<sup>3</sup> For a discussion of the situation in 1977, see the 1978 Bank report, ibid.

<sup>4</sup> Strictly speaking, two separate Investment Priority Lists have been issued for foreign investment (PMA, or penanaman modal asing) and domestic investment (PMDN, or penanaman modal dalam negeri) respectively. In many respects the Lists are similar, and it will be convenient to regard them as one and mention differences between the conditions set for PMA and PMDN only when necessary.

the technical departments, Bank Indonesia, and the Ministry of Finance are represented. In establishing the DSP, BKPM has only a coordinating role while the technical departments have a decisive influence in shaping their respective parts of the DSP.

2.09 The broad objective underlying the DSP system is to control investment in applications processed by the BKPM in a way which is in accordance with the five development objectives established in the current five-year plan (Repelita III); (1) growth in national output; (2) increased employment; (3) economic diversification away from Java; (4) increased participation of Indonesians in the development process; and (5) more equitable distribution of income. These were supplemented in the 1978 DSP by a long list (15 specific objectives) that can be summarized as: (a) increase foreign exchange earnings or savings; (b) use and process domestic raw materials and resources more extensively; (c) create linkage effects between industries; (d) transfer technology at increased rates; (e) increase ethnic Indonesian participation in employment, management and ownership; (f) protect domestic and previously established foreign industries from harmful competition; (g) protect the environment; (h) synchronize investment and maintain full capacity.

2.10 Such a long list of objectives could not serve to define reasonably clear priorities. It appears that in practice the crucial factor in deciding whether investment was to be encouraged or not, or whether a sector was to be closed to investment, was an estimate of existing capacity in the industry relative to estimated demand. The crucial factor in deciding whether lower incentives or greater restrictions were to be imposed on foreign rather than on domestic investment appears to have been the extent to which domestic capability for investment in the sector exists. These factors dominant in practice with the 1978 DSP were made explicit with the 1980 DSP. This most recent DSP is based on (a) estimating "national capacity open to investment" so as to balance supply and demand; (b) restricting the level of investment in different sectors to meet the requirements of minimum economic size "while not giving rise to excess capacity;" (c) restricting the location of investments to meet the locational objectives of Repelita but, more importantly, to maintain a balance of "supply and demand" for raw materials and output in different areas; and (d) restricting investments so as to favor the weak economic groups by either limiting activities to such firms, requiring participation by weak economic groups, or by avoiding investments in areas that would compete with or otherwise disrupt activities by the economically weaker firms.

2.11 The principles underlying the revised DSP are essentially the same as those set out in the earlier DSP, in that a large number of specific subsectors were separately identified,<sup>/1</sup> various concessions (taxation and

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<sup>/1</sup> The 1978 DSP listed 1,114 different subsectors. The 1980 DSP for domestic investments lists 526 subsectors which include 389 industrial subsectors, whereas the 1980 DSP for foreign investments lists 339 subsectors including 267 industrial subsectors. The number of subsectors in the 1980 DSP was reduced from that in the 1978 DSP list partly through the consolidation of subsectors and partly through the omission of industries that are closed for new investments or for which a decision on incentives has yet to be made

investment allowances) were offered depending on circumstances, and conditions for investment approval were set out on a subsector by subsector basis. Nevertheless, taking the 1980 DSP as a whole, conditions for investment approval appear to be more closely specified than previously, at least for some sectors, and since these conditions effectively determine the terms on which an investment license is granted, this aspect of the DSP warrants some additional comment.

2.12 First, as Table 1 in Appendix I shows,<sup>/1</sup> in some sectors the conditions on which concessions will be approved are very detailed. As a general principle, the BKPM is prepared to lay down firm guidelines in the DSP in the following areas, although it is usually not considered necessary to specify conditions under every heading: maximum allowable production; minimum economic capacity (to ensure economies of scale are achieved); location; participation of partners from the weaker economic group or cooperatives; use of raw materials; and proportion of output exported. Such restrictions are spelled out in great detail for some subsectors whereas only broad statements of principle are available for other subsectors. Some sectors are broken down into long lists of distinct processes while others are covered by only a few broad classifications of activities. Without a detailed survey of the experience of a number of investors, it is hard to know how firmly these conditions are applied because senior BKPM officials emphasize that if investors can present a convincing case, under some circumstances, conditions may be reconsidered. Further, some of the conditions set out in the 1980 DSP, perhaps even most of them, have actually been in force within the BKPM for some time - all that has changed is that now the details have been made public.

2.13 Nevertheless, the preparation and publication of the DSP in this form is consistent with a trend since early 1974, towards more clearly defined Government directives and guidelines for investment in the industrial sector. The will to intervene in a quite detailed manner has been increasingly evident for some time, but it seems that the administrative capacity to intervene has improved during the past several years as the streamlining of procedures at the BKPM indicates.

2.14 Second, one particular feature of the conditions listed in Table 1 reflects an increasing firmness in the Government's determination to implement certain industrial policies that have often been enunciated, but have not always been put into practice: the emphasis on the desirability of providing opportunities for economically disadvantaged groups to participate in industrial ventures. In quite a few subsectors the conditions set out

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<sup>/1</sup> All tables may be found in Appendix I.

by the BKPM specify that weaker economic groups must be involved in the project; in some cases, only firms belonging to the weaker economic groups may undertake production, whilst in the majority of cases investors must make provision for the involvement of these groups. This aspect of the 1980 DSP is also emphasized in the preamble to the List. It is explained that cooperatives (which are usually run by the economically disadvantaged) are eligible for better treatment, that new projects are expected to avoid competing with the weaker economic groups, and more precise definitions of such terms as "weak economic groups" and "indigenous domestic national firms" are provided than has generally been the case before. In the past, the vagueness surrounding the meaning of these terms has facilitated avoidance of the provisions promoting the involvement of such firms; the Government is now keen to demonstrate that there is a political will to implement these provisions./1

2.15 There is one other feature of the new DSP relevant to industrial licensing that deserves comment. Previously, the DSP was divided, for both the PMA and the PMDN sectors, into four investment categories: (a) open to new investment, with priority; (b) open, with some incentive facilities; (c) open, but without any investment facilities; and (d) closed for all new investment. The ranking of any particular sector was often different for foreign and domestic investment, depending on the Government's evaluation of the ability of domestic entrepreneurs to develop the sector; the decision to close a field entirely was based on the demand and supply situation as analyzed by the Government. To strengthen the promotional character of the BKPM, the 1980 DSP only lists industries that are open to investment. Industries not listed are not necessarily closed however. Non-listing may also indicate that the Government does not expect investments to be made in that particular subsector in the foreseeable future and that a decision on conditions and/or incentives will be made as and when the need arises. Government officials claim that, on the whole, the DSP system is administered flexibly and pragmatically. Industrial subsectors shown in the new DSP are listed (see Table 1) as eligible for either tax holiday incentives or investment incentives. Further, the tax incentives can be more or less generous, depending on the priority accorded to the subsector. Activities not included in the 1980 DSP are not necessarily closed. The preamble to the DSP notes that unlisted subsectors may be (a) open to investment without incentives (in which case they would fall under the provisions of BRO law, discussed below), (b) closed, or (c) as yet not classified for promotional incentives.

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/1 See Appendix 2 for Government policy towards the weaker economic group.

BKPM Investment Procedures

2.16 Although businessmen deal mainly with the BKPM in submitting applications for investment approvals, it is important to appreciate that the Board's function is merely to implement existing regulations and that its scope for independent decision making is very limited. Government departments such as the Departments of Industry, Trade, Agriculture, and Finance have yielded their authority to issue licenses only on the strict understanding that, whenever any question of interpretation of policy arises, they will be consulted by the Board and that decisions about policy will be largely for them to set down. This means that while greater authority is now vested in the BKPM than previously, the Board must still maintain close contacts with government departments. In the event of a conflict of opinion between the BKPM and Government departments, the President of the Republic, under whom the BKPM is constituted as a special agency, may decide. Bearing this in mind, it is convenient to divide the investment licensing procedures into four stages, each of which will be discussed briefly. The four stages are (a) pre-application; (b) application evaluation; (c) project licensing; and (d) project implementation.

2.17 In the preapplication stage, potential investors are encouraged to have preliminary discussions with BKPM officials mainly to ensure that, when a formal application is made, it will be consistent with the broad requirements set out in the DSP. It often happens that investors initially have tentative plans which do not fit in with the DSP guidelines, but that adjustments can be made relatively easily at an early stage. The BKPM's official position is that every effort will be made to assist investors design a suitable project which will fit comfortably into the DSP guidelines, and there have been few complaints about this aspects of the Board's operations. Even during the early and middle 1970s, when there was a good deal of dissatisfaction on the part of investors about the efficiency of the investment approval system, the problems were reportedly more to be found in other areas./1

2.18 In the second stage, the BKPM evaluates the application. Provided that the application, as submitted in the initial (Model I) application form, is broadly acceptable, a Provisional Letter of Approval (SPS) is issued. Often the BKPM requires additional information from investors, who

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/1 For a discussion of some of the problems as they existed in the early 1970s, see M. Clapham, "Difficulties of Foreign Investors in Indonesia," BIES, March 1970, and the reply by Professor Mohammad Sadli, "Difficulties of Foreign Investors: A Comment," in the same issue.

have up to 12 weeks (or more, depending on circumstances) to supply the information; if all details can be settled, the BKPM issues a Letter of Final Approval (SPT), after obtaining a Presidential decision, which indicates firm approval for the project. These steps and the time that each is expected to take, are set out in Table 2 in Appendix 1. Along with the SPT, several other documents needed by investors are issued (Table 2 provides the details). In principle, the total time the BKPM itself needs to complete the evaluation of application stage (excluding the 12 weeks allowable to investors to supply additional information) is no more than 10 weeks. This appears to be a marked improvement in the processing time that applications of this sort took some years ago.

2.19 In the third stage, as the project progresses towards the production phase, a series of licenses (listed in Table 2) is needed. Investors need licenses for the direct purchase of domestic inputs which would otherwise be bought through distributing agents. On the marketing side, domestic (PMDN) investors must obtain a Limited Domestic Trading License (IPDNT) so that they may distribute their output directly rather than through distributors; foreign (PMA) investors, on the other hand, must appoint domestic distributors for their products and are forbidden to undertake their own marketing operations except for inter-industry sales. Other licenses, permits or letters of endorsement are needed for importing equipment and raw materials, for opening Letters of Credit to pay for imports through Bank Indonesia, to clear goods through the ports, to employ foreign workers on the project, and so on. When commercial operations are ready to begin, a Permanent Operating License is issued which is accompanied by documents needed to obtain taxation concessions and to arrange export of the manufactured products. Most of these licenses can now be obtained directly from the BKPM, but some licenses that have no direct bearing on the investment activities per se can only be obtained from provincial offices; investors must, therefore, also determine the regional requirements and ensure that they are met. The total number of licenses, permits, certificates, letters of recommendation, or endorsement, etc., listed in Table 2 is 20.

2.20 Finally, when projects have reached the implementation phase, the BKPM requires investors to report annually on the progress of the project.<sup>/1</sup> In principle, this annual reporting system should provide a regular flow of information to the BKPM on the operations of the plants which have been established, but, in practice, the reporting arrangements do not work well. It appears that many enterprises either do not report at all, or provide little information, and so neither the BKPM nor Bank Indonesia (which also monitors the progress of investment projects) has a clear picture of how

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<sup>/1</sup> In the pre-production stages, investors are expected to report on progress every six months.

approved schemes are progressing. The BKPM also reviews any proposed changes to projects, which must receive the approval of the Board before they can be implemented. This aspect of the operations of the BKPM system is discussed below. The BKPM is now actively improving its capacity to monitor approved investment activities.

#### The BRO system

2.21 The Company Regulations Ordinance of 1934, commonly referred to as the BRO (Bedrijfsreglementerings Ordonnantie 1934), provides the legal basis for much of the production and capacity licensing in the industrial sector in Indonesia.<sup>/1</sup> Previous reports dealing with industrial development in Indonesia have concentrated on licensing provisions in the BKPM sector and have had little or nothing to say about the BRO firms. This is partly because information about the requirements and activities of the BKPM are more easy to come by, partly because it is the modern large-scale sector where substantial and visible industrial developments have been taking place, and partly because industrial policy makers in Indonesia have tended to neglect the provisions of the BRO (and more recent amending legislation) during the past decade. Nevertheless, recent developments indicate that the provisions of the BRO will form the basis for significant changes in policy in the next few years, so it is worthwhile looking at the Law, and the provisions that flow from it, in some detail.

2.22 The BRO, issued in 1934, established a firm legal framework for the industrial licensing system that existed at the time. The provisions of the legislation were not especially precise, but as was often the case with colonial legislation of this sort, it laid down broad rules and delegated a good deal of authority to the relevant Minister. According to the legislation, a license was required both for the establishment of a new firm and for the expansion of an existing one, and the request for a license "could only be refused if, in the opinion of the Minister, the establishment or expansion of an enterprise could be considered to conflict with the economic interests of the nation" (Clause 4, subclause 3). The broad terms in which the legislation was couched, and reports of the manner of implementation, suggest that the colonial government did not especially wish to limit entry into industrial sectors; on the other hand, vague phrases of this sort provided government officials with a good deal of discretion, and, as will be seen below, this tradition has carried over into the industrial legal system in the post-independence period. In practice, the colonial government used the legislation mainly to regulate nine types of industrial activity, and it is interesting to note that government intervention in these sectors has tended to be continued ever since; the nine sectors were:

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<sup>/1</sup> The details provided in Kumpulan Perundang-undangan Bidang Industri Disertai Beberapa Komentar (Compilation of Industrial Sector Laws with Comments), published by the Department of Industry, 1975, were useful in preparing this section.

(1) white cigarettes; (2) ice factories; (3) printing; (4) metal working; (5) textiles; (6) rubber smoking; (7) rubber remilling; (8) rice milling; and (9) wharfage and transport activities.

2.23 For some time after independence, licensing procedures continued to be based on the BRO alone. In the late 1950s, however, the increasing tendency for direct regulation of the economy led the Government to introduce Government Regulation (Peraturan Pemerintah) No. 1, 1957, which provided the Minister of Industry with increased powers to determine licensing procedures. Previously, important changes needed to be specified in Government Regulations (Peraturan Pemerintah), but under the new arrangements the Minister could introduce changes in Ministerial Decisions (Surat Keputusan) which were administratively much easier to issue. Shortly after Government Regulation No. 1, 1957, came into force, the number of industrial activities which needed licenses from the Government was increased from the nine listed above to 26, mostly in the light industrial sector.<sup>/1</sup> Another consequence of the changes introduced at this time was that the authority to issue industrial licenses was dispersed. While the Department of Industry in Jakarta retained the authority to issue some licenses, the authority to issue certain others was delegated to provincial offices of the Department of Industry, and the right to license yet others was given to the Department of Agriculture (rice mills, rubber remilling) and the Department of Transport (wharfage and transport). While clearly, there are some advantages to dispersal of authority of this sort, the arrangement complicated the administration of licensing policy in Indonesia because the various authorities issuing licenses have not coordinated their activities and do not even appear to have kept orderly records of the numbers

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<sup>/1</sup> The 17 activities added to the list of regulated industries were (1) batik, (2) garment making, (3) textile finishing, (4) coconut oil (frying), (5) alcoholic beverages, (6) sugar production, (7) biscuit making, (8) chocolates, (9) production and retreading of outer tyres, (10) lime production, (11) sawmilling, (12) brick and tile production, (13) film prints and negatives, (14) bicycle assembly, (15) assembling of radio receivers, (16) stove assembly, and (17) film subtitling firms. It is not clear from the Government Regulation why it was regarded as necessary to regulate these activities. The closest the Government Regulation comes to defining objectives is in the accompanying Explanation to the Regulation where it is stated that "..... it is felt that there is a need for regulations which will guarantee orderly development.... in the interests of the nation..... The lack of regulations which make it possible for the government to oversee and fully control various business activities ... is strongly felt."

of licenses issued. Further, rice milling and rubber remilling are quite important activities within the Indonesian industrial sector. The fact that they are outside the authority of the Department of Industry has not assisted in the formulation of small-scale industry policies.

2.24 The licensing system was again revised within the Department of Industry in 1964 when government policy was to decentralize authority to provincial levels wherever possible.<sup>/1</sup> In general terms, there were three main changes which were mainly of relevance to small and medium light industrial firms. First, the number of activities which needed to be licensed before a firm was established was reduced to nine: (1) hand printed batik, (2) alcoholic spirits, (3) other drinks containing alcohol, (4) air rifle bullets, (5) printing, (b) national white cigarettes, (7) foundaries (household goods), (8) ice blocks, and (9) textiles. These firms could obtain licenses at the provincial level. Second, all other "national firms", (i.e., those belonging to the weaker economic group) were simply required to register (not obtain a license) at the local kabupaten (regency) level when they were ready to begin operations.<sup>/2</sup> Third, all foreign firms, regardless of their field of activity, needed a license issued from Jakarta.

2.25 During the 1970s, the BRO and the amending legislation has continued to be used to license firms established outside of the BKPM arrangements. For example, in the early 1970s, the need was felt to regulate the development of the rapidly-expanding crumb rubber firms, and the BRO was the basis of the Presidential and Ministerial Decisions issued for the purpose.<sup>/3</sup> As is usually the case, these decisions delegated authority for their implementation to government officials; in this instance, two Directors General within the Department of Industry were given responsibility for different aspects of the regulatory procedures; this meant that the licensing procedures involved the staff of two separate Directorates General.<sup>/4</sup> A similar approach has been taken in other sectors in more recent years.

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<sup>/1</sup> More precisely, the change took place within the Department of Peoples' (Rakyat) Industry, but the Department of Industry remained the more important ministry.

<sup>/2</sup> A kabupaten (regency) is the administrative level of government below the province.

<sup>/3</sup> Keputusan Presiden No. 85 tahun 1971; Keputusan Menteri Perindustrian No. 198/M/K/III/1972; and Keputusan Menteri Perindustrian No. 42/SK/VII/1972.

<sup>/4</sup> The Director General of Basic Industries was responsible for supervising the use of machinery, while the Director General of Light Industry and Handicrafts controlled the issue of licenses and had authority to supervise the development of the sector.

2.26 The formal procedures that a firm must go through to obtain a license under the BRO provisions vary somewhat from province to province, but they are generally straightforward. First, when a firm approaches a local Department of Industry Office for a license, it is necessary to establish which Directorate General is responsible for regulating the category to which the firm belongs. If either the Directorates General of Basic Metals (Logam Dasar) or Basic Chemicals (Kimia Dasar) have responsibility for controlling the sector, the application is forwarded to Jakarta and subsequent negotiations between the firm and the Department of Industry are generally carried on in Jakarta. This procedure, however, occurs rather rarely since firms under the supervision of these Directorates General are generally large and usually arrange licensing procedures through the BKPM. In the great majority of cases, however, the Directorates General of Miscellaneous Industry (Aneka Industri) or Small Industry (Industri Kecil) will be responsible for local firms, and procedures differ depending on which category the application falls into.<sup>/1</sup> Prior to 1978, applicants for BKPM-type investment licenses also negotiated directly with the Ministry of Industry; but since the reforms of that year, all aspects of the application/licensing procedures are handled by the BKPM, except in the case of selected large state enterprises.

2.27 In the second stage, firms are either dealt with under the regulations of the Directorate General of Miscellaneous Industry or the Directorate General of Small Industry.<sup>/2</sup> During the last year or so there has been an attempt to ensure more orderly licensing procedures within the "miscellaneous industries" group. As noted earlier, in the mid-1960s the licensing and registration procedures for firms of this kind were decentralized. The result was that increasingly the system became rather confused. While, in principle, these firms needed licenses to operate, in practice, many of them did not have licenses and the licensing procedures went largely unpoliced. Although no estimates are available for the number of "miscellaneous" firms which did not obtain licenses, it seems that most did do so because licenses were generally issued more or less automatically by local offices of the Department of Industry and there were certain advantages to having a license. Under these procedures, then, most firms in the miscellaneous industry category found it easy to obtain an Industrial License (Izin Usaha Industri, sometimes called a Lisensi Perusahaan Industri). According to reports from manufacturers interviewed by the mission, the delay and trouble involved in getting this license was generally comparatively minor.

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<sup>/1</sup> The official definition of a "small" firm applied within the Department of Industry is one which (a) has a total capital stock, excluding buildings, land and working capital, of less than Rp 70 million (US\$112,000), (b) has a capital-labor ratio of less than \$1,000, and (c) is owned by an Indonesian citizen. In general, firms larger than this, which would generally be regarded as "light industry" in most countries (excluding textiles), fall into the Miscellaneous Industry category provided (i) they have not sought licenses through the BKPM, and (ii) they do not fall into categories (such as rice mills) which must be licensed through other Departments.

<sup>/2</sup> The Directorate-General was established in 1978.

2.28 Nevertheless, dissatisfaction with these insufficiently coordinated procedures and actions has steadily grown because there have been many reports of excess capacity in many light industries. The result has been that, recently, it was decided that all firms within the supervision of the Directorate General of Miscellaneous Industries must be licensed from Jakarta rather than through provincial offices, and so now all applications must be forwarded to Jakarta. The decision to centralize the granting of licenses in the Miscellaneous Industries Directorate General is part of a wider effort within the Department of Industry to streamline regulatory procedures for the BRO sector.<sup>/1</sup> On the one hand, licensing procedures within the Department of Industry have been subjected to close review, and the Ministry of Industry has issued instructions that, wherever possible, both forms and procedures are to be simplified. On the other hand, in what may turn out to be one of the most important extensions of the industrial licensing system in Indonesia since Independence, plans are being prepared within the Department of Industry to establish a DSP system for the whole of the BRO sector. As seen earlier, the DSP guidelines which exist for the BKPM sector are very detailed, and require officials in Jakarta to set out (and constantly revise) numerous conditions for the hundreds of subsectors specified in the Priority List. An extension of this system to the BRO sector, which is composed of perhaps 10,000 or 15,000 comparatively small firms scattered throughout the Indonesian archipelago, is bound to impose a burden on the administrative capacity of the bureaucracy. Under the proposed system, which was in an advanced stage of preparation when the mission visited Jakarta, the demand for and supply of industrial goods will be more closely monitored by officials of the Department of Industry and it is believed that it will be possible to avoid the installation of significant excess capacity in industrial subsectors.

2.29 For firms which fall within the jurisdiction of the Directorate General of Small Industry, the procedures are very simple. As a general rule, they are simply required to register (which does not involve the granting of a license) with the local Department of Industry, and agreement to their operations in most cases has been automatic. In the past, many small firms have not even bothered to register; moreover, quite a few small firms, which at some stage registered, have gone out of business, and so the data on registration have become most unreliable.

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<sup>/1</sup> In fact, the proposed changes may extend beyond the BRO firms, but details have not yet been announced. Officials within the Department of Industry indicated that they expected the firms loosely referred to as the "BRO sector" to be most affected.

2.30 In summary, under the BRO and the subsequent amending laws, most firms in the "light" industries which do not fall into the small industry category (as defined within the Department of Industry) are required to obtain a license. Although certain conditions of operation, such as the product to be produced and the scale of output are, in principle, controlled by the licensing procedures, in practice they have not been because new licenses (including licenses allowing for an expansion of existing plants) have generally been easy to obtain. For the small-scale sector, the registration procedures have been simple, and rarely enforced.

#### Other Regulations

2.31 In addition to the licenses discussed above, issued on one hand through the BKPM, and on the other through the Department of Industry, most firms (again excluding smaller firms, which are often ignored by the authorities) need to obtain a range of other licenses. The situation is often simpler for BRO firms than for the larger firms which have obtained facilities through the BKPM, because the BRO firms are more likely to serve a local market, retailing their output through local distributors. These firms, in addition to the Industrial License (Izin Usaha Industri) discussed above, are in principle required to obtain a minimum of four other licenses:/1

- (a) Environment License (Izin Gangguan), obtainable through the local municipal authorities, and issued after inspections to check on the impact of the factory on the local environment.
- (b) Trading License (Surat Izin Usaha Perdagangan, or SIUP), obtainable through the Local Department of Trade, which permits a firm to engage in local business activities; this license is required for any trading activities of any sort, such as the purchase of inputs or the sale of outputs, and is therefore automatically required by firms.
- (c) Health License (Izin Kesehatan) regulating matters concerning public health.
- (d) Labor Safety License (Izin Keselamatan Kerja), issued by the local Department of Labor, and regulating such matter as factory working conditions and hours of work.

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/1 This is the minimum number of licenses listed by a senior official of the Department of Industry, Ny. Ita Gambiro S.H., in her paper "Masalah Hukum Industri dalam kehidupan industri Indonesia" (Problems of Industrial Law in the industrial field in Indonesia), Simposium Hukum Perindustrian (Symposium on Industrial Law), Badan Pembinaan Hukum Nasional, Penerbit Binacipta, May 1978, p. 45.

2.32 However, if firms wish to engage in more substantial activities, such as assisting with the marketing of goods, exporting or importing, and maintaining vehicles for these purposes, then the total number of licenses needed by the firm and the associated business enterprises rapidly rises; an example which provides a partial list of the licenses required by one PMA cement manufacturer and the associated distributing agencies is shown in Table 3. A number of these licenses were listed earlier in the section on the BKPM firms,<sup>/1</sup> but others were not; in addition, several of the more important areas where licensing requirements exist deserve comment.<sup>/2</sup>

2.33 Internal Trade. A range of licenses is required to carry on internal trade activities, the most important of which is the Trading License discussed above. Depending on what activities a firm carries on, the transport distributors licenses listed in Table 3 may be required. Foreign (PMA) firms are forbidden to engage in marketing and distributing activities (except for inter-industry sales), and most enter into agreements with local firms which will act as agents within Indonesia. The Indonesian Government prefers that distributors from the weaker economic group be used whenever possible. In addition, there are various other controls on trade in particular sectors. On the input side, in a few selected cases, the supply of inputs is closely regulated; the best known example of this is in the kretek (clove) cigarette sector, where two Government-appointed privately-owned trading companies have the exclusive right to import kretek. On the output side, distribution of certain products is directed by the Government; for example, in the cement industry, the Government has decreed that domestic cement producers may not directly organize the distribution of their cement, but must appoint a distributor approved by the Department of Trade. Imports are to be handled by a government-owned trading company or by companies which have obtained cement import permits from the Department of Trade.

2.34 External Trade. Several licenses, the main ones which are listed in Table 2 and 3, are required for import and export activities. General licenses to act as importers or exports are required (Angka Pengenal Impor and Angka Pengenal Ekspor, respectively), and in addition, numerous forms must be completed for each transaction. On the import side, there is a wide range of tariffs and quotas (including outright prohibition on the import of some goods); on the export side, the Government also imposes restrictions on trade in some products.

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<sup>/1</sup> In such cases, the BKPM automatically provides those other licenses required (e.g. for domestic trading, importing, exporting, etc.), which are directly related to the firms' activities, as a package.

<sup>/2</sup> Often the requirements for foreign and domestic firms vary slightly. The distinction is mentioned only where necessary.

2.35 Environment. In principle, all firms (excluding small industry establishments) must obtain an Environment License issued under the provisions of the colonial Hinder Ordonnantie, often referred to as H.O., or the Undang-undang Gangguan (Environment Law). A formal request for an Environment License must be made to local municipal authorities, who will then arrange for a series of inspections to be made of the factory by different agencies (water officials, fire department, health department, and so on); these agencies, in turn, must each approve the conditions at the site before the Environment License can be issued.

2.36 Health regulations. As is common in other countries, Indonesia has a range of health regulations governing such industries as foods, beverages, pharmaceuticals and cosmetics, and so on. Provisions exist for regular testing of the products, and firms must obtain regular clearances.

2.37 Second-hand equipment. Until 1979, the import of second-hand industrial equipment into Indonesia was banned. In September 1979 there was a slight relaxation of the ban, but the import of most items of second-hand industrial machinery still remains difficult. Selected items may be imported subject to the following conditions:<sup>/1</sup> (a) items listed in Table 4 may be imported, subject to the other conditions listed below; (b) second-hand industrial equipment may be imported only when similar goods are not produced in Indonesia and when their import will not have undesirable effects on efforts to introduce a system of industrial standards in Indonesia; (c) imports of second-hand equipment not listed in Table 4 may be permitted only if a permit is issued by the Department of Trade and Cooperatives on the recommendation of the Department of Industry; imports of this sort may be carried out only by a government trading company, or by producers who have been licensed as importers by the Minister of Trade and Cooperatives; (d) requests to import second-hand equipment must be accompanied by a Certificate of Inspection from a Surveyor or Appraiser who is recognized and registered with the Government, and the Certificate of Inspection must be prepared in line with the conditions and procedures set out by the Department of Industry.

2.38 Labor laws. A number of labor laws regulate such matters as working hours and factory working conditions, but enforcement is rather lax. Minimum wage guidelines are set for some industries on a province by province basis, but their impact on wages is slight. Since the mid 1970s, the Government has supported a campaign to have Collective Labor Agreements (CLAs) drawn up on a factory by factory basis for larger indus-

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<sup>/1</sup> Set out in the Joint Ministerial Decree (Surat Keputusan Bersama) of the Minister for Trade and Cooperatives and the Minister for Industry, issued on September 5, 1979. See also the Ministerial Decree of the Minister for Trade and Cooperatives issued on May 19, 1980 which specified the requirements to be met by importers of second-hand goods in more detail.

trial establishments, and these Agreements seem to have developed into a relatively effective instrument for maintaining acceptable standards in those factories where they exist.<sup>/1</sup> Licensing requirements in connection with labor laws are of minor significance in Indonesia, and there are few reports of significant problems arising from them.

2.39 Other Regulations. It is often the case that additional regulations are specified by local governments which require manufacturers to obtain permits of one sort or another. Regulations of this sort are so numerous and difficult to track down that it is impractical to list them, but as an example, two decrees issued by the Governor of the Jakarta area will indicate the kinds that are frequently issued. First, in mid-1977 the Governor issued a decree to control the disposal of industrial waste products. It was announced that all firms were required to have their waste products tested every three months by a specified government testing agency, and that if they failed to do so they could be closed down. In effect, to continue legal operations, firms were required to obtain a letter from the specified government testing agency, and the letter therefore takes on the character of a license which firms may be asked to produce by government officials.<sup>/2</sup> A second, more recent example, is the regulation issued in February 1980 setting out standard measurements to be used in the garment industry in Jakarta. Precise measurements are laid down, firms are required to submit their products to the Jakarta Textile Council for examination every three months, and a Letter of Result of Examination (Surat Tanda Hasil Pengujian) must be obtained from the Jakarta Textile Council and endorsed by the Jakarta regional office of the Department of Industry.<sup>/3</sup> Many other regulations of this sort have been issued for the Jakarta area alone, and the total number issued throughout all of Indonesia must run into many hundreds.

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<sup>/1</sup> According to a senior official in the Department of Labor speaking in early March 1980, 1,014 CLAs existed at that time covering 2,277 enterprises see Kompas, March 5, 1980.

<sup>/2</sup> Details of the regulations were published in Warta CAFI, June 6, 1978, No. 131.

<sup>/3</sup> These requirements are set out in the Decision of the Governor of 11 February 1980 (Keputusan Gubernur Kepala DKI Jakarta No. 126 tahun 1980, tanggal 11 Pebruari 1980), published in Business News, No. 3419, 5 March 1980.

### 3. THE JUSTIFICATIONS FOR CONTROLS

3.01 Before attempting to evaluate the economic impact of the licensing system, it will be useful to establish the official economic rationale for these licenses so that their perceived role is understood. Three difficulties immediately arise in attempting to link the numerous licenses which are issued with particular objectives.

3.02 First, with the exception of the "Fundamental Objectives of the State" (GBHN) which is a general policy statement adopted by the Supreme Council of the People's Representatives (MPR), there are no broad statements of policy on the matter. It is, therefore, necessary to sift through official documents to extract the main justifications which have generally been advanced for individual controls. Second, it is often the case that any particular control appears to have been imposed or maintained for several reasons. This is not surprising, considering that the licensing requirements have emerged as a result of decisions taken within the Indonesian bureaucracy by different officials, within different agencies, over a substantial period.

3.03 Third, the most frequent justification advanced for licensing and other regulation procedures is that it is desirable for the Government to membina (i.e., build, or cultivate) the development of the industrial sector; the implication in the concept of pembinaan (founding, building or cultivating) is that the proper role of government officials is to provide leadership and direction to businessmen and to guide them in the right direction so that their private decisions will be consistent with the interests of the nation. In practice, because the influence of the Government is so great in many areas of economic activity in Indonesia, the assertion by government officials of their pembinaan role has led to a situation where pervasive government regulation is accepted in almost all circles as desirable. This justification, then, is mentioned in favor of most forms of licensing by officials at all levels, and it provides a general explanation for the more specific reasons advanced for particular licenses discussed below.

3.04 The consequence of these three difficulties is that any linking of licenses with specific objectives is inevitably somewhat subjective. Nevertheless, bearing these qualifications in mind, it is possible to discern "main motives" behind the most important licenses issued; these are summarized below.

3.05 Market Structure. Several of the licensing requirements are often justified in terms which indicate that senior government officials have

a concept of the "optimum market structure" for various industries. On one hand, it is official policy to encourage consolidation in some industries so that a few larger plants exist rather than many smaller ones. One reason for this is that officials want to maximise the benefits to be achieved from the economies of scale that are important in some industrial processes. Minimum scales of plant are, therefore, laid down for some of the manufacturing subsectors in the DSP issued by the BKPM. A second reason is that there is also considerable concern about the undesirable social consequences of market domination by special interest groups. Because regulations governing matters such as minimum health and safety standards, honest labelling, labor conditions, and pollution in the manufacturing sector are rarely effectively enforced, manufacturers (particularly smaller manufacturers) are apt to ignore them, especially when competition within an industry becomes intense. One way that government officials try to create an industrial environment where competitive pressures will not push manufacturers into "anti-social behavior" is by regulating entry into the sector. Because of both of these factors, government policy is to prefer expansion of existing enterprises in some sectors to the entry to new firms, especially when the number of existing firms is sufficient to ensure a reasonable level of competition and when economies of scale are considered important.

3.06 On the other hand, there is also concern about the need to avoid excessive industrial concentration. Indonesian policy makers wish to encourage entry in some subsectors, both to guard against the usual economic problems which can arise in monopolised industries (high profit margins, low efficiency, poor services to consumers, and so on), and because it is thought likely that it will be the economically stronger businessmen who will emerge in the most powerful position if monopolies are allowed to develop.

3.07 The upshot of these various considerations is that in some subsectors, the government is reluctant to allow new investors to enter, while in others, official policy is to encourage the establishment of new firms rather than allow the expansion of existing operators. In industries in the latter category, if demand is believed to exceed supply, preference is often given to businessmen from the weaker economic group, especially through a system of subsidized and preferential access to credit operated by the State Banks on the instruction of Bank Indonesia.

3.08 The choice between growth, which suggests a preference for large units designed to achieve economies of scale, and equity, which is seen as indicating a preference for smaller economically weaker firms, is regarded as a dilemma by senior policy makers within the Department of Industry who tend to take the view that each case needs to be judged on its merits. One senior official explained to the mission that the dilemma is resolved by broadly classifying the manufacturing sector into three categories: (a) small industries (such as garment-making) where the emphasis will be on equity; (b) large-scale establishments (such as spinning) in capital-intensive sectors where growth will be given highest priority; and (c) other industries between these extremes (for example, the industries falling within the scope of Miscellaneous Industries Directorate General) where both objectives will be taken into consideration.

3.09 Basic industry. Some sectors such as steel, fertilizers, downstream petroleum-based products, and cement, are regarded as key economic industries; entry into industries of this sort by private sector firms is closely supervised by the Government, especially in the case of refineries and other oil-based industries. Private participation in key economic industries, however, is usually encouraged and increasingly actively sought by public enterprises. Indication of this was the announcement, in mid-1979, that, under certain circumstances, private sector establishments would be allowed to generate and provide electricity to the public. Previously the electricity industry, as a basic utility, was considered the exclusive preserve of the state.

3.10 Promotion of Entrepreneurs from Weaker Economic Groups. A substantial number of the licensing conditions are partly justified on the grounds that they assist businessmen who are disadvantaged economically. For example, in subsectors where advanced technical knowledge is needed, foreign investors may generally establish new enterprises, but in industries where no special technical skills are necessary, entry to foreign investors is often refused. Similarly, such matters as ownership and funding arrangements, agreements guaranteeing cooperation between foreign and domestic firms, and regulations governing domestic distribution and marketing channels are controlled partly so as to ensure that preference will be given to domestic entrepreneurs from the weaker economic group.

3.11 Protection of "Pioneer Entrants." One reason mentioned to the mission for the protection of certain existing producers through restriction of entry and protection from imports is a variant of the well-known "infant industry" argument; it is felt by some that those foreign and domestic investors who were prepared to take the risk and trouble of establishing new ventures in Indonesia in the late 1960s and early 1970s deserve special consideration now that the industrial climate has improved. These businessmen, it is argued, initially had to develop their factories and market their products under difficult circumstances, and often incurred high establishment costs which they are still trying to recoup. In doing so, some officials argue the "pioneer entrants" contributed to the economic improvements which occurred during the 1970s and they, are therefore, entitled to some special support from the Government. It is, however, not an official Government objective to favor such firms over newer ones or to use the investment licensing system as an instrument to protect particular firms. Licensing is perceived by the Government as one instrument to assist deserving weak enterprises in becoming strong and to assist strong enterprises in preservicing their health regardless of their age. Official "pioneer status" was only granted to new firms during a limited period (1966-1968) preceding the formulation of a comprehensive investment/incentive policy. Since that time, no new firms have been granted pioneer status and the concept has lost its legal significance.

3.12 Economic Independence. Several of the controls are imposed partly to encourage Indonesian ownership and management of foreign companies. Ownership arrangements laid down in licenses issued to foreign investors by the BKPM generally specify that there must be a majority of Indonesian ownership within 10 years, and funding details and foreign staffing proposals are scrutinized to ensure that Indonesian interests are protected.

3.13 Guarantee of Domestic Supply. One reason for maintaining controls over exports is to ensure that when necessary, in times of local shortage goods can be directed to the domestic market. That the Government feels that direct controls of this sort are necessary reflects both an uncertainty born of past experience, that in times of crisis domestic supplies will be sufficient, and a lack of confidence in alternative policy tools which might be used to maintain domestic supply stability. Restrictions on exports for this reason are not an uncommon occurrence in Indonesia. In the wake of the 33% devaluation in November 1978, which suddenly made exporting much more profitable and, therefore, induced shortages at home, the export of a number of basic commodities was banned. Some of the exports which were banned were manufactured goods which were in short supply on the domestic market. The export of others was forbidden because they were raw material inputs into important manufacturing industries and it was feared that shortages would lead to factory closures and unemployment./1

3.14 Increasing Domestic Value-Added. A second reason that exports of some products are forbidden or restricted is to increase the domestic value-added content, i.e., to encourage so-called "export substitution," which is the substituting of existing exports of raw materials by the exports of processed and semi-processed materials./2 For example, for several years the Indonesian Government has been attempting to encourage some domestic processing of logs before export; timber companies have been required to set up saw mills by making it compulsory for them to process a certain proportion of output before export./3

3.15 Quality Control. A third reason that controls are sometimes placed on export is to ensure that the quality of exports reaches specified

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/1 As of December 11, 1978, the export of the following goods (among others) was permitted only with a license from the Minister of Trade and Cooperatives "in order to fulfil domestic needs" and "so as to stabilize domestic prices:" fertilizer, cement, reinforcing steel bars, motor car tyres, salt, wheat flour, paper, asphalt, sugar copra, coconut frying oil, palm oil, and stearin. For some time the export of a number of these commodities was effectively banned, although the controls were relaxed during 1979. See the Ministerial Decision of the Minister for Trade and Cooperatives, No. 268/KP/XII/78, December 11, 1978.

/2 The term "export substitution" is from Hla Myint, "Overall Report," in Southeast Asia's economy in the 1970s, Asian Development Bank, 1971, p. 20.

/3 Logs are also subject to the maximum export tax of 20%; this tax rate cannot be exceeded by legislation, hence the export controls.

minimum standards. It is regarded as in the national interest that Indonesian goods reaching world markets meet internationally accepted standards.

3.16 Modern Technology; Outdated Equipment. As noted earlier, for a number of years the impact of much second-hand industrial equipment into Indonesia was banned, and the controls remaining in this area are still quite restrictive./1 One reason for these regulations is that the Government has thought it desirable to encourage the use of modern technology. The alternative, as many officials saw it, was to allow Indonesia to become a dumping ground for old-fashioned, uncompetitive equipment from technologically more advanced nations, which would simply exacerbate Indonesia's industrial development problems./2 A second disadvantage which, it was feared, would result if this situation developed would be the existence of

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/1 The situation has varied somewhat between industries, since the regulation of the use of second-hand equipment, has depended to some extent on the regulating department. In textiles, for example, the prohibition came into force in 1974. After June 1975 textile firms were not permitted to include used machinery in their application lists submitted to the BKPM for approval. Prior to the imposition of the ban in the textile sector, several other regulations existed regarding the import of used machinery, although enforcement was rare. These regulations included requirements that machinery be not more than eight years old, that supplies of spare parts be "guaranteed," and that the price should not be more than half that of new looms. These details are from Hal Christopher Hill, "A Note on the Prohibition of Imported Second-hand Textile Machinery," Appendix 5.1, Choice of Technique in the Indonesian Weaving Industry, unpublished Ph.D. thesis, Australian National University, Canberra, December 1979, p. 167.

/2 Referring to textiles, Hill explains that the "Official reasons for the ban are vague, but from conversations with government officials two main factors emerge. First, prior to the prohibition there was considerable under-invoicing on imported machinery. ...However, after 1967, this should not have been an important consideration because the new investment regulations expressly waived the duty on imported machinery...A second and probably more important reason for the ban is the feeling, widespread among senior government officials, that used machinery which has been discarded by the West should not be imported by LDCs which are attempting to modernize rapidly and 'catch up' with the West." Hill, *ibid*, p.168.

a multiplicity of different types of out-dated equipment in any one industry in Indonesia, which would lead to a chaotic spare parts supply system. For both of these reasons, the Government has considered it generally desirable to discourage the import of secondhand equipment into Indonesia.

3.17 Other Justification. There are five further reasons which are advanced from time to time in support of licenses. These are largely self-explanatory and are identical with the reasons advanced for government intervention in many other countries; they can, therefore, be discussed briefly. The desire to encourage regional development, especially in the Outer Islands, has led the Government to impose restrictions on new entry into certain industries in particular areas, especially in Java. Further, the DSP indicates that selected industries will be given positive incentives to locate in specified sites outside Java. Second, the various pollution controls are imposed to protect the environment. Third, labor regulations are justified on the grounds that they are necessary to protect the interest of employees. Finally, in the DSP, the Government has specified that some activities may only be undertaken for export; one main reason for this is to encourage export-oriented industrialization to strengthen the balance of payments, and the other is to stimulate employment creation in the industrial sector.

3.18 These various reasons for licensing may be grouped into "economic" and "noneconomic" (social and political) categories. Those reflecting the more strictly economic objectives include: (a) market structure; (b) regional development; (c) increasing domestic value-added; (d) quality control; (e) encouragement of use of modern technology; (f) avoidance of multiple types of out-dated equipment; (g) balance of payments; and (h) employment. Those which, on the other hand, appear to reflect objectives which would be usually be considered as more "social" or "political" goals include: (a) basic industry; (b) promotion of the weaker economic group; (c) indigenous ownership and management control; (d) guarantee of domestic supply; (e) environmental controls; and (f) protection of employees.

3.19 In broad terms, the need for pembinaan (founding, building, or cultivating) of the industrial sector tends to be justified on four grounds which serve to cover the 15 more precisely defined reasons listed above. First, there is much concern within policy-making circles, discussed in interviews with the mission, about the present state of the industrial sector; there is a desire to create a more orderly industrial environment where regulations will be clearer and more effectively enforced, and where entrepreneurs will be less prone to "anti-social behavior." It is partly for this reason that the Government is attempting to direct the market structure of some industries, and has been reluctant to allow second-hand equipment into Indonesia. Second, equity is considered important, and several of the justifications listed above reflect this; equity-related reasons include promotion of the economically disadvantaged, regional development, employment, protection of employees and even environmental

controls. Third, some of the licenses are regarded as partly necessary to protect the national interest; quality control (to protect Indonesia's good name), control over basic industries, and attention to economic independence fall into this category. Finally, it is intended that some of the licenses will also promote economic efficiency. The attention to market structure, inducements to "export substitution," quality controls on exports, the encouragement of the use of modern technology all reflect a desire to stimulate greater economic efficiency.

#### 4. CRITERIA FOR THE ALLOCATION OF LICENSES

4.01 With such a wide range of licenses available, the criteria used to decide who will be awarded licenses naturally vary somewhat depending upon circumstances. Nevertheless, assuming that the applicant has fulfilled all the formal requirements (provision of all the appropriate documentation and so on), the main considerations which generally determine the allocation of most licenses do not differ substantially. The three main criteria are:

- (a) whether the particular applicant is, under the circumstances, eligible for the license;
- (b) whether the applicant is from the weaker segment of society (or, in the case of PMA (foreign) investors, whether the applicant has such affiliations);
- (c) when the application was received; a first-come first-served order of priority is generally followed.

Each of these criteria warrants some additional comment.

4.02 The first criterion is relatively straightforward; it applies to a number of licenses such as production licenses issued through the BKPM or under the BRO regulations, land permits, and some types of import and export licenses. Under certain stated conditions, licenses of this sort are available to particular investors, and under other conditions they are not; the regulating authorities must, therefore, make a simple decision as to whether the applicant is eligible. Generally the rules specifying the conditions under which licenses may not be granted are clear, and, therefore, few applications are made which are so obviously in contravention of the rules that they are refused outright. For example, if a manufacturing subsector is "saturated," the BKPM will not grant new licenses. This rule is so widely known in business circles that investors rarely apply for investment approval in sectors that are closed to them. In March 1980 it was announced that textiles were to be restricted to specified textile exporters registered with the Department of Trade and Cooperatives, and this announcement will probably be sufficient to ensure that few applications for

permission to export textiles will be received from other exporters.<sup>/1</sup> On the other hand, there are many licenses which are, in effect, available to all qualified applicants, and so the question of outright refusal on the part of authorities for these licenses very rarely arises. Environment licenses, normal export and import licenses, and local trading permits (SIUP) are generally of this nature.

4.03 Once it is established that the applicant is entitled to carry on the activity which the license covers, the issue of participation by weaker economic groups becomes relevant. There is a rather fine dividing line in this area between disqualification of an applicant on the grounds that he is from the stronger economic group, on the one hand, and firm opposition (but not outright disqualification) on the other. As noted earlier, it is clear government policy that the economically disadvantaged are to be favored in the allocation of various important licenses, so this is the second main criterion which is often applied. The degree of firmness which is applied in restricting activities of the stronger segments of society is often a matter for discretion on the part of the government officials, and a harsh interpretation of the rules can amount to a virtual ban on the entry of businessmen from this class into a particular line of business.

4.04 Third, other things being equal, most licenses are processed in order of receipt. In sectors where the Government wishes to prevent excess entry and over-capacity, this rule has assisted the earliest applicants establishing privileged positions. In other manufacturing sectors and associated activities (such as distribution), where there is effectively free entry, this criterion is of no significance.

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<sup>/1</sup> Details of the decision were given in Indonesia Times, March 10, 1980, and Kompas, March 12, 1980.

## 5. THE LICENSING SYSTEM IN OPERATION

5.01 The discussion to this stage has tended to concentrate on the official presentation of the operations of the licensing system. On paper, the arrangements are complicated, but do not seem unworkable; many Western nations, for example, have industrial licensing procedures which, on the face of it, are almost as complex as in Indonesia. In practice, however, there are two aspects of the licensing mechanism which, taken together, alter the picture significantly. First, the licensing procedures are really far more complicated and time-consuming than the picture presented above might suggest. Second, a very large number of government officials have substantial discretion to interpret regulations, and this creates a situation where corruption is likely to flourish. The actual operations of the licensing system will be considered under three headings: the BKPM regulations; the BRO regulations; and other regulations which affect the whole of the formal industrial sector.

### BKPM Regulations

5.02 Previous Bank reports have noted many complaints of long delays and difficulties with the BKPM; as noted above, the reforms introduced since 1977 appear to have led to considerable improvements. Nevertheless, the changes introduced during the last few years have been more in the nature of a streamlining of a complex bureaucratic procedure rather than a simplification. In principle, the BKPM and the Government have not liberalized the licensing system in this field so much as improved the existing supervisory machinery; the example of the Master Lists for machinery and for raw materials which must be prepared by investors will make this clear.

5.03 As Table 2 (in Appendix 1) indicates, in the licensing stage of BKPM approval procedures, investors must submit detailed "Master Lists" of equipment and machinery, and of raw materials and supplies, for examination by BKPM officials (see items 7 and 8, Table 2). This list is evaluated "for consistency with the approved project," and, if found to be in order, becomes the basis for the import of goods (often under concessional arrangements) for the project.<sup>/1</sup> The need for these lists arises directly from the detailed nature of the BKPM's regulatory approach: since import concessions are granted on a project-by-project basis, and since cases of investors abusing the import privileges have not been unusual in the past, the BKPM attempts to ensure compliance with the law by examining each investor's import arrangements very closely. So detailed is the supervision exercised by the BKPM that approval for imports connected with projects is specified on a shipment-by-shipment basis.

5.04 It is inevitable, with an approach of this sort, that investors must supply very extensive information about the goods that they plan to import. To assist investors, the BKPM issues forms which specify the data to be

provided: the precise data required varies according to whether the Master List is "provisional" or "final", and whether it relates to equipment or to raw materials. As an example, the Final Master List for Equipment must provide information about each of the following types of equipment (where relevant): agricultural, mining or processing machinery, power supply equipment (generators, steam boilers, water treatment, pollution control, workshop tools), moving and transport machines and vehicles, construction equipment, office supplies, spare parts required for all of the foregoing, and other equipment. Furthermore, for every item shown in the Master List, certain details are required: country of origin, technical specifications (capacity, type, prime mover, size, and so on), total number required, price per unit and total cost, and proposed port of delivery into Indonesia. The Final Master List for Raw Materials require similar data, which must be specified for the first two years of operation of the project. In addition, the BKPM Master List application form specifies that "where items appear doubtful to the BKPM during the examination process, the (raw materials) list must be accompanied by additional information showing calculations of raw material requirements per unit of final output." /2 Clearly, it is extremely difficult and time-consuming for investors to attempt to supply this sort of information, in such detail, in the early stages of a project. It is, therefore, frequently the case that when, a year or so later, the investor comes to import his goods, the Master Lists are out-of-date and must be resubmitted to the BKPM for approval.

5.05 Paradoxically, the increased internal efficiency of the BKPM in recent years has actually allowed the Board to exercise closer supervision over investors' plans and activities than has hitherto been possible. /3 Not

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/1 See Investment Coordinating Board, Indonesia: Investment Procedures Jakarta, August 1979, p.30.

/2 Noted in Contoh Model IV (Example of Form IV), supplied to the mission by the BKPM.

/3 Examples of this are the increased attention being paid to the requirements regarding participation by the weaker economic group, the greater detail of the 1980 DSP in a number of areas than the previous DSP, and the plans (discussed below) to carry out detailed surveys of the demand and supply situation in manufacturing subsectors so that the subsectors may be closed at the appropriate time.

only are investors still required to submit their original investment programs to detailed scrutiny by the BKPM, but all changes except the most minor ones must also be approved by the Board. For example, the following modifications must be submitted to the BKPM for its approval (the appropriate form which must be used known as a "Model," is indicated in brackets): (a) changes in products to be produced, production capacity, technology, or provincial location (Model II); (b) alteration in the composition of shareholders, but without change of status between PMA and PMDN categories (Model III); (c) change in production status from PMA to PMDN (Model V); (d) change of date of trial or commercial production (Model VII); (e) change to the approved machinery and equipment Master list (Model VIII); (f) change in the use of funds (Model X); (g) application to obtain and use additional long-term capital (Model XI); (h) change to the authorized, issued or paid-up capital (Model XI); (i) change in expatriate staffing arrangements (Model XII); (j) change in management structure (Model XII); (k) change in the proportion of output to be exported (Model XIII); (l) change in land area (Model XIV); (m) change of company name (Model XV); (n) disposal of imported machinery (Model XVI); and (o) export of machinery for repair (Model XVI).

5.06 Because considerable effort has been made to streamline operations within the BKPM, the Board's procedures for dealing with the changes listed above may be taken as representing something of an example for other Indonesian government agencies. Nevertheless, although standard forms have been prepared to facilitate applications for changes to projects, the procedures are still cumbersome. For example, to seek permission for a change in shareholders or shareholding, the Model III form must be completed and accompanied by the following attachments: (1) a bank reference for the new foreign partner; (2) a reference from the Indonesian Embassy or Consulate in the country of origin of the new foreign partner; (3) the annual report (and other appropriate documents) from the new foreign partner; (4) a statement of withdrawal by the previous partner; (5) a power of attorney (if any); (6) a reference for the new Indonesian partner (such as a bank reference); and (7) the new venture agreement (if any). Twelve copies of the completed Model III form, along with twelve copies of the appropriate attachments, must be followed when submitting requests to have any of the other changes listed above approved by the BKPM. Furthermore, after the main licenses have been obtained through the BKPM, firms must continually deal with other official agencies on matters affecting their day-to-day operations, and as will be seen below, the volume of paperwork involved is substantial.

#### BRO Regulations

5.07 According to Department of Industry officials the main advantage to obtaining a license under the provisions of the regulations based on the BRO is that procedures are easy and licenses are generally issued quickly. Regional officials, for example, assured the mission that their policy was to assist applicants as much as possible, and that the main delays were

the fault of applicants themselves who did not take the trouble to fulfill all of the official requirements. Reports from businessmen interviewed by the mission suggest that once the fully-completed documents are lodged with regional offices of the Department of Industry, licenses are indeed usually issued relatively promptly; it is in the preparation of the documents required by the Department of Industry, however, that the difficulties arise. For example, a large or medium scale firm in the Jakarta area must fill in a Surat Permohonan Izin Perusahaan (Letter of Request for a Business License) containing, inter alia, the following information: type of firm; name and address of owner; name of firm; address of firm; size of buildings and warehouses; and number of employees./<sup>1</sup> However, in addition, six copies of the following documentation must be attached to the Letter of Request: (1) articles of association; (2) environment license issued under the Disturbance Law (Undang-undang Gangguan), or application for the license; (3) official documentation of non-involvement in the 1965 coup attempt; (4) citizenship documentation; (5) previous business license (for firms continuing, expanding, or changing the place of their activities); (6) land, right of construction, or rent agreement documents; (7) list of equipment used, with details of make, place and year of manufacture, and capacity; (8) capital structure of the company, with details of both fixed and working capital in use; (9) current land tax payment receipt; (10) current local government tax payment receipt; (11) plan of the layout of the factory; and (12) sample invoice. Often one or several of these documents is not easily available. An official statement of noninvolvement in the 1965 coup attempt, for example, must be obtained by seeking approval from a number of different authorities; citizen documentation might be difficult to produce, especially for citizens with better economic advantages; tax receipts may not have been issued, or may have been lost; and so on. Further, in certain industries, additional documentation is required; for example, sawmills in East Kalimantan are required to show that they will be supplied with timber by timber-cutting firms which have a current legal timber concession, and unless proof of this can be produced, the Department of Industry will not license local sawmills./<sup>2</sup> If, as often happens, a businessman cannot produce all of the documents required, he may simply choose to operate

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<sup>1</sup> In this context, large and medium firms are firms which do not fall into the "small" category as defined in August 1979 definition issued by the Minister for Industry in his Ministerial Decision No. 133/M/SK/8/1979. Small firms applying for registration rather than licenses must fill in a Surat Permohonan Pendaftaran Perusahaan (Letter of Request for Business Registration), and supply much the same information as that required from large firms.

<sup>2</sup> Kompas, February 16, 1980.

illegally, or he may decide to begin operations in the hope of obtaining a license at some later stage, or he may resort to illegal payments to get the permits needed./1

#### Other Regulations

5.08 In collecting information about the actual experiences of investors in obtaining the numerous other licenses that they need, the mission was provided with many examples of difficulties and long delays, sometimes combined with requests for payments from officials who were in a position to hold up the licensing procedures. The following description of the situation, taken from one of Indonesia's main newspapers, is consistent with the reports received by the mission: "It is still the case that licensing in all business sectors in Indonesia is difficult, complicated, time-consuming, costly, and runs into conflicts between one government department and another."/2 Some selected examples of the licensing system in practice in several fields will illustrate how widely this generalization applies.

#### Taxation Regulations

5.09 In a quite wide range of taxation matters in their day-to-day operations, manufacturing firms need to obtain official letters from taxation officials; since these letters are often rather important to the continued profitable operations of the firms, they take on the character of a license, although BKPM approval is not required. For example, companies must apply for and obtain permission from the Head of Tax Inspection before applying the LIFO (Last In First Out) methods of inventory valuation; companies who wish to obtain tax relief for an increase in capital derived from reinvested profits must apply to the Head of Tax Inspection and obtain written approval; and companies who wish to carry forward losses from past years for taxation purposes must, under certain circumstances, obtain written approval from the tax officials.

5.10 The mission received many complaints from businessmen about their difficulties in dealing with tax officials, and about illegal payments that they were sometimes required to pay. Accountants who were interviewed by the mission and who audit company accounts and represent manufacturing firms in their dealings with tax officials confirmed these complaints.

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/1 It was reported, in early 1980, that about 100 unlicensed sawmills were operating in East Kalimantan because they were unable to meet the licensing conditions relating to the supply of timber from current timber concessions. See Kompas, February 16, 1980.

/2 Translated from Kompas, 8 December 1978. Kompas was reporting on the results of a survey carried out among businessmen.

5.11 Two other aspects of the operation of the tax system as it affects manufacturing firms deserves comment. The first is the difficulty of obtaining clarification from tax officials about the precise requirements under the tax laws, which often leave important matters vague. One firm of accountants in Jakarta has summarized the situation for its clients as follows: "The Indonesian Commercial Code states that anyone who is carrying on a business is obliged to keep records in such a manner that at any time the rights and obligations of the person may be determined. The manner in which the entrepreneur maintains the records is left to his discretion. No specific books or records are required... The tax law is not precise. Mainly as a result of this, amendments to the existing law in the form of mostly Ministerial decrees are issued frequently. Another factor in the taxation laws is the policies of the Director General of Taxes which are promulgated throughout his department but are not generally available to the public in written form. This situation leads to taxes being negotiated with assessors where the law is not explicit."/1 Many efforts are, however, being made to improve the efficiency and the image of the D. G. of Taxes. Clarifications of tax laws can usually be obtained expeditiously if the questions are precise and if the relevant official at the right level of seniority is approached directly.

5.12 The Tax Office is no less dismayed than accountants and businessmen who complain that their tax liabilities sometimes have to be negotiated with tax assessors. But this unsatisfactory situation appears to be primarily the result of the acute shortage of qualified and experienced tax assessors and, as yet, a rather poorly developed legal system. In the perception of senior tax officials, many private companies deliberately take advantage of the Government's administrative weakness and then complain about the corruption of which they themselves are the main beneficiaries.

5.13 The other aspect of the tax system deserving comment is the series of reforms introduced in March 1979. The Government has been well aware of the widespread dissatisfaction with the way the corporate tax system operates, and the March 1979 reforms were an attempt to improve the situation. The new measures, according to the President, were designed to: (a) provide better services to the taxpayers and the community (b) improve the administration of

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/1 Price Waterhouse, Information Guide, Doing Business in Indonesia, USA, February 1978, pp. 37 and 41. For a detailed discussion of the taxation system, including the method of collecting taxes and the relationship between the tax collectors and tax payers, see D. Lerche, "Efficiency of Taxation in Indonesia," B.I.E.S., March 1980.

the tax laws (c) encourage adherence to the tax laws by taxpayers (d) encourage the use of public accountants in the tax sector.

5.14 The most important innovation as far as manufacturing firms are concerned is the move towards facilitating the use of public accountants in drawing up annual corporate tax returns./1 Under the new provisions, provided a public accountant is used in the manner specified in the regulations, the scope for tax officials to adjust reported profit and loss figures (and thus adjust the tax payable) is quite limited. This change, it is hoped, will introduce more certainty into the tax assessment process, reduce the scope for arbitrary judgments and thus reduce the need for "negotiations" between taxpayers and tax officials.

5.15 If the provisions of this regulation, along with the several other regulations which were issued at the same time, are effective, then the improvements in the administration of the corporate tax law should be substantial. Because the first taxation year to which it may be applied is 1979, few companies have yet had experience of how the new system works in practice. However, accountants and businessmen interviewed by the mission were cautious in welcoming the changes. For one thing, the new regulations still leave some matters vague; for another, similar reforms were introduced in 1963, but turned out to be ineffective. Businessmen in Jakarta take the view that the way the new regulations are actually implemented will be just as important as the letter of the law. Senior tax officials share this view and stress the importance of responsible behavior and proper accounting by private firms and individuals to facilitate their difficult task.

#### Main Import License

5.16 Domestic firms which wish to import goods must obtain a Main Import License (Tanda Pengenal Pengakuan Importir, or TAPPI) from the Department of Trade and Cooperatives which is valid for three years./2 In the Jakarta area, in addition to filling in the main application form, copies of the following documents (in duplicate) must be provided:/3 (1) the official signature and

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/1 See Decision of the Minister of Finance, No. 108/KMK. 07/1979, dated 27 March 1979.

/2 Firms which have obtained facilities under the PMA or PMDN laws are not entitled to obtain a TAPPI, and must follow the different procedures outlined earlier in the section on the BKPM licenses.

/3 These details are for a "temporary" TAPPI known as a TAPPIS.

stamp of the firm; (2) photocopy of the valid Trading License, SIUP; (3) articles of association; (4) personal details of the manager of the firm, and three passport photographs measuring 4 x 6 cm; (5) details of the organizational structure of the firm and a list of employees; (6) details of the place of domicile of the firm, and Environment License; (7) groundplan of the firm; (8) the most recent balance sheet, endorsed by an accountant or an equivalent office; (9) photocopy of certificate of citizenship of the person representing the firm, and details (if relevant) of change of name; (10) any agency or distributorship agreements; (11) photocopy of the proof of the status of the office (rented, owned, long-term contract); (12) list of wages paid to employees during the previous three months; (13) inventory of office equipment of the firm; and (14) police letter of non-involvement in the 1965 coup attempt. Once the TAPPI or TAPPIS has been received, there is a further complicated process to actually import goods; this import procedure is discussed in the next section.

### Import Procedures

5.17 According to government officials, the licenses that manufacturers need to arrange imports are usually issued quickly provided the applicant is eligible to become an importer. Manufacturers confirmed that import licenses such as the TAPPI are usually easily obtainable, once documentation is complete, but pointed out that the possession of a Main Import License was merely the first stage. The process of actually moving goods through the ports remains difficult.

5.18 It immediately needs to be noted that the administrative problems in the Jakarta port of Tanjung Priok and in other harbors have attracted much attention during the past decade, and according to all reports the situation has improved very markedly during the 1970s. Not only have earlier reports issued by the Bank and other international organizations frequently drawn attention to the problems of importing into Indonesia, but the delays and so-called "invisible costs" at Tanjung Priok have attracted much adverse public comment within Indonesia.<sup>/1</sup> The Government has, on several occasions, investigated the problems and instituted reform measures, and the indications are that these efforts have slowly borne fruit. Nevertheless, just as the reforms in the BKPM appear to have led to a mere streamlining of the existing regulatory system rather than its simplification, so the amount of bureaucracy in Indonesia harbors does not seem to have actually been reduced so much as streamlined. An illustration of this

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<sup>/1</sup> See, for example, the comments in the previous Bank report on the industrial sector in Indonesia, Report No. 1647-IND, p. 64.

is the simplified list of steps shown in Table 5, Appendix I, that must be taken to handle the various documents required at the Tanjung Priok./1

5.19 The original list provided to the mission contained a total of 88 steps, and the importer is required to handle most of these stages himself (or hire someone to do it), walking from building to building to obtain stamps and signatures. Since approvals must be obtained at many stages in this process, and since the absence of one document or signature can halt the progress of the operation, the process remains extremely cumbersome. Furthermore, many of the officials involved in the process are overworked and short of facilities, and the temptation to offer illegal payments to move a document through quickly is substantial. Importers interviewed by the mission mentioned payments of around Rp 30,000 to Rp 40,000 (US\$50 to US\$60) being required to obtain import approvals at Tanjung Priok./2 Opinion among businessmen was, however, divided as to the practical difficulties that these procedures cause for them. Some businessmen reported to the mission that they regarded the whole system as very cumbersome; others said that they accepted it as part of the cost of running a business in Indonesia, and they coped with the process by employing several staff members who were experienced in handling port procedures. One businessman, frequently involved in importing equipment, commented that delays and bribes have become endemic so he has no difficulty in coping with the system; he knows the delays involved for the different documents, and depending on how quickly he needs imports, pays either the usual rates or the higher rates for "urgent" imports. There are, however, some importers who do not face all of these difficulties; they appear to be satisfied with the system as they are able to import items into Indonesia without resorting to illegal payments or having to suffer long delays.

#### Trading Licenses

5.20 The Trading License (Surat Izin Usaha Perdagangan, or SIUP) is another of the main licenses that all manufacturing firms in the formal industrial sector must obtain. According to the reports received by the mission, this license is readily available once all the accompanying

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/1 Summarized from notes on "Proses pengurusan dokumen impor di Tanjung Priok" (Process of arranging import documents in Tanjung Priok), which were provided to the Mission by an importer. Similar details are provided in Soeprijo Andhibroto, Tatalaksana Ekspor Impor Indonesia (Managing Exports and Imports in Indonesia), Semarang, Up "ASRI", 1979, Chapter 7.

/2 These figures are consistent with a report in Kompas that "The 'market' for illegal charges (pungli) in the Customs Office in Tanjung Priok (Area IV) has begun to move up recently, according to expediting (EMKL) firms. For each PPUD document (Certificate of Arrival of Goods), the amount of pungli payable varies between Rp 30,000 and Rp 35,000. In the Cakung Customs Area (Area X), the 'market' is even more active, with prices ranging up to Rp 50,000 for each document." Kompas, January 18, 1979.

documentation is complete; as is the case with several of the other licensing procedures discussed above, however, it is the thorough preparation of the accompanying documentation which is troublesome. According to the most recent set of guidelines issued by the Minister for Trade and Cooperatives at the end of December 1979, a limited liability company in Indonesia (a perseroan terbatas, or PT) must supply copies of the following documents as attachments in order to obtain a SIUP:<sup>/1</sup> (a) Articles of Association, certified by a notary; (b) certification of Legality of the Articles of Association of the company issued by the Department of Justice; (c) Letter of Registration of the Articles of Association of the company issued by the local Department of Justice Registry; (d) State Gazette containing the announcement of formation of the company; (e) minutes of the general meeting of shareholders which appointed the Directors and Management of the company; (f) Business Location License, if required, under the provision of the Disturbance Law (H.O.); (g) identity card of the person representing the company; (h) Certification of Name Change of the person representing the company issued by the Minister of Justice or the Regency Head (if relevant); (i) two passport photos of the person representing the company; and (j) Decision of the Management of the company, approved by the Directors, to establish a branch (where the application is for a branch) and the number of the SIUP of the Head Office of the company.

#### Environment Licenses

5.21 The Environment License issued under the Disturbance Law (HO, or Hinder Ordonnantie) is one of the more important licenses which, in principle, all but the very smallest firms must possess.<sup>/2</sup> Nevertheless, in practice this license is often difficult to obtain. One large investor which began operations in Indonesia in the early 1970s reported to the mission that the company was not even told of the requirement that it possess an Environment License until it had been operating for several years, and the initial application was not filed until early 1977; at the time the mission visited the plant (February 1980), the final licensing procedures had still not been completed, although at that stage the license was expected to be issued during the following month.

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<sup>/1</sup> These are set out in the Decision of the Minister, No. 721/Kp/XII/79, dated December 31, 1979 and reprinted in Business News, No. 3402, January 23, 1980. The Decision also specifies the documents which must be supplied by other types of business enterprises (cooperatives, unincorporated enterprises, state enterprises, and so on).

<sup>/2</sup> As is generally the case, cottage firms tend to be excluded, but small firms (i.e., larger than cottage firms) which register with the Department of Industry under the BRO-based regulations are expected to obtain an Environment License.

5.22 In the case of this large investor (about 600 employees; total capitalization of factory approximately \$20 million), the procedures initially began with an application to the provincial government. Along with ten completed application forms, copies of the following documentation were required:<sup>/1</sup> (a) a map showing the general location of the firm (7 copies); (b) a diagram showing details of the plant site (7 copies); (c) a letter of identification of the owner of the firm and details of ownership; for foreign investors, complete documentation is required (2 copies); (d) Construction License (2 copies); (e) Articles of Association of the company (2 copies); and (f) details of any transfer of ownership or change of name of firm that may have taken place, if relevant (2 copies)

5.23 Upon receipt of complete documentation, the provincial government officials informed the following regional offices and requested them to prepare a recommendation: (a) City Planning Office; (b) Office of the Inspector of City Planning; (c) Fire Department; (d) City Health Department; (e) Regional Department of Industry; (f) Inspector of Labor Conditions and the Office of Workers' Health and Safety. It was at this stage that the main delays occurred; officials from each of these offices needed to inspect the factory site, and they did not do so. It later transpired that one main reason that officials were not carrying out their inspections was that they did not have vehicles. When the applicant firm arranged transport, the inspections were quickly completed.

5.24 It is generally the case that each office in turn imposes a number of conditions before a favorable letter of recommendation is issued. These conditions, it may be noted, sometimes require that further approval be obtained from yet a different government agency. For example, the City Health Department must check on various matters, including (a) toilet and washing facilities, and rubbish disposal arrangements; (b) plans for discharging oil and other fuel; (c) provision of first aid equipment; and (d) arrangements for provision of trained medical services in an emergency. The Inspector of Labor Conditions imposes ten conditions, including: (a) there must be a copy of the Workers' Safety Act (Undang-undang Keselamatan Kerja) posted in a public place within the factory; sufficient first aid equipment for the work force; and fire fighting equipment available; (b) a license to operate any power generators used within the factory must be obtained from the State Electricity Corporation; (c) an operator for the generator must be stationed close to the equipment; (d) the noise caused by the generator should not disturb any nearby residents. The Fire Department required that yet a further set of conditions be fulfilled, which included the following: (a) the diesel generator must be installed on a firm base so that the machine is stable; (b) diesel fuel must be stored in a suitable place at a suitable

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<sup>/1</sup> This information was collected from the files of the company which contained copies of correspondence and other documentation on the application for the permit. The mission was given complete access to company records on this matter.

distance from the generator; (c) electricity cables throughout the factory must be in good condition; (d) after closure each day, the factory must be inspected for fire hazards; and signs saying "No Smoking" must be posted within the diesel room, and on the door to the room.

5.25 In principle, only when all of these conditions are fulfilled can all of the regional offices indicate their approval of the arrangements within the factory and the Environment License be issued. In the case investigated by the mission, all approvals had finally been granted from the regional offices when it was discovered that the original application, lodged in 1977, was in the name of the previous manager of the factory; an amendment to some of the documentation was, therefore, required before the final Environment License could be issued, and this involved a further wait.

5.26 Although the delay experienced by this particular company was long, reports received by the mission suggested that many other factories experience difficulties in completing all of the procedures necessary to obtain the Environment License. Some of these have made multiple applications and operated for several years without a licence./1 The main point that stands out is that the procedures for issuing the Environment License do not work in a satisfactory way.

5.27 To complicate matters even further, in some areas provincial authorities have also issued regulations designed to control pollution. For example, in mid-1977 the Governor of Jakarta legislated that "industrial enterprises and entities in the Jakarta region" were to have their "waste products" (hasil buangan) tested every three months by the Jakarta Research Centre for Urban and Environmental Problems. Although the regulation was issued in mid-1977, it was not published until mid-1978, and then only in a private business newsletter./2 Thus, it is not clear how firms were expected to know of the regulation, nor exactly what firms are covered since a very large number of small and cottage enterprises would appear to fall within the scope of the legislation, nor what the term "waste products" includes; yet firms which did not comply with the regulation were liable, by a provision of the regulation, to be closed down.

#### General Problems

5.28 Any suggestion that Indonesian officials or the Indonesian Government are unaware of all of these difficulties, or are satisfied with the present situation, would be mistaken. It is true that some officials derive personal benefit from the licensing system because of the opportunities for

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/1 For a specific example discussed in the Indonesian press, see Kompas, December 8, 1978.

/2 The regulation was published in Warta CAFI, No. 131, 6 June 1978. \_

collecting payments that it provides, but it does not seem to be resistance from these officials that prevents simplification. Nevertheless, it has been noted in other countries that policies which benefit the bureaucracy - whether in a broad nonpecuniary sense by cloaking officials with prestige and influence, or in a narrower sense by providing them with opportunities for pecuniary gains - are often difficult to change. This would seem to be a contributing factor to the tendency to resort to direct controls, including licensing, in Indonesia.

5.29 Although there are undoubtedly forces in favor of more or better controls, efforts to simplify licensing procedures, both in the industrial sector and in other fields, have received strong support at the most senior levels of the Indonesian Government during the last few years; the improvements in the operations of the BKPM and in port procedures are evidence of this. Senior Ministers, including the President, and Ministers for Industry and Development Reform, have frequently spoken of the need for the simplification of procedures. Within the industrial sector, the "Department of Industry Technical Team for Licensing" set up in August 1979 by the Minister for Industry is expected to come forward with detailed recommendations for improvements. Furthermore, the BKPM has engaged a team of foreign advisors to assist in its efforts to improve the effectiveness and efficiency of its operations.

5.30 Furthermore, many of the government decrees which form the basis of the licensing system contain the obvious types of safeguard clauses that are common in other countries. For example, it is often specified in regulations that application forms shall be supplied free of charge; maximum processing times are frequently set down; and review provisions are allowed for so that businessmen whose applications are refused have an avenue of appeal. For example, Article 8 of the 1979 regulation mentioned above specifying procedures for applying for the Trading License (SIUP) states the following:<sup>/1</sup>

"If a request to be granted a SIUP is refused, then an objection may be lodged with the appropriate official: (a) If the application is refused by the Head of a Regional Department of Trade Office, then the objection should be lodged with the Director General of Domestic Trade. (b) If the application is refused by the Head of the local Department of Trade Office,

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<sup>/1</sup> Translated from Decision of the Minister of Trade and Cooperatives, No. 721/Kp/XII/79, dated December 31, 1979.

an official appointed by the Head of the Regional Department of Trade Office, or by the Head of a Cooperatives Office, then the objection should be lodged with the Head of the Regional Trade Office."

5.31 In practice, however, these provisions are sometimes ignored by officials because they do not have the facilities to do their job properly. An example of this latter problem, referred to earlier, is the lack of transport facilities hampering the work of the officials in Jakarta who are expected to enforce the provisions of the Environment Law. Nevertheless, it is also the case that officials sometimes ignore the laws. Many spokesmen for business groups have explained that businessmen do not feel in a position to press for the enforcement of the regulations because they fear retaliatory action from officials. Similarly, many officials feel that some private companies and individuals deliberately and unfairly take advantage of a weak administration and thus contribute to the persistence of an environment in which illegal payments are fairly common.

5.32 Recognizing these problems, the legal officer of the Department of Industry cited earlier recently commented that:<sup>/1</sup> "As far as the licensing of industrial establishments in the provinces is concerned, there are old regulations which have never been withdrawn and are still in use; for example, the BRO 1934 and Government Regulations Nos. 1 and 53 of 1957 which were designed to implement the BRO. ... Bearing in mind that two other executing Ministerial Decisions are still in force (Decisions of the Minister of People's Industry Nos. 207/SK/VII/64 and 210/SK/VIII/64, issued in July and August 1964 respectively) which surrender various duties and authority to Provincial Authorities, and bearing in mind that the status of these Ministerial Decisions is now unclear and vague since parts of the legislation on which they are based have been superseded ... then the implementation of these two Ministerial Decisions is likely to give rise to duplication which will confuse both businessmen and officials in the provinces."

5.33 Largely because of this problem, many officials within the Department of Industry feel that legislation is needed which will set a firm legal basis for the official administration of the industrial sector. One of the main conclusions of the Symposium on Industrial Law held in Indonesia in 1978 was that a definitive Industrial Law is needed which covers the following types of matters:<sup>/2</sup> (a) planning; (b) the existence of dualism in licensing, and methods of simplification; (c) industrial classifications; (d) industrial

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<sup>/1</sup> Translated from Ny. Ita Gambiro, op. cit., p. 44-45.

<sup>/2</sup> Translated from "Perumusan Hasil Simposium Hukum Industri" (Recommendations from the Symposium on Industrial Law), in Simposium Hukum Perindustrian, op. cit., p. 226.

sectors; (e) statistics and reporting procedures; (f) protection for industry; (g) the promotion of healthy competition; (h) the use of foreign technology; (i) standardization; (j) shareholding; (k) makes of products; (l) a committee on products, a council for enterprises; (m) definition of industry (as in the Encyclopedia America) bearing in mind the stages of processing of raw materials into finished goods. However, as seen earlier, there are various other matters which affect manufacturers, such as taxation conditions and environment regulations, which are still unclear despite the laws that exist in these fields. Clearly, laws alone are not enough; the licensing problem in Indonesia extends far beyond the lack of precise legislation.

5.34 Indeed, one aspect of the licensing problem is that in some areas there are too many laws and regulations. Each regulation seems to generate more "elucidating" regulations, so that in the end minor officials in regional offices and harbors feel at liberty - indeed, feel obliged - to "define" certain vague matters by issuing their own regulations. Thus even quite trivial matters, such as the folders to be used in submitting import documents, become the subject of regulation. In addition, licenses come to depend on other licenses, which in turn depend upon other licenses. For example, in the Jakarta area, to obtain a Main Import License (TAPPI), a firm needs a current Trading License (SIUP) which in turn can only be obtained if the firm has an Environment License, which is dependent on approval from the municipal Office of Labor Safety and Health, which requires the firm to have a license from the State Electricity Corporation if (as is usually the case with a sizable factory) a generator is installed./1

5.35 This generally unsatisfactory situation is not infrequently compounded by the tendency of senior officials to attempt to cut through all of the red tape and delays by granting exceptions to the rules or by making general pronouncements as to "desirable" measures. When this happens it is often unclear as to whether they are expressing their own opinion or actually laying down government policy. An instance of a local official arbitrarily suspending normal procedures was reported from Central Java recently when the Chairman of the Provincial BKPM made an unannounced visit to the proposed site of a factory seeking facilities through the BKPM. The Chairman was surprised to find that the factory was already partly constructed, even though the Letter of Final Approval (SPT) had not yet been issued and asked for an

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/1 This is, broadly speaking, the situation; there are all sorts of exceptions for particular situations, and it is not always clear how the system works in practice. The December 1979 regulation issued by the Minister of Trade and Cooperatives for issuing the SIUP licenses does not specify that an Environment License is needed. On the other hand, the form provided to the Mission at the Jakarta regional office of the Department of Trade did specify that an Environment License was needed, and a businessman who wanted his license without undue delay would be unwise to argue the point with local officials.

explanation. The manager explained that he could not afford to allow funds to lie idle while he waited for approval, and that he had sought and received approval from the local authorities and had therefore concluded that he may proceed. After initially ordering construction of the factory to cease until the SPT was issued, the Chairman of the BKPMMD agreed that construction could proceed "provided everything needed for the SPT is fixed up quickly" and on the understanding that "if the SPT isn't granted, the factory will have to be stopped." /1 While incidents of this sort do lend flexibility to an otherwise rather rigid system, they also indicate the room for personal discretion that officials can exercise.

5.36 An example of the problems which arise when officials indicate "desirable" measures occurred early in 1980 when one senior official was widely reported as strongly supporting the new provisions of the DSP requiring cooperatives to be involved in certain projects. Because the opinions of influential officials as to what is "desirable" are sometimes more important in determining policy than the letter of the law, the matter attracted much public comment. A number of business groups issued statements explaining that cooperatives are often unsatisfactory business partners and that joint ventures of this sort "cannot be forced, but only encouraged." /2 The issue soon died away, but it does indicate a certain nervousness on the part of businessmen caused by the fact that there is sometimes quite a wide gap between stated policy on one hand, and policy as implemented by officials on the other. This unpredictable element in policy naturally causes problems for lower officials as well. Several provincial officials interviewed by the mission explained that abrupt policy changes, as senior officials were moved around, made things difficult for them. One provincial official remarked that "There are too many officials who have their own ideas. Policy should be implemented secara konsekwen (consistently)." /3

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/1 Details from Kompas, June 7, 1979.

/2 This matter was reported in Jakarta newspapers in late February and early March 1980. See, for example, Kompas of February 25, and March 5, 6 and 7, 1980

/3 Reflecting this problem, which is one that is found in many parts of the Indonesian bureaucracy, the call for policies which are "implemented secara konsekwen" often appears in Indonesian newspaper editorial columns and is made by Indonesian politicians.

5.37 The present arrangements are unsatisfactory from the point of view of both the regulated firms and the regulatory agencies. Neither group can really keep track of the situation. The upshot is that almost the entire formal industrial sector operates in a half-light of semilegality. Many businessmen mentioned to the mission that they found it difficult to keep up with all of the permits that they are supposed to have. At any particular time, the chances are that most firms are in breach of some formal or informal rule, and are, therefore, in danger of having sanctions imposed on them. The mission came across instances of firms having to reach informal accommodations, usually involving payments, with employees (who threatened to report one company for breach of labor laws), with neighbors (who complained about pollution), and with officials. The situation is little better from the point of view of officials who are expected to implement the rules. It is clear from interviews with officials in Jakarta and in provincial offices that much of the time, regulations are being implemented in an ad hoc way with officials trying as best they can to keep abreast with changing requirements. In some important instances, officials did not even have copies of the regulations they were charged with implementing. Furthermore, the very substantial amounts of documentation that businessmen are usually expected to supply in applying for licenses means that regional officials working in badly equipped offices are expected, in theory, to check extensive paperwork before approving licenses. In practice, much of the vast amount of information provided by applicants must receive only a quick checking before the permits are approved.

5.38 As to the difficulty of meeting licensing requirements and the incidence of corruption, the situation appears to vary between sectors. Naturally, it is very difficult to judge these matters, but very roughly the pattern appears to be along the following lines.

5.39 PMA companies. These firms are generally large and relatively well organized, and can afford to hire tax consultants and lawyers and employ in-firm staff to deal with formal bureaucratic problems. These modern sector firms apparently do not generally experience severe day-to-day difficulties as a result of the regulatory system once the initial effort (seen by many managers as an investment) has been made to cope with the requirements. Generally an in-firm bureaucracy consisting of several "fix-it" men who are thoroughly familiar with the ins and outs of the official bureaucracy are employed for the sole purpose of handling government paperwork.

5.40 PMDN companies. These firms are often more flexible in bending to meet the local situation than PMA firms, and tend to save on formal administrative costs, but pay more to move documents through the bureaucracy in an informal way. Large firms in this category are sufficiently well-organized to be able to meet the requirements of the formal legal system, but are also subject to more review from officials, especially if the firms are under control of businessmen from the stronger economic group.

5.41 BRO firms. Firms in this category range from quite small (under 10 employees) to medium size (perhaps 80 or more employees). Managers of these firms are often poorly trained in formal management methods and maintain disorganized filing systems; they therefore find it difficult to cope with all of the requirements of the regulatory mechanism. They are thus frequently in breach of some law or other, and are subject to harrassment from officials. When problems arise, they adopt a variety of strategies to survive, ranging from attempted compliance with all official requirements to regular payments to officials. It is not unusual for these firms to employ a sympathetic military officer as a consultant who can be called in when problems arise. Firms, with greater economic advantages, in particular, are in a relatively weak position.

5.42 Small and cottage firms. These firms are largely outside of the official procedures and although they are expected to register with the Department of Industry, often do not do so.

## 6. THE ECONOMIC IMPLICATIONS

6.01 The many different forms of licensing have many different economic effects, some more important than others. Several questions therefore arise: what and how great are the costs of administrative controls and the drastic intervention in economic affairs? How do the results compare with what the market would have accomplished? Do they, if superior, justify the costs involved? In order to highlight the main economic implications, the discussion will concentrate on the effects of ten controls. After briefly discussing the impact of these controls, some broad conclusions will be outlined.

### Product, Capacity and Output Controls.

6.02 The economic effects of the production, capacity and output restrictions are somewhat similar, and may be discussed together. The main justification underlying controls of this sort is that in their absence too many entrepreneurs would establish firms in the activity being licensed. This suggests, firstly, that the Government believes that private initiative is excessive and in need of curbing, and secondly, that there must be excessive inducements to invest in the sector. Why might there be excess entry? In what sense is entry excessive? Why are entrepreneurs, who stand to lose money, making this elementary mistake? What presumption is there that government officials can make better judgements? Licensing can only be justified on economic grounds if there are satisfactory answers to these questions.

6.03 Certainly it would appear to be the case, judging from widespread newspaper reports and comments from businessmen, that in some parts of the manufacturing sector (rice milling and the manufacture of kretek clove cigarettes, for instance) competitive pressures are very strong and there is substantial excess capacity in the sense of much machinery lying idle. But several aspects of this phenomenon of "excess entry" deserve comment. First, there is very little reliable data available with which to analyze the situation. Although there are frequent reports of factories lying idle, there are no aggregate figures which cast light on the degree of underutilization of capacity in different industries at different times.

6.04 Second, it seems likely that the reasons for overcapacity vary from industry to industry, and it is not obvious that capacity and production licensing is an especially effective way of countering the economic forces that cause the problem. One factor affecting capacity utilization is probably the macroeconomic environment and the resulting fluctuations in demand. If this is so, some of the firms that are licensed in good times will inevitably find the going difficult when market conditions deteriorate. For example, the manufacturing sector in Indonesia experienced a boom in 1974 and early 1975 as aggregate domestic expenditure expanded rapidly in real terms when government

revenues and expenditures leapt in the oil boom. But during 1975, the activities of the Pertamina oil company were sharply cut back following financial problems, and the negative multiplier effects of these cutbacks, combined with stringency in overall government expenditure programs, led to difficulties for some manufacturers. During the next few years there was a de facto revaluation of the real exchange rate because of Indonesia's relatively high rate of inflation, and this made it increasingly hard for domestic tradable goods industries to compete on international markets and with imports. The large devaluation in November 1978, partly intended to restore the competitiveness of Indonesia's tradable goods industries, was accompanied by tight monetary and fiscal policies which appear to have restricted growth in the manufacturing sector; national income account figures for 1979 show the manufacturing sector growing at about 9% (real terms) for the calendar year compared with an annual rate of over 10% for most of the period 1970-1978. Difficult macroeconomic conditions of this sort, which are a characteristic of the overall environment in which the Indonesian manufacturing sector operates are, therefore, bound to lead to substantial variations in capacity utilization.

6.05 A second factor encouraging over-investment in some other countries is the existence of incentives such as protection, tax holidays, accelerated depreciation, and low interest rates. All of these incentives exist in Indonesia and the cumulative effect of them must be considerable. It seems likely then that one reason private investors seem over-enthusiastic to enter some sectors is the differential between terms on which investment capital can be obtained and the rates of profit which can be earned in protected, sheltered sectors. In this case, the need for government intervention in the form of capacity and production licensing is a direct result of government intervention in other fields.

6.06 Third, in most countries it can happen that there is a rush of investors to enter a line of activity which has, for various reasons, only recently become feasible. This might be because new technological developments have opened up a new field, or (more likely in Indonesia's case) because the changing economic environment resulting from development provides new opportunities which previously were not present or were only dimly perceived. In Indonesia, some government officials have expressed the view that volatility of this sort is undesirable because "pioneer entrants" will not be prepared to take the initial risk of development of a market unless there is some protection against being undercut by businessmen who rush in later when a market is proven. It is true that the competitive situation in rapidly growing industries in Indonesia sometimes does seem rather chaotic, but it needs to be borne in mind that this is often the case in quickly expanding industries anywhere. In the early stage of the growth of an industry, producers are often jockeying for positions and learning about markets and their own production costs through on-the-job experience. Market shares are notoriously volatile in such a situation, and it is common for investors to install excessive amounts of capacity if they expect that ultimately entry will be controlled by licensing of output rather than by

business performance. In contrast, in a genuinely competitive environment, marginal producers will drop out of the industry and the remaining producers will have a clearer picture of market shares and the rate of growth of demand, so that capacity will be adjusted to production levels. The presence of licensing, therefore, actually encourages the installation of excess capacity.

6.07 The fourth factor which may suggest that there is excess capacity in a sector is the occurrence of a number of firms closing down. It is necessary to be wary, however, about accepting this as an indication of excess capacity in Indonesia because the Indonesian manufacturing sector is predominantly composed of firms which would be considered "small" by international standards. The simple fact is that there are really very few large (by international standards), strong manufacturing establishments in Indonesia, and there will be a high proportion of business failures in the manufacturing sector for the same reasons that many small firms fail in other countries.

6.08 The consequence of capacity and production licensing in Indonesia is that firms which would often be allowed to fail in other countries are protected by government-erected barriers to entry, although there is no reason to presume that the earliest firms to enter an industry will be the most efficient or the most socially desirable. An indication of the benefit of barriers to entry of this sort is the enthusiastic support given by existing firms to the existing capacity and production licensing arrangements.<sup>/1</sup> Indonesian Government officials, who must rely to some extent on reports from producer organizations about the extent of underutilized capacity, are aware that the organizations are not entirely disinterested observers and told the mission that they try to obtain a balanced picture by gathering their own information. Indeed, the BKPM is sufficiently concerned about the situation to have arranged for a major survey to be carried out during 1980 in order to obtain a realistic picture. "The aim (of the survey) is to collect accurate information about the demand, or society's need, for particular goods and supply situation. (The BKPM) is often approached by businessmen who say that their field of activity is saturated and that there has already been overlicensing; for example, in aluminum foil and in food additives such as monosodium glutamate."<sup>/2</sup>

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<sup>/1</sup> Much of the pressure to close off manufacturing subsectors to new investment comes from existing producers; the numerous and influential producer associations are quick to call for a ban on new entry whenever competitive pressures emerge.

<sup>/2</sup> Details of the proposed survey, and the information provided here, are from Kompas, March 3, 1980.

6.09 It is difficult, in the case of many industries, to see how a reliable survey on market "saturation" can be carried out. Capacity is often difficult to measure, especially when arbitrary assumptions need to be made about the number of shifts worked; too many different products are produced which are partially substitutes for each other; and demand patterns are changing rapidly, particularly when relative prices and real rates of exchange are subject to marked fluctuations. It is inevitable that the "snapshot" picture that such a survey will produce will be outdated almost before the data become available. The detailed matching of demand and supply in this fashion requires vast amounts of accurate information and a very capable administrative apparatus, both of which are generally lacking in Indonesia.

6.10 As might be expected, the indications are that the restrictions on entry allow manufacturers to earn higher profits than would otherwise be the case. No official estimates of profitability in the manufacturing sector are available, but businessmen reported that profit levels are generally a "satisfactory" reward for the trouble required to obtain licenses; accountants interviewed by the mission confirmed this general impression. This situation points up the dilemma that Indonesian policy makers face in trying to achieve "optimum market structures" in particular subsectors. What policy makers seem to be searching for - although they do not use the term themselves - are market structures which will encourage the emergence of "workable competition." This is not easy in the Indonesian economic environment, where markets are often small, where the legal infrastructure is so weak, and where market conditions are changing so rapidly. In searching for optimum market structures - which may be mirages in any case - Indonesian policy makers must trade off any perceived benefits from eliminating "cut throat competition" through controls on entry, against such costs of monopoly as excess profits and "rent seeking." It is a very difficult, and perhaps an impossible, trade-off for government officials to make with any degree of success, surveying as they do hundreds of different subsectors with thousands of firms in a dynamic economic environment.

#### Ownership Arrangements

6.11 Many countries have local ownership conditions which apply to foreign investment, and the desire to maximize Indonesian control over the industrial sector is a natural one. Nevertheless, while ownership controls imposed through licensing do contribute to some extent towards achieving this goal, there are several disadvantages to the system as it operates at present. One is that the ownership arrangements do little to promote active Indonesian participation in management and the situation where the Indonesian partners in a foreign (PMA) venture play a "sleeping" role is apparently not uncommon. Another disadvantage is that it is only a small, select group of

Indonesians who benefit from being placed on the boards of foreign firms and receiving a share of the profits. It is in the nature of the relationships between Indonesians and foreign businessmen that it will generally be Indonesians from Jakarta professional, military and government circles who benefit in this way. Arrangements of this sort tend to conflict to some extent with the Government's stated income distribution objectives. A third disadvantage is that those foreign investors who are reluctant to share ownership with Indonesians will be discouraged from investing in Indonesia; however, only a small proportion of foreign investors would be inflexible on this matter. In any case, the indications are that most Indonesians would take the view that investors who are not prepared to allow Indonesian ownership are not welcome.

6.12 As against these disadvantages, there is strong political support within Indonesia for steps to "Indonesianize" foreign companies as quickly as possible, and since this goal is given such high priority, ownership controls seem justified. The Government is aware of the disadvantages of the policy, and other elements of the Indonesianization program (controls over foreign staffing and development of the Jakarta stock exchange) are intended to counteract them.

#### Location of Plants

6.13 Decentralization of industrial development - both from large urban areas such as Jakarta and Surabaya to rural Java, and from Java to the Outer Islands - has been a goal of industrial policy in Indonesia since the 1950s. Support for the policy stems from concern about the social consequences of continuing urbanization in Java, from a desire to create jobs in rural Java, and from a belief that industrialization in the outlying regions is important to attract transmigrants to move from overcrowded Java and to encourage modernization in isolated areas. Apart from the political arguments in favor of industrial decentralization, there are some good economic reasons for industrial development in the Outer Islands as well. One is that regional industrial development has beneficial externalities: on-the-job-training will be provided to young people in the Outer Islands entering the workforce; pollution will be minimized in Java, where the costs of industrial pollution are already becoming alarmingly apparent in some places; and linkages emanating from new industries will stimulate local developments in other sectors. Second, much of the infrastructural improvement that has occurred in Indonesia during the past decade has been concentrated on Java, and to some extent manufacturing industries have been encouraged to locate in Java rather than in the Outer Islands. Incentives to firms to expand in the Outer Islands are now needed to balance the government-created advantages of investing in Java.

6.14 At the beginning of the 1970s, the regional distribution of industry largely reflected the pattern of industrial growth during the colonial era. Over 80% of employees in the large- and medium-scale sector were employed in Java, and half of these were in the five main industries (weaving, kretek, sugar refining, tobacco drying, and rubber milling) which were

well-established before independence. Despite the incentives provided through the BKPM for manufacturers to decentralize outside of Java, in practice there appears to have been relatively little change in the regional distribution of investment between Java and the Outer Islands in recent years. This is seen most clearly in the data published by the BKPM, which shows that throughout the period since the new investment laws came into effect, about 70% of the approved projects have been for planned investment in Java.

6.15 The tendency, especially during the early stage of industrialization, for new factories to locate in established areas has been noted in many countries, and the reasons for this pattern in Indonesia seem to be much the same as elsewhere.<sup>/1</sup> Access to senior government officials in Jakarta to tackle bureaucratic problems is one factor; another is the need for conveniently situated land; thirdly, the advantages of being close to the main financial institutions and other industries; and finally, the personal preferences of entrepreneurs and their families for living in larger cities. Together, these constitute strong reasons for investors to stay in Java if possible.

6.16 While all of these factors are important, it is clear that the licensing system alone is a strong incentive for businessmen to locate their factories close to Jakarta. In the previous section it was shown that many official approvals from different agencies are needed to carry on day-to-day operations, and for businessmen who are working to tight schedules there are substantial benefits to being able to pay a quick visit to senior officials at short notice when a problem crops up. Paradoxically then, although one of the aims of the licensing system is to encourage decentralization, the very existence of the system militates against regional dispersion of investment. Experience from other countries suggests that positive policies to encourage regional dispersion, such as the creation of industrial infrastructure in the Outer Islands and improvements to transport facilities, are more likely to stimulate regional industrial development than are licensing arrangements.

#### Cooperative Arrangements and Domestic Trading Licenses

6.17 The aim of licensing in these two fields, although not identical, is similar in that it is to promote firms who are economically disadvantaged. A clear statement of the function of Trading Licenses was given in a recent Instruction (Instruksi) issued by the Director General of Internal Trade which states that these licenses are issued:<sup>/2</sup>

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<sup>/1</sup> See, for example, ILO, Sharing in Development: A Programme of Employment, Equity and Growth for the Philippines, Geneva, 1974, pp. 154-8.

<sup>/2</sup> Translated from the Instruction issued on March 21, 1978, numbered 009/DAGRI/INS/III/78.

"... so that the Department of Trade can provide guidance to, control, supervise, and regulate trading activities in an orderly fashion (as well as) be used as a basis to organize the balanced composition of trading operations so as to create a healthy development environment and to promote the increased participation of the economically disadvantaged traders in these operations."

On one hand, the advantage of conditions and licenses of this sort is that without any direct cost to the Government, they serve to guarantee that some firms from the weaker economic group will benefit from links established with larger companies in the BKPM sector. The larger companies are expected, wherever possible, to ensure that smaller Indonesian firms are given opportunities to manufacture inputs or distribute the final product. On the other hand, to the extent that links of this sort would have been established in any case, the conditions are unnecessary, and to the extent that larger firms are forced into arrangements that they would not have chosen to make, they discourage new investment.

6.18 In evaluating regulations of this sort, much depends on the importance of the goal and the effectiveness of the regulations. That the goal is important in Indonesia today is not in doubt; that the regulations are effective in promoting the goal is less certain. For one thing, domestic firms from the stronger economic group can evade the regulations by various stratagems, and it appears that dozens of attempts by legislators in the period since independence to ensure compliance by such businessmen have been largely ineffective. For another, although foreign investors generally observe the formal requirements of the conditions imposed on them, it is impossible to ensure that they enter into the spirit of the regulations. It is not uncommon for foreign (PMA) companies to appoint distributors from the weaker economic group, but to continue with their marketing operations (many PMA firms still have a "Marketing Division") and simply arrange for the final sale to be made through these local indigenous distributors in order to comply with the law. It is true that in the longer term, as these distributors gain confidence and experience, more and more of the marketing functions might be taken over by them, but it is just as likely that they will become almost completely dependent on the larger firms. The real difficulty with the licensing system here would seem to be the goal; the simple fact is that it is extremely difficult for government agencies in any country to foster such an intangible quality as "entrepreneurship," especially by relying on tools such as licensing which can do little to actually encourage the growth of entrepreneurship. Certain positive incentives, such as training and the establishment of the mini industrial estates that the Government is now developing, are more likely to be effective in achieving the important goal of fostering entrepreneurship among the economically disadvantaged. But even with these incentives, it would be unrealistic to expect a class of vigorous entrepreneurs to emerge quickly from the weaker segments of society.

External Trade: Imports

6.19 The object of the licensing system for imports, which requires that importers be licensed, is similar to that for domestic trade, the emphasis being on the maintenance of orderly trading arrangements (including elimination of smuggling). The main economic costs of the system are that it increases the cost of imports (illegal port charges and interest costs of holding goods in the port), to some extent increases uncertainty (although regular importers say that they can usually judge the delays and costs accurately), and diverts skills and manpower in both the private and public sector away from more productive work into bureaucratic activities. It is obvious that some administrative arrangements are necessary in the import process for levying duties, checking smuggling and collecting statistics, but the present system is cumbersome in the extreme.

External Trade: Exports

6.20 The Government has implemented short-term export controls in recent years for two main purposes: as a price control device; and to maintain employment when unexpected shortages of raw materials eventuate which would, in the absence of government intervention, force factories to close and dismiss workers. The short-term controls over exports appear to be generally effective in achieving these goals. For instance, they provide the Government with a tool to direct exportable commodities onto the domestic market when shortages appear at home, and few instances of the 1979 selective export ban being flouted were reported. The export controls are also implemented for longer-term policy objectives as well. One is to encourage "export substitution," although this has been only partially successful because there is a good deal of illegal activity as in the timber industry. Another is to facilitate official quality control of some exports, and thus protect the reputation of Indonesian exports in world markets.

6.21 These advantages of export controls need to be weighed against the costs, and compared with alternative policies which might be implemented. The costs are several. One is that erratic intervention in export arrangements increases uncertainty for both Indonesian exporters and international customers, and does damage to Indonesia's reputation as a regular supplier. Another is that exporters are, in effect, taxed when they lose money by being forced to accept a lower price at home than they would receive in international markets. A third is that "export substitution" is not necessarily an efficient use of Indonesia's resources because the economics of producing a raw material are quite different to the economics of processing that material into semifinished or finished goods. There is no reason to suppose that a country which is economically efficient at the first activity will automatically be efficient at the second. Where a semiprocessing activity is not being voluntarily undertaken by the private sector despite the fact that it would seem to be economically efficient, the first best solution would normally be to establish which factors were hampering the development of the industry and act to overcome those difficulties. In the particular case

of the timber industry, given Indonesia's quasi-monopolistic position, there appears to be an argument for an optimal export tax, rather than a quota.

6.22 Further, alternative policies would be likely to be reasonably effective in achieving the desired goals, and probably with fewer of the distortions that direct controls involve. Domestic stock piling of some of the important industrial raw materials would enable the Government to cope with sudden shortages, and where the unexpected shortages are to some extent the direct result of macroeconomic policy - as was the case after the 1978 devaluation - the solution is to avoid the abrupt and destabilizing changes in macroeconomic policy which are the root of the problem. The objective of encouraging "export substitution" could be achieved through selective subsidies to the favored sectors, which would have the advantage of making the costs of such a policy more apparent. And positive incentives to exporters to improve export product quality would probably be more effective than the direct controls.

#### Pollution Controls

6.23 The importance of reducing both industrial and human pollution in Indonesia, especially in Java, can hardly be in doubt; the question is what is the most effective way of going about it? From this point of view, there is little evidence that the complexity of the pollution controls in Indonesia can be justified in terms of their effectiveness because they are widely flouted, and the costs to the Government of attempting to enforce them would be prohibitive. The costs of these controls to businessmen are the usual ones resulting from an involved bureaucratic process, and it would seem that more effective pollution controls would probably be obtained by a simplification of the laws, including the elimination of unenforceable provisions, combined with more determined enforcement of the most important regulations. The formulation of effective anti-pollution policies of various kinds remains, of course, a very important Government objective and, from an overall development point of view, of high priority.

#### Controls on Using Second-Hand Equipment

6.24 Although no data are available regarding the use of second-hand equipment in the manufacturing sector as a whole, several surveys have gathered some limited information on the subject. A survey by Wells in the early 1970s reported that only four out of 43 firms had some second-hand equipment, although it is clear that in other parts of the Indonesian economy the use of second-hand equipment is more widespread.<sup>/1</sup> Hal Hill found that of 42 mechanized textile firms surveyed in 1977/78, 14 had purchased second-

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<sup>/1</sup> Louis T. Wells, "Man and Machines in Indonesia's Light Manufacturing Industries," Bulletin of Indonesian Economic Studies, IX (3), November 1973. Howard Dick reported that a flourishing market for second-hand ships exists in the interisland shipping industry; Howard Dick, The Interisland Shipping Industry: A Case Study in Competition and Regulation, unpublished Doctoral thesis, Australian National University, Canberra, 1977, p. 342.

hand looms./<sup>1</sup> However, he thought this to understated the importance of second-hand machinery because the supply was limited as a result of the import ban and because there was a strong incentive for large and medium firms to purchase new looms to qualify for tax relief. Among small firms in Hill's sample, second-hand looms were much more important:/<sup>2</sup>

6.25 It is clear, then, that the restrictions on the import of second-hand equipment limits the range of capital goods available to Indonesian manufacturers, and encourages them to purchase new machines even when their own judgement is that second-hand equipment would be more efficient. The resulting distortions in the market for second-hand machinery appear to discriminate against the smaller firms which tend to use this type of machinery: these firms are obliged to pay higher prices for the limited supply of second-hand machinery which is available; they do not qualify for the investment incentives which are offered to the purchases of new equipment and the large firms are able to command high prices when disposing of their old equipment./<sup>3</sup>

6.26 One other aspect of the restrictions on the import of second-hand equipment deserves mention: the effect on the development of "appropriate technology" and the consequences for employment. The argument is not infrequently heard in Indonesia that unless the Government controls the import of second-hand capital equipment from developed nations, a wide range of outdated machinery will be dumped by manufacturers in rich nations onto the Indonesian market, thus exacerbating the present technological gap between Indonesia and wealthy nations. However, this argument overlooks the existing factor endowments which exist in Indonesia and in wealthy nations, and fails to recognize that technology that may no longer be suitable for wealthy nations may still be appropriate for Indonesian conditions - especially if the capital with its embodied technology can be obtained at bargain prices.

6.27 There are a number of reasons why second-hand equipment from wealthy nations may be appropriate technology in Indonesia, one of the most important being the tendency for maintenance costs to rise as equipment ages. Maintenance of equipment of most kinds tends to be labor-intensive, and machines which are due to be displaced in rich nations because of rising maintenance costs may still be economically efficient in Indonesia for some time.

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<sup>1</sup> Hill, op. cit.

<sup>2</sup> Hill, op. cit., "Of the firms processing 50 to 99 looms almost half had bought used looms, and these constituted on average 80% of their capacity. For firms possessing fewer than 50 looms, almost two-thirds had purchased second-hand looms. ... Clearly, then, small power loom firms generally commenced operations with at least some used looms. ... any policy which hinders the operation of the market for used looms and raises the price will adversely affect smaller weavers."

<sup>3</sup> Hill, op. cit., discusses the situation in the textile industry in detail.

Provided such equipment could be obtained cheaply overseas - and it is often available at relatively cheap prices - the use of the equipment would actually help to narrow the technological gap between Indonesia and rich nations rather than widen it. By helping raise productivity in the Indonesian manufacturing sector, Indonesia's competitiveness and ability to move to more advanced levels of technology would be enhanced.

6.28 The employment effort of using "appropriate technology" of this sort should not be overlooked either. Relatively cheap and relatively labor-intensive capital equipment of this sort would both increase the total amount of capital available to the Indonesian manufacturing sector for any given level of planned expenditure, and would raise the labor-capital ratio in comparison with the ratios which would prevail if new equipment were used. The result would be that the rate of growth of the manufacturing sector would tend to be raised, and this would occur in a relatively labor-intensive way, thus promoting increased employment.

#### The Costs of Licensing

6.29 In considering the overall impact of the licensing system in Indonesia, the following questions arise: is the system likely to achieve the stated goals?; are the implicit taxes imposed through licensing justified?; what are the costs? As to the first question, it appears that some of the licenses (such as the ownership controls, internal trading requirements, and export regulations) achieve their goals to a substantial extent, while others (location licensing and pollution controls) are rather ineffective. Several of the licensing conditions appear to be actually counterproductive, and overall the system would seem to be, at best, partially effective.

6.30 But these gains are achieved only by levying implicit taxes on investors and by incurring social costs. It is useful in this context to think of each license as having a "tax equivalent;" presumably, if licenses require investors to take measures that they would not voluntarily undertake, their costs of operation are increased by some measurable amount, and they would therefore be prepared to pay up to that amount of tax to be free of the particular requirement. In principle, then, the Government could abolish some or all licenses, and at the same time increase taxes paid by companies. This in turn would permit increased government spending on programs designed to assist businessmen from the weaker segments of society directly, such as the construction of mini industrial estates or special training courses. The assumption of industrial policy in Indonesia at present is that the licensing system, with all of its costs, is more effective in achieving the stated goals of policy than would be an alternative "promotional" program funded out of government revenues; this assumption may not be correct.

6.31 The earlier discussion has demonstrated that the costs of the licensing system are considerable. One of the costs is a bias in favor of companies with the specialized skills (or which can afford to hire the skills) that are needed to cope with complex bureaucratic procedures. In general, this will favor the more highly educated Indonesian businessmen,

and the larger companies, often foreign-owned, which can afford to retain experienced staff and lawyers and accountants, and will discriminate against small-scale firms. Indeed, some businessmen interviewed by the mission explicitly mentioned this as an advantage of the licensing system from their point of view. They explained that the very complexity of the arrangements gave them an edge over potential entrants; their specialized knowledge, acquired through experience, of both the formal and informal requirements of the licensing system allowed them some measure of protection. To be sure, an ability to wend one's way quickly through a bureaucratic maze is an indication, albeit rather imperfect, of a certain type of entrepreneurial ability; but there is no reason to suppose that businessmen who possess this particular skill are in charge of economically efficient companies.

6.32 Another cost is the incentive to corruption. The vast array of trivial details that officials can decide to procrastinate over in order to delay approvals delivers considerable authority into officials' hands. The mission was told by one company which had been reluctant to make illegal payments that an application for approval of a timber concession and sawmill had been rejected by forestry officials fifteen times before; on the sixteenth occasion, when such a payment was finally made, it was approved. The reasons for rejection included grounds such as the colors of roads drawn in maps (submitted in support of the application) being brown instead of red, and headings in documents being typed in the center of the page instead of at the left, and so on. When applicants for licenses must submit substantial documentation along with applications, and when such trivial matters can be used as reasons for delaying approval, the licensing system is bound to lead to corruption. Naturally, reliable estimates of the amount that must be paid in bribes are hard to come by, and vary considerably depending upon circumstances, but one joint venture company reported that it was generally necessary to make several large payments of around Rp 6 million (US\$10,000) every year, that payments of smaller amounts were more common, and that payments of between Rp 2,000 and Rp 5,000 (US\$3 to US\$8) were made on an almost daily basis.

6.33 The solution to the problem is not to complicate the bureaucratic process by attempting to build further checks into the system, but to simplify it. It is of but little use introducing the additional requirement that lower officials must consult with higher officials before such-and-such a form is approved (a process which has been taken to an extreme in the ports) because higher officials also benefit from the bribes.<sup>/1</sup> And there is little to be gained from requiring that yet another copy of the application plus accompanying documentation be submitted so that it can be sent to an anti-corruption bureau which has also been done in the ports; in practice, it has proved very difficult to catch corrupt officials red-handed. The only way

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<sup>/1</sup> It is common knowledge that in many offices, bribes are shared around in an institutionalized tahu sama tahu ("you help me, and I'll help you") arrangement.

to cut the Gordian knot is to eliminate the opportunities for corruption by greatly limiting the scope for officials to exercise discretion.

6.34 A third cost is the sizable bureaucracy required to administer the licensing system. Some idea of the staff needed to check documentation can be obtained from the description of the port procedures given in Appendix No. 1. The system seems all the more excessive because even with the large number of people involved, the amounts of data being fed into the bureaucracy are such that only a small proportion can ever be closely checked. To take just one example, it is difficult to imagine why businessmen should be asked to supply information on wages paid to their employees for the previous three months when applying for a General Import License (TAPPI). The information would not seem to be at all relevant, and the Department of Trade officials would never get around to verifying the wages reported; applicants might just as well list whatever wage levels they think officials would consider appropriate, and many of them probably do so. Thus, businessmen are required to fill in many forms, supplying much data in considerable detail, which are provided to officials already weighed down by excessive paperwork, who can only cope by never checking most of the information which comes in.

6.35 A fourth cost is the uncertainty engendered by licensing. This is caused not so much by the risk that a license will not be approved at all, but rather that it will take a good deal longer than allowed for. A clear example of this is the case cited earlier of a company waiting almost three years for an Environment License, during which time it was in theory liable to be closed for not possessing a permit; another example is the delays experienced by many firms in importing capital equipment. While problems of this sort usually get sorted out in the end to the satisfaction of the manufacturer, many businessmen find the process a frustrating one which makes it difficult to make long-term plans.

6.36 On the other hand, as noted above, some businessmen told the mission that once they had mastered the licensing system, the protection against new competitors that it provided was useful. Barriers to entry of this sort which restrict competition act to reduce uncertainty. The explanation for the apparent paradox that licensing increases uncertainty for some and reduces it for others is that whenever a firm must seek approval for any new activity, then there is uncertainty about the precise licensing procedure. When, on the other hand, a firm is engaged in routine activity where the procedures, including the routine payments, are well understood, then licensing provides protection. For example, one firm reported to the mission that the regular import of shipments of raw materials presented few problems in the Customs Office because all of the procedures are entirely routine. However, as soon as something out of the ordinary crops up, such as the import of a specialized unit of machinery for a factory, then problems arise because the BTN number needs to be settled, the correct tariff and sales tax need to be levied, and so on. Thus, one effect of the licensing system is to discourage firms from branching out into new activities.

6.37 In summary, then, it is not at all clear that licensing is an effective way of achieving the goals of industrial policy, and the costs of the present system are very high. Two broad points need to be borne in mind in reaching this conclusion. The first is that licensing is not the only way to achieve the industrial policy goals set out by the Indonesian Government. It should be emphasized that the discussion in this Annex does not concern the goals of policy, which are a matter for the Indonesian Government to determine, but whether the tools of policy presently being used are really effective in achieving these goals.

6.38 The second point is that there are limits to what government intervention can achieve in any economy. An extensive industrial licensing system imposes severe strains on the administrative capacity of a nation because it requires thousands of decisions to be taken about detailed industrial matters. It is quite impossible for teams of government officials in Jakarta, many of whom have little personal experience of running a factory, to have more than a passing knowledge of, say, current conditions in the textile industry in Central Java, or the state of the plywood industry in West Kalimantan. As noted earlier, the 1980 Investment Priorities List contains a total of several subsectors, and specifies detailed investment conditions for quite a few of these; it is asking too much of central government officials to expect them to gather enough information to make appropriate decisions for all of these subsectors. Similar microeconomic judgments are called for from officials regarding other parts of the licensing system. Planning in this degree of detail is not attempted in countries where administrative capabilities are a good deal stronger than they are in Indonesia today because the job is believed to be too difficult. The indications are that a less interventionist approach in Indonesia would be the better course.

## 7. THE INTERNATIONAL EXPERIENCE

7.01 A substantial degree of industrial licensing is to be found in many developing countries, and there is a striking similarity between the Indonesian approach and the problems stemming from it and experience elsewhere.<sup>/1</sup> As Guisinger observes:<sup>/2</sup>

"Government impose restrictions and requirements of various types on the manufacturing sector.... In developing countries, direct controls over industry play an additional and more important role. In the early stages of industrialization there is often a dearth of entrepreneurs, and resources are very scarce. Planners view the market mechanisms - which are usually in their infancy - as inadequate. Government therefore often intervenes directly in the industrial process to stimulate investment and to optimize its effects on employment and output. Investment and production licensing is relied upon in many countries to stimulate desirable investment and curtail socially unproductive activities."

It will be useful to review briefly the objectives and procedures of licensing in other countries because lessons can be drawn from their mistakes which are relevant for Indonesia.

7.02 One of the most common objectives of industrial licensing is to promote priority industries and to discourage expansion in sectors considered socially undesirable. In some countries, capacity and production licensing is limited to a few main industries which are regarded as having a key economic role and which are usually fairly concentrated and highly capital intensive (for example, steel, cement, fertilizer, and heavy machinery); sophisticated cost-benefit analysis is often used to influence the direction of investment in these circumstances. At the other extreme, industrial investment priorities are sometimes determined without reference to a clearly defined set of planning targets, and seem to be set almost by the subjective evaluation of planning committees as to what is "desirable." For example, in India, the Dutt Committee referred to:<sup>/3</sup>

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<sup>/1</sup> Useful general surveys are in Guisinger, op. cit., Little, Scitovsky and Scott, op. cit., and in Government of India, Department of Industrial Development, Report of the Industrial Licensing Policy Inquiry Committee, Government of India Press, New Delhi, July 1969 prepared under the Chairmanship of S. Dutt and hereafter referred to as the "Dutt Report."

<sup>/2</sup> S. Guisinger, "Direct Controls in the Private Sector" in J. Cody et al. (eds) (1980), Policies for Industrial Progress in Developing Countries, Oxford University Press, London.

<sup>/3</sup> Dutt Report, op. cit., p. 183.

"The lack of clarity about Plan targets and their implications in terms of creation of capacity, the failure of the planning authorities to work out inter se priorities among different industries, the uncertainty about resources that prevailed, and the nonavailability of any properly worked out industry Plan on the basis of which individual decisions about industry licensing could be taken within a rational framework...."

Such a situation is particularly likely to arise when, as is the case in Indonesia, licensing is seen as a device to achieve a multiplicity of objectives.

7.03 A second common goal of licensing is to influence the market structures that develop in different industries. In some industries, governments often aim to promote large-scale investments in order to achieve economies of scale, while in others, governments may wish, for social and political reasons, to protect small-scale firms from competition from larger plants. Thirdly, market structure may be subject to official control for another reason; to avoid the emergence of monopolies. The institutional and legal framework for the direct control of monopolies through anti-monopoly legislation may be weak, and governments in developing countries may decide that licensing procedures designed to restrict entry by large companies is the best way of keeping monopolies under control./1

7.04 Several other goals which are often pursued through licensing may be briefly mentioned. One is regional balance; governments may try to direct industrial investment to certain geographical regions, or simply away from urban areas, by licensing. Another is racial balance; many governments are concerned about the role that particular racial minorities have in domestic economic life (such as the Chinese in Malaysia and the Indians in East Africa) and try to counter the influence of these minorities with direct controls. Yet another objective of licensing is to regulate the flow of foreign investment into industry. This is done to ensure that key industries are in domestic hands, that foreign companies train and promote local employees, and that a fair share of profits is paid to the host country.

7.05 To be sure, the emphasis given to different reasons varies from country to country. In India, for example, the Dutt Committee saw the main objectives of licensing as (a) to promote import substitution; (b) to encourage regional dispersal; (c) to prevent economic concentration in the hands of the large industrial houses; and (d) to assist small and medium industries./2 But, as is apparent from the earlier sections of this annex, all

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/1 One of the main reasons that the Dutt Committee was established to investigate the industrial licensing system in India was concern about the role of the "larger industrial houses" in the Indian economy.

/2 Dutt Report op. cit., Chapter VIII on "Conclusions and Recommendations."

of the motives for licensing found in other countries listed above (as well as several others) influence licensing policy in Indonesia.

7.06 As to procedures in different countries, no comparative data are available which allow precise comparisons of the time required to obtain licenses. In any case, as has been shown, many of the difficulties arise in Indonesia before an applicant actually lodges a formal application; by the time a satisfactory application is received, the applicant may have been preparing the supporting documentation for months. According to a detailed study by Bhagwati and Desai, the delays in India are substantial.<sup>/1</sup> An extreme example was a lubricating plant whose establishment, proposed in 1960, was not approved until 1965, but delays of more than a year were found to be frequent. Nevertheless, although licensing almost invariably leads to delays wherever it exists, there seems little doubt that bureaucratic delays are longer in Indonesia than in most neighboring countries. Businessman experienced in Southeast Asia interviewed by the mission in Jakarta unhesitatingly named Indonesia as the most troublesome country in terms of licensing procedures in the ASEAN grouping.

7.07 An international comparison confirms that a number of common problems arise when licensing is used. One, noted by the Dutt Committee, is the concept and measurement of industrial capacity. The Committee quoted the First Five-Year Plan of India as noting that:<sup>/2</sup>

"Rated capacity is a complex technical concept which should take into account the design of the plant, the number of shifts per day in the case of plants adopting batch or discontinuous processes and the number of working days per annum. Rated capacity has also to take into account the balance between the different sections in a given unit, the age of the plant and its conditions."

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<sup>/1</sup> Jagdish N. Bahagwati and Padma Desai, India: Planning for Industrialization. Industrialization and Trade Policies since 1951, Oxford University Press for OECD, London, 1970, Chapter 14.

<sup>/2</sup> Dutt Report, p. 37.

The Dutt Committee reviewed some earlier attempts which had been made to devise a measure of capacity and concluded:<sup>/1</sup>

"It is apparent that the concept of capacity is by no means clear or unambiguous. Not only are there difficulties regarding the possibility of multishift operations, but there are also difficulties regarding the capacities of different sections, as it is unusual for the capacities of all sections in a unit to be perfectly evenly matched. A distinction has also to be made between technically feasible capacity and capacity that is economically worthwhile...."

A second problem is the lack of clear criteria. Guisinger notes that:<sup>/2</sup>

"A perplexing paradox of licensing is that it is undertaken to improve both efficiency and equity in resource allocation, but explicit criteria of efficiency and equity are rarely adopted by licensing authorities. Licensing decisions are typically ad hoc, relying on subjective judgments about the merits of individual applications without given clear indications of the substantive factors involved in the decision."

And, as mentioned above, the Dutt Committee found a "lack of clarity about Plan targets" in India.

7.08 Thirdly, the costs of licensing are similar whether the country under study is Pakistan, or India, or Argentina, or Brazil. In addition to delays, six main costs were listed by Little, Scitovsky and Scott:<sup>/3</sup>

- (a) Diversion of manpower in the public sector to extra administrative tasks.
- (b) Diversion of entrepreneurial resources into efforts to meet bureaucratic requirements.

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<sup>/1</sup> Ibid., p. 37.

<sup>/2</sup> Guisinger, op. cit.

<sup>/3</sup> I.M.D. Little, T. Scitovsky, M. Scott (1970). Industry and Trade in Some Developing Countries, O.E.C.D. Development Center, Oxford University Press, London.

- (c) Undue concentration of economic activity near the seat of political and administrative power.
- (d) Graft and corruption.
- (e) Failures, caused by corruption, of licensing policies to achieve their aims.
- (f) The general discouragement of private entrepreneurs when licensing is widespread.

The earlier sections of this annex demonstrate that this list could hardly be more applicable to the Indonesian situation had it been drawn up with Indonesia especially in mind.

7.09 But possibly the most serious problem is the widespread failure of licensing procedures to achieve their stated goals. The conclusions of the Dutt Committee on this matter deserve to be quoted at length:<sup>/1</sup>

"Import substitution was one of the main objectives of the Plans... Our study of licensing together with other accompanying measures such as authorization of capital goods imports and approval of foreign collaborations shows that these did not in many cases operate effectively towards the attainment of the objective....

Regarding regional dispersal, the licensing system ... could have played only a limited role .... The growth of small and medium industries could be encouraged through the licensing system only in areas where reservations for certain products or processes could be successfully enforced at an appropriate stage of the development of the concerned industries, and these were accompanied by supporting measures such as technical, financial and marketing assistance. We have observed how, in a number of instances, this objective was overlooked either because of a lack of clear guidelines or because the authorities apparently gave way to various kinds of pressures....

Finally, what can be clearly stated about the licensing system is that even without the limits of the system, the attempt to ensure the attainment of its specific objectives was half-hearted. Licenses were issued in excess of capacity targets even in non-essential industries. Influential parties and Large Houses were permitted to pre-empt capacities. The follow-up of licenses was unsystematic and licenses remained unimplemented for long periods... Production far in excess of licensed capacity has gone on for years in the case of a number of concerns without Government taking any steps.

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<sup>/1</sup> Ibid., Chapter VIII.

To recapitulate our general conclusion in the earlier Chapters, the licensing system worked in such a way as to provide a disproportionate share in the newly licensed capacity to a few concerns belonging to the Large Industrial Sector. The maximum benefit of all this went to a few Larger Houses. Our conclusions, therefore, is that the licensing system was not properly organized for the purpose which it was expected to achieve; the authorities concerned were not clear about these objectives and no clear guidelines for their attainment were ever laid down. The result has been that the licensing system has not contributed adequately to the attainment of the social and economic objectives of the Industrial Policy Resolution and Plans."

Similar comments referring to the failure of licensing to achieve their objectives can be found in other reports./1

7.10 The recommendations for reform of licensing systems which are generally proposed point to the advantages of simplification and of relying on broad policy tools which make fewer calls on the administrative capacity of the bureaucracy. Guisinger, for example, notes that governments in developed countries/2.

"... regulate the activities of private firms through general laws that affect all firms rather than through selective controls tailored to individual investments."

Little, Scitovsky and Scott favor the use of a wide range of policy tools "which make use of the market," such as taxes, subsidies, institutional measures to improve markets, and the provision of public services (such as transport facilities, industrial estates, and labor training programs) designed to assist industry.

7.11 The Dutt Committee supported the retention of some licensing controls, but only with a restricted role, and recommended the generous liberalization of the system as a whole. In particular, the Committee believed that the industrial sector in India should be divided into three sectors: the "core" industries; small and medium industries; and a "middle area." In the core sector, composed of basic and strategic industries, licensing should be retained but carried out according to sound economic principles in light of clear and carefully drawn up industrial plans. These plans "would provide criteria to ensure rational decisions and avoid ad hoc and arbitrary ones."/3

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/1 See Guisinger, op. cit., pp. 200 and 201, and Little, Scitovsky and Scott, op. cit., Chapter 6 and p. 340.

/2 Ibid., p. 191.

/3 Dutt Report, p. 188

At the other end of the spectrum, modern small- and medium-scale firms were to be assisted with a series of temporary reservations and bans. It was envisaged that "after a certain period of protection, with proper technical guidelines and the development of financial and marketing facilities, units in this sector should be able to withstand competition from large scale units." /1 In this sector, no new large-scale industrial units were to be established, and no substantial expansion by existing large-scale producers was to be allowed.

7.12 In the remaining area, which covered a large number of medium and larger scale "non-core" firms, licenses were to be freely granted to applicants not belonging to the large industrial houses or foreign firms. Under this policy licensing procedures were to become largely automatic for the middle group. The Committee recognized that the de facto abolition of regulation for this group might lead to excess capacity developing, or to the installation of inappropriate technology, or to some increased regional concentration of industry. But the Committee took the view that the costs involved in trying to control these aspects of industrial activity were not worth the benefits: /2

"All these mistakes can possibly occur in some industries to some extent, but these are risks inherent in this approach. The main point is that our review of licensing as well as the possibility of improving the system suggests that the maintenance of licensing over the whole area is not capable of preventing such mistakes. It is also likely to perpetuate a number of abuses of the discretionary authority vested in Government in areas where detailed planning is not possible. The solution suggested by us will be, we think, less harmful than the maintenance of licensing in its present form."  
(Emphasis in original.)

It has been worthwhile setting out these conclusions of the Dutt Committee in some detail because they form a useful background to the recommendations listed below. It is apparent that there is much in the experience of other countries which helps shed light on the problems caused by industrial licensing in Indonesia, and that some elements of the programs of simplification and

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/1 Ibid., p. 188. Traditional and village industries were not included in the classification, being regarded as having rather a different set of problems requiring a separate approach.

/2 Ibid., p. 191.

deregulation suggested for other countries might be applicable for Indonesia as well./1

Some Country Studies

7.13 With respect to industrial licensing, studies in Brazil, Egypt, India, Mexico, Pakistan and Spain indicate that, over the period when industrial licensing has been in force, the state was not more knowledgeable than the market with regard to the net social benefits that could be derived from the industrial sector./2 The industrial licensing system gave rise to a variety of economic costs and to very few of the expected economic benefits. The realization of these net economic costs led to the relaxation of the

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/1 A useful recent summary of the literature, which draws much the same conclusions as are presented here, is contained in Primit Chaudhuri, The Indian Economy: Poverty and Development, New Delhi, Vikas Publishing House, 1978, pp. 239-245.

/2 This section draws on Chapter III in A.M. Choksi (1979) "State Intervention in the Industrialization of Developing Countries: Selected Issues". Staff Working Paper No. 341, The World Bank, Washington, D.C. For specific country studies see:

Donges, J. B. [1976]. "A Comparative Survey of Industrialization Policies in Fifteen Semi-Industrial Countries." Weltwirtschaftliches Archiv, 112: 626-659.

Tyler, W. [1976]. Manufactured Export Expansion and Industrialization in Brazil. Kieler Studien. 134. Tubingen.

Girgis, M. [1976]. Industrialization and Trade Patterns in Egypt. Kieler Studien, Tubingen.

Banerji, R. [1975]. Exports of Manufactures from India - An Appraisal of the Emerging Pattern. Kieler Studien, 130, Tubingen.

Bhagwati, J. and P. Desai [1970]. India: Planning for Industrialization. London: Oxford University Press.

King, T. [1970]. Mexico: Industrialization and Trade Policies Since 1940. London: Oxford University Press.

Lewis, S. R. [1970]. Pakistan: Industrialization and Trade Policies. London: Oxford University Press.

Donges, J. B. [1971]. "From an Autarkic towards a Continuously Outward Looking Industrialization Policy: the Case of Spain." Weltwirtschaftliches Archiv, 107: 33-72.

Table A: LIST OF SELECTED COUNTRIES INSTITUTING INDUSTRIAL LICENSES

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Country	Industrial Licensing
Algeria	Yes
Bangladesh	Yes
Brazil	Yes
Chile	Yes
Colombia	No
Egypt	Yes (1975)
Guatemala	Yes
India	Yes (1951)
Indonesia	Yes
Iran	Yes (1955)
Ivory Coast	Yes
Malaysia	Yes (1975)
Mexico	Yes
Morocco	Yes (1956)
Nigeria	Yes
Pakistan	Yes
Papua New Guinea	Yes
Philippines	Yes
Senegal	Yes
Spain	No (1963)
Sudan	Yes (1967)
Tanzania	Yes (1967)
Turkey	No
Yugoslavia	No

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Note: Dates associated with the institution or elimination of controls have been provided where available.

system in Spain after 1963 and to its elimination in Taiwan after 1954. The other countries have, at various times, attempted to 'fine-tune' or improve on the system without much success.

7.14 In most countries, the allocation of licenses has in effect operated in an essentially ad hoc manner; economic criteria on which the decisions were to be based were rarely established and no explicit weights were attached to the different objectives. Even in Spain, where the government agencies responsible for the licensing system worked out the economic criteria for the allocation of licenses, the authorities were unable to apply them on a systematic basis. As in the case of India, the operation of the system degenerated to an ad hoc basis. Hence, the important question of optimal location, size, time-phasing and choice of technique were rarely addressed and the individual cases were, therefore, not examined in terms of their social profitability. In addition, the fact that unsuccessful applicants could not obtain the reasons for license rejection precluded any potential for "learning-by-doing" and, thus, prevented applicants from assessing their chances for obtaining formal approval with any accuracy. The applicants also could not obtain a comprehensive license for the complete project; permissions were often granted for only the initial phase of the project with no guarantees for future phases. This resulted in a sub-optimal choice of scale by the investor.

7.15 The uncertainty resulting from such an ad hoc system imposed real costs to the economy in terms of foregone social output. For one thing, the gestation lag, between an entrepreneur's decision to invest and the actual plant construction, increased. For another, the inefficiencies inherent in the administrative procedures resulted in significant delays. The delays were not caused by an attempt to obtain more information, in which case they could be justified, but by administrative shortcomings; they, in turn, resulted from a lack of clear definition of the responsibilities and from the overstaffing of the public agencies. The resulting net loss to society manifested itself in the increase in the prices of domestic and imported inputs, the sub-optimal timing of investment and the lowering of investment activity due to the associated risks and uncertainties.

7.16 The only quantitative evidence regarding the approximate costs associated with the delays in the licensing system is available from India.<sup>/1</sup> In three cases studies undertaken by the Ministry of Industrial Development in 1973, the total time-lag for obtaining an industrial license varied from 593 to 978 days. During that time, the study determined that import prices

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<sup>/1</sup> Guisinger, S. op. cit.

of capital goods were rising at 10 percent per year and, as a result, the minimum cost of the delays amounted to approximately \$50 million per year. This excluded any consideration of the costs of foregone consumption.

7.17 Countries that imposed industrial licensing systems have also suffered from the diversion of skilled manpower, in the form of extra civil servants, required to handle the extra administration of the system. This has been observed in countries with as diverging economic environments as India and Mexico. In addition, given the scarce entrepreneurial talent available in most developing countries, the diversion of the time of owners and managers to conduct non-productive activities inherent in such a system represented a high opportunity cost to the country. These socially non-productive activities included preparing and submitting applications, arguing their case with bureaucrats and undertaking activities to expedite their applications. None of these activities contributed to industrial development; each contributed a cost to society in terms of the foregone output.

7.18 Bribery, corruption and graft were also prevalent in most of the countries that were studied. This is not surprising, for any system that imposes constraints is conducive to bribery; the financial transaction is then used to influence the decision in a way that will confer benefits to the applicant. The broader the discretions that are left to the government officials and the vaguer and more ambiguous the rules, the higher the probability that bribes will be used to expedite and influence the final outcome. In addition, the low salaries paid to civil servants in some countries increases the potential for bribery and such payments become part of a "system by which those who use the services of the particular department of the government share the payroll expenses of those who labor within".<sup>/1</sup> In most countries, industrial licenses are assumed by the state to be a more equitable means of allocating resources since the decisions are made on a case by case basis in the national interest. If state bureaucrats, however, use their power to increase their income, then such discretionary power would be used to allocate resources to those who could most afford to pay and not to those eligible "in the national interest". Therefore, in attempting to avoid what has been perceived as the inadequacies and irregularities of the market system, the state has replaced one type of market force by another.

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<sup>/1</sup> Herlihy, E. D. and T. A. Leisue. [1976]. "Corporate Crisis: The Overseas Payment Problem", Law and Policy in International Business, 8: 135-145. A more sophisticated argument is presented by: Krueger, A. O. [1974]. "The Political Economy of a Rent Seeking Society", American Economic Review, 64: 291-303.

7.19 Frankena has shown that the industrial licensing system of India has also had a strong negative impact on the efficient design of goods and indigenous research and development. He concluded that the restrictive regime "reduced the incentive and ability of firms to receive the best available designs, to adopt subsequent design improvements, to adapt designs to local conditions and to undertake other innovative activities". /1 Though similar studies for other countries are not available, this effect is very likely to be present in any other similar licensing system. Research, under such an environment, is discouraged because there are never any assurances that the results can be translated into production which constitutes the only means of obtaining a return on knowledge. In addition, the "subsequent design improvements" are not undertaken because a new license is required each time there is a substantial modification of the product. There is, therefore, very little incentive to undertake the cost of research and development for the risk element is very high and the expected value of the benefits very low.

7.20 The above discussion has presented the costs to the economy of an industrial licensing system. Not all the costs have been incurred to the same extent in every country that has been studied. Clearly, some costs are more important in some economic environments than others. Nevertheless, all the countries have exhibited all these negative aspects to various degrees. But what about the benefits and the objectives of the licensing system? Have they been achieved to the extent that would justify the economic costs discussed above? The answer appears to be unambiguously no. "The licensing regimes, although they might have induced earlier and more diversified development of the manufacturing sector, clearly failed (to varying degrees among the countries under consideration) to achieve the stated objectives and to prevent investment in activities thought to be less desirable". /2 We now turn to two of the stated objectives: regional balance, and the devolution of monopoly power and the encouragement of the small entrepreneur.

7.21 The use of industrial licenses to bring about regional balance is one example of the system contributing to economic inefficiency. Most countries are subject to the political pulls and pressures of their various regions. In the absence of rational economic criteria to determine the optimal location of a plant, the regional interests represented in legislatures lead the licensing authority de facto to satisfy as many requests as possible. In addition, the objective of regional balance often merges with the government's desire to minimize monopoly power by increasing

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/1 Frankena, M. [1974]. "The Industrial Control and Trade Regime and Product Designs in India". Economic Development and Cultural Change, 22: 249-264.

/2 Donges, J. B. [1976]. "A Comparative Survey of Industrialization Policies in Fifteen Semi-Industrial Countries". Weltwirtschaftliches Archiv, 112: 626-659.

the number of individual plant units. The result, in most cases, has been a sub-optimal location for plants and the proliferation of sub-optimal plant scales in each region. Thus, economies of scale have not been taken advantage of due to the increased number of plants located in the different regions of the country. In Spain, the licensing system contributed significantly towards industrial fragmentation; the structure of firms in the heavy industries was strongly biased towards small units. The worst case was the steel industry which was fragmented into over 100 firms, none of which specialized in any products. In Brazil, industrial licenses were not effective in achieving regional balance. Despite the licensing system, industrial growth remained concentrated in the Center-South (mostly in Sao Paulo) at the expense of the poorer and more populous Northeast.<sup>/1</sup> The Northeast's share of income declined and the industrialization of the Center-South caused an increased in the migration of the rural population to the urban centers; this presented the government with additional organizational and financial burdens.

7.22 The fact that industrial licenses act as a one-edged sword is a major reason for their ineffectiveness for location policy. They can proscribe entry into a certain region, but cannot, by themselves, stimulate investment in the desired region. Additional incentives in the form of subsidies are essential to eliminate the wedge between private and social profitability; if private profitability in a region is negative, the allocation of an industrial license by itself is not likely to encourage private investment there. This characteristic of the licensing system appears to be overlooked by many governments and could in fact contribute to a less than the optimal level of total investment.<sup>/2</sup>

7.23 The objective of preventing the monopolization of market structures has also not been achieved in any of the countries studied. The primary reason for this was the sequential nature of allocating licenses, i.e. on a first-come-first-served basis. The sequential system of allocation favored the large rather than the small entrepreneur. In many cases, the attainment of licenses depended upon the closeness of the applicant to the government in power; this effectively excluded the small entrepreneurs and biased the system towards the larger firms. In addition, these large firms were generally able to allocate more resources in terms of manpower and time and were generally better informed and organized than the small firms. This

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<sup>/1</sup> Tyler, W. [1976]. Manufactured Export Expansion and Industrialization in Brazil. Kieler Studien. 134. Tübingen.

<sup>/2</sup> Guisinger, S. op. cit.

permitted them to apply for licenses more quickly and, thus, secure a position for themselves at the front of the queue. Multiple applications for the same industry also permitted the large corporations to pre-empt the available licensing capacity. These aspects, therefore, prevented the entry of small firms into the industrial sector.

7.24 It is not clear to what extent such a cumbersome system has discouraged private incentive. Clearly the ones who would be most discouraged would be the ones who could least afford to bear the cost; i.e. the small entrepreneur who is devoid of contacts with the state officials, who lacks the necessary information and organization to minimize the costs of obtaining the licenses, and who is without financial resources to bribe officials or to engage professional manpower to deal with the system. The fact that the licensing system is anti-competitive does not appear to have made an impact on state officials. Multiplying the number of inefficient units does not encourage competitive behavior; it is the free entry into the market that is the essential ingredient.<sup>/1</sup> It is, therefore, not surprising that, in most of the countries studied, the objective of encouraging small rather than large firms using industrial licenses has not met with very much success.

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<sup>/1</sup> This is a necessary though not sufficient condition for a competitive environment.

## 8. RECOMMENDATIONS

8.01 A series of specific recommendations follow from the discussion in the preceding chapters. These recommendations are grouped under several headings. But, first some general points are made since they influence the broad direction of the approach suggested here.

8.02 In countries such as Indonesia, where administrative systems are still weak, the presumption made is that broad, simple tools of policy are preferable to a detailed and interventionist approach. It is better to have broad tools that are largely effective in achieving limited goals, than detailed tools which are largely ineffective in achieving ambitious goals. In this context, it is important to be realistic about the objectives that are set for policy; there are some important objectives that direct government intervention can do little to achieve. In Indonesia today, pervasive government regulation is widely accepted as desirable, and the result is that those who are adversely affected by government intervention almost always call for "better controls", not "fewer controls". But when the regulatory mechanism is very complicated, the room for "improvement" is quite limited; at some stage, in a reform program, the issue of whether it is possible to have "better" controls without simplification must arise. Thus, it is felt that Indonesia would probably be best served by using a small number of broad and well-administered tools to implement industrial policy.<sup>/1</sup> In the recommendations listed below, some examples of the application of this principle in areas such as company taxation, investment incentives and pollution controls will be provided.

8.03 This approach, of course, does not mean that there must be no regulations. On the contrary, clearly enunciated laws and regulations and their effective enforcement are essential to an industrial environment that permeates certainty and gives assurances and lowers the risk to investors. On the other hand, vague and numerous conflicting laws can have exactly the opposite impact on investors. Thus, an attempt must be made to create a regulatory environment that inspires confidence in investors.

8.04 Furthermore, whatever else is done, most licensing procedures mentioned earlier in this report are in need of simplification. It is difficult to overemphasize the importance of this. In Indonesia thousands of

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<sup>/1</sup> Complexity, rather than simplicity, is a characteristic of the official system for the regulation of economic activity in a number of important areas in Indonesia. The Indonesian personal income tax system, which is quite unimportant as a source of government revenue, contains upwards of 20 income tax brackets and the complicated official interest rate structure is discussed in detail in Annex 4.

officials are in positions to hold up applications for licenses and to frustrate businessmen in their daily activities. One academic interviewed by the mission referred to the polusi peraturan (regulation pollution) which has grown up. In recommending simplification, a distinction is being made between streamlining of existing procedures, and simplification. Certainly streamlining is desirable, but the streamlining of certain complicated procedures is less preferable to their elimination. An example, of rather minor importance in itself, but representative of the broader challenge, indicates the approach that needs to be taken. In one province visited by the mission, merely to draw a personal cheque on his own account at his local bank branch, a businessman must sign his name a total of six times: once on the front of the cheque, twice on the back, and three times on other slips of paper presented to him by various clerks. The process usually takes about twenty minutes. In many countries banks require only one signature and can process a transaction of this sort in several minutes; it should be feasible in Indonesia to reduce the number of signatures to at least, say two or three. A complete simplification of the system is required, rather than just a streamlining of the present six-signature process.

8.05 Thus, the changes suggested here appear to go well beyond the usual simplification of procedures that have been introduced in Indonesian offices in the past. Many attempts at simplification have been made, or at least announced, in many government offices during the past decade. The mission visited offices where various simplification schemes had been introduced, but where procedures still seemed very complicated. Furthermore, it should be recalled that it is the numerous efforts at simplification that have produced the procedures at the ports described in detail earlier. Therefore, the type of simplifications proposed here would, quite simply, eliminate much of the documentation that applicants for licenses are expected to supply at present. But, for obvious reasons, recommendations such as eliminating specific documents required for particular licenses are not and cannot be made in this report. Thus, the 28 recommendations made below have been presented by functional areas, such as tax laws, investment priorities list; investment licenses etc. which establishes the appropriate framework. Because some areas have more than one recommendation, and, thus, have different timing implications, a time-frame is suggested after each recommendation.

8.06 A realistic timetable for the introduction of these proposed reforms must take into account the ease of implementation of the recommendations, their acceptability in Indonesia, and the need for or urgency of each suggested change. Some of the recommendations will involve substantial changes and should be viewed as long-term reforms. Others, however, can be implemented in the short-term. However, unless these, or similar reforms are undertaken, much of the problems of regulatory system, discussed earlier, will not be alleviated. For convenience, we view short-run recommendations as those that may take three to five years to implement; medium-run ones may take five to ten years; and long-run recommendations are those extending beyond ten years. The overall effect of these recommendations, it is hoped, would be a greatly simplified licensing system.

8.07 General Recommendation. The Government should establish a Deregulation Commission that gives consideration to and treats the recommendations made below as its initial terms of reference. Such a Commission is essential as the scope of the task is formidable and the mission is not equipped to undertake this task on its own; thus, the recommendations given below should be used as the guiding framework. This Commission could form the umbrella group under which other commissions or teams of experts, recommended below, would function. The Commission should also publish and make public reports, on a regular basis, which discuss the various phases of the reforms as they are undertaken.

8.08 Recommendation 1. In all government offices which have substantial dealings with business firms, procedures clearly need to be simplified. The main offices involved are the Department of Industry, the Department of Trade and Cooperatives, the Department of Finance (tax and customs), and various provincial offices which frequently process applications from businessmen (land, labor safety, and so on). More specifically, the following kinds of steps need to be taken; they are, of course, not the only ones.

- (a) the forms in use at present need to be revised with a view to the elimination of questions and requirements which are superfluous. This is a very detailed and sensitive task, and assistance from consultant firms which can provide advice in management techniques is needed. As a broad rule of thumb, the aim should be to reduce the amount of information that applicants must supply by at least half. Present procedures, of course, need to be considered on a case by case basis, but an example of the detailed documentation that must be produced by entrepreneurs before a Main Import License (TAPPI) can be issued include: personal details of the manager of the firm and three passport photos (4 x 6 cm.); details of the organizational structure of the firms and list of employees; ground plan of the firm; any agency or distributorship requirements; copy of proof of status of the office; list of wages paid to employees during the previous three months; inventory of office equipment of the firm; some of these appear to be superfluous.
- (b) wherever possible, the requirement that applicants supply multiple copies of documents should be minimized. This is also a matter which needs to be decided on a case by case basis; but it would seem reasonable to expect that comparatively well-equipped government offices (such as the BKPM) should make their own multiple copies where necessary. In other instances, however, considering the poor facilities that exist in some government offices (especially in the regions), the immediate abolition of the multiple-copy requirements might lead to severe administrative delays in the short run;
- (c) brochures should be available, free of charge, clearly explaining licensing requirements for different types of firms. These should be available from all government offices which issues licenses, and

in other appropriate places (such as the head office of industrial estates);

- (d) application forms for various licenses should be available free of charge. Where charges apply for any services connected with licensing, the charges should be publicly posted in appropriate places including within the offices where the charges are made;
- (e) applications should be approved or rejected within specified periods of time, and when rejected, reasons should be given for their rejection;
- (f) procedures for businessmen to appeal against rejected applications should exist;
- (g) all offices responsible for issuing the main licenses needed by manufacturers should be required to report annually on the time required to process applications. These reports should be sent to Jakarta, and should be made public.

8.09 The series of steps, suggested above, are designed to simplify procedures for issuing licenses in government offices; some of them are likely to be difficult to implement, but they are of considerable importance and are consistent with present Indonesian Government policy. Further, these improvements could be introduced quite independently of some of the other recommendations which would perhaps be best left until a later stage. Practical ways of beginning the task of simplification as outlined above should, therefore, be given high priority by the Government; the implementation of these suggestions could be completed over the medium-term and before some of the longer-term recommendations made below.

#### The Legal Framework

8.10 The legal infrastructure for the industrial sector is rather weak at present. Some laws and regulations overlap, while there are inconsistencies between others. In some cases, laws are out of date. Furthermore, there is no organized system for circulating and publicising laws and regulations relating to the industrial sector. It is apparent that there is such a large number of regulations and decisions being issued that it is not possible, even for the legal sections within government departments, to keep track of the situation. The mission was told that during 1979 approximately 3,000 regulations and formal decisions (Surat Keputusan) were issued within the Department of Industry alone; this, however, is only an estimate because an exact tally is not available. Nevertheless, between 1969 and 1975 the Minister of Industry alone issued an average of about 600 formal decisions each year, and when it is recalled that Director Generals and regional officials within the Department may also issue decisions, it does not seem at all unlikely that the

total annual figure approaches 3,000./<sup>1</sup> To be sure, many of these formal decisions deal with matters such as the pension rights of officials which are of no direct relevance to manufacturers, but on the other hand, several other Departments also issue many regulations affecting industry.

8.11 Recommendation 2. A Legal Commission should be established to conduct a codification of industrial laws and regulations. This should begin with laws and regulations issued within the Department of Industry, but should later be extended to include relevant laws and regulations in other areas, such as those issued by the Departments of Trade and Finance. The Pusat Dokumentasi Hukum (Center for Legal Documentation) within the University of Indonesia is a suitable organization to carry out this work. This codification process, inter alia, should ensure that outdated regulations are eliminated, that recent regulations that supersede old ones clearly identify those regulations which no longer apply, and the language of all regulations should be such that ambiguity and confusion is minimized. Thus, the legal status of one directive vis-a-vis others must be made clear to avoid conflicts.

8.12 Recommendation 3. There is a clear need for a well-organized and generally recognized system of making public various Government directives issued. Thus, a system should be established to provide for the official publication of regulations and formal decisions within the main Departments which have responsibility for the industrial sector. The first steps in this direction should be taken within the Department of Industry, the Department of Trade and Cooperatives, and the Directorate General of Taxation. A suitable official publication should be issued regularly, on a monthly or two-weekly basis, which would contain the text of all significant regulations and decisions, and which would list all others issued at both national and provincial levels. This publication should be on sale to the public at suitable distribution points throughout Indonesia, and should be available on a subscription basis. The publication of regulations in Cafi is an excellent example of cooperation between the private and public sector, and can be used as a model to improve dissemination.

8.13 Recommendation 4. Regulations and formal decisions should not come into force until announced in the regular publication proposed in Recommendation 3.

8.14 Recommendation 5. Steps should be taken to facilitate the distribution of all official material dealing with industrial policy to the public. Government book stores should be established in the main cities in Indonesia, or alternatively, distributors should be appointed. The regular publication proposed in Recommendation 3 should be available at these stores, and other official documents should also be on sale. It should be possible for all members of the public to purchase copies of any laws, regulations or official decisions at these stores, and the compilations of regulations which are

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<sup>1</sup> The list (without text) of the Ministerial Decisions (Surat Keputusan) issued by the Minister for Industry between 1969 and 1974 runs to 606 pages; see the Daftar Surat Keputusan Menteri Perindustrian Tahun 1969-1974 issued by the Ministry of Industry in 1975.

issued by some government offices in Jakarta should also be available at these stores./1

8.15 Recommendation 6. The Central Government needs to reemphasize to all provincial authorities that regional officials may not issue decisions which contradict regulations from "higher" level officers or from the Central Government. To provide firms with adequate security against the proliferation of such contradictory decisions, a mechanism must be established that would protect such firms against prosecution for ignoring such instructions if they run counter to those legally issued by a higher authority.

8.16 There is general agreement, both within official circles and in public discussion about the issue that the present confused legal arrangements are quite unsatisfactory; thus, measures to improve the situation would probably receive general support. Consequently, very high priority should be given to implementing the recommendations above intended to improve the legal infrastructure as it affects industrial policy; these measures should, therefore, be undertaken in the short-run. It will, however, take some time before all can be fully implemented.

#### Tax Laws

8.17 The recommendations below suggest approaches that the Government may wish to consider to begin to alleviate the problems associated with the taxation process discussed earlier.

8.18 Recommendation 7. The present system of listing an extremely detailed set of taxation and investment incentives in the DSP should be discontinued in favor of general incentives. Normally, the tax and incentives provided should not vary between industries, and the Government should increase or reduce these incentives in a uniform manner depending on the degree of overall assistance that is judged to be appropriate for the manufacturing sector. One departure from this principle may be worth considering in order to promote regional development, provided it is done in a uniform manner and is sufficiently large: the Government may wish to encourage firms to locate in the Outer Islands by setting two sets of company tax rates and incentives, one set for Java and one for outside Java. Such incentives for the Other Islands will, however, have to be accompanied by appropriate regional policies regarding infrastructure and services. On their own, such incentives will have, at most, only a marginal effect./2

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/1 For example, in recent years the Department of Trade and Cooperatives has been publishing an annual compilation of regulations under the title of Himpunan Peraturan-peraturan Di Bidang Perdagangan (Collection of Regulations in the Trade Field).

/2 Annex 5 discusses the economic principles that the BKPM should consider in the provision of special tax incentives.

8.19 Recommendation 8. A thorough review of the Corporate Law system is needed because the present law, based on an Act introduced in 1847, is in need of revision in a wide range of matters; these include limited liability of owners, issuance of shares, and voting rights. This is a major task which can be expected to take several years to complete. As a first step, it is suggested that an expert group or a Tax Commission be established to prepare a preliminary report. This group might be composed of several Indonesian lawyers and accountants, as well as several foreign advisers experienced in taxation law and accounting procedures. The recent decision to reactivate the Court of Appeal for tax matters (Majelis Pertimbangan Pajak) is likely to improve the situation, because the Court had been largely inactive for over a decade; however proper staffing and facilities, as well as efficient management and fair judgments, will be needed to re-establish faith in the tax system./1

8.20 Recommendation 9. Because of the many complaints that the mission received about the difficult relations that exist between company taxpayers and tax officials, a substantial simplification of the company tax system is indicated, particularly for smaller firms. It is proposed that low rates of company tax should be levied according to some clearly defined and measurable variable. This is likely to be a particularly difficult task given the existing reporting system in Indonesia, particularly for the small firms.

8.21 Recommendation 10. To minimize the problems associated in assessing taxes that so often arise between taxpayers and assessors, the March 1979 reforms introduced by the Government are to be encouraged and should be effectively enforced. In particular, the use of public accountants is an important innovation to solving some of the problems.

#### Customs and Port Procedures

8.22 Recommendation 11. It is clear that customs and port procedures remain in need of reform. An investigation is needed to establish (a) why previous attempts at improvement have been so ineffective, (b) the problems with existing studies, and (c) to recommend detailed measures for simplification within the port. This recommendation has been proposed so often to the Indonesian Government - and indeed so often adopted - that it is difficult to see what more can be done. It appears that there is very strong administrative resistance within the Customs Office and at the ports

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/1 See Kompas, June 30, 1980, for details. Businessmen interviewed by Kompas were cautious in welcoming the change, saying that they would suspend judgment until they had some experience of how the reactivated institution operated in practice.

to meaningful improvements. The greatest difficulty is not in obtaining agreement, in principle, from senior officials to reforms - agreement has been reached on this matter several times - but in actually eliminating bureaucracy in the ports. One step towards reducing the paperwork may be to arrange for a team of management experts to study the administrative procedures, but the more difficult task of having any changes accepted by officials on the job would remain.

#### The Investment Licensing System

8.23 The recommendations so far have focused on the broad regulatory environment such as the procedures, the legal situation and tax laws. The Government can begin to undertake these in the short and medium run. Some of these (such as Recommendations 1 and 4) are relatively simple and could be instituted immediately, whereas others, such as Recommendations 8 and 11 would take a considerable amount of time to be fully effective. We now come to a set of recommendations that focus specifically on certain licenses. Again, some recommendations are of a short-run nature, whereas others are not.

#### The Investment Priority List (DSP)

8.24 Recommendation 12. Currently, the DSP contains very detailed conditions for investment approvals for an extremely large number (866) of subsectors. In the short-run, the Government may wish to consider pruning these conditions, some of which can cause serious economic problems (e.g. projects should utilize new technology); some of which are ineffective (e.g. projects should use domestic inputs as far as possible; or certain projects should be located outside Java) and some of which are ambiguous (e.g. the output should be mainly for exports). Other conditions that have deleterious economic effects include the minimum economic capacity; the use of new materials, and the specified proportion of output that must be exported. Thus, an early and substantial reduction in these conditions would facilitate the licensing procedures at the BKPM.

8.25 Recommendation 13. The Government could also take immediate steps to clarify the ambiguity in the current DSP regarding sectors that may be either open for investment, or closed, or not yet classified. It is suggested that those sectors for which this ambiguity exists be revolved as follows: these sectors should be open for new investments with no conditions of approval and no special investment or taxation incentives; these sectors would only be eligible for the general incentives discussed earlier in Recommendation 7. Such an approach would provide a useful first step towards the medium-run solution regarding investment licenses suggested below (Recommendation 15).

#### Imports of Second-Hand Equipment

8.26 Recommendation 14. The restriction on the import of second-hand equipment could be further liberalized in stages and eventually eliminated.

The presumption in this field should be that industrialists are better placed to judge what is economically efficient than government officials, and there would not seem to be any case for banning the import of second-hand equipment of any types of industrial equipment. This suggested liberalization could begin in the immediate future, especially since the principle has now been accepted for a small range of equipment. The Department of Industry and the Department of Trade and Cooperatives should consider whether an extension of the liberalization could be arranged in the near future. This change should be particularly easy to implement since all that would be initially required would be an expansion of the list of approved equipment shown earlier in Table 4 (Appendix I).

Investment Licenses: Division of the Industrial Sector

8.27 The recommendations made below and taken together, amount to an increased deregulation of the licensing system since they would tend to limit the investment control system and replace it with general taxation and investment incentives. These changes are likely to arouse some opposition in some quarters; nevertheless, this proposed deregulation of the licensing system is of major importance, especially since an expansion of a DSP type system is planned at present to include the BRO sector. The fact that thinking in some circles in India is moving in this direction is worth considering, particularly since some senior policy makers in the industrial policy field in Indonesia have clearly been influenced by the Indian example.

8.28 The proposal of the Dutt Committee in India is suggestive of a useful medium-run approach which might be suitable for Indonesia; it concerns the division of the industrial sector.<sup>/1</sup> On the one hand there is obvious need to exercise some control over large-scale investments in important sectors and over foreign investment. On the other hand, there is a range of traditional cottage and small-scale industries at the other end of the spectrum which are faced with special problems that mostly lie outside the scope of this report.<sup>/2</sup> Between these extremes, as in India, there is a large middle area of heterogenous firms; this division thus points towards a three-way classification of the industrial sector for investment licensing purposes.

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<sup>/1</sup> Government of India, Department of Industrial Development, Report of the Industrial Licensing Policy Inquiry Committee, Government of India Press New Delhi, July 1969, prepared under the Chairmanship of S. Dutt.

<sup>/2</sup> The recent Bank report on Indonesia: Cottage and Small Industry in the National Economy, November 1979, Report No. 2490-IND, discussed this sector in detail.

8.29 Recommendation 15. The industrial sector should, therefore, be divided into three broad groups for investment licensing purposes: (a) the "high priority" group; (b) the "main" group; and (c) cottage and small-scale industries.

8.30 Recommendation 16. The "high priority" group would encompass certain large-scale, capital-intensive industries such as cement, petrochemicals, fertilizer and steel which require lumpy investments and which the Government, for economic or noneconomic reasons, would wish to supervise closely. For this group, in the medium run, the present system of attempting to control investment should be maintained. The detailed sector-by-sector specification of taxation and investment concessions now listed in the Investment Priority List, should be eliminated unless there are economic arguments for providing these incentives. Thus, the equipment and raw materials master list would become superfluous and could be eliminated. Furthermore, the numerous detailed conditions of approval could be restricted only to those of location, timing, scale of operation and choice of technology. In the long run, as the industrial sector develops and entrepreneurs are more able to undertake these large projects on their own, the Government should consider relaxing the investment licensing requirements for this group unless there are strong overriding economic reasons for not doing so. These firms would then only be subject to registration licenses which would be issued automatically.

8.31 Recommendation 17. Furthermore, these large projects in the "high priority" group should be subject to sound cost-benefit analysis which would take into account issues of optimal scale, location, timing and choice of technology. This would need to be carried out by trained staff, perhaps within the BKPM.

8.32 Recommendation 18. In the middle, which for convenience may be referred to as the "main" industries, would fall all of the firms presently classified under the BRO and associated legislation, as well as the domestic (PMDN) firms now registered through the BKPM. These firms would no longer be subject to capacity or production licensing, and there would be no Investment Priority List or conditions of approval determined by the Government for this group, but neither would they be eligible for special taxation and investment facilities; they would only be eligible for general taxation and investment incentives. These firms would, however, be required to register annually with the local Department of Industry, and report information useful to the public, such as its location, previous years production, any planned expansion, and number of employees. (For reasons see Recommendation 22.) None of these would be subject to approval and a registration license would be issued automatically.

8.33 Recommendation 19. At the other extreme, the administrative arrangements for the cottage and small-scale industry sector should remain broadly as they are now. It is, however, questionable whether the

registration requirements (which are, in effect, largely voluntary) should be maintained at all since they appear to be widely ignored. For this group, no Investment Priority List should be determined and all firms in this group would be eligible for general taxation and investment incentives.

8.34 Recommendation 20. The Government may also wish to reconsider the attempts made to monitor "supply and demand" in different sectors of the economy and the use of the DSP system to close or restrict capacity or location of new investment or expansion in areas with estimated excess capacity. The shortcomings of such policies are apparent. Private foreign (and domestic) firms will not have an incentive to enter activities with "excess capacity" unless they are in competition for monopolistic rents or unless they can produce more efficiently than existing firms. Free import competition and liberal investment policies are the most efficient mechanisms for transferring such monopolistic rents to the Indonesian consumer or worker and the gains by these groups will almost inevitably dominate any losses to previously established firms. In addition to the harmful effect of investment controls, it should be noted that there is little capability or incentive within Government agencies for estimating market supply and demand more accurately than would potential investors who must bear the cost of any errors.

8.35 Recommendation 21. The attempt to set lower limits on capacity output in the DSP system so as to force private sector firms to capture "economies of scale" could be abolished. Competitive pressure maintained through unrestricted trade flows and unrestricted investment represents the most effective mechanism for ensuring that firms choose the most efficient scale of production. As in the previous case, there is no compelling need for Government intervention and little reason to expect that Government agencies would have the expertise or incentives required to improve on the decisions made by firms in the private sector.

8.36 Recommendation 22. The definition of "small industry" used within the Department of Industry could also be simplified and based on some unambiguous measure, such as number of full-time employees within the firm. The present definition, which is based on (a) current value of equipment, (b) capital-labor ratio, and (c) nationality of owner, suffers from several disadvantages. First, inflation quickly alters the current money values of equipment and other capital, and thus an unknown number of small firms are automatically pushed outside of the "small" category each year. When this happens, they become subject to a different set of licensing requirements and are liable to various penalties if they do not possess the required licenses. During a period of, say, five years, the number of firms which are "inflated" out of one licensing category to another must be quite substantial. Second, the intent of the capital-labor ratio criterion is vague. Because of these two disadvantages, and in the interest of consistency, it would seem best to adopt the definition used by the Indonesian Central Bureau of Statistics to define small-scale firms, as all firms with between 5 and 19 workers. This proposal to define "small industry" in an unambiguous manner, although not in itself a major recommendation, would contribute to a clearer legal and

administrative situation and may be accepted as a minor matter by Indonesian officials. This suggestion, therefore, could also be undertaken at an early stage.

8.37 Recommendation 23. Regarding foreign investment, all such firms would be expected to register with the Ministry of Industry or the BKPM. Investment licenses could be maintained for large-scale capital intensive projects, in the extractive industries, but detailed investment incentives by sector should not be maintained. Foreign investors would, thus, be entitled to only those general taxation and investment incentives decided upon by the Government. With the gradual liberalization of the economy, current restrictions on the entry of foreign investment could be gradually eliminated./1

8.38 Recommendation 24. A public register of firms in the "high priority sector" and the "main sector" should be maintained at the national, provincial and regency (kabupaten) levels. All firms in these two groups would be required to register annually with the local Department of Industry and supply the basic information which would be kept in a public register; e.g., location, production during the previous year, any planned expansion, number of employees. This public register would be open to public examination so that officials and others seeking basic information about the industrial sector would be quickly able to compile data. In particular, it would assist businessmen planning investments to make their own assessments of the market situation.

#### Other Licenses

8.39 The general principle underlying the licensing system in Indonesia should be changed so as to rely as far as possible on the enforcement of broad laws governing undesirable behavior rather than on the detailed licensing procedures which have proved ineffective. For example, since many factories which at present are in possession of an Environment License are in breach of the license, it is clear that the mere possession of a license is little guarantee that a factory will observe environmental regulations. It would be better to draw up a general Environment Law setting out minimum requirements for the manufacturing sector and concentrate on the enforcement of the law whenever breaches were reported. If enforcement were reasonably effective, factories would tend to regulate their own pollution emissions because of the probability of being detected and strongly disciplined.

8.40 The suggestion made below of replacing various licenses with laws and the abolition of others involves a major change in policy and an acceptance of a new approach to the problems in the areas that licenses cover. There is, however, the view that is widely held in some quarters that the best approach to problems is to enforce the existing licensing

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/1 Annex 5 discusses recommendations for foreign firms in detail.

system more strictly rather than to look for more effective tools. An alternative approach is outlined below.

8.41 Recommendation 25. Over the long-run, the Government may wish to consider replacing licensing requirements by legal mechanisms with strong punitive measures. There are many licenses that may be candidates for such replacement; some examples are the Environment License; the Domestic Purchasing License; and the Labor Safety License. Where existing legislation is not adequate, new legislation for enforcement at a national level should be prepared. Furthermore, it is not clear what function certain other licenses perform (e.g. communication license, entreport license, internal trade license, transport licenses) and the possibility of their being eliminated should be considered. External trade licenses (on imports and exports) should also be eliminated, and, where appropriate, they should be replaced by tariffs./1

6.42 Recommendation 26. In the short-run, until the above recommendation can be implemented, the Government could take immediate steps to eliminate much of superfluous and time-consuming detailed requirements which are a strict precondition to obtaining the licenses. (See also Recommendation 1.) Thus, for example, the BKPM approval process can be streamlined significantly by eliminating the many categories of project modification for which reapproval is necessary. At the same time, the detailed documentation required with each modification can be minimized.

8.43 Recommendation 27. In the same vein, the interdependence of the various licenses should be abolished. Thus, for non-BKPM investors, procedures should be established that permit firms to simultaneously apply for those licenses considered, in the short-run, to be essential by the Government.

8.44 Recommendation 28. Pollution costs and environmental concerns should be accounted for by the use of efficient taxes and industrial zoning supported by regulation on minimum levels of pollution control required. Investment controls should not play a major role in this system. It must be recognized that it is exceedingly difficult to control external diseconomies from pollution effects on the basis of an investment license application. A system of effluent taxes, industrial zoning, and regulations that allow for substantial differences between regions so as to reflect wide variability in these cost depending on the neighboring environment should be established and local authorities should play a major role in establishing and enforcing this system. With such a system, the Investment Coordinating Board can serve a useful function in disseminating information on the pollution control system to potential investors to increase the information available to Government

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/1 For a fuller discussion of this foreign trade related recommendation, see Annex 2.

authorities and to provide some further assurance against excessive pollution, an environmental assessment should be an integral part of project design and should also be added to the investment application process in which the firm specifies the type and level of environmental change (e.g. pollutants) expected from its production activities. An environmental impact statement of this type would serve to alert policy authorities in the area of intended investment of potential external costs connected to the proposed investment. This could be especially useful if the project involved some particular type of pollution that was not accounted for in the affluent tax, zoning, or regulatory system.

INDONESIA

SELECTED ISSUES IN INDUSTRIAL DEVELOPMENT AND TRADE STRATEGY

Selected Industrial Items in the 1980 Investment Priority List  
(Foreign and Domestic Investments Combined)

<u>Sector/subsector /a</u>	<u>Incentive /b</u>		<u>Conditions</u>
	<u>Tax</u>	<u>Investment allowance</u>	
Forestry (Sectoral conditions)			<ol style="list-style-type: none"> <li>1. The forestry sector covers planting, raising, crop collection, processing and integrated agro-forestry based businesses.</li> <li>2. Progressive and maximum utilization of forest products will be based on the principle of forestry resources preservation.</li> <li>3. In principle, these should be protection, participation and development of businesses with small and medium amounts of capital; this can be done by, for example, involving these businesses as suppliers and distributors, and arranging for them to become shareholders through the capital market.</li> <li>4. Feasibility studies will be carried out with the knowledge of the Directorate General of Forestry in the Ministry of Agriculture.</li> <li>5. Industries using logs as raw materials will protect the environment by observing the conditions of the Directorate General of Forestry.</li> <li>6. (a) Forest product industries will be located as close to the source of raw materials as possible. (b) The location of these industries will be within timber industrial complexes.</li> <li>7. Employment of foreign personnel should be consistent with the regulations of the Department of Labor, Transmigration and Cooperatives.</li> </ol>
Logging + sawmilling + (drykiln) + waste using industries or sawmills + (drykiln) + wood	x	-	<ol style="list-style-type: none"> <li>1. The minimum capacity of sawn timber production must be 12,000 cu m. per annum. The production should be used as the basic material for further processing.</li> <li>2. A maximum tax holiday of three years is allowable.</li> </ol>

Sector/subsector /a	Incentive /b Investment Tax allowance	Conditions
<u>Industry</u> (sectoral conditions)		<ol style="list-style-type: none"> <li>1. The area of industry comprises miscellaneous industries, basic chemical industries, and basic metal industries.</li> <li>2. Each application must include a feasibility study which provides information on the following aspects of the project: <ul style="list-style-type: none"> <li>- economics</li> <li>- environment and pollution</li> <li>- social effects</li> <li>- multiplier effects</li> </ul> </li> <li>3. Projects should not compete with small industries.</li> <li>4. Projects should utilize new technologies and machinery.</li> <li>5. Projects should use domestic inputs as far as possible.</li> <li>6. Employment of foreign personnel should be consistent with the regulation of the Department of Labor, Transmigration and Cooperatives.</li> </ol>
<u>Food and milk</u> Seasoned meat (D)	x -	<ol style="list-style-type: none"> <li>1. For production of <u>abon</u> (meat fibres) and <u>dendeng</u> (meat strips).</li> <li>2. For economically weak groups/cooperatives.</li> </ol>
<u>Canned vegetables</u> Preservation of fruit & vegetables in cans (D)	xx -	<ol style="list-style-type: none"> <li>1. Mainly for exports.</li> <li>2. Location: South Sumatra, Jambi, West Kalimantan, North Sumatra, South Kalimantan, Lampung.</li> <li>3. Economically weak groups should be involved.</li> <li>4. Domestic raw materials should be used.</li> <li>5. Markisa fruit juice may not be produced in North Sumatra.</li> </ol>

Sector/subsector /a	Incentive /b		Conditions
	Tax	Investment allowance	
<u>Grain milling</u>			
Soybean flour, etc. (C)	x	-	<ol style="list-style-type: none"> <li>1. Outside of Java the supply of raw materials should be from privately owned plantations.</li> <li>2. Economically weak groups should be involved.</li> </ol>
<u>Bread, biscuits, etc.</u>			
Biscuits (D)	-	x	<ol style="list-style-type: none"> <li>1. Location: outside of Java, mainly in big cities (Medan, Pontianak, Palembang, Ujung Pandang, Manado, Ambon).</li> </ol>
<u>Wearing apparel</u>			
Garments (F)	xx	-	<ol style="list-style-type: none"> <li>1. Must be exclusively for export.</li> </ol>
<u>Sawmilling, wood products</u>			
Plywood (F)	xx	-	<ol style="list-style-type: none"> <li>1. There must be majority Indonesian shareholding.</li> <li>2. Supply of raw materials must be guaranteed.</li> <li>3. Location: outside Java.</li> </ol>
<u>Pulp and paper</u>			
Pulp and paper (F)	xxx	-	<p>The sites (with the attached conditions) including the following:</p> <ol style="list-style-type: none"> <li>1. Location: Takengon, Aceh. Annual production and capacity: 50,000 tons of sack craft paper and 70,000 tons of liner board. Raw materials: pinus merkusii. Marketing: domestic and export.</li> <li>2. Location: Sesayap, East Kalimantan. Annual production and capacity: 58,500 cu m of sawn timber, 25,000 cu m of plywood, 6,300 cu m of veneer, 109,000 tons of pulp, 30,000 tons of paper (writing/printing). Raw materials: mixed tropical hardwoods. Marketing: domestic and export. Participation: Government.</li> </ol>
Cheque safety paper, bank-note paper, bond paper (B)	x	-	<ol style="list-style-type: none"> <li>1. Written consultation with the Department of Finance required.</li> </ol>

Sector/subsector /a	Incentive /b		Conditions
	Tax	Investment allowance	
<u>Basic chemicals</u>			
Olefines (F)	xxx	-	1. Location: near Lho'Seumawe, Aceh. Production and capacity: <u>core unit</u> of ethane 450,000 tons and ethylene 35,000 tons. <u>Downstream unit</u> of LDPE 180,000 tons, HDPE 60,000 tons, VMCl10,000 tons, MEG 70,000 tons. Raw materials: natural gas/ethane from LNG unit. Marketing: domestic and export. Participation: Government.
<u>Electrical machines</u>			
Electric motors (F)	xxx	-	1. For utilities.
Distribution transformers (F)			} A majority of local components should be used.
- above 5,000 kVA	x	-	
- below 5,000 kVA	-	x	
<u>Other electrical products</u>			
Dry batteries (D)	-	x	1. Excluding carbon zink.
Electric lamps (D)	-	x	1. Excluding incandescent bulbs, neon tubes, and decorative lamps.
Isolators (D)	xxx	-	1. High tension (nonceramic) isolators only.
Electric cables (D)	-	x	1. Extension of existing plants only, above 14 kV.
Storage batteries (D)	-	x	1. Full manufacturing of batteries.  2. High quality products only (maintenance free).

/a Abbreviations: D = taken from domestic investment (PMDN) list. There is a total of 526 items in the full list.

F = taken from foreign investment (PMA) list. There is a total of 340 items in the full list.

/b The more "x's", the higher the priority.

Source: Compiled from the BKPM Investment Priority List as published in Business News and Warta CAPI, in February and March 1980.

INDONESIA

SELECTED ISSUES IN INDUSTRIAL DEVELOPMENT AND TRADE STRATEGY

Licenses and Permits Issued by the BKPM

License/permit	Function of license	Time and conditions of issue
<u>APPLICATION &amp; EVALUATION STAGE</u> (Licenses 1 to 4)		
1. <u>Provisional Letter of Approval</u> (Surat Persetujuan Sementara, SPS).	Sets out the BKPM's approval, in principle, to the proposed investment.	Issued after BKPM's approval of Model 1 application form. Target processing time: 4 weeks.
2. <u>Letter of Final Approval</u> (Surat Persetujuan Tetap, SPT). Presidential approval is needed for PMA projects	Provides firm approval for the investment and specifies the conditions upon which the approval is issued, including production and capacity levels, employment, implementation schedule, and source and use of funds. Attachments to the SPT set out the concessions granted and provide a Temporary Operating Permit (see below).	Issued after consideration of additional information submitted by the investor to the BKPM after receiving the SPS. Investors are allowed 12 weeks to supply this information which may be extended by agreement with the BKPM. Target processing time (excluding the 12 weeks allowed to investors): 6 weeks.
3. <u>Statement of Incentives</u> (Fasilitas Fiskal)	Specifies, in principle the incentives that an investor will receive.	Issued automatically with the SPT.
4. <u>Temporary Operating Permit</u> (Izin Usaha Sementara, IUS)	Enables the investor to proceed with project and produce on a trial basis. The permit expires on the estimated date of the start of commercial production.	Issued automatically with the SPT.

BKPM LICENSING STAGE (Licenses 5 to 15)

Following the granting of the SPT, investors commence implementation of the project. A number of licenses are needed at this stage, all of which are issued by the BKPM.

License/permit	Function of license	Time and conditions of issue
5a. <u>Limited Domestic Purchase Permit</u> (Izin Pembelian Dalam Negeri Terbatas, IPDNT). For PMA projects only.	Authorises the direct purchase and use of domestic inputs. Without this permit the investor would be automatically required to purchase inputs through a distributing agent rather than direct from the manufacturer. The permit also allows the company to conduct market research and sales promotion.	Licenses 5 & 6 are issued after (a) SPT has been granted, (b) company registration, and (c) submission of application for them. Target processing time: 1 week.
5b. <u>Limited Domestic Trading Permit</u> (Izin Perdagangan Dalam Negeri Terbatas, IPDNT). For PMDN projects only.	Same as for 5a, except that PMDN firms may sell directly without using an agent (PMA firms must sell their output through domestic distributors).	
6. <u>Limited Import License</u> (Angka Pengenal Importir Terbatas, APIT).	Provides an import identification number and authorises the investor to import goods for the project directly rather than through an agent, which is the normal requirement. It also allows Bank Indonesia to issue a Letter of Credit.	As for 5.
7. <u>Machinery Imports Permission</u> (SP Mesin-mesin).	Provides a detailed "master list" of approved machinery that may be imported and states the customs duty concessions to be given. Also provides guidelines for the subsequent issue <u>on a shipment by shipment basis</u> of (a) letter of credit recommendation from BKPM, and (b) tax and customs clearance (MPO and SPPB).	Issued after a proposed master list has been submitted to the BKPM. The master list should list all individual items to be imported, including sources of supply, capacity, price, etc. Six copies of the master list should be supplied to the BKPM within 12 weeks of receiving the SPT and APIT. The list is evaluated by the BKPM for consistency with the proposed project. Target processing time: 4 weeks.

License/permit	Function of license	Time and conditions of issue
8. <u>Raw Materials Import Permission</u> (SP Bahan-baku)	Essentially the same as No. 7 except relates to raw materials.	Essentially the same as No. 7. Six copies of the raw materials master list to be supplied when 75% of project machinery installed. Master list should specify volumes, price, country of supply, etc.
9. <u>Recommendation for Letter of Credit</u>	Allows Bank Indonesia to issue Letter of Credit.	Application should be submitted after Nos. 7 and 8 have been approved. Target processing time: 1 week.
10. <u>Import Clearance Statement</u> combining (a) Tax Clearance Certification (Menghitung Pajak Orang, MPO), and (b) Customs Clearance License SPPB).	To expedite importation through customs. (a) allows investors tax concessions. (b) allows investors to import specified items with the nominated customs duty and tax concessions.	Clearance is required for each <u>shipment</u> . Application should be made to the BKPM prior to arrival of goods on a standard from accompanied by 7 copies of the appropriate invoice, packing list and Bill of Lading. Target processing time: 1 week.
11. <u>Visa Recommendation Letter</u> for foreign personnel.	Allow the Indonesian Embassy in the expatriate's country of residence to issue an entry visa and the expatriate to obtain a Provisional Entry Permit (Kartu Izin Masuk Sementara, KIMS) on arrival.	Issued when trial production tests are complete and the BKPM has inspected the plant. Target processing time: 10 weeks.
12. <u>Work Permit and Decree</u> for foreign personnel.	The decree allows the company to employ an expatriate in a nominated occupation for a stated period. The work permit identifies the expatriate who is granted approval to work in Indonesia and states his occupation period of approval.	Issued after employee arrives in Indonesia and after application has been made. Target processing time: 1 week.

License/permit	Function of license	Time and conditions of issue
13. <u>Permanent Operating License</u> (Izin Usaha Tetap, IUT)	Specifies the activity which the company is allowed to undertake, production capacity, and other operating conditions. All companies must have a current IUT. Licenses Nos. 14 & 15 are issued at the same time.	Issued within trial production tests are complete and the BKPM has inspected the plant. Target processing time: 10 weeks.
14. <u>Final Statement on Tax Facilities</u>	Provides a detailed statement of facilities granted to the project. Must be submitted each year to the Directorate General of Taxation.	Issued automatically with License No. 13.
15. <u>Limited Export License</u> (Angka Pengenal Eksportir Terbatas, APET).	Provides an export identification number and allows the company, through specified personnel to export goods directly rather than through an agent.	Issued automatically with License No. 13.

REGIONAL LICENSING STAGE (Licenses 16 to 20)

Approval must be obtained from provincial offices to establish a factory on a particular site. Application is made to the Governor of the Province, or through a regional BKPM where they exist. It is the official view that these licenses should take about 10 weeks to obtain.

16. <u>Location Approval License</u>	Approves the establishment of the project at a particular site.	Appropriate accompanying documentation must be provided.
17. <u>Right to use Land</u>	Various different land rights are granted under the 1960 Basic Agrarian Law. Investors must obtain right to use land on specified conditions.	As for No. 16.
18. <u>Building Permit</u>	Specifies building construction conditions.	As for No. 16.

License/permit	Function of license	Time and conditions of issue
19. <u>Environment License</u> Under the Disturbance Act (Hinder Ordonnantie of 1926).	Regulates environmental aspects of the investor's activity.	As for No. 16.
20. <u>Land Certificate</u>	Allows investors use of the site.	As for No. 16.

Source: BKPM, Investment Procedures , Jakarta, August 1979, and Price Waterhouse, Doing Business in Indonesia, USA, February 1978.

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SELECTED ISSUES IN INDUSTRIAL DEVELOPMENT AND TRADE STRATEGY

A Partial List of Licenses & Permits Required by a Foreign  
Investor & Associated Distributors in the Cement Industry /a

No.	Name of Permit	English Equivalent	Prepared by	Issued by	Validity
1.	Izin Usaha Tetap/Izin Usaha Sementara	Permanent/Temporary Operating License	Manufacturer	BKPM	-
2.	Izin Gangguan	Environment License	Manufacturer	Regional Government	3 years
3.	Izin Tempat Usaha	Location License	Manufacturer	Regional Government	3 years
4.	Izin Industri	Industrial License	Manufacturer	Dept. of Industry	30 years
5.	Surat Persetujuan Pendirian Perusahaan	Presidential Approval (PMA)	Manufacturer	President	
6.	Izin Mendirikan Bangunan	Construction License	Manufacturer	Regional Government	30 years
7.	Izin Komunikasi	Communication License	Manufacturer	Dept. of Communications	6 months
8.	Working Permit (for foreigners)		Manufacturer	BKPM	1 year
9.	Angka Pengenal Exportir Terbatas (APET)	Limited Export License (PMA)	Manufacturer	Dept. of Trade & Coops	2 years
10.	Angka Pengenal Importir Terbatas (APIT)	Limited Import License (PMA)	Manufacturer	Dept. of Trade & Coops	2 years
11.	Surat Izin Perdagangan Antar-Pulau	Interisland Trading License	Manufacturer	Dept. of Trade & Coops (Regional Office)	1 year
12.	Izin Pembelian Dalam Negeri Terbatas (IPDNT)	Limited Domestic Purchase License	Manufacturer	Dept. of Trade & Coops	2 years
13.	Izin Entrepourt	Entrepourt License	Manufacturer	Dir.Gen. for Stamp Duty	6 months

No.	Name of Permit	English Equivalent	Prepared by	Issued by	Validity
14.	Dispensasi Angkutan Jalan Raya	Road Transport Dispensation	Trucks (Transporter)	Dir.Gen. for Land Comm.	3 months
15.	Dispensasi Angkutan Jalan Raya	Road Transport Dispensation	Trucks (transporter)	Road Office (Regional Office)	1 month
16.	Surat-Surat Kendaraan Bermotor	Motor Vehicle Letters	Trucks (transporter)	Various Government bodies	1 year
17.	Surat Izin Trayek Antar Propinsi	Interprovincial Route Clearance	Trucks (transporter)	Dir.Gen. for Land Comm.	1 year
18.	Surat Izin Trayek	(Interisland) Route Clearance	Vessel (transporter)	Dir.Gen. for Sea Comm.	1 trip
19.	Surat Izin Usaha Perdagangan (SIUP)	(Central) Trading License	Distributors	Dept. of Trade & Coops.	1 year
20.	Surat Izin Usaha Perdagangan (SIUP)	(Regional) Trading License	Distributors	Dept. of Trade & Coops (Regional Office)	1 year
21.	Surat Pengesahan Sebagai Distributor	Legalised Distributors License	Distributors	Dept. of Trade & Coops	1 year
22.	Surat Izin Tempat Usaha	Location Approval License	Distributors	Dept. of Trade & Coops	1 year
23.	Surat Tanda Pendaftaran Pergudangan	Warehouse Registration License	Distributors	Dept. of Trade & Coops (Regional Office)	1 year
24.	Surat Fiskal	Fiscal Certificate	Distributors	Department of Finance	1 year

/a Note that PMA investors may not undertake distribution activities but must deal through Indonesian agents.

INDONESIA

SELECTED ISSUES IN INDUSTRIAL DEVELOPMENT AND TRADE STRATEGY

List of Second Hand Equipment which may be Imported Subject to Certain Conditions

Items	BTN No.	Comments
<u>Machine tools</u>		
Metal machine tools	84.45.00	For ferrous and non-ferrous metal-working industries, powered with electric motor. Especially shearing and shoring machines. Metric system in international standard units. Especially from Europe, America and Japan.
Erosion machining equipment	84.45.00	
<u>Equipment for smelting plants and rolling mills</u>		
Smelting plants for non-ferrous metals	84.14.00	In the form of complete units, except for the production of plain reinforcing steel bars.
	84.43.00	
	84.56.00	
	84.11.10	
Smelting plants for iron ores	84.14.00	
	84.43.00	
	84.56.00	
	85.11.10	
Steel making plants and steel works equipment	84.43.00	
	83.11.10	
Rolling mill machinery	84.44.00	
<u>Industrial furnaces, oil and gas heating plants</u>		
Furnaces of the following sorts: melting, reheating, holding, heat-treated, cooling, reduction, sintering, firing, separation, refining, surface-coating, metal joining, roasting incineration.	84.14.00	For the production of quality goods. For iron over 500 kg and for non-iron over 100 kg, except for rotary furnaces and certain other processes. In the form of complete units.

Items	BTN No.	Comments
<u>Foundary machinery</u>		For the production of quality goods. For iron over 500 kg and for non-iron over 100 kg. Metric system and international standard units. In the form of complete units.
Conditioning machinery and equipment for foundary sands foundary sweeping, etc.	84.56.00	
Moulding machines	84.56.00	
Casting machines	84.59.00	
Pneumatic tools for foundary	84.49.00	
Fettling machinery & equipment	84.59.00	
<u>Contractors and building machinery, machinery for building materials, Machinery for ceramic and glass industries</u>		Especially for machines from Europe, America and Japan. In the form of complete or semi-complete units. Excluding builders hoists of less than or equal to 1 ton, and building cranes less than or equal to 2 tons.
Machinery & equipment for building sites	84.23.10 84.23.20 84.23.90 84.03.20 84.23.29	
Dredgers	84.23.90	
File drivers, pile extractors	84.23.40	
<u>Machinery for processing rubber and plastics</u>		In the form of complete units.
Rubber processing machinery	86.16.90 84.17.44	

Items	BTN No.	Comments
<u>Mining machinery</u>		Especially for machines from Europe, American and Japan. In the form of complete units.
Equipment for open-pit mining	84.22.00	
	84.23.00	
Dressing machinery for brown coal, coke, ores, and other materials	84.56.00	
Coking-plant machinery	84.59.00	
Oil well drilling and other deepsea drilling plants	84.23.10	
<u>Paper making and converting machinery</u>		Only for machines to produce paper.
Machinery for the manufacture of paper	84.31.00	
	84.17.40	
	84.17.90	

Source: Joint Ministerial Decision, September 5, 1979.

INDONESIA

SELECTED ISSUES IN INDUSTRIAL DEVELOPMENT AND TRADE STRATEGY

Import Procedures

Document Examination Section

1. The PPUD document (Certification of Arrival of Goods), along with the required attachments (letter of introduction from the port expediting firm (EMKL), copy of bill of lading, copy of invoice, copy of packing list, insurance policy, consular invoice, copy of delivery order, letter of authority from importer, complete list of documents surrendered to authorities) is provided to the Head of the Section./1
2. The Head of the Section examines the documents and signs them.
3. The PPUD is processed, noted in registry, given a number and Import Yard code.
4. The PPUD is noted as processed and noted as forwarded onto the next section.

Checking Section

5. The PPUD is registered as having entered the section.
6. Head of Section notes the name of the staff member who checks the PPUD.
7. PPUD checked; if incorrect, the process must begin all over again. If correct, it is registered as leaving the section.

Cashier Section

8. The PPUD is registered as entering the section. It is rechecked. Stamp duty is paid and a "paid" stamp must be received. This must be noted on the back of the PPUD, and a receipt issued.
9. The Head Cashier must sign the receipt.
10. The PPUD is forwarded to the Public Notice Section.

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/1 Soeprijo Andhibroto, op. cit., notes that these documents must be contained in a manila folder issued by the Customs authorities; there are many trivial procedural conditions of this sort imposed in government offices which manufacturers must deal with. Many of these minor matters involve small payments which are official, but troublesome.

Public Notice Section

11. The PPUD is registered as having entered the section.
12. A Customs official examines the PPUD details concerning the make of the import, total amount, details of contents and consistency between PPUD and attached documents.
13. The PPUD is taken to the Head of the Section who must approve it.
14. The PPUD (which consists of one original plus six copies) is distributed to various sections: two to the Import Yard, one each to the Finance Section, Central Statistical Bureau, Customs, Taxation Office and Anti-Smuggling Bureau.

Import Yard

15. The PPUD is registered as having entered the section. A Customs official passes the document to the Head of the Section.
16. The Head of the Section decides whether the goods are to be opened, and if so, how thoroughly checked.
17. Details of required checking are sent to the warehouse (hanggar).

Hanggar

18. The Examination Note is registered as having entered the section, and is passed to the Head of the Hanggar. The Head appoints staff to examine the goods, and notes the names of these staff.
19. The examination is carried out, and a "contents note" is marked on the delivery order. This is returned to the Head of the Hanggar for checking.
20. Customs official takes the approved Examination Note back to the Import Yard along with a sample of the goods.

Import Yard

21. Examination Note and sample received; all appropriate documentation is collected by the Registrar of the Section, and forwarded to the Head of the Section for examination.
22. If everything is in order, documents are forwarded to the Tariff Section.

Tariff Section

23. The PPUD is registered as having entered the section. The documents are reregistered according to the category of goods (machines, textiles, electrical goods, and so on), and forwarded to the examination staff.
24. The tariff is checked by an examiner, and returned to the Head of the Section for approval. If approved, the documents are stamped "Tariff correct," and returned to the Head of the Section for signing.
25. The documents are returned to the examiner, and passed on to the Registrar of the Section for noting; the documents are sent to the Price Section.

Price Section

26. The documents are registered as having entered the section.
27. The documents are reregistered according to the category of goods, and sent to the appropriate examination section.
28. The examiner provides a price Examination Note, and sent to the Head of the Section for approval. If approved, the documents are returned to the Head of the Section for signing.
29. The goods are registered once more, and sent to the Import Yard.

INDONESIA

SELECTED ISSUES IN INDUSTRIAL DEVELOPMENT AND TRADE STRATEGY

Government Policy Towards the Weaker Economic Group

1. Since this section of the 1980 DSP is a clear statement of Government policy on the matter, and since the official approach towards favoring pribumi businessmen affects many other aspects of industrial policy (such as credit allocation) as well, it is worth quoting at length:/1

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/1 Translated from Business News, No. 3412, 18 February 1980. Note that the Presidential Decision No. 14, 1979, mentioned in the quote is a decree governing, amongst other things, the manner of expenditure of government monies; the Decision set out guidelines for favoring pribumi firms.

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"In order to foster and promote the activities of the weaker economic group, certain new fields of business will be required to ensure participation or cooperation with existing weaker economic groups or with cooperatives. The type of participation or cooperation intended here falls into two categories:

(a) Participation with weaker economic groups/cooperatives.

Participation with the weaker economic groups, the majority of which consist of pribumi firms including cooperatives, is intended to mean that their initial shareholding will be a minimum of 10% for large investments, which are defined as being Rp 625 million and above (US\$1 million); for smaller investments a shareholding of between 10% and 20% will be required. The definition of the weaker economic group will be as stipulated in Presidential Decision No. 14, 1979 ... on 2 May 1979 as follows:

'... firms classified as economically weak national companies will be those which fulfil the following provisions:

- (i) At least 50% of the capital of the firm must be owned by pribumi smallholder.
- (ii) The majority of the executives of the firm (Board of Commissioners/Board of Directors) must be pribumi.
- (iii) The capital/net assets of the firm must be as

follows:

- a. less than Rp 25 million (US\$40,000) in the trade and services sector;
  - b. less than Rp 100 million (US\$160,000) in the industrial and construction sector.
- (b) 100% involvement of the weaker economic groups. Cooperation with the weaker economic groups under this heading is intended to mean cooperation in purchasing their products, both in the form of raw materials or other inputs as well as developing subcontractor systems with them.

Pribumi national domestic companies: these are defined as a company:

- (a) whose shares are entirely owned by pribumi, or
- (b) which has a minimum share ratio between pribumi and nonpribumi of 75%:25%, or
- (c) which has a minimum share ratio between pribumi and nonpribumi of 50%:50% and which has a majority of pribumi executives."

This extended quote is representative of the type of detail that government regulations are increasingly providing in an attempt to control more closely the precise conditions on which industrial licenses are allocated.