

# THE POLICY ANALYSIS OF FDI IN THE FRAMEWORK OF LOCAL GOVERNMENT ECONOMY: A COMPARATIVE STUDY

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*This paper discusses a comparative policy study of FDI that has been boosting local government economy in some selected countries. The output of this study is to provide empirical portrait about FDI policy that can be applied in Indonesia. This study was conducted through 2 (two) approaches: first, a comparative policy study on FDI in Singapore, Japan, South Korea, Malaysia, Vietnam, China; and second, a study on FDI policy in some regions in Indonesia. Finally, this paper proposes policy recommendations to the regions for improving their foreign direct investments in order to foster their economic development.*

*Key words: Foreign Direct Investment – policy analysis – local government economy*

## A. Introduction

As Jeffrey Sachs (1999) states in his book, “International Economics: Unlocking the Mysteries of Globalization” that the word globalization is as a mystery and has shown its power to Asian economy. Its power can be indicated from the financial crisis of Thailand, Korea, Malaysia and Indonesia in 1997. This condition shows that the globalization can be a threat for a country. One of the phenomena of globalization is that the foreign direct investment is developing in Asian countries. Foreign direct investment is one of external finance sources that has a significant role in developing countries since the Second World War.

The development of foreign direct investment is supported by an entity of relatively stable financial source and based on such factors as longer-term marketing & potential growth, and functions as structural character of a host country. In pure finance, foreign direct investment can be a direct investment supporting to other financial sources of a country. In a broad sense, foreign direct investment may function as a factor to push endogenous growth in economic and social welfare of the country. This can be indicated by several countries which have good economic growth and high competitiveness, such as Singapore (the growth was 5% in 1999 and highly competitive price ranked at number 2) and Malaysia (the economic growth was 4% and its competitive price ranked to number 29).

The successful key for both countries can be seen, *first*, from their policy that can be evaluated either from foreign direct investment study of national economic or from service promotion regulation known as an effort to attract foreign direct investment. *Second*, from the study of internal strength improvement in the form of economy knowledge bases on that improving both countries to attract foreign investors and locally use its benefits for economic needs.

Recently, Indonesian economic growth is indicated by the decrease of foreign investors’ trust to Indonesian investment climate. This condition can be seen from the unregistered name of Indonesia in a foreign investment list published by the well-known institution of foreign investment at Karney in England. Meanwhile, other countries hit by financial crisis

such as South Korea, Malaysia and Thailand are included in the foreign investment list. There are three reasons why foreign investors are reluctant to invest in Indonesia. Firstly, the effect of economic globalization results in competition to attract investors not only among the developing countries but also among the developed ones. Secondly, the recent effects on Indonesia's economic growth, social, politic and security decrease the position of global competitive power. Finally, this condition is worsening due to the highest economical budget caused by lots of local government new taxation.

The new regulation number 22 year 1999, about local government, followed by government regulation number 25 year 1999, regarding the balance of central and local government finance, creates competitiveness in attracting investment in home country which are not only among countries but also among provinces, regions or cities. Therefore, only those that can provide best services such as fast, accurate, easy, cheap and transparent will become the first choice for investors. In brief, it is very important to increase competitive power of each region in order to attract investment and to make use of it for the sake of regional economy.

Based on the above background, economy of Indonesia should be restored especially to strengthen the regional economy in facing autonomy. Therefore, a study on foreign direct investment is needed to increase regional economy of certain developed countries. The aim of this study is to get ideas on investment policy in Indonesia so that it can increase its regional economy/income.

This comparative study includes aspects of foreign direct investment in increasing regional economy of several countries such as Singapore, Japan, South Korea, Malaysia, Vietnam and China, whereas, in Indonesia the study is conducted in several regions such as: East Kalimantan, North Sulawesi, Batam, and East Java.

## **B. Theoretical Framework**

One of the big challenges in the 21<sup>st</sup> Century for a developing country like Indonesia is to reach a sustainable development and to increase national competitiveness. This important role can be functioned by society in its country through private enterprises and public organizations either locally or nationally. In a abroad sense, this important role can be functioned through foreign direct investment that has been developed along with the significant role of economic globalization and technology towards the economic development.

In capital fundamentalism perspective, the process of establishing capital formation though foreign direct investment is the key to one's country growth. The role of FDI as a capital requirement towards the economic development has been conceptualized in a development model of Harrod-Domar. This model has been used widely by the developing countries as a simple way to see the relationship between capital requirements with its development. Based on this model, the lack of domestic saving for developing one's country or a region needs investment as much as the lack of its domestic saving (Khurseda, 1998).

Moreover, the development factor as a foreign direct investment can influence positively and negatively, or in other words, it can benefit or cost towards government economy of a host country. Peter Dicken (1992) states that besides development aspects, by having FDI through trans national cooperation (TNC) such as: technology, trade and industrial structure interrelatedness, private enterprise and job vacancy will give the host country some advantages. Based on this idea, a thesis written by United Nation (1999) states that there are some benefit impacts of foreign direct investment towards economic

development of one's country such as increasing financial sources, increasing technology power, supporting export competitiveness, increasing quality and human resources quantity and protecting the environment. Therefore, such factors can contribute to economic growth and development by their function as a catalyst activity and domestic company work performance.

Some negative factors that can be raised by MNC and its ability are to generate supernormal profits and to transfer them to shareholders that residentially are not being a host country. Moreover, FDI can directly influence negative factors towards government economy. For an example, MNC can influence a policy of regional economy (e.g. import protection on local market).

To maximize some financial profits and to minimize some financial losses raised by FDI and MNC, therefore, public policy is needed in local, national and international levels in order to attract FDI and use its profits. This condition can be determined by three factors (UN, 1998). Firstly, policy framework either nationally or locally including economy, social and politic; exit permit and operation; standard towards foreign affiliation, policy on marketing structure especially on competition policy; international agreement on FDI; privatization policy; trading policy (tariff and non-tariff barrier); coherency between trading policy investment and taxation policy. Secondly, economic factors including market, resource, asset and efficiency (such as transportation zone, human resources, etc). Finally, business facility including investment promotion; investment incentives; hustle costs (such as things related to corruption and administrative efficiency); social facilities (such as bilingual schools, quality of lives, etc); investment post services.

In order to face some possibilities of FDI threats of one's country or region, therefore, it needs an additional study for encouraging competitiveness that goes along with the "dangerous of globalization". As the President of Asian Development Bank, Tadao Chino (2001) states that in general the economy of Asia has been using the globalization successfully. On the other hand, globalization has some crucial risks to be overcome. It is not only to raise social and economical pressure but also financial pressure. Similar to this, Ahmad Badawi (2001) says that globalization is a kind of game called "a winner takes all". It means that those rich countries like Northern European will be the winner if Asian countries do not improve their labors' education, skills, productivities and innovations.

In order to improve competitiveness either on a country or a region level, therefore it can use a knowledge management factor that is known as a competitiveness approach. This approach not only stresses on a comparative excellence but also competitive excellence. It also based on any kinds of factors that influence international competitiveness of one's country or region. According to regional Economic Competitive drivers, there are 5 (five) supporting factors that influence economic competitiveness. They are knowledge, social cohesion, infrastructure, connectivity, and productivity (Martani, 1999).

Knowledge is the property of an organization or a region that includes information, ability, awareness, admittance, an experience, an acquaintance and an understanding. This knowledge is categorized into three groups; they are human capital, structural capital and relational capital. Human capital is a knowledge possessed by manpower of an organization or from an educational and training field. Structural capital is a way on which the components in an organization or in an educational and training field is systematized, internalized and processed. Relational capital is a relationship among components in an organization or in an educational and training and international world.

The development of the knowledge tends to be very important, first, because of having its methods, systems, products and new processes that can be developed aiming to

increase demands, income and quicker process. This will lead to an excellent source and added value in an organization or a region.

The second successful factor is having a social cohesion. This factor is an organization/region that illustrates habits, ethics, way lives and relationships of the organization or the region. According to Azua-Azua (1998) a certain social cohesion can be divided into two aspects. They are culture and solidarity. Culture is a way, a feeling and an intellectual development of a certain region. In other words, the culture of one area means something that grows all the time and forms an identity. Culture represents social acts of society to what that they like and dislike, their language, their way of organizing something, their education, and their stories. Culture is an invincible factor that has a strong influence to social activity. Therefore, culture is very important and represents how people work, do, analyze and solve their problems.

Solidarity refers to culture of one's region that has some needs. These needs form a culture, whereas, the ways that form the needs produce a solidarity. The solidarity grows faith, happiness, and gathers society to create a good environment.

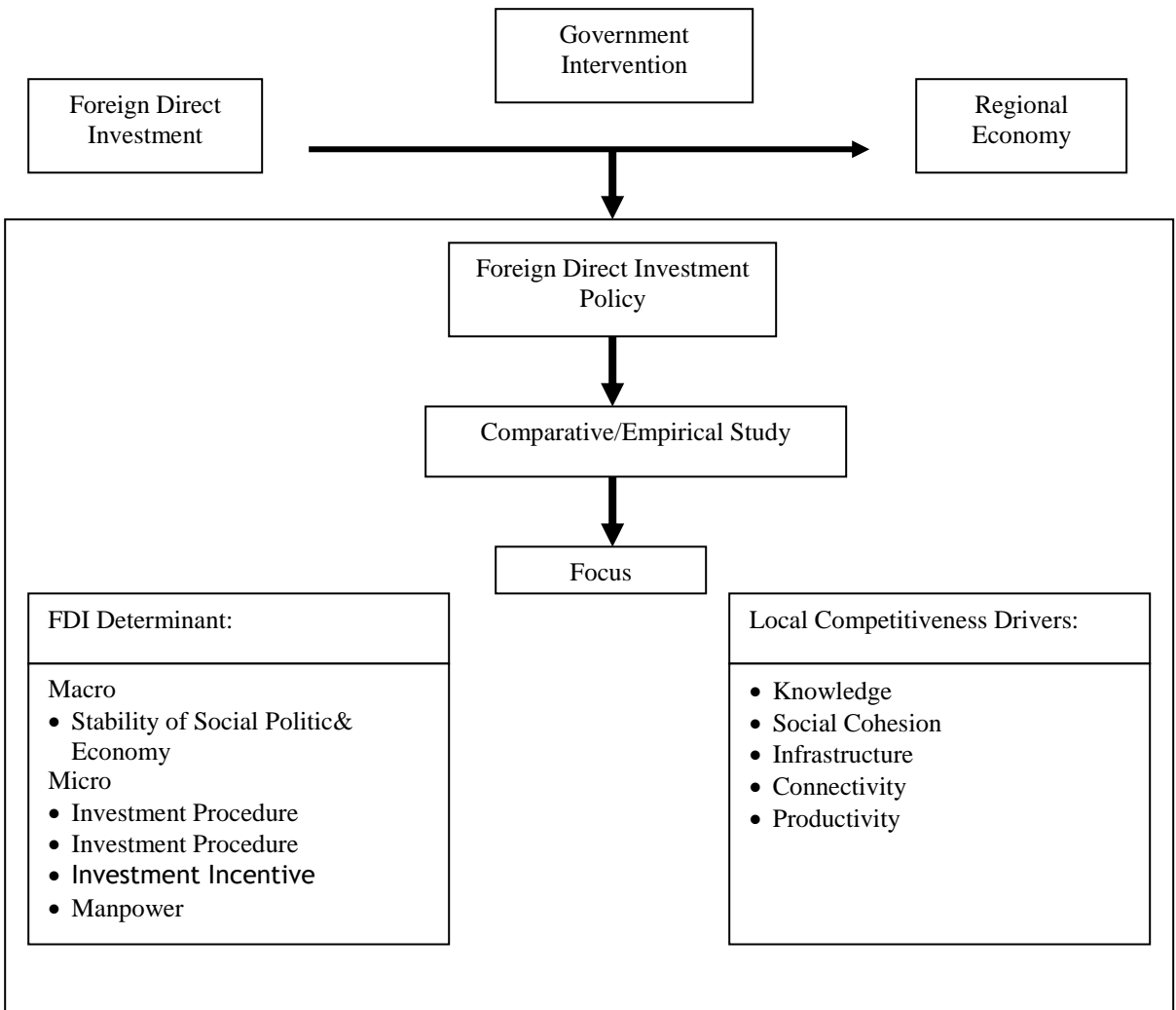
The third successful factor is having infrastructure that can be defined as a basic structure or definite asset tool from regional economy system. Azua and Azua (1998) differentiate between a mature infrastructure and a high-tech infrastructure. The mature infrastructure means the prepared basic needs of one's region, for example, a road system. It is always developed and repaired in order to make an excellent region. The high tech-infrastructure refers to modernization of given infrastructure, for example, a center of research and development. Infrastructure is very important because it provides some elements and services that function to develop the system of a regional economy.

The fourth successful factor is having a connectivity that means a readiness of one's region to be opened. The connectivity of one's region forms its knowledge like a rational capital. Therefore, connectivity refers to: (1) relationship inside region, and (2) relationship outside the region. The relationship inside region indicates a regional relationship with institutions, universities, government, and even related societies. The relationship outside region indicates relationship with other regions and international. This relationship is very important as a basic of one's region to reach an international excellence.

The fifth successful factor is a productivity that means the total of goods and services are created and innovated in one's region to achieve efficiency. This factor is very important to show the economic performance of one's region based on two kinds of productivity, namely: tangible and intangible of one's area.

Therefore, this study is focused on two approaches. First, FDI's determinant approach, known as a special approach that will apply some policies that function as the determinant of FDI in various countries, namely: a) the stability of social economy and politic; b) tax incentive; c) investment procedure (exit permit and operation); d) investment promotion; and e) manpower. Second, regional competitiveness approach that used to study the implementation of the increasing of regional competitiveness in several chosen countries by looking at its regional competitiveness driver grouped on knowledge management cluster.

## The Framework Study on Analysis of Foreign Direct Investment Policy in Regional Economy



### C. Comparative Analysis of Foreign Direct Investment in Several Countries

The previous description regarding various policies approaches to increase the regional economy in various selected countries reflects the lack of cheap labor as the competition instrument to attract foreign investment. While other factors which include political, economic and social stability, investment service, investment incentive, labor force, infrastructure and local human resource empowerment tend to become policy instrument implemented in Korea, Singapore, Japan, Malaysia, China and Vietnam to attract foreign direct investment (FDI) in order to increase the national and regional economy. Each country has varied policy instrument scenarios.

#### *Social, Economic and Political Stability*

Several countries in East Asian Countries such as: Singapore, Japan and Korea tend to have relative stable political, economic and social condition compared to Indonesia. Similarly, it happens to the political, economic and social condition in Malaysia and Vietnam. The stability in several East Asian countries is due to the environment conditions that can be predicted and supported by transparency. Besides, it is supported by a government system that can make important policy decisions based on the economic reasons instead of political reasons and the costs such as often found out in many developing countries including Indonesia. This condition is due to: 1) the ideology of the elite is in line with the policy which is oriented to growth; 2) the elites who are non-economy actors/businessmen are participated in the income redistribution program due to the rapid economic growth of the local country; 3) bureaucracy and the clean/honest economic technocrat are free from short-sighted political pressure; 4) The awareness towards the threat of failure in development acceleration in the form of hegemonic foreign power.

The income redistribution in Japan and Korea occurred is due to the historical accident, namely the land reform after the destruction due the lost in the war. This program has caused the rich land in 1945-1953. Further, the economic development of Korea is focused on the achievement of rapid growth and tended to ignore the social development aspect. This condition is quite different from Singapore that tends to pursue the growth with the purpose to increase the welfare of most Singapore people.

The political, economic and social stability can be achieved in Malaysia due to the clear economic development direction in considering various ethnic groups especially for the empowerment of the indigenous people that are the majority of the people in Malaysia. This is manifested in Vision of Malaysia 2020. Besides, the Malaysia economic growth has achieved a fantastic increase 7.0 percent during the period of 1991-2000 that the target determined by the government can be achieved. More fantastic, this growth is achieved in a low inflation rate, stable price and full employment. Other progress is the per capita income that has increased 7.8 percent or increase twofold from RM 6.298 in 1990 to RM 13.359 in 2000.

Almost equal with Malaysia, the political, economic and social stability in Vietnam is significant results from comprehensive reformation steps through *Doi Moi policy*. The inflation rate that achieved 700% in 1980s decreased to below 6% in the year 2000. The average economic growth was 8% since 1991 up to 1998. In 1999 Vietnam economy was shocked again with the regional economic crisis and natural disaster and caused the GDP growth only 4.5%. However, the economy of Vietnam in the year 2000 increased again with average growth 6.7% in the first quarter. The GDP of Vietnam increase twofold at the end of this decade.

### ***Incentive Policy***

Even though the tax incentive is considered by some observer is not too interesting for investors, however, most of the countries in Asian region tend to compete in increasing the tax incentives. The specific purpose of the incentives generally is to promote the regional development. Those countries offer various incentives: tax holidays, income tax exemption or tax rate reduction, investment allowance and customs duty exemption to equipments and goods intended to production in remote areas. Several countries offer additional incentives according to the investment value invested or the number of jobs created in those regions. The priority industry development, high-tech and pioneer industry (an industry which has not been developed in the local country) is also given similar incentive. Several countries offer tax reduction to attract the operation head office of the companies

in their countries. Expenditures for research and development is generally given tax reduction up to 100 percent. The export is encouraged through tax and exemption of customs or by determining special economic zones that is determined by a special tax regime. Total taxes of the companies are generally about 30 percent of the taxable income tax. Mostly the countries have withholding tax for dividend and payment of royalty (honorarium).

As a relatively advanced country, the government of Japan provides different investment incentives with other countries, namely incentive in the form of loan guarantees by industrial structure improvement Fund and credit guarantee for investment that develop small and medium industries in Japan. This step is very possible in Japan because it is supported by the sufficient government financial ability.

### ***Labor force***

The labor force regulation in Indonesia and Korea tend to be very liberal. This is indicated with the lack of maximum limit of foreign labor composition that can be allowed to be employed in a foreign investment company in the two countries. The foreign workers only need working permit to the related government agency and pay foreign workers tax according to the provision (the case of Indonesia). While other countries, tend to require the utilization of the local labor for the local economic interest in the long term. The government of Singapore determines maximum (ceiling) percentage of foreign workers and monthly tax to reduce the dependency of Singapore's economy on the foreign workers. The government of Malaysia and Vietnam tend to sanction the regulation that is more oriented towards the local workers. The policy of Malaysia government encourages the trained workers and can be employed at all levels. The foreign workers can only be employed in business sectors that lack of the trained local workers. The foreign companies must provide training for the local workers that the human resource composition at all levels is a multi-racial composition. While the Chinese government is free from the organization of local workers in the companies, however, the companies are required to employ local human resources.

The tendency of several countries not to use the cheap labor as the competition instrument is due to:

- The wage is no longer a critical factor in the determination of investment. Meanwhile, research and development and marketing become more important, that the competitive advantage of lower wages have been reduced. According to a recent study, the labor market share that have low skill in many industries has dropped from 25 percent within two decades to only 5-10 percent for the total production cost in industrialized countries. Direct labor cost only comprises 3 percent of the total cost of semi-conductor, 5 percent in production of color TV, and 10-15 percent in the car industry. However, the labor cost still plays important role in clothing and shoes industries that comprise about one-third of the total production cost.
- The lower labor cost per unit can be easily offset by other loss such as low quality infrastructure or low quality labor force.
- Advanced technology and production methods require stricter standard for quality and reliability. The new production method is more vulnerable towards bottleneck, and therefore become more important to have the strength such as reliable electricity supplier and good transportation. One of the reasons of decreasing attractiveness to produce the less developed countries is due to their infrastructure constraints.

- The educational standard in the developing countries still far left behind compared to the industrial countries. The lack of skilled workers has limited the shifting of complex technology operation to these developing countries.

### ***Business Service Facilities***

Many of the steps of business facilities are done to increase the efficiency of foreign investment administration system at the national and local/regional level. Generally, the one-stop service becomes an alternative mechanism to the provision of foreign investment services. For such management activities, each country has one-stop agency (promotion agency), like the institution which is formed at the local/regional level in China, namely Foreign Investment Service Center, BKPM in Indonesia; FIND (Foreign Investment in Japan Development Corporation); MOFTEC (Ministry of Foreign Trade and Economic Co-operation) in China; KISC (Korean Investment Service Center) in Korea.

The above institutions generally only have the authority in permits and promotion aspects. However, the KISC institution in Korea has been revitalized in its function that includes: liberalization and protection of FDI, augmentation of tax incentive, increase of ownership (wealth) incentive and subsidy, simplification of procedure, and determination of one-stop service, establishment of foreign investment zone, and establishment of commission of FDI policy. Even that institution has an ombudsman system and home's doctor to establish relationship between investment stakeholders.

Besides the procedural streamlining, a more automatic investment service model has been implemented in Singapore. This model is known as *electronic public services* and provides convenience of service of investment application without face-to-face contract directly and spends more time and expenses.

### ***Infrastructure***

Each country relies on the physical infrastructure development to increase the investment competitiveness. Each country makes efforts to increase the transportation, telecommunication and other supporting infrastructures. High-tech infrastructure has been developed in Japan and Singapore. Even several other countries make efforts by developing cooperation with private companies both local and foreign companies to improve their infrastructure.

### ***Empowerment of the Local People***

The empowerment paradigm used is *knowledge-based economy* to encourage the development of local industry. Therefore, each country performs human resource investment through education and training to produce the availability of trained/skilled workers to facilitate the absorption and diffusion of technology and managerial skill and increasing the industrial infrastructure. Besides, facilitating the cooperation between big, medium and small industries develops the small and medium business empowerment, for example, through the SMIDEC forum in Malaysia. In order to encourage the involvement of the indigenous people in the business, the Malaysian government determined the equity increase (share ownership) of the indigenous people in trading. Now, the indigenous people only have 19.1 percent of the corporate equity. The target is to increase the indigenous people ownership into at least 30 percent before the year 2010

## **D. Conclusions and Recommendations**

Based on the description in the previous chapters, this chapter will reveal the conclusion regarding foreign investment policy in several countries and policy recommendation for increasing the regional economy in Indonesia.

## 1. Conclusions

The micro foreign direct investment policy in general is a derivation (follow-up) of the national great vision that provides the policy direction in the short term, middle term and long term. As a state that has high competitiveness, Singapore has the vision of “Singapore 21” which outlines the internationalization of the industry to overcome the regions problem and scarcity of resources in Singapore. Malaysia increases the labor-intensive industry orientation and overcomes the income disparity between the ethnic groups through “Vision 2020”. A comprehensive economic reformation in Vietnam is done through the policy of Doi Moi (renovation). The economic structure increase for the economic recovery in Korea is supported by the vision of development by knowledge based economy. And Japan performs the environment adaptation through Evolution of Japanese industries, besides it also has started to revise the labor policy that enables the flow of foreign labor into Japan.

Several issues/problems resolved through the policy to attract foreign direct investment in Japan, Singapore, Korea, Malaysia, China and Vietnam generally include:

- Stable national social, political and economic condition which can support the business development and growth
- How to achieve the administrative system of foreign investment which is suitable with the international standard or support the global integration promotion;
- The necessity of incentive to encourage the entrance of foreign direct investment and development of local industry;
- How to overcome the many contact points, red tape, delay, and many informal cost;
- Provision of infrastructure
- Design a labor policy, which guarantee a harmonic relationship between the companies, labor, and the government (tripartite).

While several negative impacts that are resolved include:

- The possibility of establishing small companies which are not efficient and are not able to encourage the development in the state or local regions comprehensively;
- The existence of branch companies (subsidiary companies) of MNC in host countries is only an extension of the parent companies instead of economic growth engine in the local countries;
- MNC tends to introduce the types of technology is not appropriate and tends to destroy the development of the indigenous technology. The MNC also performs capital-intensive production techniques that cause unemployment in the host countries. With the pretext of growth and efficiency, the MNC tend to prefer capital intensive instead of labor intensive.

In general, the sample countries indicate similarity in the policy steps in liberalizing the investment policy, provision of various incentives, and development of infrastructure with varied achievement level. However, there are several special steps (that have comparative advantage vis-à-vis Indonesia) that have become the success factor of Japan, Singapore, Korea, Malaysia, China and Vietnam in attracting the foreign direct investment and empower the local resources. Several policy approaches can be seen in the following table.

Policy Approach	State
1. Clarity of vision/ policy direction	Cases: Vision 2020 Malaysia, and Vision of Doi Moi Vietnam
2 Political, economic and social stability that is established due to the involvement of the whole components of development stakeholders (government, society, political elite, and business sector) in achieving the policy vision.	Case: Achievement of collective vision towards the best from the best in Singapore.
3. Special incentive for research development and development which encourage the local potential and the growing small and medium local industries.	Cases: R&D allowance in Singapore; SMIDEC in Malaysia; and Loan guarantee through the development fund for industrial structure in Japan
4 The management of the relationship between business sector, the government, and the education institution in developing top priority research	Korea
5 Efficiency in FDI administration through:	
- One-stop service and is supported by ombudsman system and home's doctor to guarantee prime service effectiveness	One-stop service through KISC in Korea
- One-stop service and supported by Electronic public services (EPS)	One-stop service through Economic Development Board in Singapore
- Blue print of Public Service for 21 <sup>st</sup> Century to provide prime quality service	
6 The government maximum level (ceiling) of composition of foreign workers	Singapore
7. Foreign workers are employed in business sector which is lack trained local workers	Malaysia, and Vietnam
8 The necessity for foreign companies to provide training for local workers that the workers composition is a multi-racial composition	Malaysia
- The work period of the foreign workers is limited	Vietnam
9 Facilitate the absorption and diffusion of technology and managerial ability and increase the structure of Singapore industry through education and training to produce the availability of trained/skilled workers.	Singapore
10 Facilitate the management of industrial relationship between large, small and medium industry through SMIDEC	Malaysia
11 Encourage equity ownership by local businessmen	Malaysia
12 Facilitate the credit guarantee for development of small and medium business	Japan
13 Privatization of large infrastructure projects such as road, plantation, airport, provision of electricity,	Malaysia

	telecommunication, rail transportation, and port	
14	Harmonic industrial relation between businessmen, labor and the government	Singapore

In the context of Indonesia, before the reformation and autonomy era, the investment policy referred to GBHN (Outline of State Policy), in which it is stipulated basically that *foreign direct investment* plays the role as a complementary to the domestic investment which is the host in its own house. However, after the reformation and autonomy era, and the increasing dependency of Indonesia towards international assistance, and especially with the globalization era, such a policy has shifted, in which there is a tendency for Equal Treatment between Foreign investment (PMA) and domestic investment (PMDN) that the foreign investment is treated equal with the domestic investment in provision of investment facilities which still applied.

In its implementation, the steps to increase the regional economy through the entrance of FDI are facing the following problems:

- The lack of clarity of the investment policy, especially related to the local human resource empowerment. The promotion and foreign investment activities in the regions have not become an entity in the planning dimension at the level of Regency or Municipality. This condition has caused several cases, such as:
  - a. The objective/targets to be achieved tend to exploit natural resources. This among others is indicated by the involvement of several investment companies in exploitation of mining resources that tend to deplete non-renewable resources.
  - b. The tug of war between investment authority between the central and the regions. In such a constellation, generally the central government will be in favor because of the centralistic/hegemonic power.
  - c. People do not feel the side effect of the investment. This among others is indicated by the strong hegemony of the foreign investment in utilizing the internal natural resources to exploit the mining in East Kalimantan without giving opportunities for the local businessmen in a related business cooperation (backward linkage). Besides, the foreign investment companies focused more on the technology intensive industry that the local resources are not much absorbed.
  - d. Many cases of local land acquisition that is done by force by the government and the local people question the land that has certified again.
  - e. The supervision towards the use of spatial/regions and its allocation is still unresolved.
- Some city governments do not have quantitative and qualitative data regarding the foreign investment that such agencies cannot design the policy scenario related to the foreign investment. This condition also shows that the cooperation that should be developed between the city government and the investment service provider (BPID, Sucofindo, central government, and KAPET) has not existed. Besides, the lack of initiative from the stakeholders to develop the data based in the regency/city level.
- The permit procedures still faced the following problems:
  - a. There is still overlapping of authority in giving permits or procedure between the central government (BKPM) and the BPM of Batam City.
  - b. The investment administrative system applied tends to be complicated, needs longer time, and charges with hassle cost which has indefinite amount.
  - c. The sub-optimum of One-stop service application that is due to a strong sector ego.

- BKPM has not fully become a strategic institution which can attract investors because the major functions of the Investment Coordinating Board (BKPM) which until now is taken over by technical department. Now BKPM only acts as institutions that only give permits for foreign investment (PMA). While other major functions such as provision of convenience and facilities or incentives is performed by technical department.
- The tax incentive still becomes the constraint for the investors, especially foreign investors. This among others indicated with the elimination of tax holiday that is converted into tax reduction.
- The lack of facilities/infrastructure as a support of the investment, such as transportation and telecommunication.
- Several foreign investment policy problem related to the regional autonomy, namely:
  - a. The city government does not have clear Government Regulation and faced the ambiguous central government policy; on the other hand the city government does not have initiative to take concrete steps, which means they still for the clarity.
  - b. The regional government is considered as very low in following the development in the business world (in the sense the investors as the business players)
  - c. With the application of the regional autonomy Law, the whole structural official in the regions (governor, mayor, etc) is very difficult to be coordinated. Similarly, such things also occurred in investment, all parties feel that they have more rights over the fund in their region. Actually all of them should be in cooperation in a synergic way for the welfare of all in which the central government plays the role as balancing power.
  - d. The emergence of taxes or new retribution imposed on the businessmen. The regional government takes such a step to increase their Regional Original Revenue
- There is lack of involvement of the people in formulating the policy.

## 2. Recommendations

In order to overcome the problems above, the Indonesian government needs to take the following steps:

- The government, both the central and regional government, needs to uphold the democracy and consider the economic distribution. This needs to be done in several things. First, in determining the investment policy direction; second, in studying carefully various structural adjustment program and letter of intent from IMF.
- Seek consultation from the NGOs, labor, urban poor, students, and household mothers to discuss the impact of globalization. Indonesia has been an opened economy for a long time, and it is impossible to close the market. Rejecting the entrance of foreign capital, means that Indonesia is exposed to the boycott its products abroad. Therefore, the policy that the government takes is to make the globalization as much as possible beneficial for many people.
- To make the target/objectives is clearer in order to attract the foreign investment, that the entrance of the foreign investment massively is not only advantageous for the foreign investors/companies, but also provides various benefits for the local people. The clarity of objective or target is highly needed at the national and local level.

- The foundation of the policy which determines the direction, the sector, and what economic activities that the stakeholders must take and the investment that should be invested, needs to be formulated.
- BKPM/D or similar agencies must have the role and become a strategic institution that has authority to give facilities to the investors. With the role, the institution can establish a better relationship with investors that they will not escape, but come and expand their business into Indonesia.
- The efficiency of FDI administration system through one-stop service and is supported by ombudsman system and *home's doctor* and Electronic Public Services (EPS) to guarantee the effectiveness of prime service; The platform of public service vision which is formulated to develop commitment of public servant in providing prime services.
- Determination of FDI policy commission to consider and prepare decision related to the following problems: basic policy and the affairs related to FDI regime; the affairs in increasing the climate and FDI environment; the affairs related to the criteria for tax reduction/ exemption for foreign investment companies; the affairs related to the cooperation and reconciliation of opinions and conflicts between the central government and municipalities related to FDI; the affairs related to the appointment and support of the regional government efforts in attracting the FDI; and other important affairs in attracting the FDI.
- Promote a special incentive for development of research and development that encourages the development of local potential and the growth of local industries especially small and medium industries.
- Determine the maximum (ceiling) of the foreign workers composition.
- The foreign companies are required to provide training for the local workers that the workers composition will become multi-racial composition.
- Facilitate the absorption and diffusion of technology and managerial ability and increase the Indonesian industry structure through education and training to produce the availability of trained/skilled workers.
- Facilitate the management of relationship between large, small and medium industries in certain institution.
- Encourage the ownership of equity (shares) by the local businessmen.
- Develop investment database system that connects the central and regional government.
- Provide training regarding investment policy management that involved the stakeholders especially in the regions.
- The management of authority in a synergic relationship and not counterproductive between one agency with the others.
- Reformulation the taxes and new retributions imposition to the businessmen that it does not only increase the PAD (Regional Revenue) but also support the business sector.
- Letter of intent must be changed drastically. The parts which do not directly affect the financial recovery must be eliminated. The structural adjustment program must be changed, that the foreign capital flow will be controlled. The government, together with the people, prepares the regulations, that the operation of private foreign companies can be started when "the level of playing field" has been achieved.
- Indonesia should remain to apply opened economic policy. However, various regulation instruments should have been made, that the domestic business

especially in agriculture and industry could compete fairly. The business retail such as Carefour, Tesco, etc, should be let to operate but should be limited and placed in a location that is not for domestic business.

- Foreign direct investment to various regencies and cities should be done after a well-negotiated decision between the local government and DPRD. Besides, the Indonesian labors compete fairly with the foreign labor which seeking the job vacancies in Indonesia.

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