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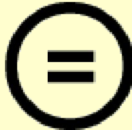

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國際學碩士 學位論文

Analyzing Indonesia's Competitiveness for a Sustainable Growth:

An Investment Policy Analysis

지속적 성장을 위한 인도네시아 경쟁력의 분석

투자정책의 분석

2012年 8月

서울大學校 國際大學院

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무티아라 베이비 아드메이나스티

Analyzing Indonesia's Competitiveness for a Sustainable Growth:

An Investment Policy Analysis

A thesis presented by

Mutiara Baby Admeinasthi

A dissertation submitted in fulfillment of the requirements for the degree of Master of International Studies in the subject of International Commerce

Graduate School of International Studies

Seoul National University

August 2012

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위원장 이영섭___________(인)

부위원장 안덕근___________(인)

위원 문휘창___________(인)

The Graduate School of International Studies,
Seoul National University

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An Investment Policy Analysis

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Contact Number:
Author: Mutiara Baby Admeinasthi
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Abstract

Analyzing Indonesia's Competitiveness for a Sustainable Growth:
An Investment Policy Analysis

Mutiara Baby Admeinasthi
International Commerce
Graduate School of International Studies
Seoul National University

Indonesia's economic growth has always been the lowest among its neighboring countries. To boost its economic growth, Indonesian government tried to provide a supportive investment climate by amending a previously stricter investment policy with an expectation that a higher amount of Inward Foreign Direct Investment (IFDI) would boost its economic growth. However, up until five years after the law was amended, Indonesia's IFDI remains low compared to its neighboring countries. This study aims to observe strengths and weaknesses of Indonesia's competitiveness in attracting IFDI and examining whether the amendments of Indonesia's Investment Law increase Indonesia's competitiveness. The study shows that Indonesia's current status of strength and weaknesses had been increasing after the year of the amendments. However, there is a tendency that the low IFDI receipt might not due to the amendments.

Keywords: Indonesia, Investment Law, Policy Analysis, Competitiveness, Diamond Model, FDI

Student ID.: 2010-24186

Table of Contents

Abstract V

Table of Contents VI

Figures VIII

Tables IX

1. Introduction 1

2. Literature Review 7

3. Analytical Tools 12

3.1 Us: Country Perspective 12

3.1.1 Diamond model. 13

3.2 Them: Company's Perspective 14

3.2.1. The OLI paradigm 14

3.2.2. The imbalance theory 15

3.2.3 Determinants of FDI 16

4. Analysis 17

4.1 Comparison of Indonesia's Diamond Before and After the Amendments 18

4.2 Comparison between Neighboring Countries 21

4.3 The Amendments of Indonesia's Investment Policy 24

4.4 Are the Amendments Positively Affects? 26

4.5 Comparing Policies 28

4.5.1 Policies that governs 28

4.5.2 Alien defined 29

4.5.3. Foreign investment defined 30

4.5.4. Business subject to restrictions 31

4.5.5. Visa and immigration 32

4.5.6. Minimum capital requirement 32

4.5.7 Exemptions 33
4.5.8 Form of business organization 35
4.5.9 Alien employment 36
4.5.10 Foreign exchange/currency control 37
5. Conclusion 40
References 41
국문초록 47

Figures

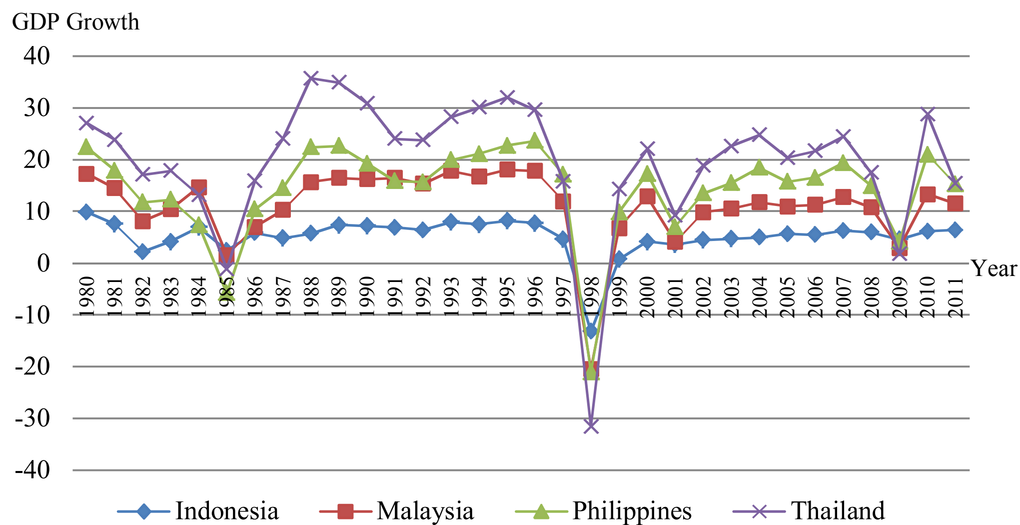
Figure 1-1 GDP Growth 1
Figure 1-2 Foreign Direct Investment, Net Inflows (BoP, Current US$) 2
Figure 1-3 Foreign Direct Investment, Net Inflows (% of GDP) 3
Figure 2-1 Indonesia's Key Attractiveness Survey Result 11
Figure 3-1 Diamond Model 14
Figure 4-1 Factors Analyzed in Diamond Framework 18
Figure 4-2 Indonesia's 2006 and 2010 Diamond Comparison 20
Figure 4-3 Diamond Comparisons between the Four Countries 22
Figure 4-4 Comparison between Indonesia and Average of the Three Countries 23

Tables

Table 1-1 Comparison of Law No. 1 of 1967 and Law No. 25 of 2007 5
Table 2-1 Studies Comparing Foreign and Domestic Plant in Indonesian Manufacturing 8
Table 2-2 Studies on Spillovers from FDI in Indonesian Manufacturing 9
Table 2-3 Factors Analyzed in Previous Study 10
Table 4-1 Summary of Sub-factors 17
Table 4-2 Comparison of Indonesia's Scores on each Sub-factor 19

1. Introduction

Indonesia has been regarded as one of the most promising country in the region. In 1993, Indonesia was regarded as “emerging tigers” along with Malaysia, Thailand, and Philippines for their rapid growth in World Bank published report titled “East Asian Miracle” (Page, 1994). Indonesia outperformed its neighboring countries and, along with China and India, regarded as the only G20 member countries that posted growth during 2007-2009 crises because of its heavy reliance on domestic consumption. That is why in 2009 Morgan Stanley said that Indonesia’s economic growth may accelerate to 7% starting in 2011, providing a case for its inclusion in the so-called BRIC (Ghosh, 2009). However, despite Indonesia's expected high growth rate, its actual Growth Domestic Product (GDP) growth is relatively low compare to its neighboring countries.

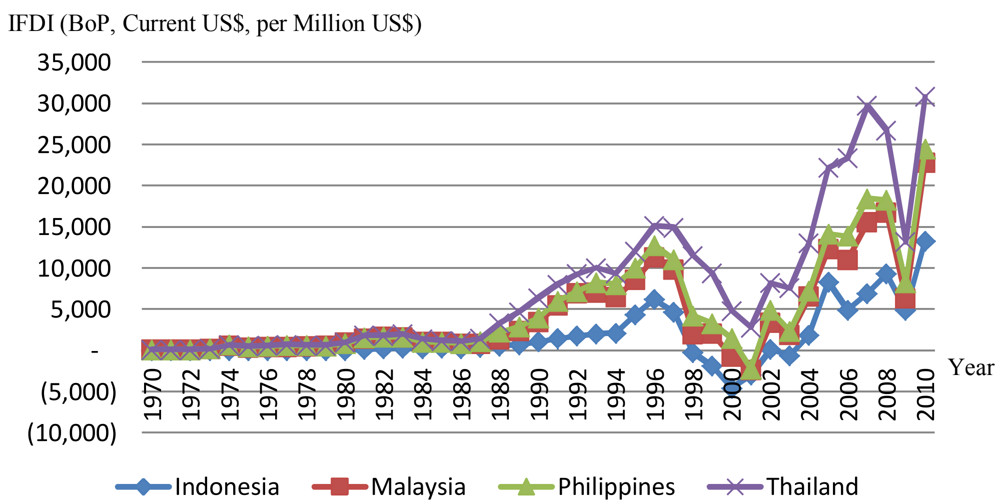


Source: IMF (2012)

Figure 1-1 GDP Growth

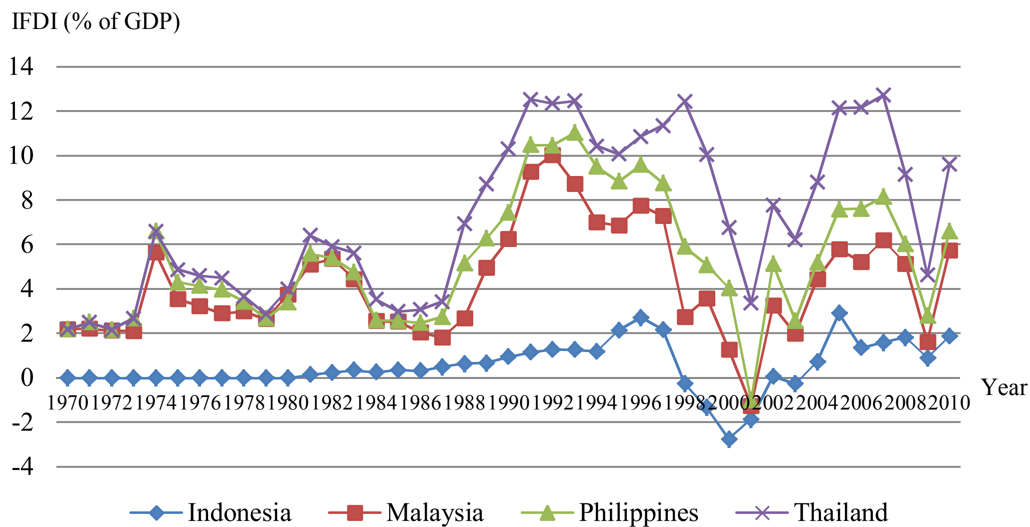
Classic economic theory stated that a country's GDP is formed by summing up domestic consumption, investment, government expenditures, and net export. According to Bark and Moon (2007), Ito and Krueger (2000), Lipsey and Sjöholm (2010), Urata, Chia, and Kimura (2006), and Zhang (2001), instead on relying on consumption, Korea, China, and Japan were vastly grow due to foreign direct investment (FDI) inflow. From that standpoint, since Indonesia has put a heavy reliance on domestic consumption for its GDP growth, Indonesia might consider inviting inward foreign direct investments (IFDI) as one of the ways to be able to accelerate growth.

Historical data shows, Indonesia has always been the lowest among its neighboring countries in terms of IFDI. Compared to its neighboring countries, Indonesia also has not maximizes the potential of growing by relying on investment as much as its other neighboring countries, as shown in percentage of investment to its GDP.



Source: World Bank (2012)

Figure 1-2 Foreign Direct Investment, Net Inflows (BoP, Current US$)



Source: World Bank (2012)

Figure 1-3 Foreign Direct Investment, Net Inflows (% of GDP)

Knowing the potential that IFDI can affects to growth, attracting more IFDI had always been in Indonesian government's interest while forming Law No. 1 of 1967 concerning Foreign Investments, as amended by Law No. 11 of 1970 concerning Amendments and Supplement to Law No. 1 of 1967 concerning Foreign Investments, and Law No. 6 of 1968 concerning Domestic Investments, as amended by Law No. 12 of 1970 concerning Amendments and Supplement of Law No. 6 of 1968 concerning Domestic Investments then replaced with Law No. 25 of 2007 for previous law has no longer being consistent with the need of accelerated national economic enhancement and law development, most notably, in the field of investment.

Some major changes amended the new law involve additional principles (legal certainty, transparency, accountability, equitable, and nondiscriminatory against country of origin, togetherness, sustainability, environmentally sound, independence, and balanced advancement and national economic unity),

assurance that there will be no nationalization and repatriation, longer right of use, leasehold and broking period, investment incentives (fiscal facility, immigration, import license, and expatriate in specific expertise), and simplification of investment procedures. Indonesia's government also decreases its corporate tax rate from 30% to 28% to 25% starting fiscal year of 2010.

With all the amendments, it is expected that investors will see Indonesia more attractive than neighboring countries and increase their amount of investment in Indonesia. By having a higher number of investments, it is expected that Indonesia's economy will be boosted faster.

	Law No. 1 of 1967	Law No. 25 of 2007
Definition of Foreign Capital Investment	*Run the company* in Indonesia	Do *all kinds* of business in Indonesia
Definition of Foreign Investment	Fund that is *utilized for finance an enterprise* in Indonesia	*Limited liability company,* domiciled within Indonesia
Treatment against Investment	-	Equitable treatment
Regarding Nationalization and Compensation	Shall not undertake *a total* nationalization Compensation: agreed upon by both parties	Shall take *no measures* of nationalization Compensation: market value
Regarding Business Sector	The *government determines* the fields of activity open to foreign investment	All business is open except those which are declared to be closed
Regarding Labor	*Allowed* to bring and employ foreign expert which cannot yet be filled by Indonesian nationals Required to gradually replacing foreign employees by Indonesian nationals	*Must give precedence* to Indonesian-national workers Must improve the competency of Indonesian-national workers
Regarding Land Titles	Right of Use: according to needs Leasehold: 50 Years Building Utilization Right: 50 years	Right of Use:140 years Leasehold: 190 years Broking: 160 years
Arrangement of Rights to Transfer and Repatriation in Foreign Exchange	Capital, costs, shrinkage of the means of fixture, and compensation in case of nationalization	Capital, profits, funds required for sustaining business, the sale or liquidation of the investment, income, compensation for damages and expropriation, and sale of assets

Note: The table is compiled based on Law No. 1 of 1967 and Law No. 25 of 2007

Table 1-1 Comparison of Law No. 1 of 1967 and Law No. 25 of 2007

However, unlike what Indonesian government tried to improve, Lipsey and Sjöholm (2010) conducted a research on FDI and growth in East Asia, then came up with three suggestions specifically for Indonesia on how to attract

more IFDI, which with it, multinational firms that can choose between different locations will tend to stay out of Indonesia unless these issues are addressed: good institutions, skilled workforce, and openness to trade. There is only one other suggestion that align with the government's effort, which is on improving business environment and institutions, with attempt to decrease the cost of production (Lipsey and Sjöholm, 2010).

Therefore, this study aims for observing strength and weaknesses of Indonesia's competitiveness in attracting IFDI and examining if the amendments of Indonesia's Investment Law (Law No. 25 of 2007) increase Indonesia's competitiveness.

There are two research questions to answer. The first question is what are Indonesia's competitive strengths and weaknesses in terms of foreign direct investment inflow? The second question is has the amendments of Indonesia's Investment Law (Law No. 25 of 2007) increase Indonesia's competitiveness?

The paper proceeds as follows. We first discuss existing literatures on country's competitiveness and reasons why Indonesia has not receive as much IFDI as it expected to receive. We then develop a model fit for analyzing policies related to investment and analyzing Indonesia's current state and forming ideal policies suited. The next session, we compare and contrast Indonesia's ideal policy with its current policy and discussing obstacles and possible solutions. Lastly, we conclude and point to some directions for policy improvements.

2. Literature Review

Studies confirmed that inward FDI contributes to economic development. Dunning (2001) summarizes his work on international business as follow: his Ph.D. thesis found US affiliates were not as productive as their parent companies, but were more productive than their local competitors. He argues that this is due to the ownership advantage of managerially related which to some extent might be transferable across national boundaries. A book edited by Ito and Krueger (2000) titled *The Role of Foreign Direct Investment in East Asian Economic Development* concluded that FDI have been a source of the rapid growth of some Asian countries. Zhang (2001) found that FDI does promote economic growth. However, FDI tends to be more likely to promote economic growth when host countries adopt liberalized trade regime, improve education and thereby human capital conditions, encourage export-oriented FDI, and maintain macroeconomic stability. Urata, Chia, and Kimura (2006) studied that Korea, China, and Japan were vastly grow due to FDI inflow. Bark and Moon (2007) found that FDI plays a more important role than do bank lending and portfolio investment in an economy's sustained and stabilized economic growth.

Studies on effects of IFDI in Indonesia, as summarized by Lipsey and Sjöholm (2010) tend to have favorable results, as shown on Table 2-1 and 2-2 below. The first table is a summary of studies on Indonesia's manufactures owned by foreign firms compared to those owned by domestic firms. The main result on those studies shows that productivity of foreign-owned manufactures is high, have high export-intensities, and pays high wage. The second table shows that foreign investments share positive spillovers on several factors, such as value added per employee, growth in value added per employee, wage, and

output. All those studies were conducted in Indonesia, showing that foreign investments are in fact favorable to increase our competitiveness, therefore inviting more foreign investments are expected to bring us more favorable outcomes.

Author(s)	Year	Dependent Variable	Main Result
Takii (2004)	1995	Productivity	Foreign Firms have high productivity
		Total Factor Productivity	Wholly foreign owned relatively high, new foreign firms relatively low productivity.
Takii and Ramstetter (2005)	1975-2001	Labor Productivity	Foreign firms have high productivity The difference varies by time and industry
Okamoto and Sjöholm (2005)	1990-95	Total Factor Productivity	Foreign firms have high growth
Arnold and Javorcik (2009)	1983-1996	Total Factor Productivity	Foreign Acquisitions of domestic plants increase productivity
Ramstetter (1999)	1990; 1992; 1994	Export, Export Intensities	Foreign firms have high export intensities
Sjöholm (2003)	1996	Export	Foreign firms relatively able to start export
Sjöholm and Takii (2008)	1990-2000	Export	Foreign firms relatively able to start export
Lipsey and Sjöholm (2004a)	1996	Labor Market Wages per Employee	Foreign firms pay high wages
Lipsey and Sjöholm (2006)	1975-1999	Wages per Employee	Foreign firms pay high wages
Lipsey and Sjöholm (2010)	1975-2005	Growth in Employment	Foreign firms have high growth in employment

Source: Lipsey and Sjöholm (2010)

Table 2-1 Studies Comparing Foreign and Domestic Plant in Indonesian Manufacturing

Author(s)	Year	Dependent Variable	Main Result
Blomström and Sjöholm (1999)	1991	Value added per employee	Positive spillovers
Sjöholm (1999a)	1980; 1991	Growth in value added per employee	Positive spillovers
Sjöholm (1999b)	1980; 1991	Growth in value added	Positive spillovers
Todo and Miyamoto (2002)	1995-1997	Value added per employee	Positive spillovers
Lipsey and Sjöholm (2004b)	1996	Wages per employee	Positive spillovers
Takii (2005)	1990-1995	Value added	Positive spillovers
Blalock and Gertler (2008)	1988-1996	Output	Positive spillovers
Temenggung (2008)	1975-2000	Output	Positive spillovers
Blalock and Gertler (2009)	1988-1996	Output	Positive spillovers
Takii (2009)	1990-1995	Value added, wages	Positive spillovers

Source: Lipsey and Sjöholm (2010)

Table 2-2 Studies on Spillovers from FDI in Indonesian Manufacturing

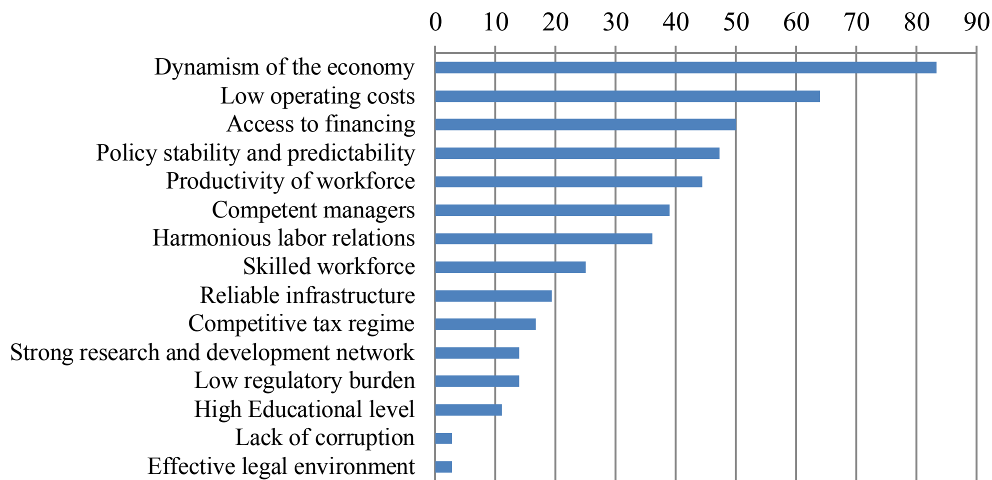
As previously mentioned, Indonesian government is well aware that attracting more IFDI will suit Indonesia's interest. Therefore, in 2007, Indonesia's Investment law was amended in order to attract more IFDI. However, even after five years passed after the amendment, Indonesia's IFDI still low. As below tables illustrate, Lipsey and Sjöholm (2010) provided some guidelines for Indonesia to improve its investment climate. These sub-factors will be used for this study's analysis.

Physical Factors	Sub-factors	Indonesia's Position in attracting FDI, according to Lipsey and Sjöholm (2010)
Factor Conditions	Worker	Education Level: Poor
Demand Conditions	-	-
Related and Supporting Sectors	Infrastructure Control of Corruption	Rank 96 out of 133 2.8 out of 10 (perceived high level of corruption)
Strategy, Structure, and Rivalry	Openness Ease of Doing Business Tariff and Taxes	Some business field are restricted Rank 122 out of 183

Note: The table is a compilation of factors analyzed in Lipsey and Sjöholm (2010), put in diamond model by Porter (1990)

Table 2-3 Factors Analyzed in Previous Study

Another study conducted and stated in the IMD World Competitiveness yearbook 2011 shows key attractiveness factors of Indonesia's Economy according to respondents of the Executive Opinion Survey. As below figure shows, three of the most important key attractiveness to do business in Indonesia according to the respondents are dynamism of the economy, low operating costs, and access to finance. The figure also shows that competitive tax regime and corruption are not attracting as much as high productivity of the labor and skilled workforce. Therefore, this study will include productivity and skilled workforce as sub-factors to be analyzed.



Source: IMD (2011)

Figure 2-1 Indonesia's Key Attractiveness Survey Result

Since the study by Lipsey and Sjöholm (2010) do not provide us guidelines on analyzing the demand conditions, for the demand condition, this study follows a paper by Moon (2005) on Economic Cooperation between Vietnam and Korea through Foreign Direct Investment, which assessed three sub-factors: population size, income level, and demand sophistication. The paper comprehensively describes Vietnam's attractiveness to Korean investors.

All the studies on Indonesia's relation to FDI have given us a lot of information. However, the lack of proper framework on the previous studies resulted in scattered and incomplete analysis on Indonesia's true condition. This study will combine all the three studies mentioned above to be used as the sub-factors to complement the previous studies and put it in a sufficient framework.

3. Analytical Tools

An effective policy is a policy which is able to drive all related actors to the direction in which favorable to the policy maker. In composing FDI policy, there are two major actors: *us* and *them* (Reich, 1990, 1991). As Reich defined in his “Who is *them*?” article, *them* is global managers who want to increase their world market shares, profits, and share prices. *Us* are citizen of a particular nation, want to secure national wealth and national economic well-being. Since those who form policies are governments, in this regard *us* refers to the government.

3.1 Us: Country Perspective

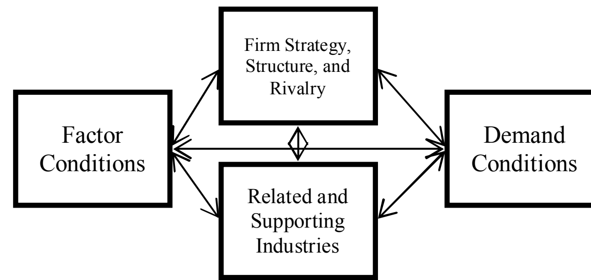
To make a policy effective, there are two questions that policy makers have to answer. The first question is what do we want from the investment made by foreigners? The second question is what do we have to offer? The answer for the first question is usually provided in Principles and Purposes articles in countries’ existing investment law. As for Indonesia’s Investment Law No. 25 of 2007, it is provided in Chapter II: Principles and Purposes.

For the second question, there are so many scholars tried to answer this question by studying developed countries’ experiences (Porter, 1990), developing countries with unique characteristics, such as Korea (Cho, 1994), Korea and Singapore (Moon, Rugman, and Verbeke, 1995, 1998), etc. The outcome of their studies are models the proposed to assess countries’ competitiveness.

3.1.1 Diamond model.

Diamond model is an approach to analyze one country's competitiveness, developed by Porter (1990). As stated in his paper, he conducted a four-year study of ten important trading nations: Denmark, Germany, Italy, Japan, Korea, Singapore, Sweden, Switzerland, the United Kingdom, and the United States. Together, the ten nations accounted for fully 50% of total world exports in 1985.

The diamond model highlights four determinants that determine one country's competitiveness. They are factor conditions (FC); demand conditions (DC); related and supporting sectors (RSS); and strategy, structure, and rivalry (SSR). Factor condition is the nation's position in factors of production, such as skilled labor or infrastructure, necessary to compete in a given industry. Demand condition is the nature of home-market demand for the industry's product or service. Strategy, structure, and rivalry is the conditions in the nation governing how companies are created, organized, and managed, as well as the nature of domestic rivalry. Related and supporting industry is the presence or absence in the nation of supplier industries and other related industries that are intentionally competitive. Aside from the four main factors, Porter also added government and chances as external factors that also affect one country's competitiveness.



Source: Porter (1990)

Figure 3-1 Diamond Model

To have an exact interpretation from the tools we use to analyze, first we need to select key characteristics of the country we want to analyze and put them into suitable factors required in the model, thus we can define exactly what we have to offer investors. This model will be used as this study's analytical tool.

3.2 Them: Company's Perspective

The all-time question for *them* is: what makes them invest abroad? Several scholars have tried to answer this question. The OLI Paradigm and the Imbalance Theory are two of the most famous theories on answering the question.

3.2.1. The OLI paradigm

The OLI Paradigm by John Dunning is best known as the most popular theory of FDI. Dunning (1976) provided a frame work to identify and evaluate the significance of explanatory factors influencing FDI. He called it the eclectic or OLI Paradigm. This paradigm has three explanatory elements: ownership advantage, location advantage, and internalization advantage. As summarized in Moon's (2004) *the evolution of theories of foreign direct investment*, Ownership Advantage (O) is an advantage an MNC should posses to compensate the cost

of foreignness. There are three types of ownership advantages: those which stem from the exclusive privileged possession of, or access to, particular income generation assets; those which are normally enjoyed by a branch plant compared with a *de novo* firm; and those which are a consequence of geographical diversification or multi-nationality *per se.* in 1988, Dunning also distinguished between the *asset (Oa)* and *transaction (Ot)* advantage of the MNC. Location Advantage (L) is immobile factor endowments, or other intermediate products, in host countries. The location decisions for foreign activities are made by multinational firms based on the purpose of enlarging or exploiting their already existing firm-specific advantages or ownership advantage (Dunning, 2001). Lastly, Internalization Advantage (I) is a response to a transactional market imperfections. The greater the perceived costs of transactional market failure, the more MNCs are likely to exploit their competitive advantages through international production, rather than by contractual agreements with foreign firms.

3.2.2. The imbalance theory

The Imbalance Theory was first introduced by Moon in 1988 and Moon and Roehl in 2001. This theory modifies and extends the OLI Paradigm and explaining the motivation of FDI with either ownership advantages or disadvantages. That is, FDI depends not only on the surplus factor (ownership advantage) but also on the deficient factor (ownership disadvantage). In another words, the imbalance theory propose that firms would invest abroad to gain access to strategic assets.

3.2.3 Determinants of FDI

According to Behrman (1972), there are four different objective of FDI: resource seeking, market seeking, efficiency seeking, and strategic/asset seeking. Botric and Skuflic (2006) defined FDI determinants as host country's economic policy, economic performance, and attractiveness. They found positive relations between country's inward FDI and those three factors which desegregated into size and growth potential of a nation's economy, natural resource endowments and quality of workforce, openness into international trade and access to international market, quality of physical, financial, and technological infrastructure. There are so many other studies defining other determinants of FDI. However, to limit the scope of the analysis, we will use only factors mentioned in above study to answer the question *what makes them invest abroad?*

4. Analysis

The first part of this chapter will discuss about the sub-factors used, the data sources, and the methodology used to conduct this study. Combining the three studies mentioned in chapter two, below is the summary of sub-factors that are going to be studied in this paper.

Diamond Factors	Sub-factors
Factor Conditions (FC)	Worker's Productivity Educational Level Professionals, Managers, Engineers Research and Development Budgets
Demand Conditions (DC)	Population Income Level Consumer Sophistication
Related and Supporting Sectors (RSS)	Ease of Doing Business Corruption Perception Index Infrastructure Financial Accessibility
Strategy, Structure, and Rivalry (SSR)	Corporate Tax Investment Facilities and Protections for Competitions

Table 4-1 Summary of Sub-factors

The data was gathered from CIA World Factbook (2012), U.S. Department of States (2008), IPS National Competitiveness Research Report 2006, IPS National Competitiveness Research Reports (IPS, 2006, 2010), U.S. Bureau of Economic Analysis (U.S. BEA, 2010), World Bank (2010), World

Bank's (2011) Doing Business, Tax Rates (2006, 2010), Transparency International (2011), and Country Reports on Human Rights Practices (U.S. Department of States, 2006, 2008).

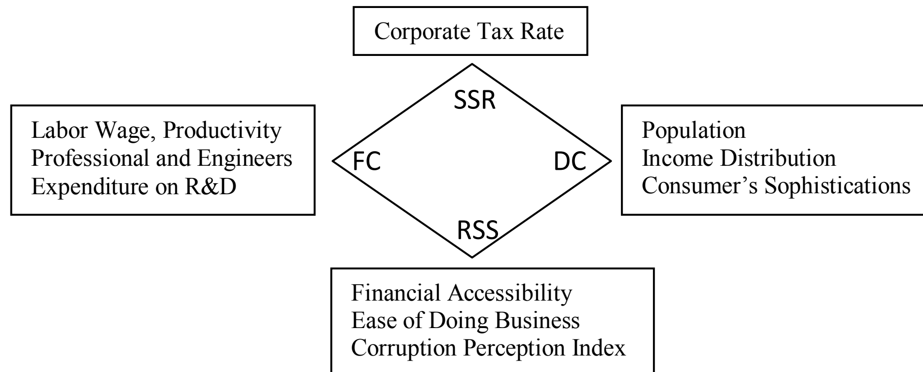


Figure 4-1 Factors Analyzed by Diamond Framework

The methodology use in this study is comparative methodology. The units of analysis are the countries (Indonesia versus Neighboring countries), and the situation before amendment versus after amendment. Sub-factors chosen affect the shape of the diamond. For the factor condition, this study is focused on the human factors rather than both human and natural resources because the focus of the amendments is the increase of human factor quality (Chapter II art. 3.2 d, e.).

4.1 Comparison of Indonesia's Diamond Before and After the Amendments

Below is the table that shows comparison of Indonesia's scores on each sub-factor before and after the amendments. The last column is the weight of each sub-factor, divided evenly on every sub-factor in each factors. Based on

data on the table, the diamond is calculated. The basis of the calculations is the best score. For example, bigger gross annual wage salaries are used as the denominator for the calculation. Smaller scores are used as the denominator in Gini Index, corporate tax, and ease of doing business rank. Then, the result is timed by the weight.

	Sub-factors	2006	2010	Weight
FC	Gross Annual Wage (US$)	1092	1476	0.20
	Labor Productivity Score	5.76	4.76	0.20
	Number of Scientist and Engineers per Million People	182.00	205.33	0.20
	Government Expenditure on R&D as a Percentage of GDP	0.00	0.04	0.20
	Business Expenditure on R&D as a Percentage of GDP	0.00	0.01	0.20
DC	Total Population	229,918,547	248,216,193	0.33
	Gini index 2010	37.58	36.8	0.33
	Overall Customer's Satisfaction Index	5.78375	7.128	0.33
RSS	Ease of Doing Business Rank	115	129	0.14
	Corruption Perception Index 2010	2.30	2.80	0.14
	Paved Road Density (% of Total Roads)	58.00	55.40	0.14
	Annual Investment in Communication (US$ Million)	1703.26	3516.6	0.14
	Access to Loans	4.23	5.44	0.14
	Venture Capital Availability	4.73	5.31	0.14
	Maritime Transport (Container Port Traffic)	2464.00	4,481.38	0.14
SSR	Corporate Tax Rate	30 %	25 %	0.50
	Competition Protection	Yes	Yes	0.50

Table 4-2 Comparison of Indonesia's Scores on each Sub-factor

Compared to 2006 diamond conditions, Indonesia's diamond in 2010 showed improvement in all factors. In 2006, the weighted score of Factor Condition is 92%. Demand Condition's weighted score is 90%. Firm Strategy, Structure, and Rivalry's weighted score is 92%, while Related and Supporting Sector's score is 79%. The change in policy shows the biggest effect in the

Strategy, Structure, and Rivalry factors where Indonesia decided to lowered the corporate tax, as seen in 2010's weighted score on Firm Strategy, Structure and Rivalry which is 100%. Another significant change is also shown in factor condition's sub-factors. In 2006, the score was only 57% but it jumped to 97% in 2010. Although there was a decrease in labor productivity, it was compensated with the significant increase of number of scientist and engineers. Government's efforts to improve financial and real infrastructures have also shown in the increase score of Related and Supporting Sector's factors which increase from 79% in 2006 to 98% in 2010. Lastly, the increase number of population, followed by the enlargement of middle class proportion affect positively to the Demand Condition's condition. The weighted scores rise from 90% in 2006 to 99% in 2010. Below is Indonesia's diamond before and after the amendments.

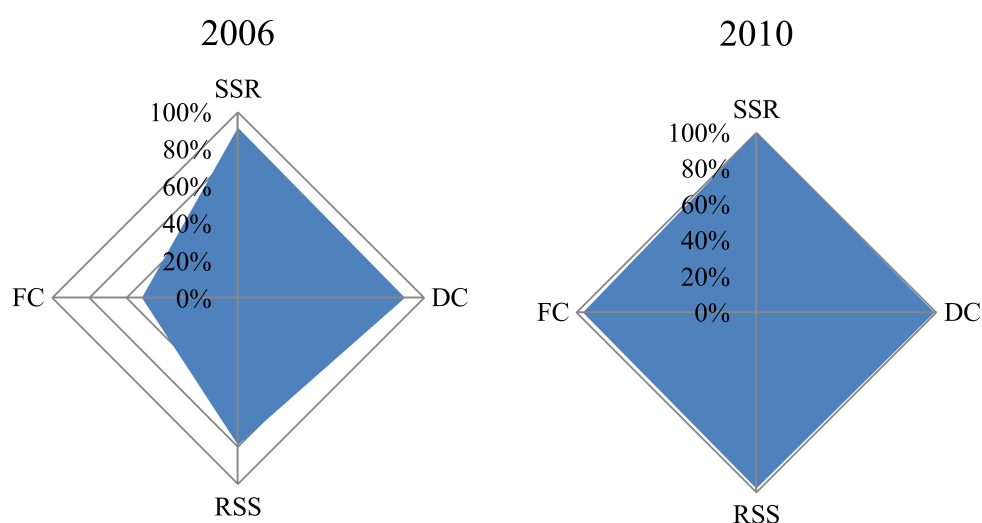


Figure 4-2 Indonesia's 2006 and 2010 Diamond Comparison

4.2 Comparison between Neighboring Countries

Below is the scores of Indonesia, Malaysia, Thailand, and Philippines's scores on each factors. With the same weighting used in comparison of Indonesia's before and after the amendments' diamond, the diamond of each country is calculated.

	Sub-factors	Indonesia	Malaysia	Thailand	Philippines
FC	Gross Annual Wage (US$)	1027	4735	2293	2053
	Labor Productivity Score	4.76	5.05	5.83	6.05
	Number of Scientist and Engineers per Million People	205.33	371.50	310.95	80.66
	Government Expenditure on R&D as a Percentage of GDP	0.04	0.10	0.14	0.05
	Business Expenditure on R&D as a Percentage of GDP	0.01	0.54	0.11	0.07
DC	Total Population	248,216,193	29,179,952	67,091,089	103,775,002
	Gini Index 2009	36.80	37.90	53.60	44.00
	Overall Customer's Satisfaction Index	7.128	6.518	7.038	6.924
RSS	Ease of Doing Business Rank	129	18	17	136
	Corruption Perception Index 2011	3.00	4.30	3.40	2.60
	Paved Road Density (% of Total Roads)	55.40	79.10	98.50	9.90
	Annual Investment in Communication (US$ Million)	3516.60	634.00	1050.00	1310.50
	Access to Loans	5.44	5.41	6.42	4.32
	Venture Capital Availability	5.31	4.76	5.84	4.40
	Maritime Transport (Container Port Traffic)	4,481.38	14,872.84	6,200.42	3,834.62
SSR	Corporate Tax Rate	25%	25%	30%	30%

Table 4-3 Scores of Indonesia, Malaysia, Thailand, and Philippines's Scores on each Sub-factor

Below are the results of the comparison between Indonesia and its neighboring countries. Indonesia has a perfect score for Strategy, Structure and Rivalry factors and Demand Conditions' factors. Malay is also scored 100% in

SSR factor, even though its DC factors only scored 69%. Thailand's SSR scores 83% as well as Philippines, but in DC factors, it outperforms Malaysia and Philippines with the score of 90% whereas Philippines are scored 86%. In RSS factors, Indonesia is scored 64%, way lower than that of Malaysia (94%) and Thailand (79%), but still higher than that of Philippines (41%). As for the FC, all four countries scored low, where among the low, Indonesia scores the highest with 32%, followed by Thailand (27%), Malaysia (26%), and Philippines (25%).

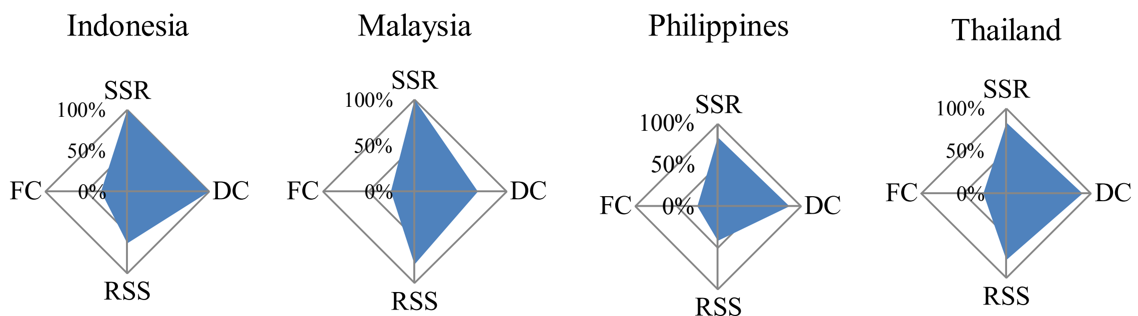


Figure 4-3 Diamond Comparisons between the Four Countries

From the above figure, we can see the comparison of the four countries. However, it is difficult to see whether on the overall Indonesia outperforms all the neighboring countries or not. Therefore, an average of the three neighboring countries is calculated. The result is as follow.

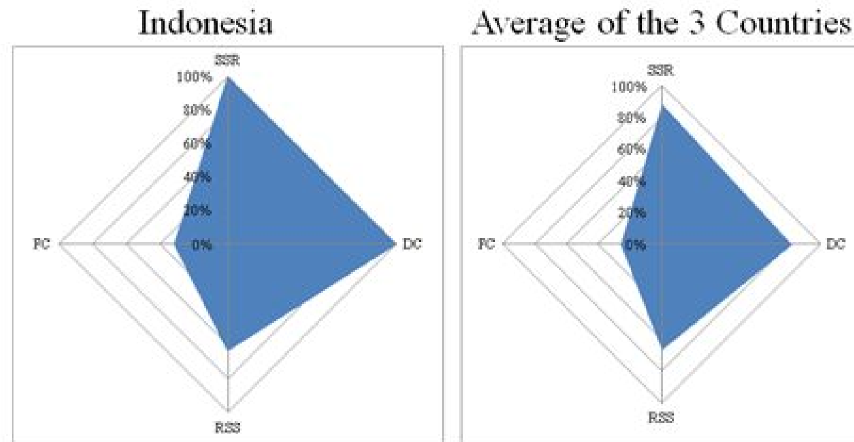


Figure 4-4 Comparison between Indonesia and Average of the Three Countries

As we can see in the above diamonds, Indonesia's factors on factor condition, demand condition, and strategy, structure, and rivalry outperform the average of Malaysia, Thailand, and Philippines. The only factor that Indonesia still lacked from the average of the three countries is the RSS factors, even though only for 3% (Indonesia scored 64% while the average of the three countries scored 67%)

The diamond analysis shows that in overall, Indonesia outperforms its neighboring countries. However, the IFDI level is still the lowest among all. This might be due to the weighting. This study uses the same weight for all the sub-factors in the same factor. This might not properly describe the reality since some sub-factors might appear more important than the other sub-factors. For example, according to the IMD survey that had been mentioned in chapter two, investor put more concern in the level of productivity rather than the low wage level. This differentiation of weighting could not be performed in this study because it need further study to estimate the proportionate weighting.

4.3 The Amendments of Indonesia's Investment Policy

Indonesia has several strength points compared to its neighboring countries. Indonesia's corporate tax rate is among the lowest. Its investment facilities, as will be discussed in the next part of the chapter, are the most attractive for investors. Its huge population defines its potential market and its huge labor market availability. Its financial accessibility index is also among the highest compared to its neighboring countries.

Indonesia also has several weaknesses that the government has tried to fix. To overcome the low number of professional and engineer and also the low expenditure of research and development, and infrastructure, the law stated that the government will give facilities to investors who invest in fields, inter alia, that absorbs many workers, conduct research, development, and innovation activities, transfers technology, is engaged in infrastructure construction, etc. The form of investment facilities may be in the form of relief on taxes, exemption or reductions of taxes, import duties of raw material, capital goods, and so on.

As for the ease of doing business, chapter 12 and 13 of the Law No. 25 of 2007 regulate on simplifications of regulations that the government tried to do, such as one door policy for providing investment services, better central/local coordination, etc. Regarding the labor, since the inflow of investment is increasing, the overall employment was also increasing. Employments in all sectors are increasing, except in Agriculture, Forestry, Hunting and Fishery and Transport, Storage and Communication. However, the increase of employment in Mining industry is lower than that in manufacturing industries. The highest increase of employment is in Finance, Insurance, Business Rental Buildings, Land, and Business Services.

Field of Employment	2007 (%)	2011 (%)	Difference (%)	
Agriculture, Forestry, Hunting, and Fishing	41.24	35.86	↓	-5
Mining and Quarry	1.00	1.34	↑	47
Processing Industry	12.38	13.26	↑	18
Electricity, Gas, and Water	0.18	0.22	↑	37
Construction	5.26	5.78	↑	21
Wholesale, Retail, Restaurant, and Hotel	20.57	21.33	↑	14
Transport, Storage, and Communication	5.96	4.63	↓	-15
Finance, Insurance, Business Rental Buildings, Land , and Business Services	1.40	2.40	↑	88
Community, Social, and Personal	12.03	15.18	↑	38
Total	100	100		

Source: Indonesian Statistics Bureau (2007, 2011)

Table 4-4 Field of Employment in 2007 and 2011

Indicator	2007	2011
Ease of Doing Business Rank	135	129
Starting a Business	161	155
Dealing with Construction Permits	131	71
Registering Property	120	99
Protecting Investors	60	46
Enforcing Contracts	145	156

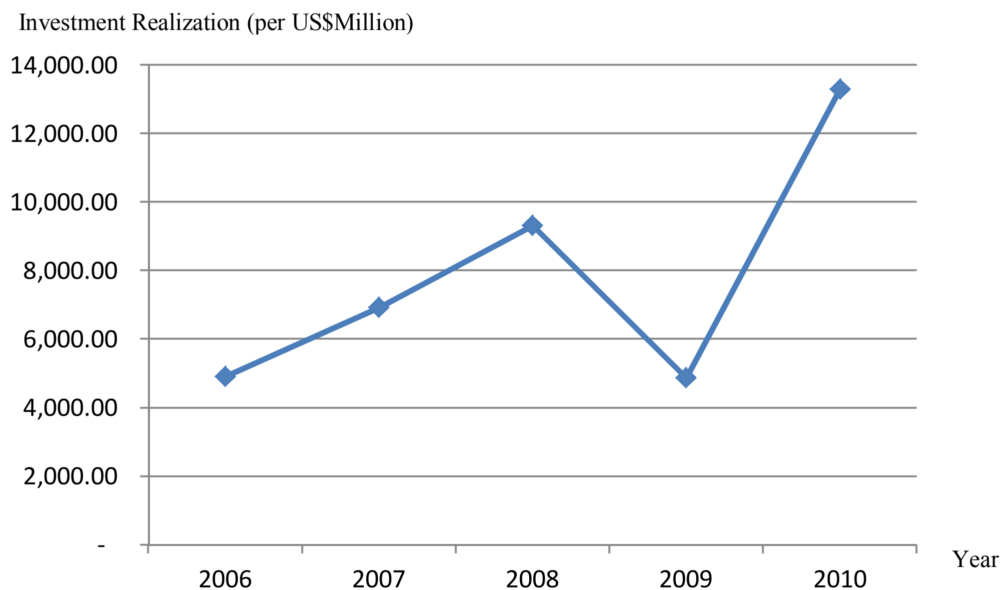
Source: World Bank (2007, 2011)

Table 4-5 Ease of Doing Business Rankings

The rank of ease of doing business related with permit and other government services are lowered. It shows that our position compared to the world is getting better. As for the corruption perception index, even though it is not regulated under the investment law, the overall CPI index is also increase from 2.3 in 2007 to 3 in 2011. This means people perceive the government's performance are getting better and more transparent.

4.4 Are the Amendments Positively Affects?

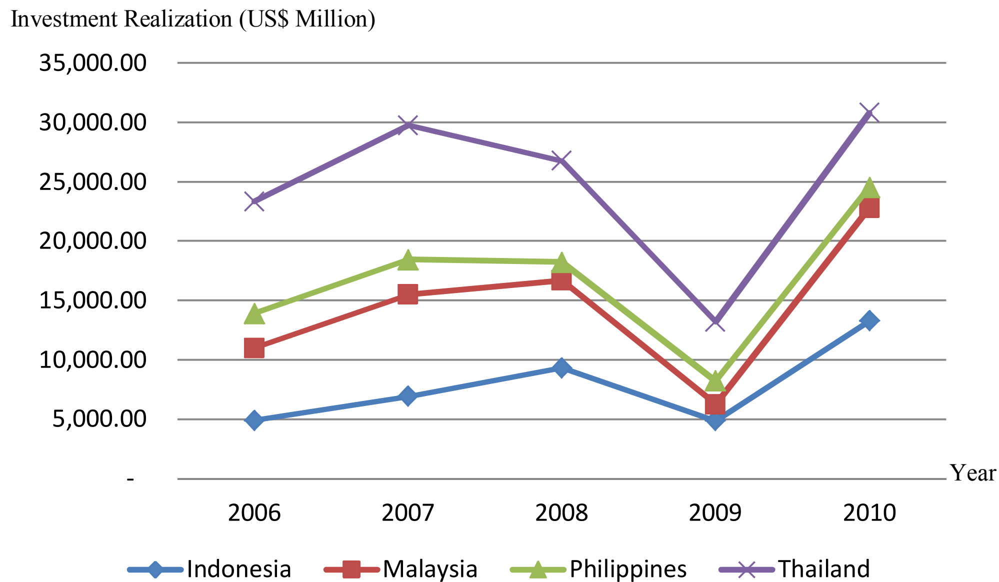
To see whether the amendments are giving the favorable result, below is a figure showing the value of investment realization after the amendments. The value of Investment realization in Indonesia in 2007 was jump by 169.02% from investment realization in 2006. According to Head of Badan Koordinasi Penanaman Modal (BKPM – Investment Coordinating Body), Muhammad Lutfi at the Presidential Office, "Realized investment this year is the highest since 1967 (Indonesia's first Investment Act)," (Wuryanto, 2007, December 18). Below is Indonesia's investment realization in 2007.



Source: World Bank (2012)

Figure 4-5 Indonesia's Investment Realization 2006 - 2010

The Investment realization did increase from 2007-2010, except the fall in 2009 which might be due to international financial crisis. However, the overall trend of IFDI in the region is also the same. Other countries also follow the same trend even though they did not amend their law.



Source: World Bank (2012)

Figure 4-6 IFDI Trend in Neighboring Countries 2006-2010

Thailand uses its Foreign Business act 1999 and Investment Promotion act 1977. Philippines uses its Foreign Investment Act 1991, while Malaysia does not even have laws governing FDI that lay down the general principles and rules for foreign participation in local businesses as in the case of Thailand, Philippines, and Indonesia. This has allowed the Malaysian government maximum policy and regulatory space to screen and control FDI to suit the economic and industrial needs of the particular time. For example, unlike in Thailand, the foreign equity restrictions in Malaysia are not determined by a law. Malaysia only has "Foreign Equity Guidelines" that can be easily changed by the Government. Until 1998, foreign equity share limits were made conditional on performance and conditions set forth by the industrial policy of the time. Therefore the increase of Indonesia's IDFI in the years after the

amendments might not due to the amendments, but due to the regional investment trend.

4.5 Comparing Policies

Every country has its own different focus on the law. Malaysian law focuses a lot on Bumiputera's (Malay people) participation. Indonesia's law focus a lot on liberalizing competition between domestic-foreign big companies (limited public corporation) and growing small-local enterprises, while Thailand accept all kinds of investment with a minimum investment of Baht 2 million in general. Philippines have the most general rule of investment which not has any particular focus. Below is the comparison of Investment policies in the four countries.

4.5.1 Policies that governs

In Thailand, foreign investment policies are governed by Foreign Business Act Buddhist Era 2545 Art and Decree 1999 (Foreign Business Act B.E. 2545 (A.D. 1999)), Alien Employment Act B.E. 2551 (A.D. 1978), Investment Promotion Act B.E. 2520 (A.D. 1977), other various statutes and regulation, such as immigration law, exchange control, import and export regulations, stock exchange regulations, etc. In Indonesia, it governed by Law No. 25 of 2007. In Philippines, it governed by Foreign Investment Act 1991, while in Malaysia, it governed by Foreign Investment Committee (FIC) Guidelines. Malaysia does not have laws governing FDI that lay down the general principles and rules for foreign participation in local businesses as is the case of Thailand, Indonesia, and Philippines. This has allowed the government maximum policy and regulatory space to screen and control FDI to suit the economic and industrial needs of the particular time. For example, unlike in

Thailand, the foreign equity restrictions in Malaysia are not determined by a law. Malaysia only has "Foreign Equity Guidelines" that can be easily changed by the Government. Until 1998, foreign equity share limits were made conditional on performance and conditions set forth by the industrial policy of the time.

4.5.2 Alien defined

In Thailand, an alien is defined as a natural person who is not of Thai nationality; a juristic entity that is not registered in Thailand; a juristic entity incorporated in Thailand with foreign ownership accounting for one-half or more of the total number of shares and/or registered capital; a limited partnership or ordinary registered partnership whose managing partner or manager is a foreigner.

In Indonesia, alien is defined as foreign nationals, business entity, and/or foreign government that make an investment in the territory of the Republic of Indonesia. In Philippines, "Philippine national" shall mean a citizen of the Philippines; of a domestic partnership or association wholly owned by citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least 60% of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines; or a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which 100% of the capital stock outstanding and entitled to vote is wholly owned by Filipinos or a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least 60% of the fund will accrue to the benefit of Philippine nationals: Provided, that where a corporation and its non-Filipino stockholders own stocks in a Securities and Exchange Commission (SEC) registered

enterprise, at least 60% of the capital stock outstanding and entitled to vote of each of both corporations must be owned and held by citizens of the Philippines and at least 60% of the members of the Board of Directors of each of both corporations must be citizens of the Philippines, in order that the corporation, shall be considered a "Philippine national" (as amended by Republic Act No. 8179).

In Malaysia, Bumiputera means: (a) for Peninsular Malaysia, Malay individual or aborigine as defined in Article 160(2) of the Federal Constitution; (b) for Sarawak, individual as defined in Article 161A (6)(a) of the Federal Constitution; (c) for Sabah, individual as defined in Article 161A (6)(b) of the Federal Constitution; foreign company means a foreign company as defined in the Companies Act 1965.

4.5.3. Foreign investment defined

In Thailand, foreign investment is defined as 50% and up of share. A company is considered as a Thai Company: when alien only participate up to 49% in the company. In Indonesia, foreign investment is defined as capital that is owned by a foreign state, a foreign national, a foreign business entity, a foreign legal entity, and/or an Indonesian legal entity, of which the capital is in part of in whole, is owned by a foreign party.

In Philippines, the term "foreign investment" shall mean an equity investment made by non-Philippine national in the form of foreign exchange and/or other assets actually transferred to the Philippines and duly registered with the Central Bank which shall assess and appraise the value of such assets other than foreign exchange. As for Malaysia, Bumiputera's interest means any interest, associated group of interests or parties acting in concert which comprises: (a) Bumiputera individual; or (b) local company or institution

whereby Bumiputera holds more than 50% of the voting rights in the company or institution. foreign interest means any interest, associated group of interests or parties acting in concert which comprises: (a) individual who is not a Malaysian citizen; or (b) foreign company or institution (unless the effective shareholding is stated); or (c) local company or local institution whereby the parties as stated in item (a) and/or (b) hold more than 50% of the voting rights in the company or institution.

4.5.4. Business subject to restrictions

In Thailand, businesses that are subject to restrictions are divided into three classifications: strictly prohibited, prohibited unless permission is granted by the Cabinet, and prohibited unless permission is granted by the Director-General of the Commercial Registration Department (CRD). In Indonesia, production of weapons, ammunition, explosive devices, and armaments; and business sectors that are explicitly declared to be closed by law. (President's Decree No. 96 of 2000 classifies it into 4 classifications: strictly prohibited, prohibited to foreign participation, domestic-foreign venture, or open with certain requirements.

Philippines are quite strict on types of industries that are allowed for foreign investors. The Philippines government then developed a list called Philippines Regular Foreign Investment Negative List A and List B. List A is a list of industries that foreign ownership is limited by mandate of the constitution and specific laws (no foreign equity), while List B is a list of industries where foreign ownership is limited for reasons of security, defense, risk to health and morals and protection of small and medium–scale enterprises, (up to 40% of foreign equity).

In Malaysia, foreign interest is not allowed to acquire: residential unit under the category of low and medium low cost as determined by the State Authority; properties built on Malay reserve land; properties allocated to Bumiputera (Bumiputera quota) in any property development project as determined by the State Authority; stall and service workshop; agricultural land developed on the basis of the homestead concept; and properties gazette under National Heritage Act 2005.

4.5.5. Visa and immigration

Thailand's government will provide investors with visa type B (business), a one-year visa, renewable each year prior to the expiration date. A multiple entry option is available for an extra fee. Indonesia's government provides non-permanent residence permit: two years. Permanent residence permit after resides for two consecutive years. Multiple re-entry permits for non-permanent and permanent resident after reside for four years. Philippines and Malaysia do to state any particular rules on this matter.

4.5.6. Minimum capital requirement

In Thailand, the minimum capital requirement for investment is Baht 2 million in general, Baht 3 million for Classification 2 and 3. Indonesia's Law No. 25 of 2007 does not state any minimum capital requirement to invest in Indonesia. To start investing in Philippines the minimum capital requirement is US$100,000. In Malaysia, foreign interest is only allowed to acquire property other than residential unit valued at more than RM150,000 per unit with no limit on the number of property acquired. Acquisition of commercial property valued at less than RM10 million by foreign interest does not have to incorporate a local company and will be subjected to the commercial property is

only for own use. Foreign interest is only allowed to acquire agricultural land valued more than RM250,000 or at least five (5) acres in area subject to the conditions for acquisition; Acquisition of agricultural land by foreign interest is only allowed for the following purposes: to carry out agricultural activities on a commercial scale using modern or high technology; or to carry out agro-tourism project; or to carry out agricultural or agro-based industrial activities for the production of goods for export. However, for this purpose relaxation on equity condition may be considered. Foreign interest is allowed to acquire industrial land without any price limit and must be registered under a locally incorporated company and will be subjected to the conditions for acquisition and the conditions for foreclosure. Foreign interest including foreign bank and financial institution incorporated outside Malaysia is allowed to acquire property through public auction valued more than RM150,000 per unit other than residential unit and will be subjected to the conditions for acquisition. Foreign interest is allowed to acquire two (2) or more contiguous properties with a total value of RM10 million and above and will be subjected to the conditions for acquisition. Acquisition of an entire building or an entire property development project, valued at RM10 million and above must be registered under a locally incorporated company and will be subjected to the conditions for acquisition. Foreign interest is allowed to acquire land or land with building for redevelopment on a commercial basis. If this acquisition is not meant for own use, it has to be registered under a locally incorporated company and will be subjected to the conditions for acquisition.

4.5.7 Exemptions

In Thailand, there is a Treaty of Amity and Economic Relations between the US and Thailand. Under this treaty, Americans enjoy the privileges of being

exempted from the application of the Act and is permitted to do almost anything a Thai company does except own land, engage in business of inland communications, engage in business of inland transportation, engage in fiduciary functions, engage in banking involving depository functions, exploit land or other natural resources, and engage in domestic trade in indigenous agricultural products. In Indonesia, facility is given for investments that at least meets one of the following criteria: absorbs many workers; falls under a high priority scale; is engaged in infrastructure constructions; transfers technology; is engaged in a pioneer industry; is located in a remote area, a less-developed area, a contiguous area, or another area deemed needy; keeps the environment sustainable; conducts research, development, and innovation activities; is in partnership with micro, small, and medium enterprises or cooperatives; or is engaged in an industry that uses domestically produced capital goods or machines or equipment.

Philippines' investment policy does not clearly states what kind of investment exemptions they provide, while Malaysia has numerous exemptions as follow: acquisition of property valued at less than RM10 million by local interest; Multimedia Super Corridor (MSC) status companies are allowed to acquire any property in the MSC area provided that the property is only used for their operational activities including as residence for their employees; any acquisition of property by companies operating in the approved area in the Iskandar Regional Development and have been granted the status by Iskandar Regional Development Authority (IRDA); any acquisition of property by companies operating in the approved area in any regional development corridor by companies that have been granted the status by the local authority as determined by Government; any acquisition of property by companies which have obtained the endorsement from the Secretariat of the Malaysian

International Islamic Financial Centre (MIFC) provided that the property is meant for own use in carrying out international Islamic financial transaction and the acquisition is a result of Islamic financial financing scheme which is required in order to comply with the Syariah principle only; foreign interest is allowed to acquire residential unit valued at more than RM250,000 per unit subject to approval of the relevant local authorities while "Malaysia My Second Home" Program is to be referred to Ministry of Tourism; transfer of property pursuant to a will and court order; acquisition of industrial property by manufacturing company licensed by the Ministry of International Trade and Industry as well as manufacturing company which is exempted from obtaining manufacturing license for own manufacturing operation; any acquisition of property by Ministries and Government Departments (Federal and State); any acquisition of property by Minister of Finance Incorporated, Chief Minister Incorporated and State Secretary Incorporated are considered to have been approved by the Government; any privatization projects whether at the Federal or State level provided that it involves the companies which are the original signatories in the contracts for the privatized projects; any acquisition of property for own use by local companies that have been granted the status of International Procurement Centre, Operational Head Quarters, Representative Office, Regional Office and Labuan offshore company or other special status granted by the Ministry of Finance, MITI and other ministries; and any acquisition or disposal of property/asset for the purpose of Asset-Backed Securities (ABS).

4.5.8 Form of business organization

Thailand allows sole proprietorship, partnership, limited company, and public limited company. Branches of foreign corporations are also recognized.

Indonesia only allows limited public company. Philippines allows soliciting orders, services contracts, opening offices, liaison offices or branches, appointing representatives or distributors, participating in management, supervision or control of domestic business, firm, entity or corporation, but not investment as a shareholder by foreign entity in domestic corporations duly registered to do business, and or exercise of rights as such investor, nor having a nominee director or officer to represent its interest in such corporation, nor appointing a representative or distributor domiciled in the Philippines which transact business in its own name and for its own account. Lastly, Malaysia allows individual, company or institutions.

4.5.9 Alien employment

Thailand and Philippines's investment policy do not state a clear rules on alien employment. Indonesia's alien employment rules are as follow: (1) any investment companies shall prioritize in recruiting workers those of Indonesian citizen. (2) Any investment companies shall be entitled to use experts of foreign citizen on certain position and expertise in accordance with the rules of law. (3) Any investment companies are required to improve the competence of workers of Indonesian citizen through work trainings pursuant to the rules of law. (4) Any investment companies employing foreign experts are required to provide trainings and transfer of technology to workers of Indonesian citizen pursuant to the rules of law. Malaysia's policy is as follow: Companies must, to the best of their ability, recruit and train Malaysians so as to reflect the country's population composition at all levels of employment.

4.5.10 Foreign exchange/currency control

Regarding foreign exchange/currency control matter, Thailand is very strict on setting the rules. Below are rules on foreign exchange matter in Thailand:

1. Import of foreign currency

   Persons living in Thailand are required to surrender Foreign Exchange received to an authorized dealer or deposit the same in a foreign currency account for 15 days from the date of receipt.

2. Import of local currency

   There is no restriction on the amount of Thai currency that may be brought into the country. Foreign Currency Accounts Thai individual and juristic persons in Thailand are allowed to maintain foreign currency accounts under the following conditions:

   a. The accounts are opened with authorized banks in Thailand and with funds that originate from abroad;
   b. The accounts may be withdrawn either for payments of normal business transactions to persons outside the country upon submission of supporting evidence or for conversion into Baht at authorized banks.

3. Trade

   a. Exports

      Exports are free from any exchange restriction, but export proceeds exceeding Baht 500,000 in value must be collected within 120 days from the date of export and surrendered to an authorized bank or deposited in a foreign currency account with an authorized bank in Thailand within 15 days from the date of receipt.

   b. Imports

Importers may freely purchase or draw foreign exchange from their own foreign currency accounts for import payments. Letters of credit may also be opened without authorization.

4. Permissible Transactions by Authorized Banks

The following transactions do not require prior authorization from the BOT:

a. Foreign direct investments or lending to affiliated companies abroad not exceeding US$5 million per year;
b. Remittances to Thai emigrants with permanent residence abroad not exceeding US$1 million per person yearly provided that funds are derived from the emigrants' personal assets;
c. Remittances of an estate to a recipient who has permanent residence abroad not exceeding US$1 million per person yearly;
d. Remittances of funds to family or relatives who have permanent residence abroad not exceeding US$100,000 per person yearly; and
e. Travel expenses of up to US$20,000.

5. Gold

Generally, sale and purchase of gold are permissible without authorization except the sale or purchase of gold in future markets regardless of

a. whether it is a direct dealing or through a broker, agent or by any other means;
b. whether or not there is a delivery of the gold; or
c. whether the transaction is domestic or overseas.

In Indonesia, investors shall be granted the following rights to transfer and repatriate in foreign currencies, inter alia: capital; profits, bank interest,

dividends, and other income; funds that are needed: to purchase raw materials and components, intermediate goods or finished goods, or to replace capital goods in order to protect the viability of the investments; additional funds that are needed for investment financing; funds for repayment of loans; royalties or fees that are payable; income of foreign nationals who work for an investment company; proceeds of the sale of liquidation of an investment; compensation for damages; compensation for acquisitions; payments made in connection with technical assistance, fees payable for technical and management services, payments related to intellectual property rights; and proceeds of the sale of assets as intended by the law. There are no clear stated rules on this matter in Philippines and Malaysia.

Comparing Indonesia's investment policy with the neighboring countries' policy, Indonesia's investment policy is a lot more attractive than that of other countries. Indonesia imposes fewer restrictions and provides more incentives. The fact that Indonesia's IFDI is still lower than that of its neighboring countries is might be due to the lack of promotion. Therefore, Indonesia still has potentials to invite more FDI by enforcing more promotion. However, this needs further study to discover ways to enhance our IFDI.

5. Conclusion

One of many ways to increase one country's growth rates is by receiving IFDI. Numbers of studies has shown how previous experiences of East Asian Countries receiving higher level of IFDI had resulted in a firm and stable growth. Therefore nowadays many countries try to attract more IFDI to their countries.

The focus of this study is investigating on why despite Indonesia's expected high growth rates, its investment receipt has been relatively low compare neighboring countries. The purpose of this study is observing strength and weaknesses of Indonesia's competitiveness in attracting IFDI and examining if the amendments of Indonesia's Investment Law (Law No. 25 of 2007) increase Indonesia's competitiveness. Porter's diamond model is used as the analytical tool for this study for its comprehensiveness.

The study found out that the Law No. 25 of 2007 increases Indonesia's competitiveness, as seen in the improvement of rank and increase number of employment in sectors that need skills. However, it seems that the amendments has not show a favorable effect, since even if the IFDI is increase, neighboring country's IFDI were also increase, even though they did not report any changes on their investment policy. The result might occur due to the lack of promotion.

Although the current findings add substantially to our understanding of factors that may affect the receipt of IFDI in one country, it needs further study to put the more describing weighting constants and answering a practical question on how to enhance the effects of amendments to be as favorable as expected.

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국문초록

인접국의 경제 성장에 비하여 인도네시아 의 경제 성장 수준은 낮다. 경제 성장을 부양하기 위하여 인도네시아 정부는 외국인직접투자(Inward Foreign Direct Investment, IFDI)가 경제 성장 에 도움을 줄 것으로 예상하고 엄격한 이전 투자 정책의 개정을 통해 지지투자 상태를 부양하려고 노력했다. 그러나 투자 정책을 개정한 5년 이후 인접국에 비해 인도네시아의 외국인직접투자는 아직도 낮은 수준에 머물러 있다. 이 논문은 외국인직접투자를 유치하기 위해서 인도네시아 경쟁력의 강점과 약점을 관찰하고, 또한 투자 정책의 개정이 인도네시아의 경쟁력에 미친 영향을 검토하는 것을 목표로 한다. 이 연구는 정책 개정 몇 년 이후에 인도네시아 강점과 약점이 늘어나는 사실을 밝혔다. 그러나 낮은 수준의 외국인직접투자가 정책의 개정으로 인하여 나타난 것이 아니라는 가능성이 있다.

핵심어: 인도네시아, 투자 정책, 정책 분석, 경쟁력, 다이아몬드 모델, 외국인직접투자

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