

# **MONITORING INVESTMENT CLIMATE IN INDONESIA : A REPORT FROM THE MID OF 2005 SURVEY**

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## **1. INTRODUCTION**

**W**hile in the region of South East Asia some other countries in the ASEAN-4) have shown improvement in key investment climate factors following the crisis, Indonesia is the only country beside the Philippines that follows different path<sup>1</sup>. A significant deterioration in several key investment climate factors has been observed in particular in the area of taxation, customs, infrastructure, labor regulation and investment policy.

As a preliminary step to develop policies to improve this situation, the Government of Indonesia should possess indicators that can be used periodically to monitor the national investment climate. These indicators first and foremost should be simple and at the same time should rely on quantifiable variables and rather than based on perception or subjective judgment. These indicators should cover the basic element of business climate faced by firms as stated above. If these indicators can be measured periodically, say once every six months, then it will enable the government to track changes in the general business climate and to take necessary measures accordingly.

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<sup>1</sup> The ASEAN-4 comprises of Indonesia, Malaysia, Thailand and the Philippines.

The ultimate goal of this study is to produce a set of quantitative indicators that can be used to track progress in the investment climate, both as a signal where additional effort is needed and as indicator of which reforms have paid off. The specific objective is to conduct survey series activity on bi-annual basis from which the indicators can be measured, analyzed and presented quickly, in concise format.

## 2. RESEARCH METHOD

### 2.1. Survey Technique

The primary concern in the study of business climate is how to get reliable data (Lambsdorff, 2003). Even with a carefully designed question set there is a chance that respondents will refuse to answer such a question—or answer it dishonestly—and for example the strategy for collecting information on bribe payments needs to be designed within the context of local culture. The choice of local surveyors was designed with this consideration in mind. From the past surveys on business climate, LPEM has developed an extensive network with local universities and or local company/industry association in almost all big cities in Java to do interviewing. Each city will need 5-7 surveyors and one supervisor.

To measure the indicators regularly, the survey will be conducted twice per year. This is the most plausible time interval since most of the indicators relate to regulations does not change very much in a short period. The first survey was conducted in mid April or early May 2005 and would serve as the benchmark for the subsequent surveys. The plan is to conduct three more surveys on bi-annual basis. The repeated surveys will create a panel data set that maximizes comparability over time. In the process, the respondent will be surveyed 4 times. To avoid the problem of survey fatigue some efforts will be needed to convince the chosen firms – that, the survey is for their own benefits – to improve the Indonesian business climate. Over a period, some attrition of respondent will be unavoidable, but we are familiar with a statistical procedure based on the stock-flow method to replace those drop out from the next successive surveys because one reason or another (death or relocating to other locations). So the panel will remain to be ‘balanced.’

### 2.2. Investment Climate Indicators

The indicators will cover the important obstacles to doing business in a set of quantitative indicators. The policy maker will be the prime user of these indicators on a regular basis

accordingly they in principle should be simple, easy to understand and not perception indicators. These indicators will be discussed as follows:

### 2.2.1. Days to start a business

Obtaining all permits and licenses and meeting notification requirements to start a limited liability company in Indonesia involves 12 steps that take on average 151 days<sup>2</sup>. Local companies also face similar problem that they need at least 14 days for each permit or license from local government<sup>3</sup>. This contrasts with 50 days in the Philippines, 30 days in Malaysia and 33 days in Thailand. This indicator has received considerable public attention and the Government has indicated its intention to shorten the process. Monitoring the number of days required to start a business can be carried out through a survey of companies that have completed registration over the previous six months. The Company Register is collected from the Head of Investment Coordinating Agency (BKPM). As the company law requires the use of notaries in this process, it might also be possible to survey notaries.

### 2.2.2. Customs

#### **a. Days to clear merchandise through Customs**

Exporters and importers report that it requires on average 5.8 days to clear goods through customs in Indonesia. This is faster than China (7.9 days) and India (6.7 days) but far slower than the Philippines (2.8 days)<sup>4</sup>. Reducing customs clearance time to the Philippines level would greatly improve the investment climate for exporters and for firms that require imported raw materials. This indicator is monitored through a business survey. Clearance time should be measured separately for imports and exports, by red lane (physical inspection) and green lane (no physical inspection).

#### **b. Unofficial payments to expedite Customs clearance (frequency and cost).**

Transparency International Indonesia reports that Customs is perceived by businesses as the most corrupt government institution. Among respondents that had interactions with Customs, 62% acknowledged payment of bribes. An average of 31 corrupt

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<sup>2</sup> World Bank, *Doing Business in 2005*

<sup>3</sup> LPEM FEUI, *Construction Index of Cost of Doing Business, 2001 and The Impact Of Regional Taxes and Levies, Interregional Trade Barriers, And Cost Of Doing Business On Poverty Reduction, 2003.*

<sup>4</sup> World Bank, *World Development Report, 2005*

interactions took place per respondent per year and during each transaction an average of Rp 5.2 million was paid in bribes. *Given these findings, it is possible that the relatively fast Customs clearance time reported in previous studies is a result of these unofficial payments.* Both the frequency and the cost of such payments will be included in the survey.

### 2.2.3. VAT Refunds

Businesses have long complained about delays in VAT refunds. These delays tie up badly needed working capital, and refunds are perceived by businesses as generally being less than the full value owed. This is a particular problem for export firms using local raw materials<sup>5</sup>. The time required to obtain VAT refunds can be measured from business surveys which are asking specifically about time required for each stage of this refunds i.e. proposal, inspection and payment. Generally, time required for refund proposal is 1-2 months, for inspection is 6-12 months, and for payment is 12-18 months<sup>6</sup>. Since the main exports of Indonesia are textile and garments, footwear, electronics and furniture, the respondents should come from those manufacturing branches.

### 2.2.4. Labor Regulation

#### **a. Severance pay**

The more costly it is for businesses to lay off a redundant worker, the more reluctant firms will be to hire new workers. Under current regulations, laying-off a worker with 20 years service will cost a business 25 months of salary<sup>7</sup>. This is much higher than other countries and poses a significant obstacle to the creation of new jobs in the formal sector. This indicator can be monitored both from a survey of businesses and by tracking changes to employment regulations.

#### **b. Labor disputes**

This could be measured as a binary 0/1 variable recording whether the firm experienced a labor dispute relating to pay, social security, redundancy or other problem, over the previous six months<sup>8</sup>.

#### **c. Absenteeism**

Days lost due to absenteeism, whether or not for a “legitimate” reason<sup>9</sup>.

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<sup>5</sup> Exporters are usually granted VAT exemption for imported raw materials that will be re-exported. Local purchase of the same material is subject to VAT that can be refunded after export.

<sup>6</sup> LPEM FEUI, *Study of Implementing VAT Refunds in Indonesia – Jabotabek Area*, 2003.

<sup>7</sup> GIAT (USAID), *Indonesia’s employment protection legislation: Swimming against the tide?* November 29, 2004

<sup>8</sup> World Bank, *Raising investment in Indonesia: A second generation of reforms*, December 15, 2004

<sup>9</sup> *ibid*

#### 2.2.5. Time Wasted as a Result of Excess Regulation:

##### **a. Percent of senior management time spent dealing with local and national regulations.**

According to the CODB Survey conducted by LPEM in 2001, a senior manager spent their time to deal with national and local government regulations around 12.8% of their time each week<sup>10</sup>. Local governments need less time required than central government. This is higher than the Philippines (8.8%) and Malaysia (8.5%)<sup>11</sup>. Reducing bureaucratic red tape will directly cut costs and limit opportunities for corruption. This can be monitored through a direct survey of businesses.

##### **b. Average time spent filing tax returns each month.**

Small and medium businesses report that the tax reporting system in Indonesia is much more complex and time consuming, and requires far more documentation, than in other regional economies such as Singapore.

#### 2.2.6. The Percentage of Firms that Report Paying "Gifts" to Government Officials, and the Cost of "Gifts" as a Share of Production Cost

The World Bank study in 2005 suggests that about 51% of Indonesian firms reportedly paying bribes on average 4.6% of sales<sup>12</sup>. Meanwhile, the LPEM study in 2001 suggests that the corresponding figure is 10.8% of annual production cost. In the case of new firms the cost of 'gift' can also be calculated as a share of initial capital of about 9.6%<sup>13</sup>. The frequency and cost of bribes can be measured through a direct survey of businesses.

#### 2.2.7. Public Infrastructure Services

Time required to obtain a PLN electricity connection, a landline telephone connection, and a water connection is one of important indicators to assess investment climate in Indonesia.

#### 2.2.8. Harassment

The extent of real bureaucratic harassment experienced by firms is measured by the frequency of local officials, to conduct inspections or to request donations. The more frequent is the visit the higher is the harassment. The frequency of visits can be measured through a direct survey of businesses.

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<sup>10</sup> LPEM FEUI, *Construction Index Cost Of Doing Business*, 2001

<sup>11</sup> World Bank, *Raising investment in Indonesia: A second generation of reforms*, December 15, 2004

<sup>12</sup> World Bank, *World Development Report*, 2005

<sup>13</sup> LPEM FEUI, *Construction Index Cost Of Doing Business*, 2001

### 2.3. Scope of Survey: Area, Sector, and Firm Size

In the fieldwork, survey will be conducted in particular areas, where most of companies are agglomerated i.e. in five greater metropolitan areas, Medan, Jabodetabek, Semarang, Surabaya and Makassar. The survey is focused on manufacturing firms because the only readily available sample frame for businesses is the 2003 BPS manufacturing firm directory. At present there is no good sample frame for services, so these sectors will not be in the sample. Agriculture is also not surveyed. According to LPEM 2003<sup>14</sup>, the agricultural sector has relatively minor problem in licensing regulation, compared to others.

Small businesses face a different set of obstacles because the small-scale companies are excluded from most of business-licensing regulations<sup>15</sup> and will need to be covered in a separate survey. Accordingly, the general field survey will focus on manufacturing firms with 100 (one hundred) or more employees, covering a broad range of manufacturing sectors.

There are three different surveys:

- a. Approximately 50 notaries are interviewed for the “days to start a business” question.
- b. Approximately 15 PMA and PMDN companies are interviewed to determine length of time required to obtain BKPM approval.
- c. Approximately 600 manufacturing establishments are interviewed for the other questions. Since we focus on firms with 100 employees or more the average export orientation of the sample will be likely quite high. Firms in this category are usually manufacturer-exporter that happens to import much of their inputs, so the chance of answering the VAT and Customs related questions will also be high. From these 600 establishments, roughly 100 will be establishments that export 90% or more of output, while for the rest of the sample, the export orientation will be between 10-90%.
- d. The number of respondents in each region is roughly proportional to the population of manufacturing establishments in each region as reflected in the BPS 2003 Directory of Manufacturing Establishments.

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<sup>14</sup> *ibid*

<sup>15</sup> LPEM FEUI, *The Impact Of Regional Taxes And Levies, Interregional Trade Barriers, And Cost Of Doing Business On Poverty Reduction*, 2003

### 3. RESULTS

Until the end of June the survey managed to collect questionnaire from 600 manufacturing firms. The sample is distributed broadly across manufacturing sectors (**Table 1**).

**Table 1**  
**Distribution of Firms across Manufacturing Sector**

Sector	Number of firms	Number of firms in (%)	Cumulative Frequency (%)
1. Food, beverages and cigarette	65	10.67	10.67
2. Textile, garment, leather and shoes	135	23.06	33.73
3. Wood, bamboo and rattan	59	10.15	43.89
4. Paper, paper products, printing and publishing	22	3.27	47.16
5. Chemical products, oil and gas, rubber and plastic	90	14.97	62.13
6. Non metallic mineral products	36	6.20	68.33
7. Basic metal products	61	10.33	78.66
8. Fabricated metal, machinery and equipment	120	19.45	98.11
9. Others	12	1.89	100.00
Total	600	100.00	

**Table 2**  
**Distribution of Firms according to Size**

Less than 100	22	3.67
100 to less than 500	351	58.50
500 to 1000	113	18.83
More than 1000	114	19.00
Total	600	100.00

**Table 3**  
**Summary Statistics**

	Mean	Median	Std. Dev	Min	Max
Employment size	649.0	333	1016.4	44	13252
% of exported output	62.3	75	38.1	0	100
% of imported inputs	51.2	50	31.7	0	100
Age	18.3	16	11.3	0	99

There are 600 firms spread over all sizes, the most numerous in the sample is from the “100 to less than 500” category (**Table 2**). Interestingly, although the firms chosen from the 2003 BPS Manufacturing Firms Directory are those with at least with 100 employees the reality in the field could be different. The firm size might fall below this cutoff because some firms might have made adjustment to external conditions before this survey commenced. The average employment size in 2004 is 649. There is a huge variation of

firm size as reflected by a large standard deviation (**Table 3**). Firms tend to have export orientation (the mean is 62.3%), and at the same time relying on imported input (the mean is 51.2).

### 3.1. Investment Climate for New Businesses

#### 3.1.1. FDI Approval Time at the Investment Coordinating Agency (BKPM)

The sample frame for FDI firms is based from the list provided by BKPM. The problem with this list is that the addresses are not clear. Many addresses turned out to be wrong or only a small office attended by less than 3 persons who apparently only knew very little about the respective company. These offices seemed to function only as “post office boxes.” In the end we could only find credible addresses (10 PMA and 1 PMDN firms) that were also attended by credible companies’ representative. Since there were very few firms, instead of using a pure statistical analysis, in depth interviews for each of those 11 firms were conducted personally by LPEM senior staff. While the results might not meet the minimum sample size for a proper statistical analysis, the information obtained could still be the source of valuable information concerning the approval process at BKPM.

If one uses the median (**Table 4**) it takes on average 7 weeks (36 working days or 50 calendar days) for BKPM to approve a foreign investment. This is much longer than the official time of just 2 weeks. The extra time is partly because the official time is counted only when an application is accepted as “complete and correct.” There are many reasons why the applications was not accepted by BKPM; incomplete document of letter of imports, formal letter of share holder, letter of detailed assets, MOU with local partner if any, incomplete copies of passports of prospective foreign workers, mistyping by BKPM staff and so on. In practice, because BKPM’s rules are nontransparent and discretionary, investors need to check with a BKPM official on a case by a case basis to determine what supporting documents and information are required. This adds considerably to approval time. Our survey suggests that on average (median), respondents claimed that their applications were rejected twice prior to the final document acceptance.

It is nontransparent because not all the rules are in writing. For illustration, there is no rule (no law, regulation, SK or written guidelines) limiting the size of investment, but in practice BKPM will not accept any FDI application below \$ 100,000. Another example is that there was no rule stating that FDI firms cannot use leased equipment. But recently it has insisted that leased equipment be listed as part of the applicant equity. This is a contradiction because if its equity it means the company owns it.

It is discretionary because the officials approving FDI applications do not follow clear written rules and guidelines. Instead they make discretionary judgments about what

to approve and to reject. This makes it hard for an investor to know in advance what will be approved. This type of discretionary and nontransparent behavior makes the approval process unpredictable and opens the way for face-to-face negotiations. The shortest approval time was 5 days, while the longest was 9 months (180 working days). This huge range reflects the discretionary and nontransparent process of the approval process<sup>16</sup>.

**Table 4**  
**BKPM Approval Process : Time Required (Working Days)**  
**and Frequency of Not Acceptance Application**

1	How much time to collect all of the information and documents required for first submission of an application to BKPM?	24 days	1 day	120 days	5 days
2	If first application is not accepted, how much time to gather any additional information or documents to satisfy BKPM?	24 days	1 day	60 days	5 days
3	How many times was the application to BKPM on the grounds that it was not complete and correct?	24 days	2 days	60 days	16 days
4	How much time to issue the approval letter (SP) after documents accepted by BKPM?	58 days	3 days	180 days	36 days
5	How much time to issue the approval letter (SP) after documents accepted by BKPM?	58 days	3 days	180 days	36 days
Total Time required of BKPM = row 4 + row 5		58 days	3 days	180 days	36 days

Note: 1 week = 5 working days, 1 month = 30 working days. According to notaries it takes only 80 calendar days on average to establish and

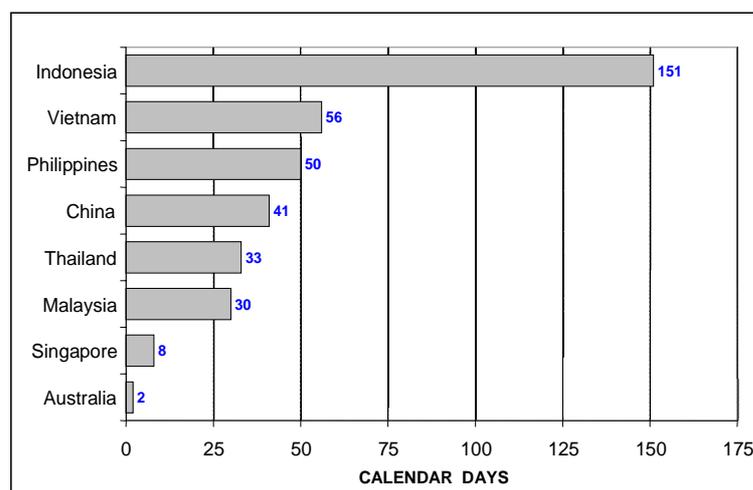
to register a PT company, much less than the time reported by law firms. Obviously 80 days is already a huge improvement over 151 days. However, it is still much longer than

<sup>16</sup> Alternatively, we can also add-up row 1, 2, and 5 in table 4, but the resulting sums are not the same. Because of this, we assume that row 1 and row 2 are the subsets of row 4, so we use row 4 to be added with row 5.

other regional economies such as Vietnam, the Philippines, China, Thailand and Malaysia (see **Figure 1**). Moreover, it does not include the time to obtain sectoral or local licenses (e.g. mining license, a nuisance permit or a building permit). It also does not include approval time for foreign investments at BKPM.

The difference result in days to start a business perceives a different perception of law firms and notaries. The World Bank survey (2005) measured by expert opinion by conducting an in-depth interview with law firms, whereas the notaries survey measured by a structured closed questionnaire interview. The law firms may exaggerate the difficulty of establishing a PT company, while notaries may exaggerate their efficiency in providing their services.

**Figure 1**  
**Days to Establish and Register a Limited Liability Company**



The following table shows the time needed for each stage of company establishment based on the notary survey and the World Bank interview (2005).

**Table 5**  
**Average Days\* to Establish a PT. Company**

No	Activities	Notary Survey LPEM (2005)	Law Firms Interview (World Bank 2005)	Institution/ Entity
1	Obtain clearance for the company name from the Ministry of Law (MoL); obtain the standard form of the company deed from MoL	2	7	Ministry of Law
2	Founders draw up the deed of establishment (articles of association) and sign it in front of a notary.	2	7	Notary
3	Obtain a certificate of domicile from the local municipality	4	10	Local sub-municipality office ( <i>kelurahan</i> )
4	Obtain a taxpayer registration number (NPWP) and taxable entrepreneur identification number (NPPKP)	6	14	Local Tax Office
5	Open a bank account and deposit the initial issued capital in the name of the proposed company	4	4	Bank
6	Pay to the State Treasury the non-tax state revenue (PNBP) fees for legal services pursuant to the Decree of the Minister of Law No. M.OI-UM.01.06/1993	1	1	Ministry of Law
7	Arrange for the notary to apply for the publication of the articles of association of the company in the supplement to the State Gazette from the State Printing Press, get payment receipt	1	2	Notary office
8	Submit physical documents to the Ministry of Law	1	75	Ministry of Law
9	Issuance of the SK approving the deed of establishment by the Minister of Law	14		Ministry of Law
10	Register with the Company Register at the Local Trade Office and obtain the Company Registration Certificate (TDP)	9	15	Local Trade Office ( <i>Dinas Perdagangan</i> )
11	Apply for the business trading license ( <i>Surat Izin Usaha Perdagangan</i> or SIUP)	11	14	Local Trade Office ( <i>Dinas Perdagangan</i> )
12	Register with Ministry of Manpower	1	1	Ministry of Manpower
13	Apply for workers social security ( <i>Jamsostek</i> ) program	1	1	PT. Jamsostek
<b>Total Time in Working Days</b>		<b>57</b>		
<b>Total Time in Calendar Days</b>		<b>80</b>	<b>151</b>	

\*Notes: The notaries are answering in terms of working days, whereas the law firms are answering in terms of calendar days

In establishing a limited liability company (*PT biasa*), there are several steps should be conducted that involving different entities. The steps that are arranged by notaries mostly are the ones related to the Ministry of Law. Whereas, other steps (such as: making a certificate of domicile from the local municipality, opening bank account, registering a taxpayer registration number NPWP and NPPKP, obtaining TDP and SIUP) can be managed by the company itself or by service bureau. Some notary also can provide services in obtaining TDP and SIUP with extra service charge.

The longest step in the PT registration process is the approval (legalization) of the company's deed of establishment by the Minister of Law. It takes 15 working days according to the notary survey and it takes 75 calendar days based on the World Bank survey. Besides the issuance of SK, the time to obtain TDP and SIUP from the Local Trade Office is also relatively longer.

According to the notaries, the process of registration of company establishment has shown a significant improvement since 2002 when the Ministry of Law established an information system (*Sisminbakum – Sistem Informasi Badan Hukum*)<sup>17</sup>. The system gives an on-line access for notaries to data base of Ministry of Law for registered companies. It has made a face to face contact with the Ministry of Law officials is minimized.

If one takes into account the time needed for local permits, the picture becomes even less encouraging for investors. Figure 2 lists local permits required by all factories; environment permit, building license, location permit, principle permit, nuisance permit and worker safety permit. If one assumes that those local permits can only be obtained sequentially then the total time is 192 days. Adding back the total time to establish PT biasa, the figure becomes 272 days, which means it takes about 8 to 9 months for a domestic entrepreneur to establish a 'fully licensed' new business. It is true however that the sequential assumption may be unlikely, but there is some sequencing – it is not possible to apply for all permits at once. So the true amount of time to obtain local permits could be between 43 and 192 days.

**Figure 2**  
**Days to Obtain Local Permits**  
**(permits required of all factories)**

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<sup>17</sup> The SISMINBAKUM is managed by a private company as a partner of the Ministry of Law. The system only covers registration (legalization of the deed of establishment) for PT (limited liability) companies. Whereas, for other type of institution, such as CV, Foundation, and Cooperation, the registration procedure is still done manually, so that it requires longer time compare to establishment of a PT.

The times required for other types of permits are shown in the table 6. Interestingly, the time for trademark permit is quite long (94.5 days). If a firm applies for a new brand name, it must prove that the brand has not been used elsewhere, which must be verified by the trade office. The local trade office claimed here that the length of time involved here may arise from the fact that one brand may look a like with others, which legally can be perceived as to mimic other popular brand name. This may end up with one firm suing another for brand duplicating - so more time is needed for verification. The *halal* certificate also takes quite some time which is not too surprising given the time needed in laboratory to check the ingredients contained in a particular food brand.

The mean times for manufacturing production related permits like boiler permits, crane usage, generator, pressure vessel and so on are around 15 to 18 days. These permits must be renewed between 3 to 5 years, but more and more regencies, perhaps for revenue reason, have moved to the 3 years cycle. In most of regencies surveyed, local official offers special service to renew these permits with fees. These fees broadly can be categorized into two types: fast lanes (*jalur cepat*) and regular lanes (*jalur biasa*). Fast lane is certainly more expensive. These fees are legal in some kabupatens, but for others are still under the table, but it appears there is a general trend toward legalizing these “fast lane” fees, simply because in this way localities can reap more revenues. Under the table payment or grease money, as also observed in this survey, may fall as a result. It remains to be seen whether this trend will continue in the future.

**Table 6**  
**Times Spent to Obtain Permits**

No	Type of Permits for businesses	Mean (days)
1	Change land status permit	44.1
2	Industrial business permit	21.6
3	Company registration	16.8
4	Warehouse permit	20.9
5	Trademark permit	94.5
6	Trade license	22.8
7	Foreign worker permit	19.9
8	Permit to deviate from standard work and break time	10.6
9	Permit for woman for night work	10.2
10	Halal certificate	44.3
11	Boiler usage permit	17.6
12	Pressure vessel usage permit	16.3
13	Elevator usage permit	16.9
14	Crane usage permit	15.5
15	Production machine usage permit	15.8
16	Diesel motor usage permit	15.8
17	Forklift usage permit	14.6
18	Generator usage permit	15.8
19	Road lighting usage permit	15.5
20	Underground water drilling permit	21.5

Although most of these permits are issued by the local office of industry, local labor offices also have some authorities over these permits based on the worker safety regulations. Therefore, local labor office have jurisdiction not over purely labor matters such as lay-off and hiring, severance payment, minimum wage and so on, but also over many “machinery things.” So in terms of frequency of “inspections,” potentially local labor offices can harass firms more than other local agencies.

### 3.2. Time to Clear Goods through Customs

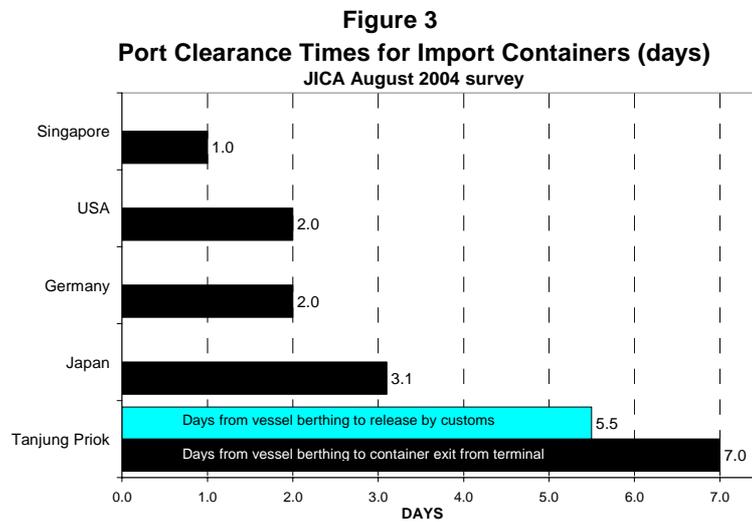
On average it takes 5.4 days to clear import and the corresponding figure for export is 3.8 days. Moreover, the longest time for customs clearance is about 10 days (imported goods) and 8 days (exported goods). Customs clearance time is fairly similar to times reported in previous surveys (see **Table 7**).

**Table 7**  
**Time to Clear Goods through Customs**

Institution Involved	Imports (days)	Exports (days)
LPEM/WB 2005	5.4	3.8
ICA 2003 (WB/ADB)	6	4
JICA 2004	5.5 (7.0)	1-2 (27 hours)

However, compared to other countries, the lead time for import containers through Tanjung Priok is much longer (Figure 3). According to JICA study (2005), it took 7 days to clear import containers through Tanjung Priok (in August 2004), including 5.5 days to clear custom plus an additional 1.5 days to exit terminal<sup>18</sup>. Port clearance in Singapore, Japan, the United States and Germany is just 1-3 days.

Table 8 provides detailed break down of good clearance through Customs according firms' location: bonded versus outside bonded zone. The advantage of locating within bonded zone is confirmed. It takes only 4.5 days to clear import for firms locating in bonded zones versus 6.7 days for those outside. The same advantage also applies to exports.



**Table 8**  
**Time for Export-Import Clearance**  
**Bonded Zone versus Non Bonded Zone**

### 3.3. Unofficial Payment to Expedite Custom Clearance

Of 463 respondents who had contact with customs, 81% acknowledged making informal payments to custom officials; 38% said “occasionally” while another 43% said “frequently.” Such payment averaged 2.3% of export/import values.

It is interesting to examine which part of imports that generate this informal payment. For custom clearance informal payment can only thrive if human interaction still takes place. So, the way to limit informal payment is to limit human interaction. This is the logic behind the introduction of EDI (Electronic Data Interchange) for imports in 1997, which does not require face-to-face interaction with custom officials. But this is not what the survey found in the field. Despite the adoption of EDI, respondents claimed that every import shipment, even green lane, requires face-to-face meeting (either with a company employee or the company’s shipping agent) to submit the hard copy documents. Responding to this assertion, the Customs admitted that it is true that contact points still exist at the gate, and hard copy is still needed because they argued that electronic data may not be sufficient to hold in the case of dispute as there is no law on digital signature, electronic document etc. This notion is confirmed by the JICA study in 2005, which noted that “human element still remains a great deal and documentation is necessary from other department.” In the case of green lane, documents are still need to be verified at least by one custom official whose title is “functional official responsible for document verification or PFPD (*Pejabat Fungsional Pemeriksa Dokumen*), with whom companies need to maintain “good relation.”

Theoretically speaking, green lane imports, which account for 60%<sup>19</sup> of import shipments, do not require any face-to-face meeting with a custom official, so the official payment should be close to zero. If the means of informal payment and the frequency of meeting with custom officials for the green lane are not zero then it must be some problems with EDI. In our questionnaire the survey asked each respondent how many times they interacted with custom officials every time the company exports or imports - about 344 respondents (out of 600 completed questionnaires) answered the question. The median response was two times, both inside and outside bonded zones/industrial zones. This strongly suggests that face-to-face meetings are still common.

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<sup>19</sup> Bisnis Indonesia 28 March 2005: “40% of Imported Goods Required Physically Inspection”

**Table 9**  
**Informal Payment and Human Contact in Custom Clearance**

	Mean of Bribes as Percentage of Export or Import	Frequency of Meeting Custom Officials
Only ≤20% imports through red lane	2.2	2
All respondents	2.3	2

To test further this proposition we separate the sample into two parts – green lane and the whole sample which include the red lane importers (table 8). The green lane importer is defined as if red lane import is less or equal to 20% of total imports. It turns out that mean of informal payment for the green lane importer is not zero. About 76% of “green lane respondents” responded to the bribe question - the mean for informal payment is 2.2% of export or import values (the standard deviation is 3.2). This is exactly the same as the mean for all 292 firms that responded both to the custom bribe and green/red lane questions. This supports the recent Transparency International survey, which found that businesses view Customs as the corrupt public institution. For the green lane importer, the median value of the meeting frequency with custom official is 2.

Since the informal payment on Customs is specified as a percentage of import value then one can estimate how much extra costs are born by importing firms. Assuming that the mean for informal payment is right (2.3%), with non oil imports amounted to US \$ 35 billion in 2004, the extra costs could be as much as \$800 million (Rp. 7 trillion). This estimate is a ceiling rather than the actual burden from corruption activities. If we assume that only red lane imports are problematic and the green lane is free from informal payment then only 40% of the non-oil imports would be the potential source of corruption. This translates to a figure of 2.8 trillion Rupiah. But this survey indicates that even the green lane is not free from informal payment. One may never know how much the actual burden of the corruption is, but rather than focusing on the right amount of corruption burden, efforts should be made to minimize corruption, even in the green lane.

Customs were naturally objected with this figure they argued that although in totality the overall amount may not too far-off from the mark, it is still too high for a single entity like Customs. In this respect, one should distinguish between Customs and custom clearance<sup>20</sup>. There are about 30 entities involved in the custom clearance including port authority.

<sup>20</sup> With respect to informal payment in the custom clearance, the questionnaire is very clear referring to Customs as one entity, not to confused with custom clearance, so there should be non misunderstanding on the part of respondents.

Port authority and poor infrastructure condition may also bear some responsibility for such informal payments. Without such informal payments, the terminal handling charge (THC) in Indonesia is already among the highest in the region. For a 20 feet container the cost paid by a respondent to a shipping agent is \$ 150, while for a 40 feet container the cost is \$ 240 <sup>21</sup>. For a comparison, THC in Thailand is much cheaper – \$ 60 and \$ 100 for these two types of container respectively.

Customs claimed that the longest delay is in unloading the goods for physical inspection due to lack equipment such crane, forklift and so on – so a long waiting line is unavoidable. In this situation, it is not too surprising if the opportunity to extract informal payment arises from those that want to jump the queuing. The amount of informal payment for unloading varies depending on whether the goods are considered as hazardous material or not. Higher amount of money will be demanded for chemical materials or any other materials perceived as “dangerous.” The informal payment will go to port apparatus not to custom officials. There is no standard practice with regard to the treatment of hazardous materials. For illustration, in the port of Semarang, cotton which is included in this category must pay additional official charge (100% over the normal charge) for storage in 2002, which fell to 50% in 2003. The same policy also applies to the Surabaya port. Interestingly, respondents claimed that there is no such requirement in Jakarta for cotton.

#### **Shipment through Airport**

For live animals, perishable goods like flowers, meats, poultry etc. shipment by air is the only viable mode of transportation. From the interviews, respondents reported that import clearance in airport may not be necessarily faster than through ports. If there are mistakes in the document, both document and merchandise must be returned to the country of origin. If the imported refused to do that, the merchandise will be seized and put in the storage, must pay storage fee. Since it is prohibitively expensive to send back the merchandise, there is no alternative for the importer but to pay informal payment to speed up the process.

### **3.4. Time and Cost to Obtain VAT Refund**

VAT refunds may a major source of corruption. Respondents report that it takes 5 months on average to receive a VAT refund and the amount refunded is only 87% of the claim. Delayed refunds are a major impediment for the business climate because they tie up a huge amount of working capital. For companies that regularly request VAT refund and have managed a good relationship with tax officials, the refund rate can be relatively higher (nearly 100% of the claim) and the time is faster (about 3 months).

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<sup>21</sup> Source: PT Pelindo

In terms of the amount of net actual VAT refund, it appears that size lends firms more leverage (**Table 10**). The bigger is the firm size, the higher is the net refund. For firms with above 1000 workers, the net refund is about 90% of the claim, while it is less for the other size categories. With regard to the waiting time, the bigger sizes with stronger working capital can afford to wait longer (the mean range is from 4.8 to 5.2 months), while for the smallest size category the mean 3.3 months. It appears that smaller firms will settle for less actual amount refunded provided that it is relatively fast.

**Table 10**  
**VAT Refund according to Firm Size**

Firm Size (workers)	Waiting Time (months)	% Net Actual Refund	N
<100	3.3	86.0	6
100 to <500	5.6	85.6	101
500 to 1000	5.2	88.1	40
>1000	4.8	90.1	51
All Firms	4.9	87.3	193

Notes: Number of observation N is for waiting time

**Table 11**  
**Respondents Reporting VAT Return Negotiation and Extra Payments according to Firm Size**

Firm Size (workers)	Yes		No		N
<100	6	50.0%	6	50.0%	6
100 to <500	58	55.8%	46	44.2%	104
500 to 1000	23	60.5%	15	39.5%	38
>1000	30	57.7%	22	42.3%	52
All Firms	114	57.0%	86	43.0%	200

It is also found that 57% of the 200 respondent answering to the extra (informal) payment question reported that they must make informal payment and negotiate with tax officials to get their VAT refund. The amount of informal payment can be simply deduced from table 10 i.e. from the amount of claim not refunded on average 12.7% of their claims. Bigger firms tend to pay smaller informal payment in percentage of the amount claimed, so again the biggest burden is on smaller firms. The respondent tends to give informal payment to tax officials if they perceive that the net value of money of the VAT refund is higher compared to the expected informal payment they should pay. The interviews suggest that firms are still willing to submit request for refund even if the net actual refund is only 60% (the value of the net actual refund for the 5<sup>th</sup> percentile).

### 3.5. Time Required to Filing Monthly Tax Return

Businesses are required to file 7 different types of tax return every month (PPN: Value Added Tax for consumers, PPh article 24, PPh article 22, PPh article 22 (prepaid), PPh article 4 clause 2, PPh article 23/26 and PPh article 21/26). The longest time is needed to fill in PPN return (see **Figure 4**). For all monthly tax returns, on average they devote 45-man days each month to filling these returns. This is a waste of productive time – many countries require only quarterly or annual tax filling, not monthly filling.

*Figure 4*

*Average Days Needed to Fill in Monthly Tax Document*

### 3.6. Labor: Severance Payment, Labor Disputes and Absenteeism.

The most common dispute is demand for wage increases followed by disputes with labor union (**Table 12**). Most of the indicators above will serve as basis to be compared with future surveys. Only one indicator (strikes) can be compared with some past studies – 5.8% of respondents experienced strikes in the previous year, down from 9% in the 2003 ICA survey (WB/ADB). With regard to absenteeism, on average 3.1% of workers were absent in the previous month which had 24 effective working days. On average

firms allocate 3.8% of production costs to handle labor issues such as demand for wage increases, minimum wage disputes, worker social safety net, disputes with labor union, demonstrations and strikes. Not all labor disputes can be resolved internally, some needs government interventions. For example, if a strike occurs, firm should report not only to the local labor office but also to the police to anticipate chaos situation due to this strike. For the firms who ask government institutions to resolve those labor problems, it will take 34 days on average. But, from the 2005 LPEM-NBER survey which was conducted prior this survey, the average time to solve labor problems with government involvements took one to less than four weeks<sup>22</sup>. It means that if we compare early and mid 2005, the firms now might require more time to handle those labor problems.

**Table 12**  
**Percentage of Firms Experiencing Labor Disputes in the Previous Year**

Types of Disputes	Percentage of Firms Affected	Number of Respondents
a. Demand for wage increases	12.6	595
b. Minimum wage disputes	5.4	592
c. Worker social safety net/social security	6.3	590
d. Disputes with labor union	8.1	592
e. Demonstrations	6.1	589
f. Strikes	5.8	587

In the interview many firms complained about the high cost of laying-of workers – implicitly they implied that the current government policy on severance payment is too high or on average 5% of annual production cost. But when asked on how much it would cost to layoff a worker with 5 years service (measured in term of monthly salary/wage), the mean answer is 6 month salary plus 2 month salary as benefits, which is what the regulation says. It seems that while they resent the current policy, no firm wants to be seen as practicing unfair labor practice. In the future survey, to resolve these ambiguities, we will rephrase all questions related to labor and perhaps linking them to firms' ability to compete in both domestic and international markets. For example, if a firm is asked to respond in a scale from one to six, whether the current labor policy really is really detrimental to their competitiveness, their responses are perhaps will be more open. This question can also be followed by another one - asked a firm to rank various labor policies according to their detrimental impacts on its competitiveness. Only then, we follow up with questions asking – what is a more proper policy for example in severance payment. Other aspects of labor regulations (minimum wages, overtime, outsourcing etc) can also be asked in similar manner.

<sup>22</sup> LPEM-NBER, "Corruption in Indonesia – Java Island", 2005.  
The field survey was carried out in two months (January-February 2005).

### 3.7. Corruption

#### 3.7.1. Bribes and the Percentage of Senior Management Time Spent with Government Officials

Two indicators of corruption dropped sharply. Bribes to government officials as share of production costs fell from 10.8% in 2001 to just 1.8% in the current survey (3.4% in the 2003 ICA). At the same time, percent of senior management time spent dealing with government officials dropped from 12.8% in the 2001 survey to just 4.9% (**Table 13**). The figure for bribe appears to be too low. It is worth to note that in the 2001 survey there is no question separating tax and customs from the government officials in general, so it is possible that this low figure is because that in the 2005 survey both tax and custom officials have separate questions for bribes. If we add back the bribes for these two offices to that in table 12 for 2005, the bribe rate could reach a figure between 5% and 6% of annual production cost - still a significant drop compared to 2001.

Another possibility why the bribe figure is low is that our sample is focused on large manufacturing firms, while the emphasis of the 2001 survey was on small and medium firms (20 to 100 workers), which on average might pay as much as 3% above the large firm category. From our observation in the field, the low bribe figure could be attributed to the decline of bribe cost and time wasted for bureaucratic hassle at the local government level.

**Table 13**  
**Key Corruption Variables**

	2001 (LPEM)	2005 (WB-LPEM)
Bribe as % of production cost	10.8	1.8
% of senior management dealing with government officials	12.8	4.9

To examine the reasons behind the apparent decline of the bribes several regressions explaining the sources of bribes are estimated (**Table 14**). The logic behind the model is very simple – the question is whether bribes could lower regulation burdens (getting more VAT refund) or not. The theoretical literature makes ambiguous predictions about the relationship between corruption and its impact on economic activities. The first view asserted that excessive taxes and regulation would remain excessive without bribery, so bribery had in effect acted like deregulation. This view is termed as the efficient grease hypothesis which argues that corruption could increase economic growth because it acts as grease money, which enables firms to avoid bureaucratic red tape. Lui (1985) in support of this view showed that in a queuing model, corruption could be growth enhancing. In this respect the different of the size of bribes by different firms may

reflect their different opportunity cost with respect to bureaucratic delay, so buying lower red tapes could increase efficiency. The crucial assumption of the efficient grease model is that the red tape and regulatory burden can be taken as exogenous, independent of the incentive for officials to take bribes.

In contrast, the second view rejects the notion that corruption could be efficiency enhancing, for example Shleifer and Vishny (1993 and 1994), Bliss and Di Tella (1997) and Kaufman and Wei (1999). The conventional wisdom suggests that if a firm pay more bribes then it might get back larger share of its VAT claim, but this did not happen. The simple correlation coefficient between bribe and the net actual VAT refund from the survey is negative at -0.21. This seems to be a rather counter-intuitive, but this is exactly what had been advanced by the second view on bribes. The opposite view asserts that because the bureaucrats (in this case tax officials) have discretionary power with given regulation, regulatory burden may endogenously set by corrupt officials such that they customize the nature and amount of harassment on firms to extract maximum bribe possible. In this model firms that pay more bribes could still face higher, not lower effective burden. In this case the net actual refund red tape is made smaller purposely by tax officials, with the expectation that firms would pay higher bribes to get refund.

The empirical work in this study is based on the theoretical model developed by Kaufmann and Wei (1999), which is subsequently extended by Henderson and Kuncoro (2004). In the empirical implementation of this model, bribes would become the dependent variable while tax burden, regulations burdens would become the independents. In this setting, it is possible to decompose the bribe burden into its sources i.e. taxation and/or regulations. If the tax official turns to be customizing in setting the tax burden then the coefficient of the percent of VAT refund not refunded would be positive. Similarly if the custom officials are customizing in their export-import 'inspection' to extract more bribes then the coefficient of the percent of export positive would also be positive. The number of local permits in each locality is based on the discretion of local official to extract higher bribes, so this would also have positive coefficient. The estimating equation is

$$(1) \quad B = a + \mathbf{b} \cdot \mathbf{X} + \mathbf{c} \cdot \mathbf{Y} + \mathbf{d} \cdot \mathbf{Z} + u$$

$B$  is the bribe as a percent of production cost. For explanatory variables,  $\mathbf{X}$  is a vector of 'government variables' that capture the relationship between firms and government officials (% VAT refund not refunded, % of output exported and the number of local permits),  $\mathbf{Y}$  is a vector of 'firm variables' (age and FDI dummy),  $\mathbf{Z}$  is a vector of 'district variables',  $u$  is the error term, and  $a$ ,  $\mathbf{b}$ ,  $\mathbf{c}$  and  $\mathbf{d}$  are parameters to be estimated. Due to

the limited number of regencies (kota and kabupaten), there is not much variation between one locality to another, consequently **Z** has no representation in this set up.

**Table 14**  
**Determinants of Corruption**

Explanatory Variables	Dependent Variables	
	Time Spent by Senior Management (%)	Bribes as % of the Annual Production Cost
Constant	-0.09	-1.70
	[-0.03]	[-0.66]
% of exported output	0.02	0.03
	[0.96]	[1.81]*
VAT refund not refunded	0.18	0.13
(in %)	[3.82]**	[3.12]**
The number of local permits	0.09	-0.08
	[0.59]	[-0.66]
Dummy for off-Java	0.32	0.66
	[0.11]	[0.30]
Firm age	0.05	0.07
(years)	[0.76]	[1.07]
Dummy FDI firms	0.09	0.82
	[0.05]	[0.69]
R-Squared	0.10	0.12
No. of observation	149	130

Notes:

\*\* : Significant at the 5% level

In the second column of table 14 the number local permits serve as the source of corruption originated from the local government. The coefficient is negative and not significant in both time spent and bribe regressions. There are several possible explanations for this trend. First, competition among kabupatens to attract or to maintain business may moderate discretion to extract bribes from customizing bureaucratic red tape (licensing, permits etc). The second reason is that many local governments may have moved from bribes to user fee charge to increase their incomes. By paying higher fee, firms in effect attempt to trade-off higher fee for less uncertainty. Alternatively, in the license/permit application process, firms can also employ the service of license/permit broker, which often bundle several licenses/permits in one package. All of these may make the amount of bribe declines, but the actual amount paid by firms for licensing (informal payments plus official fees) may not decrease and may even slightly increase. The difference is that firms may have more certainty now and also may spend less time than in the past in the licensing process or permit applications. Regardless of the causes,

it appears that relative to the first years of regional autonomy, the squeeze on businesses through informal payments demanded by local officials may be declining.

This is in contrast with national authorities such as customs and tax, which might not feel the same competitive pressures to avoid killing the “golden goose.” The export ratio is a proxy to capture potential harassment from import clearance, not only Customs, but also the whole array of entities involve in it including port authorities. Exporter-manufacturer in our sample depends on imported input, so this variable captures the potential of informal payments that can be extracted from export-import activities at the firm level. At first, we experimented with the red lane variable to capture this, but it is not successful and dropped from the model.

The second variable capturing the influence of national authorities in informal payment paid by firms is the percentage of VAT refund claim that is not refunded. These two are the only significant variables (**Table 14**). The coefficient of VAT refund is larger and significant at the 5% level, while the export ratio is smaller and significant at the 10% level<sup>23</sup>. After multiplying each coefficient with its respective mean, one can calculate the relative contribution of each variable to the predicted bribe mean. The export ratio explains about 43% of the predicted bribe mean, while the tax variable captures another 38%. This implies that about 81% of bribe burden at the firm level might be originated from national authorities. This leaves 19% to be explained from “other sources”, including from corruption at the local government.

The regression for the time spent by senior management looks similar although it is weaker statistically. The only significant variable is VAT refund. This suggests that much of the time is spent in negotiating VAT refund or dealing with tax offices.

### 3.7.2. Harassment

The extent of bureaucratic harassment is measured by the frequency of government officials visit to a firm in 2004 (**Table 15**). Looking at the median the biggest harasser are from police/military (12 times in 2004), followed by township (6 times) and Customs (4 times). Interestingly, contrary to our earlier assertion the harassment from local labor offices is not significantly higher than local industry offices, although the former have jurisdiction over both purely labor matters and production/machinery related items. One possible explanation is the character of our sample which emphasizes on medium-larger and larger firms. Bigger companies may follow the regulation books better than smaller size simply because they have more capacity to comply, so there is little reason for local officials to harass these companies.

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<sup>23</sup> This supports the ADB-World Bank study in 2003 that exporter paid larger informal payment to national authorities than non-exporter.

**Table 15**  
**Frequency of Visit by Officials in 2004 (times)**

Types of Officials	Mean	Std	Median	N
Township	8.3	9.3	6	410
Sub district	5.6	5.8	2	328
Labor office	4.4	5.3	2	488
Industry office	4.3	8.5	2	243
Police/Military	18.9	50.6	12	381
Tax Office	5.3	23.3	2	288
Customs	50.1	110.1	4	182

Firms reported that in the aftermath of economic crisis they must cope with harassment from local hoodlums at the factory site and street thugs, thief or robbers when they are shipping goods. About 20% of respondents are claimed that they are bothered by thugs. Firms obviously cannot rely too much on police to manage security situation. To prevent harassment from local hoodlums, the first line of defense is to be involved in community development. Firms' contribution to neighborhoods around the factory sites can take in various forms: sport facilities, local roads, mosque, money for an event like the Independence Day celebration etc. Companies also hire people from the surrounding communities and sometimes to recruit some of hoodlums themselves as security guards<sup>24</sup>.

When shipping goods to some distance destinations they have option to hire a security company to protect the shipping. As a warning to potential robbers, companies will paint the name of the security company on every side of the truck. One such security company is Gajah-Oling, which is well-known in East and Central Java. Firms said that this measure is quite effective to prevent thefts. For all these security measures including maintaining good relation with their surrounding communities, firms are reportedly to allocate about 1 to 2 percent of annual production cost<sup>25</sup>.

### 3.8. Infrastructure

Time to obtain a PLN electricity connection and a PDAM connection has risen, whereas time to obtain a phone connection has fallen (**Table 15**).

<sup>24</sup> In some isolated cases, the township heads (*lurah or kepala desa*) sometime come to the companies in their location asking companies to hire people from their communities.

<sup>25</sup> LPEM-NBER, "Corruption in Indonesia – Java Island", 2005

**Table 16**  
**Average Time to Obtain Utility Connection (in days)**

Types of Utilities	2005 LPEM/WB Survey	2003 ICA Survey (WB/ADB)
Electricity (PLN)	24	15
Telephone (Telkom)	16	27
Water (PDAM)	17	13

In the case of PLN, the time duration involves above is not as much as to get a new connection rather the problem arises when a firm tries to add more capacity. If the equipment costs (usually to buy transformer) to increase capacity is beyond the ceiling set by PLN, then a firm is usually required to buy its own transformer in a cost sharing scheme<sup>26</sup>. However, it does not come cheap – for medium size transformer, a firm could pay as much as Rp. 500 million. In return, a firm will pay lower electricity rate for some agreed duration – after which the transformer will be owned by PLN and firms will again pay the prevailing normal rate. Although this arrangement looks reasonable, for some, particularly for medium size firms, the cost might be prohibitively expensive.

Other infrastructure indicators will also serve a basis for future comparison. For example, the number of days of electricity outages is 19 times in the last 6 months, while the frequency of electricity brown out is 38 times. On average it took 124 minutes in each blackout. On average the frequency of telephone failure is 9 times in the previous 6 months. The problem with water quality from PDAM on average is 29 times in the last six months. The problems range from the smell, the color of water to services disruption. One important note is that the supplier of water supply is PDAM (local government company) that is usually more concerned with residential customers rather than industrial customer due to limited capacity as well as the scarcity of water sources. For this reason almost all of respondents in the sample use other water sources for production activities (mainly deep well), while PDAM water is only for office activities.

As in the case of PLN, the cost-sharing scheme for water provision is also commonly applied by PDAM for firms that locate far from the main distribution pipes. PDAM would ask firms to bear the installation cost of pipe construction from the nearest water terminal or water pump to their respective locations.

What is overlooked in this survey is the quality of road. Repeatedly the survey met with respondents that complained on the deterioration of road quality – in terms of physical quality as well as overcrowding. The travel time between the factory and main markets/shipping points is getting longer and longer. One reason behind the absence

<sup>26</sup> The scheme is often called public-private partnership in infrastructure provision.

of road indicator is that because we thought originally there would be no problem with road. In line with the focus of the survey which to obtain quantitative and objective measurement, travel time from factory sites to distribution points can be used as a proxy for road quality. However, learning from the experience of the first survey, we may still need a qualitative indicator of road, so in the next survey a couple of qualitative perception based indicators will be included as complement to our quantitative indicators, not only for road but also for other infrastructures as well.

But here one must aware that the perception indicator will not be the sole indicator. There may be problem in interpretation since the respondent response tends to be conditional on other matters in her mind. For illustration, we quote the results from other surveys, which were also implemented by LPEM. In the 2001 survey LPEM asked respondents to rank the quality road (and other utilities) from one to six. One is for very bad to six for excellent. In the 2005 LPEM-NBER survey, the same question is asked again. The results suggest that for road the percentage of respondents who are less than satisfied (therefore gave score of one, two or three) fell from 32% in 2001 to 26% in 2005, while for electricity increases from 24% to 26% - giving the impression that the road quality has improved. This conclusion might not fully agree with the casual observation in the field. Again, this is perhaps the main weakness of perception indicator. Respondents might feel that the quality of electricity has been deteriorating so bad, that even if the road quality has actually not yet improved, they could still think that the road quality was "better" because naturally every qualitative response is conditional on something. The best approach is therefore to include both quantitative and qualitative measurement in the study.

The other overlooked issue is natural gas as an alternative source of energy. In the field survey it was found that most large companies use natural gas as source of energy instead of using electricity. This becomes more common after the increase of electricity tariff. In the next survey, gas could be included as one indicators of infrastructure.

#### 4. SUMMARY AND POLICY SUGGESTIONS

The FDI approval in BKPM is slow, discretionary and unnecessary. Foreign investment procedures could be streamlined in the new investment law and its implementing regulations. Domestic investment procedures could be streamlined through improvement in the 1995 company law and the 1982 business registration law.

Inefficiency and corruption remains major problems at the import clearance procedure-Customs, port authorities and other entities share responsibilities. About 81% of the total burden of informal payment might be caused by these authorities, while another 19% of might be originated from other sources, including corruption at the local government level.

Minimization of human contact can be pursued further by full implementation of the EDI system, and also port infrastructures should be improved to shorten waiting time in unloading, by doing so eliminate these as sources of corruption and inefficiency. The current rule of thumb that requires 40% of imports must pass through red lane is too high and too costly for Indonesia to be competitive.

With respect to taxation, delayed VAT refunds are still major problems for exporter-manufacturer that depend on imported inputs. The waiting time should be shortened as the delay will tie up a huge amount of badly needed working capital. In other area of taxation the types of tax returns should be simplified as now there too many of them. Also, time spent in filing these returns each month can be more productively used elsewhere in firms' operation. Many countries require only quarterly or annual tax filing, not monthly filing.

Relative to the first years of regional autonomy, the "squeeze" on businesses through *informal* payments demanded by local officials may be declining presumably because of competition among local governments. These are apparent from the fall of two indicators of corruption: bribes as a percentage of production cost from 10.8% in 2001 to 1.8% in 2005, and percent of senior management spent with government officials from 12.8% in 2001 to just 4.9% in 2005. But national authorities, such as customs and tax, might not feel the same competitive pressures.

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