The May 6 Package: New Incentives to Export and Investment

Those who are interested in Indonesia's economic development must have had an uneasy feeling about the apparent defects of the government's reaction to the recent decline of international commodity markets and the tightening resource constraints resulting from them. While the signs of this decline have been detected as early as 1982 and a series of policy adjustments in the financial system have been initiated in the following years, the industrial and trade policies continued to deteriorate.

The complaints about the industrial and trade policies with the investment policy being one of their major component are well-known. Most important among them are the increased reliance of the import policy on rent-creating measures such as exclusive import licences, severe restrictions on the entry to many areas of new investments and the ambitious target of local content regulations. In other words, the flexibility of the financial system was lacking in the necessary support of a corresponding adjustment in the industrial and trade policies, meaning that contradictions in the overall economic environment were worsening.[1]

It requires an external shock for the government to fully realise the damaging impact of the accumulated contradictions. It was the decline of oil prices to an unexpectedly low level[2] which eventually led to the conviction that the financing of Indonesia's current account and that of the badly needed investment have now to rely on alternative sources. The imperative of both exports of manufactured products and the increase of private investments became clear. The long awaited adjustment in the industrial and trade policies was announced on May 6, 1986. A series of incentives were revived, known collectively as the May 6 Package.

Main Elements of the Package

Among the many incentives included in the May 6 Package, some are of particular importance to note. Firstly, the status of a full exporter which empowers a company to certain privileges, such as the freedom to choose an investment are, irrespective of the "negative list" of the Investment Priority

[1]See for instance Djisman S. Simandjuntak, "Frontiers for Further Deregulation in Indonesia's Economy," in *Indonesian Quarterly*, vol. XIII, no. 4 (October 1985).

[2]The 1986/1987 state budget was based on an oil price of US$25/barrel, yet the spot price has slided to about US$12/barrel with no sign of an immediate rebound as the underlying causes are structural rather than cyclical.

List,[3] can now be obtained under less stringent conditions, in that the minimum export-production ratio is reduced from 100 per cent to 85 per cent.

Secondly, a less stringent local content regulation is provided for exporting producers. Recognising the direct linkage between the costs and quality of production inputs on the one hand and the competitiveness of export on the other, freedom is given to exporting producers to directly import the inputs they need for the production of exportables, if the price of locally made inputs is higher than that of imported ones. In other words, the May 6 Package seeks to free export from the element of high costs which goes back either to inefficient local production of inputs or to exclusive licences that, unfortunately, have been growing in terms of their product coverage in recent years. Furthermore, a duty exemption is granted to exporting producers operating in the Bonded Area while a drawback system is available for the rest of exporting producers.

Thirdly, investment permits which basically are limited to 30 years, can be renewed. The renewal, however, is made dependent on the performace in reinvestment, the record in the creation of value added and the record in using locally produced components.

Fourthly, recognising the frequent complaints of potential investors about the difficulty they face in finding local partners,[4] the minimum equity participation of local partner(s) in joint ventures with a high risk of business failure, a need for big capital, a need for high technology, a location in remote areas or an export-production ratio of 85 per cent or more, is reduced from 20 per cent to 5 per cent. However, this local equity participation is to be increased to 20 per cent in the first five years of commercial operation and to 51 per cent in the following ten years.

Fifthly, a domestic treatment is given to joint ventures with local equity participation of 75 per cent or more. The same applies to joint venture corporations with a local equity participation of 51 per cent or more, provided that at least 20 per cent of the corporation's shares are made available to the public through the stock exchange. This change is not immaterial. It implies access to domestic distribution and to the domestic capital market which, on inscrutable reasons, was denied to joint ventures irrespective of whether or not they are dominated by local partners in terms of equity ownership.

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[3]This list contains a negative list of investment areas to which entry is basically closed. However, the list does not apply to investment which is fully export oriented.

[4]Notice that joint venture is the only entity which legally is open to foreign capital. A company with local equity participation of over 50 per cent is treated as a foreign company.

Sixthly, in respect to plantations and shrimp breedings which presently are perceived to be among the few areas in which Indonesia can improve its international competitiveness without much delay, the May 6 Package offers a minor relaxation of the core-plasm ownership formula. In this connection, it is important to recall that entry of big investment to these two areas is subject to the acceptance of the "Inti-Rakyat" scheme,[5] meaning that entry is provided only to an investor who is willing to open up a plantation or breeding area to be distributed among smallholders (the plasm) in exchange for an area to be owned by the investor (the core) and the right for operating a processing unit. The original core-plasm ownership ratio is 20 : 80, but the May 6 Package allows a ratio of 40 : 60 in the first ten years of commercial operations. Notice, however, that the ratio is to be brought back to the original one of 20 : 80 at the end of the tenth year of commercial operations.

Seventhly, with the announcement of the May 6 Package a promise is given to relax the Investment Priority List. The positive list, that is a list of investment areas which are open to new investment, is to be enlarged while the negative list is to be shortened. Meawhile, the Investment Board has issued a new Investment Priority List with a negative list which is in fact shorter than in the previous version.

There still are other elements of the Package such as the lowering of the minimum value of investment to US$1 million in favour of "small" foreign investments in the services industry with the exception of consultant and engineering services. However, it is the first seven elements which constitute the core of the Package.

Sign of Realism

The May 6 Package left many things to be desired if the private sector is really expected to boost investment and export of manufactured products simultaneously. Firstly, it refrains from touching upon some basic issues like the ones related to the serious erosion of the investment environment following the announcement of the January 22 Regulation in 1974. Not only has this regulation withdrawn some of the incentives provided by the two initial laws on investment, namely the Act of Foreign Investment of 1967 and the Act on Domestic Investment of 1968, but it also has resulted in a disintegration of Indonesia's business community.

Secondly, the way in which the May 6 Package defines the conditions under which each of the incentives is to be made available reflects clearly the

[5]Literally, Inti-Rakyat means Core-People, in which the Core is represented by the big investor and the People by a big number of smallholders.