Van Zorge Report on Indonesia

Commentary & Analysis on Indonesian Politics and Economics

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of the Van Zorge Report on Indonesia, our feature article examines one of Indonesia's longest running environmental disasters, the Sidoarjo mudflow. Almost a year after the grey tide first began to envelop the East Java town, neither the trigger of the deluge nor who will be ultimately liable for the cleanup has been decided. In the Interview section, we speak to three scientists with different theories on the reasons for the mudflow.

In the From the Editor section, we welcome in the new investment law, a landmark piece of legislation that could give Indonesia's faltering economy a much-needed shot in the arm. But a booster injection is not a cure for cancer. The outcome of the Newmont trial will tell whether Indonesia's legal system has gone into remission or remains in terminal decline.

Intelligence details bogus bank guarantees given to construction projects in Aceh, putting millions of dollars of donor money at risk. It also examines the conservative mindset behind the Ambalat block dispute and looks at alleged political interference in the National Commission for Human Rights.

This month sees the race for the Jakarta gubernatorial elections beginning to heat up. But with only two or three candidates in the running are the public being sold out? The In Brief section examines this issue along with the latest revelations of corruption in the notoriously graft-ridden State Logistics Agency. Finally, the Report tracks how Indonesia's bilateral relations with Timor Leste are being threatened by the ironically named Truth and Friendship Commission.

In Parliament Watch, our continuing series on the nation's House of Representatives, the Report looks at the proposed amendments to the 2003 Labour Law, currently stuck in legislative limbo. Can the government go under the unions' radar and push through some changes?

In the expanded Industry Briefs section we interview one of the chief architects of the investment law. We also detail trials and tribulations of software giant Microsoft's ongoing fight against piracy. Could it have lost the support of its most important ally?

We hope that you find this issue useful and of interest to yourself and your colleagues. Please feel free to contact us here at the Report if you have any comments or suggestions; we are genuinely grateful for your feedback.
FROM THE EDITOR...

Justice for all?

In a landmark piece of legislation, the national House of Representatives has finally passed a new bill to replace the old 1967 Foreign Investment and 1968 Domestic Investment laws. The new law includes provisions for stronger property rights, relaxed immigration rules, tax incentives, one-stop licensing for investors, and protection from expropriation.

The good news is that, in principle, the law provides for equal treatment of foreign and local investors. When the law and implementing regulations are signed by the president—which is supposed to occur within the next 30 days—there should be reason for considerable optimism about Indonesia's future as an investment destination. For an administration that has come under increased criticism from the international business community for not doing enough to improve the investment climate, the new law will be seen as a significant step forward. The president and his economic team deserve a loud round of applause.

While the new law will provide Indonesia with an important framework for dealing with business, one critical question remains: Will government officials also change their attitudes and behaviour toward investors?

Since 1998, foreign and local investors alike have watched in dismay as numerous companies have faced a series of unfriendly administrations. Mexican cement giant, Cemex, is a case in point. After investing hundreds of millions of dollars in the state-owned cement producer Semen Gresik, corrupt politicians conspired to strip cash from the company in violation of a previous agreement with the government. Eventually, Cemex's corporate heads in Monterrey threw up their hands in disgust and sold their minority shares to a local buyer.

A more recent case worth watching is the trials and tribulations of Newmont, the world's largest gold mining company. Under the Megawati presidency, Newmont was attacked by local NGOs on bogus charges of pollution. Soon after, Megawati's administration joined the fray and in spite of a mountain of scientific evidence that Newmont had not polluted, the Attorney General's Office filed civil and criminal cases.

When President Yudhoyono took over the reigns of power, there were high hopes that he would call for a reassessment of the legal proceedings and let Newmont get on with its business. Instead, the company was pressured into making a US$30 million "goodwill" payment to the government to make the civil case go away. And, Rick Ness, the firm's president director at the time, was told that he would still have to stand trial on criminal charges.

The judges presiding over the Newmont case are expected to issue a verdict on April 24. At stake is not just the well-being of an innocent man, but also Indonesia's reputation. If the judges should rule against Newmont, then there is little doubt that it will result in a major setback for the government's efforts to improve the investment climate. New investment law or not, if Indonesia's leadership does not make sure that the rule-of-law and not rule-by-law prevails, then all bets for an improved investment climate will be off.

As the trial comes to a close, it has become apparent that very powerful local corporate interests with ties to the political elite are intent on gaining a foothold inside Newmont's operations on the island of Sumbawa.

Bumi Resources, a mining company controlled by the Bakrie family, has recently partnered with the local government in Sumbawa to finance a share purchase of Newmont. Bumi Resources already proved its adeptness in such moves when it previously raided another foreign mining company, Rio Tinto's Kaltim Prima Coal.

Newmont's original contract of work obliged it to divest some shares to a local entity, with the national and local governments getting the right of first refusal. With no expression of interest from the central government in the shares, the provincial government of West Nusa Tenggara has signaled that it would like to make the purchase—with Bumi Resource's backing.

This is potentially a nightmare scenario for Newmont. Bumi Resources looks set to exploit the situation and enter into the firm's business through the rear door. And, if the experience of Kaltim Prima Coal is anything to go by, Newmont could also become subject to asset stripping on a scale that could spell financial disaster.

Knowing the connections that Bumi enjoys and how business is sometimes conducted in Indonesia, one cannot
help but wonder whether or not the Ness case will fall victim to vested interests. In the worst-case scenario for the company, Ness will be found guilty and given a stiff fine, perhaps even go to jail. If that happens, heads at Newmont headquarters will have to seriously reconsider staying the course in Indonesia. In turn, such a nightmare could be a dream come true for Bumi Resources because a distressed asset usually translates into discount prices. This will be music to the ears of the principals behind Bumi if they set their sights on acquisition.

The next few weeks will be interesting ones for Indonesia. After having passed a watershed piece of legislation for investment, very soon we will discover whether or not the Yudhoyono administration really intends to deal foreign investors an even hand.
Intelligence

Bogus bank guarantees issued for Aceh rebuilding

Up to 90 percent of bank guarantees issued for construction projects in Aceh are likely to be bogus, putting hundreds of millions of dollars of international aid money at risk, a Report source says.

The executive from an international finance agency said he had scrutinized a sample of “around 30” guarantees purportedly issued by Indonesian banks for rebuilding work in the tsunami-hit province.

The certificates, granted to large national construction firms, were for NGO-managed projects worth between “a few hundred thousand dollars up to around US$10 million.”

Most of the documents looked real. But when the issuing banks were contacted about 90 percent had no record of the debt paper. Around 10 percent of the documents were obviously fakes, the source said.

“Some didn’t even have proper letterheads—the quality was so bad, it was like someone had gone to a McDonald’s and written them on the back of a French fries packet.”

Getting a bank to guarantee construction work is standard international practice to insure a project. It is meant to protect both the manager of the venture and the contractor carrying out the work. They generally require builders to finish their work within a certain time and also cover a building’s structural integrity over a specific period.

If a dispute occurs between the project manager and the contractor then the guarantee can also be used to help recover the manager’s money.

The source said international banks normally issued guarantees after performing due diligence on the builder. The construction firms then pay the banks some collateral, often a small percentage of the contract of work.

However, Indonesian banks were generally unwilling to take any risk on building projects, and invariably demanded up to 100 percent collateral from construction firms.

This unrealistic demand creates a disincentive for companies to follow good management practices, he said. Enterprising bank officials then created an industry out of issuing forged guarantees.

The source said he found bogus certificates printed on letterheads from all the major Indonesian banks, including the largest lender by assets, the government-controlled Bank Mandiri.

According to the source, on some occasions the construction firms were not even aware the papers they had were fake.
“Some of these certificates look very convincing. So it’s not fair to just blame the builders. There is quite a high degree of willingness from these construction firms to engage in good business practices, and often they are quite proactive in this regard.”

Despite this, the practice is well-known in Indonesia, and is as common in Jakarta as it is in Aceh, he said. International aid agencies and their NGO managers were increasingly becoming aware of the risk and were now “putting pressure on the builders to do something about it.”

The best institution to solve the problem is the Indonesian government, the source said. Instead of expecting private institutions to guarantee the projects, it would be better for the state to underwrite NGO-based schemes, he said.

“The Aceh-Nias [Rehabilitation and Reconstruction] Agency is sitting on billions of dollars of aid money that still hasn’t been spent yet.”

“It would be far better for the government to create a quasi-financial agency using that money to help insure the projects.”

Military fears Indonesia will lose Ambalat

Increased naval exercises around the Ambalat oil and gas block reflect conservative fears that Indonesia will lose the disputed territory to Malaysia if the case goes to international arbitration, a Report source says.

Both countries’ militaries have increased patrols of the area in the past two months. In a recent seminar Defense Minister Juwono Sudarsono advocated increasing Indonesia’s armaments to act as a “deterrent force” to trespassers.

The source close to the military believes that a legal claim on the area will suffer a similar fate to the Sipadan and Ligitan islets, which were awarded to Malaysia by the International Court of Justice in 2002.

Both countries had claimed those islands using a number of historical sale agreements and maps. Rejecting all these arguments, the court ruled Malaysia should have the islands because it had built lighthouses in the territory and regulated the collection of turtle eggs there.

Despite this, officials here believe Britain’s Somerset House refused to give the Indonesian legal team a vital map that could conclusively prove its claim on the territory. This, the rationale goes, is because the institution was biased against Indonesia as a non-Commonwealth country.

Resentment over this decision is believed to be behind Indonesia’s reluctance to sign a mutual defence agreement with Singapore.

This fear of prejudice has also led conservatives in the military to push the government for a martial solution to the Ambalat dispute.

“A diplomatic approach may take quite a long time and it is bound to be
fruitless, so I suggest the government to hold a military campaign against Malaysia. We may not win, but at least we will keep our dignity,” the source told the Report.

**Komnas HAM ‘compromised’**

The political horse-trading surrounding the appointment of new delegates to Indonesia’s major human rights commission only shows how compromised the supposedly independent body is.

Speaking to the *Report* on the condition of anonymity, a candidate for the National Commission for Human Rights (Komnas HAM) alleged a senior member of the Indonesian Democratic Party of Struggle had promised to guarantee his appointment if he attacked the government on rights issues.

Meanwhile, Golkar and Democrat Party delegates were approaching other candidates offering them a seat on Komnas HAM “to protect—or not to protect—military figures accused of committing human rights violations,” he said.

According to the 1999 Law on Komnas HAM, legislators are authorized to select 35 commissioners through fit-and-proper tests.

The current commissioners terms of service will end this August. Around 200 candidates, including human rights activists, legal professionals and senior journalists, initially applied for the positions. That number has now been whittled down to 68. Final screening will start in mid-April, with the House's Commission I approving the final 35 in August at the latest.

Komnas HAM has previously been criticised for doing little to push for investigations into the 2004 murder of noted human rights campaigner Munir Said Thalib. Commissioners have also been accused of dragging their feet over probes into the Trisakti shootings and Semanggi I and Semanggi II incidents of 1999.
**THE SIDOARJO DISASTER**

**Clear as mud**

It is said that mixing science and politics makes a strange brew. The two are often thought to be polar opposites, with science focused on the pursuit of empirical truth, and politics the pursuit of interests. But as scientists throughout the ages have discovered, politics and sciences habitually collide, sometimes to the detriment of both disciplines. Witness Galileo, the acclaimed 17th Century astronomer, who was tried for heresy in Rome after he proved that the sun revolved around the earth, rather than vice versa.

Indonesia’s latter day Galileos, scientists caught up in a whirlpool of interests, are the geologists and engineers who have commented on the Sidoarjo mudflow, known locally as Lusi, a contraction from the Indonesian lumpur panas. Emanating from around a commercial gas drilling operation, the mudflow has so far engulfed more than 400 hectares of farmland, homes and businesses, forcing 12,000 people into temporary shelters.

But something strange has been happening since the mudflow first began. Almost a year into the disaster, the assessment of what triggered the eruption and who is therefore responsible for its costs has become less, rather than more, clear. While in some ways the scientists may appear to be at the centre of the debate, what has become increasingly apparent is that liability is being allocated through a chaotic process of political negotiation. But, like the mudflow itself, what exactly these negotiations are being based upon remains opaque.

As Lusi’s one-year anniversary approaches and the term of the government team created to handle it ends, the Report takes stock of the current situation. First, it details the current level of compensation paid to the mudflow victims and who is likely to bear the brunt of the disaster’s costs. Then it features an interview with three international scientists, who have differing opinions on the trigger of the mudflow (see *The Scientific Debate*, p.13).

**The art of escapology**

Just three weeks into the mudflow, the residents of Sidoarjo were already beginning to get desperate. Left to watch helplessly as the ever-rising deluge took possession of their homes, some villagers began to frantically dismantle dams to divert its flow. This prompted Indonesia’s leaders to swing into action, with Vice President Jusuf Kalla visiting the site on June 20 to calm frayed nerves.

Kalla assured the residents that “All losses affecting local residents from the mudflow, such as to their homes, will be borne by [gas prospecting company] Lapindo Brantas … as well as compensation for the damage to a nearby turnpike, rice fields, schools and other public buildings.”

“Whatever the amount asked for, whether it is Rp 5 billion (US$533), Rp 10 billion or more, Lapindo will pay it,” Kalla said.
Just weeks later, however, that message began to change. At the same time the owners of Lapindo went into emergency mode. But they did not confine their attempts to disaster mitigation and helping the victims of the mudflow; also on their list of priorities was saving their business interests.

At first Lapindo looked to be in deep trouble. Days after the deluge began, one of its business partners, Indonesian oil and gas company Medco, accused Lapindo of gross negligence in its drilling operations. The company, Medco said, had failed to put proper casing on its well, an industry-standard procedure that some say could have prevented the disaster. Filing for arbitration in the US to prove its case, many believed that as an inside party Medco would be able to produce the evidence necessary to clear up just exactly what happened.

Fast forward to March 2007, and it looks likely that Medco’s arbitration will no longer be pursued. Not due to a lack of evidence or a change of opinion, but because Medco’s shares and therefore liability were recently bought by a firm owned by the same company that owns Lapindo. In effect, Medco has bargained the lawsuit in exchange for escaping their share of the liability.

The purchase of Medco’s shares by Lapindo’s parent company, Energi Mega Persada (EMP), followed hot on the heels of several attempts to sell Lapindo to other companies also owned by EMP. Blocked by the Indonesian stock market regulator, these attempted sales were seen by many as an EMP effort to escape liability for the mudflow. Others, however, have pointed out that it is “good business practice” to isolate a troubled firm from its parent company.

Were these sales an attempt to reduce EMP’s future liability? “It’s difficult to say,” environmental lawyer Achmad Santoso told the Report, “it would depend on the sale agreement.”

The degree to which Lapindo’s parent company could be held liable for costs incurred by its subsidiary is vital to the issue. EMP is one of Indonesia’s richest energy companies with declared assets worth US$1.08 billion in 2006. Meanwhile the total cost of the mudflow’s compensation and clean up has been estimated as high as US$800 million. Santoso notes that even if Lapindo declares bankruptcy in the future, the company’s costs could be passed on to EMP through a provision in the company law called “piercing the corporate veil.”

However, with Indonesia’s recent experience of holding the shareholders of troubled companies to account, one cannot be too optimistic. In the aftermath of the 1998 Asian financial crisis similar attempts were made to pass responsibility for huge debts to the shareholders of companies and banks. At that time, some shareholders did accept responsibility. But most tellingly, the process through which this occurred relied on non-transparent deals between the government and the business people concerned. Indeed the ultimate majority owners of Lapindo—the Bakrie family—were subject to just such a deal. At the time though, current Minister for People’s Welfare and powerful political player, Aburizal Bakrie, headed the family firm.

In addition to these business contortions, Lapindo began a full-scale media
A campaign to change public opinion about the trigger of the mudflow, which included sponsoring a scientific workshop in February this year. Leaving aside all prior evidence, the workshop concluded that the mudflow was a “natural disaster”, caused by natural processes. These remarks, publicised in part through Lapindo’s specially created media centre, were widely reported. However, Lapindo’s “star witness” Jim Mori, the US scientist widely credited for proposing the earthquake-eruption theory, told the Report that such language simply confuses the issue.

“We have to differentiate between the cause and the trigger of the eruption. The cause is a natural phenomenon: there is something very large, hot and volatile underneath the site there, which is causing the eruption. It only begins to get contentious when you start talking about the trigger, or what actually initiated the eruption,” he said.

Despite an ongoing debate between scientists of what prompted the deluge, many local and some international media are now reporting that the mudflow was triggered by the earthquake as a matter of fact.

The liability foxtrot

In Indonesia, everything is open to negotiation and nothing stays fixed for long. Determining just who is going to be held responsible for the mudflow is no easy task because statements about the costs of the disaster and who should be made to pay have shifted from month to month.

The most solid evidence that Lapindo is being held culpable for the disaster is a presidential decree issued in September 2006, which stated Lapindo must pay Rp 3.8 trillion (US$416 million) to deal with the mudflow. This figure includes compensation and alleviation efforts, with Rp 1.3 trillion (US$142 million) due before the end of March and another Rp 2.5 trillion (US$274 million) to be paid afterwards. But has the company really paid up?

According to the government team set up to handle the mudflow, Lapindo has spent Rp 900 billion (US$99 million) on the mudflow until this March, around US$40 million shy of the figure in the presidential decree. Of the Rp 900 billion so far paid, around 60 percent has been spent on failed efforts to stop the mudflow. Far less has been spent on the affected residents. The information released by Lapindo’s media centre records just Rp 40 billion paid in compensation to the mudflow’s victims until February 20. An additional Rp 9 billion has been paid for the rent of land used to alleviate the mudflow. This leaves a mysterious Rp 310 billion unaccounted for.

As for the other shareholders in the gas concession, Medco appears to have paid nothing and in view of its recent deal, it does not seem likely that it ever will. The Australian firm Santos has paid US$16.3 million towards costs until January 2007. Santos executives have publicly complained that the firm is being kept at arm’s length and that getting information on developments has been difficult.

But as the sole operator of the gas concession, Lapindo has been the main focus of compensation claims and, judging from the above data, the company

Lapindo has also been busy spinning the news in their favour.

Lapindo’s spin has only led to further confusion.

The presidential decree clearly states how much Lapindo should pay.

Lapindo has failed to make the full payments within the time given.

Medco has paid nothing and Santos US$16 million.

It is also unclear what the money spent so far has gone towards.
has failed to meet the presidential deadline. Also unclear is the exact use of the funds already spent. Meanwhile, many Sidoarjo residents have protested angrily about the unfulfilled promises of compensation, staging increasingly desperate demonstrations in Jakarta and Sidoarjo.

**Lapindo claims payments can not be made without land certificates.** Nevertheless, some funds are coming through from Lapindo, and on its part the firm claims compensation has been held up by the residents’ lack of land titles. This is indeed a problem in Indonesia, where an estimated 75 percent of landowners do not have the requisite papers. Because of these problems, Lapindo now has some more wriggle room, with the company saying certification must be obtained first before it will pay out. This was then contradicted by the head of the Indonesian Land Agency, who said the mudflow victims did not need the certificates to claim compensation.

**Lapindo have already announced that their funds have run out.** Meanwhile at the end of January, Lapindo began to publicly state it could only pay Rp 1.3 trillion toward the mudflow’s costs. If the total bill exceeded that figure, the government would have to pay the remainder, a Lapindo spokesperson said.

**The issue of liability has recently moved to who will pay for the destroyed infrastructure.** By March 5 of this year, however, the issue of liability had moved again. This time the Minister of Public Works Djoko Kirmanto announced the original estimation of Rp 3.8 trillion would not be enough to cover all the mudflow’s costs. Grumbles had already been heard from senior bureaucrats in the Ministry of Finance as early as two months after the presidential decree was issued. Once the number crunching by officials began, it became quickly apparent that the price tag of the disaster would more than double to Rp 7.6 trillion (US$835 million) once the cost of rebuilding roads, rail links and power infrastructure was factored in.

**Agung Laksono announced that the government would pay for infrastructure.** Immediately after the release of the revised figures, House of Representatives (DPR) Speaker Agung Laksono declared the government would pay for the extra costs. But Minister of Finance Sri Mulyani did not seem so certain. “There is no more money available to finance the restoration,” she said on the same day as the announcement.

**The finance minister seems less keen to cover the costs.** According to Mulyani any government liability in the disaster should be settled “through a legitimate political process,” using “…a presidential decree or an agreement between the government and the House” before she would put it into the mid-term budget revision.

**Some NGOs think the government should step in.** Despite Mulyani’s reservations, some NGO activists interviewed by the Report agreed that the government should pay for rehabilitating Sidoarjo up front, since the situation called for immediate action. However, they also emphasised the public money spent should be claimed back from Lapindo once the question of liability was settled.

“I think Lapindo can use the government’s money as a loan, but this must be reimbursed later if Lapindo is found to be negligent,” Ivan Agueng, an advocate for the Indonesian Forum for the Environment said. Santosa agreed, adding “but it is crucial that the public knows exactly who is paying for what, and that it doesn’t get submerged.”
Everyone, it seems, is still waiting for the final decision on who will be held liable. But what kind of information will such a decision be based on, and who will make it?

**Moment of truth**

Most observers are currently pinning their hopes on a slowly moving and poorly funded police investigation. East Java Police officers have so far detained 13 suspects from Lapindo and its subcontractor company, the majority of whom are low-level on-site managers. This, says Ivan, is patently unfair. “In the mining industry there is a site report filed with all the executives of the company every day, so everyone knows what’s going on. The executives all knew that the drilling was going ahead without the necessary casing,” Ivan told the *Report*, referring to the alleged lack of protection in the well.

Even so, Ivan is hopeful that the police investigation could bear fruit. On the other hand, this too could end up as part of a bargain. In a statement before a DPR commission, provincial police chief Herman Suryadi Sumawiridja, declared that the police investigation showed the eruption to be triggered not by negligence, but instead by “human error”.

“We have documentary proof as well as drilling instruments,” he told a press conference on March 7.

However, in a potential taste of things to come, he also complained that the Attorney General’s prosecuting team had already returned the police’s case files against the defendants twice.

“The prosecutors have said that the situation was a natural occurrence, whereas our suspects tell us it was due to human error,” he said.

Under the best of circumstances, a case such as Lapindo’s can take a long time to resolve. But if the prosecutors obstruct the proceedings, the government will be faced with paying Lusi’s costs over the medium term with no clear mechanism for how this money will be reimbursed. “The President should make some indications about who he thinks is responsible while the legal process is continuing. In Indonesia the legal process depends on politics,” Ivan told the *Report*.

While waiting for the court decision, the situation has recently come to a complete impasse. With Lapindo’s payments to the national team already stopped, the Minister of Mines and Energy, Purnomo Yusgiantoro, has publicly stated his unease with the current lack of direction on the issue. “We need clarification on the status. Whether we will be using the state budget from now on or not will depend on that decision,” Purnomo said recently.

With all three of the scientists interviewed by the *Report* saying that they have not been contacted by the Indonesian government, just what that decision will be based on remains to be seen. □
The scientific debate

The degree to which Lapindo or the government are taking responsibility for the costs of reconstructing Sidoarjo has shifted over time. At the beginning of the disaster in May 2006, the blame fell squarely on the shoulders of Lapindo as news began to break of several major irregularities in the drilling operation.

However, this perception changed gradually with Lapindo’s launch of a full media campaign, culminating in a scientific workshop at the end of February. Held by the government’s technology agency, the BPPT, with some sponsorship by Lapindo, the main message to come from the workshop was that it was not the drilling, but the earthquake that caused the mudflow.

“According to data and analysis, the Sidoarjo mudflow is a natural activity,” the chairman of BPPT, S. Jenie, said at the end of the workshop, adding that the "central government must therefore handle the situation.” Seemingly in support of this position, Jim Mori, a US scientist working in Japan who spoke at the workshop, was widely quoted as saying that “the mud volcano would still have happened without any drilling.”

But this was not the end of the matter. Perceived by many as being at best one-sided and at worst a deliberate manipulation of scientific theories, critics lined up to question the validity of the workshop’s findings. Two British scientists, Richard Davies and Richard Swarbrick, were among those who contested the workshop’s main message.

In an effort to bring some clarity to this debate, the Report contacted Mori and the British team for further comments, bringing together the three scientists for the first time. What follows is an edited excerpt of the discussion.

VZR: Jim, can you say something about how you came to be invited to the workshop? Were the organisers aware of your position about the role of the earthquake in the mudflow before you were invited?

Mori: I was invited to attend the conference by a Lapindo representative and the company paid for my travel. They were aware of my interest in the possibility of the earthquake triggering the mudflow since I had talked with Lapindo people in Sidoarjo when we visited the area in December. Besides the travel for this conference, I have not received any other support from Lapindo.

VZR: Are you happy with the main message that has come out of the workshop, that the mudflow was caused by the earthquake? Is that what you expected?

Mori: It is probably not reasonable to expect ‘independent’ or ‘fair’ conclusions from any conference. Consensus type statements are always judged considering the participants. I do not think the main message that came out of the workshop was, 'the mudflow was caused by the earthquake'. My impression of the main point of the concluding discussion (which was in Indonesian so I did not understand it) was that it was a 'natural phenomenon'. This means the cause was a natural reservoir of hot fluids and mud (the reservoir was not created by the drilling). I am not sure what was concluded in regards to the effects of the drilling or the earthquake.

VZR: Can you all briefly describe your explanations of what caused the mudflow and raise any points of contention?

Mori: I don’t really have any well-formulated model or explanations of how it started. But I think first of all we have to differentiate between the cause and the trigger of the eruption.

Davies: I think the conclusion of the BPPT conference was 'unfortunate' and to be quite honest I have difficulty working out how this conclusion was arrived upon. Yes - volcanoes occur in this area naturally, but this volcano was most likely not a natural one, that occurred 200 metres from an exploration well that had (by coincidence?) also been having significant well-control issues.

VZR: Are you happy with the main message that has come out of the workshop, that the mudflow was caused by the earthquake?
The cause is a natural phenomenon: there is something very large, hot and volatile underneath the site there, which is causing the eruption. It only begins to get contentious when you start talking about the trigger, or what actually initiated the eruption. The question then becomes ‘would the eruption have happened anyway even if there had not been drilling or an earthquake?’ I think it would have. We do not know the size or the time scale of such an eruption, but it might have been hundreds to thousands of years.

And then you get into the question ‘What is the relationship of the eruption with the drilling and the earthquake. Well I think it’s very reasonable to say that the drilling had some effect. It does seem too much of a coincidence that the drilling happened 200 meters away from where the eruption occurred. In the same way, I think that the earthquake also had an effect. Again just because of the timing. The earthquake happened and then six minutes later there was some change in the pressure of the well. Both those things seem to me to be more than just coincidences so that’s why I think that both the drilling and the earthquake had some effect on triggering this particular eruption.

Davies: We think that the well was drilled very close to a major aquifer to a depth of 9297 feet and that there were some issues with well control at that depth which led to a sub-surface blowout. This blowout meant that the fluid in the rocks then caused a fracturing of the rock that they drilled through. Because the well was not protected by casing, these rocks were fractured by the pressure of the fluid that they drilled into. There are records of well control issues on May 27 which provides evidence they were having problems controlling the pressure of the well, and there is also evidence that operational problems led to a loss of control of the well. I think they tried to pull out of the hole and when doing so they finally lost control of the well.

This kind of drilling site problem has happened before, in Brunei in the 1970s, for example. There is nothing particularly remarkable about the geology or the processes which started the mudflow in Sidoarjo, so we don’t believe that you need an earthquake to explain what happened.

In response to the idea that problems began just six minutes after the eruption, I understand that 25 barrels of mud were lost in the well just 10 minutes after the earthquake. That’s new information that has just come out recently. The first information released was that problems occurred six hours after the quake. So various bits of information are coming out that didn’t come out initially. The first information was that it was six hours, then ten minutes and now I hear that it was six minutes, so the timing between the earthquake and the accident is certainly getting less.

I also want to respond to Jim’s idea that the mudflow would have happened anyway at some point in the future with or without the drilling. The natural failure of a rock seal normally occurs at the structurally highest point. This is not actually at Sidoarjo, but at or near the Porong-1 well, a few kilometres away—where there is evidence for natural rock seal failure already. In other words, East Java is susceptible to mud volcanism but Sidoarjo is not the natural location for this. Local geological conditions would favour eruptions elsewhere, near the Porong-1 well for instance.

Mori: If weak zones already exist around the well, this means the ‘triggering’ (maybe from an earthquake) can be possible. Is it possible that the earthquake unlogged vertical fractures at Porong that started a process leading to the eruption?

Let me just go through some of the reasons why I think the earthquake should also be considered as a trigger to the eruption. A pressure change was recorded in the well just a few minutes after the earthquake. This could have led to a cascading effect, where small changes in pressure can lead to a rock fracture opening and the eruption.

Another nearby well apparently had a flow rate response to the earthquake. So there are indications that the earthquake did affect the local pressure conditions.

I agree there are many good reasons that indicate the eruption is related to the drilling, so I am not saying that the earthquake is the only trigger. I think that the earthquake may also be a contributing factor in addition to the drilling. This is a very unusual occurrence. I don’t know of any other examples where an eruption has occurred several hundred meters from the well site. An unusual event may need an unusual set of circumstances.
VZR: Jim presented a graph at the BPPT workshop that seemed to suggest no other recorded mudflow has ever been triggered by an earthquake as small as the one felt in Sidoarjo (see above). Is it therefore fair to say that, while scientific opinion can differ on the exact trigger of the mudflow, it is statistically highly improbable that the earthquake had any impact on the mudflow at the time it erupted?

Davies: Correct. I think anyone introducing the earthquake has to provide a clear and well-founded geological argument for the exact processes they expect occurred. Other studies show that the Sidoarjo mudflow is an anomaly if we conclude it was triggered by the May 26 earthquake. Michael Manga and Robert Mellors authored two papers which support the idea that in comparison with other mudflows around the world, the earthquake which hit Yogyakarta on the 26th May was too small and too far away to have an impact on the Sidoarjo mudflow.

Mori: The point I was trying to make is that we see pressure changes, earthquakes, and other fluid related activity, that are triggered by very small motions from earthquakes at very large distances. Then, the pertinent question is whether or not these small changes can trigger an eruption.

I think that the drilling also had an important effect. Maybe, the drilling perturbed the system, and the earthquake was the final ‘straw the broke the camel’s back’. Other mud volcanoes probably did not have both drilling and an earthquake occurring at the same time.

It’s just one of those intriguing questions that is just difficult to prove one way or another but there are more and more examples of triggering with the kinds of levels of earthquake that you might not expect. Earthquakes that are not felt have had very large effects all over the world.

VZR: Economics Minister Boediono is on record saying that ‘the government has yet to decide the status of the mudflow in Sidoarjo, pending inputs from experts from Japan and UK. Have any of you been contacted by the Indonesian government for your input?’

Mori: No
Davies: No
Swarbrick: No

VZR: Have you received full cooperation from Lapindo?

Davies: Lapindo rang us after our paper came out and told me that some of the detail of our paper was not correct—but nothing they said changed our model. I also informally chatted to one of the Lapindo staff at the Feb 2007 Jakarta conference. That’s the only contact—very little. This was one month after our paper came out in the journal GSA Today.

Mori: My associations with Lapindo have been only informal discussions in Sidoarjo and recently in Jakarta.

VZR: Do you have any advice on what can be done to alleviate the mudflow? Are relief wells or the concrete balls the better option?

Davies: It is possible to calculate the volume of the aquifer and use the information to estimate the mudflow’s life-span. Then a dam system could be designed which is more significant than the earth dams currently used to cope with the upper estimate of the mudflow’s life-span. The mudflow can then be left to die out naturally.
Too hot to handle

With the threat of a national strike looming, the government last year shelved plans to amend the 2003 labour legislation. In the second instalment of the Parliament Watch series, the Report checks up on the progress of the draft bill.

If there is anything guaranteed to stoke nationwide protests, it is amending the country’s labour legislation. Long seen as a lightening rod between employers and workers, the amendments to the bill proved too controversial last year when they were introduced by the government to the DPR.

Representing the government, the Ministry of Manpower was behind the draft law, which it had finalized by late February 2006. The overall substance of the bill was backed by the Indonesian Employers Association (Apindo). However, in March 2006 it too submitted its proposed revisions. On the agenda were suggestions to increase outsourcing and contract-based labour, reduce severance pay for dismissed workers and have minimum wages decided by bipartisan negotiations without government interference.

Most importantly were amendments designed to simplify dismissal procedures, long regarded as the most unfair and rigid in Southeast Asia. Employers have frequently reiterated that the current rules make the process of firing underperforming or even grossly negligent workers time-consuming and extortionately expensive. This, they say, is a major impediment to more investment, and is putting Indonesia at a comparative disadvantage to neighbours like China, India, Korea and Malaysia.

On the other side of the argument are the nation’s two major labour unions, who have staunchly opposed any changes to pay and conditions, which they argue are already among the lowest in the region. With vocal support from the Indonesian Democratic Party of Struggle (PDI-P) and other legislators from the National Awakening Party (PKB), it was this collusion of interests that won out last year.

Widespread labour rallies and a concerted political campaign in the DPR meant the bill never even went through its first stage of official amendments. The draft was shelved before it reached Commission IX on manpower which means that currently no one can formally question its content.

However, it now seems the government has a new strategy designed to avoid the arduous political debate. Instead of altering the 2003 law, quieter changes are being proposed to amend the existing law’s implementing regulations, a business source told the Report. These are meant to dovetail with the 2007 Investment Law just passed by the House.

“Issuing new government regulations is a win-win solution [for business and the government]. The government can avoid the protests in the labour market which are likely after the implementation of the new law on investment,” the source said.

It remains to be seen whether changes to the implementing regulations will occur, although if they do, sources tell the Report the process could begin in the next two months. However, with labour officials vigilantly scrutinizing government actors, further industrial fireworks are highly likely.
Ganging up in the gubernatorial race

Following the March 15 announcement of a 17-party coalition to support Fauzi Bowo in the Jakarta gubernatorial race, the political factions involved are becoming increasingly anxious they have made a major tactical blunder. But as the May 18 deadline for registering candidates approaches, they may be running out of options fast.

The August contest is shaping up to be a two-horse race between Bowo and the Prosperous Justice Party's candidate (PKS) Adang Daradjatun. An outside chance comes from an unlikely alliance between the National Mandate the National Awakening parties. Just last week, the traditional rivals announced their nomination of legislator Sarwono Kusumaatmadja for the governor position. However, neither PAN nor the PKB can agree on a deputy and observers have speculated this alliance could quickly evaporate.

In terms of significance, Jakarta's gubernatorial elections are second only to the national party and presidential elections. The financial stakes are high, with the victor's political backers set to gain control of an annual budget worth more than Rp 20 trillion (US$2.19 billion). A win in these polls is seen as a barometer for future success in the 2009 national elections. If the PKS candidate succeeds in taking the post, it is considered likely that their showing in the 2009 elections will be strengthened.

This is also the first time that the 7.8 million inhabitants of Jakarta will directly elect a governor. Before the change to the election law in 2004, voters were only able to choose a political party in the local elections. The governor was then decided behind closed doors by the political parties with the most votes.

The announcement that 17 political parties will form a coalition to back incumbent deputy governor Fauzi has sounded warning bells, since the coalition includes arch rivals PDI-P, Golkar and the Democrats. Candidates backed by multi-party alliances are not uncommon in Indonesian politics since only parties with an electoral threshold of 15 percent are allowed to nominate gubernatorial, and indeed presidential, candidates. This means that smaller parties have to group up with the majors if they want representation.

However, giant-sized political groupings of this size are still unusual, and the present shape of the contest says as much about the political establishment's apprehension of the PKS as it does about the significance of the prize.

There are some good grounds for the major parties to fear the Muslim-based group. Jakarta has been a PKS stronghold since its rapid rise in the 2004 local elections when it won 24 percent of the seats on the Jakarta Provincial Council. By 2005, it had also triumphed in the Depok mayoralty, and polled well in the Banten, Tangerang and Bogor races.

However, more recently the party's support has flagged. Joining the national government coalition has meant the party leadership has become implicated in some damaging corruption scandals. Backing the nation's controversial
IN BRIEF: POLITICAL

anti-pornography bill has also cost it patronage from more moderate voters. In Jakarta, the willingness of the majority PKS council faction to work with Governor Sutiyoso means they are seen by many to be in the incumbent’s pocket, and this has also hurt the party.

Nevertheless, by opposing the PKS in such a heavy-handed way, many are worried that the coalition is giving the party undue importance. It is also seen as allowing voters the option of choosing the Islamist party to protest against entrenched power interests. Amidst widespread public criticism of the coalition, observers have argued that the mainstream political parties are selling voters short.

Previous elections have shown that political parties have paid dearly for joining in opportunistic grabs for power. The best example of this is the 2004 presidential poll, when Megawati Sukarnoputri’s high-powered Golkar-PDI-P coalition lost in a landslide to Susilo Bambang Yudhoyono and his start-up Democrat Party.

For the major parties, the realization of this tactical error has only come recently. Some political actors are now focussing their hopes on changing the election rules by amending the Jakarta Administration Bill, currently before the national House of Representatives (DPR). This has led to some unusual suggestions and some strange political bedfellows.

To shore up support for the current coalition, incumbent Jakarta Governor Sutiyoso has suggested changing the law to allow the future governor to have up to four deputies—each from a different political faction.

The small number of candidates has also led to renewed calls for a revision to allow independent candidates to contest the Jakarta polls. Support for this idea comes from liberal intellectuals, who would like to see the party stranglehold on national politics ended. But it also is backed by a conservative military faction, who fears the ascension of a police-backed PKS leader. Since the institutional re-organisation which split the military and the police in 2000, rivalry between the two has intensified.

A senior military source also told the Report that many military figures find it difficult to back Fauzi Bowo due to his “neo-liberal and socio-democratic spirits.” The source added that “If we can pressure influential figures inside the DPR to endorse the promotion of independent candidates, it means that we will see an open door for our candidate, Bibit Waluyo, as well as civilian candidates like Faisal Basri, to contest in the election.”

With most work on the bill finished, it seems unlikely that such suggestions will make the final cut. However, the chairman of the commission finalizing the draft has hinted about a possible delay of the legislation’s endorsement, pending consideration of these ideas.

Whatever the final makeup of the poll, with control of the capital at stake, it is likely to be the most colourful campaign Report readers will see for some time.
When the cash cows come home

The March 20 arrest of the former State Logistics Agency (Bulog) head on corruption charges raises yet more questions about the government’s anti-graft campaign. Could the charges be trumped up, part of successful power play by Golkar to control the notoriously corrupt body before the 2009 elections? The Report investigates.

While most graft probes against Indonesian officials are pursued in fits and starts, the case against Widjanarko Puspoyo has been pressed with unusual haste. In early March, the former Bulog head was investigated by the Attorney General’s Office for misappropriating up to US$1.2 million of the agency’s money; an affair dating back to 2001. The incident, an alleged cattle importing scam, had earlier been investigated in 2005 but was then dropped due to a lack of evidence.

This time around, prosecutors deemed the case worth of further scrutiny. Within the space of a fortnight, Widjan was detained, interrogated and formally charged with graft. The same day as his arrest, Vice President Jusuf Kalla brusquely announced his replacement, Mustafa Abu Bakar; a Golkar Party member, and an “honest and experienced” civil servant.

The speed of the case has sounded warning bells. Widjan is a known member of the opposition Indonesian Democratic Party of Struggle (PDI-P) and PDI-P legislators note that in comparison, other politicians from Golkar have not been detained or replaced so quickly after being implicated in similar incidents. They point to an earlier affair where Golkar politician Nurdin Halid was initially set free by police after being charged with misappropriating funds at Bulog, and did not lose his job until a court had heard his case.

This conjecture is also strengthened by the flimsy nature of the AGO’s initial evidence against the ex-Bulog boss. In a recent interview with Tempo magazine, Widjan’s lawyer LLM Samosir, claimed the charges against his client reeked of political interference. Rather than the case being one of graft, it was simply a business deal gone wrong, he said, and one which Widjan did everything in his powers as head of the agency to right.

When the cattle suppliers failed to deliver the animals, Samosir notes that his client aggressively pursued the debtor companies through the courts, successfully recovering some of the money. That legal action is a matter of public record, he said.

If Widjan’s elimination is politically motivated, Report sources say, it will be for no good reason. His removal symbolizes the return of an important money-making machine to Golkar, which historically controlled Bulog during the Soeharto era.

Set up in the New Order as the centrepiece of the regime’s food security programme, the body endures as a symbol of the nation’s wealth, with warehouses throughout the country piled with rice, corn and grain. But Bulog’s bank accounts are as replete as its warehouses, and this has made them
IN BRIEF: POLITICAL

particularly attractive to raiding by politicians—especially in the run-up to expensive elections.

The agency also has added significance as a political weapon. During Widjan’s watch, PDI-P-driven Bulog scandals were used to publicise the extent of Soeharto’s pilfering from the agency. Later, also under Widjan, Bulog graft allegations were used to help impeach president Gus Dur in 2001 and then to neutralize ex-Golkar chairman Akbar Tandjung before the 2004 elections.

Whatever the reason for the legal action, the strength of the prosecution’s case against Widjan will likely indicate whether the charges are politically motivated. Luckily, for Golkar, the cattle scam isn’t the only thing AGO prosecutors have against him. On March 23, police searched Widjan’s home and office, conveniently finding buckets of money stashed in his bathroom. They also have documents apparently indicating evidence of bribe-taking in a rice importing case involving a Vietnamese supplier.

Of course, with all the graft going on in Bulog, it is quite possible that Widjan is guilty, and that like Golkar’s Akbar Tandjung, he will be found to have channeled the agency’s funds to a political party.

Or perhaps as the head of a scandal-ridden body, he just knew too much. Political insiders were struck by Kalla’s offhand remark regarding Widjan’s dismissal; that the head of the agency must be removed or a Bulog scam might “bring down the entire government.”

Meanwhile, it will be interesting to see what scandals Mustafa, the new head of the agency, dredges up before 2009. Now that Golkar controls Bulog, former PDI-P government ministers look set for some uncomfortable times ahead.

The truth hurts

The very existence of the joint Timor Leste-Indonesian Truth and Friendship Commission (KKR) is as controversial as the alleged human rights violations it is supposed to be investigating. It has also become a way for Indonesian officials accused of serious crimes to thumb their noses at the United Nations.

After more than 18 months of delays, the KKR finally began meeting in late March. The bipartisan body was convened to hear evidence of atrocities committed by Indonesian forces during East Timor’s 1999 independence referendum, in which more than 1400 people died and 70 percent of the nation’s infrastructure was destroyed. While it is officially supported by the governments of Indonesia and Timor Leste, the commission has also come under serious fire.

At issue is the fact that the body has no formal powers to sanction alleged human rights violators. Nor is it allowed to recommend punishments against those that testify before it. What it can advocate, however, is amnesties from prosecution for those who bear witness.
Interestingly, both those in favour and against the KKR base their arguments on the same point: all previous attempts to prosecute Indonesian officials have failed. Of 18 military and civilian leaders indicted by Indonesian courts over the 1999 violence, only one has been successfully prosecuted. Meanwhile, legal action by the Timor Leste authorities to bring Indonesian actors to account have been unsuccessful because Jakarta has refused to allow those charged to be extradited.

In view of this, Jakarta has claimed the commission is the only realistic way to lay to rest the bloody history between the two countries. Arguing for principles of restorative justice, it notes the commission is modelled on a similar one formed in South Africa after the end of apartheid.

This idea has also been accepted by the pragmatic Timor Leste elite. Dili officials have argued that maintaining good relations with their huge neighbour is vital if the country is going to attract much-needed investment and trade. Cross border security is also seen as critical. On the back of the commission, the nation’s defence minister has already suggested the two nations ink deals on mutual security agreements.

The two sides seem to be content to put friendship above justice. Both nations have noted that while the body has few official powers, it will produce a report that could lead to compensation for the victims of violence. The KKR is also intended to function as a transparent public forum to educateIndonesians about this sensitive period.

All this would make sense if the Indonesian leaders testifying at the commission did what was expected of them and apologised for the violence.

However, this has not occurred. In the past month, three of four Indonesians summoned before the body have refused to take any of the blame for the bloodshed and destruction. Along with flat-out denials of military involvement in the carnage of 1999, they have fingered the United Nations’ presence in the area for inflaming the situation. The balance of those testifying is also skewed, with Indonesians getting more time to give their side of the story than the Timorese victims.

The KKR’s opponents argue the KKR’s toothless status is threatening to undermine its usefulness as a tool for goodwill. With no legal powers, the forum cannot protect Indonesians from future prosecutions, but can only recommend amnesty. The report it produces could also be used as evidence in later trials. Because of these uncertainties, it is understandable if suspicious Indonesians do not wish to incriminate themselves by apologising.

But without true repentance, Dili cannot be counted on for its continued support of the commission. Despite the participation of Timorese independence figure Bishop Carlos Belo, the nation’s churches are against the body. Wider Timorese tolerance of the KKR’s work also seems to be running out, with protests in the nation likely to intensify as the hearings continue.
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The proceedings bear out what a former UNAMET official, James Dunn, has predicted about the KKR. It may “give the appearance of justice,” he wrote in a February blog, but “there will be little transparency and no accountability.”

Dunn and others believe the commission is doomed to failure because it was created as part of a cynical political compromise. By mid 2005, angered by the lack of successful prosecutions of Indonesian actors, the UN was threatening to take the nation to the International Court of Justice. In a crafty diplomatic move, officials here managed to head off the move by convincing Dili to support the KKR’s creation.

However, in the end, as Dunn argues, just concentrating on the violence in 1999 may be too narrow a focus, regardless of whether the KKR is credible or not. The civilian militias that ran riot that year were created and armed at least 12 months earlier by the Indonesian special forces, he says. This means the 1999 incidents cannot be separated from the military’s brutal 24-year occupation of the former province.

But if the entire period of Indonesian rule is taken into account, then it is not only Jakarta that could be held responsible. Recent declassified defense papers from Australia indicate that in early 1974, a wary president Soeharto asked for and gained tacit approval from both Canberra and Washington before he invaded the nation. Because of this, and Indonesia’s new importance in the West’s war on terror, it is unlikely that Jakarta’s powerful friends will want to open that particular can of worms. ☐
Investment law

Main Features of the New Investment Law

In principle the new investment law provides legal grounds for the equal treatment of local and foreign investors, including:

- Increased protection against the nationalisation of assets.
- The repatriation of funds using foreign currencies is now allowed.
- Land can be used by foreign investors for up to 95 years.
- Buildings can be used by foreign investors for up to 80 years.
- More sectors are now open to foreign investment with exceptions including health, land and security.
- Government incentives are available for businesses which invest in infrastructure projects, sectors which absorb many workers or promote the transfer of technology, rural areas or in partnership with small and medium enterprises.
- Investment policies will be implemented by the Investment Coordinating Board (BKPM), which will report directly to the president.

Interview: Pak Hatanto, Secretary General, Ministry of Trade

After more than a year of revisions and a number of noisy protests the government’s new investment law was passed through the House of Representatives on March 29. Replacing two earlier edicts, the new legislation ends the legal discrimination between local and foreign investors and aims to streamline business procedures. A chief architect of the bill was the Ministry of Trade’s secretary general Hatanto. The Report spoke to him in early April about the shape of the legislation and the likely effect it will have on capital inflows. Following is an edited excerpt of that interview.

Van Zorge Report: You were involved a great deal with drafting the new investment law. What, in your opinion, was the impetus driving the new legislation? Why was there a feeling that this law had to be prioritized now?

Before the new legislation, the only investment laws we had were the 1966 [Domestic] Investment Law, and the 1967 [Foreign Investment] Law, which were issued just after the end of the Sukarno era. There have since been many implementing regulations, which often conflicted with these laws. Secondly, the private sector has for many years criticized the legal aspects of business in Indonesia. Meanwhile, our neighbors and other emerging economies like China are moving far ahead in terms of legal certainty and the facilities they provide for investment. These are the primary reasons why the government decided it was high time to change the law. This is not just something that happened recently, mind you. A new investment law has been mooted for the past six or seven years but before now, it had never become a reality.
VZR: Who was supportive of the law, and who was opposed to it—and why?

I don’t think anyone was against the new legislation. Everybody was for reforming the old laws. Yet when you start talking about content, then there are people who agree with one thing and disagree with another. This is what happened. A law is a legal document, but at the same time, it is political. You have to look at it that way. No one is against providing more legal certainty. Everybody also knows that a new investment law is not the only thing that will attract investors. It is also necessary to provide legal certainty—transparency—and most people understand the need to reform.

“EVERYBODY ALSO KNOWS THAT A NEW INVESTMENT LAW IS NOT THE ONLY THING THAT WILL ATTRACT INVESTORS.”

VZR: What were the politics like within the House of Representatives? Did the Ministry of Trade have to make any sacrifices with respect to the content of the law in order to gain the support of the DPR?

First, it is wrong to assume that this legislation was the exclusive program of the Ministry of Trade. The ministry was the office assigned by the president to represent the government. So, probably what you are asking is whether there were any sacrifices, as such. I don’t think there were. However, with any political discussions, there will always be compromises. We came up with the proposal, and there were many new ideas and initiatives from parties within the parliament on different subjects or chapters of the bill. And what has been produced is a document that is, in my opinion, more comprehensive than what, in fact, the parliament came up with.

VZR: What are the key features of the law, and in your opinion, how will these features help improve the investment climate?

This law addresses very clearly and explicitly a number of subjects that were not very business friendly within the previous laws. As you know, previously there were two laws; one on foreign investment, and another on domestic investment. The fact that you have two different laws covering two different sources of investment essentially meant the government was discriminating between the two forms. And this is very crucial, because we wanted to show that all investors would be treated similarly. The new idea of ‘national treatment’ means we are not discriminating against any investment, foreign or domestic.

The second point is equally as important—through the law we have guaranteed there will not be any nationalization of investment, foreign or local. This is something that people fear, mostly foreign investors. It has happened before—the government has nationalized assets for political purposes. In the new law, it says very specifically that the government cannot nationalize an asset, unless
it does so through a law. This will be very difficult because to do so the government must gain permission from the people [through the DPR]. If there were still only one or two parties in the House, it might be possible, but because there are many different parties, this will be difficult.

The third focus of the bill relates to investment procedures. We want as much as possible to cut the red tape in Indonesia to make sure all the players know the process of investing will be quick, transparent, and legally binding. Because of regional autonomy, the process of obtaining licensing does not solely depend on Jakarta. However, there are specific sectors where the central government must be involved. For example, if someone wants to invest in an airline, they cannot just go directly to a regional government. They will also have to comply with additional requirements set by the central government; by the Ministry of Transportation, for instance. But if an investor wants to invest in, say, manufacturing, such as electronics or garments, then that should be done quickly and directly within the regions.

This idea expressed in the law is an integrated service—or a one-door policy. Investors will be able to pay for most of the licensing requirements in one office, where the head of the unit will issue all the permits. Another focus will cover land title arrangements. In my view the law is relatively complete and a basis for investors to feel more confident. That’s probably the long answer to your question.

**VZR:** How much work will need to be done to implement the regulations, and which government agencies will be responsible?

The government understands very well that any law will not have an impact unless its implementing regulations are in place very quickly. So the plan of the government is that by the time the president signs the law, he will also sign off on the two necessary implementing regulations. The two regulations each have two parts. One will integrate the system, the other will cover the procedural processes. The third will regulate the role of the implementing institution—the [Investment Coordinating Board] BKPM. The fourth section will govern restricted or ‘closed sectors’. These include security, safety, the environment, and anything that has to do with any of these areas. The rest of the sectors are basically open. But even in these open areas, there will be some barriers. For instance, we want to keep large foreign and local investors away from the small and medium enterprises in the domestic batik industry.

**VZR:** Is there any chance that the implementing regulations might have some sort of a ‘watering down’ effect on the core intent of the law?
IN BRIEF: INDUSTRY

No. Not at all. I cannot envisage anyone with an interest in doing so. We prepared the law at the same time as we prepared the implementing regulations. That approach was intended to protect the law, so it could be implemented right away. Of course, deciding on [closed sectors and barriers] required a lot of time in order to speak to all the stakeholders and related government officials.

VZR: What kind of feedback have you been getting from the foreign investment community?

Well, personally, I haven’t had any foreign investors that have come to me. But I guess if I were them, I would wait and see. Basically, at this time the law is just something on paper. I think the law’s implementation will take some time. There are many different elements required to implement a smooth transition between the old system and the new. We will have to go through certain structural changes. When you are used to having a dominant government, whose authority is now being decentralized, there will inevitably be mistakes. We will have to see how the government manages this process.

Intellectual Property Rights

Pirate wars

After years of spearheading an anti-piracy campaign in Indonesia, Microsoft is currently on shaky ground with its most important ally—the central government. The company is now uncertain whether the Indonesia will renew a November 2006 agreement obliging all officials to use original Microsoft software on government computers. With the agreement set to expire at the end of March, the Report looks at the build-up to the increased tensions.

Meeting Bill

The roots of the dispute date back to May 2005, when President Susilo Bambang Yudhoyono travelled to the United States. During his stay, President Yudhoyono requested a meeting with then Microsoft chairman Bill Gates. Responding to Yudhoyono’s question about what Indonesia could do to attract more investment, Gates told him to focus on English proficiency, general education and, unsurprisingly, the protection of intellectual property rights.

During the meeting Yudhoyono conceded to Gates that piracy was a serious problem, and that it may be constraining Indonesian creativity. Acknowledging that piracy was a serious disincentive to international investment in research and development, he noted that pirates contributed nothing to the Indonesian government’s coffers because they didn’t pay taxes.

The two leaders agreed something had to be done and Yudhoyono later took action by establishing the National Information, Communication and Telecommunication Council. The government then set out to legalize computers used by public servants and offered a competitive tender for vendors interested in refurbishing the state’s communications infrastructure. Microsoft was the only company that offered an expression of interest, and was then
assigned the contract. The firm estimated the work was worth upwards of US$200 million, but submitted a bid of US$45 million—an 86 percent discount.

A biblical backlash

Before long, stories began to appear in the media portraying Microsoft as the “Goliath”, while the Indonesian public were the meek and disadvantaged “Davids”. Microsoft’s competitors, open-source software suppliers, have since joined the debate through the Commission for Fair Business Competition.

A disgruntled Microsoft executive expressed the mentality behind the piracy campaign like this: “If a pedicab smashes into a Mercedes Benz on a busy Jakarta street—even if it is his own fault—as the crowd gathers, the owner of the Mercedes Benz usually is tagged with the blame.”

For their part, Microsoft management acknowledge they may have made public relations mistakes. In the end, a source told the Report, “simply trying to do the right thing can sometimes be as risky as doing nothing at all.”

The backlash on the anti-piracy initiative has also led to a missed opportunity for both Microsoft and Indonesia. The company had intended to roll out the red carpet and bring Bill Gates to Indonesia in April this year, but cancelled the plans after several derogatory political cartoons were published in the Indonesian media. The comic strips portrayed Gates as a robber baron out to buy the Indonesian government with US$40 billion in donations from his philanthropic foundation. The company feels that now is not the appropriate time to raise its profile with charitable grants.

A Political wedge

Cabinet infighting is believed to be another reason for the delay in renewing Indonesia’s MOU with Microsoft. It is rumoured that Research and Technology Minister Kusmayanto Kadiman is taking a stand against the MOU based on complaints he has received from other software producers. This is in direct opposition to Communications Minister Sofyan Djalil, who supports the MOU. Speculation is rife that senior Golkar party leaders are encouraging the rift with the ultimate aim of gaining control of the valuable communications ministry if there is a cabinet reshuffle.

Intellectual property rights do not appear high on the list of priorities of either the central government or the DPR. The House legislated against piracy in 2000 when it passed a bill on the Trade Related Aspects of Intellectual Property Rights (TRIPS). However, since then the issue has largely been sidelined, with supporting legislation stagnating in DPR commissions. But in the end it is law enforcement which will be more important than passing legislation.

As part of a drive to increase foreign investment, Indonesia would do well to look to Vietnam’s example. After launching an anti-piracy campaign, the country has seen significant investments by Intel, IBM, Sun Microsystems, and Hewlett Packard. The very same companies which continue to avoid investing in Indonesia.