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BUSINESS

Indonesia

Still living dangerously

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When FDI means foreigners ditching Indonesia

WITH a population of 220m people and some of the richest natural resources in the world, Indonesia should be a magnet for foreign investors. Instead it is a place some are glad to escape from. Among the latest to flee are Rio Tinto and BP, which this month sold Kaltim Prima Coal (KPC), their jointly-owned Indonesian coal mine. The two British multinationals thought they were experienced enough to be able to take care of themselves, but they were still outmanoeuvred in a country where corruption, shifting political priorities and an unreliable legal system make it difficult to do business.

The two companies tried to sell 51% of KPC back to the Indonesian state for $420m—in line with a previously agreed option. But the government refused to honour the agreement. After months of fruitless negotiations, the two firms were forced to part with their entire holding to a local rival for $500m. Then their workers went on strike demanding a share of the proceeds. After three weeks of lost production—costing $500,000 a day—the 2,700 miners were coaxed back with the offer of $6m in bonuses. Then they walked out again, demanding that the firms also pay their personal income taxes.

Other companies face similar woes. Cemex, a leading Mexican cement producer, is considering international arbitration in a final attempt to resolve a long-running dispute involving a so-called "renegade" subsidiary of Semen Gresik, Indonesia's largest cement firm. Cemex owns 25% of Semen Gresik. Manulife, a Canadian life insurer, saw its Indonesian subsidiary declared bankrupt by a commercial court last year even though it was solvent. Only after an international outcry did the Indonesian Supreme Court overturn the ruling.

All this makes foreign investors nervous about putting more money into the country. A unit of Britain's Imperial Tobacco Group has delayed a $70m investment until it learns the outcome of its case against Sumatra Tobacco, which is accused of copying Imperial's Davidoff brand. Although the Supreme Court has ruled in favour of Imperial, Sumatra Tobacco has launched an appeal. Indonesia has a dire record of trademark violations, including piracy as bizarre as Sony underwear, Intel jeans and Rolex cigarettes.

While regional growth is returning, in 2002 Indonesia was the only country in South-East Asia to record a net outflow of foreign direct investment (of $1.7 billion). Alarmingly, even Dorodjatun Kuntjoro-Jakti, minister for economic affairs, readily reels off reasons why investors remain wary. As well as poor road and rail links, an unreliable water supply and nationalist opposition to the sale of state assets to foreigners, at the top of most people's lists is the lack of a legal system capable of passing good laws and enforcing them.

“Our number-one problem is the legal system,” affirms Mohammed Syahrial, a deputy chairman at Indonesia's bank-restructuring agency. Allied to this is corruption: Indonesia is often cited as one of the most corrupt countries. Judges regularly have to be bribed. In a report this week, the World Bank says Indonesia faces many of the same problems encountered by transitional democracies in Eastern Europe, but fails to do much about it.

One reason is that, according to some businessmen, things have got worse since the fall of President Suharto in 1998. It is now less clear who needs to be bribed to get things done. Under the current president, Megawati Sukarnoputri, power has been decentralised to 416 municipalities. While intended to boost local democracy, this has, in practice, merely “decentralised corruption” says Stewart Hall, chief executive of Standard Chartered Bank in Indonesia. Regional and local fiefdoms now make their own rules and even raise spurious extra taxes. This has dramatically raised the cost of doing business.

On top of that, crony capitalism continues. A number of Suharto's family and cronies still wield influence, and are trying to regain their old empires. And if rampant wage inflation of up to 40% and inflexible labour laws were not bad enough, legislation is pending to stop “modern” (ie, foreign) retailers from opening in rural areas. Particularly barmy is a plan for a $30 visa fee on tourists, including Australians who make a big contribution to the economy. Given the threat of terrorism since the Bali bombings in October 2002, Indonesia needs to make friends, not lose them.