Asia

# Indonesia Deregulates Foreign Investment

**On 2 June 1994, the Indonesian government announced the most fundamental deregulation of its foreign investment rules and policies since Foreign Investment Law No. 1 of 1967. The changes are contained in Government Regulation No. 20 of 1994 (GR 20) and commence from 19 May 1994.**

**Existing investors will need to consider adjusting their joint ventures to the new regime. Potential investors in projects that would not have been permitted prior to the issue of GR 20 should consider the new regulations carefully.**

### Ownership and shareholding levels up; power, telecomms and transport sectors open

The five key changes introduced by GR 20 are:

- 100% ownership of a foreign investment (PMA) company is now generally permitted, provided the company does not undertake activities in certain key fields (see below). There will be a divestment obligation after 15 years, but with no stipulated minimum divestment.
- The maximum permitted level of foreign shareholding in a PMA company which includes an Indonesian participant is increased from 80% to 95% with no further obligation to divest any shares below this level.
- No minimum value is prescribed for foreign investment projects.
- PMA companies may set up, or acquire shares in, other Indonesian companies.
- Joint venture PMA companies (but not wholly foreign-owned PMA companies) are for the first time permitted to participate in the following keyfields: production, transmission and distribution of electricity for the public; telecommunications; air transport; railways; shipping; ports; drinking water and nuclear power. GR 20 also states that joint venture PMA companies may participate in the mass media, but it appears the government will not permit this.

### Seven features of the new regime

The fundamentals of Indonesia's new investment rules cover seven areas:

**Levels of foreign ownership** - Foreign investment in Indonesia may be made, following approval from the Capital Investment Coordinating Board (BKPM), through a foreign investment (PMA) company which is either:

- a joint venture company in which an Indonesian company or citizen holds at least 5% of the issued capital. There is no longer any requirement for a foreign investor with an initial shareholding of up to 95% of the issued capital in a PMA company to divest any of its shares to a level below 95%. Formerly, as a general rule, the maximum foreign shareholding was 80% of the issued capital with an obligation to divest to not more than 49% within 20 years; or
- wholly owned by a foreign company or individual (except in certain sectors). The foreign shareholder in a wholly foreign-owned PMA company is, however, required to sell some of its shares to an Indonesian citizen or company not later than 15 years after the PMA company commences commercial production. The number of shares sold is to be determined by agreement between the investors. Formerly, 100% foreign ownership of a PMA company was only permitted in certain limited circumstances. Investors in existing PMA companies are permitted to adjust their respective shareholdings, by agreement, based on the revised levels of foreign ownership.

**Project value** - The amount of the investment for any foreign investment project is based on the project's reasonable economic feasibility, as determined by the investors. This is a significant departure from the former requirement where a foreign investment project was generally required to have a minimum value of one million United States dollars. It is not clear, however, from GR 20 whether the project value, as agreed by the investors, will be subject to further approval from BKPM.

**Period of investment licence** - A foreign investment licence is granted for a period of 30 years following commencement of commercial operations. GR 20 provides that the investment licence can be renewed for a further 30 years if the PMA company at that time still provides a positive impact on the Indonesian economy from the perspective of exports, employment, taxation compliance and the environment.

**Location of project** - PMA companies may be located anywhere in Indonesia, but will be encouraged to choose a bonded zone or industrial estate if these already exist in the relevant region. If land is already owned for the project, the project may be situated on that land provided that it is located within an industrial zone under the relevant regional planning scheme. This new provision suggests an adjustment to the recent informal policy, which has been applied rather inflexibly and required new manufacturing and industrial projects to be located in an industrial estate or bonded zone.

**Shares in other Indonesian companies** - For the first time, foreign investment companies may establish new companies or purchase shares (through the Indonesian stock exchange) in existing Indonesian companies which have or have not commenced commercial operation, provided that the activities of the target company are not closed to foreign investment. Joint venture PMA companies (but not wholly foreign-owned PMA companies) may also, by agreement, acquire shares in any existing Indonesian companies by direct placement or acquisition.

**Conversion of existing Indonesian companies to PMA status** - Foreign companies are permitted to acquire shares in any existing Indonesian companies which have or have not commenced commercial operation, either through the stock exchange or by direct placement or acquisition, provided that the activities of the target company are not closed to foreign investment. The acquisition must, however, be for the purpose of rescuing or improving the economic prospects of the company.

**Trade** - The general prohibition on foreign participation in trading and retailing remains, whether through a PMA company or directly.

### Investment after the new rules

There are important questions which arise from GR 20. The general principles will be subject to elaboration in specific Ministerial Regulations to be issued shortly. The new principles will have a major impact on many other areas of Indonesian regulation which will have to be adjusted accordingly - this may take some time to work through. Given the uncertainty arising from some of the major changes introduced by GR 20, investors will need to consider new foreign investment projects carefully, particularly where the project and/or its structure would not have been permitted prior to the issue of GR 20. Those with established joint ventures should determine whether they wish to adjust their joint ventures to the new regime.

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