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Disbanding Batam's Free Trade Zone: Ending a Dualist Authority?

By Adri Wanto and Santi H. Paramitha

Synopsis

Indonesia's Ministry of Home Affairs plans to end the dualistic administrative authority that has been the basis of the free trade zone in the Riau Archipelago. This has raised uncertainty in investment and business circles, particularly Singapore which is Batam's main investment partner.

Commentary

FIFTEEN YEARS after the introduction of regional autonomy in Indonesia in 2001, the dualistic administrative authority in Batam – one for the management of free trade and the other for the administration of the province – is headed for closure. Following conflicts of interest between Batam's Free Trade Zone Management Agency (BPK FTZ) and the Batam administration, the Minister of Home Affairs, Tjahjo Kumolo, announced that he intends to initiate the disbanding of BPK FTZ this year.

The announcement generated deep concern from various sectors of the economy, which viewed such moves as a threat to the allocated investments for the agency. Instead of disbanding the outfit completely, the government could resort to integrating the two overlapping bodies or transform the BPK FTZ into a state-owned enterprise (BUMN).

Conflicting Status

Mr. Kumolo claimed the decision to disband the BPK FTZ was formulated according to Cabinet deliberations. Over the last 10 years, BPK FTZ had lost around Rp 20 trillion (US\$1.45 billion) of Batam's potential tax revenue. The decision to disband it

took into account the fact that many investors have moved their businesses away from Batam. Interestingly, Mr. Kumolo spoke optimistically that all problems related to BPK FTZ will be resolved in 2016.

However, Mr Kumolo's statement cannot be considered an official pronouncement from the government, as it contradicts a previous order by the Coordinating Ministry of Economic Affairs for BPK FTZ. The Coordinating Minister for Economic Affairs, Darmin Nasution, stated on 31 December 2015 that BPK FTZ will continue its development programmes in Batam.

The future of BPK FTZ clearly remains in limbo. Pending an official decision, BPK FTZ will continue to function as usual. Mr Nasution urged investors to keep their businesses in operation irrespective of the Minister of Home Affairs' comments.

The BPK FTZ head, Mustofa Widjaja, stated that the agency, which had been established in Batam since 1971, has become a strategic partner of the Batam administration. Mr. Widjaja feels optimistic that President Joko "Jokowi" Widodo will not craft policies that will have a negative impact on the local inhabitants and investors by disbanding the agency.

Economic Implications

According to an Indonesian Regional Representative Council (DPD) member, Haripinto Tanuwidjaya, the overlapping authority over the Batam Free Trade Zone has led to a decline in investment in Batam, compared with investments in other parts of Indonesia. It has resulted in the protraction of business licences and become a source of burden to investors.

Investors are seeking assurances that Batam is still an investor-friendly environment that possesses an effective system with the full authority to issue business permits. As the recent dip in investments show, the dualistic administrative structure has been the main obstruction to the effective development and implementation of the Free Trade Zone.

The central government and the House of Representatives (DPR) have approved more than one trillion rupiah in budget funding for the BPK FTZ for 2016. Thus more than one trillion rupiah worth of projects will be in jeopardy if the BPK FTZ is disbanded. Under threat will be projects such as the construction of the Telaga Punggur Port, Sekupang Domestic Port, improvements for Hang Nadim Airport, and the development of the BP Batam Hospital.

Besides the wastage of funds, liquidating BPK FTZ would lead to a decline in confidence among investors. This will ultimately result in major capital outflows from Batam – not to mention undermining investor confidence in the entire Indonesian economy.

Viable Alternatives

Batam, Bintan, and Karimun, a cluster of small islands in the Riau Islands Province near Singapore, are being developed as industrial areas. Therefore the most

effective way to solve the overlapping systems of governance would be to integrate the administration of the free trade and free port zone into the municipal administration.

The Batam city mayor should become the ex-officio head of BPK FTZ. In this way, BPK FTZ will continue to exist and funds from the state budget will be disbursed for the implementation of previously planned projects. Such an approach will mean that there will no longer be a dual authority structure managing the free trade zone, particularly in matters concerning business and investment licensing.

The other alternative is to give Batam special autonomy status where the municipal administration and BPK FTZ function as a state-owned enterprise, owing to the business-driven nature of free trade zones. Also, the BPK FTZ could be designated as a Special Economic Zone (SEZ), covering Batam and the two nearby islands of Bintan and Karimun. If the SEZ materialises, investment matters will fall under the regional government's authority. A single administrator with powers vested by the relevant ministries should be responsible for the coordination of tax incentives, the maintenance of facilities and the expediting of licensing in the SEZs.

However, a shortcoming exists when converting the BPK FTZ into a BUMN. As it had its origins as a public service institution, it cannot function as a state-owned enterprise because its role goes beyond business objectives. A BUMN is a profit-making enterprise and is therefore not allowed to manage public service projects.

Turning the BPK FTZ into a BUMN will result in the shedding of many of its responsibilities such as the construction of roads, the provision of support for the Batam Polytechnic and the management of hospitals. With the absence of other options, the central government needs to take a firm decision to prevent the economic development in Batam from being seriously jeopardised.

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