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## **The SEZ Plan for Batam, Bintan, and Karimun: Looking Back and Ahead**

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A YEAR has passed since Indonesian President Susilo Bambang Yudhoyono and Singapore Prime Minister Lee Hsien Loong witnessed the signing of a Memorandum of Understanding to set up special economic zones (SEZs) in Batam, Bintan, and Karimun of the Riau Archipelago, Indonesia. The Joint Steering Committee established under the MoU has since held a series of meetings to discuss the plans to achieve shared objectives. These include increasing exports, attracting investment, and creating jobs in each of the three zones. Although the preparations for the implementation of the SEZ plan have moved ahead, the process has not been smooth.

On June 22, the S. Rajaratnam School of International Studies' Indonesia Programme hosted a public lecture by Minister of Trade Mari Elka Pangestu. This was followed a week later by the inaugural meeting of the "Riau Roundtable 2007," which will be an annual forum for an exchange of views on diverse issues and challenges in Riau. Ideas presented at these different events, along with recent news from the region, provide us with a clearer picture of the status and prospects of the SEZ plan at present.

### **Taking stock**

As Minister Pangestu was quick to point out in her lecture, Riau has played a key role in the development of economic cooperation between Singapore and Indonesia. The Sijori (Singapore-Johor-Riau) Growth Triangle, which was promoted in the 1990s, is its clearest example. The competitive business environment that has prevailed in Batam and Bintan since then has indeed attracted global players from diverse industries, such as precision engineering, plastics, chemicals, and garment fabrication. There are presently about 1,000 foreign companies operating in 25 industrial parks in Batam and three in Bintan. Singapore is the largest source of foreign investment.

The plan to develop SEZs in the Riau Archipelago represents an important effort to boost the region's development and is of great strategic interest to both Indonesia and Singapore. There are, however, many reasons to be concerned about the future of the plan. Top of the list is the future attractiveness and competitiveness of Batam and Bintan. This threat has two main sources: developments within Indonesia and developments in the regional economy.

Many of the problems concerning the SEZ plan for the Riau Archipelago stem from the confused state of the political and administrative arrangements governing the region. In particular, the implementation of regional autonomy since 2001 has changed the rules of the game for doing business. Local governments have assumed greater authority, but their use of this authority has not always been effective. Local and foreign investors have struggled to deal with inconsistencies and

contradictions in local governments' policies and regulations.

While Indonesians have struggled to work through these issues, Batam and Bintan have begun to face stiff competition from other special economic zones in the region, including those in Vietnam and China. An increasing number of foreign companies on Batam and Bintan have already relocated to SEZs in other countries or expressed their intentions to do so unless they see prompt improvements.

As one Singaporean businessperson at the Riau Roundtable 2007 remarked, the SEZ project is indeed "an important milestone" from the perspective of foreign investors. This was followed by a warning: It is imperative that the SEZ plan be implemented, labour-business relations improve, and production costs fall. Otherwise, investors' confidence in the SEZ plan may continue to falter.

### **Looking Ahead**

On June 4, after a long delay, President Yudhoyono signed Government Regulation in lieu of a law (Perppu) No. 1/2007 on the SEZ project. It is also expected that the national assembly will legislate a law on SEZs by the end of this year.

Despite the passage of Perppu No.1 of 2007, however, both national and local officials have a number of issues to resolve. An overarching question is the legal bases of SEZs. Presently, it appears that national agencies and local officials have taken different positions. While national agencies prefer an enclave system, which allows only certain industrial areas free trade status, local officials have recently proposed that all the areas, excluding the hinterlands, in Batam, Bintan, and Karimun be developed as free trade zones.

On Batam, another pressing issue is the ambiguous division of authority between the municipal government and the Batam Industrial Development Authority (BIDA). Established by presidential decree in 1971, BIDA remains outside the power of local government and retains its monopoly over the island's properties and development policies.

Like many other regions in Indonesia, Batam's new, democratically-elected municipal government has assumed a wide range of authorities and thus, BIDA is no longer the only relevant authority on the island. The problem is that there is no clear legal framework dictating the division of authority between the two institutions. Investors have complained about overlaps in the respective policies pursued by BIDA and the municipal government.

Some stakeholders have argued that Batam should be granted "undisputable legal status" and that BIDA and the municipal government ought to be integrated into a single body. A national government regulation on the working relationship between the two institutions has been under consideration since 2000, but it is still uncertain when it will come forth. On July 5, a small group of Batam students was reported to have staged a demonstration in Jakarta, asking the Department of Home Affairs to dissolve BIDA. Given that some prominent local figures have also expressed their support for the idea of dissolving BIDA, it seems likely that pressure to resolve the situation will continue to grow in both Batam and Jakarta.

### **What needs to be done now?**

Drawing a consensus on the legal status of SEZs and coordinating a feasible working relationship between BIDA and the municipal government on Batam may take a while. There are reasons to be hopeful, though. As Governor of the Riau Archipelago Ismeth Abdullah emphasized in his keynote speech at the Riau Roundtable, President Yudhoyono is strongly determined to develop SEZs in Indonesia. Local officials have worked around the clock to ensure investors that the investment environment would improve once the SEZ plan is implemented.

On the other hand, foreign investors have sent out a clear message that they were running out of confidence and patience. They have been looking at Vietnam, China, India, and most recently, Malaysia, which last year announced the establishment of the Iskandar Development Region (IDR) in southern Johor. If IDR is developed before Riau's SEZs, it can provide an alternative to investors who are considering relocating from Batam and Bintan. In other words, the clock is ticking.

What, then, needs to be done? In addition to the local issues addressed above, action is needed with respect to human resource improvements, the development of infrastructure, and the fashioning of more effective industrial relations between business and labour. With regard to the latter, both employers and workers have also expressed concerns about rising living costs. Some businesspeople have asked local officials to consider such policies as subsidising transport costs for workers and building more public houses close to industrial parks.

There is no doubt that Batam, Bintan, and Karimun have great potential and that they can offer one of the best investment environments for industries and tourism in the region. But realizing that potential will require more prompt, proactive, and concrete actions.

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