Indonesia

Aceh Investment Climate Policy Note

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Executive summary

Specific sector studies into the value chains of key Acehnese commodities have revealed critical gaps in handling and processing capacity – in mills, cold chains, refining capacity etc. These 'missing investments' by the private sector are themselves impediments to the achievement of both the scale and quality of production that are required for competitive, export oriented chains of operations. They are a product of a deficient investment climate. If Aceh is to turn latent advantage into a basis for growth it must achieve reduction in risk and uncertainty about access to land, simplification of investment procedures, securely serviced infrastructure, improved market intelligence, scale and quality of inputs to agri-processing. The policy measures discussed in this paper are designed to address this investment climate deficiency. It is one of a number requested by the World Bank[1].

As a result of thirty years of conflict and recent natural devastation the economy of Aceh:

- Remains one of the four poorest in Indonesia (28 per cent living in poverty);
- Has experienced three years of donor and national government based injections which have doubled investment levels from pre tsunami levels but still leave the ratio of investment to output (14%) well short of the national average ratio (22%);
- Has, as a result of this, and lingering post conflict effects, an investment profile which is currently heavily skewed to public investment;
- Faces a falling away of public sector investment injections with the winding up of the national government and donor supported Reconstruction and Rehabilitation Agency (BRR), despite a 'peace dividend' of annual special payments from the national government;
- Requires a sustained growth in private investment and related value adding to underpin the economic, employment and social development aspirations created by its recently gained special autonomy status;

[1] Others include studies of environmental management issues, poverty assessment and priorities and gaps in Government of Aceh/BRR development plans

- Has established, but underdeveloped, activities in the key sectors of mining, plantation and other agriculture, aquaculture and fisheries where there are critical gaps in the supply chain holding back greater value adding. (These gaps reflect more fundamental problems a number of which can be addressed by the provincial government, with cooperation from disticts and city administrations);

- Requires changes to the prevailing investment climate that will allow it to take advantage of identifiable latent advantages in key sectors and infill of the missing links;

- Has opportunities for provincial and district governments to intervene constructively to achieve investment climate improvement.

Comparative[2] advantage, disadvantage and the investment climate

Part A of this policy note assesses Aceh's investment climate and the comparative advantages and disadvantages of key sectors in Aceh as an investment destination. It does this from the perspective of what prospective investors are known to emphasise. These 'location offer' factors that dominate investor decisions include macroeconomic stability, political risks, governance and the regulatory environment, natural resource availability, access issues - to markets and information, to land and to value adding opportunities, transport and other infrastructure and taxation and incentives. All have a bearing on the bottom line considerations for investors– sustained profitability (rates of return on investment) and risk.

Part A assesses the comparative advantages that lie with key sectors nominated by the provincial government in its draft Investment Policy Statement and stressed as targets by the Governor in opening the province's Investor Outreach Office (IOO) in 2006.

The emphasis is on what provincial and district governments can do in their own right to contribute to an improved 'location offer' from Aceh.

This analysis finds:

- The resolution of civil conflict and enactment of the LOGA should be translating into an improvement in political risk relative to other locations, but perceptions of risk remain high, reinforced by unauthorised activity and arbitrary charges imposed on businesses at the district and local level;

[2] The term comparative advantage is used throughout in a general sense to refer to factors potentially attractive to investment rather than in the trade theory sense where it is used to explain patters of trade.

- The government capacity to facilitate investment has, in principle, improved with the passage of the LOGA, and the BRR has established the IOO, the Export Development Centre and the Clinic for Packaging and Branding. However broad dinas capacity remains weak, and the supporting legal and regulatory framework for implementing investment policy needs major clarification;

- The comparative advantage arising out of natural resource endowments, including minerals and agricultural land, is being seriously impaired by limited progress in land titling in an administrative environment made complex by the prevalence of traditional 'adat' title, the inability of foreign investors to hold direct freehold title, and the powerful but not always clear role of district heads (Bupatis) in allocating land for commercial purposes. While these problems are Indonesia-wide they are enlarged in Aceh by post conflict and post tsunami title disputes;

- Known energy sources remain undeveloped in the face of power deficits. Independent power producers need both favourable access conditions and commercially viable contracts with the national grid;

- The advantages of geographical proximity to a major industrial and trade centre - Medan- and to regional markets, including neighboring Malaysia, is undermined by weak supply chain linkages to wider domestic and global chains, market information failures and poor bargaining power of smaller growers, poor extension services and poor product quality. Access to halal markets is inhibited by lack of processing capacity embodying Malaysia-like standards;

- The lack of local processing and value adding in agribusiness lines (no palm oil refinery, little value adding to wood products other than paper processing etc) is both a reflection of impediments to investment and a constraint on successful exports and further export led investment;

- Restoration and renewal of transport infrastructure still leaves relatively weak road and port links and risks of inadequate budget support for asset maintenance and risks to market access;

- Despite relatively low nominal wages compared to regional neighbors and high per capita education expenditures, inequitable allocation across districts and between quality-raising and other education/training expenditures means labor productivity growth is at risk of lagging behind administratively determined increases in minimum wages.

Many of the above comparative advantages and disadvantages are reflected in the performance and prospects of key sectors and individual products.

Key sectors and products –some examples and contrasts

Mining, energy and forestry

Rapid depletion of resources in oil and gas reserves and unsustainable forestry practices limit investment prospects in the short term. Development of known significant reserves of minerals including tin and coal, as well as further prospecting for oil and gas reserves are being restrained in part by (i) uncertainty over what the new national mining legislation will imply for provincial control over these resources and (ii) local regulations, profit sharing licensing requirements and land access rights.

Palm oil

Market demand and natural growing conditions and reasonable access for some growing areas to the major port and processing centre of Medan underpins good prospects for profitable additional investment in palm oil. However, investment in plantations is being held back by:

- Access to land of sufficient area with clear title for larger scale plantations;
- Access to technical and market information for smallholders, restraining profitability; lack of finance.

Investment in crude palm oil mill capacity, lacking in some districts is impeded by:

- Threats to ability to market product as 'socially responsible' because of land made available through illegal land clearing;
- Poor quality fruit from small holders who suffer from information access problems .

Until these problems are resolved in a way that increases both scale and quality of output, and until tranport logistics favour it, further value adding via a crude palm oil refinery will be delayed.

Cocoa

A relatively efficient supply chain and favourable growing conditions is compromised by handling practices. Profitability is reduced through lack of fermentation. Low crop productivity is realized from conflict affected plantations and low farmer knowledge of good practice and the ability to finance it. Extension services are not bridging this gap.

Organic coffee

USAID assistance has helped build a 4461 member cooperative supplying certified product to major international retail chains, as well as local sales. Expert assistance to attain certified status will see output doubling in the short term.

Horticulture, animal products

Remoteness from the expanding supermarket demand from Java is exacerbated by exsting transport infrastructure deficiencies and locally imposed tolls. Access to Malaysian markets will hinge on product standards and investment in cold chain facilities, specialised handling and warehousing.

Fisheries and Aquaculture

An extensive natural resource base in Aceh is currently supplying a largely local market in fish. Shrimp farming by contrast is providing significant export volumes, but via Medan. Species of large, organically produced stock favoured in the export market are not being exported directly and profit margins, particularly of small growers are small. Their capacity to invest, and the incentive for external investment is limited while traders are able to exercise bargaining power advantages. Again there is a vicious circle, with lack of investment in cold chain facilities compromising product quality and profits to growers and in turn limiting the capacity to finance investment to redress the problem.

Part A and the Appendices examine these sectors in greater detail. But main messages emerge that inform the strategic approach to investment climate improvement taken up in Part B. A number of these messages come directly from investors or through their contact with the IOO.

Targeting investors and investor perceptions

The IOO does not actively target investors in particular sectors. Rather, its approach is a passive one, responding to investors registering an interest and offering its facilitation services as part of this response.The modest recent private investment in Aceh appears to have been concentrated in plantation development, fisheries, mining,chemicals (fertilisers) and the service sector (hotels). There is no comprehensive reliable actual private investment data for Aceh and this is a serious deficiency. The Appendices shows a wider set of interests by potential investors, including value adding activities in wood and forest products and palm oil refining and power generation. Investors themselves emphasise to the IOO concerns with land access, getting local partners, unclear responsibilities and powers of the different levels of government, electricity supplies and incentives. They have also directly communicated the importance of continuing political risks, transportation adequacy and security issues.

Leads and lessons from Malaysia

Opportunities to leverage off Malaysian experience and experiments have been explored in developing findings in this note. In particular, Malaysia is embarking on an integrated approach to driving development in the states making up the so called Northern Corridor Economic Region (NCER) which contains states with similarities to Aceh. The essence of this approach is a theme of increased value added from existing industries to drive growth and social equity.

Like Aceh, a ‘cluster’ based approach has been envisaged, with specialisation around existing core activities in particular locations. These are largely agricultural and fisheries based. Traceability of product and good practice standards accreditation is increasingly demanded in these sectors. There is emphasis on technical and product innovation along the processing chains, with particular emphasis on the provision of enhanced government extension services, research and development and product standards. The NCER initiative also stresses the central role that enhanced transport infrastructure and international container port linkage will play.

Aceh has opportunities to be part of any success that this strategy will generate, by tapping in as a supplier to these processing chains. But to do so it will need to decide to devote adequate budget resources to matching standards requirements and lifting productivity and output to production levels that are sufficient for export. Without that support further export oriented investment will be compromised.

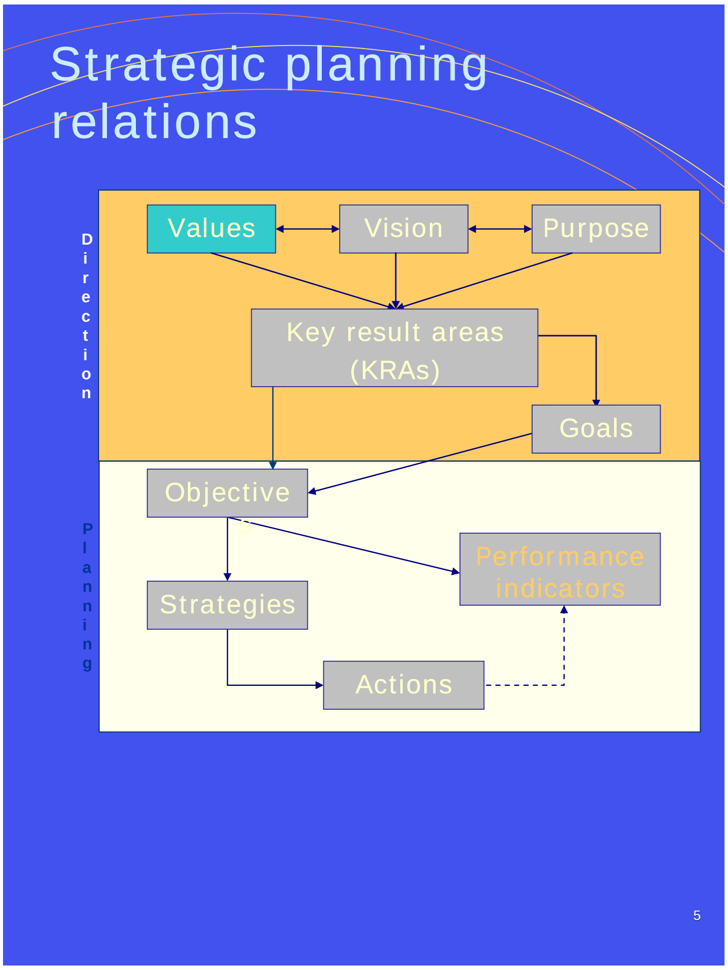
The legal and regulatory framework for investment in Aceh: reducing costs and uncertainty

Despite the emergence of the LOGA considerable uncertainty remains over Aceh's ability to regulate on investment independently of national law and regulations. The real scope to make significant changes to business registration, licensing and permit granting processes remains unclear while national regulations pertaining to the recently amended national investment law remain uncertain. Will apparent autonomy change with the finalisation of the national regulations? In the face of this uncertainty Aceh can nevertheless pave the way for a one stop shop at the provincial level. It can establish clear rules for issuing licences, publish their costs, introduce on-line sevices and canvass opportunities for bundling licences and permits and perhaps removing some while awaiting finalisation of national regulations that will impact on its own Investment Qanun. It can develop the existing 'Technical Procedures on Investment Permits and Facilities' into a genuine roadmap for investors, explaining sequences and timing of procedural steps.

Adopting a strategic approach to investment climate policy intervention- 'what' 'why' 'how' and 'who' issues

In 2006 the Foreign Investment Advisory Service of the World Bank Group (FIAS) conducted a workshop and leadership consultations with senior management of BRR and BAPPEDA. These consultations established the elements of a strategic approach to Aceh's transition and future development challenges. The basic framework of a strategic approach is set out in Figure 1:

Figure 1



To apply this systematic approach to investment climate challenges the vision of private investment driven growth for Aceh needs to be approached by setting out some target areas (key result areas) for government investment policy intervention. These KRAs provide suggestions about what to target as priorities in investment policy. The goals/objectives associated with each area are about 'why' these areas are important. They provide the rationale for the strategies and detailed actions. The strategies and actions are about 'how' to act. There is also a need to identify appropriate responsibilities – for strategies and the individual actions for implementing them (the 'who' question). In some but not all cases there is an opportunity to monitor effectiveness of strategies and actions through performance indicators (KPIs).

Selecting key result areas for Aceh

Part A of this report supports the idea that some of Aceh's best investment prospects lie in activities where there is a strong resource base and there are export opportunities – either to other Indonesian markets or internationally. (Aceh's own purchasing power for these products is limited.) For investment to be attractive in natural resource and land based products with an export focus, competitiveness is central. The investment must be able to provide an acceptable return at acceptable risk when compared with alternative locations. ('Acceptable' rates of return are higher the higher the risks). But there are identifiable threats to achieving this in the key sectors analysed.

- Perceptions of political risk to private investment – especially through unauthorised charges and lack of asset protection – remain high;

- Complexity (and hence effective cost) of establishing a business, though typical of Indonesia, is excessive by international standards;

- Real costs of basic electricity services are inflated because of unreliable supply due to supply deficits;

- There is a risk that Aceh will try to compensate for these and other deficiencies (including those related to market access and productivity) by using increased provincial DAU[3] revenues allocated to it by the National Government to offer additional incentives rather than adequately addressing the fundamental problems;

- Land-intensive activities, including plantation estates have strong market potential but access to land is compromised by land titling problems and lack of reliable information on land availability;

- Ability of local producers to save and invest in improved production methods and further value adding in some of Aceh's most marketable agribusiness products (eg shrimp growing) are held back by poor price information and weak grower bargaining power;

- Standards and methods for halal production and traceability of food sources are not adequate to fully exploit complementarity with growth in Malaysia as a halal food hub. Provincial and national government intervention is required;

- Transport infrastructure has benefited from reconstruction but there are risks that this critical contributor to market access will not be adequately maintained or rationally extended;

[3] DAU is Dana Alokasi Umum (General fund allocation) from the APBN (national expenditure and income plan), which the Provinces are entitled to spend in accordance with their provincial government plan.

- Productivity gains in plantation agriculture horticulture, livestock, fisheries and aquaculture would help to raise scale and quality of output to levels that would attact further investment in processing chains and enable greater lock-in with developments in Malaysia. But effective extension services are lacking in Aceh and this is a key impediment.

These weaknesses are the basis for selecting the KRAs set out in Table 1. In all cases there is scope for action by provincial and/or district authorities, sometimes with the need for national government support. Some KRAs need to be addressed through multiple strategies.

With an emphasis on competitiveness, three main paths have been suggested for developing strategies for addressing these target areas. One is for government to take steps that will help raise competitiveness, and attractiveness of investment directly – through measures that *directly* reduce perceived risks, and the government-induced costs of getting a business started and the operating costs of production. The other two paths contribute to competitiveness and the 'location offer' *indirectly* – (i) by tackling access issues – to land, market information and materials and end product markets and (ii) through government services that influence productivity at the beginning of the product chain.

These recommended strategies largely involve making an immediate start. Most of the specific actions are required now – in the transition phase as the BRR is disengaging in favour of provincial and district 'ownership' by 2009. The suggestions for who should be responsible for individual strategies and actions are just that – suggestions. In some cases strategic responsibility has been suggested as best lying with newly formed Technical Working Group 'clusters' of interested government and donor organisations within the jointly sponsored Aceh Recovery Framework (ARF). The ARF provides the basis for an integrated rather than a fragmentary approach. Some regulatory changes must necessarily await national government clarification of investment regulation, as explained in Part A. But there is much that Aceh can do now to lay the ground work for private sector investment recovery. Table 1 summarises the recommended approach. It is not intended to be exhaustive. Without changes that cover these key areas Aceh will struggle to attract the investment that will fill the gaps in processing chains, increase value adding and generate the jobs that this creates.

Table 1: Summary of key result areas, strategies, actions and responsibilites

Targeting direct improvements to competitiveness	Objectives	How competitiveness is improved	Other benefits	Who takes responsibility for strategies / actions
KRA 1 Investor perceptions of political risk **Strategy**: Provide credible explicit government guarantees and assurances against illegal acts/unauthorised charges **Actions** (i) Governor and distict heads sign **joint** security guarantees (ii) Adopt reform framework for Aceh district revenue administration to minimize arbitrary charges (iii) Fast track response to investor complaints about illegal treatment/ extortion	Reduce investor risk premiums- a hurdle to investment	Investors' required rates of return are reduced if risk premiums fall	Culture of rule of law strengthened	Governor's Office (i)Governor/bupatis/ mayors (ii) Bupatis,mayors with donor assistance (iii) Governor's office
KRA 2 Administrative costs and uncertainties of business establishment **Strategy**: Minimize regulatory and licensing complexity and create investor access to clear guidelines on required clearances **Actions** (at national, provincial and district levels) (i) Establish and publish clear rules for issuing licenses, publish license/permit costs, set maximum time limits for issuance of provincial/local clearances (ii) Identify and act on opportunities to bundle/eliminate licence steps once national investment regs. clarified then (iii) Construct 'road-map to registration and approval' (iv) Create reliable record of business registrations and actual investments	Make Aceh a national leader in reducing business establishment time and process uncertainty	Set up costs reduced, improved rates of return for investors	Administrative budget savings for government Creates performance indicator for success of investment policies	Governor's Office (i) & (ii) Governor's office, BKPMD with cooperation of district government agencies (iii) BKPMD (iv) BKPMD and local Dept of Trade and Industry

KRA 3 Costs imposed on business through power deficits **Strategy**: Explore public-private partnerships to attract cost effective independent power producers (IPPs) **Action :** Incorporate secure, attractively priced access to energy sources and related land into MOUs and IPP contracts	Reduce power-related costs through improved reliability from grid based supplies KPI – proportion of businesses relying on grid based power supply	Reduced capital and operating costs of investors, reduced spoilage costs in cold chains	Possible future power export revenue to province	BAPPEDA in consultation with district heads and national power body (PLN)
KRA 4: Alternatives to inefficient use of fiscal incentives to attract investment **Strategy**: Allocate provincial funds for infrastructure rather than additional fiscal incentives **Actions**: (i) Resolve to limit incentives to those already available through national investment law/regulations (ii) Provide detailed guide to Aceh investors' entitlements to central government-offered incentives (iii) Adopt and publicise minimum commitments to benchmark infrastructure spending (see KRA 8 below)	Avoid costly 'top-ups' of central government tax based incentives while improving Aceh's location offer'	'Infrastructure before incentives' approach improves long term profitability of *all* Aceh investors, existing and new	Signals a fiscally responsible approach strengthening provincial borrowing position. Likely higher overall social and economic return cf additional incentives	Governor's Office (i) Governor's Office (ii) BKPMD/IOO (iii) See KRA 8 below

Targeting competitiveness through access to markets and market information and land	**Objectives (and KPIs if appropriate)**	**How competitiveness is improved**	**Other benefits**	**Who takes responsibility and actions**
KRA 5 Access to land as an investment prerequisite (2 strategies required) **Strategy (A)** Coordinate land use and land titling information- a single 'available plantation/industrial land' register **Action** (i)(Immediate) Identify provincial and district owned land immediately available for plantation and industrial lease purposes. (ii) Before 2009 seek donor assistance to evaluate the case for establishing an Aceh land office to take over BPN functions. **Strategy(B)**: Adopt competitive tendering approach for allocation of government owned land for plantation and other purposes **Action** (i) Seek agreement at the district/kota level to a transparent tendering approach. (ii) Advise potential investors of tendering process through IOO	(A) Ensure plantation land availability estimates are credible and land is from degraded or abandonned plantation sources; (B) Ensure government owned land achieves market value when leased or sold to investors KPI: published values of governerment land sales and leases	Reduced search costs and uncertainty for prospective investors; improved market access and profitability for 'socially responsible' plantations Reduced risk that most productive users will be arbitrarily exluded through administrative discretion	Reduced risks to provincial economy and environment through limits to monoculture. Enhanced provincial reputation for transparency in commercial transactions	BAPPEDA (i) Governor's Office/bupatis and mayors with assistance from BNP and Plantations dinas (ii) Governor's office Governor's office/BAPPEDA (i) Governor's office/BAPPEDA (ii)IOO
KRA 6 Market price information for agribusiness suppliers **Strategy**: Strengthen grower bargaining power with traders through better price information **Actions**: (i) Determine price information gaps (shrimp industry pilot) (ii) determine best model for continued information gathering and distribution, and commit funding	Improved grower profit margins to enable profitable reinvestment KPI – monitor grower profit margins	Reduced financial constraints to scale and quality improvement	Improved credit status for suppliers reinforcing access to finance	Aceh Recovery Framework Econ Development Group (i) EDC/dinas assistance from Trade and Industry, Marine and Fisheries, Agriculture (ii) BAPPEDA/Trade and Industry/EDC with donor assistance

KRA 7 Culturally based market niches and market access **Strategy**: Develop direct ties with Malaysian halal standards authorities **Actions:** (i) Conduct 'Standards' mission to Malaysian Accreditation Council and NCER Implementation Authority (ii) Subsequent implementation plan for 5 year convergence with Malaysia	Implement halal standards in food chain products consistent with Malaysian standards	Expanded export market revenues through product acceptance in Malaysia, Thailand India/Pak,M. East.	Cultural benefits through international recognition of Aceh halal produce	Trade and Industry/EDC (i) Trade and Industry, EDC, representatives of national standards office BNS (ii)BAPPEDA/dinases
KRA 8 Managing transport infrastructure assets for market access purposes (2 strategies required) **Strategy(A):**Prioritise transport infrastructure in infrastructure budget planning **Actions** (i) Determine appropriate ownership structure for transport infrastructure assets (ii) Value assets (iii) Develop asset management plans with benchmark O&M expenditures **Strategy (B)** Link future ports development to balancing local demands and emerging export opportunities **Action**: Integrated economic ports study	(A) Maintain and improve infrastructure-based access to markets (B) Optimise future ports capital spending	Reduce risks of higher transactions costs for investors in future Reduce risks of export oriented investments facing uncompetitive future transport options	Social benefits of reliable transport networks Reduce risks of stranded government assets through poorly targeted ports	Aceh Recovery Framework Asset and infrastructure Group/BAPPEDA (i) Governor's Office assisted by ARF Asset Group, Transport dinas (ii) BRR (iii) Future transport asset authority Aceh Recovery Framework Economic Development Group/donors Consultancy

Targeting competitiveness through agricultural productivity growth	**Objectives**	**How competitiveness is improved**	**Other Benefits**	**Who takes responsibility and actions**
KRA 9 Extension services contribution to productivity/ efficient scale operations in key sectors **Strategy:** Develop effective extension services training, staff retention and implementation program **Actions:** (i) Review extension services budgets (ii) Set minimum extension budget shares for staff training and service implementation at provincial and district levels (iii) Identify potential private suppliers of extension services	Quality of extension services at least matching service in Malaysia NCER in 5 years KPI: Budget shares tracked against benchmarks	Raise outputs and quality of individual producers to commercial levels	Improve livelihoods of small producers	ARF Economic Development Group (i) BAPPEDA assisted by FAO/World Bank (ii) BAPPEDA /dinas/bupatis (iii) ARF Capacity Building Group

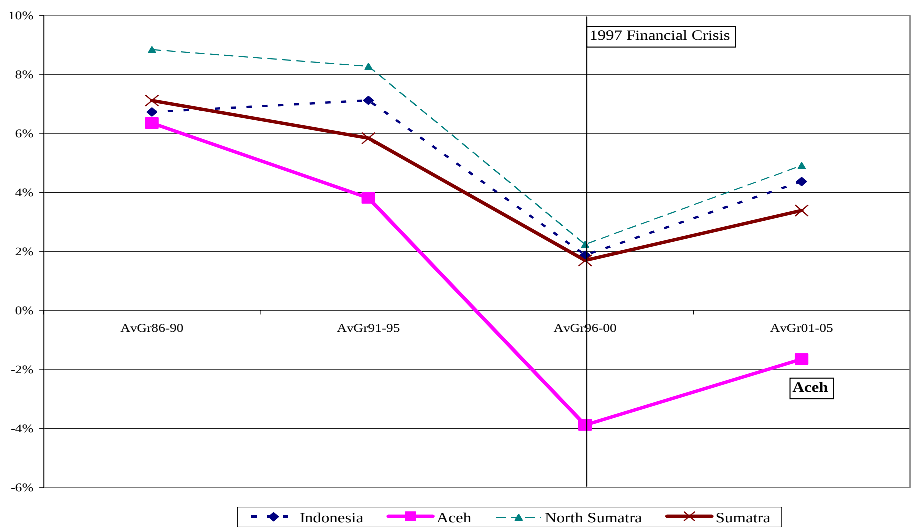
Part A

1 Aceh's comparative[4] advantages and disadvantages

Economic overview[5]

Aceh's economy has historically registered lower growth rates than Indonesia as a whole, and the neigbouring province of North Sumatra, which is hardly surprising given the prolonged conflict that has affected the NAD province. Less than 50 percent of all the PMAs/PMDNs (registered foreign and domestic businesses) were active during the conflict period. The slow economic growth rate post-tsunami reflects sluggish business activity. In 2006, Aceh's economy grew by 2.4 percent[6], driven primarily by the reconstruction effort. The better security situation in the wake of the Helsinki Memorandum of Understanding of mid 2005 and the passing of the Law on the Governance of Aceh in mid 2006 has thus far had minimal impact on the overall economic condition of the province. Many potential investors still regard Aceh's political stability and related security issues as a live issue, and have adopted a "wait and see" attitude for further signals of stability.

Aceh's economic growth vs. Sumatra and National Average



Source: BPS and World Bank staff calculations.

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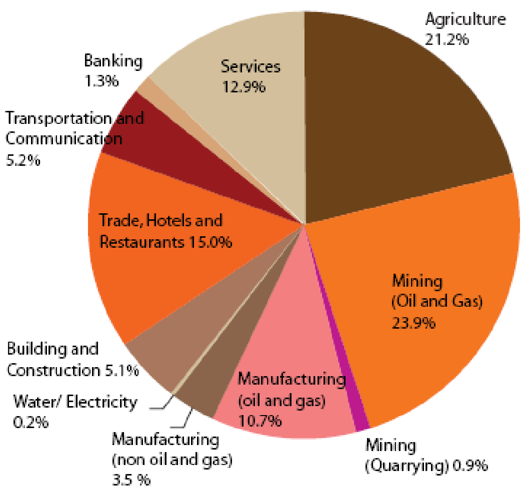
[4] The term comparative advantage is used throughout in a general sense to refer to factors potentially attractive to investment rather than in the trade theory sense where it is used to explain patters of trade.
[5] Sourced primarily from the World Bank's *Aceh Economic Updates* for April and November 2007.
[6] Excluding oil and gas, the economy grew by 7.7 percent in 2006

The commercial sector of the province's economy before the tsunami was heavily dependant on oil and natural gas production. After the conflict and disaster, the contribution of oil and natural gas has decreased as resource stocks have declined; by contrast, rehabilitation and construction-related sectors tended to show significant increases. In 2005, the economy declined by 10 percent, primarily caused by the slowdown in the mining, agriculture and manufacturing sectors. Meanwhile, the services sector expanded, due to the need to supply the reconstruction effort after the tsunami.

Aceh's economy, 2006



Source : BPS

Economic Growth in Aceh 2003 - 2006

Sector (%)	2003	2004	2005**	2006*
Agriculture	3.2	6.0	-3.9	1.5
Oil, Gas and Mining	9.8	-24	-22.6	-2.6
Manufacturing	1.6	-17.8	-22.3	-7.9
Electricity and water	16.9	19.5	-2.0	12.0
Building / construction	0.9	0.9	-16.1	48.4
Trade, hotel and restaurants	2.4	-2.6	6.6	7.4
Transport & communication	3.8	3.6	14.4	11.0
Banking & other financial	30.9	19.4	-9.5	11.8
Services	6.3	20.1	9.7	4.4
Total incl oil and gas	5.5	-9.6	-10.1	2.4
Total w/o oil and gas	3.7	1.8	1.2	7.7

*Preliminary figures. ** Revised figures
Source : BPS

Private consumption increased significantly during 2005, serviced primarily by inter-province imports. The inter-province trade balance changed from a surplus of 13 percent in 2004, supported by a large volume of exports of raw commodities, to approximately 0 in 2005. Consumption patterns have also shifted and non-food items now comprise 47 percent of private consumption, up from an average of 34 percent in 2001-04. This shift in consumption is related to the acquisition of goods in tsunami-affected areas.

Investment has increased substantially. Gross Domestic Capital Formation (GDCF) contributed only 7 percent of GDP in 2004 but by 2006 this had doubled to 14 percent of GDP. According to official figures, the combined value of domestic investment in 2005 and 2006 was about US$400million. This figure is surprisingly low given the large funds spent in Aceh by the reconstruction effort (estimated at US$2.8 billion to end-2006). GDCF is dominated by public capital expenses at all government levels, reflecting the predominant role of public investment in Aceh's reconstruction. Despite this increase, total investment is still significantly lower than the average national investment level, which is 22 percent of GDP. The total foreign investment realization is minor compared to the domestic public expenditure, which was to May 2007, US$817,995,400. The total private domestic investment realization to May 2007 was Rp.2,227,968,184,371 (US$239,598,574).

Employment generation remains one of the main challenges in Aceh. *Recorded* unemployment increased from about 6 percent in 2000 to 12 percent in 2006.Nevertheless, wage increases have continued. Wage increases result from a combination of the following four factors: (i) supply shortages for particular labor categories in high demand (e.g. semi-skilled construction workers); (ii) lack of population mobility, creating labor shortages in some areas, as reflected by the large inflow of construction workers from North Sumatra; (iii) public sector wage increases granted following high inflation rates to protect workers' purchasing power; and (iv) the wide availability of safety nets from NGOs and donors having the effect of reducing the incentives for many people to actively seek low-paying employment.

Agriculture, by far the largest employer in the province (absorbing 56 percent of the workforce in 2006), has in fact been shedding labour since before the tsunami. The structure of employment is shifting away from agriculture towards other sectors, particularly services.[7] This trend may have been accelerated by the needs of the reconstruction effort. The size of the workforce has grown by 5 percent since the tsunami, partially explaining why unemployment has increased despite the large reconstruction effort. The services sector (including construction) now employs 38 percent of the workforce. Meanwhile, the number of home and small industries has increased substantially in the past two years as a result of the continuing assistance from donors and NGOs encouraging many individuals to start micro-enterprises. This has led to increasing employment in the manufacturing sector.

Year-on-year inflation in Aceh has exceeded national levels, which has lowered the competitiveness of the province compared to other parts of Indonesia and the rest of the world[8]. Monthly inflation in Aceh fell back to single-digit levels at the end of 2006, but average inflation in 2006 was 24.8 percent, almost double Indonesia's overall rate of 13.4 percent.

However, by June 2007, inflation had dropped to 8.5%, narrowing the overall gap with the national level. High inflation was driven primarily by high food and transport prices. This was a result of interrupted road connections following the tsunami and the transport supply constraints met in coping with increased demand for goods needed in the reconstruction effort. Inflation for transport decelerated after March 2006 and is now on a par with national inflation levels. High inflation has so far served as one of the strong deterrents for seasoned businessmen and prospective entrepreneurs to put their money in Aceh. Although inflation is now dropping, at the 2006 inflation rate, a business had to earn as high as 30% in nominal profits just to break even in real terms and thus preserve the real value of his or her invested capital.

The investment climate in Aceh

What constitutes an investment climate?

The World Bank defines a business and investment climate as the opportunities and incentives for firms to invest productively, create jobs, and expand. The investment climate can be defined by three broad sets of variables:

- Macroeconomic policies such as fiscal, monetary and trade policies;

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[7] This sectoral shift mirrors Indonesian national trends. Agriculture currently employs about 45 percent of the national workforce.

[8] After the tsunami the annual inflation rate has been in excess of 20 percent, reaching a high of 41.5 percent in December 2005, compared with 17.1 percent for Indonesia as a whole. Inflation was also exacerbated by the reduction in fuel subsidies in October 2005, which caused an inflationary surge across the entire country.

- Governance[9] and institutions; and
- Infrastructure.

The state of a country's business and investment climate is a key factor in that country's ability to attract foreign investment and develop small and medium enterprises. Transnational companies prefer to invest in enterprises in countries with a healthy business climate – where cost, delay, and risk are minimized. In addition, SMEs are more likely to flourish in a climate where they are not overburdened by taxes and regulations. The Government of Aceh, as an autonomous region, should endeavour to create an investment climate that is competitive with the other provinces of Indonesia, and surrounding countries in the region.

Governments generally do have the means to make it easier for people to do business. Increasing the overall level of technology or spurring economic growth are complex and difficult matters, but changing laws regarding employment, simplifying permit and licensing procedures, developing a national land registry, or supporting infrastructure development are all things that governments can do. If the Government of Aceh wishes to attract foreign direct investment (FDI), investment from other parts of Indonesia or encourage homegrown private investment, it must engage in prudent policy-making. Weak regulatory regimes and law enforcement, and/or poor institutional capacity leading to non-competitive market behaviour are bound to have a negative effect on FDI.

To understand the link between investment-targeting policies and private sector investment performance and prospects, it is important to recognise what influences an investment decision. This is especially relevant for those investors with an option to locate in the NAD province or elsewhere in Indonesia. What are the elements of a 'location offer' that matter to investors? The table below provides a summary and approximate order of importance of these factors as revealed by global FIAS investor surveys. The table also considers the impact that NAD provincial/district level policy can have on the location factors.

Location criteria	**Main location factors that impact on investors**	**Provincial/district policy influence**
Macroeconomic stability	• Stable exchange rates, interest rates and domestic prices requiring fiscal restraint and good governance	Negligible – central government control
Political stability	• Absence of risk to sunk capital, profits, normal operations and assets from social unrest,	Significant. Enforcement of law protection of property rights, but national government stability also an

[9] Includes microeconomic policies such as those governing state owned enterprise pricing, local taxation, etc

	opportunism	issue
Government capacity	• Clear, predictable regulatory environment • Government institutional capacity	Significant. NAD province needs to build government institutional capacity with semi-autonomous capability. Province responsible for effective and efficient application of national level law, and all legal authority under the Law on the Governance of Aceh.
Natural resources	• Abundance and quality • Profit impact through productivity, investment 'life'	Significant. Environmental protection powers and measures taken to ensure sustainable exploitation
Land	• Location, availability and quality of land and/or commercial property • Land administration systems with capacity to show clear title and development plans • Property costs and contractual conditions	Significant. Provincial and district land titling administration must be reconciled with national level administration methods, to determine available land for investors. Quality of land and environmental protections also significantly impacted by provincial and district policy.
Access to markets	• Size, nature and purchasing capacity of local demand • Access to regional and other international markets • Openness to trade and investment; absence of entry barriers • Existence of clusters for select sectors or investors • Availability, quality and cost of suppliers for critical resource inputs	Significant.
Value adding ability	• Existing manufacturing capacity and value add technology • Extension services	Significant. Provincial government (through Agriculture and other sectoral dinases) can provide extension services and foster research and development, harnessing improved technology; processing and packaging capability.
Transportation and communications	• Availability, quality and cost of communications and transport infrastructure (road, rail, port, air) – supports accessibility to market	Significant.

Operating infrastructure	• Availability, quality and cost of basic utilities (electricity, gas, water, waste management etc)	Significant for availability and quality. Limited for cost.
Labour	• Availability, quality, flexibility and cost of labour • Availability and quality of education and training facilities • Issues of productivity, turnover and militancy	Moderate. Provincial allocation of DAK, DAU for education and training.
Access to finance	• Availability of finance for smallholders, domestic investors and international investors • Supporting financial infrastructure such as credit bureaus	For smallholders, significant. Currently some microfinance programs. Could support smallholder cooperatives as borrowers. For domestic and international investors, finance available outside of NAD province.
Taxation and incentives	• Level of corporate taxation • Availability and nature of specific grants, low –interest loans, tax breaks and other offsets	Limited. Risk that Aceh will use the OTSUS[10] or DAU revenues to offer incentives rather than addressing the fundamental problems.
Culture and quality of life factors	• Availability and quality of the physical and social facilities and their attractiveness – especially for expatriate staff and staff recruitment • Cost of living – including housing and schooling	Moderate. Can ensure consistent treatment of investors.

The following section considers NAD province's comparative advantages and disadvantages, in relation to each of the locational criteria listed. It considers those that can be enhanced by prudent policy making at the provincial/district level. Part B will provide key result areas in which the NAD province must improve its location offer, and strategies to do so.

Comparative advantages and disadvantages: overview[11]

The table below outlines sources of advantage and related disadvantage in terms of what matters to investors.

10 OTSUS is Otonomy Khusus (Special Autonomy) fund, which is provided for under the Law on the Governance of Aceh as a profit share mechanism with the central government for oil and gas revenue.
11 This chapter uses published sources and mission interviews to assess the prospects of individual sectors and selected key commodities, both from the point of view of investment prospects in their own right (the plantation crops sector, mining), and along the processing/export chain of which they are a part (shrimp, palm oil refining). The summary treatment in this Chapter is supported with more detailed information in Appendix A.

Advantages		Disadvantages
• The resolution of the civil conflict[12] and passage of the Law on the Governance of Aceh (LOGA) • Governor elected, parliament seated and declarations to investors guaranteeing political and civil stability	Political Stability	• Perceptions of political risk to private investment – especially through unauthorised charges and lack of asset protection – remain high

• Passage of the LOGA
• Investment Policy Statement recently issued by Governor; draft Investment Qanun before parliament.
• The BRR has established:
  ◦ Investor Outreach Office
  ◦ Export Development Centre
  ◦ Clinic for Branding and Packaging
	Government Capacity	• Although the LOGA has passed, supporting policy and qanuns are yet to pass, leaving a weak policy, legal and institutional environment
		• Governor's office and Dinas (provincial and district) responsibilities and capacity uncertain, especially with impending expiration of BRR
		• Complexity (and hence effective cost) of establishing a business, though typical of Indonesia, are excessive by international standards

Large quantities of natural resources that can potentially be extracted (minerals, forest, marine)	Natural Resources	Extraction complicated by: • Land administration issues • Undertermined environmental protections and sustainability benchmarks • Law enforcement and conflict of interest for resource based activities, eg illegal logging.
Large quantities of fertile land suitable for horticulture and plantation products, which have strong market potential	Land	Land titling uncertainty resulting from: • Adat land • GAM reclaimation of land • Governor declaration to distribute 4 hectare parcels to NAD citizens • Poor land administration – eg, administration of titles sits informally with Bupati rather than BPN Land may be infertile or environmentally hazardous (eg peatland). Perverse incentives to make land available through illegal methods.

[12] Civil conflict is still present in other parts of Indonesia and the region, which are also resource rich

Proximity to Sumatra's main port and industrial centre of Medan Proximity to East and South Asia region	Access to Markets	• The NAD province market is small with limited purchasing capacity[13]. Investors would factor Indonesia wide domestic demand, but transport connectivity to the rest of Indonesia is weak. • Lack of local processing and value adding capacity within NAD across all sectors • Weak supply chain linkages to domestic, regional and international supply chains. • Market information failures (about price, quality premia, size of potential export opportunities) • Substandard extension services fail to fill another critical information gap with respect to good practice that affect both agriculture and fisheries. • Ability of local producers to save and invest in improved production methods in some of Aceh's most marketable agribusiness products (eg shrimp growing) are held back by poor price information and weak grower bargaining power
• Significant number of crude palm oil processing mills • Clinic for Branding and Packaging established by the BRR • Coffee industry supplying to organic market	Value Adding Ability	• No biotechnology facilities to improve seedlings • Limited processing capability. Cocoa poor quality • No palm oil refineries • Limited capability for storage and processing of fish produce • Limited halal capability in production, processing, packaging, warehousing and logistics
• Proximity to Sumatra's main port and industrial centre of Medan • Proximity to East and South Asia region • Transport infrastructure has benefited from reconstruction • Reliable communications technology domestically and internationally	Transportation and Communications	• Although some restoration of road networks and ports, weak transportation connectivity by land and sea to Medan and region remains. • Risks about maintenance and extension of networks • Related logistics infrastructure needs to be established and supported • Illicit 'tolling' behaviour

[13] In 2004, 28.5% of Acehnese were below the poverty line, according to the Donor Working Group on Local Governance

• Untapped sources of geothermal, coal gasification and other alternative sources of energy for power utilities	Other Infrastructure	• State owned enterprises currently dominate infrastructure, but lack of clarity of ownership and division of responsibility between national and provincial levels • Real costs of basic electricity services are inflated because of unreliable supply due to supply deficits • Pricing caps restrain private sector investment in electrcity • Water is mostly unsanitised
• Aceh has the second highest per capita education expenditures in Indonesia, at Rp.457,000, more than twice the national average of Rp. 198,000. • Aceh has a higher enrolment level than Indonesia or North Sumatra across all income levels and types education. • Affordable labour is an attraction for investors in processing industries. An unskilled production operator in Malaysia attracts a monthly wage of between \$125 and \$283 compared to an average of \$74 in Aceh.	Labour	• Teacher gaps in rural areas. • A majority of teachers do not have the legally mandated qualifications • Spending for operation and maintenance of schools is inadequate. A large (and increasing) share of the funds are spent on salaries for teachers, leaving little funds to improve the quality of education. • The 'effective wage rate' depends on labour productivity and the nominal manufacturing wage, and this is likely to be held back by an under-performing education system in NAD province.
• Numerous microfinancing schemes available from donor community	Access to Finance	• Farmers continue have little or no access to working capital to purchase necessary agri-inputs in a timely manner • Economies of scale not achieved, which is necessary for sustainable growth. Lending to cooperatives not developed. • Savings hampered by low profit margins
Strong cultural identity, and regional linkages with similar cultures via the Indonesia-Malaysia-Thailand Growth Triangle. Opportunities to exploit complementarity with growth in Malaysia as a halal food hub	Culture	• Lack capacity to meet cultural standards for products, eg halal standards for horticulture, animal products and palm oil based cosmetics

The advantages and related disadvantages discussed above permeate all of the sectors in which NAD province has a potential competitivness. Sectoral level considerations are discussed in detail below, with further information located in Appendix A.

- Natural resources:
    - ♦ Mining and forestry;
    - ♦ Plantation crops (palm oil, cocoa and coffee);
    - ♦ Horticulture;
- Animal husbandry;
- Fisheries and aquaculture;
- Manufacturing and services;
- Infrastructure.

Consideration is also given to Aceh's human resources, geographic location and potential trade as investment drivers.

Natural resources and primary production as a basis for investment

NAD province has the physical basis for future investment in natural resource related sectors. Strategic economic prospects include mining, forestry, fisheries, plantations and agriculture. A regions's basis for specialising in some sectors and activities rather than others depends in part on the relevant abundance of its resources. For potential exporters, any advantage conferred by natural resource abundance and favourable production or extraction conditions must translate into *competitiveness* for investment to occur. A combination of distance from markets, high cost utilities and transport, high business establishment costs, labour and property rights constraints and political risk can mean little investment in the very activities in which resource abundance would give Aceh an advantage.This section documents some of the potential, drawing on the GTZ-sponsored ATAP project findings and individual sectoral value chain analyses completed by the IFC over the past two years.

Mining and forestry

The economic performance of NAD province has, up to now, been dependant on the contribution of the oil and gas sector. However, oil deposits are now running low. It is quite possible that new oil and gas deposits/fields will be found. This will depend on minimal impediments to prospecting activities. Law No 18/2001 on Special Autonomy for the Province of Aceh allows NAD a share of the net-revenue from oil and gas that is more favourable to the Government of NAD than that allowed in other provinces.

Mining sectors outside of oil and gas, such as coal, gold, iron ore and lead, still have the potential to be developed to balance the decline in oil and gas reserves. All these minerals are found in fairly large quantities in the province.[14] However, exploration and exploitation of these minerals remains problematic, in part due to confusion over which is the appropriate government department to manage the resources (contenders have been the Department of Forestry, Department of Mining and Department of Environmental Affairs). There is also uncertainty over the ongoing power of the national government in these areas.[15]

The new national level mining law may bring certainty to Aceh's current investment climate for mining. The increase in Acehnese government autonomy which has accompanied both the decentralisation program of the national government and the 2006 Law on the Governance of Aceh (LOGA) has been a cause of more uncertainty among potential mining investors with the proliferation of local regulations that hinder business investment, along with local government fees, profit sharing and other licensing regulations for mining enterprises. While these impediments are also present in other provinces, until the new national mining law is passed, when combined with political risk and poor transport networks in Aceh, it helps retard further exploration and development.

Estimates of Aceh's forest resources vary. The area of forest of NAD province, based on the Assigned Forest and Water Area according to the Decree of the Minister of Forestry Affairs No. 170/Kpts-II/2000, dated 29 June 2000, is 3,549,813 hectares (with its total water area). The forest area is about 66.22% of the total area of the province, which includes conserved forest, protected forest and production forest.

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[14] Other potential mining materials in the Province include tin, iron, ferruginous sand, manganese, molybdenum, chromium, copper, zinc, platinum, silver, mercury, sulphur, river sand, trass, mica, gypsum, granite, andesitic, serpentine, magnesia, phosphate, dolomite and ocher). According to the Aceh Triple A Project (ATAP 2007) class C mining of industrial/building materials (sand and stone, coral, land-fill soil, hill stone, limestone, quartz sand and marble) also have significant economic potential.

[15] There is a draft national level mining bill which is to replace the Law No. 11/1967 on Mining-Related Subject matters. The draft law will update the 1967 law by defining local government responsibilities under fiscal decentralization and regional autonomy. The bill also eliminates differences in treatment of foreign and domestic investors by stating that both will be eligible to receive either a Mine Operation Permit or Mine Operation Agreement.

Since the 1970s, Aceh forests have been used in what is now emerging as an unsustainable exploitation of an economic resource for export of logs and timber based industries. The forest management system is still dominated by Hak Pengelolaan Hutan (Concession for Forest Management) that is granted in an opaque manner to certain private enterprises without involving the local people and local government.

There has been unclear authority and responsibility for forest management. Local government autonomy has changed the model of the central-local Government relationship. High costs for forest management and weak control and law enforcement have all resulted in less effective forestry planning. Cases of over cutting, illegal logging, timber smuggling to other countries and other illegal activities have occurred. Failure of forest management is also caused by land-tenure problems, unsustainable forest management, and the community's hindered access to forest resources. However, a logging moratorium was declared and signed by the Governor of Aceh on June 6, 2007. It was issued as Governor Instructions No.05/INSTR/2007 but its effectiveness is questionable with conservation areas under continued threat. The Aceh forestry agency must conduct evaluations concerning the status and total area of concession in Aceh as a matter of urgency.

Despite the significant forestry resources there has been limited value adding, apart from pulp and paper making. There is some small scale local woodworking and furniture manufacturing. The BPS publication, Aceh in Figures 2004, shows only one 'medium/large' furniture enterprise and 12 non furniture wood and wood products manufacturers in 2003 employing a total of 940 people. Like most of the value adding to Aceh's primary production, the majority is done outside the province.

Plantation crops and products and other agriculture

Plantation crops

The latent comparative advantage enjoyed by Aceh in plantation and other agriculturally based activity, and the mitigating disadvantages are examined here through the lens of three key plantation crops – palm oil, cocoa and coffee –and horticulture and livestock. Illustrative details on these and other promising commercial plantation and cropping activities, including peanut production are presented in Appendix A.

The topographic conditions of NAD province are variously suited to the cultivation of oil palm, rubber, coffee and cocoa which are the major plantation commodities of the province. The ATAP (2007) states "in the NAD province, there is fairly extensive land available for cultivation of plantation crops. There is a total of 250,000 hectares of abandoned land (ex-HGU) that can be switched into plantation area. Around 761,572 hectares are potential to be individually owned and large scale plantations." Estimates of this kind, however, remain highly controversial.

As discussed in Chapter 2 (Potential investors and targets) below, one of the key attractions for potential investors in Aceh is a perceived abundance of available, fertile land. In particular, there are many investors keen to invest in palm oil plantations. However, the reality of what land is available for investment is highly contentious. Land identified as available to investors may in fact be unsuitable, pose environmental hazards if planted (peatland) or have undocumented customary title which is only discovered through disputes after a lease is obtained. In general, plantations within NAD province are cultivated in a mono-cultural manner, whereas land ownership is often less than 1 hectare and only primary products are produced. Depending on market information and strengths of bargaining power, farmers' incomes may be higher if greater value adding takes place within the province[16].

On November 6, 2006, the Directorate General of Plantations within the Ministry of Agriculture in Jakarta launched a comprehensive five year plan for the plantation sector nationwide, including Aceh. The 'Plantation Revitalisation Program 2006 – 2010' (commonly known as the Plasma scheme) covers three commodities: palm oil, cocoa and rubber. It is aimed at boosting output of these sectors and targets smallholders. Eye on Aceh's 'The Golden Crop?' report (September 2007) explains that the program relies heavily on companies (core plantations) establishing smallholdings in a nucleus system. Companies become "foster parents" to facilitate smallholders gaining access to land and finance to establish small plantations.

[16] According to the ATAP, there are 21 palm oil factories, 111 coffee manufacturers, 129 pala refineries, 29 nilam refineries, coconut oil manufacturers, 2 cocoa manufacturers and 4 rubber manufacturers. At present, the fresh fruit bunches of the oil palm can be milled to be turned into Crude Palm Oil (CPO) in Aceh, but must be sent out of the Province (mostly to Medan) to be further refined (such as being turned into soap or frying oil).

The program includes substantial financial support to the smallholders in the form of loans and investment credits from several Indonesian banks, with interest rates subsidized by the government. Financial support will also be channeled to companies whose responsibility it is to oversee implementation of the program and repayment of the loans. In Aceh, this program is being executed through the provincial Department of Plantations. The program aims to facilitate the expansion of 40,000 hectares of new palm plantations and the revitalization of 4,775 hectares in 12 districts. The local Department of Plantations is actively seeking partnerships with established plantation companies as “foster parents” as part of this scheme, and has already approached 17 such companies to request their active involvement (see Chapter 2 and Appendix B).

Palm oil

Aceh’s climate and soils are well suited to growing oil palm on both east and west coasts (as are other parts of Sumatra). Sumatra is favoured by the major Crude Palm Oil (CPO) companies due to its large areas of land available for oil palm plantations and its accessibility to the major trading port of Medan. Aceh is a relatively minor producer with 6 percent of national production. Although the province is a priority region for expansion with the main CPO companies, limitations have emerged.

Several areas of concern with regards to land for Palm Oil were identified by the Eye on Aceh report:

- *Land ownership*: Land identified for producing palm oil is often private or community-owned land, farmland that is being used by locals to grow vegetables or even forested areas that local people would rather remain forested. Local needs, however, are rarely taken into account when permits are issued. The problem is exacerbated by the fact that most Acehnese lack land certificates to prove ownership, meaning that locals often receive little or no compensation for land taken over by plantations. Plantations are also often found to have expanded beyond their permit area, encroaching onto national parks as well as onto private or community owned land. The industry has become probably the biggest agricultural offender in Aceh in terms of these types of problems. But land disputes rarely receive any publicity in Aceh and so tend to go largely unnoticed, the complainants eventually giving up their struggle to prevent permits being granted or to fight for compensation.
- *Land clearing*: The potential for establishment of lucrative plantations is used as justification for issuing permits to clear conservation-value forest, even though such areas are not necessarily best for cultivating palm oil. Some companies have used their plantation permits simply to cash in on timber, sometimes without palm oil ever being planted. Peat areas, which are important carbon sinks, are also cleared.
- *Environmental implications*: There are serious environmental implications from the introduction of toxins as pesticides, clearing land through burning, flooding and landslides as oil palm trees do not retain water in the same way as native forest, loss of ecosystems and biodiversity and greenhouse gas emissions.

Paradoxically, while there is an assessed overall deficiency in milling capacity a number of CPO plants are operating at half capacity, partly because of low grower productivity.

The quality of fresh fruit bunch (FFB) supplied by smallholders to CPO mills is very poor resulting in low processing efficiency at the mill and poor prices paid to farmers. The FFB quality issue is driven by:

- Little or no access to working capital for farmers to purchase necessary agri-inputs in a timely manner;
- Low knowledge of crop management and harvest practices to improve oil content of FFB;
- Poor genetic quality of existing trees, little access to improved seedlings and resowing of poor quality seedlings.

The FFB production and quality problems result in poor smallholder returns and effectively reduce the economic incentives to revitalise their farms. Training and extension services to smallholders are very limited. The high level of oil palm research and development work undertaken by public and private oil palm companies does not reach smallholders. The network of regional Dinas offices have a crucial role to play in extension and do not actively engage with research providers. Current selling arrangements from smallholders to CPO mills do not facilitate the flow of price/quality market information. Farmers are paid by collectors on a weight basis only and do not bother to collect higher oil yielding loose fruit. Cultural characteristics of indigenous Acehnese can result in insufficient time allocated for necessary tree crop maintenance.

Increasing awareness of damaging environmental impacts of plantation development is a market risk for the industry. The industry faces the challenge of improving its management of environmental resources and its interaction with local communities. The establishment of the international Roundtable on Sustainable Palm Oil is a positive step in this direction. Strengthened industry regulation is likely to be the best approach to achieving lasting improvement in environmental outcomes.

Cocoa

According to a recent IFC study (IFC 2006) the Indonesian cocoa supply chain is relatively efficient although current collector and trader handling practices (e.g., mixing clean bean with waste, weighing inaccuracies) distort price quality signals and reduce the incentive for most farmers to undertake bean fermentation. Current crop productivity is low due to crop neglect from the combined effects of conflict and tsunami. Most farmers lack an understanding of pruning requirements, pest, disease management and input requirements to lift yields and bean quality up to the standards achieved by leading farmers.

Fertiliser and compost use is very low due to knowledge and working capital constraints.

Farmers and exporters have noted that the current tree age of Aceh cocoa crops impacts on bean quality and yields. Many of the trees are more than 25 years old. Replanting with improved varieties would address some of the bean quality issues. Aceh farm-gate prices are susceptible to world price fluctuations for free air quality control (FAQC) cocoa as fermented bean has a stronger global demand and a more robust market. Without improved post harvest handling, improved bean quality and fermentation, Aceh growers are relatively more exposed to market risk than producers of higher quality fermented bean. Improved bean quality for FAQC bean (without fermentation) will partly address this issue.

Smallholders face a number of other barriers to improving returns associated with supporting structures and related industries:

- Farmers have little or no access to working capital to purchase necessary agri-inputs in a timely manner;
- Low availability of improved seedlings;
- A low level of extension services provided by Government, Ministry of Agriculture or Dinas.

Coffee

USAID has invested significantly in building the organic coffee industry, which has the potential to be a competitive industry for Aceh.

Koperasi Baitul Quiradh Baburayyon (KBQB), an Acehnese coffee cooperative has 4,461 farmer members representing 5,089 hectares and 111 farmer groups. Of that total, only 171 farmers had been disqualified for organic farming practices violations. All had been NOP (USDA), EU and JAS (Japan) organic certified; CAFÉ Practices (Starbucks) certified; and FairTrade Certified (FLO Preconditioned Status). Recently, an additional 2,456 farm families joined the cooperative as project beneficiaries with a total of 3,238 hectares of coffee plantations. These additional project beneficiaries were inspected for organic certification during October 2007 and will become full members upon passing inspection.

Coffee purchases from cooperative members will occur on a seasonal basis reflecting the harvest period of late October to late May every year. The project purchased a total of approximately 6.1 million lbs. of wet parchment during the past season ending May 2007, or more than double the previous season's results. Payments to Farmer/Members during that period has amounted to approximately Rp. 30 billion. It is anticipated that volumes will double over the next seven months of the harvest season starting November 2007 to May 2008.

From April to September 2007 exports of Grade One Certified Organic Coffee from KBQB have amounted to 1.071 million lbs and together with local sales, totaled a value of $2.32 million FOB Medan equivalent. As the industry was entering the beginning of the harvest season in November 2007, it was anticipated that volumes will at least double over the next seven months of project implementation.

First Year (audited) KBQB Financial Statements resulted in operations being undertaken at a profitable level. This is considered a substantial accomplishment given its rapid start-up phase, higher prices paid to farmers, and one-time initial development costs. Current employment generated over 700 jobs for coffee production, seedling production, processing and export operations.

Non-plantation agriculture

Horticulture

As Indonesia and Asia display trends more generally in both urbanisation and the shift in food consumption away from traditional staples and towards diversified diets, more opportunities will emerge for producers of both fresh fruit and vegetable crops. A study of the link between supermarket development and horticulture in Indonesia (World Bank Report No 38543-ID, June 2007) suggests that as demand grows, particularly in Java, there may be scope for a shift of supply of 'commodity vegetables' away from traditional sources in West Java, where production is moving up the value chain, to other islands where land and labour is cheaper.

Strengths of Aceh include the availability of land and growing conditions for important potato and tomato crops as well as the commodity products like cabbage. Its profile as a cheaper land and labour province fit the above profile, and if it can satisfy commercial production requirements of modern retailers, its proximity to Malaysian markets offers a further opportunity.

Against this, Aceh faces the problem that it is relatively remote from Javanese markets which dominate the Indonesian supermarket trade and has to overcome the problems of ‘poor supply chains - moving over poor roads, fraught with rampant corruption, and lacking cold chains and logistic services’ – problems noted for Indonesia in general (World Bank loc cit p vii) and exaggerated in Aceh through conflict and natural disaster. Neighbouring Medan has 6.5% of the nation’s supermarkets and Aceh suppliers may need to first establish their capability there if there is to be substantial investment in this sector.

As discussed in Chapter 3, Lessons and leads for Aceh from Malaysia, Malaysian government authorities and investors all emphasised that Aceh would be better placed to export to the Malaysian market if it value-added to its primary produce. NAD province would be in an optimum position if it added value in compliance with international halal standards. The ATAP outlines plans to construct a Unit Pengolahan Hasil (Product Processing Unit), as well as facilitating product marketing, during a pilot spanning 2008 – 2012. The ATAP states that the primary products for this would be coffee[17], oil palm (food oil products) and cocoa. It is not clear if this pilot is going ahead or who is funding and facilitating it. There is also a recently established product packaging and marketing clinic that is currently funded by the BRR.

Animal husbandry

Pre-disaster, Aceh was one of the few parts of Indonesia where livestock populations were increasing, reflecting favourable local conditions and good genetic diversity. Preliminary assessments of losses put these at a value of Rp126 billion. While local and Indonesian demand for livestock-based foods continue to grow, prospects for local processing and subsequent export face the constraints of a lack of export capable abattoirs/slaughterhouses and the familiar problems of transport infrastructure and handling inadequacies and poor extension services. Artificial insemination is not widely available. While there is active support for improved breeding from local university research and through foreign aid, significant progress is required in the area of livestock biosecurity and traceability. There is ongoing ADB support for construction of livestock quarantine offices, laboratory and holding facilities in Banda Aceh and Aceh Besar but livestock biosecurity remains an issue and an impediment to export driven growth.

[17] A USAID project is already underway working with coffee cooperatives to produce certified organic coffee. This is discussed further in Appendix A.

Fisheries and aquaculture

NAD owns extensive marine resources with a total coastline of 1,660km and a total marine area of 295,370km2, consisting of territorial waters, waters around islands and an Exclusive Economic Zone which makes up 238,807 km2 of the total water area.). The fishery resource has been estimated at 423,410 tonnes with a sustainable potential of 272,701 tonnes[18]. The amount of consumption in 2004 was 102,555 tonnes. There is illegal, unregulated and unreported fishing by domestic and foreign ships in Aceh waters and the Exclusive Economic Zone continues, due to weak control and law enforcement with respect to fishery crime.

Tuna and coral reef fish have been identified as two species where there is significant scope for commercial development and value adding[19]. Indonesia is the world's second largest exporter of fresh tuna with exports of yellow fin and skipjack tuna accounting for $91m. Aceh is not an exporter of tuna and resources are perceived to be sustainable. Aceh's skipjack supplies form the basis of strong domestic demand and prices are in the region of US$750/ton (Rp8.3 m/ton) as compared with around US$900/t (Rp9.9 m/ton) on the international market. The differentials in the yellow fin tuna market are however more substantial, US$200 to 1195/ton in Aceh as compared with US$3,900 on the international market. This may be because the average size of Yellow fin tuna in Aceh (a result if the fishing method used) is smaller and commands a lower premium price.

Aquaculture in Aceh is socially, economically and environmentally important, and represents a significant part of the livelihoods of many coastal people in NAD. The main farming system is the brackish water pond (locally known as a tambak) producing mainly shrimp (Penaeus monodon) and milkfish (Chanos chanos). Pre-tsunami, tambaks covered 47,000 hectares. Most tambaks are traditional, low input, farming systems producing shrimp and milkfish in polyculture and monoculture, relying on tidal inflows for water supplies and an intricate network of drainage channels. Some 20,500 hectares were destroyed in the Tsunami, representing a 70% loss in producing area in Pidie, Bireun, Aceh Utara, Lhokseumawe and Aceh Besar. Hatcheries also suffered heavy losses (193 out of 223) in Pidie. Bireun, Lhokseumawe, Aceh Utara and Aceh Besar.

Significant volumes of shrimps produced in Aceh are ultimately destined for export markets. But exports are largely indirect (via traders to Medan). Pre-tsunami, the shrimp farm gate value was US$62m, generating an export value of US$95m. This represented some 10% of Indonesia's total shrimp exports. Shrimp remains a high potential under developed product in Aceh's primary production list of prospects.

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[18] IFC, *Value Chain Analysis on Fisheries (Phase 3),* May 2006.
[19] IFC, *Value Chain Analysis on Fisheries (Phase 3),* May 2006.

Acehnese Shrimp: Unrealised Potential
(IFC Fisheries Phase 3 Report, May 2006)

The NAD province's strengths for shrimp are:

- The product is associated with being largely organic, low input (no chemicals or anti-biotics)
- Large varieties are favoured for export and as a result of the strength in the broodstock (250-300g) and the traditional low input systems used, 60% of the shrimp destined for markets is over 33gr
- Tiger shrimps are perceived as being more marketable to specific markets (Japan), having a better taste than other species
- The peak production period is in May and then again in December which falls outside the international peak supply periods of international competitors (August)

Some principal weaknesses are as follows:

- There is a large lack of technical know how. Extension support is minimal, there are no laboratory testing procedures and the farmer institutional structures are weak.
- Hatcheries are not monitored and domestic broodstock is not subject to virus checking
- There is no traceability of post larvae (PL) supplies. Farmers use several sources thus making it difficult to isolate the source of any disease.
- Farm inputs in traditional systems are inefficient in traditional systems with the result that yields are very low – around 0.2 tonnes per cycle. Specific problems identified are:
    - Up to 90% of farmers fail to use feed for the first two months resulting in very low yields per hectare
    - Feed costs / ha are high because of poor Feed Conversion ratios (as low as 1:1.8)
    - Use of fertiliser, lime, dolomite and chemicals is almost non existent
    - Around 50% of PL, as and when supplied, often passes through intermediaries. Consequently, there is insufficient attention to water PH and salinity, resulting in high levels of mortality (around 30% or more)
- Semi intensive systems suffer from:
    - High output (5 tons / ha / annum) but low size grades (18-24g7). Thus failing to command premium prices
    - Costly labour and energy inputs
    - The risk of disease (when systems are not isolated)
    - Slow growth rates and less efficient FCRs that Vannamei8
    - Inability to produce large shrimp
- Aceh shrimp is perceived as good quality but some shrimps are damaged because of excessive soakage and application of chlorine.
- Producers harvest small quantities at irregular intervals which cause excessive soakage times and delays in transport (up to 36 hours) whilst the middleman has a sufficient batch to collect prior to dispatch
- Transport margins are high relative to those in competing countries
- Because of a lack of collateral, access to finance is restricted to creditors/suppliers and agents. A principal constraint is that this system acts as a barrier to interaction between traditional farmers and the commercial private sector (Hatcheries and feed suppliers) for appropriate advice.

Manufacturing and services

Manufacturing in Aceh, despite contributing 17.43%[20] of the province's total GDP in 2005, is essentially small scale and catering for the relatively small local market and absorbs little labour. There are four larger companies in the industrial sector in NAD province and they are resource based and capital intensive.[21]:

Aceh Government officals have discussed the intention to develop 4 industrial zones. The ATAP, however, lists seven potential industrial zones, all to be partnered with seaports.[22] The industrial zones are, according to ATAP to be developed 'in accordance with existing human and natural resources, initiated by the Governments' BUMDs/BUMNs (State Owned Enterprises/Provincial Government Owned Enterprises)'. Briefly, Lhokseumawe has been designated as the gateway of industrial development, West Aceh as the gateway of agricultural development, Banda Aceh the base for industry and trade and Sabang as the key international port and center of tourism. Although a "concept note" is said to exist as to how these ports and industrial zones would interact and compliment eachother, it is not easily available, nor is there any no clear statement available as to how 'anchor' investors for each industrial zone might be secured to support cluster development or what role the province's Investor Outreach Office (IOO) might play in targeting such investments.

Despite the growth in services during reconstruction, private investors tend to seek services such as banking and finance, and legals from North Sumatra or Jakarta, or from overseas, rather than seeking services in NAD province.

Infrastructure

Part B of this report emphasises the key role of infrastructure – transport and power in particular – if Aceh is to turn latent comparative advantage into realised private sector investment. Despite the large injection of post-disaster spending on infrastructure[23], Aceh remains disadvantaged compared to Malaysia and neighbouring North Sumatra.

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[20] This includes processing of gas into LNG. Without processing of oil and gas, manufacturing is much lower (3.5% in 2006

21 PT Iskander Muda Fertiliser, PT Asean Aceh Fertiliser, PT Semen Andalas Cement and PT Kertas Kraft Aceh Paper. These factories are located in Lhokseumawe and Aceh Besar industrial zones. These companies have all been stunted by the conflict and tsunami.

[22] Blang Ulam Industrial Zone (Malahayati Seaport, Banda Aceh),Sabang Industrial Zone (Sabang Seaport)'Lhokseumawe Industrial Zone (Lhokseumawe Seaport, North Aceh),Langsa Industrial Zone (Langsa Seaport, East Aceh)'Kutacane Industrial Zone (Langsa/Singkil Seaport, Southeast Aceh),Singkil Industrial Zone (Singkil Seaport, Aceh Singkil),Lhok'Nga Industrial Zone (Malahayati Seaport, Aceh Besar).

[23] Transport infrastructure is 12.5% of total BRR allocation. It is below the allocation for housing and governance. As a whole (all players, not only BRR), transport infrastructure has absorbed 12.8% of the reconstruction effort

Road networks throughout Aceh are integral to economic development, to allow for freighting of goods. About 25% of the road network in NAD province is damaged. There is also disparity between the development of road in the east and west of the province, with more attention being given historically to the east because of the availability of gas and oil. There is a proposal to construct a new east-west road link.

While there are 10 seaports (three operated by the state owned PT Pelindo-I) serving the province there is no coastal feeder system to dovetail with world containerised supply chains. There is no port supporting an international freighter liner service north of Medan, and its port (Belawan) handles containers shipped in from the region's main container ports. However, the ATAP project shows that stakeholders envisage Lhokseumawe, Malahayiti K. Langsa and Meulaboh accomodating international traffic by 2015. Malahayati, Calang, Sinabang and Singkil seaports were all heavily damaged by the tsunami and are being redesigned and reconstructed.

No international direct air service has been available until the recently announced Air Asia service between Kuala Lumpur and Banda Aceh.

The communication sub-sector has grown rapidly as can be seen in the use of wireless communication systems, both GSM or CDMA-based, and internet connections. Investors consulted said that telecommunications in NAD province had improved dramatically and was no longer a real impediment to their operations. In contrast, energy supply remains problematic. Around 70% of the demand for electricity in NAD province is supplied from the North Sumatra System, which is still in a power deficit situation, while 30% is supplied from isolated systems, with a low degree of reliability.

Meanwhile the provincial branch of the state owned national supplier PLN NAD continues to make deficits since the selling price of electricity is lower than the typical production cost. In 2006, PLN NAD had a deficit of Rp840 billion . A contributing factor has been the recently increased fuel price, with lagged adjustments in selling price.

To meet the increasing demand, it is necessary to develop new electric generating capacity at the rate of approximately 20MW per year. Power is a big concern for investors, who in many cases have to rely on their own power plants. The investment climate would be more attractive for investors, especially those processors who have to generate their own power, if they could sell power back into the grid at reasonable market rates, which is currently not the case.

Human resources

The high rate of unemployment and absolute poverty in Aceh are coupled with relatively low education and skill levels in the region. However, compared to the rest of Indonesia, Aceh has relatively high education and skill levels. Aceh is perceived by the national government as being land rich and population poor. For this reason, and for the purposes of decentralization, Indonesians from urban centres are encouraged to transmigrate to Aceh, and receive a national government allowance for doing so. This could be a way for Aceh to attract skilled labour. Further, legal provisions establish that 30 percent of the enhanced oil-and-gas profit share returned to Aceh by Jakarta is to be used for education. The challenge will be to ensure that this is not absorbed in other departmental spending that does not target educational outcomes.

The World Bank's Aceh Poverty Assessment stated that Aceh has the second highest per capita education expenditures in Indonesia, at Rp.457,000, more than twice the national average of Rp. 198,000. Currently, provincial and district government provide the bulk of spending for education (63 percent). Aceh has a higher enrolment level than Indonesia or North Sumatra and this holds true across income levels and all types of education. However, Aceh's spending patterns are preventing Aceh from reaping the full benefits of such large expenditures. Although there are enough teachers in the region, a rural-urban imbalance creates unnecessary personnel gaps in rural areas. A majority of teachers do not have the legally mandated qualifications and spending for operation and maintenance of schools is inadequate. A large (and increasing) share of the funds are spent on salaries for teachers, leaving little funds to improve the quality of education.

Affordable labour is an attraction for investors in processing industries. An unskilled production operator in Malaysia attracts a monthly wage of between $125 and $283 compared to an average of $74 in Aceh. However, the 'effective wage rate' depends on both the nominal manufacturing wage and labour productivity, and this is likely to be held back by an under-performing education system in the province.

Geographic location and trade as investment drivers

NAD province lies in a strategic position at the northwest end of Sumatra. It could potentially serve as the gateway for trade in the East and South Asian region. According to Aceh Government officials, the province has potential for relatively easier access to China and India, two of the world's fastest growing economies, than the rest of Indonesia.

Currently however, NAD province is dependant on Medan as a trade port, especially for exports and imports that depend on the Medan/North Sumatra market. Ports and airports in the Medan/North Sumatra region serve as the regional hub for both inter-regional and international air transportation. During the post-tsunami period, both during the emergency response period and the rehabilitation and reconstruction time, the supply of materials flowed from Medan, reinforcing this dependence.

Aceh currently lacks the infrastructure and ports to be a regional hub. Despite inter-provincial rivalry and reported animosity of some Aceh government officials towards Medan, it is essential that Aceh maintains and improves links with Medan for trade at this point in time. Investors consider proximity and transport links to Medan when considering investing in Aceh, not only for the trade capacity in Medan, but for value-adding to Aceh products. Potential investors may also prefer to run their operations in Aceh from a Medan base at this point in time, taking a stepwise approach to investment in Aceh.

Aceh's exports continue to be underpinned by oil and gas. Amid the rapid depletion of natural oil and gas reserves, as per June 2007 total exports were US$883million, a decrease of 21 percent year on year. This decline was driven by a marked decrease in oil and gas exports, while non-oil and gas exports increased by almost 200 percent year on year. Fertiliser exports, which all but disappeared in 2006, along with production, increased significantly in the first half of 2007. This resumption of production and exports is the result of a government commitment to subsidise gas for the fertiliser industry until 2010. Agricultural exports are starting to recover, driven by coffee. As per June 2007, coffee exports from Aceh increased to US$6.7million from US$2.6million year on year., demonstrating in part the benefits of a USAID program tying plantation renovation to satisfying the quality requirements of global retailers (see Appendix A). Fisheries exports also increased, by over 300 percent compared with the same period in 2006 from US$117,000 to over US$0.5million. Although still relatively small in scale, these improvements are important in the efforts to diversify Aceh's export base.[24]

Principal export of many prime commodities is still made via Tanjung Priok Port in Jakarta and through North Sumatra. The value addition of the province's prime commodities benefit other provinces other than NAD. Furthermore, almost all provincial imports, particularly daily consumerables such as sugar, frying oil, rice, eggs, garments etc, come via the province of North Sumatra.

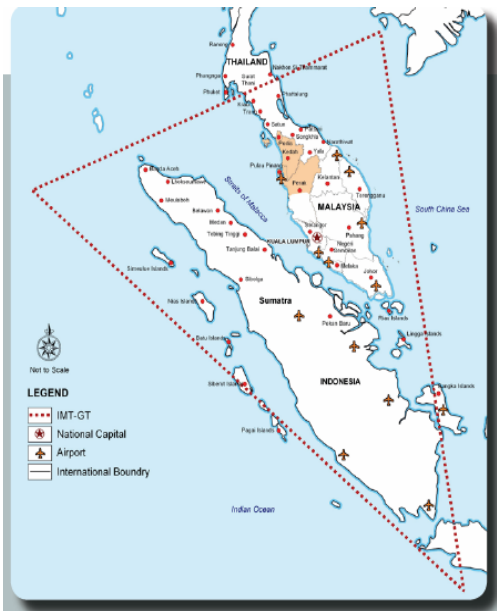
[24] For the first nine months of 2006, the biggest export earning was derived from chemicals, with a share of 40.1%. This was followed by food and live animals with a share of 36.6%. Likewise, a siginificant contribution of 22.7% came from machinery and transport equipment. On the other hand, manufactured goods accounted for the bulk of imports with a share of 47.4% followed by food and live animals with a share of 23.8% and machinery and transport equipment with a share of 21.4%.By destination, 93 percent of the region's 2005 exports went to just two countries: South Korea and Japan which respectively account for 69.4% and 23.6% of total export value. Aceh imported from six main countries: Thailand, Switzerland, Malaysia, USA, France and Singapore. These countries accounted for 92.3% of the region's total imports

The BRR has founded an Export Development Centre (EDC). One of its stated objectives is to shorten the export marketing channel of Aceh commodities by minimizing the middleman role of Medan trading houses whose margin reduces the margins available to Aceh producers. The EDC collaborates with NAFED (National Agency for Export Development) based in Jakarta. In 2007, the EDC has begun to engage in consolidation and gathering of information about Aceh commodities and their distribution channels. It is also studying international marketing and foreign buyer behaviour. The EDC plans to become fully operational in 2008. Funding beyond the life of the BRR remains an issue which could seriously impact Acehnese direct export success.

The Indonesia-Malaysia-Thailand growth triangle (IMT-GT)

(The IMT-GT was set up in July 1993 to accelerate the economic growth of three nations (Indonesia, Malaysia and Thailand) and to develop closer cooperation in both public and private sectors.

The IMT-GT covers an area of 569,652 square kilometers with a population of approximately 67.7 million. It includes 10 provinces of the island of Sumatra (Aceh, Bangka-Belitung, Bengkulu, Jambi, Lampung, North Sumatra, Riau, Riau Islands, South Sumatra and West Sumatra), 8 Peninsular Malaysian states (Perlis, Kedah, Pulau Pinang, Perak, Kelantan, Selangor, Melaka and Negeri Sembilan) and 8 provinces of Southern Thailand (Nakhon Si Thammarat, Narathiwat, Pattani, Phattalung, Satun, Songkhla, Trang and Yala).



The overall goals of the IMT-GT are to:

- promote foreign direct investment and facilitate economic development of the sub-regions by exploiting underlying economic complementarities and investment opportunities;
- enhance international competitiveness for direct investment and export production;
- lower transport and transaction costs;
- reduce production and distribution costs through economies of scale.

To date, most activity within the IMT-GT has centred around trade fairs and promotion of the location offers of the region. The Aceh Investor Outreach Office (IOO) attended a trade fair in Thailand last year. Malaysia’s Small and

Medium Industries Development Corporation (SMIDEC) was planning on hosting a trade fair in Kuala Lumpur in December 2007 for small and medium enterprises in the region. It is common opinon that the IMT-GT has been fairly inactive in undertaking programs to achieve its stated objectives.

Altough the IMT-GT is relatively inactive, the shared cultural values in this region and shared location offers hold potential for expolitation by Aceh, particularly by engaging in the halal goods chain that are important to all members of the IMT-GT. Once linked into the halal goods chain in the region, there would be potential for Aceh to also tap into existing Malaysian halal trade links with the Middle East.

2 Potential investors and targets

Given the apparent comparative advantages and disadvantages documented above, it is now appropriate to consider the types of investments Aceh is attracting, and targeting.

The role of the Investor Outreach Office (IOO)

The Investor Outreach Office (IOO) or Kantor Penunjang Pelaku Investasi (KPPI) in Nanggroe Aceh Darussalam (NAD) was created by the provincial government (with the technical and financial support of the IFC) to support the development of the province by facilitating investment via a client-service oriented approach. The IOO's objective is to assist new and existing investors to invest or expand business in NAD province. The IOO currently aims to achieve these objectives by helping investors understand NAD's regulatory environment , and finding prospective local partners and available land. An additional function of the IOO is policy advocacy to the Government of NAD.

The IOO does not have an active strategy in place to achieve these objectives, nor does it currently use formal criteria to allocate their resources or prioritise work. However, a separate IFC review of the IOO's objectives, functions and capacity is being undertaken, so this report provides only limited comment.

It is understood that at present, the IOO does not deliberately target particular investors. It did have a marketing strategy to conduct investor outreach, but due to a decree of the Ministry of Finance restricting international travel, is unable to host exhibitions outside of Banda Aceh. The IOO did participate in an Indonesia-Malaysia-Thailand Growth Triangle event in Thailand last year. It's head has travelled to India and the USA as part of Aceh Governor delegations and at this time, as part of the delegation, targetted particular investors. Overall however, the IOO has a passive approach, where it will act as a facilitator for investors that have needs centred around meeting regulatory requirements, and finding prospective partners and land. If the IOO is to move towards being more proactive in future, and targeting particular investments, it may need to establish further links with the Achenese diaspora. A returning pool of entrepreneurial Acehnese talent would provide confidence to other potential domestic and foreign investors.

The IOO does have some interaction with current investors. It has sought to network with current investors in Aceh through setting up the Aceh International Business Chamber. The Chamber aims to lobby the provincial government to improve its regulatory environment for investors The IOO hosted the Chamber's first meeting in approximately June 2007, and it has continued to meet informally since.

The IOO is also involved in the Aceh Business Forum. Based on statistics available in the ATAP, recent private sector investment appears to have been concentrated in plantations, fisheries, chemical production, mining and forestry. (Further information on current investment in NAD province is located in Appendix B.)

Aceh is attracting investment interest in plantations such as palm oil and cocoa, mining of black tin and coal, fisheries, and forest products such as pine and particle board. These are the sectors with comparative advantages as identified in Chapter 1 above. However, as discussed previously, one of the main comparative disadvantages for Aceh is uncertainty about available land. As can be seen from Appendix B's Potential Investors table, one third of the potential investors are trying to source appropriate land for their investment. Another common problem for international investors is finding a local partner with which to operate, and some local investors are seeking an international partner.

The IOO advises that most interest from foreign investors with which it has had contact comes from Malaysia and Singapore, and that the issues potential investors most commonly seek guidance on are:

- Accessing land;
- Locating local partners;
- Electricity supplies;

- Incentives: the IOO currently defers to the incentives available at the national level until the Aceh Investment Qanun is passed;
- Seeking to clarify the authority of the provincial government versus the national government for investment approvals, business registration and licensing.

Accessing land in Aceh

The logical method for an investor to ascertain available land for investment in Aceh would be to access BPN maps and BAPPEDA plans. Ideally, BPN and BAPPEDA would coordinate with the relevant sectoral dinases at the provincial and district level to keep the maps and plans up to date. However, an informal methodology prevails. The IOO assists potential investors to access land by contacting the Bupati (District Head) in the area in which the investor is interested to assess if there is land available. According to the IOO, the Bupati has the ultimate decision, over and above the different Dinas in the district, on land allocation. Therefore, investor access to land is dependant on the IOO's relationships with Bupati and other relevant networks, rather than accessing land through registries and maps. Discussions with the IOO indicated that although BPN does have a map of available land in Aceh, it is not valid, and contains no details on which areas are forest. The IOO has problems coordinating land access when an investor seeks to invest across multiple districts. The IOO has recently encountered difficulties while trying to coordinate an investment that requires 40,000 hectares of land. Due to the size of the land required, the National Government (Forestry Department) has the final decision. It is not clear what the benchmark number of hectares is to require national approval.

Investor perceptions

This section outlines the perceptions of potential investors in Aceh, that are based in Banda Aceh, Medan and Malaysia.

Investors noted that as land availability is one of the main attractions for them, the Acehnese government urgently needs to prioritise mapping, zoning and titling. The previously discussed attraction of land and countervailing concerns about access led to some investors requesting a master development plan regarding land, indicating which land is protected as forestry, and which is zoned for commercial plantations. Investors also said that information needs to be made available as to how valuation of land is calculated. With regards to Palm Oil, they would also like to see a blueprint of the planned Plasma initiative, and also to understand which areas are being targeted for further infrastructure development, such as roads and ports. The investors specified the need for transparency with such blueprints. If a summary of the blueprint were available, that would suffice. Investors said that through experience they have learnt that BKPM does not have the records/plans they need, nor BAPPEDA. Investors claimed that BAPPEDA does not know where to direct them to go for plans. The IOO is also not aware if a blueprint exists. According to investors, the IOO not only needs a blueprint for land availability and infrastructure development, but also an ability to indicate what other investments/developments are planned in Aceh. A contact person responsible for this information needs to be made known.

The investors interviewed perceived the key disadvantages of investing in Aceh as follows:

- Accessing land: Several departments to deal with, maps in different departments, difficult to find out zoning, difficult to confirm if land owned/titled.
- Leasing land: Several departments to deal with, different and overlapping requirements in terms of accounting.
- Encouraged by reforms at federal level (to BKPM, the OSS, changes to Investment and Tax Laws and changes in pipeline for Companies Law and Labour Law), but perceive the uncertainty in the NAD province as a disadvantage compared to other Indonesian provinces. Realise it will take time to adapt to national level changes in all provinces.
- NAD's autonomy perceived to cause some extra financial burdens, such as extra charges per kilo of palm oil produced.
- Infrastructure is one of the main disadvantages; however conceded infrastructure is a problem throughout Asia.
- Security of transportation is a concern.

Investors identified the following critical factors to decide the location of their investment:

- Cost of transportation/proximity to Medan or another viable port
  - Considers Aceh is positioned well, especially if a port is developed. However, immediate concern is transportation to Medan.
- Civil security, perhaps an issue of the past for Aceh but still perception that Aceh is insecure.
- Economic and political security, eg rule of law, predictability of economy. It was noted that Kalimantan has introduced economic changes that have made it more stable which is viewed well.
- Corruption. It is known that a 'special tax' is often requested by former combatants.
- Degree of risk on return.
- Accessibility of communications back to Jakarta office.
  - Noted that this is less of a problem, and these days information can be relayed between Jakarta and Aceh quickly
- Whether Acehnese welcome investors to the region – are they receptive to the investment?
  - Noted that Malaysian business seems to be generally welcome in Aceh.

- Human resources capacity.
  - Low level skills required for palm oil plantation not a specific concern for Aceh. Competition for getting the right people is there.
  - There is not a pool for skilled managers.
- Local ownership/partnership issues are quite standard. The partnership principle is embedded in Indonesia's Investment Act.
- Support plantation plasma initiative as long as the ratio of plasma : private lease are favourable. Plasma portion should be less than 50%.
- Local services (Jakarta and Medan based) are quite expensive, although they are high in quality – the advice given is very good. However, the expense is not so high as to make projects unviable – services are also expensive in Malaysia, and more expensive in Singapore. Malaysia is in fact experiencing a brain drain, where human resources in the financial and legal industries are migrating to the Middle East. Therefore using services in Jakarta and Medan are more viable for Indonesian investments.
- Importing/customs/exporting costs
- The legal/regulatory/administrative environment in Indonesia/Aceh does not kill the appetite to invest. The changes made by the national government in the last 2 years have further whet the appetite. Changes referred to include the new Investment Act, Taxation Act. Some investors were also aware there is a new Manpower bill and Companies Code before parliament at the national level. They are unhappy with the current Manpower Act that allows minimum wages to be adjusted every year by up to 25%, which makes it difficult to predict costs. After 5 years, with constant increasing labour costs, an investment can turn bad. Some investors regard the new Manpower bill to be in favour of the employer, and reflecting global standards. They also regard that legislative changes have been made very quickly and are encouraged by that.

3 Lessons and leads for Aceh from Malaysia

As part of the process of formulating suggestions for policy driven improvements to Aceh's investment climate, lessons have been drawn from Malaysia. Bearing in mind the very different stage of development of the industrialized parts of that country relative to Aceh and the different history in reaching that stage, focus has been placed on the region with the greatest resource similarities and development status to Aceh – the north east. However recent policy initiatives in that area need to be understood in the context of a different national model for regulating and promoting investment than that adopted in Indonesia.

Malaysia's regulatory, policy and institutional environment for investment

The Ministry of International Trade and Industry (MITI) is the lead agency that formulates policies on external trade and investments in the manufacturing and non-Government services sector in Malaysia. The Malaysian Industrial Development Authority (MIDA), which is an agency of MITI, was set up to foster FDI in manufacturing/industry only. MIDA's functions are guided by Industrial Master Plans.

The second Industrial Master Plan (IMP II) for the period 1996 – 2005, focussed on ‘manufacturing-plus-plus’ and cluster based industrial development. Manufacturing- plus-plus focused on moving along the value chain towards highter value-added activities, including emphasis on research and development and product design at one end of the value add, and support services, distribution and marketing at the other end. Cluster based industrial development involved an agglomeration of key industries, suppliers, critical supporting sectors and services, requisite infrastructure and institutions interlinked in a cluster. Cluster development also involved enhancing value added and value chain activities. Eight industry groups and twenty-two potential industry clusters were identified, grouped as either internationally-aligned, policy driven or resource-based. The resouce based clusters were wood based rubber based, food and non food palm oil based products. The Agri-based focus was on cocoa, fish, livestock, fruit and vegetable products and floriculture. The third Industrial Master Plan is for the period 2006 – 2020, and its theme is “Towards Global Competitiveness”. Its key thrusts are to strengthen Malaysia’s position as a major global trading nation and generate investments in targeted growth areas, by integrating Malaysian companies into regional and global networks. The IMP III aims to ensure industrial growth contributes towards equitable distribution and balanced regional development and sustaining the manufacturing sector’s significant contribution to economic growth. Malaysia is also now positioning the services sector as a major source of growth and facilitating development and application of knowledge intensive technologies.

Malaysia does not have a history of encouraging investment in agriculture, due to the complexities of land issues, and has only recently begun to consider liberalising this sector. Its focus in doing so is on value-adding, including manufacturing food based and other resource based products. A new regional initiative, in Malaysia’s northern corridor (the NCER), does contain some pointers for investments in agriculture and agribusiness, in a program that addresses agriculture from ‘the farm to the table’.

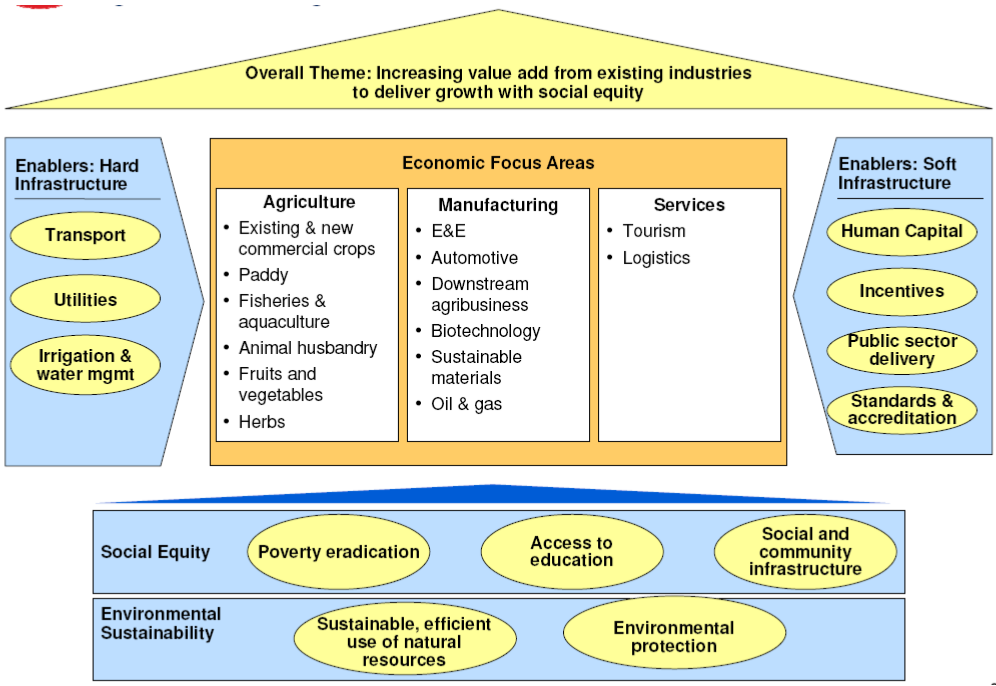
Leads from the Northern Corridor and Kedah

The NCER

This report uses the efforts of the state of Kedah, in northern Malaysia, to attract investment, as a case study. Kedah was selected because it is currently relatively dependent on subsistence agriculture and has the highest levels of poverty in Malaysia. Although the state government of Kedah is itself taking some initiatives to attract investment, it is again a federal government driven program of regionalisation which promises to have the biggest impact on Kedah’s investment climate. It is also from this program, the Northern Corridor Economic Region (NCER), that Aceh can possibly learn valuable lessons to strengthen its own investment climate.

The NCER initiative – spanning the period 2007-2025 – is part of an overall move by the Government to promote balanced development across the different regions in Malaysia, whilst at the same time accelerating Malaysia's move towards high-value, knowledge-driven economic activities. Five economic regions have been set up: Northern Corridor, East Coast, Iskander, Sabah and Sarawang. The Northern Corridor encompasses the states of Kedah, Perlis, Pulau Pinang and the north of Perak. The NCER initiative is an economic and social development agenda for the region, with the overall theme of "increasing value-add from existing industries to deliver growth and social equity."

The program is structured as follows:



The North, which is already the rice bowl of the country, aims to embrace commercial-scale farming and technologies to become a modernised food zone, increasing exports of premium fresh and processed agricultural products and helping Malaysia to meet its food self-sufficiency objectives in staple foods such as rice. It also aims to develop new industries in the Region, such as the cultivation of new commercial crops and the promotion of downstream activities in the agricultural sector, the promotion of new manufacturing activities such as biotechnology, sustainable materials and oil and gas, and the leveraging of the NCER's well-established transport infrastructure and geographical proximity to Thailand and Sumatra to become the processing, logistics and trade centre for the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT). In brief, Perlis will provide the seeds from biotechnology hubs, Kedah and Perak will grow them and breed livestock and aquaculture, and Penang, as the port, will distribute the final products.

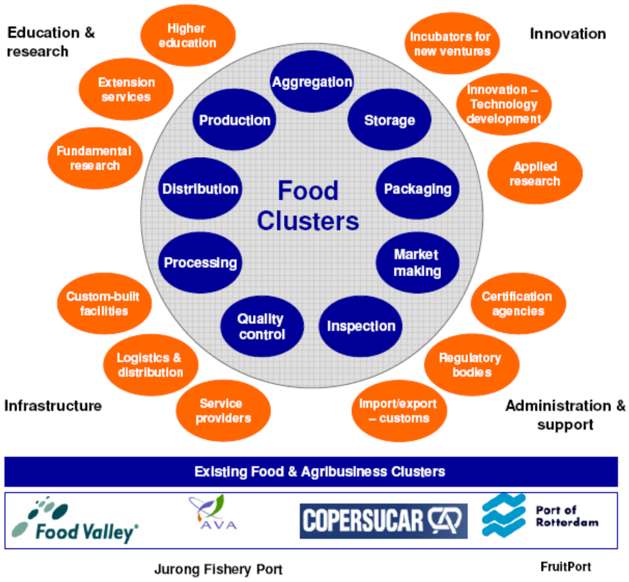
In order for the rural areas of the North to realize the full potential of agricultural development, the NCER recognizes connectivity will need to be improved. The NCER plans to enhance national and international linkage through road, rail, port and airport infrastructure expansion. This will include improving:

- load carrying capabilities of the road system to service agricultural areas within the villages, border towns, sea ports, airports;
- sea connectivity by expanding and modernising Penang Port, exploiting coastal ports such as Kuala Kedah and Langkawi and promoting trade links with Sumatra, Phuket and Myanmar;
- fast ferry services to Sumatra, Phuket and Myanmar to spur business and trade relations;
- air connectivity with external trading partners by promoting Pulau Pinang and Langkawi airports as hubs for budget carriers and small jets;
- rail connectivity with external trading partners.

Complementarity and competitiveness with Aceh

Like Aceh, the majority of the land in the north is protected forest (51.9%) and agriculture (39.6%). Further, 83 percent of the agricultural land is privately owned by rice paddy smallholders, with an average of 1.06 hectares per family. Like Aceh, the NCER faces challenges with regards to economies of scale for its agricultural sector. The planned solution is to group 100 farms (of 1 hectare each) under one cooperative management team, resulting in mini estates of 100 hectares each. Malaysia’s Department of Cooperatives is to train the farmers on managing cooperatives. The cooperatives will also receive assistance from the government in the form of fertilisers and other subsidisies. In addition to achieving economies of scale, the intent is to allow farmers to experience the whole supply chain, from farm to factory to table. Farmers will also improve profits if they are tied into the distribution end of the supply chain, rather than being limited to production. The farms will produce niche crops strategic to the conditions prevailing in the area in which they are operating. They will include inland aquaculture, integrated animal husbandry and high value horticulture, plus processing in agro-industrial parks. The initiative will revolve around integrated food and agribusiness clusters, which will be supported by peripheral business, education and research, government and innovation centres.

- Success of Food & Agri Clusters in the Northern Corridor requires:
  - Access (to products & markets)
  - Differentiation (strategy)
  - Infrastructure/technology (soft & hard)
- Public and private sectors are key stakeholders in providing:
  - Financial support for innovation & implementation
  - Extension of R&D and best practices to commercial applications
  - Flexible regulatory environment compliant with international standards
  - Infrastructure to execute
- Value addition is a continuous process of re-inventing niche positioning
- Integration among stakeholders and Clusters will create value addition



The products from the area will comply with Good Agri Practices (GAP), Good Animal Husbandry Practices (GAHP), Vetinary Health Mark (VHM), HACCP and halal standards. The Malaysian government has been revamping its extension services scheme to advise farmers on best practices to comply with these sustainable farming standards and to provide all important traceability in the processed food chain. Aceh also needs to comply with these international standards to be able to successfully compete with or complement the supply chain of NCER products. Further, Aceh needs to stay abreast of the technology initiatives the NCER will take if it is to comply with standards required to dovetail supplies and ultimately to successfully compete in some areas with NCER products. Product innovation is also at the forefront of planned agribusiness in the NCER, for example, in aquaculture.[25]

The NCER will also specialise in the production and export of fresh halal certified meats and related products. The halal market is one that Aceh should be pursuing vigorously, and there is potential for it to link into the NCER supply chains. According to officials from the NCER and various Malaysian government agencies, Aceh has more available, fertile land than the NCER does, and a longer coastline with access to the Malacca straight. If Aceh can produce halal compliant food and other products, there will be opportunities for complimentarity, especially given the IMT-GT. However, Aceh needs to be able to value-add to its agri-base, so that its produce has a shelf life. Malaysia is also focussing on a ‘farm to table’ halal chain (for food,

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25 Planned initiatives include Shrimp shells to be used in pharmaceuticals industry, Engineered safflower with gene for carp growth hormones to produce drug to optimise farmed shrimp production, Algae ponds for feedstock base of biodiesel plants, Kurama shrimp for export to Japanese market, Eel farming for fresh export to Japan and Korea, Seafood based cosmetic products for export, Nutraceuticals from seafood, especially omega 3 fatty acids, Marketing associations specifically for “fresh halal seafood from Malaysia”.

pharmaceuticals, cosmetics and supplements), which encompasses ingredients, packaging and logistics. For halal, dedicated warehouses, trucks and ports are required as halal can not be mixed with non-halal produce. Malaysia’s Small and Medium Industries Development Corporation (SMIDEC) provides grants for production and promotion of halal and herbal based foods to SMEs. The grants usually cover renovation to make premises and production equipment halal compliant.

Public sector service delivery to NCER investors will also be improved through the establishment of a dedicated implementation organisation, the Northern Corridor Implementation Agency (NCIA). A bill will be tabled in Malaysian parliament in December 2007. The NCIA will have powers delegated from the federal government and the relevant four state governments and operate as a one stop shop for investors. It will have an office in Kuala Lumpur as well as satellite offices in each of the four states. It will be chaired by the Prime Minister, and its board members will include the Deputy Prime Minister, four Chief Ministers of each state, members of the public service and the private sector. It will be run as a private sector entity, though in the first phase, 70 percent of funding will be from the government. By the third phase, it is intended that 70 percent of funding will be private.

In dealing with the fact of an uneven spread of investment attraction and economic development in Malaysia, the government has shown preparedness to adopt innovative approaches to stimulate investment and growth in the less prosperous states of the north east. It recognises the integrated nature of key ingredients for successful industry clusters – with food clusters and their supporting institutions prominent. Economies of scale, technical innovation, standards and traceability at the top of the production chain, and a role for cooperatives in achieving these is central. A single implementation authority has been created to smooth investment establishment process. The NCER concept works with the exisiting strengths of the component states in mind, including the key port city role of Penang. It assigns a role to private sector firms in developing the blueprint for this cluster based initiative. And it places emphasis on the transport connectivity in the region and export potentiality of a key location in the IMT Growth Triangle.

Kedah

The Kedah Regional Development Authority (KEDA) is an agency under the national level Ministry of Rural and Regional Development. One of KEDA’s programs is building linkages between small, poor villages to rural growth centres, which then link to industrial growth centres and main growth centres. This program aims to move subsistence farmers into providing produce for export-driven supply chains. KEDA does this by providing supporting infrastructure in the chain and focussing on the industrial growth centre where the value adding occurs. It is promoting frozen horticultural products, rice based products and rubber based products such as tyers and safety gloves. KEDA plans to integrate this program into the NCER initiative.

InvestKedah

The state investment promotion authority, InvestKedah, shares offices and promotional material with MIDA’s Kedah office, and acts as the state’s ‘one stop shop’ for investors. InvestKedah has a wide range of material available for potential investors, including the costs of doing business in the state, and specific material on investment opportunities in the individual sectors, including halal food hubs.As stated above, the NCIA, once established, will be the overarching OSS for InvestKedah and the MIDA state offices in the northern region, and the activities of these investment promotion authorities will have to be aligned.

Summary lessons and leads for Aceh

In crafting its own policy development Aceh lacks some of the advantages of the NCER component states. Given decentralisation and special autonomy, the provincial government would need to fill at least part of the role of the Malaysian government in driving such an integrated development plan. Where possible, the provincial government could coordinate with the central government to achieve mutual policy objectives. Relationships – especially funding - between the province and district/kota governments are not as clearcut as in the Malaysian model and a one stop shop ‘implementation’ authority may be harder to make functional.

The following table summarises the lessons from Kedah, and how these lessons can be applied to Aceh.

Lessons from Kedah	Applied to Aceh
NCER theme: Increasing value-add from existing industries to deliver growth and social equity.	Aceh should also focus on value-add to the sectors for which it already has a comparative advantage/potential comparative advantage
Integrated food and agribusiness clusters will be supported by peripheral business, education and research, government and innovation centres, including biotechnology.	Aceh could also take a cluster approach. This requires identification of the clusters it wishes to develop (same sectors as identified above), and as Malaysia did under its second IMP, group the clusters as either internationally-aligned, policy driven or resource-based, and have respective strategies for each cluster. Form public-private partnerships for supporting infrastructure, and research and development. Stay informed on international technological innovation in selected cluster areas, and invest in this technological capability and own product innovation. Assist in forging downstream and upstream linkages, especially through market information.
Economies of scale for 1 ha farms achieved through cooperatives (commencing with 100 farmers per cooperative)	NAD province horticulture and plantations also a majority of smallholders. Governor wants to allocate 4 ha allotments to smallholders. Economies of scale could also be achieved through allocation into designated cooperatives.
Malaysia's Department of Cooperatives is to train the farmers on managing cooperatives. The cooperatives will also receive assistance from the government in the form of fertilisers and other subsidisies.	NAD province Department of Cooperatives could undertake similar training and provide assistance with set up costs. Refer to KRA 9 in Part B.
NCER is to leverage established transport infrastructure (including the main port of Penang) and geographical proximity to Thailand and Sumatra to become the processing, logistics and trade centre for the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT).	Aceh needs to leverage its existing infrastructure, including the port of Medan to access the rest of Indonesia and the region. Aceh needs to evaluate how it can complement the NCER's intention to supply to the IMT-GT. Refer to KRA 8 in Part B.
The NCER will improve connectivity through road, rail, port and airport infrastructure expansion.	Aceh needs to improve connectivity and load carrying capabilities of the road system to service agricultural areas. Needs to establish ports development strategy and connectivity to ports. Refer to KRA 8 in Part B.
NCER ensuring compliance with Good Agri Practices (GAP), Good Animal Husbandry Practices (GAHP), Vetinary Health Mark (VHM), HACCP and halal standards. The Malaysian government has been revamping its extension services scheme to advise farmers on achieving compliance and traceability in the processed food chain.	Aceh also needs to comply with these international standards to be able to successfully compete with or complement the supply chain of NCER products. Strong opportunities to link into halal supply chains. Needs to develop halal compliant production methods, including packaging and logistics. Refer to KRA 7 in Part B.

The NCIA will operate as private sector one stop shop entity, providing public sector service delivery to investors with powers delegated from the federal government and the relevant four state governments. It will have satellite offices in the four states, and Kuala Lumpur.	Aceh should aim to have an independent OSS that operates privately, with powers delegated from the national and provincial government, and districts where possible. The OSS should aim to have satellite offices in the industrial zones/agri-business clusters/major ports. Refer to KRA 2 in Part B.

4 Analysis of investment law, policy and institutions

The institutional framework for investment in NAD province

National
Investment Coordinating Board (BKPM)
Responsible for issuing Investment Approval (SP), monitoring and coordinating investments in Indonesia. Coordinates with the Ministry of Justice, Ministry of Manpower, Custom and Immigration and the Directorate General of Tax. Responsibilities may expand to being a One Stop Integrated Service (OSIS) when implementing regulations for the national Investment Law 2007 are passed.

Ministry of Justice
Responsible for the incorporation of limited liability companies (based on the SP issued by BKPM).

Ministry of Manpower
Responsible for the manpower permit and working permit (based on the recommendation issued by BKPM with respect to the RPTKA/Foreign Manpower Usage Plan).

Customs and Immigration
Responsible for the issuance of staying permit (based on the recommendation issued by BKPM with respect to the RPTKA/Foreign Manpower Usage Plan).

Directorate General of Tax
Responsible for the issuance of the Tax Payer Identification Number (a pre-requisite when the investment company wishes to obtain a permanent business permit (IUT) to commence commercial operation).

National Land Authority/Board (BPN)
Responsible for land administration including registration of titles, and issuance of land use certificates and other rights, such as leases

Line Ministries
Responsible for the issuance of sectoral permits (based on the SP issued by BKPM).

Provincial
Provincial Investment Coordinating Board (BKPMD)
Process applications for Investment Approval. Potential to be a provincial OSIS once implementing regulations for the Investment Law 2007 are passed at the national level.

Aceh Development Planning Board (BAPPEDA)
Responsible for spatial planning

National Land Authority/Board (BPN) – Provincial Office
Aceh office assists in the issuance of land use certificates and other rights, such as leases.

Dinases/Agencies:
- Tax office
- Immigration office
- Customs and Excise office
- Relevant Dinases in accordance to which sector the investment is taking place. Usually BKPMD will liaise with these Dinases.

NAD Governor's office
- Governor - Vice Governor

- Provincial Secretary (Sekretaris Daerah/Sekda)
- Economy and Developlent (Assistant II)
- Legal Bureau

In Article 13 of national Law No.32/2004 on Pemerintah Daerah, provincial Governors' powers are stipulated as follows:

- responsibility for provincial government
- development planning
- spatial planning, usage and supervision
- ensure public order and security
- provide public facilities and amenities
- healthcare
- education and human development
- taking care of social issues across district/cities
- labor issues across districts/cities
- facilitate development of cooperatives and SMEs
- environmental issues
- land issues
- demographic admin issues
- general public services
- investment
- other basic services beyond districts/cities ability
- other responsibility stipulated by law and regulation.

<u>Provincial One Stop Shop (OSS)</u>
A provincial OSS has been mandated by Governor's decree to do all provincial level licensing, removing these licensing responsibilities from the dinases/agencies. The OSS also issues 'non licenses' such as recommendations from the Governor or dinas. However, it has not been fully effective as many dinanes are still reluctant to hand over the right to license to the OSS/PPTSP - Pusat Pelayanan Terpadu Satu Pintu. Also, this provincial OSS has no clear legal standing – the Governor's decree may not suffice.

District

- Bupati/Walikota and their key apparatus (Sekda, Assistant II)
- BKPMD at districts. (Each district has a different arrangement with its investmet coordination function. Some attach to the Assistant II office, or attach to the SME and Cooperative Dinas, Trade Dinas, etc. Only a few have their own BPKMD type agency. For instance, in Nagan Raya district, there is the Investment and District Asset/Business Management Board - Badan Penanaman Modal dan Pengelolaan Usaha Daerah (BPM-UD).

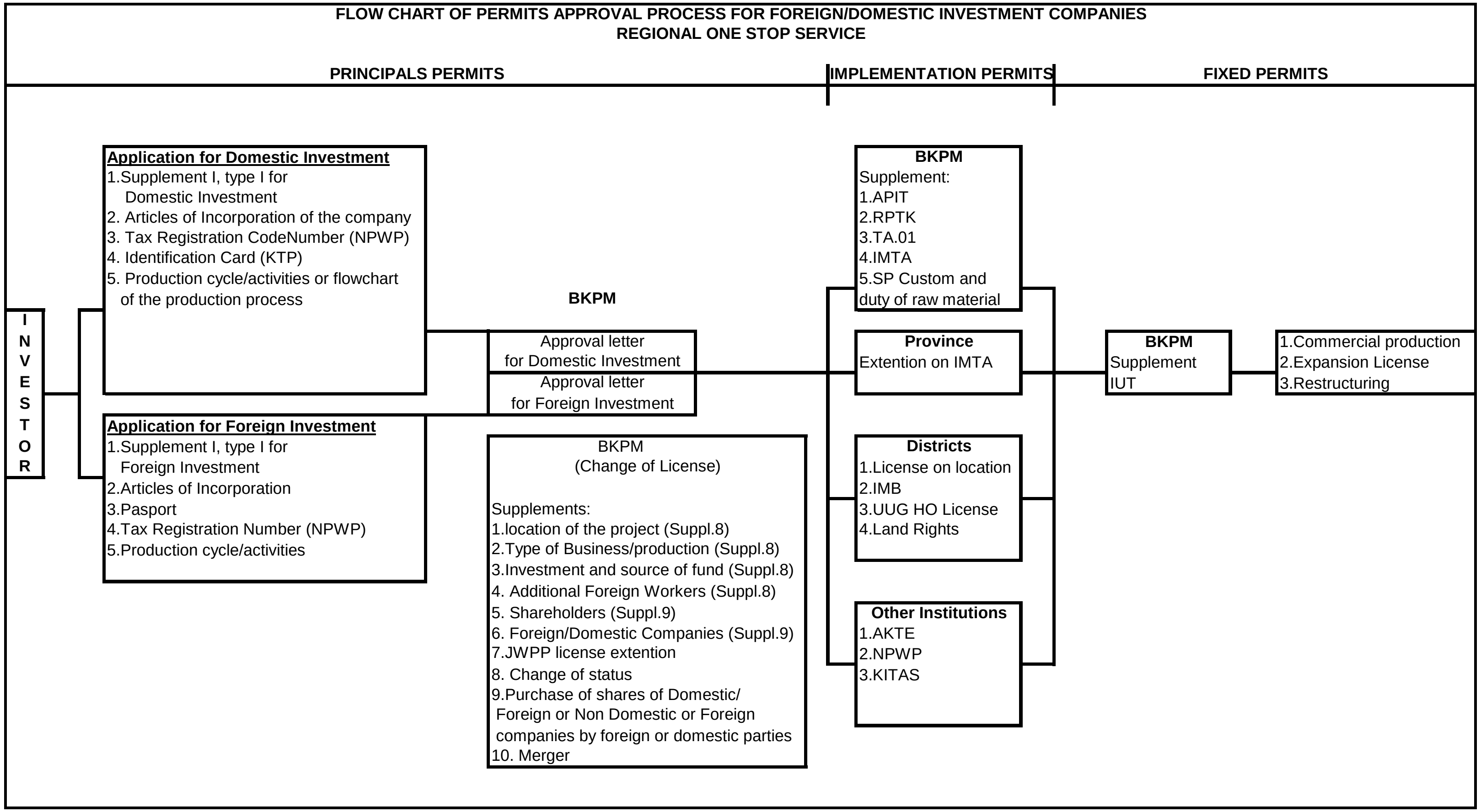
There are currently 4 district/city level One Stop Shops (OSS) in NAD province, which have clear mandate through Ministry of Home Affairs Regulation (Permendagri) No.24/2006.

These OSS generally issue:

- Tanda Daftar Perusahaan (TDP) - Company Registration
- Izin Gangguan (Nuissance permit)
- Izin Usaha Industri (Industrial permit)
- Izin Mendirikan Bangunan (Construction permit)
- Surat Izin Usaha Perdagangan (Trading permit)

In addition to the national, provincial and district government institutions, newly formed technical working groups under the Aceh Recovery Framework (ARF) can also share responsibility for addressing challenges to Aceh's investment climate. The ARF is jointly sponsored by the BRR, the Governor's office and key donors sitting on particular technical working groups. It provides the basis for an integrated rather than a fragmentary approach. The technical working groups are as follows:

1. Aceh Reintegration (of former GAM)
2. Governance, Rule of Law and Democratic Decentralization
3. Basic Services
4. Capacity Building
5. Infrastructure/Assets management
6. Economic Development.



Source: "Technical Procedures on Investment Permits and Facilities" Investment Board of Nanggroe Aceh Darussalam (BKPMD) 2005

Abbreviations

NPWP: Tax registration code number
KTP/KITAS: Identification card
JWPP: Shortest period time frame
APIT: Limited import code number
RPTK: Plan to employ foreign workers
TA.01: Form TA.01
SP: Approval letter
IMTA: Foreign worker’s permit
IMB: Building construction permit
UUG HO: Nuisance permit
IUT: Fixed business permit

Investment law and policy

Degree of autonomy

The biggest question for Aceh on the topic of investment law, policy and institutions is the degree of autonomy Aceh has from the national government to regulate its own investment climate. The degree of autonomy can be assessed in part by examining the Law on the Governance of Aceh (LOGA), but the LOGA is ambiguous. The LOGA employs many phrases throughout such as “the Aceh government shall …xyz…pursuant to their authorities”, or “pursuant to the applicable norms, standards and procedures” which in effect means that the Qanuns generated by such provisions are subject to national law.

In some cases, it would be to Aceh’s benefit to more closely align itself with the national level Investment Law (No 25/2007). In the FIAS reviews of the draft Investment Qanuns (conducted in October 2006 and October 2007 and supplemented by workshops), it was noted that Aceh had not adopted certain key definitions and investor guarantees (non discrimination, settlement of disputes, protection against expropriation, profit transfer) that do occur in the national Investment Law. It is understood that the IFC worked with the Investment Qanun drafting committee over October 31 – November 1, 2007 to include the missing international best practice definitions and investor guarantees that do already occur at the national level.

One important legal consideration is that Aceh is still part of the unitary Republic of Indonesia, and that the Investment Law, like the Customs and Immigration Laws, apply equally across Indonesia as well as Aceh. While there might be some as yet undefined scope for Aceh, under the LOGA, to make significant changes to the business legalization, registration, licensing and permitting regime, this may not be feasible for two reasons. The first is that the LOGA indicates, as stated in the first paragraph above, that Aceh’s regulatory framework must be “pursuant to the applicable norms, standards and procedures”. Second, if Aceh makes significant changes to the numbers and types of licenses and permits that they issue, this may create difficulties for firms headquartered in Aceh to do business with the rest of Indonesia (ie: participation in tenders, proposals etc where certain documentation is required).

During the process of reviewing the second draft Investment Qanun, BKPMD stated that the Aceh Government could draft its own, shorter negative list than that at the national level[26], plus legislate independently on foreign workers and simplify the investment approvals/registration and licensing procedures. However, during the drafting session for the third draft of the Investment Qanun, BKPMD staff, the Legal and Economic Bureaus in the Governor’s

[26] National level negative list is contained in Government Regulation PP No.77/2007

office, BRR, academics and lawyers took a more cautious view on the degree of autonomy granted by the LOGA. It was decided the Investment Qanun must utilise the same negative list at the national level and follow the same investment approvals/registration process, rather than adopt FIAS recommendations on replacing approval with registration.

Streamlinging and simplifying investment approvals/registration

The process for issuing investment approvals/registration remains uncertain at the national level. Although the Investment Law No 25 of 2007 was passed earlier this year, implementing regulations have not been put in place. While there was a stated goal of moving from an approvals to a registration regime, the Investment Law is silent on this point, as part of a compromise modification of the law during the parliamentary deliberations. Therefore, the 1967 Investment Law approvals process continues to be followed. BKPM has been issuing statements that the implementing regulations will allow for a ‘best practice’ simplified registration process, where investors do not require approval. It is difficult for Aceh to progress its Investment Qanun on the approvals/registration issue until the national level implementing regulations are in place. One strategy would be to reflect the silence of the national level law, and also clarify with implementing regulations once the national level regulations have passed.

The IOO verbally advises investors that foreign investors can currently obtain investment approval at BKPMD. However, the IOO website contradicts this, stating “Foreign investment approval will be issued by Investment Coordinating Board (Badan Koordinasi Penanaman Modal/BKPM) in Jakarta.” There was a decree issued by the Governor of Aceh which authorized the BKPMD to issue investment approvals, but there is feedback from investors that they are encountering problems with the Customs service, which is a national function, whereby they do not recognize the provincial investment approval and consequently do not allow the duty free importation of capital equipment or goods. Some investors also continue to be advised by their notaries to obtain approvals at the national level, to avoid the legal uncertainty that may occur if pursuing approval by BKPMD.

Streamlining and simplifying the issuance of licenses/ permits

One of the most important things Aceh can do to differentiate its investment climate from the national level is to simplify and streamline the issuance of licenses and permits at the provincial and district level, and have these procedures administered by One Stop Shops (at provincial and district level).

The LOGA provides in Article 155(3) that Aceh shall simplify the regulations for a conducive business climate (pursuant to their authorities), and in Article 165(4) the granting of a number of listed permits (which can be issued pursuant to their authorities and based on norms, standards, and procedures applicable at national level) must refer to the principles of fast, appropriate, inexpensive services with simple procedures. Thus, it appears under the LOGA that Aceh does have the authority to simplify licensing, but subject to national law and procedures. It is difficult to ascertain what this means. The interpretation of the degree of regulatory autonomy is dependant on the central government, and particularly who in the central government is in power and their particular position on the degree of autonomy Aceh should exercise.

Further, the landscape for the issuing of licenses at the national level may change in the near future, when the implementing regulations for the One Stop Integrated Service are passed. There is confusion as to the degree of authority the One Stop Integrated Services (OSIS) can exercise at the provincial level. In Article 26(2), the Investment Law provides that “licensing and non-licensing” can be issued at the provincial or regency/city level. However, implementation of the OSIS shall be governed by a Presidential Regulation, which is yet to be passed. Again, there is much speculation on the degree of autonomy provinces will be given in this area. In the drafting session for the third draft of the Aceh Investment Qanun, it was reported that the Qanun will provide BKPMD with the authority to process investment approvals and some licenses through a One Stop Shop approach. There is currently no OSIS/OSS operating out of BKPMD. It is also unknown what licenses would be encompassed under the OSIS.

A provincial OSS has been mandated by Governor’s decree to do all provincial level licensing, including sector licenses, removing these licensing responsibilities from the dinases/agencies, using what appears to be the Post Office Box model. Forms and documents are dropped off, sent for processing at the sectoral departments, and then returned for collection. This model provides a single known contact point for investors, and friendlier customer service, and may also allow for some form of oversight or monitoring/evaluation of issuance times and costs. However, it has not been fully effective as many dinases are reportedly still reluctant to hand over the right to license to the OSS/PPTSP - Pusat Pelayanan Terpadu Satu Pintu. Further, since this office deals with sectoral license, and investors only typically get one main sectoral license, there is a question as to whether or not the Post Office OSS speeds things up, or actually creates a “One More Stop Shop”. The OSS also issues ‘non licenses’ which establish compliance with recommendations from the Governor or dinas. Some licenses still need to be issued at the national level, such as export/import licenses. This provincial OSS has no clear legal standing – the Governor's decree which established it may not suffice. There will also certainly be overlap between its current functions and the functions of the provincial level OSIS, once it commences.

In contrast, the existing district level One Stop Shops typically issues several local permits to each investor. This Banda Aceh city OSS, has been observed to be quite busy, and the office has all the authority to issue local permits under the one roof. This allowed some permits to be issued in minutes or hours rather than days.

The NAD province is already at liberty to undertake non-regulatory reforms to simplify the issuing of licenses/permits at the provincial and district level.

Common, non-regulatory reforms that can be undertaken by Aceh to simplify the issuing of licenses include:

- Establish clear rules for the issuing of licenses and make the information easily available;
- Publish the costs for each license/permit;
- Introduce online licensing applications;
- Merge licenses with overlapping requirements into bundles, shifting from sequential processing to parallel processing;
- Set maximum time limits and response rules;
- Curb inspections;
- Consolidate clearances.

Regulatory reforms that can simplify the issuing of licenses include:

- Reduce licensing rerquirements and eliminate unnecessary licenses;
- Extending the term for which licenses are valid, including for a business's 'lifetime'.

Constraints on reform to investment law and institutions

Some potential investors in Aceh are deterred by the current legal uncertainty and are waiting to see what the Investment Qanun contains before they invest. However, the Government of Aceh should not rush the Investment Qanun, as it would be best to first understand what the implementing regulations of the national Investment Law will require. If the Government of Aceh feels that it can wait no longer, the Investment Qanun should reflect the silence of the national level on the investment approvals/registration process and functions of the provincial level One-Stop Integrated Services until clarification is achieved through implementing regulations at the national level. Once clarity at the national level is achieved, Aceh would be advised to process map the new approvals/registration and licensing processes and establish what the central government requires to occur at the national level and provincial level. The Government of Aceh would also need to consider what licenses/permits are issued at the regency/city level. When this process map has been completed, Aceh will be in a better position to identify opportunities for procedural simplification and streamlining for national, provicial and regency/city level processes. After all of this is determined, the Government of Aceh would be best placed to identify what procedures would be appropriate to place under One Stop Shop arrangements for the national level (presumably housed within BKPMD and reflecting the OSIS), provincial level (housed within the Governor’s office) and regency/city level. As stated previously, there are non-regulatory reforms that can be undertaken with the licensing regime in the interim, and these reforms should be prioritised (see KRA 2 in Part B).

The Aceh Investment Policy Statement will need to be updated, once the Investment Qanun has been passed, to reflect the Qanun’s contents, such as including the key investor guarantees that are currently not listed in the Investment Policy Statement. Alternately, the Investment Policy Statement could simply reaffirm or re-state the key investor guarantees that are provided by the National Investment Law.

Finally, the Investor Outreach Office (IOO), established with technical and financial assistance by the IFC, is operating in accordance with international best practice, as a separate investment promotion authority, outside the functions of BKPMD. It is not however, operating to a strategic plan and rejuvenation of such a plan may be a prerequisite.

Part B

A strategic approach to investment climate improvement

The first part of this report has demonstrated that while significant opportunities exist in principle for accelerated private sector participation in capital formation, there are major hurdles.

Despite the prospect of substantially improved revenue flows through the new revenue sharing arrangements that will commence in 2008, every effort must be made to address the impediments that are currently undermining the resource based and locational attractiveness of Aceh as a home for private investment. Without a strategic approach to improve the 'locational offer' presented by Aceh to prospective private investors there is a danger that these improved government revenue flows will prove a 'winner's curse'. If in the short run they mask the need for coordinated provincial government policies targeted at enabling private investment in a normalised market environment, the Acehnese economy will remain badly unbalanced.

The low flow of private investment during the civil war and since the events of 2004-5 is unsurprising, The foregoing analysis suggests that, realistically, until the end of the transition phase from reconstruction to development, only isolated projects of any significant scale can be expected. These include the possibility of a palm oil refinery, a world scale wood processing plant and several power sector investments. Meanwhile, the small and medium scale investment that has been growing, particularly in the service sector, must have every possible barrier removed.

Capital investment has been dominated by BRR-directed reconstruction spending. The inevitable contraction in the construction sector, which has provided provincially dispersed capital spending will leave a gap that will need to be filled at least in part by private investment post 2009. The challenge is to ensure a strategic rather than piecemeal approach is adopted in crafting policies to fill that gap and underwrite future private sector investment growth in the province.

What are the ingredients of a strategic approach?

Aceh's latest Investment Policy Statement (2007)'recognises the fundamentally important role the private sector plays in the creation of wealth and employment in the province and the contribution to public sector revenues'. Externally sourced investment is critical to this. This provides a vision – the government's intention to create an investment climate that is attractive and fair to all investors'. The social cultural and religious values underpinning this are stated in the LOGA.

A strategic approach to realising this vision is one that would have twin over-arching goals of (i) 'investor readiness' by the end of BRRs remit in 2009 and (ii) full realisation and exploitation of its resource and geographic location -based comparative advantage by 2020. By (i) we mean that, having recognised the key role of external private investment – both from other provinces and as FDI – in its Investment Policy Statement, the Government of Aceh will seek to establish an environment that will be appreciably more investor friendly than that of 2007. This requires recognition of critical shortcomings in the current investment climate that need to be dealt with in an integrated rather than a piecemeal way.

A strategic approach means:

- Setting out the investment vision for Aceh – in this case the role for private investment in Aceh's growth, consistent with the values that guide policy making in the province;
- Acknowledging areas of opportunity and deficiencies in, and threats to, Aceh's investment climate which the provincial and district governments have power to address;
- Specifying target areas ('key result areas' -KRAs) for government intervention. (KRAs identify what to concentrate on for improvement or threat management given some broad goals and specific objectives related to those key result areas. The goals and objectives provide the rationale (the 'why')for government action;
- Outlining strategies for achieving these objectives.(The 'how' to approach objectives. More than one strategy may be required if there are multiple objectives for a KRA.);
- Identifying specific actions for implementing these strategies and suggesting who should be responsible for implementation. (Typically more than one agency will be involved in strategic implementation. To implement a strategic approach therefore requires the adopting government to assign responsibility and authority to pursue a strategy.);
- Where meaningful, measuring progress using performance indicators, and modifying objectives in the light of performance.

Choosing Key Result Areas to drive strategic intervention – focusing on competitiveness

In nominating key result areas (KRAs) for attention we observe that:

- Part A of this report has identified sectors where there are favourable resource and other input conditions stimulating investor interest, but there are institutional and political factors raising risks and restraining expected profit opportunities;

- The underlying driver of private sector investment is profitability, adjusted for risk. An improved investment climate is one that supports improved risk- adjusted profits and therefore supports competitiveness;

- Competitiveness is ultimately about investor success – measured relative to returns available elsewhere. Competitiveness means being able to sell goods or services into markets, in the face of competition, at prices that generate an adequate rate of return on capital invested, given the risks faced;

- Because of limited consumer purchasing power and high levels of poverty, and the sectors products in which Aceh has a latent advantage, investment in the near term will be significantly reliant on accessing markets outside Aceh – investors will have to compete in wider national and international markets;

- Access to markets (for outputs, inputs – including land - and information) and productivity are two major determinants of competitiveness because they help determine revenues and costs relative to those faced elsewhere;

- Government can directly target competitiveness –by interventions that reduce risk, or costs or taxes and charges, or some combination of these;

- It can also strategically influence competitiveness – and hence investment attractiveness – indirectly, by targeting both productivity and market access;

- An integrated approach to investment climate improvement therefore suggests focusing on result areas that target competitiveness directly (targeting risks and costs) , and indirectly through impacts on access (to markets, land and information) and productivity.

Aceh's problems in achieving and maintaining competitiveness

Part A of this note demonstrates the following:

- Perceptions of political risk to private investment – especially through unauthorised charges and lack of asset protection – remain high;[27]

- Complexity (and hence effective cost) of establishing a business, though typical of Indonesia, is excessive by international standards;

- Real costs of basic electricity services are inflated because of unreliable supply due to supply deficits;

- Risk that Aceh will try to compensate for these and other deficiencies (including those related to market access and productivity) by using increased provincial DAU revenues to offer incentives rather than addressing the fundamental problems;

- Land-intensive activities, including plantation estates have strong market potential but access to land is compromised by land titling problems and lack of reliable information on land availability;

- Ability of local producers to save and invest in improved production methods in some of Aceh's most marketable agribusiness products (eg shrimp growing) are held back by poor price information and weak grower bargaining power;

- Standards and methods for halal production and traceability of food sources are not adequate to fully exploit complementarity with growth in Malaysia as a halal food hub. Traceability and accreditation of producers is also a problem for wider market access, not just halal;

- Transport infrastructure has benefited from reconstruction but there are risks that this critical contributor to market access will not be adequately maintained or rationally extended;

- Productivity gains in plantation agriculture horticulture, livestock, fisheries and aquaculture would help to raise scale and quality of output to levels that would attact further investment in processing chains and enable greater lock in with developments in Malaysia. But effective extension services are lacking in Aceh.

These weaknesses and threats to competitiveness provide the basis for nine key result areas around which strategic policy interventions can be developed.

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[27] These types of risk were assessed by Australia's Export Finance and Insurance Corporation (EFIC) as moderate for Indonesia in 2004. No separate assessment was available for Aceh. EFIC also drew attention to 'decentralisation risks' in Indonesia with special reference to indiscriminant local taxing following the passage of decentralisation legislation in 2001 and to the power of local goverments to set minimum wages

KRAs related to direct impacts on competitiveness

KRA (1): Investor perceptions of political risk in Aceh

As Part A discussed one of the key inhibitors of accelerated private sector investment is the perceived risk of a return to political instability and the risk to business assets and operations posed by that. Guarantees against unlawful expropriation are incorporated in the national Investment Law, in the draft provincial Investment Qanun and in the draft NAD Investment Policy Statement.

There are examples of local communities violating property rights of foreign investors and of contractors facing multiple 'informal taxes' imposed by separate local groups. The ability of the provincial and local governments to reduce the perceived level of risks from these sources is limited, but tangible steps are available.

A broad goal: *'To enhance competitiveness through risk reduction signals'*

Faced with the choice of investing in a cement plant or a palm oil refinery in Aceh when a comparable opportunity is available in say North Sumatra or Kalimantan, investors may need a higher return in Aceh to compensate for perceived higher risk. If that risk premium cannot be reduced through government action, Aceh may fail to compete for the investment.

Objective: *Reduce required rates of investor returns (risk premium effects) by addressing government-influenced risks.*

Much of the investor resistance to investing in NAD is a legacy of more than thirty years of conflict and a relatively brief time lapse since the Helsinki agreement. Many investors, including the all important Acehnese expatriots, will want to see more time elapse without conflict or political instability before commiting, especially those with potentially high levels of sunk costs[28]. While government cannot 'speed up the clock' to deal with this problem there are measures that can send improved signals to those already invested and potential investors. Success will contribute over time to reduced risk premiums that investors build into their required returns and therby reduce hurdle rates of return that prove to high for investment to occur.

Strategy: *Provide credible, explicit government guarantees and assurances of protection against risks of illegal acts/unauthorised charges [Responsibility-Governor's Office]*

[28] Investors who are highly mobile can easily withdraw in the face of unacceptable risks. This would present a particular problem if plantation development were permitted on presently timbered land. While plantations have long gestation periods investors might find risks acceptable through aquick return on timber without proceeding to the next stage.

To implement such a strategy government must identify actions that signal to investors that government (both provincial and district) is prepared to fully implement the rule of law, especially with respect to preventing illicit revenue extraction, and that it is prepared to respond to complaints about such activities.

The revised draft Investment Qanun (Chapter IX Article 14) provides investors with a 'security guarantee'. But the scope of this is not clear. The vulnerability of investors to risks of this kind are posed at the district level and need to be dealt with at that level.

Action (i) *District heads (bupatis) sign up jointly to a Governor-issued guarantee, making explicit the rights of investors already outlined in broad terms in both the draft Investment Policy Statement and the Qanun. [Responsibility-Governor/Bupatis and Mayors]*

This approach has the advantage that there would be an incentive for individual districts and cities to sign up to the investigation and prosecution of violation of investor guarantees. It would introduce an element of competition to attract investors to individual districts on the basis of explicit assurances. Failure to sign up would send a negative signal about the seriousness of a district in assuring the rule of law.

This district level participation should include a published full documentation of all statutory taxes and charges that prevail in each individual district – signed off by the district head. Action is needed to reduce uncertainty of exposure to arbitrary, possibly illegal local taxes and charges used for corrupt purposes or to supplement revenue.

Action (ii) *Adopt a reformed approach to locally sourced public revenue, possibly using Banda Aceh local government practices as a template. [Responsibility-Bupatis with donor assistance]*

According to a recent World Bank study[29] some districts have no framework for managing debt and public investment. Regulation and guidance on public revenue raising is lacking in a number of districts and in some no tax receipts are issued. The World Bank study pointed out the superior performance of the Banda Aceh local government in relation to local revenue sources. 'Policies for local levies and taxes are set out in local legislation which is consistent with national legislation. The local revenue base is reviewed annually to calculate revenue capacity for each revenue item'. (p25)

[29] World Bank (2007b)'Public Financial Management in Aceh: Measuring Financial Management Performance in Aceh's Local Governments' Jakarta, March

Regularisation and standardisation of the framework within which local government revenue needs are appraised and revenues raised would be a necessary step in minimising the opportunity and incentive for ad hoc and illegal taxing and charging.

Action (iii) *Fast track responses to any complaints of illegal treatment/extortion'imposed in local areas.[Responsibility BKPMD/Governor's office]*

While strictly speaking these are law enforcement issues which should in principle be handled by the police in the first instance, investors need assurances that there is a body at the provincial level, beyond immediate local influences, whose first responsibility is to remove impediments to investment including following up complaints from investors. The Governor's office may be the most suitable body. If so its role should be made known to all existing investors – domestic and foreign – and, through the IOO to all prospective investors.

KRA (2): Administrative costs and uncertainties of business establishment

Indonesia does not rate well in costs of doing business and in implicit business set up costs in particular (see box below).

A broad goal for Aceh in improving competitiveness vis a vis other provinces in particular should be to establish a reputation for rapid facilitation of business start up in Aceh and a high conversion rate of approvals into actual investment.

As Part A explains not all the capacity to deliver against this goal lies within Aceh, but some does.

> A recent LPEM- FEUI survey results reported by the national Co-ordinating Ministry of Economic Affairs has uncovered a lengthy 86 calendar days as the average elapsed time for the legalisation and basic licensing steps to establish and register a limited liability business across a range of Indonesian centres. An immediate response has been a retraction of the 2006 measure (INPRES No 3 2006) which delegated the authority to issue the Letter of Establishment for a new company from the central office of the Ministry of Justice in Jakarta to the provincial offices. Notaries (who act as the agents of businesses) surveyed cited this as a leading cause of increased delays in business start up. This still leaves some critical steps in the hands of provincial and local authorities, including the issuance of the Certificate of Registration by the office of the Department of Trade. While the survey did not include Acehnese centres, nearby Medan was surveyed. There is little reason to believe that performances in Aceh would significantly out-perform the national average.

Objective: *Make Aceh a regional leader in reducing business establishment processing time and costs and uncertainties in this process.*

Strategy: *Minimize regulatory and licensing complexity and create investor access to clear guidelines on required clearances. [Governor's Office]*

As the national Co-ordinating Ministry points out, the complexity of starting a business in Indonesia is compounded by the fact that it is unclear which licences and approvals should be obtained and in what order, with considerable regional variation. Reaching this objective requires that Aceh (i) identify at what points in the legalisation/registration system provincial and local authorities respectively can influence overall speed of business establishment and (ii) apply pressure to those points. For instance, the scope for reducing set-up time by improving issuance of business trading licences (SIUP) and others (SITU, IUI) lies with kota authorities.

According to survey information from 2005 the time to accomplish the registration step alone with the local Trade offices can be an average of 15 days nationally. This would be a sensible performance indicator to monitor.

Part A of this report has emphasised the ambiguities about national, provincial and local responsibilities that continue to trouble investors about planning permission and permits. The ATAP study (ATAP Atlas, section 4.2) agrees.

The national Investment Law (Chapter XI Article 25) refers to the intention to offer a 'one stop integrated service' (OSIS) to investors with respect to the issuance of necessary permits to establish and operate a business[30], but the implementing regulations are yet to be passed. Part A also discusses the One Stop Shops already operating in Aceh at the provincial and district level. However, with cooperation between national, provincial and district agencies, work can be done prior to the establishment of an OSIS which will simplify regulatory requirements.

Action (i) *Establish and publish clear rules for issuing licenses, publish license/permit costs, set maximum times limits for issuance of provincial/local clearances [BKPMD, Governor's Office, with district cooperation]*

Action (ii) *Identify and act on opportunities to bundle/ eliminate license steps once national investment regulations are clarified [BKPMD and the Governor's office with district cooperation] then*

Action (iii) *Construct and distribute a clear roadmap of each of the steps to registration and commencement of operations in Aceh [BKPMD]*

[30] One stop shops have a very mixed record in servicing investors. They have not in practice guaranteed a more efficient route to investment approval and realization. In practice the 'delegation model' where authorities are handed over from other agencies has not worked well and may be difficult to implement given the multi level government powers (central, provincial and local) present in Aceh. There are reports that the OSS model operated by BRR during the reconstruction phase has worked effectively. Without the impetus of distaster reconstruction such success might be hard to replicate.

This roadmap should set out who is involved, where they are located, what the investor must provide, whether clearances can be obtained locally or must involve central approval in Jakarta, or district approval and the expected approval time. Such information should cover cases where businesses are multi-locational. Aceh should strive to be a model of clarity in this. The existing document provided by the national government – PP38 'Implementation of Investment Law at the Provincial Level' –is not a roadmap in this sense. Nor is the BKPMD 'Technical Procedures on Investment Permits and Facilities' document which is reproduced in Part A. Notaries who act for investors in obtaining required licences and clearances continue to assess the process as time consuming and complex.

Progress would necessarily require reaching early agreement and clear mutual understanding by the provincial and local authorities of the powers and responsibilities that each is exercising in licensing/registering /'approving' investment given clarification of the national investment regulations. Such clarity seems to be lacking at present.

This would require a multi government group which would be tasked by the Governor's office to identify simplification opportunities. Relevant KPIs to measure progress in this area could then include information on the time taken to effect the registration step for each new registrant with the local Trade office.

Action (iv) *Create reliable record of all new registrations of businesses and follow up to record actual investments. [BKPMD, Dept of Trade and Industry]*

These records would then provide some guidance on the effectiveness procedures in Aceh compared to other provinces and of bodies such as the IOO in shepherding investments through to the start up stage[31]

KRA (3) Costs imposed on businesses through power deficits

There have been several investors in the energy sector, among them foreign investors, showing interest in Aceh in the past year. Despite the announced contract from nationally owned PT PLN for the Medco – Ormat –Itochu consortium to build 340 MW capacity geothermal plants in Sarulla, North Sumatra, adequate power capacity will likely remain a weakness in Aceh. Although currently served by the transmission system from North Sumatra, there is an estimate 220 MW deficit in Aceh additional to the current power deficits in North Sumatra itself. The additional capacity from Sarulla will come on line in 110-120 MW stages over the next five years.

[31] Because most domestic investors do not interact with BKPMD, in constrast to FDI, the registering authority would be the main source of data.

If Aceh is unable to offer power with comparable reliability and cost as its neighbor, it will remain difficult to attract investors currently based in Medan who have the option of expanding there or extending into Aceh. Among the few larger scale investors present in Aceh cement producers have options of expansion or relocation.

The deficit means that processing industries will continue to face the additional costs of installing their own diesel generating capacity in the presence of increasing fuel costs. The success in attracting investment in the hospitality sector (hotels) would be more likely to be sustained if, other things equal, a reliable power supply from the grid could be assured.

Several MoUs have been signed between Aceh government representatives and prospective IPPs but these need to evolve into firm contracts. The latest of these was signed by the Deputy Governor and Malaysian firm SPM in September 2007. USTDA has supported a study of a possible geothermal plant for Aceh.

A broad goal in this KRA would be sufficient generating and transmission capacity to service all commercial and industrial needs within five years, given supplies from North Sumatra. A longer term goal would be to develop economic renewable resources including geothermal to the point where Aceh can export power to North Sumatra and possibly Malaysia.

Objective: *Lower power related costs to existing and new investors through improved reliability*

Strategy *Explore public-private partnerships to attract cost effective Independent Power Producers (IPPs). [BAPPEDA].*

In the absence of provincial subsidies to generators this will involve attracting IPPs who can exploit those resources that allow power generation at cost levels consistent with PLN contract prices. (Some hydro projects have shown preliminary costings well above such prices.) Provincial capacity to implement this is somewhat limited because of the central government influence over PLN, the national power corporation which is the single buyer of generators' output.

Action: *Incorporate secure attractively priced access to energy sources and related land into MOUs and contracts with IPPs*

This process will also benefit from maximum contractual transparency and the employment of strict bidding procedures if more than one potential supplier expresses interest in accessing an energy source.

Progress in this area will be measured by the proportion of businesses over time relying on grid-based power supply.

KRA (4) Alternatives to using inefficient incentives to influence competitiveness

Measures to remove government- influenced costs to setting up and operating a business in Aceh, though somewhat difficult to implement, can yield unambiguous benefits. The use of incentives – and tax-based incentives in particular – is an area which is more problematic. The GOI has reformulated its approach to incentives in its 2006 Investment Law and accompanying regulations. The approach adopted offers a range of priviledges to investors in new and expansion enterprises in designated provinces including Aceh. These concessions work to increase the post tax rate of return of investors by offering them investment allowances, accelerated depreciation and extended loss carry forward. In certain 'pioneer' industries – presumably those not yet represented in these locations – tax holidays may also be offered.

Lessons from Malaysia on the usefulness and role of incentives in promoting investment in areas with similar attributes to Aceh are mixed. Whilst a mixture of 5 year tax holidays, import duty relief and investment allowances have been available to investors establishing in poorer states like Kedah and Perliss, the responses have been muted, with the notable exception of the Kulim industrial park development in Kedah.

Apart from offering direct subsidies, generally regarded as among the least desirable forms of assistance, Aceh is limited in what it can independently offer in this area beyond what is on offer through the central government. There is scope to reduce the minor taxes on motor vehicles, business licences and similar. But if the provincial government wished, for instance, to offer more generous investment tax allowances than the national norm, it could not do so directly, having no power over corporate income tax. To implement such concessions it would need to negotiate some form of offset arrangement with the central government which would withhold part of the agreed DAU payments to cover the additional cost to central revenue of these additional concessions. This would raise both measurement and administrative complexities that would be unwelcome and add to overall cost of government.

The revised draft Investment Qanun repeats the broad categories of incentives ('facilities) available to eligible expansion and new investors offered through national law. There is no *detail* on any additionality that might be provided by the province.

Any strategy for targeting this KRA should be based on the evidence that fiscal incentives have had little impact in improving the attractiveness of less developed locations when other major impediments to competitiveness go unaddressed. Indeed incentives often go to those who would have invested anyway.[32] The appropriate **overall goal** would therefore be *to ensure that investors in Aceh are very well informed as to their entitlements to <u>national</u> government- provided incentives, while avoiding an 'incentives competition' with other provinces using provincial funds.*

Objective: *Avoid costly 'top-ups' of national incentives. Additional incentives would contribute to fiscal stress without necessarily attracting investment that would not otherwise have occurred*

Strategy: *Allocate provincial funds for infrastructure rather than additional incentives as the more effective inducement to investors [Governor's office,BAPPEDA]*

Action (i) *Resolve to limit incentives to those already available through national investment law/regulations[Governor's office/Provincial House of Reps-DPRD]*

Action (ii) *Produce a clear guide to investors' national incentive entitlements and steps for accessing them to accompany the Aceh investors' 'business start-up roadmap'[BKPMD/IOO]*

Such a guide would also include a statement of entitlements available to *expansion* investors already located in Aceh and could be publicised through the IOO. While strictly speaking this information task is a central government responsibility Aceh could take the lead in the interests of marketing itself as a stand out investor friendly province

Action (ii) *Implement ' benchmark' expenditure on transport and communications asset maintenace as discussed under KRA (8) below in preference to outlays on incentives [BAPPEDA]*

Adequate infrastructure, and transport in particular, dominates tax incentives in most surveys of investor priorities. Investtors have to be able to make a profit before tax advantages are of value. Adequate infrastructure enables this. Good policy prioritises this in the use of public revenues. If the provincial government chooses not to follow this advice and to offer additional incentives, it is imperative that it lock in spending commitments on infrastructure and education and training *before* deciding on budget allocations to incentives.

[32] This so-called 'redundancy problem' is well documented in work by FIAS and others. See for example L. Wells et al (2001) Ch 7; *Using tax incentives to compete for foreign investment*, Ch 7, FIAS Occasional Paper No. 15

KRAs where competitiveness is impacted through market access and market information

Markets for outputs produced or potentially produced in Aceh may already exist in principle but remain relatively inaccessable. The challenge is to map out strategies where access to such markets can be developed *on a sufficient scale* that make investment in these products viable – offering acceptable returns at acceptable risk.

There is variation across Aceh's most promising products in this respect. The market for crude palm oil, for instance is well established and the constraints to further exploitation appear not to be so much product market based as *input* market related – issues of sustainable land, milling capacity, supply chain organisaton etc discussed in further detail below. However for small growers, access to finance markets can also be an issue.

In other product lines, such as shrimp and some other plantation crops like coffee, there are a number of impediments to market access that must be addressed. There is a circularity problem. Further investment is retarded while market access remains restricted. But some investment at critical points is needed to *enable* greater market access. Information failure is a partial cause of this impasse.

KRA (5) Clarifying access to land as an investment prerequisite

Contact with existing and potential investors suggests that access to land, absence of a true market for land and uncertainty surrounding this key input, is a major concern and possible impediment. There is no market for land open to foreign investors as purchasers, as freehold acquisistion by a foreign investor is prevented through law. But leasehold arrangements and partnership arrangement offer means of overcoming this. A deeper problem is the impediment created through lack of information about development planning and zoning restrictions on commercial land use particularly at the district level.

At present it is understood that the BPN has its own records of land under various title categories for the province. Plantation authorities also have their own data sources. The Central Bureau of Statistics (BPS) has in the past published estimates of hectares of land under various usages.

Significant uncertainty now exists among potential investors about the realistic limits to land availability in Aceh as a constraint to plantation expansion in general and palm oil plantation expansion in particular. Opportunities for legal and sustainable expansion rely on the availability of degraded land in particular, in sufficient quantities and with sufficent clarity of title to support the claims for the industry's growth potential.

Critics of the palm oil industry point to the perverse incentives being generated by the rapid growth in demand for crude and refined palm oil product. Experience in Kalimantan and Sumatra has seen large tracts of land with conservation value and timber value clear felled and burned for subsequent plantation establishment. To avert this the current Governor's moratorium on all logging will need to be reinforced. Initiatives under the Aceh Fund for Environmental Protection (AFEP), the Leuser International Foundation (LIF), which is supporting locally based reafforestation on the edges of the extensive but endangered Leuser ecosystem, and the World Bank Carbon Partnership Facility are all contributing to more rational land use and restoration. Payments to local communities as rewards for protecting tracts from exploitation are being considered. All need to be part of the overall strategy for sustainable palm oil development.

However, there are current reports of extensive continued illegal deforestation in Aceh. To ensure that plantation development is not a contributor to this, but a contributor to investment, government needs a strategy for restricting the demand for and supply of inappropriate land while at the same time improving the incentive to invest in existing and appropriately zoned tracts.

The broad goal for policy intervention would be *to achieve consistency between investment in profitable plantation crop production and sustainable and sufficiently diversified land use as a prerequisite for agribusiness investment growth.*

Objective (A): *Ensure plantation land availability estimates are credible and that land is sourced from rehabilitation of abandoned or degenerate plantations and from suitable existing degraded land.*

Objective (B): *Ensure government owned land achieves market value when sold or leased to investors.*

The strategies for achieving these objectives clearly depends on more than land- focussed issues. The meeting to discuss formation of a Palm Oil Forum recognises this as does the IFC value chain analysis of the industry and the Eye on Aceh (2007) study. These analyses variously point to the limited milling capacity, compromised fruit quality from smallholdings etc as contributory constraints. However, unless immediate steps are taken to provide potential investors with realistic location -specific information on the size of existing suitable land tracts unencumbered by title uncertainties, plantation estate investors will look elsewhere.

Strategy (A) *Coordinate land use and land titling information into a single 'available plantation/industrial land' register.[BAPPEDA]*

The register should identify only land that has been made available legitimately. The challenge will be to avoid inducing 'anticipatory' clearing of land so as to qualify it for future plantation use by passing it off as previously logged or degraded land. To that end the complementary work around the forest tracts discussed above is critical. The World Bank is working towards a comprehensive forestry sector redesign involving a dinas- controlled special task force and clarification of the roles of the different agencies currently involved in forest resource management. Such a strategy successfully applied to palm oil would be a means of facilitating compliance of Acehnese crude palm oil product with RSPO requirements. Such compliance may become an increasingly important requirement for participation in certain export markets.

Action (i) *Identify provincial and district government owned land immediately available for leasing or sale for plantation and other commercial purposes [Govenor's Office,bupartis]*

This would involve bupatis informing the designated provincial agency of the amount of land available for specific commercial purposes within their control. Spatial planning powers are an area attracting a high level of interest at the district and village level and remains controversial.

As the provincial authority with responsibility for spatial planning BAPPEDA is suggested as the agency which should compile the authoritative land availability register.

As part of this strategy there is a need to reinvigorate the struggling systematic land titling projects involving the issue of title certificates by the national land office (BPN) through local officers involved in the RALAS project. There is also a need to reinforce community-driven adjudication of land rights which has been happening under RALAS. There are reports that the non-Acehnese BNP officials encounter resistance in their work. Furthermore their titling efforts are proceeding under national law (UUPA No 5, 1960) and attendant procedural regulations ill suited to accommodating the circumstances of Aceh.

Where viable plantation activity relies on nucleus development (eg–in the PLASMA approach discussed in Part A) a combination of large scale plantation and adjacent smallholder supplies, investment in the former can be jeopardised if outstanding land disputes jeopardise smallholding development. Without clear land title opportunities for more progressive smallholders to rent land from neighbours for commercial development is likely to be inhibited.

Action by the rovincial government is required to implement both aspects of this strategy. The regional autonomy legislation confers substantial land administration powers to provincial and district governments and in Aceh's case this is reinforced by the LOGA (Chapter 20). A provincial land office, taking over the various functions of BNP, but with titling and mapping priorities, could be an important step to reducing land access- related obstacles to investment in Aceh.

Action(ii) *Before 2009, seek donor assistance to evaluate the requirements, strengths and weaknesses of establishing a provincial land office. [Governor's Office]*

Subject to a positive recommendation and establishment that office should have responsibility for creating a land use 'blueprint'. Subject to the findings of that evaluation there should then be a gradual transfer of responsibilities and personnel from BPN.

Strategy B: *Adopt competitive tendering approach for allocation of government-owned land for plantation and other purposes[BAPPEDA,Governor's Office Bupatis and Mayors]*

Developing economies struggling to attract foreign investment and to generate local sources of revenue often engage in one- off contractual arrangements with investors, including the provision of access to land. The demand for plantation land, and palm oil plantation land in particular, should be satisfied through mechanisms that allow competition to emerge so that appropriate returns are provided to land owners. This requires active agreement by district and kota heads who control significant tracts of land that this approach is best.

Unless there is a commonly shared understanding of what land is available for what purpose it is not only agribusiness pursuits that will be jeopardised. The potentially high impact investment in a world scale medium density fibreboard (MDF) plant depends on access to fibre inputs. If the plant is built in advance of the establishment of purpose planted plantation timber feedstock, it will have to rely on rubber wood waste or similar material. In the longer term however firm property rights of land use will be needed to support the plantation. All potential investors should be aware of the process for competing for available land.

Action (i) *Seek agreement at the district level to a transparent tendering approach [Governor's office]*

Action (ii) *Advise potential investors of tendering processes through the IOO*

KRA (6) Market price information for agribusiness suppliers

Part A reveals the small scale producers in one of Aceh's most promising sources of commercial growth and exports – the brackish water shrimp industry – are held back by a market failure – lack of price information for their product. This is true of other Acehnese growers who supply agribusiness chains.

The value chain analysis conducted for the IFC in 2006 suggests that many small scale tambak farmers are only able to form price expectations on the basis of what a single trader, often Medan- based, will offer them for their product. Subsequent assistance to that sector confirmed that these producers have little or no knowledge about export prices, or indeed any prices beyond those on offer from the monopsonistic buyer. This gap contributes to a market failure. It is a failure that is present wherever small producers have only one source of market intelligence – the trader they deal with. Its rectification will not alone necessarily drive increased investment specifically targeting the export market. But filling it is a necessary condition to bring this investment about.

The broad goal would be *to enable better investment appraisal and export led investment growth by ensuring that primary producers in critical fresh food and crop production enterprises have timely access to relevant market price data, including export prices.* Without this information the sector will be unlikely to rapidly redirect its output and quality in a way that will raise returns along the value chain sufficiently to support the investment in cold storage or other supports for export.

Objective: *Improve grower margins to enable profitable re-investment.*

The gross margins reported in the IFC Value Chain Analysis of the shrimp industry (IFC 2006) illustrate just how little room small producers have to reinvest in their industry. While small growers remain in a situation where traders are able to appropriate a disproportionate share of returns, reinvestment will remain problematic. This situation also reduces their access to external finance because of the difficulties in establishing either collateral or a good earnings track record.

Strategy: *Strengthen grower bargaining power with traders through the timely provision of relevant price information to growers.[Capacity Building Group, ARF]*

This strategy will involve support for grower organisations and cooperatives to help them develop greater appreciation of, and demand for, market intelligence as a route to improving their profitability and investment capacity.

Action(i) *Conduct survey to pinpoint price information gaps –shrimp industry pilot [EDC/Trade and Industry]*

This would normally be a task for the Department of Trade and Industry with input from the relevant dinas. However, depending on capacity it could be overseen by the newly established Export Development Centre. The EDC would then need the financial resources to task either the provincial Department of Trade and Industry (represented at the Centre), or private sector market survey firms, or some combination of these, with collection of current market price data, including export prices, and its dissemination at the district level[33]

Action (ii) Determine the best model for ongoing price and market information gathering and distribution and commit funding to this model.

It is likely that the weak capacity in dinases may delay their capacity to get effectively involved in market related work until the next decade. Until such time as current efforts to strengthen dinases (with donor assistance) have effect, government needs to explore methods for involving the private sector in the provision of market information. This could be considered through the ARF Capacity Building Group in consultation with the IFC which has a 2008 program to link shrimp farmers to markets and finance.

This strategy, directed at improved margins for growers, can be the first step in establishing a *virtuous circle*. Combined with better information on quality and disease control and productivity improvement, better margins provide the financial leeway for growers to invest in their own enterprises in a way that will provide the volumes and qualities required for direct entry to export markets. A starting point for this approach could be the shrimp industry.

KRA (7) Exploiting cultural niches to gain greater market access

It is one thing to successfully identify the potentially most useful price information and other market information that would best enable suppliers to respond to market signals with the objective of enhancing export-led growth. It is another task to establish the market links.

According to some assessments[34] Malaysia's food and beverage processing industries are among the most dynamic in South East Asia. Furthermore, Malaysia is becoming a regional hub for halal food processing, with Malaysia's accreditiation of halal products highly respected and recognised by most Islamic nations. At the same time Malaysia imports 70 percent of the food ingredients.

[33] At present the EDC, like the IOO, is effectively a task force of the BRR. There is the attendant danger that beyond 2009 the EDC will be 'orphaned' in terms of funding, and that its functions, will revert to the local Department of Trade and Industry. This uncertain future could well undermine any overall strategy for developing a coherent approach to linking increased private sector investment and export growth

[34] Department of Primary Industries, Government of Victoria (Australia), *Malaysia Food Market Overview*, 2006.

This suggests short and long term opportunities for Acehnese investors. **An overall goal** is *to boost investment in Aceh's food production chain through development of a reputation as a high standard halal source.*

Given its high level of recognition in the region as an Islamic- inspired culture, Aceh is potentially well positioned both culturally and geographically to benefit as a food provider. Indonesia as a whole does not enjoy the same high reputation as a halal food source as neighbouring Malaysia. But Aceh's proximity to Malaysia could allow it to profitably differentiate itself . As Part A of this report states, development plans for the NCER in Malaysia envisage a halal hub in that region ajacent to Aceh.

Objective: *Establish and implement halal handling and production standards within Aceh that are consistent with Malaysian requirements*

Strategy: *Develop direct relationships with Malaysian authorities to meet their Halal food standard requirements for future direct exports to Malaysia and other Islamic markets. [Department of Trade and Industry/EDC]*

Until such time as livestock, fish and shrimp production levels and supporting infrastructure make further local processing economically viable the opportunities for high end value adding will be limited in Aceh. These opportunities already exist in Malaysia. But Aceh can seek to become an increasing source of input to the chain,as discussions with those involved with the NCER suggest. In doing so, important reputation and branding benefits can be gained. Longer term, by the middle of the next decade, the combination of high input standards and increased input volumes and significant wage cost disparities should encourage Malaysian and other investors to establish halal food production closer to the source of supply - in Aceh.

Action (i): Send 'standards' mission to *establish an immediate dialogue with representatives of the Northern Corridor Implementation Authority and the Malaysian agencies certifying food industry products.[Department of Trade and Industry, EDC, provincial representatives of national standards body DSN]*

By 2009 and beyond, Aceh needs to be in a position to deliver in line with those standards through strenthening of its own dinas and through attraction of requisite investment in the 'missing capacity links' in domestic supply chains.

Action (ii): *Develop subsequent implementation plan for five year convergence with Malaysian halal standards[BAPPEDA]*

KRA (8) Maintaining and augmenting infrastructure assets for market access purposes

The critical importance to investors of adequate infrastructure to facilitate market access is well documented. The post Tsunami period has seen the construction of a mixture of assets designed to deliver both productive services (transport and communications, energy, education and training facilities) and individual and social consumption (housing, health etc). Many of these assets have been delivered with the involvement of the BRR. In 2009 there will be a wrap up of that body's functions and there is a 2010 horizon for the US $713m Multi Donor Fund which has financed significant port and other transport link rehabilitation (37 per cent of allocations), as well as community driven development projects (52 per cent) and capacity building and governance.

A major challenge and **a broad goal** within this KRA would be *to ensure that restored and enhanced transport and communications assets are managed in a way that closes the gap with competitors like the northern states of Malaysia.*

Objective (A): *Maintain and improve Aceh's access to markets through management of existing transport infrastructure*

As part of the emergency response to the disaster there has been an expansion of the stock of some assets, (including schools, health centres etc) not simply a replacement, and the demands on fit-out costs and future recurrent expenditures have not always been fully considered. Competition for funding looms as a problem.This legacy of possible mismatches of capital assets and operational capability is now being addressed on several fronts[35]. But developing appropriate asset ownership and management structures and target or 'benchmark' spending allocations for future operating and maintenance expenditures for transport infrastructure is a priority if market access is not to suffer. Existing road and sea links with Medan will remain critical as a major market outlet and source of imports. Maintenance and improvement of road links to the west coast is also vital.

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[35] BAPPEDA and BRR have set up an Economic Development Fincancing Facility(EDFF), while the Provincial Government have set up technical working group 'clusters' within the Aceh Recovery Framework (ARF) administered by UNORC to prepare a result- based matrix that contains goals, deliverables, timelines, available resources, etc that can be integrated into the 5 year Medium Term Plan prepared by BAPPEDA. There are six clusters of Technical Working Groups of experts, including Capacity Building, Infrastructure/assets management and Economic development.
Currently the Economic Development Cluster of the Aceh Recovery Framework is preparing a draft of challenges and priorities through consultation with stakeholders including representative from USAID, World Bank, and Bank of Indonesia. This funding issue should be a high priority for both the Economic Development and Infrastructure cluster groups. Meanwhile, with substantial unexpended funding through 2009, BRR has been assisted with the establishment of a World Bank/ MDF Infrastructure Reconstruction Enabling Program (IREP). As part of this project there will be identification of further priority infrastructure projects to be funded with MDF finance and remaining BRR funds. There will also be a review of local and provincial governments' plans for infrastructure as a basis for BRR funding. For the West coast logistical area technical assistance will include institutional development support,

Strategy (A): *Prioritise transport infrastructure in infrastructure budget planning. [Governor's Office/ARF Asset/infrastructure Group/BAPPEDA]*

Action (i): *Determine appropriate ownership structure for transport infrastructure assets [Governor's Office/ARF Asset Group]*

There needs to be rapid agreement as to the best assignment of asset ownership/management responsibility, with recommendations from the Infrastructure/Asset Management group of the Aceh Recovery Framework informing that decision. Questions will arise as to whether there needs to be some new provincial entity created to take ownership responsibility.

Action (ii): *Compile asset register and Value assets [BRR/]*

Without a comprehensive asset register and valuation exercise no effective total asset management plan can be constructed.

Action (iii): *Develop and implement asset management plans incorporating O&M expenditures based on expert-determined benchmarks.[Future tranport asset authority/BAPPEDA]*.

The strategy recommended here involves matching forward budget commitments to O&M needs. It involves establishing and adopting realistic expenditure benchmarksfor operations and maintenance expenditure in each of the major asset classes over which there is provincial and district control..The 'Agenda' component of the GTZ-financed assistance to BAPPEDA shows that multiple stakeholders support the establishment of benchmark expenditures for key budget requirements. The benchmarks will serve as performance indicators for tracking budget outcomes.The benchmark expenditure requirements should reflect good engineering practice for the local conditions.

Beyond 2009 each of the districts needs to have its medium term development plan (RPJMD) linked to a multiyear budget, within which the benchmark expenditures for assets under its control are incorporated. There should also be ongoing evaluation of publicly owned assets.

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including the development of a long term maintenance strategy. Experience accumulated in this process needs to be translated to all districts

A recent World Bank study of public financial management at the district level in Aceh[36] gives rise to concern about planning and budgeting and asset management capabilities at the district level. There is a big range in performance across these bodies. The key role of the district leadership is noted. In the case of well- performed districts like the report states "the research team for Aceh Utara identified the political will and commitment of the Bupati as the main driver of good performance in financial management' (p18). Furthermore the report argues that there is a need for 'rigorous regional multiyear budgets clearly linked to regional plans.' If some critical assets generated through the reconstruction phase are transferred to local administrations, the adoption of the report's recommendation will be vital to their ongoing capability.

Objective (B): *Optimise future ports capital spending*

Strategy (B): *Link future ports development to balancing local demands and emerging export opportunities [ARF Economic Development Group/Donors]*

Beyond 2009 Aceh will need to develop an approach to marine port enhancement that is consistent with expected capacity requirements to service the different district 'clusters developments' discussed in Part A above. There is no coastal feeder system to dovetail with world containerised supply chains. There is no port supporting an international freighter liner service north of Medan, and its port (Belawan) handles containers shipped in from the region's main container ports. But the ATAP project shows that stakeholders envisage it, Lhokseumawe, Malahayiti K. Langsa and Meulaboh as accomodating international traffic by 2015.

Action: *Undertake integrated economic ports study [ARF Economic Development Group/Donors]*

A necessary action in the interests of rational port infrastructure (and market access) enhancement would be to initiate, with donor assistance, an integrated economic ports study for completion by 2010. Such a study would force a focused view of critical volumes of key commodities required to support proposed enhancements, links between processing industry growth prospects and transport demand. It would assist the planning of cluster development and the attractiveness to private investors of any industrial park development within cluster areas. Beyond 2010 selective port enhancements must support links to world containerised supply chains.

[36] See World Bank (2007b) 'Public Financial Management in Aceh: Measuring Financial Management Performance in Aceh's Local Governments', Jakarta, March

KRAs where competitiveness is influenced through productivity

For Aceh to progressively attract increasing amounts of private investment, particularly investment directed at serving export markets, continued progress will be required in raising productivity levels. This has already been touched on in discussions of strategies to improve market access but its importance merits the adoption of specific KRAs and related objectives. Appropriate government intervention is required in technical and extension services in both agriculture and fisheries industries to influence production practices and quality control. In its Agricuture and Rural Development Strategy 2004, the Asian Development Bank (ADB 2004) specifically recommended strengthening rural extension centres (BPPs) across Indonesia, which, according to the ADB have fallen into neglect after decentralisation.

In extension services the appropriate role for provincial and local government will be influenced by the approach to implementing the recently enacted Extension Law (No 16 2006) which clarifies the responsibilities of the national government in this area. Under 1999 legislation37 the central government has set standards and guidelines and provided accreditation. Provinces have had responsibility for training extension workers, districts have been responsible for management and delivery of the extension services. Delivery of these services at the district and local levels throught the dinas has been an ongoing weakness. The new legislation opens the opportunity to introduce private sector provision of some extension services.

KRA (9) Extension services contribution to improvements in productivity and efficient scale of operations in key sectors

Adequate allocation of funds to (a) training of extension staff and (b) implementation of extension services is an area of similar need if Aceh is to realize its investment goals on the basis of agribusiness growth. A recent FAO assessment has stated that ‘while decentralisation is a step in the right direction it has proved disastrous for agricultural extension in Indonesia’.[38]

The broad goal is to move provincial and district government support for extension services to levels that restore and improve grower confidence in these services as contributors to the sustainable productivity growth needed for increased commercialisation.

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[37] See for example Amrin Zakaria (2003) ‘Decentralizing Extension to Local Governments: Indonesia Experience’, paper presented to Regional Workshop on Operationalising reform in Agricultural Extension in South Asia, New Delhi, May.
[38] M Kalin Omar (2002) ‘Global Trends in Agricultural Extension: Challenges Facing Asia and the Pacific,’ Keynote paper presented at FAO Regional Expert Consultation on Agricultural Extension, Bangkok, July

If Aceh is to exploit the combined potential of its agricultural and fisheries resources as drivers of export growth, in the first instance in the immediate region, it will need to provide extension services and standards regulation that ensure its productivity in these primary sectors do not decline relative to those of its neighbours. Under the new extension legislation the central government will still have responsibility for setting standards. But these may need to be treated as minimum standards and Aceh may need to strive to exceed them. As Malaysia and Thailand become increasingly industrialised the opportunity will be there to complement that change by servicing some of their food and material needs. But that opportunity will only arise if extension services are adequate in areas not serviced by the private sector (which is currently confined largely to interaction from seed companies, agricultural chemical companies etc, interactions where small producers often miss out).

Objective: *Extension services that at least match the quality of extension services on offer in the neighbouring North East Corridor Economic Region of Malaysia within five years*

If achieved, this objective would enable the adoption of accreditation services to agricultural and fisheries producers along the lines being offered through the Malaysian Departments of Agriculture and Fisheries under the MFAS standards scheme. This approach dovetails with the strategy for improving market access through halal standards.

Strategy: *Develop effective levels of extension staff staff training, retention and service delivery based on regional comparisons and growers expressed needs[ARF Agric.Group]*

Action (i): *Review extension services budgets.[BAPPEDA/FAO]*

This should be done with the focus on the adequacy of the overall provincial (BPPP) and district(BPPK) extension services components of provincial and district budgets but with special attention to the relative share allocated to training and reducing turnover of staff, and to the delivery of services that reflect grower needs.

Action (ii):. *Set minimum budget shares for staff training and service implementation at provincial and district levels [BAPPEDA/dinas/Bupatis]*

These benchmarks would be set as a minimum proportion of the relevant agency budgets total extension budgets and as a proportion of overall budgets. In setting these benchmarks, government should take into account budget allocations to extension services in Malaysia which rose by more than 14% between the 8th and 9th Masterplans.

The strategy for achieving this will require preparation of both provincial and district level forward budget estimates for extension services responsibilities. Their introduction should be consistent with the provisions of the national Extension Law No 16 2006 and Regulations.

Specific actions comprising this strategy will involve representatives of the Capacity Building Cluster of the Aceh Recovery Framework , in consultation with BAPPEDA and the national government's Ministries of Agriculture and Fisheries.In particular, it will require examination of the extension budgets of the districts and recommended preliminary minimum increases in budget targets for a 5 year period. Actual outlays against the benchmarks will provide the relevant KPIs. In the longer term these targets should be adjusted in the light of experience reported with the World Bank funded FEATI program which has an extension focus.[39]

Action (iii): *Identify potential private suppliers of extension services [ARF Capacity Building Group]*

The opportunity to engage private sector operators in the provision of advisory extension services, provided for in the new national extension law, could be important in providing the vital link between market requirements and appropriate production methods. Aceh should immediately take steps to identify potential private service providers. The Malaysian NCER model for achieving this should be monitored with this in mind.

Conclusions

Aceh is an economy endowed with substantial agricultural, marine and mineral resources. The fact that it is yet to achieve much greater private investment, particularly in value addition, is partly a function of a recent history of conflict and disaster. But the absence of key links in processing and export chains is also a reflection of other shortcomings in the investment environment. Market information and assured longer term market access are striking examples. This policy note has tried to identify the investment potential, expose the shortcomings and the opportunities for government intervention within a systematic strategic framework. The recommended measures are internally consistent and reinforce each other. If implemented they would raise the credibility of the provincial administration in the eyes of investors. This review considers that all of the above policy initiatives are *necessary but not sufficient* for ensuring private investment lift off. Other specific interventions to address environmental constraints and poverty will have to be adopted alongside the measures discussed here.

[39] The World Bank funded 'Farmer Empowerment Through Agriculture Technology and Information' (FEATI) program (2007 – 2011) will be implemented in 18 provinces and includes districts in neighbouring North Sumatra. It does not include NAD Province. It aims to 'develop demand driven market oriented agricultural service systems based on partnerships between farmer groups, public agencies and private enterprise.

A Appendix: Sectoral detail

Plantation crops

The ATAP identifies the following strengths and weaknesses of Aceh's plantations sector:

Strengths:

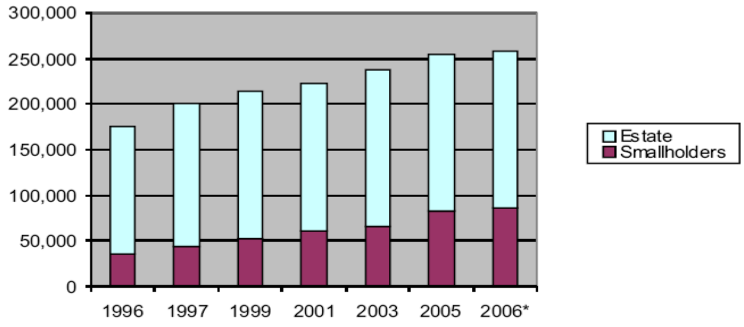
- Natural conditions (climate and land) of the province much supportive for the development of plantation commodities;
- Fairly large built plantation area and potential land to be developed;
- Availability of plantation labour and personnel;
- Clear regulatory framework for plantation enterprise development.

Again, the ATAP states there is available land but the mission was unable to access a map showing available land from BPN, the IOO, BAPPEDA or any other authority. Further, the mission is uncertain why the ATAP found there is a clear regulatory framework when the promised Governors' Regulation on palm oil has not yet been issued, nor the draft Aceh Plantation Development Authority (APDA) qanun.

Weaknesses:

- Low plantation productivity, at only 50% of potential. This is caused in part by damaged/old plantation crops, low investment capital and the seeds used do not qualify for technical criteria;
- Small area of owned farming land (less than 1 hectare) and commodities produced are still primary by nature; and low commodity quality causing low income;
- Low mastery of information and low-quality human resources (plantation workers) and farmers;
- Limited access to plantation enterprises, with exploitation by monopoly middlemen;
- Minimum supporting infrastructure (roads).

Plantation Coverage in Aceh 1996 – 2006 (Ha)



*Source: Department of Plantations, Aceh, Annual Data. *Preliminary figures*

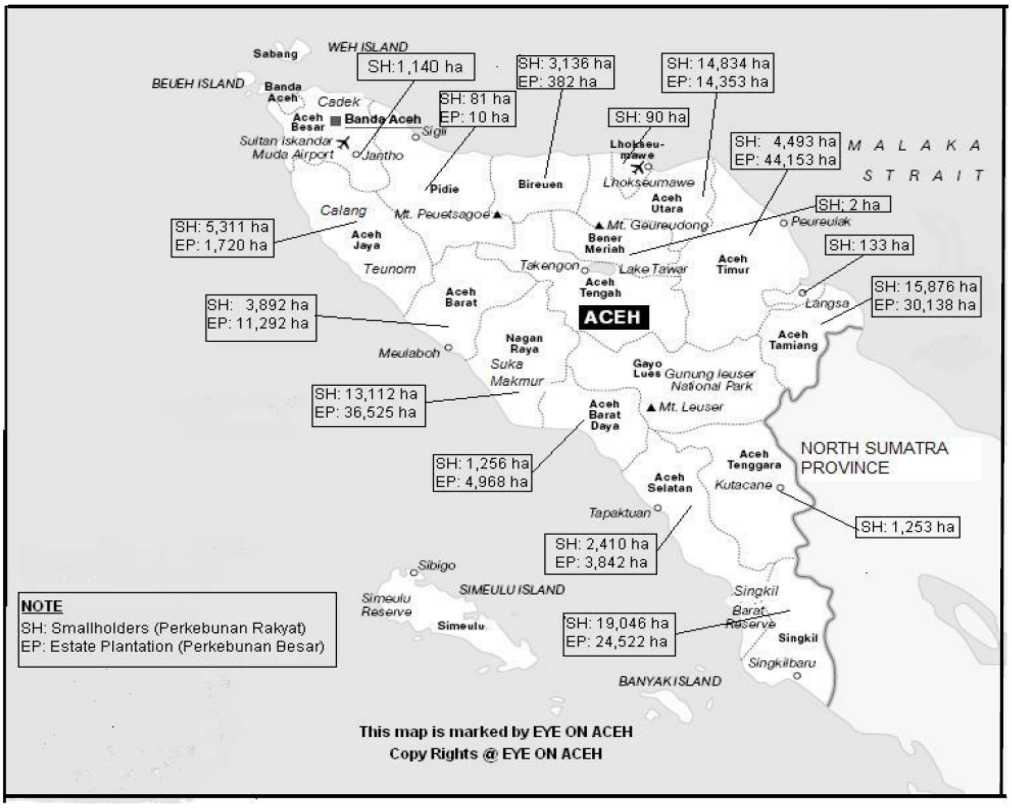
Palm oil

Eye on Aceh, in their September 2007 publication, 'The Golden Crop? Palm Oil in Post Tsunami Aceh', reports in total 57,712 hectares of smallholder and 32,316 hectares of estate plantations were abandoned during the years of the most intense conflict between 1999 and 2004. Local government departments were also unable to respond to the problem of inactive plantations as staff were killed, kidnapped or tortured, while others were simply to stay and left the local area. In addition, only 171,905 hectares of the total amount of land issued with permits to grow oil palms were actually planted. Of those, 39,353 hectares belonged to national estate plantations and 22,139 hectares to foreign companies. 86, 065 hectares of land make up smallholders' farms which have become a source of livelihood for more than 53,000 families. Programs are now being undertaken by the provincial Department of Plantations to rehabilitate 28,000 hectares of palm plantations devastated by the tsunami, and 85,028 hectares of conflict affected estate. Further, there is a program for independent smallholders whereby each family receives two to four hectares of land and also assistance to prepare the land, including equipment. District level departments are responsible for the implementation of this policy and decisions on eligibility of beneficiaries. Under this program alone, smallholder plantations in Aceh will expand by 43 percent, and this does not include other government of private intiatives.

In July 2005, the Ministry of Agriculture, in Jakarta released a document stating that 454,468 hectares of new land is available for palm oil expansion in NAD province. The Eye on Aceh report records Saminuddin B. Tou from the Department of Forestry in Aceh as asking "Where is all that land coming from?" In addition to questions about the availability of land (and whether it would involve the conversion of protected forest, there is also the question of whether it would be wise to use over 400,000 hectares of land for palm oil alone. Other commodities, such as cocoa, rubber and coffee must also be accomodated.

Further, there are issues as to productivity in the NAD province. A number of Aceh CPO plants are operating at half capacity due to a lack of FFB (Fresh Fruit Bunch) supply.. The government plans to allocate some areas for resettlement of Acehnese people affected by the conflict. Plantation and smallholder areas of oil palm in Aceh have been severely neglected due to conflict, transmigration of farmers and farm labour to safer areas and affected by tsunami damage and population loss. Plantation and CPO processing companies with operations in Aceh have suffered significant financial (government NPL issue) and political (caused by conflict) disruption over the past ten years. The industry requires significant investment in plantation rehabilitation and mill upgrade to restore profitability.

The location of estate and smallholder palm plantation area in Aceh

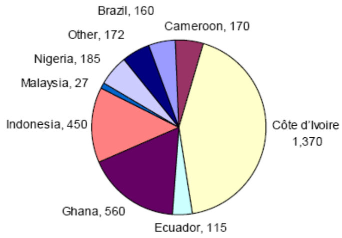


Cocoa

Indonesia is the world’s third largest cocoa producer behind Ivory Coast and Ghana. The Ivory Coast and Ghanese cocoa industry are marred by child labour problems. If Aceh could comply with the International Labour Organisation’s conventions on labour, it could distinguish itself from the West African producers and potentially gain a competitive edge. In 2004 Indonesia produced just over 600,000 tonnes of cocoa beans. The national crop is grown by around 400,000 farmers, of which 95 percent are smallholders with an average area of 1.1 hectares. Despite the position of Indonesia as a major producer, due to the fragmented structure of industry (dominated by smallholders), cocoa is a lower priority sector for central government investment and development. The table below shows cocoa production from the main producing countries.

A comparison of the world’s leading cocoa producers shows that Indonesian producers have a comparative advantage in productivity per hectare, with average yields of around 1.2 tonnes per or 2.5 time higher than the average of other major producing countries (see table below). Actual cocoa yields per hectare in Aceh are closer to 800kg per hectare.

World Cocoa Production (2005/06) (MT 000s)



Source ED&F Man, Cocoa Market Report, February 2006

Industry data from main cocoa producing countries

Producing Country	Tonnes produced*	Area Harvested (ha)*	Productivity (kg/ha)	Average Producer Price (USD/t) **	Average Export Price	% Gap Export/ Producer Price
Brazil	184,572	636,776	300	843	2,296	63%
Cameroon	133,290	372,000	397	825	1,303	37%
Côte d'Ivoire	1,334,746	1,775,510	743	922	1,475	37%
Ecuador	95,024	366,622	320	1,034	1,493	31%
Ghana	480,150	1,509,000	327	673	1,395	52%
Indonesia	467,494	482,000	1,187	977	1,314	26%
Malaysia	49,046	53,656	867	706	1,291	45%
Nigeria	349,000	1,005,200	343	977	1,468	33%

Source FAO Stat
*5 year average from 2000 - 2004
**Average Producer Price from 2001-2003

The table above also shows that the gap between average export price and producer price in Indonesia is less (26 percent) than that for other producing countries. This indicates two factors; that the Indonesian cocoa value chain is comparatively more efficient than in other producing countries and; that export cocoa from Indonesia commands a lower price than other countries. It may also indicate that there is relatively more value added between farmer and exporter in other countries. The Indonesian government is promoting industry development by encouraging increased yields. The national cocoa industry association believes that yields can be lifted from 0.7 to 1.8 tonnes per hectare. Increased yields and farmer returns will rely on improved management of pest and diseases. International confectionary foods producer, Mars Inc. estimates that Cocoa Pod Borer (CPD) destroys at least one-third of Indonesia's cocoa crop and costs the industry about $350 million in lost revenue per year. Indonesia is not alone in having to deal with the problem of CPD. The pest is major issue affecting returns for other competing countries in Africa and South America.

Aceh is a relatively minor producing region with roughly 2 percent of the national production in 2005. Like other regions in Indonesia, the farm sector in Aceh is made up almost entirely by smallholders. The difficulty in controlling pests and diseases in large mono-crop plantation systems has discouraged plantation companies from expanding areas of cocoa. The most serious pest for the cocoa industry is the Cocoa Pod Borer (CPB).

The poor quality of current cocoa beans makes farmers susceptible to heavy price discounts from traders and puts them in a weak selling position. Restoring farmers trust on farmers groups to cluster supply using existing farmer groups (e.g., KTNA groups and farmer cooperative) may improve farmers' marketing positions. Farmer groups would also provide a forum for training. CPB is an industry-wide issue that significantly reduces crop yields and requires careful management. Government and private sector research institutions continue to work on developing improved control methods, including bio-controls. Smallholders can reduce the impact of CPB and the rate of spread in Aceh through improved control practices.

A low standard of smallholder drying and fermentation (very limited) practice exacerbates bean quality issue and causes farm gate prices to be discounted by traders with little or no objective measures used. Cash flow constraints (it can take 5 – 7 days to ferment and fully dry cocoa beans) and distorted quality signals reduce the incentive for farmers to practice fermentation.

Sulawesi is Indonesia's main producing region with 80 percent of cocoa production and exports. The remaining Indonesian cocoa production takes place in North Sumatra, West Java, and Papua, with some small production areas in Bali, Flores, and other islands. As a region for smallholder production, Aceh has potential in that there are areas within the province that are relatively free of the CPD. With careful management, industry experts believe it is possible to control the spread of CPD over the medium term. Utilising this current strength of the Aceh region will require improved knowledge and management practices at the smallholder level.

Cocoa Production by Region

Region	Area (ha)	Production (tonnes)	% of Total	Productivity (tonnes/ha)
NAD	28,235	12,859	2%	0.455
Sumatra	154,574	86,426	14%	0.559
Java	60,278	24,739	4%	0.410
Kalimantan Total	48,337	27,524	4%	0.569
Sulawesi	575,976	433,217	69%	0.752
Maluku and Papua	81,888	37,670	6%	0.460
Other	50,675	21,823	3%	0.431
Indonesia	971,728	631,399		0.52

Source: Indonesian Department of Statistics (2004)

Coffee

USAID provided the mission with the following information on the organic coffee industry, which has the potential to be a competitive industry for Aceh.

Koperasi Baitul Quiradh Baburayyon (KBQB), an Acehnese coffee cooperative has 4,461 farmer members representing 5,089 hectares and 111 farmer groups. Of that total, only 171 farmers had been disqualified for organic farming practices violations. All had been NOP (USDA), EU and JAS (Japan) organic certified; CAFÉ Practices (Starbucks) certified; and FairTrade Certified (FLO Preconditioned Status). Recently, an additional 2,456 farm families joined the cooperative as project beneficiaries with a total of 3,238 hectares of coffee plantations. These additional project beneficiaries were inspected for organic certification during October 2007 and will become full members upon passing inspection.

Coffee purchases from cooperative members will occur on a seasonal basis reflecting the harvest period of late October to late May every year. The project purchased a total of approximately 6.1 million lbs. of wet parchment during the past season ending May 2007, or more than double the previous season's results. Payments to Farmer/Members during that period has amounted to approximately Rp. 30 billion. It is anticipated that volumes will double over the next seven months of the harvest season starting November 2007 to May 2008.

From April to September 2007 exports of Grade One Certified Organic Coffee from KBQB have amounted to 1.071 million lbs and together with local sales, totaled a value of $2.32 million FOB Medan equivalent. As the industry is entering the beginning of the harvest season in November, it is anticipated that volumes will at least double over the next seven months of project implementation.

First Year (audited) KBQB Financial Statements resulted in operations being undertaken at a profitable level. This is considered a substantial accomplishment given its rapid start-up phase, higher prices paid to farmers, and one-time initial development costs. Current employment generated over 700 jobs for coffee production, seedling production, processing and export operations.

Non-plantation agriculture

NAD province offers a wide range of agricultural opportunities, from the production of shorter term crops of rice, soybean, peanuts, vegetables, nutmeg, pepper and other spices, to livestock and plantation crops. The agricultural sector is dominated by the plantation sub-sector rather than farming. The total area of plantation is currently around 1,103,803 hectares, which is almost three times larger than the total area of farming land

The contribution of the agricultural sector to the provincial GDP between 2001 and 2005 was relatively stable (20.46 to 21.04%) and between 2003 and 2004 its growth was 3.43% and 5.66%. However, in 2007 growth was a disappointing 1.5%, indicating that the sector is stagnant. The overall importance of the sector, however can be gauged by the fact that, according to Zulham and Sudaryanto (2005) the sector in 2003 accounted for 48% of recorded employment.

Around 70% of the households in rural areas depend on the agricultural sector for their livelihoods, particularly from the food-crop sub sector. According to the multiple Value Chain Analyses conducted by the IFC (on Cocoa, Fisheries, Palm Oil and Peanut), smallholders in traditional farming systems fail to achieve the income potential for their produce through lack of market knowledge, ignorance of quality requirements, lack of market signals (ie little incentive from traders for higher quality) and lack of commercial/business expertise in managing their farming systems. As a result, most appear to remain at or below the subsistance poverty level and struggle to retain or access sufficient working capital for inputs of seeds, fertiliser etc. Many rely on traders who may provide limited inputs and finance in return for all produce, all at the trader's price. Little has been developed by way of local processing and access to markets, with most products being purchased by traders for processing and/or export from Medan.

Strengths and weaknesses of Aceh's horticulture sector

Strengths

- Available adequate lands for food crop and horticulture cultivation;
- Available micro-financing;
- Adequate Dinas support;
- Available farming institution;
- Available partnership with business owner (ALSINTAN);
- Adequate number of human resources at provincial and district level.

Weaknesses

- Low competitiveness of food crop and horticulture due to transportation problem;
- Less farming facilities and infrastructure;
- Limited personnel for agricultural information campaigns;
- Narrow farming land;
- Limited capital of farmers and farm business owners;
- Weak roles of farming institutions;
- Less open information on farming technology and market;
- Unavailable farming insurance;
- Low availability of quality seeds;
- Relatively expensive production facilities;
- Farming policies are not benefiting the farmers;
- Percentage of poor farmers relatively high.

Aceh's peanut sector

Indonesia is a net importer of peanut and Java is the main peanut growing region in Indonesia with around two thirds of the national production. Indonesian peanut production is not able to meet the growing national demand for peanut, as significant volumes of peanut are imported each year. In 2004 Indonesia imported a total of 160,000 tonnes of peanut at an average value of USD285 per tonne. Despite this situation, Indonesia is able to export a small volume of peanut (15 – 20,000 tonnes) for comparatively higher prices. Imported product volumes fluctuate to cover seasonal supply lows and are used mainly by the snack foods industry. The main exporting countries to the Indonesian market are China, India, Vietnam and more recently Australia. The government of Indonesia imposes a 5 percent import duty and 10 percent VAT on all peanut imports in an effort to protect domestic producers. The large volume of imported and exported peanut traded in Indonesia reflects that local producers are not able to produce sufficient quantities at the quality specification demanded in the domestic markets. The table below shows the main peanut producing provinces in Indonesia. Aceh is a relatively minor producer on a national basis with less than 2 percent of national production.

Peanut Production by Province (tonnes)[3]

	2000	2001	2002	2003	2004	%(2004)
NAD	9,179	5,047	7,377	16,887	16,507	1.5%
Sumatra Total	70,882	68,032	67,249	81,227	85,737	7.6%
Jawa	503,622	487,803	497,636	529,219	569,188	50.6%
Bali dan Nusa Tengarra	57,610	58,293	62,091	72,578	86,044	7.6%
Kalimantan	24,239	22,462	23,648	22,650	23,041	2.0%
Sulawesi	70,657	63,094	62,956	74,442	66,986	6.0%
Maluku dan Papua	9,507	10,086	4,491	5,410	8,143	0.7%
Outside Jawa	232,895	221,967	220,435	256,307	269,951	24.0%
Indonesia	978,591	936,784	945,883	1,058,720	1,125,597	100%

Source: Department of Agriculture

A number of NGOs are assisting farmers to rehabilitiate peanut crops and supply is expected to increase by 10 – 20 percent above the 2004 supply. The same level of assistance and investment has not been made in the processing sector and farm gate peanut prices are expected to decline as a result. A number of farmer groups have tsunami damaged deshelling equipment that requires repair. Peanut growing is dominated by smallholders owning 1 – 2 hectares, generally grouped into Farmer Associations and Cooperatives. Farmer returns are low due to poor yields and poor quality product (due to small nut size). There is significant potential to increase crop yields, nut quality and farmer returns

Peanut is a traditional crop in Aceh, mostly grown on unirrigated land with the major growing areas located on the West Coast. Farmers in this area are familiar with the crop. According to a recent IFC Value Chain Analysis of Peanut, the Aceh peanut sector is currently undergoing strong expansion after the ability of farmers to supply and local capacity to process peanuts were severely affected by conflict and the tsunami.

Despite current low crop returns Aceh growers receive higher prices for local peanut varieties than growers in other parts of Indonesia. The local variety is a unique variety of smaller, flavoured peanut suitable for processing, although crop yields are lower than in other parts of the country.

Peanut is a suitable crop for farmers with few other viable cropping options as it doesn't require irrigation and the short rotation (100 days growth) provides immediate benefit and relatively low capital investment. It is a desirable crop to have in rotation with other crops due to the beneficial effect on soil fertility.

Current market barriers and industry issues are common with those facing horticulture and include:

- A selling system that uses local village traders and larger regional traders and inhibits the flow of price and quality signals from the end user to farmers;
- Local traders appear to be making significant profits and do not adequately pass on price quality signals to farmers - a barrier to improving smallholder returns and peanut quality;
- A lack of access to finance for the purchase of quality seeds and agri-inputs such as fertilizer and agri-chemicals inhibits productivity;
- Poor road infrastructure reducing the flow of peanut from more remote areas (e.g., Calang) to processors in the main centres of Banda Aceh and on the East Coast;
- The current quality of seeds used is poor and constrains yields and nut quality;
- Poor support from government research and extension services to improve the supply and quality of local production.

B Appendix: Investor detail

Current investors in Aceh

The Aceh Triple A Project (ATAP) of May 2007 identified 225 companies consisting of 65 foreign investments and 160 domestic investments in NAD. According to ATAP, 52 companies are still operating, 35 companies are under reconstruction and 138 companies are no longer operating due to lengthy conflicts, tsunami and deficit as well as shifting to more profitable businesses.

It is understood ATAP obtained this data from BKPMD.

Sector	Number of Companies
Plantation	63
Fishery	21
Chemical industry	14
Forestry	13
Mining	12
Food industry	12
Hotel	9
Husbandry	8
Timber industry	8
Transportation	7
Trading	5
Paper industry	5
Non-metal industry	2
Cash crops	1
Textile Industry	1
Other services	32
Other industries	12

As can be seen above, plantations are by far the most popular sector in which to invest, followed by fisheries and chemicals. The total foreign investment realization was to May 2007, US$817,995,400 and the total domestic investment realization was Rp.2,227,968,184,371.

In terms of domestic investments, in 2004 there were two companies operating in Aceh with a total investment of Rp. 9.7 billion. They were:

- Koperasi Pemberdayaan Rakyat (Community Empowerment Cooperative) located in Banda Aceh, with a total investment of Rp. 2,300,000,000 operating in transportation/travel services;
- *PT. Abad Jaya Abadi Sentosa* located in North Aceh, with a total investment of Rp.7,400,000,000 operating an Asphalt Mixing Plant.

In 2005 there were no investments in Aceh, but in 2006 two domestic investors commenced business in Aceh, with a total investment of Rp. 218,623,552,000. They are:

- PT. Agra Para Citra located in Nagan Raya, with a total investment of Rp.158,623,552,000, operating in the oil palm industry;
- PT. Berlian Global Perkasa located in Banda Aceh, with a total investment of Rp. 60,000,000,000 operating a hotel.

During the last three years from 2004 to December 2006, new foreign investments were made in NAP province to a total of US$156,279,675. PT. Simeulu Investment Group operates in accommodation and has a total investment of US$ 9,533,000. In 2005 there were four foreign investments made in Aceh with a total investment of US$93,645,000. The four foreign companies are:

- PT. Simecons Group located in Simeulue, working in oil consulting services;
- PT. Sari Melati Kencana located in Banda Aceh and Lhokseumawe, working in the restaurant business with a total investment of US$59,100,000;
- PT. Energi Alam Raya Semesta located in the Regency of Aceh Barat with a total investment of US$34,200,000 in a coal-powered electric generator;
- PT. Indo Cafco located in the Regency of Bener Meriah with a total investment of US$315,000 in coffee and cacao pealing.

In 2006, there were nine new foreign companies with a total investment of US$53,101,675. They are:

- PT. Beuna Trading House located in Banda Aceh, with a total investment of US$250,000 and working in major trading and imports;
- PT. Indonesia Malaysia Thailand Jaya Raya located in Sabang, with a total investment of US$48,630,000 and working in the fishing industry;
- PT. Glory Pearl Nusantara, located in Sabang, with an investment of US$3,000,000 and operating in fuel storage;
- PT. Mercy Teams Internasional in Banda Aceh, with a total investment of US$220,000 in lobster breeding,;
- PT. Nolemon Banda Aceh has invested US$1,000,000 in major trading and after-sale services;
- PT. Seoyong Company in Banda Aceh with a total investment of US$1,000,000 operating in metal industry and housing construction;
- PT. Cadg Indo located in Banda Aceh with an investment of US$200,000 working in business management consulting services (property sector) and in the agricultural sector;
- PT. Haritos Shipping Logistics in Banda Aceh has invested US$ 335,000 and operates in business management consulting services;
- PT. Darulaman located in Aceh Besar with a total investment of US$140,000 in major trading (main distributor).

Potental investors

The IOO identified the following thirty seven potential investors that had visited the IOO, and that as a consequence, the IOO was activiely assisting:

	Company/Organisation	Country of Origin	Business Line	Status	Land	Need Partner
1	CBCL Limited	Canada	Consulting Engineering	Assessing opportunity to set up company branch and finding local partners. Signed MoU with two local partners.		X
2	Hitech Mega	Malaysia	Pressed Bricks	Have found a suitable 5 Ha site in Aceh Besar and have approval to use the land for their factory. Issues as to electricity installation pricing.		
3	PT. Sumber Karindo Sakti	Medan, Indonesia	Moulding and Laminated Board Industry	Assessing the potential of raw material available in East and West Aceh.		
4	Maju Ikan Nusantara Sdn Bhd	Malaysia	Fishery	Find out potential fish available		
5	PT. Permata Surya Makmur	Medan, Indonesia	Mining, Coal	Has license to explore 9296 Ha. Needs partners to do exploration		X
6	PT. Sinar Anugrah Pertiwi	Jakarta, Indonesia	Mining, Black Tin	Has license to explore 5000 Ha. Needs partners to do exploration		X
7	Macan Syari'ah	Indonesia	Retail			
8	LaFarge	France	Cement	Awaiting the Investment Qanun to be passed		
9	PT. Sumber	Indonesia	Wood	Trying to source land	X	

	Karindo		processing			
10	PT. Era Pet Aron	Indonesia	Black tin	Trying to source land	X	
11	PT. Lhoong Setia	Indonesia	Steel pellets	Need to lock in potential area	X	
12	PT. Ganda Budi Cakrawala	Indonesia (Aceh)	Trade palm oil, coal	Trying to source local partner with 15 – 20,000 Ha land	X	X
13	CCH Steel Fabrications SDN	Malaysia (Acehnese)	Steel fabricators	CCH will open a factory		
14	Suriadi (company name not yet registered)	Indonesia	Palm Oil	Need to confirm local partner and location (need 15 – 20,000 Ha)	X	X
15	PT. Tuah Sejati	Indonesia	Agriculture	Need to confirm local partner		X
16	PT. Tusam Hutani Lestari	Indonesia	Wood and Agro-industry	Need to find an international investor partner, and appropriate land to expand.	X	X
17	Evergreen Multitrade Co	Thailand	Commodity training (trading?)			
18	N.T. Huat Kee Fisheries	Malaysia	Sea Weed	Researching potential for the sector in Aceh		
19	Applestar Trading	Malaysia	Import & Export			
20	PT. Ganpati Trading	India	Gambier Arecanut Patchouli Coconut	Need location approval from Bupati – want government owned land, but plantation, production and export will be handled by the company. Foreign Investment Approval (SPPMA) application delivered to BKPM in Jakarta.	X	
21	PT. Dynea Mugi	Indonesia-	Wood glue	Were having issues with illegal fees		X

	Indonesia	Finland		being charged by customs, but the IOO addressed this. They are now trying to secure a partner.		
22	PT. Cocoa Ventures Indonesia	Philippines	Cocoa Processor	Want to open a chocolate fermentation factory		
23	DSFI		Tuna Fish Processor	Want to put a freezer and chiller in Lampulo		
24	Nastran and Jasa Lintas Sumatra		Shipping and Airport Logistic Handling	Want statistics on import and export in Aceh, to see if capacity to operate a vessel of 10,000 tons. Long terms possibility of operating a seaport in Aceh		
25	Citra Kencana Industry		Joint Figure Pine Wood	Need information on land for pine trees in Central Aceh from the Aceh Governor and Bupati	X	
26	PT. Canang Indah		MDF and Particle Board	Requested 40,000 Ha of land from East Aceh Government. Forestry agency of Aceh Timor needs to map available HPH land, but due to size the National Forestry Department has final decision, in consultation with the Governor, Provincial Forestry Department and Bupati of Aceh Timur. 5,000 Ha should be community owned/involved. Would export from Langsa/Bayen Seaport. MoU drafted between Aceh Government and Canang Indah (5	X	

				Sept 07). Factory will be built from early 2008.		
27	Aceh Trading Centre	Malaysia	Export and import company for agricultural sector	Sought information about Aceh's export and import tariffs, customs regulations, electricity. Potential for them to represent the IOO in Malaysia.		
28	Zainal Osman and Kathi (individuals)	Malaysia	Energy and Mining			
29	Surya Sakti Power	Singapore	International Trading	Sought information on regulatory environment and coal data		
30	Southern Acids Berhad	Malaysia	Oil Palm Plantation Development	Need 15,000 Ha of land for Oil Palm Plantation, mill and potentially a refinery.	X	
31	Merukh Enterprises Inc	Jakarta	Coal	Liaising with Aceh Barat's Bupati and Provincial Mining Agency to reestablish exploration license for 15,000 Ha granted in 2003. Decision that the license was cancelled but being appealed.		
32	Cimita Resources	Malaysia	Cocoa	Need information about land available for Cocoa farming and also interested in purchasing other cocoa grown in Aceh to process in Medan and Malaysia.	X	
33	Koperasi Mulia Jaya	Aceh Timur	Cocoa	Need investor to trade cocoa/chocolate, either for the national or international level		X

34	Incitec Pivot	Australia	Coal gasification	Feasibility study being undertaken, and need to persuade Central Government to cancel their plan to sell the fertilizer plant to China.		
35	System Protection and Maintenance	Malaysia	Electrical & Instruments	To conduct feasibility studies to build power plants in Aceh and sign an MoA		
36	Save our Planet Investments	Singapore	Bio Diesel	Looking for land and to work with the community to plant Jatropha. Bupati of Bener Meriah able to provide 400 Ha.	X	
37	PT. Hollondfor Weter	Dutch	Water Filters	Went to Jakarta to obtain approval.		

Palm oil investors

As stated above in the consideration of the comparative advantages and disadvantages of Aceh's palm oil sector, the NAD Department of Plantations is actively seeking partnerships with established plantation companies as "foster parents" as part of the Plasma scheme. It has already approached 17 such companies to request their active involvement (see the table below). Others have also shown interest, including Indonesia's largest publicly traded agriculture company, PT Astra Agro Lestari.

Companies invited to participate in the Plantation Revitalisation Program 2006 – 2010 in Aceh

District	Foster Parents	Area (ha)
Aceh Besar	PT Tuah Sejati	1,500
Pidie	PT Gotong Royong	2,000
Bireun	PT Blang Keutumba	3,000
North Aceh	PTPN I, PT Satya Agung	3,000
East Aceh	PT Banda Aceh Sakti Jaya, PT ARCO, PT Timbang Langsa, PT Damar Siput, PTPN I	3,000
Aceh Jaya	PT Boswa Megalopolis	5,000
Nagan Raya	PT Fajar Baizury, PT Kallista Alam	5,000
West Aceh	PT Mopoli Raya, PT Karya Tanah Subur, PT Telaga Sari Indah	5,000
South West Aceh	PT Kallista Alam	3,000
South Aceh	PTPN-I	3,000
Aceh Singkil	PT Delima Makmur	5,500
Bener Meriah	PT Perkebunan Lembah Bakti	1,000

Source: Proposal on the Location and Activities of Plantation Revitalisation 2006 - 2010 of NAD, Department of Plantations, Aceh, November 2006.

According to the Eye on Aceh report, by June 2007, only PT Fajar Baizury in Nagan Raya district had committed to developing and facilitating some 5,000 hectares between 2006 and 2010. This table does not include some of the potential investors that the mission met with, and it is expected that the transparency of targeting particular foster parent companies, to the exclusion of other interested companies, would be viewed negatively by potential investors.

C Appendix: Malaysia's NCER – further details

The NCER initiative will span from 2007 to the end of the 12th Malaysia Plan period, 2025, and is phased as follows: