

BACHELOR'S THESIS

Proper property rights for foreigners?

A case study of the institutions for foreign
property investments in Lombok, Indonesia

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Preface

We had the good fortune to get in contact with a social budget consultant, Ian MacKenzie, who is working with issues of economic development in Indonesia. He is planning to conduct a policy reform paper, in order to influence the policies and regulations around foreign direct investment, particularly investment of property, in the West Nusa Tenggara province of Indonesia. The purpose is not only to promote tourism-led economic growth but also an economic growth with equality, which would mean sharing wealth and helping people rise above the poverty line.

In order to make a policy recommendation, MacKenzie first needs a descriptive study of the current policies and regulations around foreign investment of property, as well as the purchasing process in practice. That is where we come in.

We would like to thank our advisor at Lund University, Hans Falck, for valuable input during the work with the thesis. Thanks also go to all the interviewees in Indonesia, who never hesitated to give honest answers or to offer us coffee. Last, but not the least, we give our gratitude to family and friends (moose is a nice substitute for nasi goreng).

Somewhere in Northern Sweden, January 2011

Malin and Fredrik

Abstract

The development of tourism is important for Indonesia and has potential to increase economic growth. Lack of capital is a constraint that affects the growth potential negatively. However, capital gaps can be filled with foreign direct investments. Lombok is the closest neighbor to tourism flourishing Bali and has a big potential to expand its tourism industry. An international airport is planned to open in 2012, infrastructure is being improved and the island is generally considered to be, in terms of tourism, “the next Bali”. The thesis aims to explore the policies, regulations and procedures around foreign investments of property in Lombok. Furthermore, the thesis aims to analyze these policies, regulations and procedures and how they are likely to affect incitements for foreigners to make the investments.

The questions at issue are: *What are the policies and regulations in Lombok concerning foreigners that are purchasing property? What are the procedures for foreigners that are purchasing property in Lombok? According to institutional theory and the World Bank’s indicators that are affecting the possibilities to do business; what are the effects of the policies, regulations and procedures on the incitements for foreign investors to purchase property in Lombok?* The questions are answered by a descriptive and explanatory case study. Economic growth- and institutional theories are used to describe the policies, regulations and procedures, and their effects on the incitements to invest. Empirical material is collected from the Internet and from semi-structured interviews with lawyers, governmental officials, property agencies and foreign property investors.

The results from the analysis point at issues that affect the incitements for property investments negatively for foreign investors. The largest issue is the insecurity and risk of not being able to own property as a foreigner. The second largest concern is not being able to find satisfying information about the laws and procedures concerning the purchasing process, and that the procedures are complicated and many. Also, the results indicate that time and cost demanded for completing the different procedures are factors that can affect the incitements to invest negatively, and that the time aspect affects the incitements more than the cost.

Keywords: Lombok, Indonesia, economic growth, FDI, foreign direct investment, tourism, institution, property right

Contents

- 1 Introduction** _____ **1**
- 1.1 Background _____ 1
- 1.2 Purpose and questions at issue _____ 2
- 1.3 Thesis outline _____ 2
- 2 Theory** _____ **3**
- 2.1 Economic growth and the role of institutions _____ 3
- 2.2 Foreign direct investments (FDI) _____ 5
- 2.3 The tourism industry _____ 5
- 2.4 Institutions for foreign property investment _____ 7
- 3 Method** _____ **10**
- 3.1 Approach _____ 10
- 3.2 Empirics _____ 11
- 4 Formal institutions for foreign property investments** _____ **13**
- 4.1 Policies _____ 13
- 4.2 Regulations _____ 14
- 5 Informal institutions for foreign property investments** _____ **18**
- 5.1 Information gathering and prerequisites for the purchase _____ 18
- 5.2 Making the purchase _____ 21
- 5.3 Using agencies and lawyers _____ 23
- 5.4 Summaries of the procedures, time and costs _____ 24
- 6 Effects of the institutions on foreign property investment** _____ **28**
- 6.1 Formal institutions _____ 28
- 6.2 Informal institutions _____ 30
- 7 Conclusions** _____ **34**
- 7.1 Policy recommendations and reflections on the results _____ 34
- 7.2 Suggestions to further work _____ 35
- References** _____ **37**
- Appendix A: Interviews** _____ **40**
- A.1 Interview questions _____ 40
- A.2 Interviewees _____ 40
- Appendix B: The impacts of tourism** _____ **42**
- Appendix C: Property rights for foreigners** _____ **43**

1 Introduction

This chapter gives an overview of the thesis. First, background facts are given in Section 1.1. The purpose of the study and the questions at issue are presented in Section 1.2. Lastly, guidance for the reader is given in the outline of Section 1.3.

1.1 Background

Indonesia is currently a low-middle income country with a wide spread poverty (World Bank, 2010). Lombok is the island to the East of Bali and constitutes, together with the island of Sumbawa, West Nusa Tenggara, which is one of the poorest provinces of the country (Badan Pusat Statistik, 2010b). Tourism development is important for Indonesia and can potentially increase economic growth. Lombok has a big potential to expand its tourism industry; it is strategically well-positioned to the East of the neighboring, tourist exploited island Bali and efforts are being made on tourism-friendly infrastructure, e.g., construction of roads and an international airport (BLIS¹, 2007a; Lombok Invest, 2010a). The number of visitors increased with nearly 30 %² between 2005 and 2009, indicating that the growth potential within the tourism sector is being realized (Badan Pusat Statistik, 2010a:431).

Lack of capital might be a constraint that affects economic growth and in the case of growth potential in the tourism industry, negatively. However, the capital gap can be filled with foreign direct investments (FDI) (Todaro and Smith, 2002:103-107). Shortcomings of investments in Indonesia, both domestic and foreign, are confirmed by OECD³, which states that it is not sufficient to meet the country's requirements for infrastructure and productivity (OECD, 2010:19).

The potential of attracting FDI depends on many factors. Institutional economic theories mean that the quality of institutions, which will be discussed and defined further in Chapter 2, affects the inflow of FDI. One of the factors that institutional theorists find important is secure and well functioning property rights. This can also be considered as one of the most important institutional factors for investors wanting to purchase property. To start a business in the tourism sector, it is most likely that investments in property, land and buildings are needed, e.g., for hotels or restaurants.

In the World Bank's report, *Doing Business 2010*, 183 nations' business environment for domestic companies are investigated and compared. One of the ten indicators used in the report is focused on purchasing property and concerns the procedures, time and cost of transferring property rights. However, with the need of attracting FDI, it can therefore be of interest to make a more specific and deeper investigation of the business climate for foreign investors purchasing property. (World Bank, 2009:1f)

¹ BLIS: Bali and Lombok Global Business Information Services Indonesia

² Sumbawa is included in the statistics.

³ OECD: Organization for Economic Co-operation and Development

1.2 Purpose and questions at issue

Firstly, this study aims to explore the policies, regulations and procedures around foreign property investments in Lombok. Governmental policies and regulations that possibly affect foreign investors' will to purchase property are described. Furthermore, the method that is used in *Doing Business 2010* is applied on all the required, and possibly required, procedures of the purchasing process⁴ for a foreign property investor in Lombok.

Secondly, this study aims to analyze the policies, regulations and procedures, in order to see how, according to institutional theory; they are likely to affect foreign investors' will to purchase property. As mentioned in the previous section, this is important, since the FDI can promote development of the tourism sector and economic growth in Lombok. It is also possible to make recommendations about how the policies, regulations and procedures concerning foreign property investments can be improved in order to attract more FDI.

With these aims for the study in mind, the questions at issue are:

- *What are the policies and regulations concerning foreigners that are investing in property in Lombok?*
- *What are the procedures for foreigners that are investing in property in Lombok?*
- *According to institutional theory and the World Bank's indicators that are affecting the possibilities to do business; what are the effects of the policies, regulations and procedures on the incitements for foreigners to invest in property in Lombok?*

1.3 Thesis outline

The frameworks for theory and method are presented in Chapter 2 (theory) and 3 (method). Chapters 4, 5 and 6 contain the empirical material, and describe and analyze the policies, regulations and procedures concerning foreign property investments in Lombok. The conclusions are given in Chapter 7, composed by policy recommendations, reflections on the results and suggestions for further work.

⁴ A clarifying remark on the terminology: In the following, the *process* of purchasing property refers to everything concerning the investment, i.e., it includes the whole chain of *procedures* that need to be completed.

2 Theory

As a theoretical frame of reference, this chapter aims to present different theories and why they are relevant to the thesis. Some definitions that are important for the analysis are also brought up. Section 2.1 describes economic growth and the influence of institutions. Section 2.2 gives an overview of foreign direct investments, which is then connected to tourism in Section 2.3. Finalizing the chapter, Section 2.4 describes the institutions that are related to foreign property investment.

2.1 Economic growth and the role of institutions

There are many different theories around how and why economies develop and grow. The early economic development theories from the 1950s and 1960s saw economic development as a series of stages of economic growth, which the countries had to pass through to develop. An advocate for these theories is W. Rostow. He means that the countries, in order to develop, have to go through a stage of takeoff into a self-sustaining growth. According to this theory, the takeoff is induced with the right savings, investment and aid. The model, in which the relationship between economic growth, investment and savings is explained, is called the Harrod-Domar growth model. What the model says is that, in order to reach a self-sustaining growth, an economy needs to save and invest a certain proportion (around 15-20 %) of its GDP, and it is a linear relationship between investment and economic growth. Thus, the model explains why some countries do not reach the stage of takeoff with a lack of savings and capital constrains. In order to fill this “saving gap”, the theory promotes aid and private foreign investments. (Todaro and Smith, 2002:103-108)

The reality, however, does not seem to work in this simple way. Many later theories add factors, and present different points of view and explanations to why and how economies develop. In spite of this, even today it is recognized that sufficient savings and investments are necessities for economic growth to accelerate. (ibid.)

Around the 1990s, the role of institutions grew bigger in economic development theory. Douglass C. North is a spokesman for this school and he received the Nobel Prize in economics in 1993, together with Bert Fogel (Nationalencyclopedia, 2010a). North states:

“I wish to assert a much more fundamental role for institutions in societies; they are the underlying determinant of the long-run performance of economies.” (Aron, 2000:90)

This school emphasizes the importance of the effects that the economical, political and social institutions have on the development of a country’s economy. The theory does not present one overarching and clear definition or structure on the institutions and their effects on economic growth. Instead, it leaves that to each specific analysis and its specific circumstances. A definition of institutions is given by the renown professor S. Bowles; *“the laws, informal rules, and conventions that give a durable structure to the social interactions among the members of a population”* (Carlin, 2010:11). North’s definition is a bit more narrow, as he presents institutions as *“formal and informal rules of the economic game”* (Todaro and Smith, 2002:79). The formal institutions then include politics, constitutions and laws governing economies, and the informal include customs, traditions and taboos (Aron, 2000:103).

The role of institutions

Based on the reasoning above, the term institution thereby includes a wide range of indicators. Aron means that economists often need to include several types of indicators to understand the structures of the institutions, which all are likely to have an impact on economic growth in different ways. She presents five categories with indicators which are used to measure institutions with;

“Quality of formal institutions (typically drawn from surveys or risk ratings by investors); measures of social capital, which capture the intensity of social participation and organization; measures of social characteristics, including ethnic, cultural, historical, and religious categories; characteristics of political institutions, including constitutional rights and descriptions of the type of regime (dictatorship, democracy); and measures of political instability, including riots, strikes, civil war, duration of regime, and changes in the executive.” (Aron, 2000:106)

Economists often rely on several of these types of indicators to capture the features of institutions and each has an own potentially different channel of impact on economic growth. North’s explanation to why third world countries are poor is that of their institutional constrains, which harm the political and economic activities in the countries. According to North, “bad” institutions can affect political, economic, social organizations. (Aron, 2000:100-104)

North mentions the importance of a functioning judicial system for the possibilities of good economic performance. He also stresses the importance of trustworthy and efficient bureaucracies, and overly secure property rights of capital, profits and patents; in order to increase incentives to invest, innovate and obtain foreign technology. (Mauro, 1995:681)

Dollar, Hallward-Driemeier and Mengistae discuss what institutional-, policy- and regulatory environment are preferable for investments, and call it the “investment climate”. This is similar to “high-quality institutions” presented by Knack and Keffer (1995), where strong property rights and government efficiency are emphasized. They mean that an environment with good governance and a good business environment are more likely to attract investment and thereby gain higher returns and economic growth. (Dollar, Hallward-Driemeier and Mengistae, 2005:1f)

Poorer countries’ institutions often differ from more developed ones in the way that the latter generally have institutions providing better and clearer property rights, effective and available courts or other dispute resolution mechanisms, less corruption, and more transparent institutions; just to mention a few of the differences (Todaro and Smith, 2002:79).

Mauro examines the institutional effect on economic growth through social capital and property rights laws; including both direct effects (more efficient investments) and indirect effects (larger volume of investments). Mauro concludes that institutional inefficiency harms economic growth, mainly through a decrease of the investment rate. (1995:695)

Knack and Keffer (1995) and Knack (1996) also study the relationship between institutions and economic growth, by examining property rights and security of contract. They find that institutions effect investments in an indirect way, but not in a direct. Later literature gives more attention to and includes the performance and quality of the institutions rather than just their characteristics; such as respect for contract, property rights in practice, trust and civil freedom. The institutions then show a significant indirect relationship with economic growth, through the effects on the investment volume, and also a (although weak) direct relationship. (Aron, 2000:123, 126ff)

2.2 Foreign direct investments (FDI)

USAID's⁵ definition of FDI is "*capital expenditure by an entity resident in one country (direct investor) for an enterprise resident in another country (foreign direct investment enterprise)*" (2005:C-2). Todaro and Smith define FDI as "*overseas investments by private multinational corporations*" (2002:813). For this thesis, the definition of FDI combines and widens the two definitions above and will include all overseas investments by an entity or private person resident in any other country than where the investment is made.

As mentioned above when discussing the Harrod-Domar growth model, domestic saving and investment are important for growth, and aid and FDI can fill saving gaps in order to reach higher economic growth. Although most of the total FDI goes to industrial countries and the fastest growing low development countries, there is a fast growth of the FDI in all the developing countries. FDI is the largest foreign funding and makes up the majority of the resources that flow into developing countries. (Todaro and Smith, 2002:707f)

FDI influences economic growth in different positive ways. In the short run, FDI can cover liquidity constraints that developing countries are facing. The impact can be higher in the long run by improving human and physical capital, providing employment, transferring new technology and knowledge, and increasing competition and productivity; all of which are factors that lead to higher economic growth. (Vadlamannati and Tamazian, 2009:299f)

There are empirical studies, e.g., Li and Liu (2005), that show statistical support for FDI effecting economic growth positively, while other studies, such as UNCTAD⁶ (1999) and Carkovic and Levine (2005), cannot prove a statistical significance for the relationship (Busse and Groizard, 2008:861f). Thus, there is no consensus whether FDI is only positive for the host country. The debate around the impact that FDI has on development is divided into those who claim it is positive, and those who claim it is also negative (Todaro and Smith, 2002:710-714). This will not be discussed further within the scope of the thesis, or be included in the empirical analysis, since it is not the effects of FDI on economic growth that is in focus but the effects of institutions on foreign property investment. However, the standpoint will be that such investments are likely to help the economic development in Lombok, based on the lack of capital in the tourism sector discussed in the next section.

2.3 The tourism industry

The tourism industry is expanding fast and it is recognized by governments, international funding agencies and business communities as an effective sector to create economic growth. This is why many developing countries that are facing a decline in agriculture have increased the efforts of making tourism a source of growth. The tourism industry involves many economic and social sectors, which makes it a good choice to focus development on. (Gatsinzi and Donaldson, 2010:224f; United Nations, 2010:1)

Haley and Haley emphasize the positive effects that the tourism industry has on the economy. They state that it creates more demand for the other sectors of goods and services, as well as more employment, both direct and indirect (1997:596).

The United Nations presents a good overview of the possible positive, as well as the negative, effects that tourism might bring. Positive effects are, e.g., increased income, employment

⁵ USAID: United States Agency for International Development

⁶ UNCTAD: United Nations Conference on Trade and Development

possibilities and improved infrastructure. Negative effects are, e.g., overdependence on tourism, increased costs for land and adverse impact on cultural and natural heritage. See Appendix B for the complete set of effects presented by the United Nations. (2010:8)

Despite the possible negative effects it can have on the host country, the tourism industry has a high potential to boost the economy in many countries – given a sufficient amount of investment (Blanke and Chiesa, 2009:71). In the developing world, lack of capital is the largest challenge for developing the tourism industry and many countries increasingly look to FDI to fill the investment gap (United Nations, 2010:1). There is a visible change in FDI, which is shifting from being invested in natural resources, manufacturing and infrastructure; over to the service sector, involving banks, retail construction, insurance, telecommunication and tourism (Gatsinzi and Donaldson, 2010:226f). The FDI related to tourism is mostly concentrated in hotels, restaurants and car rentals, and there is less FDI in other areas, such as tour operators and airlines (United Nations, 2010:14). The expected positive contribution it has on the host economy make governments in developing countries encourage the inflows of FDI (Gatsinzi and Donaldson, 2010:225). However, attracting FDI is often difficult, and the competition to attract it is high (United Nations, 2010:1). Gatsinzi and Donaldson investigate the investment challenges in the hotel industry in Rwanda and argue that developing countries now are competing to attract FDI to their domestic hotel industries, and that they have changed their policies on foreign investments in order to do so (2010:227f).

Institutions and FDI in the tourism industry

As cited in the beginning of the chapter, the Harrod-Domar theory concludes that in order to promote economic growth, there is a need of sufficient investment. It also concludes that lack of domestic investment and aid can be filled by FDI. If this theory is combined with those of North (also cited in the beginning of the chapter), which emphasize the importance and the effects that institutions have on economic growth, it can be asked which the institutions are that promote and have positive effects on FDI and eventually, economic growth.

Vadlamannati and Tamazian explain increasing FDI with economic policy reforms, such as privatization, trade liberation, simplifications of FDI policies and industrial and public sector reforms. In general, except for some exceptions, where FDI is high due to other factors such as natural resources, countries receive more FDI due to policy reforms. (2009:301)

Carrier and Marsh mean that businesses, and especially foreign firms, are affected by the efficiency and integrity of the legal environment and the regulatory environment the foreign firms meet when seeking approvals and permits (1995:485).

Looking more specifically at the tourism industry, Blanke and Chiesa present 14 factors that are likely to affect the possibility to develop tourism in different ways; including infrastructure, domestic price levels and natural and cultural resources. Among the factors are policy rules and regulations, where Blanke and Chiesa include to what extent the country welcome and facilitate foreign ownership and FDI. They also include how well property rights are protected and the time and cost needed to set up a business. (2009:4ff)

Many different institutions are involved and important when considering FDI, but the theories stress the importance of property rights. The fact, that most of the FDI in tourism comes from investments in hotels and restaurants, indicates the importance of property rights for the investment rate (Badan Pusat Statistik, 2010a). North and other fundamental spokesmen of the institutional theory stress the importance of property rights protection for attracting the FDI needed for the necessary growth in the developing world (Vadlamannati and Tamazian, 2009:301). North also means that investments in

specific assets are likely to be higher, the more protected the property rights of the assets are (Claessens and Laeven, 2003:6).

Busse and Groizard are others that discuss the importance of institutions for FDI. They argue that the proper regulations and institutions are needed to be able to benefit from FDI. Taking excessive regulations as an example, i.e., in the sense that they are too costly, bureaucratic and supported by too complicated procedures; would make capital flows likely to be hindered for reallocation to the most productive sectors. Thus, they would be restricting potential economic growth. (2008:863)

In the further analysis, Indonesia's general policy around FDI will be discussed and also the matter of property right protection, which is further discussed below. However, the main focus will be on the process of purchasing property, which is also discussed in the following section.

2.4 Institutions for foreign property investment

An index for measuring property rights, developed by UNDP⁷, is the "International Property Right Index". The definitions of property and property rights used in the index are:

- *“Property:*
An object of legal rights, which embraces possessions or wealth collectively, frequently with strong connotations of individual ownership. In law the term refers to the complex of jural relationships between and among persons with respect to things. The things may be tangible, such as land or goods, or intangible, such as stocks and bonds, a patent, or a copyright.
- *Property Right:*
A legal right or interest in or against specific property. Based on these definitions of property and the right of property, the study's assumptions and results derived from the opinion survey, the IPRI incorporates three core categories essential to the strength and protection of a country's private property system:
 1. *Legal and Political Environment (LP)*
 2. *Physical Property Rights (PPR)*
 3. *Intellectual Property Rights (IPR)**(Horst, 2007:13)*

With the focus on FDI within the tourism industry, the thesis is limited to include Physical Property Rights (PPR).⁸ A country with strong PPR is seen as protective of private property rights, it ensures implementation of policies, procedures and laws of registering property, and creates opportunities to access credit and thereby opportunity to participate in economic activity. The index includes three variables for measuring the quality of PPR. The first variable is "Access to Loans", which measures the accessibility of bank loans. It aims to give a picture of the possibilities for an individual to buy property. The easier it is to get loans, which makes it possible to buy property, the stronger the support is for a formalized property right system. With the focus on FDI, lack of liquidity might not be the greatest obstacle and there are substantial possibilities of getting loans from other countries than those where the property is purchased. Therefore the variable "Access to Loans" is not included in this study.

⁷ UNDP: United Nations Development Programme

⁸ A clarifying remark on the terminology: In the following, "property" refers to land, since that is the focus in the study. If a building is included, this is seen as a technicality and will not change the analysis.

The second variable is “Protection of PPR”, which measures the strength of the country’s property right system. This is done through the view of judicial protection of private property quality experts and their opinions on the clarity of the legal definition of property rights. Since North and his like-minded stress the importance of property rights protection, this factor will be included in the analysis. Due to limitations of time, and ability to find adequate interviewees, the analysis will not be based on experts' opinions but rather on lawyers and property agents, who are working with foreign property purchases, and foreign investors' experiences and views. In this way it is possible to get insight of how a foreign investor experiences the protection of the property rights in Indonesia, and how that actually affects the incitement to invest.

The third and last variable is “Registering Property”, which includes the process of transfer the property right from the old to the new owner. It is measured by how many days and the number of procedures are demanded to make the transfer. (Horst, 2007:15f)

Efficient property registration is important to formalize property titles, and simple procedures to register property are also connected with greater security, benefiting all entrepreneurs. Less complicated and cheaper procedures to transfer property also increase the chance for property titles to stay formal. The procedure of register property can affect FDI in different ways. The institutional theory means that costly and bureaucratic procedures hinder capital flows, which must include national as well as foreign capital, to the most productive sector. (World Bank, 2009:19)

Quality of the property institutions

There are different ways of measuring the quality of property right institutions. The World Bank is publishing the annual report *Doing Business*, in which the business regulations in 183 countries are investigated, along with number of objective and good measurement tools for studying and comparing business regulations among countries. The focus is not on the characteristics of the institutions, but rather their functions and their actual effectiveness. In *Doing Business 2010*, 10 stages of a business’s life are presented, one of them handling the procedure of registering property. (Busse and Groizard, 2008:863; World Bank, 2009:1).

While the International Property Right Index is focused on the amount of procedures and time necessary to purchasing land to measure the variable “Registering Property”, *Doing Business 2010* also includes the cost, giving the three (procedures, time and cost) a weight of 1/3 each. When measuring the purchase of property, *Doing Business 2010* records all procedures needed for transferring the property title from the old to the new owner's name. The property is meant to be transferred in its entirety and the transaction is seen as ended when the buyer can use the property as collateral for loans. (World Bank, 2009:19)

In *Doing Business 2010*, “Procedures” are defined as the interaction of the buyer or the seller, their agents or other parties (government, agencies, inspectors, notaries, lawyers, etc.). All the procedures needed, legally or in practice, to transfer the property is recorded. In order to measure “Time”, the median duration needed to complete all the needed procedures is recorded. If procedures can be made at the same time, it is assumed that they are. Time spent on gathering information is not considered. The “Cost” is recorded as a percentage of the property value. The costs are only included if they are required by law and both the buyers’ and the sellers’ costs are included, if the costs differ from sources, the median value is used. (ibid.)

A concluding remark

With North's definition of institutions as "*formal and informal rules of the economic game*" in mind, the definition of institutions for the purpose and focus of the thesis can be expressed as "formal and informal ways of the economic game of purchasing property as a foreigner in Lombok". The "formal way", can be said to refer to governmental policies and regulations that affect the economic game. Other circumstances around the purchasing process that are not included in the policies and regulations then represent the "informal way", such as the procedures, time and the cost of completing the different steps of the purchasing process. In the thesis, these definitions will be used as the formal and informal institutions, respectively.

3 Method

The method used for the study is presented below. In addition, criticism of the limitations, and motivation of the choices made, with regards to the method are presented. In Section 3.1, the case study and the use of theory are described. Section 3.2 then describes the empirical material, which mainly is composed by interviews conducted in Lombok.

3.1 Approach

Although Indonesia is a large country and there are many regions where foreigners investment, this study is limited to Lombok. It is the closest island to Bali and therefore likely to be one of the most promising areas for developing tourism in. Thus, it is an interesting and relevant region to focus on.

The questions in focus of the thesis are answered by a descriptive and explanatory case study. By making a case study, it is possible to go deep into one specific issue, and it is suitable for getting a detailed description and thus a deeper understanding of the matter (Lundquist, 1993: 104f). It also makes it possible to take into account many possible variables; in this case things likely to affect the incitement for foreigners to invest. Another benefit with making a case study is that its results often have good validity⁹ (Teorell and Svensson, 2007:13). However, the results from a case study are not suitable for generalization, i.e., the results cannot be assumed to generate any general conclusions which can be applied to other cases (Esaiaasson *et. al.*, 2004: 119f). Since the aim of this study is to get a good description of the policies, regulations and procedures concerning foreigners who are purchasing property in Lombok, and what effects they have on the incitement for foreigners to invest; it is not important to be able to generalize the results and a case study is suitable for the purpose of the thesis.

The study uses economic growth- and institutional theories, to describe the policies, regulations and procedures, and their effects on the incitements for foreigners to invest. As presented in Chapter 2, there are more factors, i.e., other institutions, that affect these incitements, such as political stability, tax regulations, import- and export regulations, labor laws, etc. These factors are not considered in the study due to limitations of time and scope. The approach taken is that, since property is a prerequisite for restaurant- and hotel businesses, which are the main contributors to economic growth from the tourist sector, looking at institutions related to property is an important first step towards a complete analysis of all institutions that affect tourism-related FDI.

Institutions related to property investments that have been included in the analysis are both formal and informal, as described in Chapter 2. Taking more institutions into account broadens the perspective of the business climate of investing property as a foreigner. The formal institutions accounted for are governmental policies and regulations concerning a foreign property investor. The institutional theories stress the importance of secure property rights for promoting investments and a good business climate, which is why it is important and highly relevant to also include the formal institutions in the analysis.

⁹ Validity refers to the degree of which the study examined what was intended.

The informal institutions are “softer”, and relate foremost to the procedures for completing a property purchase for a foreign investor. The description of the different procedures of purchasing property is, as mentioned in Chapter 2, based on the method used in *Doing Business 2010*. The method was an adequate starting point. However, *Doing Business 2010* only includes the procedures for making the transfer of property from one domestic firm to another. With the aim to make a broad and detailed description of the entire process of purchasing property as a foreign investor, all different procedures, not only those concerning the transfer of the ownership, are included in the analysis and applied to both private and commercial foreign investors. These other procedures are included, since they are also likely to affect the incitements to invest. In addition, also other aspects, such as language and customs, are taken into account.

Due to lack of information, it will not be possible to compare the results with any other country. Only the specific procedures of transferring property will be compared for foreign purchasers and domestic companies, as presented in *Doing Business 2010*. However, one can assume that, if purchasing property as a foreigner is subject to many procedures, takes a long time and costs a lot, it is negative for the business climate also for foreign investors. Thus, it might affect the incitements to invest and purchase property negatively.

3.2 Empirics

The empiric material is collected from governmental-, international institutions- and property agencies homepages. The analysis of the institutions is objective but can be questioned because of the existence of bribes and the uncertainty of time and costs.

Material was also created by conducting interviews. By getting first hand information from different people involved in, or connected to, the process of purchasing property in Lombok, it is possible to fill information gaps and to include more subjective opinions, which is not available in the other material. Thus, the interviews provide an opportunity to deepen the analysis about the process and to cover more aspects of it. The interviewees were either people connected to the purchasing process or foreign investors; two lawyers, three property agencies, one state employee, and seven foreign investors. The information and opinions from the interviewees are more subjective and can therefore influence the reliability¹⁰ of the study negatively.

Interviews

In order to get a deep description and give the interviewee a possibility to come up with facts and reflections that maybe would have been left out otherwise, the interviews are semi-structured. Semi-structured interviews have flexibly outlined questions, which allows the interviewer to ask attendant questions, as well as the interviewee to come with own reflections. It also allows the interviewer to skip some questions or to change the order of them. (Teorell and Svensson, 2007:89)

The interview questions are wide and open and were conducted to get information about the whole process of purchasing property as a foreigner in Lombok, as well as to get opinions about how the different policies, regulations and procedures affect the foreign investors will to invest.

¹⁰ Reliability refers to the degree of which the measurements of the study are consistent, i.e., the measurements would give the same results if repeated.

May means that the results from interviews can be affected from the situation, the position of the interviewee and the approach from the interviewer (2001:174f). Efforts were therefore made in order to eliminate the risk of affecting the result from the interviews, i.e., making the interviewee comfortable in the role as interviewee and well informed about the topic of the study and the questions at issue. The interviews were recorded and transcribed to minimize the risk of misinterpreting the answers given by the interviewees. All interviewees were asked for the permission to use them as reference, and given the possibility to be anonymous. The interview questions are presented in Appendix A.1.

Interviewee sampling

The selection of respondents was mostly (although some were found over the Internet) based on snowball-sampling, in which respondents are identified through connections emerged at the field (Marsh and Stoker 2002:205). To be able to generalize the result from descriptive studies, it is important that the sample reflects the population that is intended to be described (Teorell and Svensson, 2007:68f). In this case, the sample is composed by the interviewees, and the population by people involved in the institutions concerning property investments for foreigners in Lombok. The interviewees are foreign investors and people working with property matters in Lombok. Foreign investors are relevant because they can give information and opinions that are built on their own experience, which is important to understand the purchasing process from the foreigner's perspective, e.g., how easy it is to gather relevant information. Concerns and issues that the foreign investors experience are crucial to identify for making policy recommendations. Local lawyers and officials have insight in the regulations and property laws and can provide information about the legal matters and technicalities required for purchasing property as a foreigner; including property rights, transaction documents etc. Finally, the agencies can provide the same information as the lawyers and officials, but from a more practical perspective, i.e., more hands-on information about costs and the time it normally takes to complete the different procedures. Short presentations of the interviewees can be found in Appendix A.2.

The choice of number of interviewees was based on filling information gaps, i.e., whether any new information and opinions were brought up for discussion. When the interviews stopped contributing new information or opinions, the need of interviewees was assumed to be filled. Because of the limitation of time for conducting the research, the representativeness of interviewees could not be considered in great extension. The possibilities to generalize the results are thereby limited, since the focus rather was to collect the information needed, to fill information gaps, and to get interesting and widely spread opinions and point of views. However, since the procedure to purchase property is the same for all investors in Lombok, regardless of e.g. the size of the investment, and since all the investors expressed similar opinions; one can assume that the result is quite general for all foreign investors in Lombok.

Another thing considered when sampling interviewees, was making sure the foreign investors could give information that is up to date. Therefore, all interviewed foreign investors purchased the property recently (later than 2005).

The USAID's definition of FDI only includes investments from entities. Two of the foreign investors had no intention of starting a business in Lombok. These interviewees were also included since, as mentioned above, it is more or less the same procedures and risks when purchasing property for private use as for business use. Also, one of them had invested in infrastructure, i.e., a road, which can be valuable for the tourism industry.

4 Formal institutions for foreign property investments

This chapter aims to describe the formal institutions of purchasing property as a foreigner in Lombok. The formal institutions are the same in the whole of Indonesia and refer to, as mentioned in Chapter 2, governmental policies, laws and other regulations; including property rights. Section 4.1 presents the governmental policies of foreign investment and 4.2 the property rights concerning foreigner ownership.

4.1 Policies

The Indonesian government recognizes the importance of foreign investments as means of economic growth through increased employment, development of resources, transfer of technology and technical skills, export growth and improved balance of payment. The present investment policy covers the whole of Indonesia and focuses on:

- Creating and increasing work opportunities.
- Increasing the effects of development and economic growth from investment projects that attain new business opportunities and provide work opportunities.
- Increasing tax income.
- Increasing income on foreign exchange by promoting investments in the production of exported goods.

(BLIS, 2007c)

According to the Indonesian government, an increase in tourism specific foreign investments can provide the opportunity of fulfilling these goals. It can create more work, business opportunities and tax income, and purchases from foreigners will increase the income on foreign exchange. Furthermore, the government states the importance of appropriate policies and legislation (legal framework) for promoting a stable and good business environment that encourages private economic activity by Indonesian citizens and foreigner investors. Policies and legislation have been created and adopted to promote and facilitate private investment in Indonesia, and are in line with standard international practices recognized by WTO¹¹. (ibid.)

Indonesia has also established many bilateral- and regional investment agreements (OECD, 2010:20). According to OECD, the main areas of policy reforms in Indonesia are:

- Macroeconomic and financial policies.
- Infrastructure development.
- Investment regulations, including customs, taxation, labor, small business development, transmigration and environment.

(OECD, 2010:27)

¹¹ WTO: World Trade Organization

To realize these principles and to promote and facilitate investments, the government works against transparent governmental procedures and administration (BLIS, 2007c).

The policies concerning investment regulations and investment climate are market orientated and include liberalizations of rules for foreign investors. The Indonesian government state that it is committed to eliminate the remaining restrictions for foreign and local private investment. This has been realized by, e.g., the national investment law from 2007, which replaced the previous domestic capital- and foreign investment laws and unified them under one law. (ibid.; OECD, 2010:19f, 21)

The principle in the Indonesian national investment law is;

“equal treatment of investors in similar circumstances irrespective of nationality; protection against expropriation, confiscation or requisition of investments and unilateral alteration or termination of contracts; freedom to repatriate foreign investment capital and net proceeds there on; and access to impartial, quick and effective mechanisms for the resolution of commercial and other investment disputes.” (BLIS, 2007c)

In addition, there is a “negative list” of sectors where private investment is prohibited. The list is short, which could be seen as to promote investment. The provision of the list increases transparency and makes it easier for investors to obtain information about possible investment sectors. (OECD, 2010:20)

Policies have been made to ensure availability of land. The government claim that it ensures land for industrial and commercial investors, and that it will simplify land licensing and environmental approval procedures. Since the government recognizes that security of assets is of great importance, it assures that any measures that would affect property rights adversely are avoided. (BLIS, 2007c)

In an investment policy review from OECD, it is stated that the Indonesian government strives to register, i.e., certify, as much of the land as possible (2010:19). Formerly, there was a policy that forbade land certificates of being issued in tourism areas to prevent speculations from brokers. However, this was against the land law and the policy is not longer valid. Thus, it is now possible to issue land certificates on all land. (BLIS, 2008)

BLIS has a list of eight potential sectors of investments in Lombok, in which the tourism sector is included. There are also listed suitable areas for tourism development. The interest of promoting the tourism sector in Lombok is also visible in Lombok’s transport development program. Development of main roads and tourist vessels are planned and a new international airport in Lombok is soon to be open for use. (2007a, 2008)

4.2 Regulations

In the Indonesian constitution is stated: *“The land, waters and natural wealth contained within them are controlled by the State and shall be utilized to increase the prosperity of the People.”* (Oktavarossy, 2010) The basic agrarian law act (Law number 5 of 1960), called the UUPA, regulates all land in Indonesia and is influenced by the statement above. What it says is that Indonesian land can only be owned by Indonesians or organizations, with the promotion from the government. (BLIS, 2007b)

However, such rights are not absolute as the UUPA recognizes the “social functions” of land and allows a right of “peaceful occupation” by titleholders (Oktavarossy, 2010).

Nominees, PMAs and Indonesian property rights

The constitution says that foreigners cannot by themselves own or lease property in Indonesia by law but there are different ways to go around this in a legal way. The first and most common way is to use an Indonesian nominee, i.e., an Indonesian citizen that is registered as owner on the land, but with an additional contract, in which is stated that the foreigner has the right to use the property. The second alternative is to start a foreign investment company, called PMA (*“Penanaman Modal Asing”*). When the PMA has been approved by the government, the company is seen as an Indonesian “legal entity”, with the same rights as domestic companies. One more semi-alternative is worth mentioning, and it is the obtaining the right to use property by holding certain types of stay permits, either a KITAS visa or Social Bundaya visa. However, the right to use property will not be taken into account in the further analysis, for reasons that will be discussed in the coming. (BLIS, 2007d; Oktavarossy, 2010; Suarni, 2010)

There are two different types of land rights. The first category is called “customary land” and includes all land that is not registered at the local land office. This type of land is generally owned by individuals or communities through heritage and it is based on traditions and family ownership. All customary land is intended to eventually be converted into the second category; “certificated land”. Land registered at the local land office falls into this category. Land bought by foreigners must be certificated land. If the land is customary, the buyer and owner will need to go through the process of converting it into certificated land before the purchase takes place, which will be brought up in the next chapter. (BLIS, 2007d)

The following five types of rights for certificated land are of relevance:

1. Right of Ownership, or HM (*“Hak Milik”*):
An absolute ownership of land, which can only be hold by an Indonesian citizen or by certain governmental legal entities such as state banks, agricultural cooperatives and social foundations; and not corporate entities (domestic or foreign). It can be sold, transferred to a third party and mortgaged.
2. Right to Build, or HGB (*“Hak Guna Bangunan”*):
The right to build and own buildings on land for a time period of 20 or 30 years with the possibility of an extension of 20 years. It can be hold by Indonesian citizens and legal entities, but not foreign private persons. It can be sold, transferred to a third party and mortgaged.
3. Right to Use, or HP (*“Hak Pakai”*):
The right to use land that is owned by someone else for any purpose for a time period of 25 years, with the possibility of an extension of 20 years. It can be hold by Indonesian citizens or legal entities, as well as foreigner private persons holding a stay permit. The right may not be sold, transferred to a third party and it has no collateral value.
4. Right to Rent, or HS (*“Hak Sewa”*):
This is a “lighter version of the Right to Build. It is the right to use buildings, or part of buildings (typically offices or residential premises), on land that is owned by someone else for a limited time period. The duration of the lease and the possibility of transferring the right, both depend on the agreement between the two parties. It can be hold by Indonesian citizens or legal entities, and foreign private persons domiciled in Indonesia.
5. Right of Land Cultivation, or HGU (*“Hak Guna Usaha”*):
The right to exploit state-owned land for cultivation for a period of up to 35 years with the possibility of an extension of 25 years. The right can be hold by Indonesian citizens and legal

entities, but not foreign private persons. It can be sold, transferred to a third party (with the approval of the government) and used as collateral.

(*ibid.*; Oktavarossy, 2010; Suarni, 2010)

The extension of a right has to be applied for, one year before expiry, in the National Land Office and is subject to an obligatory fee (BLIS, 2007b). Some important notes should be made:

- It is not possible for a foreigner to hold a HM as a private person.
- Neither domestic nor foreign companies can hold a HM. It is HGB, HP and HGU that concern properties for commercial use.
- Holding a HGB means, in practice, the same as owning the land on which the building is standing. Thus, in the sense of property investment, it is the same as owning the land. (This is also true the opposite way; holding a HM includes the ownership of any buildings on the land.)

(*ibid.*)

Within the scope of the thesis, to look at the regulations and procedures for foreign investors of purchasing property related to tourism, the most important property rights are HM, HGB and HP, where the holder of the right can be seen as the actual owner of the property (i.e., not leasing or property connected to agriculture).

Property rights concerning foreign investors

Before describing the general procedures for investing in land in Lombok, the nested property rights will be broken down in order to simplify matters a little. The only way to hold a certificate of HM is to use an Indonesian citizen as nominee, while a citizen or a PMA could be used as a nominee to get a HGB and HP certificates. So, firstly, HM involves foreign private persons obtaining property for private use, or PMAs for commercial use, through a nominee. However, most common in practice is that only private foreign investors use a nominee and that will be the standpoint in the following analysis. Instead, PMAs use HGB, which involves PMAs raising or buying buildings for commercial use on land own by others. This right can also be obtained by a foreign private person through a nominee, but just as for the first case with PMAs using nominees, this is not very common and will be left out in the following. Lastly, HP can be used as means of creating a nominee agreement and is not an owning right per se. Therefore, the focus here will be on the nominee procedure in general for private investors, and PMAs using HGB. (BLIS, 2007d; Oktavarossy, 2010; Suarni, 2010)

The two main ways of investing as a foreigner in Indonesia is illustrated in Figure 4:1 in the end of this section (and for a more detailed picture, see Appendix C).

The nominee is nominated to buy the land on behalf of the purchaser, and the land title will be in the name of the nominee. However, a contract between the nominee and foreign investor will be closed, and gives the investor total and exclusive authority to utilize, sell, transfer and lease the property without any reference from the nominee. The contract also includes that the money used to purchase the property belongs to the foreign investor. Often, the nominee will receive a nominal fee for his responsibilities as the title holder. This contract between the foreign investor and the nominee can be arranged with a "Simple Nominee Agreement" or a HP. The two alternatives can differ by, e.g., the way tax is paid or how the underlying asset (the property) is valued. This depends on the design of the contracts. As mentioned in the previous paragraph, HP will not be closely analyzed when looking at the different procedures, much because it is still uncommon, but mainly because it can be seen as a technicality of how the nominee agreement is formed. It means little for the purpose of the agreement, since it is the HM that is the underlying property right.

The nominee arrangement is legal but it is in a way working against the governmental policy and law, saying foreigners do not have the right to hold land titles. If the nominee should pass away, the contract is passed on to the family of the nominee. (BLIS, 2007b; Nunung, 2010; Oktavarossy, 2010; Bali Property Sales, 2010; Lombok Broker, 2007)

With a governmentally approved PMA it is possible to hold a HGB in the company name, as long as the company operate and utilize the land. A PMA has a requirement of a minimum of two shareholders initially. However, it is required that the company starts to be divested through selling some of its shares to Indonesian citizens or entities after 15 years of operation at latest. The most common PMA is a joint venture between a foreigner and an Indonesian partner, but it can also be established as a straight foreign investment with a total foreign ownership. In both cases, there is no requirement of a minimum amount being invested and the PMA gets a time period of 30 years to operate as its legal formation. (ibid.)

Right to Own (HM)	Right to Build (HGB)
<ul style="list-style-type: none"> • Only available for Indonesian citizens • Combine with nominee arrangement – Single Nominee Agreement or <i>Right to Use</i> (HP) seals the contract • Buildings on the land are included in the property 	<ul style="list-style-type: none"> • Only available to Indonesian citizens and legal entities • Most commonly used by PMAs in practice and not foreign private persons • "Ownership" of the land that the right concerns

Figure 4:1. The two main ways of obtaining property in Indonesia as a foreign investor is a) through a nominee, who holds a Right of Ownership (yellow), i.e., Hak Milik (HM), for the property in question, and b) buying a Right to Build (red), i.e. HGB, through a PMA. There are two types of nominee arrangements, Single Nominee Agreement and Hak Pakai (HP), but since this is considered only a legal technicality, it is disregarded in the scope of the thesis. (Reproduced from Bali Property Sales, 2010; available in Appendix C.)

5 Informal institutions for foreign property investments

This chapter aims to describe the informal institutions of purchasing property as a foreigner in Lombok. This concerns the different procedures of purchasing property as a foreigner, both of using a nominee and using a PMA.

Additionally, the case when the property is customary, and needs to be certified at the local land office¹² before the actual transfer to the foreign investor, is described, along with a more traditional and informal transfer. Also, the purchasers' option of using either a property agency and/or a lawyer is presented. The descriptions focus on the different procedures and the time and cost for them, as well as the experiences from foreign investors who have been interviewed; experiences that are likely to effect the incitements to invest.

Section 5.1 describes the procedures that can be seen as prerequisites to the actual purchase, such as information gathering or finding a property, Section 5.2 the actual purchase, Section 5.3 the procedures for use of agencies or lawyers. Finally, a summary of the different procedures, and the time and cost for completing them, is given in table form in Section 5.4.

When conducting the research, it was hard to find proper information, especially about how long time the steps of the procedures take and how much they cost. There were often many different answers to the same question. Thus, the times and costs that are presented are based on averages of what the sources gave as answers. There are most often no fix prices; e.g., the notaries (officials who write contracts, approve PMA registrations, sign property transfers, etc.) all charge different prices and they are set by the notaries themselves. The time and cost is also vague due to severe corruption. The agencies and lawyers all mention the corruption and see that as a natural part of the procedures of dealing with governmental agencies such as the land offices or notaries. At times, these do not even start a procedure until they get an extra payment. The presented costs do not include bribes, although it is important to have in mind that if more money is paid "under the table", it is more likely that the procedure is completed faster, which affects the time (and effort).

5.1 Information gathering and prerequisites for the purchase

Before starting the process of purchasing property, it is necessary to have information about the property laws and the procedures around the investment. Most of the interviewed foreign investors expressed lack of information around the first approach as a problem, and that they spent time to talk to different lawyers, agencies and other foreigners who has purchased property in Lombok, in order to obtain the information. In other words, if counting the time foreigners spend on purchasing property, it is relevant to take into account the extra time before starting the process of actually purchasing the property. The interviewees expressed that just to gather the information needed to get started is difficult, since there are no obvious guidelines available. (Eskilsson, 2010; Johansson, 2010; Lester, 2010; Robinson, 2010)

¹² The governmental agency which deals with land and property registration.

Looking for a property and settling an agreement with the owner

The purchaser needs to spend some time looking at property for sale, which is not different from domestic purchasers. Naturally, the time spent depends much on the purchaser. It is possible to go via real estate agents and brokers, but also to talk around in the area of interest to get to know if property is for sale, and in that case which property it is. To take into account the time it takes to look around for properties before deciding on one is left out in the analysis, since it is the same for any investment. When decided on a property however, the purchaser needs to agree on a price with the owner. This procedure can be seen as quite informal and includes meeting with the land owner, often with involving eating dinner or drinking coffee. During these informal meetings, the purchase of the property is not being mentioned until after a while. In the case of bargain, the seller often needs to talk to family and friends and there will be more meetings arranged for further negotiations. The whole procedure can be time consuming and it varies depending on the seller and selling family. As an example, Eskilsson did not even begin to bargain, since he had heard about the lengthy negotiations. He realized he lacked the time in Lombok to stay for such a bargain procedure. (Lester, 2010; Eskilsson, 2010; Johansson, 2010)

Finding a nominee

In the case of purchasing property through a nominee, the foreign investor needs to find a person who agrees to take the role of nominee. If the purchase is done through a property agency, which will be discussed in the end of the chapter, the agents often have nominees to offer the purchaser in return of a fee; often around 1 % of the purchase. It is also common that the foreign investor organizes a nominee on his/her own. Also then, it is common that the nominee receives a payment, normally 1 % of the value of the property when it is purchased and 1-10 % of the value of the property when it is sold. The payment can also take the form of a lump sum, the details is negotiated between the nominee and the investor. (Nunung, 2010; Eskilsson, 2010; Robinson, 2010)

Although the contract between the nominee and the foreign investor is binding, there is a risk for the investor. The nominee owns the land by law, and can legally violate the investor's ownership in different ways, if not a correct formulated parallel agreement between the nominee and the investor is written at time of signing the contract. Also, when the property right has run out, the nominee is only liable for the flat price of the property (if not changed by an additional agreement), which would mean the investor would lose the increase in value. The risk can be eliminated by making proper agreements between the nominee and the investor, and nominee payments are likely to help too. However, the difficulty is rather to form the agreement in a way that secures the contract. (Oktavarossy, 2010)

This is also confirmed by interviewees holding property in the name of Indonesian nominees. Robinson, who decided to give lump sums of US \$100 when purchasing and US \$100 when selling to his nominee, said it is important to have a good relationship with the nominee in order to eliminate the risk of the nominee breaking the contract. (2010)

There are a number of contracts that need to be signed to arrange a property purchase with a nominee. The nominee needs to sign a purchase contract, which transfers the right of the property from the previous owner to the nominee. It is also necessary to sign contracts and additional agreements, if any, between the foreign investor and the nominee. The number of contracts depends on the arrangement. It is normally around 5 but it can be as many as up to 30 contracts. The 4 most important contracts are:

1. Loan agreement:
Declaration that the foreigner has lent the purchase price of the land to the nominee.
2. Statement letter:
The nominee acknowledges the loan and also the foreigner's intention to own the land.
3. Right to use agreement¹³:
The nominee allows the foreigner to use the land.
4. Power of attorney:
The nominee gives the foreigner the right to sell, transfer, lease, mortgage, etc. the land and to represent the nominee in any dispute regarding the property.
(Bali Property, 2010; BLIS, 2007b; Murray, 2010)

For further protection for the foreign purchaser, it is good to place a mortgage upon the land. The certificate will be written in the name of the nominee but the authentic certificate is held by the mortgagee. It shows that it was the foreigner who paid for the land, and the land can only be transferred by the nominee to a third party when the mortgage has been paid. (Suarni, 2010)

The nominee will also be asked to hand over the original land titles, i.e., the land certificate, to the foreign investor. The contract should be signed before a local land deed official, in most cases a notary. The fee is around 50'000 IDR (Indonesian Rupees) per page signed and around 750'000–1'000'000 IDR in total and it takes roughly 1 day. (Bali Property, 2010; Murray, 2010; Nunung, 2010; Interview 2)

Setting up a PMA

As mentioned in Chapter 4, in the case of purchasing land through a PMA, the foreign investor will not have the right to own property. Instead, either the right to build or the right to use the land is used for the purchase. Since the aim of the thesis is to examine the matters around purchasing property, an in-depth description on how to start a PMA will not be presented. To give a brief overview of what is involved in starting a PMA, it is required to:

- Submit a detailed business plan and get it approved by the government.
- Operate a business that will add value to Indonesia in form of foreign skills, employment and environmental benefits.
- Make an appropriate cash deposit in an Indonesian based Bank.
- Show the property investment as an asset of the company.

Setting up a PMA takes approximately 3-4 months to complete and the cost is around 30'000'000–50'000'000 IDR, or US \$4'500. (Bali Property, 2010; Interview 2)

A disadvantage with using a PMA is that the property needs to be used for the approved business and that (as any other company in Indonesia) it is not possible to hold the "right to own" title. So whenever freehold land, i.e., certificated land with a HM, is transferred to a PMA, the land certificate will be changed to HGB (discussed further in Section 5.2), which has to be renewed after 20-30 years. According to Lombok Invest, property agency, the procedure of starting a PMA is complicated and can be "*a mine field*" to investors who are not used to deal with Indonesian bureaucracy. (2010b)

¹³ This can be a HP, but also a Single Nominee Agreement, depending on the arrangement.

5.2 Making the purchase

When the initial requirements are fulfilled, i.e., the foreign investor is allowed to invest in property and has found property to invest in; then the part of the process that involves the actual purchase can be initiated.

Land certification

The majority of the land in Indonesia is non-certificated, so called customary land. The most land in areas of interest for foreign investors has some kind of land title, but if this is not the case, then the procedure of purchasing the land will be more complicated, since the land first has to be certificated. In order to do so, the local land office needs to be contacted. First, the land needs to be measured, which costs 1'000'000 IDR/hectare¹⁴ with a total minimum of 1'000'000 IDR. The time it takes for the measurement varies but it can be done in 1 day (Eskilsson, 2010; Murray, 2010). When buying customary land, it often involves insecurity, since it might be unclear who actually owns the property and what the exact land area actually looks like. This is settled during the measurement. The owner of the property and the owners of surrounding properties discuss the borders of the property and come to an agreement. Thereafter, the measurement and ownership needs to be confirmed by the Head of the District ("*Kepala Desa*"). The Head of the District requires a fee for giving his/her confirmation. The sum depends on the price of the property, the attractiveness and the expectations of future interest. Some interviewees also mentioned that it can be profitable in the negotiations with the Head of the District to know the local customs and language of the area where the land is being purchased. It can also be better to let the seller and the Indonesian nominee (if that way of purchasing property is being used) to negotiate with the Head of the District, since it is more likely the charge will be higher if it is obvious that the purchaser is a foreigner. An approximate figure was given by Murray, property agent, who said that a Head of the District can charge around 100'000 IDR/are. (Murray, 2010; Interview 2; Interview 3; Oktavarossy, 2010; Suarni, 2010)

After the measurement and getting the confirmation from the Head of the District, the local land office can start making a land certificate. The price depends on the size of the land. The official fee is around 850'000 IDR. However, due to corruption, this price is often exceeded. Murray said that she, as an agent, always paid around 15'000'000 IDN. The time varies but is normally around 3-6 months. Although paying more than "normal price", it often takes longer than the land office promises. (Murray, 2010; Interview 2; Suarni, 2010)

According to Oktavarossy, lawyer at the business agent Bali Mode, the procedure could take as little as 2 weeks and that it normally is faster for agencies with good connections to the local land office ordering the certification (2010). When asking Interview 2 (who gave the answer of 3-6 months), how it was possible that the same procedure only takes 2 weeks according to another property agency, the interviewee meant it must be a result of good connections with the local land office, which could make the procedures faster, but also that it is likely due to bribes (2010). Eskilsson and Lester, two foreign private investors, both feel it is more of a risk if the land is not already certificated and they also consider the extra time and cost as a big minus for customary land compared to certificated (2010; 2010).

Suarni mentioned that if the property does not have a certificate, it is possible to do the transfer from the seller to the nominee (if that way of purchasing is used) as customary land, which is the traditional way of making the transfer of ownership. This procedure is called "*Ganti Rugi*". The Head

¹⁴ 1 hectare = 100 are = 10'000 m²

of the District then has to confirm the transfer and the customs are the same as for the land certificate confirmation described previously. (2010)

Johansson, who did a Ganti Rugi, had to pay the Head of the District 1'200'000 IDR and the time it took to receive the transfer was around 1 week. However, the time and cost depends on how fast and well the negotiations proceed from the investor's point of view, and it is likely to vary. (Johansson, 2010)

The benefit of making the Ganti Rugi transfer to the nominee before certifying the land is that the seller- and buyer tax of 5 % each, as well as additional notary fees of 1 % are avoided. Also, the time of the purchase will be shortened since it is not necessary to go through the procedures for transferring the property from old to new owner. (Suarni, 2010)

Transferring the property to the new owner

The transfer from the old to the new owner, no matter if it is through a nominee or a PMA, is compulsory and must be done by a local land deed official, called PPAT (*"Pejabat Pembuat Akta Tanah"*). The PPATs are privately managed offices, often notaries, authorized by the National Land Agency to handle land transfers and easily found in towns all over Indonesia. However, Oktavarossy advice a potential foreign investor to select a good and experienced PPAT, since many of them, although looking and acting professionally, lack the knowledge and skills to properly advice foreigners who wish to purchase property. (Oktavarossy, 2010)

The Bali and Lombok Global Business Information Services recommends that all the documents are in Bahasa Indonesia¹⁵, although it is not so by law, to prevent future possible arguments caused by the involved people not fully understanding the documents (2007d). Transferring the property from the seller to buyer can be comprised into 4 procedures:

1. The land certificate needs to be examined at the land office, which cost 100'000-300'000 IDR and takes around 3-7 days, depending on how busy the office is.
2. If the property certificate needs to be changed, e.g., from a HM to a HGB, or vice versa, it has to be done before transferring the property and is done at the land office. The cost is roughly 12'500'000 IDR and it takes around 1 month to complete.
3. A seller- and a buyer tax of 5 % of the assessed value of the property needs to be paid at the bank.
4. The transfer of the property needs to be done by a PPAT, who then registers the land at the local land office and tax office on the name of the purchaser. The PPAT charges around 1-1.5 % of the property value, with a minimum of 1'000'000 IDR.

(Murray, 2010; Nunung, 2010; Suarni, 2010)

According to Murray, the transfer should take around 2 months, but she said it always takes longer time, normally around 3 months. This is confirmed from the lawyer Suarni, who said it takes around 2-3 months. However, Nunung, who has worked as a property agent in Lombok for a long time, said the time for the transfer varies a lot and that it depends on how busy the PPATs and the land offices are. In some places, it can take around 2 weeks, while in areas where there are a lot of transfers, it can take much longer. As an example, she mentioned that in the area where the airport is currently being built and where many transfers are being made, it takes around 1 year. Furthermore, who of the buyer and seller that is going to pay these fees, has to be agreed on beforehand. (Murray, 2010; Nunung, 2010; Suarni, 2010)

¹⁵ The official national language of Indonesia.

5.3 Using agencies and lawyers

It is possible for the foreign investor to go through the whole process of purchasing property single-handedly but more common is to go through a property agent. The agent offers help of finding property, finding a nominee, making the land certificate and transferring the property. It makes it possible for the purchaser to leave all the different procedures for the agency to deal with, which means that the investor only needs to meet with the property agency and possibly the seller, to agree on the price (if it is not already done by the agents) and sign the documents needed to complete the purchase. This decreases the number of procedures that the foreign investor needs to complete single-handedly, which most likely makes the investor experience the purchasing process as less complicated and bureaucratic. (Oktavarossy, 2010; Interview 2, 2010; Murray, 2010)

The time to complete the purchase can be assumed to be about the same, as the agency also has to go through the different procedures of the process. However, it is possible that it is shorter, due to fact that the agencies usually have connections at the land offices and the PPATs. Experience of the process (e.g., when to pay a little extra and to whom) will also make it smoother and probably faster. Overall, it can be assumed that the time for the purchasing process will be shorter if using an agency than not using one. The downside is that the purchase will be more expensive. The prices of the agencies differ. Two examples from interviewed agencies, assuming the HM-nominee contract for purchasing customary property, are 1) charging 5 % from the property value from the seller and purchaser, plus 1 % of the value of all the legal costs (i.e., documents at the PPAT) for the purchaser and 2) charging 2.5 % from both the purchaser and seller. (Oktavarossy, 2010; Interview 2, 2010)

When purchasing property as a foreigner, it is also common to hire a lawyer to get help with the legal matters. The lawyer offers legal advice about everything concerning the purchasing process. This also includes investigating if the land is legally secure and properly documented, so that the land is not under a dispute, subject to multiple ownerships, etc. (Suarni, 2010)

Using a lawyer can be seen as an extra procedure when purchasing property. It will not add extra time, since it is done parallel with the other procedures. However, the use of a lawyer makes the purchase more expensive. For example, one of the interviewed lawyers charged 15'000'000 IDR per property and another interviewee mentioned a charge of 25'000'000 IDR. Most agencies use lawyers, either employees of the agency or contracted externally. This is included in the price charged by the agency if nothing else has been agreed on. It is also possible for a purchaser who uses an agency to hire a third part lawyer of own choice. (Murray, 2010; Suarni, 2010; Oktavarossy, 2010)

It is clearly more expensive to purchase property through an agency and/or use a lawyer, than to go about the whole procedure single-handed. On the other hand, it makes it much easier to purchase property for a foreigner without experience of previous investments in Indonesia, and it can make the purchaser feel safer throughout the process. This is confirmed in the interviews with the foreign investors, and it is a possible explanation to why the majority of foreign investors use an agency and/or lawyer when they purchase property.

5.4 Summaries of the procedures, time and costs

As discussed, there are different ways of purchasing property in Indonesia as a foreigner; to go through a nominee or to start a PMA, if the aim is to start a business in Indonesia. The investor can choose to go through the whole procedure on his/her own, or to use an agency and/or a lawyer. The number of procedures, the time and cost spent on purchasing a property also depend on the property; if it already has a certificate or not.

First, a table with the procedures for domestic companies purchasing property, taken from *Doing Business 2010*, is presented. The remaining tables, concerning foreign investors, follow the same disposition as the previous sections in the chapter. Note that time and cost stated in the tables are approximations based on the empirical results. They can all vary quite a lot depending on parameters such as extra payments to selected people involved in the process, or the amount of work a PPAT or a land office has at the time for a registration application. Also note that by "Vary" means that the time or cost of the certain procedure cannot be specified in a meaningful way.

Domestic property registration

As point of reference, the results from *Doing Business 2010*, concerning the requirements for domestic companies to purchase property, is first represented in Table 5:1. There is recorded the whole sequence for a buying domestic company to purchase property from a selling domestic company. The property (land or building) is transferred in its entirety and is considered being completed when the buyer can use the property as collateral for bank loans. The buyer and seller are companies without any foreign ownership, located in Jakarta and conducting general commercial activities. The property is certificated, free of disputes and consists of land and a two-story building (a warehouse), also located in Jakarta. The land area is 557.4 m² and the warehouse a total area of 929 m², and the total value is approximately US \$200'000. (World Bank, 2009:19)

Table 5:1. Transferring a property right between domestic (Indonesian) companies. (Reproduced from World Bank, 2009:63)

Procedure	Time	Cost
1) Land certificate examination at a land office	1 day	25'000 IDR
2) Seller pays transfer tax at a bank	1 day (simultaneous with procedure 3)	5 % of property price
3) Buyer pays tax on acquisition on land and building at a bank	1 day (simultaneous with procedure 2)	5 % of property price minus 60'000'000 IDR, which is tax-free
4) Execution of sale and purchase of the land by a PPAT	3 days	1 % of the property value
5) Registration of the land at a local land office under the name of the buyer	15 days	25'000 IDR (registration fee), plus stamp duty of 6'000 IDR per document (2 required)
6) Registration at the National Land Office under the name of the buyer	1 day	No cost

Information gathering and prerequisites for the purchase

Table 5:2 shows a summary of the procedures involved in arrangements with a nominee. The procedure of finding a nominee, i.e., procedure 1) in the Table 5:2, can be done simultaneously with gathering information about the purchasing procedures, and finding and settling the price for a property. However, foreign investors who want to find a nominee without going through an agency can find it to be time consuming. Since the purchaser might want to spend time with the nominee, in order to get to know and build a relationship of trust; it can increase the time for the purchasing process substantially. When a nominee has been found, the other two procedures, i.e., procedure 2) and 3) in Table 5:2, can be done at the same time as the remaining steps of the total process of purchasing property and will therefore not increase the total time for property investment.

Table 5:2. Finding and settling an agreement with a nominee.

Procedure	Time	Cost
1) Finding nominee	Vary (no time if using agency nominee)	No cost
2) Making contract with the nominee in front of a PPAT	1 day	750'000-1'000'000 IDR
3) Fee paid to nominee, negotiated between the foreigner and the nominee	1 day	1 % of purchase, plus 1-10 % when selling (or a lump sum)

Table 5:3 shows the accumulated time and cost for setting up a PMA, given the application is approved and the business suggestion is granted a governmental recognition. Since the PMA registration takes several months, it might be a good idea to go about other procedures at the same time, e.g., looking at property, securing land certification, etc. If the investor first want to start a PMA, i.e., before starting the process of purchasing property, the time will add on to the total time spent purchasing a property.

Table 5:3. Setting up a PMA.

Procedure	Time	Cost
1) The procedure of setting up a PMA	3-4 months	30'000'000-50'000'000 IDR

Making the purchase

The procedures presented in Table 5:4 concern investments in customary land, i.e., they only need to be considered if the property is not certificated. In that case, it will then be done before transferring the property from old to new owner. If the property does not have a certificate, e.g., starting a PMA could be done at the same time as getting the certification done, which would mean that if both accumulated procedures take 3 months; there will not be any extra time needed for the certification. If, on the other hand, the PMA takes 3 months to complete and the certificate 6 months, then the total process of purchasing the property takes 3 months longer than it would for a certificated property.

Table 5:4. Getting a land certificate on customary property.

Procedure	Time	Cost
1) Measurement of the property	1 day	1'000'000 IDR/hectare, minimum 1'000'000 IDR
2) Getting confirmation from the Head of District	Simultaneous with procedure 1	100'000 IDR/are
3) Making the certificate at a land office	3-6 months	850'000 IDR

As mentioned in Chapter 5, a foreign investor who uses a nominee to purchase customary land, has the alternative of using a traditional transfer of the land to the nominee before paying for the land certification, called a *Ganti Rugi*. As mentioned above, this would reduce the time and cost of transferring the property from the old to the new owner. This demands that finding, and settling an agreement with, a nominee first has been done and the *Ganti Rugi* needs to be completed before a land certification can be made. Thus, transferring the property to the nominee is then only the procedure of Table 5:5, which is, as we will see in Table 5:6, less costly than first making a certificate of the land and thereafter transfer the ownership, since some procedures of transferring the ownership, including paying tax, are skipped.

Table 5:5. “Ganti Rugi”, traditional transfer of customary property.

Procedure	Time	Cost
1) Getting allowance from the Head of the District and making the transfer	3-7 days	1'200'000 IDR

If comparing the number of procedures for transferring property for domestic companies (Table 5:1) and foreign investors (Table 5:6), they are rather similar. Procedures 2 and 3 in Table 5:1 are bundled into procedure 2 in Table 5:6. Similarly, procedures 4, 5 and 6 in Table 5:1 are bundled into procedure 3 in Table 5:6, since all of them are done, or ordered, at a PPAT and usually on the same occasion. However, the time it takes for completing the procedures differs between the two tables. *Doing Business 2010* presents an average time of 22 days for a domestic company. The table gives another picture of the time and cost of making the purchase. According to the table, the shortest time would be around 18 days but the longest more than 1 year.

The extreme case of 1 year refers to areas and situations where a lot of transfers are currently being made, which might put an abnormal pressure on the PPATs. Another aspect that should be taken into account is the capacity and the experience of the PPATs. *Doing Business 2010* focuses on areas around Jakarta, and it is likely that PPATs in Lombok have less capacity and experience. Furthermore, the corruption can make the procedures take longer time if no extra payments are done on the side of the fees mentioned in Table 5:1 and 5:5. If payments are done, the time for the procedures might be significantly shortened.

The cost for the transfer is on average 10.7 % of the property value for domestic firms. It is harder to give the average percentage paid for foreign investors a specific value. Counting both the seller- and the buyer tax, as done in *Doing Business 2010*, the cost would be around 11-11.5 %, plus the lump-sum of 100'000-300'000 IDR. The possibility of negotiations between the seller and buyer about who will pay these fees will also have to be considered, as will the money that might have to be paid to corrupt officials.

Table 5:6. Transferring the property from old to new owner

Procedure	Time	Cost
1) Land certificate examination at a land office	3-7 days	100'000-300'000 IDR
2) Paying seller- and buyer tax at the bank	1 day	2 times 5 % of property value
3) Transferring the property from old to new owner at a PPAT	2 weeks-1 year ("normally" 3 months)	1-1.5 % of property value, minimum 1'000'000 IDR

If the property right certificate needs to be changed into another type, e.g., from HM to HGB when purchasing property through a PMA, then the conversion needs to be done before the transfer from the old to the new owner. Table 5:7 shows the time and cost for this procedure.

Table 5:7. Converting a property right into another type of certificate.

Procedure	Time	Cost
1) Converting the land certificate to another (e.g., from HM to HGB)	1 month	12'500'000 IDR

Using an agency and/or a lawyer for purchasing property

When using an agency the prices and time for the other procedures are the same, although the procedures are arranged and taken care of by the agency. It is possible it takes a bit shorter time due to the agencies' connections with the officials and knowledge about the customs, i.e., accuracy in the extra payments. This has already been discussed in the previous section. The extra costs charged by the agency are summarized in Table 5:8.

Table 5:8. Hiring a property agency.

Procedure	Time	Cost
1) Hiring an agency	Vary	5-10 % of the property value, 1 % of legal costs

The use of a lawyer was also discussed in the previous section, and the additional cost is shown in Table 5:9. One thing is worth mentioning about the use of a lawyer for the legal matters concerning property purchases; the total cost will depend on 1) the lawyer and the negotiations between the lawyer and investor and 2) the number of legal matters which the lawyer is going to assist the investor in. Note that, as far as the research has revealed, the price of a lawyer does not depend on the price of the property.

Table 5:9. Hiring a lawyer for legal advice about property investment.

Procedure	Time	Cost
1) Hiring a lawyer for legal advice	Vary	15'000'000-25'000'000 IDR per property transfer

6 Effects of the institutions on foreign property investment

It is hard to say exactly what the effect of the policies, regulations and procedures (formal as well as informal) on the incitement for foreigners to invest in property in Lombok. However, the information from the government, the property agencies and the interviews with foreigners, who are or have been involved in the investment process, revealed various aspects that could affect foreigners will to purchase and invest in property in Lombok.

This chapter aims to deepen the analysis about the information gathered about the formal and informal institutions and their impact on the incitements of investing in property as a foreigner. Section 6.1 feeds back to governmental policies and regulations, including the property rights and certification of land. In Section 6.2 are brought up the different procedures, and the including procedures and the time and cost connected to them, as well as some other aspects that are considered informal, such as language barriers.

6.1 Formal institutions

Policies

As mentioned in Chapter 5, Indonesia's policies and legislation, which are in line with WTO's, are intended to promote and facilitate private investments. The Indonesian government claims to have liberalized the rules for foreign investors by shortening the negative list of restricted investments, by introducing equal treatment for foreign and domestic investments, and by allowing free repatriation of foreign investment capital. As cited in Chapter 2, Vadlamannati and Tamazian (2009) state that certain economic policy reforms, i.e., trade liberalization, simplification of FDI policies and industrial and public sector reforms are likely to increase FDI, which should be applicable on the case with the Indonesian policy liberalizations mentioned above. In addition, Blanke and Chiesa (2009) mention the importance of infrastructure to develop the tourism sector. Thus, another factor that could increase both Indonesian citizens' and foreigners' will to invest in the tourism sector in Lombok is development of infrastructure; both the new international airport on Lombok and new roads on the islands. This can be seen as a governmental policy in order to promote the tourism sector

Property rights

As cited in Chapter 2, the institutional theory stresses the importance of secure and protected property rights to attract FDI. The Indonesian constitution states that land only can be owned by Indonesian citizens and organizations, which have the government's allowance. The right to own land is limited to a "peaceful occupation" of the property, which might sound a bit insecure from an investment perspective. However, it will probably not affect the incitements for foreign investors, since the government recognizes the importance of security of assets and assures to avoid any measures that would affect the practicality of property rights adversely. What is more, since the government claims to be aware of the importance of private investments for obtaining economic

growth, it would be unlikely that it takes any extreme measures that would affect the incitements of investing, i.e., violating the property rights. Another factor that actually is improving the property right protection is the decision by the government to diminish the prohibition of making certificate on property in tourist areas. One can assume that would increase the incitements for both Indonesian investors and foreign, to purchase property for use within the tourism sector.

On the other hand, the “governmental protection” is questioned by some: As Sandström, owning a surf school in Lombok, said; *“It feels very corrupt and instable in Indonesia. It feels like the state can throw you out if they want to.”* (Sandström, 2010)

One concern for foreign investors is the legal security of the property rights, i.e., the security of ownership of property. A main negative factor for foreign investors, which makes the property rights insecure and less legally protected, is the fact that land cannot be owned by foreigners per se. Although there are ways for foreigners to hold property, as discussed in the previous chapter, the risk is higher than it would be if foreigners could own the land themselves. The most interviewed foreign investors mentioned that the inability to hold property in their own names was a big negative factor. Eskilsson pointed out that it would be much easier if it was possible to own property in his own name and that he thinks that it is a big trade barrier for attracting foreign investors (2010).

When asking Johansson, who currently was purchasing property in Lombok, what he thought the effect on the incitements of purchasing property for foreigners were of the inability to hold property in their own names, he answered;

“I am sure that it must scare away many investors. My friend, who was thinking of purchasing property, did not go through with it due to the fact that he could not hold the property in his own name. I, personally, would not purchase property if I had not come in contact with my nominee, who I became a good friend with and who I trust a lot.” (Johansson, 2010)

The risk of having problems with the foreign “ownership” is minimized through legally binding contracts between the nominee and the foreign investor, as mentioned in Chapter 4. Still, the contracts are at times broken by the nominee. Robinson, who has purchased property in Lombok, said that he had heard about investors who lost their property because the nominee had sold it when the investors left the country for a while. Such incidents were also described by Oktavarossy, who also meant that the risk increases with the property value. He also mentioned that the risk can be minimized by paying the nominee a sufficient fee. (Robinson, 2010; Oktavarossy, 2010)

With a PMA (with HGB certificate), the risk of a broken nominee contract is eliminated. However, the property then needs to be used for the business purpose acknowledged by the government. Furthermore, the feeling of insecurity is expressed also by foreign investors who have used the PMA arrangement. When asking a restaurant owner in Lombok what would need to be improved about purchasing and holding property as a foreigner, he answered; *“More protection of the property rights!”*. (Interview 1, 2010)

Land certification

Although, as stated in Chapter 4, the government strives to register all land, a lot of land is still not certificated. According to the experience of lawyers and investors, this makes the ownership and the exact measures of the properties less secure. This is likely to decrease the incitements to invest; as cited in Chapter 2, North (1990), Dollar, Hallward-Driemeier and Mengistae (2005), etc., state that unsecure property rights have a negative effect on investment.

In Chapter 5 was the importance of controlling the ownership of the seller of the property described, so that the property not is indebted or overlapping with other properties. Murray, property agent in Kuta Lombok, said that multiple ownerships and overlapping land are common in the area. She meant that the previous Head Officer at the local land office often had issued several certificates, to different owners, for the same land, in exchange for bribes. However, the Head Officer was now replaced and the land office was now working with eliminating the problems with multiple ownership, and overlapping land plots. (Murray, 2010)

The existence of the risk that it is not the correct owner selling the property was confirmed by Johansson, who was in process of purchasing two different properties that both had ownerships under discussion. The procedures of getting certificates for the properties had been put on hold until the ownerships were settled. If it should turn out to be the incorrect owners, it was likely he would not be able to purchase the properties without starting the whole process over with the correct owners – if they were interested in selling. (Johansson, 2010)

6.2 Informal institutions

Information gathering

Most of the interviewed foreign investors expressed the lack of knowledge around the process of purchasing property and land laws as troubling, and many said they would like better information being available. They also experienced that the information differs and that it at times is contradicting, which they found confusing. As Johansson expressed it, when asked for his opinion about the matter;

“You have to find the information yourself and check the correctness of it ten times, since there are so many different versions. I have talked to four different agencies, and with many foreigners who already bought property, and it is still not absolutely clear to me.” (Johansson, 2010)

Robinson said that he would like a handbook, covering the laws and the different steps and alternatives of the purchasing process (2010).

Oktavarossy, lawyer at a property agency, considered obtaining and holding property in Indonesia as secure, as long as the foreign purchaser gets the proper advice and information. According to him, the whole system and process of purchasing property for foreigners are relatively easy for the foreigners to go about single-handedly. However, he also pointed out that, although not the process in itself, the lack of information makes it hard for foreigners to go through with a purchase without help. (Oktavarossy, 2010)

The Bali and Lombok Global Business Information Services confirms this on their homepage, where it says that most foreigners have problems with the process of purchasing property due to lack of information about the Indonesian land laws (2007b). It is also confirmed by Thüering, a foreign investor who was conned by his nominee. The nominee falsified the contracts so that Thüering’s ownership was questioned and the dispute was in court for four years.¹⁶ After winning the case, Thüering started a PMA and is now holding the property in the name of his hotel in Lombok. He said that there is definitely a need for easier access to-, and better publications of information on how to invest and purchase property as a foreigner and that it would decrease the chance of being

¹⁶ Note that this also exemplifies the risk of a nominee arrangement.

conned. Thüering says that his bad experience could have been avoided if he had better information about the risks involved in the nominee arrangement, since he then would have made sure the legal bindings made the investment secure. (2010)

Murray said that she too was conned when purchasing property in Lombok and that it actually was one of the reasons to her and her partner setting up the property agency, to provide service and advice to foreigner investors. She points out that good information would improve the investment conditions for foreigners. (2010)

The lack and ambiguity of the information, expressed by the interviewed foreigners, can be a sign that the procedures are complicated and bureaucratic. On the other hand, the lack of information can also make the procedures feel more complicated than it needs to be. As mentioned in Chapter 2, the institutional theory says that too bureaucratic and complicated procedures have a negative effect on FDI. A simplification of the procedures of purchasing property is therefore likely to attract FDI and promote development in the tourism sector.

Another effect of the lack of information is that the likelihood of foreign investors using property agencies and lawyers increases. With experienced advisors, the procedures appear less complicated for the investor and it decreases the risks involved in purchasing the property, which could have a positive effect on the incitements for investing. However, the cost increases, which, according to *Doing Business 2010*, affects the incitement to invest negatively (World Bank, 2009:19).

Prerequisites for the purchase – nominee and PMA arrangements

The additional procedures of finding and closing an agreement with a nominee, and the time and costs connected to these procedures, were not mentioned explicitly in any of the interviews. However, according to the theories and the method used from *Doing Business 2010*, it affects the business climate, and in this case, the incitement to invest, negatively. More in focus was the insecurity of letting a nominee stand as the legal owner of the property in the contract. Moreover, the interviewees emphasized the importance of finding a trustworthy nominee rather than making the legal arrangements as secure as possible.

Compared to a nominee arrangement, holding land with a PMA is perfectly secure but the complete process is more complicated, takes longer time and costs more (both because of the cost of setting up the PMA and also additional cost of converting the land certificate from a HM to HGB if that is necessary). Also, as mentioned in the previous section, the property needs to be used for the registered business. As an illustrative example of the strenuous procedures for starting a PMA can be mentioned an interviewed foreign entrepreneur who is managing a restaurant on Lombok. The interviewee actually chose not to start a PMA but to arrange an unofficial ownership through a nominee for not only the property, but also the business (i.e., the official owner of the restaurant is the nominee). The interviewee thought starting a PMA was too complicated and too expensive, and although the risk of not owning the property (or, in this special case, the business) had been a large factor of insecurity, it had been worth not going through the PMA procedures. (Interview 1; Oktavarossy, 2010)

Making the purchase

The actual transfer of the property from to the new owner was not explicitly mentioned as a problem in the interviews with the foreign investors. As mentioned in Chapter 5, the time for the transfer could vary a lot. The interviewed foreign investors did not express a concern about the fact that it

could take a long time, but rather about the fact of not knowing how long time it could take. The cost involved in the procedure was not either a concern for any of the investors, and when discussing the likelihood of needing to pay bribes, many of the interviewees saw that as a part of the purchase process. (Sandström, 2010; Lester, 2010; Johansson, 2010)

Purchasing customary property involves more procedures, time and higher cost, all of which are factors likely to decrease investment according to the method used in *Doing Business 2010* (World Bank, 2009:19). The additional time was confirmed by Johansson, but he also expressed it as positive to be able to use a Ganti Rugi to make the transaction of the ownership to his nominee, since he then paid less tax than for a normal transaction. He concluded that if the extra time is not too long, then certification of the land could be beneficial, which is, however, only the case if the Ganti Rugi is used, and not if the land is first certificated in the old user's name and then transferred to the new. (Johansson, 2010)

Using an agency and/or a lawyer for purchasing property

In the interviews, many foreign investors expressed their concern about the risk of being conned or of losing the property later on, after the purchase. Several interviewees had heard stories of bad examples or had negative experience of their own. As Sandström said; *"Everyone tries to trick you!"* (2010). The interviewees had all used, or were using, an agency or a lawyer to get help with the purchasing process, in order to eliminate the risks of things that could violate their property ownership. As Robinson, who had gone through the process of purchasing property, said:

"The first concern is being ripped off for your land; do I really own it and can I really keep it? I realize that I am gambling, willing to take risks. However, I used a lawyer to get help with the purchase of my property, in order to improve my odds of winning and making the whole process being done correctly." (Robinson, 2010)

Based on the statements above, it is clear that the risk and the poor protection of the property rights, especially when the land is not certificated, are likely to decrease the incitements for foreigners to purchase property in Lombok. This risk is also likely to increase the cost of the whole procedure of purchasing property, since it is more likely that the foreign investors are using property agencies and/or lawyers, in order to minimize it. As Oktavarossy mentioned, the agencies' experience could make it preferable for a foreign investor to go through an agency to decrease the risk of purchasing an incorrectly certificated land, i.e., land with the wrong measurements or owner. Eskilsson thought it felt more secure with an agent, since it is in their interest to solve the possible problems so that they get their commission, and because an agency's good reputation is important to protect. (Oktavarossy, 2010; Eskilsson, 2010)

Language and customs

As mentioned by Oktavarossy, another factor that can make foreigners use lawyers and agencies are the language and custom/culture barriers (2010). Lester, who was currently purchasing property in Lombok, said: *"Language and customs are important to know when buying property. It makes it easier to gain respect from the Indonesians and it is easier to negotiate."* (Lester, 2010)

Suarni, a lawyer in Lombok, said it is easier to negotiate with the Head of the District and to get a cheaper price for getting a confirmation of ownership when making a certificate on a property or making a traditional transfer of property (Ganti Rugi) if you know the language and the customs (2010). One of the agency representatives that Eskilsson talked to was from Australia. He thought

that was a benefit, since he felt more secure with the agency having a more "Western" way of doing business than the agencies managed by Indonesians. The Australian property agent spoke good English, had better information and felt more professional and experienced than the other agencies he had talked to. (Eskilsson, 2010)

The customs of doing business in Indonesia can feel unfamiliar for a foreigner. It is likely that it will increase the use of agencies and lawyers, especially those managed by westerners. They have the benefit of knowing the more "Western way" of doing business, compared to the Indonesian agencies. Sandström did not see the time and the cost of purchasing the property as particularly problematic, he thought that the cultural differences were the biggest obstacle; both when negotiating with the property sellers and also with officials.

Sandström stressed the importance to not only know the formal and legal procedures but to know the informal rules and systems as well. As he so fittingly summarized it:

"Nothing is easy, nothing is secure and you have to negotiate about everything." (Sandström, 2010)

7 Conclusions

This chapter finalizes the study. Based on the results, policy recommendations for the Indonesian government, aiming at increasing the incitements for foreigners to invest, are given in Section 7.1, along with reflections of the results from the analysis. Section 7.2 gives suggestions to further research.

7.1 Policy recommendations and reflections on the results

The aim of this study is to describe the policies, regulations and procedures concerning the process of purchasing property in Lombok and how that can affect the incitements for foreigners to invest.

The Indonesian government recognizes the importance of FDI for promoting economic growth and clearly strives to create policies that promote and facilitate foreign investments, which are likely to affect the incitement to invest positively. Investment policies are intended as a means of liberalization for foreign investors, e.g., equal treatment of investors, irrespective of nationality, or freedom to repatriate foreign investment capital. These policies are the same for the whole of Indonesia and not only Lombok. Furthermore, the development of infrastructure in Lombok can promote the will of invest in the tourism industry, especially the new international airport.

Insecurity

It is a shared opinion among the interviewed investors that the regulation of ownership of property makes investments insecure and complicated, and that it is the main issue of purchasing property as a foreigner. There are two primary alternatives for a foreigner to obtain property, which are the two alternatives considered in the study: Going through an Indonesian nominee, or setting up a PMA company. Getting a nominee makes the effort of the investment both costlier and more time consuming. Apart from this, it is a factor of insecurity, since the nominee will own the property and it calls for well-formed contracts with the nominee, in order to secure the property right. Setting up a PMA is the safest option for a foreign investor. However, it makes the investment process substantially longer, costlier and more complex, and besides – the property must then be used for the purposed business.

The foreign investors' concern about risk and insecurity of not being able to hold the property in the own name, opens up for the argument of changing the property right laws so that it is possible to own land as a foreigner. This would promote foreign investments in property, and thereby also promote the development of the tourism sector. It would also make the whole process of purchasing property less complicated and shorter, i.e., it would involve less procedures, which would most likely further increase the incitements to invest.

The Indonesian government strives to register and turn customary land into certificated land. However, the result from the study show concerns about the non-certificated customary land. The risk of starting a process of purchasing property with erroneous certification, or with the wrong owner, increases the insecurity of such investments. It also involves more procedures, which costs

money and time. This implies that the government needs to continue to promote the certification of land.

Ambiguous information and complicated procedures

In comparison with transferring property for domestic companies, the results show that it is more complicated for foreigners. The main reason for this is that foreigners are not allowed to hold property. They are restricted to use one of the two alternatives discussed above, i.e., the process involves more procedures, longer time and higher cost. Moreover, the procedures are potentially more difficult, since foreigners have to overcome issues with language and culture, e.g., bargaining. This is expressed by the interviewees as a larger problem than the actual time and cost for the process, much because it adds to the factor of insecurity.

Regarding the time compared to the cost (for completing the different procedures), the cost is not explicitly mentioned in the interviews as a large problem but rather as an economical detail of the investment that has to be considered. Time on the other hand is a factor that the interviewed investors find disturbing, especially the difficulty of knowing how long time the different procedures take, or might take.

A factor that contributes largely to the insecurity and risk expressed by the interviewees, is the lack and ambiguity of information. Many of the foreign investors claim to have worked intensely with researching the purchasing process, but they think that the information was hard to find and that it often varies. The lack and ambiguity of information make the different procedures involve in the process feel more complicated than they are. It could be a suitable starting point for the Indonesian government to provide a basic, clear explanation of the laws and the procedures, which could also be provided on governmental homepages, and to lawyers and agencies working with property matters. The publication of good and easily obtainable information could also promote foreign investments, since it can 1) make the procedures of purchasing property as a foreign investor seem less complicated (complicated procedures are seen as affecting foreign investments negatively) and 2) make the foreign investor more aware of the whole process of purchasing property, which is likely to increase the security (so the investor makes the purchase properly and avoids getting conned).

7.2 Suggestions to further work

The study gives ideas of further work and presents several issues to study and investigate further:

- From the results, conclusions were drawn that the incitement to invest would probably increase if it was possible to hold property in the foreign investors own name. To make it possible for foreign investors to hold land in their own name would most likely increase the incitement to invest. However, it probably have both negative and positive effects on economic-, as well as social- and other aspects in the society. Therefore, it should be necessary to conduct a large investigation on how such a change would affect the whole society, and weight the positive-, and negative effects before make such a vital change in the law.
- A similar study on Bali would provide the opportunity to compare the results with an exploited tourism area. The laws and procedures should be the same but the actual purchase process might differ. That would make it possible to compare the process and to see in which areas and procedures Lombok is in need for a change in order to attract more foreign investors purchasing property to Lombok. The functioning of the procedures in Bali could then be used as benchmarks

on how the same procedures in Lombok could be changed, if the procedures in Bali are found to function better.

- Corruption could play a larger role than investigated in this study and could be of interest to include more in a similar analysis.
- It would be interesting to investigate how FDI and a growing tourism sector affects, and could affect, different economic aspects, such as economic growth, amount of work opportunities, poverty reduction, etc. Such a study could also preferably include policy recommendations so that FDI and economic growth, coming from the tourism sector, will give the most desirable effects on Lombok's welfare as possible.
- The method of *Doing Business 2010* is based on domestic companies and focuses on ten indicators that affect the business climate, e.g., starting a business, paying taxes and trading across borders. In this study, one of the indicators, "Registering Property" was extended to include the whole process of purchasing property, for foreign private persons or companies. An idea is to extend the method for all ten indicators in the same manner and to include all of them in the analysis. By doing so, further research could be made in order to study the business climate, with focus on foreign investors, and to compare the results from such research between other Indonesian regions or other countries, as in *Doing Business 2010*. Such a report could not only be useful for investors to retrieve information concerning investment prospects abroad, but also for policymakers who can see where changes and improvements need to be done for attracting FDI.

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Interviews

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Interview 1. *Anonymous*. (2010-12-02)

Interview 2. *Anonymous*. (2010-12-02)

Interview 3. *Anonymous*. (2010-12-07)

Johansson, Jakob. (2010-11-29)

Lester, Mark. (2010-11-25)

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Nunung. (2010-11-22)

Robinson, Bruce. (2010-11-27)

Sandström, Olle. (2010-12-15)

Suarni, Ni Luh. (2010-11-22)

Thüering, Jan. (2010-12-03)

See Appendix A.2 for more details.

Appendix A: Interviews

A.1 Interview questions

Below follow the semi-structured interview questions. (Note that, when interviewing lawyers, and people from property agencies and from the governmental land office, the questions were modified: Instead of “you”, the interviewee was asked about “foreigner”, e.g., question 1 was phrased as: “Can you describe all the procedures *a foreigner* has to go through when purchasing property in Lombok?”)

1.

Can you describe all the procedures you had to go through when purchasing property in Lombok?

Considering each procedure:

- How long time did each procedure take?
- How much did each procedure cost?
- How did each procedure affect your will to invest?

2.

What was your biggest concern when purchasing property in Lombok?

3.

What do you think can be changed and simplified concerning the process of purchasing property in Lombok?

4.

Do you have any further inputs that you think could be interesting or that you find important concerning the procedure of purchasing property as a foreigner in Lombok?

A.2 Interviewees

Eskilsson, John

Foreign investor. Purchased property for private use in Lombok.

Interview 1

Foreign investor. Owns and manages a restaurant in Lombok. Purchased property for setting up the business.

Interview 2

Employee at a property agency in Lombok. Works with assisting foreign investors that are purchasing property for either private or business use.

Interview 3

State employee at the governmental land office in Praia, Lombok. Works with land certification.

Johansson, Jakob

Foreign investor. Is in the process of purchasing property in Lombok, with the aim of starting a hotel and a tourist agency. Johansson also has a shared business with an Indonesian citizen, in which he has filled an investment gap by purchasing a boat.

Lester, Mark

Foreign investor. Is in the process of purchasing property in Lombok, and also starting a hotel and restaurant business in partnership with an Indonesian citizen.

Murray, Belinda

Owner of a property agency in Lombok. The agency assists foreign investors that are purchasing property for either private or business use.

Oktavarossy, Tri

Lawyer at a property agency in Bali. Works with assisting foreign investors that are purchasing property for either private or business use both in Lombok and in Bali.

Nunung

Owner of a property agency in Lombok. Works with assisting foreign investors purchasing property for private or business use.

Robinson, Bruce

Foreign investor. Purchased property for private use. Also invested in infrastructure, or more specifically; in the improvement of a road.

Sandström, Olle

Foreign investor. Owns and manages a surf school, a hotel and a restaurant in Lombok. Purchased property for setting up the business.

Suarni, Ni Luh

Lawyer in Lombok. Specializes in assisting foreign investors setting up businesses, purchasing property, and other technicalities that concerns foreign investors.

Thüering, Jan

Foreign investor. Owns a hotel in Lombok and who purchased property for setting up the business.

Appendix B: The impacts of tourism

Table B:1. Possible positive and negative impacts of tourism on the host country. (Reproduced from United Nations, 2010:8)

Positive	Negative
Increased income/improved standard of living	Overdependence on tourism
Employment opportunities	Increased costs for land, housing, food and services
Improved infrastructure and tourism facilities	Pollution and traffic; congestion
Increased tax revenues	Tourism market is dominated by transnational corporations
Strengthened awareness and more resources for natural and cultural heritage	Adverse impacts on cultural and natural heritage
Provision of capital	Sensitivity to business cycles or sudden changes in sentiment
Transfer of expertise and managerial skills	Little control over tourism development
Market connections	Inappropriate form and scale of development
Demonstration effect for local entrepreneurs	Invasion of open spaces

Appendix C: Property rights for foreigners



Figure C:2. The two main ways of obtaining property in Indonesia as a foreign investor is a) through a nominee, who holds a Right of Ownership (yellow), i.e., Hak Milik (HM), for the property in question, and b) buying a Right to Build (red), i.e. HGB, through a foreign investment company (PMA). There are two types of nominee arrangements, Single Nominee Agreement and Hak Pakai (HP), but since this is considered only a legal technicality, it is disregarded in the scope of the thesis. The differences are mainly concerned with the arrangements of tax payments, interest rates and value correction. Adding other contracts to a Single Nominee Arrangement will give similar conditions and it can therefore be seen as merely a matter of how the arrangement is designed. Leasing (blue) is also not considered, as it can be seen as not belonging to the context of property investment. (Source: Bali Property Sales, 2010)