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Opportunities in Indonesia's Special Economic Zones

SPOTLIGHT
on
High Profile SEZs
to Help You Choose the Best Location for Your Business

Introduction

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Buoyed by the success of its free trade zones, Indonesia's government made the development of special economic zones (SEZ) a priority policy in 2014. As of 2022, there are 19 SEZs, of which 12 are in operation and the remaining in the construction phase. Through the SEZs, Indonesia aims to attract over US$50 billion in foreign investment in the next decade.

The SEZs are designed in this way to maximize the ready availability of local resources and serve specialized primary industries. Further, through these SEZs, the government hopes to drive economic growth away from the island of Java, which currently contributes to 60 percent of Indonesia's GDP and 60 percent of the total population.

For foreign investors, entering Indonesia's special economic zones and taking full advantage of what they offer requires a long-term outlook. Having this long-term outlook will allow the foreign entity to benefit from Indonesia's unique advantages – competitive labor costs, huge domestic market, and continuing expansion of SEZ land – a constraint many businesses are experiencing in other ASEAN markets.

In this issue of the *ASEAN Briefing* magazine, we provide an overview of Indonesia's special economic zones and explore the tax incentives available. Finally we discuss choosing the ideal location in Indonesia's SEZs by highlighting select zones.

With offices located in the ASEAN region and years of experience helping foreign enterprises set up operations, Dezan Shira & Associates is well positioned to assist your company in entering ASEAN markets. For more information, please email us at asia@dezshira.com.

With kind regards,

Alberto Vettoretti

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An Introduction to Special Economic Zones in Indonesia

Indonesia's government has made the development of the country's special economic zones a priority policy with the aim of attracting over US$50 billion in foreign investment over the next decade, particularly for SEZ-oriented manufacturing.

Ayman Falak Medina
Author

As of 2022, there are 19 SEZs of which 12 are in operation and the remainder in the construction phase. Eight are designated for tourism with the rest for manufacturing and processing. The concept of SEZs in Indonesia was only announced in 2014 when President Joko Widodo came to power. Buoyed by the success of the country's free trade zones, SEZs were developed to further increase foreign investments into the country. As such, the first SEZs in Indonesia have only been in operation since 2015, with the majority only beginning operations in 2019.

In establishing the SEZs, the government has sought to diversify away from the island of Java and are spread across the country. As of 2021, Indonesia's SEZs have attracted just over US$5 billion in investments, and employed over 28,000 workers.

The SEZs serve as a hub for selected activities from logistics, to export processing activities, to tourism. They are designed in this way to maximize the ready availability of local resources and cater to upstream and downstream industries. For instance, the Arun Lhokseumawe SEZ, located in Aceh province, has its primary activities surrounding petrochemicals, oil and gas, and paper production. The province is known for its vast resources of oil and gas. The Mandalika SEZ, located on the scenic island of Lombok, is being pushed as an SEZ that supports eco-tourism and the agro-industry.

Further, the Kendal SEZ has its primary activities in manufacturing, particularly garment and textiles, automotive furniture, electronics, and food and beverages. The SEZ is found in Central Java province, one of Indonesia's main manufacturing hubs.

Within an SEZ, the following business activities can be undertaken:

1. Production and processing;
2. Logistics and distribution;
3. Research, digital economy, and technology development;

4. Tourism;
5. Energy development;
6. Education;
7. Healthcare;
8. Sports;
9. Financial services;
10. Creative industries;
11. SEZ development and management; and
12. Procurement of SEZ infrastructure.

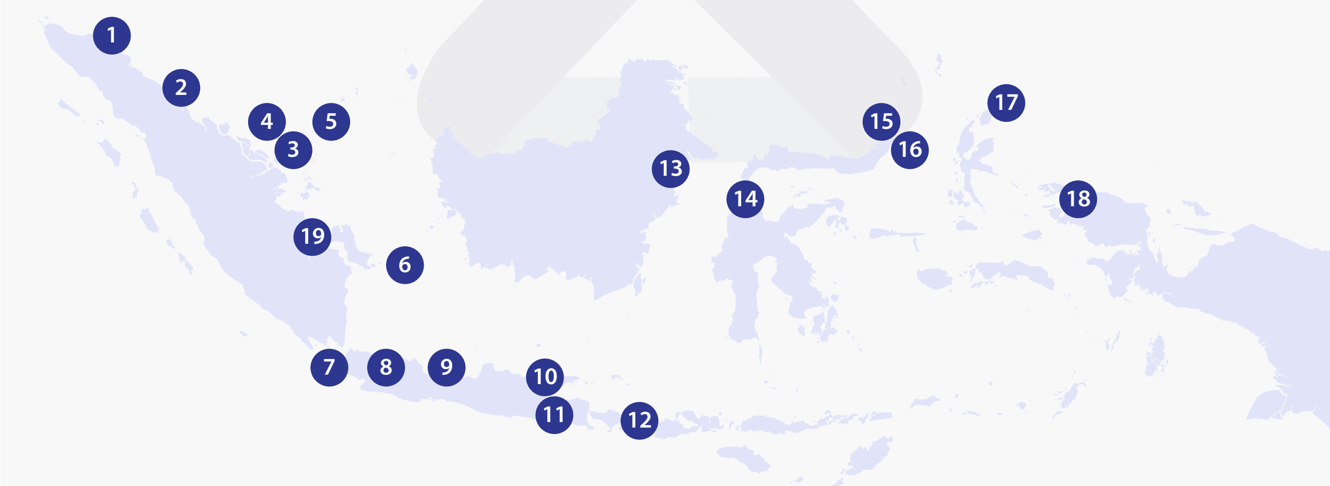
Investors operating in Indonesia's SEZs will find they are supported by well-integrated infrastructure from highways, drainage systems, high-speed internet and communication systems, ports, and airports. Moreover, the Indonesian government has prepared an array of fiscal and non-fiscal incentives, such as easier immigration process, corporate income tax reductions, exemptions on import duties and excise duties, among many others.

For foreign investors, entering Indonesia's special economic zones and taking full advantage of what they offer requires a long-term outlook. Companies must first ensure their industry is suited to the infrastructure and benefits afforded in the SEZs, as well as understand the long-term domestic and regional policies that could impact their industry.

Diversifying away from Java

Indonesia's special economic zones are located across the vast archipelago with the aim of stimulating equal economic growth. Until the year 2000, centralization and economic development

Map of Special Economic Zones in Indonesia



1 Arun Lhokseumawe SEZ
2 Sei Mangkei SEZ
3 Nongsa SEZ
4 Batam Aero Technic SEZ
5 Galang Batang SEZ
6 Tanjung Kelayang SEZ
7 Tanjung Lesung SEZ
8 Lido SEZ
9 Kendal SEZ
10 Gresik SEZ
11 Singhasari SEZ
12 Mandalika SEZ
13 Maloy Batuta Trans Kalimantan SEZ
14 Palu SEZ
15 Likupang SEZ
16 Bitung SEZ
17 Morotai SEZ
18 Sorong SEZ
19 Tanjung Api-Api SEZ (will not be classified as an SEZ in 2022)

Java and its Provinces

policies were centered on Java and the country's capital, Jakarta (also located on Java).

Java is supported by a strong consumer base since the island accounts for approximately 60 percent of Indonesia's total population — making it the most populated island in the world (with over 141 million people). This also means Java accounts for 60 percent of the country's GDP.

Further, Java has the most developed services sector in Indonesia and more than half of the country's 100 or so industrial estates are located on the island.

After Java, the biggest contributor to Indonesia's GDP is the island of Sumatra (approx. 21 percent), followed by Kalimantan and Sulawesi (eight and six percent), respectively. Bali and Nusa Tenggara contribute three percent to GDP while Maluku and Papua, the remaining two percent.

The majority of Indonesia's manufacturing sector is also located on Java, with West Java province accounting for 60 percent of the country's manufacturing activities.

The main drag on national growth has come from the provinces outside of Java as they are heavily reliant on commodities processing and extractive industries, such as oil and gas, nickel, tin, palm oil, and coal.

This overreliance on commodities means that these provinces are susceptible to global price shocks, such as when the government began banning the export of unprocessed commodities in 2014, and when commodity prices declined at the beginning of the COVID-19 pandemic. As a result, supporting businesses related to commodities extraction, such as transport, were also impacted.

Since entering office, President Joko Widodo and his government has emphasized a regional development strategy with a focus on investing in roads, ports, railways, and power plants – spearheaded by the development of special economic zones. In his second term, the President plans to spend more than US$400 billion until 2024 on a variety of infrastructure projects that will help to integrate the country more effectively.

Further, his government have attempted to tackle bureaucratic reforms through the issuance of the Omnibus Law, which amends more than 75 current laws for simplifying the process to obtain business licenses and start a business, formalizing special economic zones, and amending the country's strict labor laws.

The development of SEZs can also stimulate regional administrations to take measures to improve the local business environment, such as by reducing corruption and improving healthcare and education. These are important steps that can support long-term growth.

How the government implements its infrastructure plans and SEZ development will be vital in not only reducing the economic dependency on Java, but also helping Indonesia shift from being a primary exporter of raw materials to diversifying into export of processed goods.

Indonesia's fourth industrial revolution

The development of Indonesia's special economic zones will be vital in pushing the country's 4.0 industrial revolution (4IR) roadmap.

The 4IR roadmap, also dubbed 'Making Indonesia 4.0', was first touted by President Joko Widodo in 2018, and lays out the government's plans to transform the country's manufacturing sector to a higher-value future with the capacity to add some 10 million new jobs. The industry contributed the largest to national GDP, at 17.34 percent (in 2021).

The Making Indonesia 4.0 roadmap focuses on five key sub-sectors of manufacturing. These are:

1. Food and beverage – to be an F&B powerhouse in ASEAN;
2. Textile and apparel – to be a leading producer of functional clothing;
3. Automotive – to become a leader in the export of internal combustion engine vehicles and electric vehicles;
4. Chemicals – to become a leader in biochemical manufacturing; and
5. Electronics – to nurture domestic industries to be globally competitive.

These five sectors account for 60 percent of the country's GDP, 65 percent of total exports, and employ some 60 percent of Indonesia's workforce. Through Making Indonesia 4.0, the government hopes to improve its net export-to-GDP from one percent to 10 percent by 2030 and increase the manufacturing sector's contribution to GDP to 25 percent by the same year.

In addition to the five focus sectors, there are 10 national priorities to achieving the goals of industry 4.0. These are:

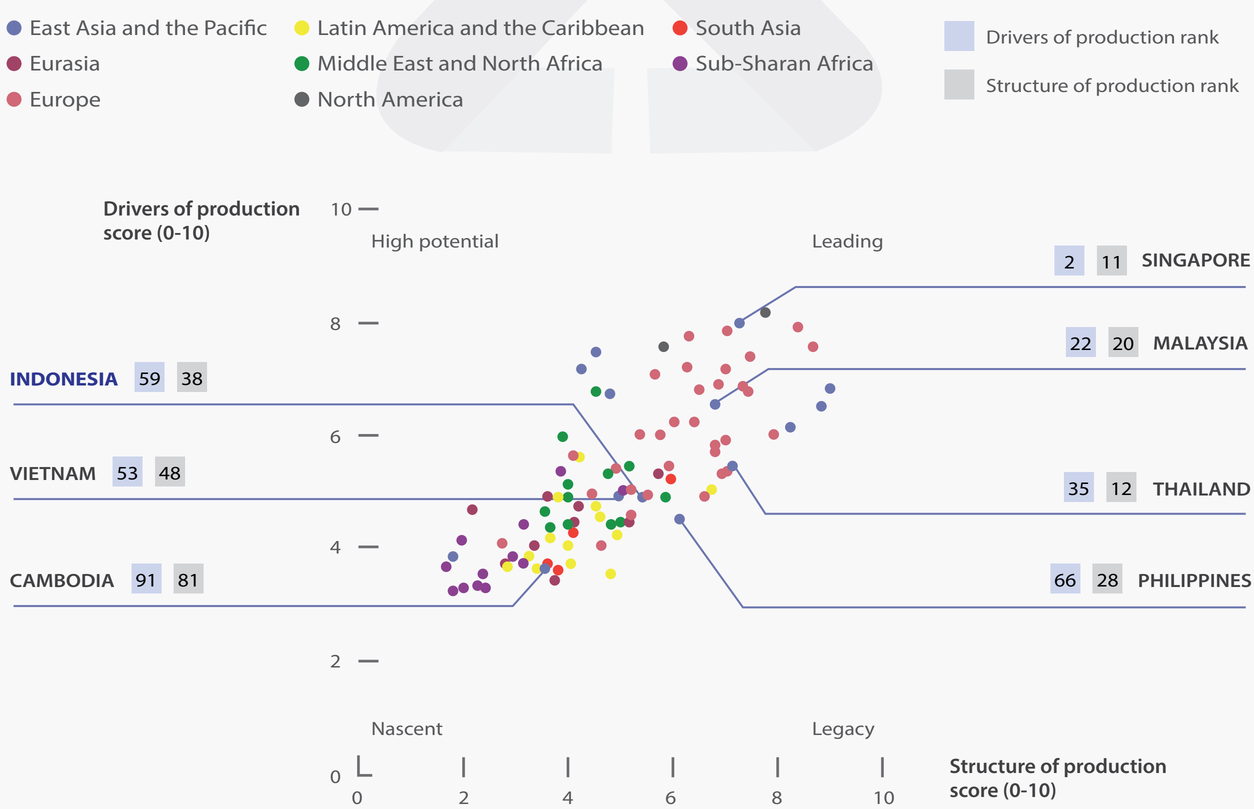
1. Reform material flow to enhance domestic upstream production.
2. Attract foreign manufacturers to incorporate in Indonesia and accelerate technology transfer.
3. Redesign industrial zones to develop a single nationwide industry zoning roadmap.
4. Encourage sustainability to explore opportunities in sustainable industries, such as renewables.
5. Empower some 3.7 million SMEs by embracing digitization and technology. This is crucial since

62 percent of the workforce are employed in micro or small enterprises, which often have low productivity rates.

6. Building a nationwide digital infrastructure to advance the national network and build digital platforms, such as 5G technology and data centers.
7. Developing human capital for preparing Indonesian talent that is compatible under the industry 4.0 era. The country has the world's fourth-largest working population; however, the majority are considered as unskilled.
8. Regulation and policy reforms to build more coherent policies.
9. Establish an innovative ecosystem to enhance research and development initiatives by the public and private sector, and higher education institutions. Indonesia currently spends only 0.1 to 0.3 percent on R&D.
10. Incentivize investments in technology to provide an array of incentives, such as tax exemptions and subsidies for local businesses who are adopting new technology in their operations.

Compared to other ASEAN states, Indonesia, along with the Philippines, Cambodia, and Vietnam, are still in the planning phase of their 4IR strategies. Singapore leads the bloc in 4IR adoption, which is focused on reskilling its workforce and transforming its industries. Singapore will invest over S$3 billion (US$2.1 billion) in manufacturing and engineering to this end.

The 4IR Country Readiness Evaluation



Source: Indonesia Ministry of Trade, A.T. Kearney

Structure of Tax Incentives

To better attract foreign investment and boost industrial activity in its special economic zones, the Indonesian government has offered various tax incentive programs ranging from exemptions from income tax, and value-added tax, to a reduction in import duties, and excise duties.

Ayman Falak Medina
Author

The Indonesian government has pledged to make the special economic zones (SEZs) a policy priority to attract foreign investment, boost industrial activity, and promote job creation. This strategy has been further facilitated through various tax incentive programs by Indonesia's Ministry of Finance.

These tax incentives include exemptions from income tax, value-added tax (VAT), import duties, sales tax on luxury goods, and excise duties.

The incentives are regulated under Ministry of Finance regulation No. 237/PMK.010/2020 (PMK 237) before it was amended in Ministry of Finance Regulation 33 of 2021. Further, Government Regulation 40 of 2021 was issued on how to propose and maintain an SEZ.

Moroeover, locations that are proposed to become SEZs must remember to fulfil the strict criteria set out in the regulations, such as those related to spatial planning.

Proposing an SEZ

Indonesian businesses or regional governments can propose an area for the development of an SEZ if they adhere to the following criteria:

- The proposed land is not a protected area, nor does it have the potential to disturb protected areas. The land must also be in accordance with regional spatial plans;
- At least 50 percent of the required proportion of the land must already be possessed; and
- The land must have clear boundaries.

Exemption on corporate income tax

Business stakeholders in an SEZ are differentiated into two types of taxpayers: *badan usaha* (business entities) and *pelaku usaha* (businesspersons).

Both business entities and business players are eligible for a 100 percent reduction in corporate income tax (CIT) provided their investments are conducted in SEZs and with a minimum investment value of 100 billion rupiah (US$7 million) for a period of 10 years.

Businesspersons can be granted a longer concession period, the greater their investment, as noted in the following table on page 11.

After the expiration of the aforementioned CIT incentives, taxpayers are eligible for a 50 percent CIT reduction payable for the subsequent two years.

Further, during the concession period, no withholding tax (WHT) is applied to eligible income, such as income from land and building rental.

Corporate income tax allowance

Taxpayers that invest 100 billion rupiah (US$7 million) are also eligible to receive several CIT allowances. These are:

- A 30 percent reduction in net income on the total investment on fix assets reduced over six years over six years, at five percent per year;
- Accelerated depreciation allowances of up to 100 percent of tangible and intangible assets;
- A WHT rate of 10 percent, or the treaty rate (whichever is lower) on dividend payments made to non-resident recipients; and
- Tax-loss carried forward for up to 10 years.

Import and excise duties

The import of consumer goods into an SEZ by a business entity is eligible for the exemption for import duties as well as the non-collection of import taxes, and luxury goods sales tax.

The facilities granted will differ depending on the stage of business activity the business entity is currently implementing (e.g., construction, development, or beyond), in addition to the origins/destinations of the goods that enter or exit the SEZ.

There are additional tax relief for businesses that import raw materials or capital goods used in relation to tourism activities (tourism SEZ), such as accommodation supplies, food and beverages services, entertainment services, among others.

Further, imported goods into an SEZ may not be subject to import limitations and will not be subject to the Indonesian National Standard (SNI) system.

Corporate Income Tax Holidays for Special Economic Zones in Indonesia

Taxpayer	Investment amount	Concession period (years)
Business entity	100 billion rupiah (US$7 million)	10
Businessperson	Between 100 billion rupiah (US$7 million) to 500 billion rupiah (US$35 million)	10
	Between 500 billion rupiah (US$35 million) to 1 trillion rupiah (US$70 million)	15
	More than 1 trillion rupiah (US$70 million)	20

VAT and sales tax on luxury goods

VAT will not be collected in relation to the following activities:

- The import of taxable tangible goods into an SEZ by a business entity;
- The delivery of taxable tangible goods from another Indonesian free trade zone, customs area, or bonded storage facilities to a business entity;
- The delivery of taxable services or goods, including land or buildings by a business entity in an SEZ to another business entity in the same or another SEZ; and
- The import of consumer goods into a tourism SEZ.

The non-collection of VAT also applies to raw materials needed to produce taxable services or goods related to ship and aircraft maintenance, repair, and overhaul (MRO) activities.

Eligibility criteria

To be eligible for all the mentioned incentives, businesses will need to meet the following conditions:

- Possession of business license;
- Evidence of being a domestic corporate taxpayer;
- Have approval from the Indonesian Investment Coordinating Board, based on the company's standard industrial classification (KBLI);
- Location of the project is final; and
- Determination of the type of production/services to be conducted.

Choosing the Ideal Investment Location

Companies looking to incorporate in Indonesia's special economic zones must select their location strategically based on available infrastructure and natural resources.

Ayman Falak Medina
Author

Indonesia's special economic zones (SEZs) have been designed to maximize the surrounding resources. Companies looking to incorporate in the country's SEZs must select their location strategically based on available infrastructure and natural resources, particularly since most of the country's SEZs only began operations in 2019.

Moreover, foreign investors need to be aware of the Indonesian government's development plans, which often determine which industries receive the most support and incentives.

Having this long-term outlook will allow foreign business to be rewarded by Indonesia's unique advantages, such as its competitive labor costs, huge domestic market, and the potential expansion of land in the SEZs – an issue that has constrained businesses in other ASEAN markets like Malaysia and Singapore.

We highlight some of Indonesia's prominent SEZs in the following section and their specialized industries.

Nongsa SEZ

The island of Batam has been a free trade zone since 2009, along with the neighboring Bintan and Karimun islands, and its first SEZs were set up in 2017. Together, the three islands are known as the BBK free trade zone.

Due to its proximity to Singapore (only 20km away), some 70 percent of Batam's foreign investors are from Singapore, who use the island as an alternative manufacturing hub.

According to the Badan Pengusahaan Batam (BP Batam), the local investment and development authority, Singaporean companies have contributed some 42 percent of the US$2.5 billion of foreign investment that Batam has received between 2015 to 2020. The island produces goods ranging from computer chips to precast concrete and is home to multinational companies, such as Caterpillar, Ciba Vision, and Schneider Electric.

Indonesia is also set to open two new SEZs on Batam after President Joko Widodo recently approved the decision, which includes the Nongsa Digital Park. The digital park will focus on research and development, education, and creative industries, along with its existing focus on technology and tourism. The park originally opened in 2018 after bilateral discussions between Indonesia and Singapore to develop an 'IT hub and digital bridge' between the two countries. Currently, the park's 155.43 hectares of land is home to over 100 technology companies, mostly from Singapore.

As an SEZ, the park aims to attract more international investors, beyond the largely Singapore-based contingent currently active in the area. Its goal is to receive 16 trillion rupiah (US$1.1 billion) in investments and to create 16,500 new jobs. To reach this target, the park hopes to become a hub for data centers, an industry the market research firm Technavio projects will grow by US$10.57 billion between 2019 and 2023 in Southeast Asia.

The park will be at the forefront of Indonesia's booming digital economy, which according to a report by Google, Temasek, and Bain & Company, will have a gross merchandise value (GMV) of US$146 billion by 2025 – the largest in ASEAN. This growth will be primarily driven by e-commerce, which is expected to have a GMV of US$104 billion by the same year.

Batam Aero Technic SEZ

Batam Aero Technic (BAT) is the other new SEZ declared by President Joko Widodo alongside the Nongso Digital Park. With the upgraded SEZ status, Batam Aero Technic plans to expand from maintenance, repair, and overhaul (MRO) of passenger aircraft to logistics and distribution, production and processing, and technology development.

BAT hopes to capture the US$1 billion that local airlines spend on MRO and the US$100 billion that airlines in the Asia Pacific will spend by 2025. Other supporting industries currently being developed in the SEZ are in the form of logistics, such as warehousing of equipment and components. Further, BAT aims to manufacture cabin items from head racks to galleys, airplane lavatories, airplane seats, carpets, and hand-rests.

The 30-hectare facility is owned by Lion Air Group, the holding company that owns Indonesia's largest private airline, Lion Air. In 2013, the airline made the largest-ever single order of Airbus A320 planes at 234, valued at US$22.4 billion.

Batam Aero Technic aims to receive 7.2 trillion rupiah (US$500 million) in investments and to create close to 10,000 new jobs with the upgrade to SEZ status. Indonesia is the second-fastest-growing aviation industry in the world after China, and the country's air passenger market is expected to become the fourth largest in the world by 2039.

Sei Mangkei SEZ

Sei Mangkei SEZ has exported over 26 trillion rupiah (US$1.7 billion) worth of goods since its establishment in 2015, mainly for palm oil and palm oil products. The North Sumatra Province is one of the leading palm oil producing regions in the country.

PT Unilever Oleochemical Indonesia (PT UOI) – a subsidiary of multinational consumer goods company Unilever — is the largest tenant in Sei Mangkei SEZ with the company operating in 27 hectares of land, producing a variety of by-products of palm oil refining, such as soap noodles, surfactants, fatty acids, and glycerin, which are raw materials needed for household goods like detergents. The company also invested a further US$150 million in 2021 to expand its operations in the SEZ, and once completed, PT UOI will have the largest palm oil processing facility in Sei Mangkei SEZ. Further Sei Mangkei aims to have the largest integrated facility for palm oil processing.

Palm oil is by far the most consumed and traded edible oil in the world. According to the United States Department of Agriculture, 77 million tons of palm oil are expected to be produced this year – with Indonesia accounting for around 60 percent of the global supply share. Malaysia ranks second with a 25 percent supply share.

Grown only in the tropics, the oil palm tree produces a high-quality oil that is used as a common ingredient in cosmetic and household items, such as detergents, margarine, soaps, chocolates, cakes, and cleaning products, and biofuels, among others.

The Indonesian government is also planning to develop a railway from the Sei Mangkei SEZ to Kuala Tanjung port. Currently, trucks from the SEZ transport goods to the port some 50km or so by road. The port has a current capacity of 600,000 twenty-foot-equivalents (TEUs) but this is expected to be upgraded to handle over 12 million TEUs by 2039.

Kendal SEZ

The Kendal SEZ in Central Java Province was only given SEZ status in 2019 but has managed to attract over 70 businesses from Indonesia, Singapore, Malaysia, Japan, South Korea, and China. Before being upgraded as an SEZ, Kendal was an industrial park; in fact, it is the only industrial park on Java island that has been given SEZ status.

The Kendal SEZ is designated for export-oriented manufacturing ranging from automotives to electronics to textile and fashion. Out of the 66 tenants that have established in the Kendal SEZ, 16 are fully operational with the remaining in the construction phase. PT MasterKidz Indonesia, a subsidiary of Hong Kong toy manufacturer MasterKidz, is among those fully operational, and has committed to invest over 400 billion rupiah (US$26.5 million), one of the largest investments in the SEZ.

Another company, textile manufacturer, Dae Young Textile, has committed to invest 81 billion rupiah (US$5.3 million). Meanwhile PT Sasakura Indonesia, a joint venture between Japanese engineering firm Sasakura Engineering Co., Ltd. and Indonesian engineering firm PT Wasamitra Engineering, have committed to invest 350 billion rupiah (US$23.2 million) to engage in steel fabrication activities.

The government has projected that the Kendal SEZ will attract 72 trillion rupiah (US$4.7 billion) by 2025, employing a workforce of 20,000 people.

Central Java Province is being pushed as one of Indonesia's manufacturing hubs. 30 percent of the country's manufacturing activities are already located in this province, mainly for labor-intensive industries, such as textile production, attracting some of the largest apparel companies in the world like Nike, Uniqlo, and Adidas. The province saw US$980 million in foreign investments between January and September 2021.

As wages continue to increase in Jakarta, a growing number of foreign businesses see the opportunity to tap into the more cost-effective workforce in Central Java, which has a population of 34 million – larger than the whole of Malaysia — and a provincial minimum wage of US$119 per month. The province is also supported by 11 seaports, four international airports, and more than six industrial estates.

Economic Profiles of Selected SEZs in Indonesia

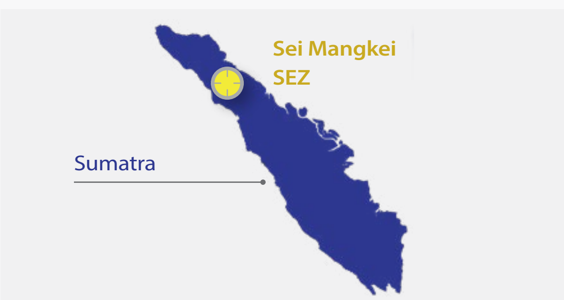
Location
Main industries
Realized investments (2021)
Minimum wage (monthly)
Total area
Committed investments
Total workforce (2021)

Nongsa SEZ

- Batam city, Riau Province
- 166.45 hectares
- Digital economy, tourism, education, creative industry
- 17.35 trillion rupiah (US$1.15 billion)
- 1.84 trillion rupiah (US$122 million)
- 1,070
- Approx. 4,186,000 rupiah (US$279) (Batam)

Batam Aero Technic SEZ

- Batam city, Riau Province
- 30 hectares
- Airplane maintenance, repair, and overhaul
- 1.24 trillion rupiah (US$82 million)
- 334 billion rupiah (US$22 million)
- 1,474
- Approx. 4,186,000 rupiah (US$279) (Batam)



Sei Mangkei SEZ

- Simalungun regency, North Sumatra Province
- 2,000 hectares
- Palm oil processing, rubber processing, tourism, logistics
- 14.61 trillion rupiah (US$972 million)
- 6.22 trillion rupiah (US$413 million)
- 1,889
- Approx. 2,607,000 rupiah (US$173) (Simalungun)

Kendal SEZ

- Kendal regency, Central Java Province
- 1,000 hectares
- Textile and garment manufacturing, automotive manufacturing, food and beverages, electronics, furniture and toys, logistics
- 22.9 trillion rupiah (US$1.5 billion)
- 12.1 trillion rupiah (US$805 million)
- 11,380
- Approx. 2,340,000 rupiah (US$155) (Simalungun)