

## **State Control and the Privatisation of the Indonesian Telecommunications Industry: From Ownership to Regulation**

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**Abstract:** The International experience including Indonesia shows that after privatizing their telecommunications, countries employed three new methods of state control: creating a golden share mechanism, establishing an independent regulatory body and employing a licensing system. All these methods represent the paradigm shift of control from state ownership to state regulatory based control. This paper examines Indonesian telecommunications privatization and its implications in terms of the meaning of state control under the Indonesian Constitution of 1945. Privatization, with various definitions and its rhetoric, opposes state intervention in the economy. Meanwhile, telecommunications is a classic example of a strategic sector under direct control of the state. The central issue of this paper concerns the methods of state control applied following the privatization of telecommunications, the adequacy of these methods and their implications in the context of Indonesian legislation stipulating that telecommunications is a strategic sector that should be controlled by the state. The ultimate conclusion of the paper is that privatization of telecommunications is not intended to remove state control, but rather change the manner from a direct into an indirect control – from state ownership to state regulation.

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### **1. Introduction**

The telecommunications industry has always been given special treatment because of its great importance to society (Melody, 2001). In Canada, for example, this industry has legally been recognized for its significant role in the maintenance of Canada's identity and sovereignty. Traditionally, therefore, the telecommunications industry has been state-owned and subject to a complete monopoly, leaving the government with full control over this sector (Zhao, 1999). The Indonesian Telecommunications Act stipulates that the telecommunications sector is of national strategic importance and must therefore be controlled by the state. This provision is basically derived from Article 33 (2) of the Indonesian Constitution of 1945, which states: "Sectors of production that are important for the country and affect the life of the people shall be controlled by the state". This constitutional provision - particularly the words "shall be controlled by State" (state control) - indicates that Indonesia is properly characterized as an interventionist state. In other words, this is a constitutional justification for state intervention over strategic sector such as telecommunications.

Since the late 1980s, there has been a radical policy reversal whereby governments have progressively reduced their ownership and involvement in this sector by increasing private sector participation. Advances in telecommunications technology, the inefficiency of the state-owned enterprises (SOEs) and the changing market structure of the telecommunications industries are commonly seen as the three most important factors behind the movement (Wallstein, 1999). One country after another, including Indonesia, has reformed their telecommunications industry by privatizing this sector, as well as introducing other reforms (Cho and Lee, 1997).

As discussed by Noll (1999) and Wallsten (1999), privatization of the telecommunications sector signals a dramatic shift from state-dominated institutions to market institutions in many countries. The main aim is to dismantle a monopoly and to enhance competition over the sector by allowing private participation. One of the important implications of this is that governments become less able to carry out direct political control over the sector.

The privatization of the Indonesian telecommunications industry, therefore, raises a critical question; in what ways might the government maintain its control over the sector when privatization reduces state ownership in SOEs? This paper examines the privatization of the Indonesian telecommunications industry and its implication for the notion of state control over the sector. More specifically, it examines the method of state control after privatization of the Indonesian telecommunications industry. Finally, the paper will conclude by articulating new meanings of state control and advocate that Indonesia should give greater consideration to these post-privatization state controls.

## 2. The Meaning of Privatization

Privatization has become an icon of economic and political reform in both developed and developing countries (Hanke, 1987). In other words, the phenomenon of privatization is now truly global in nature (Moe, 1987). However, writers and researchers believe that the term and concept are still in need of academic refinement. They complain that the term privatization is indeed very *omnibus* and its concept is imprecise (Ghosh, 2000). In the words of Starr (1998), "privatization covers a great range of ideas and policies, varying from the eminently reasonable to the wildly impractical".

The ideological underpinning of privatization is based on minimum state intervention in economic and public affairs. This idea is built on the notion that state intervention produces inefficiency, and that furthermore, state intervention leads to decisions that are mostly politically motivated and either ignore or override factors which markets would recognize. It should, therefore, be minimized. It also believes that government, as Peter Drucker (1992) put it, is "a poor manager". Privatization, therefore, is intended to be an economic tool to solve this economic inefficiency.

Privatization is both an economic and political concept. Hence, privatization is actually a matter of the political economy. The political economy is concerned with the distribution of economic resources and products for both the people and the state (the sovereign). In other words, the purpose of the political economy is to guarantee the development of both the state and individuals in a proper, safe and fair way. Either the private or public sector, or a mixture of the two, can carry out the distribution. In this context, privatization and governmentalisation are viewed as two opposing extremes.

If the government chooses to have a more direct influence in business, it will direct companies to the government extreme. On the other hand, if it prefers to allow the private sector to play a greater role, the tendency will be toward privatization (Bastian, 1998). Privatization, therefore, pertains to the policy regarding the level of state intervention in the economy. Thus, privatization involves change only in the form of the state's economic role, rather the role itself. In other words, privatization is a policy of changing, not removing the state intervention in the economy. Privatization may reduce the state's ownership but at the same time increases the state regulatory function in the economy.

## 3. Traditional Telecommunications Regimes

### 3.1. Public and Private Monopoly

Telecommunications has been in state hands since the dawn of the electronics era in most developed countries, as well as in virtually all developing nations (Bortolotti et al, 2001). It was generally combined with postal services and, in most European countries, was provided within the framework of the national Post, Telegraph and Telephone Administration (the PTT model). This regime has traditionally been characterized by a high degree of government intervention (Klodt, 1997). State institutions such as ministries of post and communications controlled the PTT, holding monopoly over all mail and telecommunications services (Hulsink, 1999).

The classic argument dictating that the provision of these services should be reserved to a particular enterprise controlled by the state was that these were strategic industries, and that specific security concerns were involved. In addition, there are three main reasons justifying telecommunications monopolies. First, an economic argument has been put forth which states that telecommunications is a typical 'natural monopoly'. It was argued that the establishment of telecommunications networks involved large fixed costs<sup>1</sup> and that a single enterprise would therefore be able to provide services at lower costs than would two or more different enterprises (Geradin and Kerf, 2003).

Secondly, telecommunications is a public utility - a service that is essential to the public, such as water, electricity and postal services, usually involving elements of natural monopoly. Thirdly, some have argued that network externalities justified organizing the telecommunications sector on a monopoly basis. Network externalities are present in the area of telecommunications since the value of a network increases, for each user, with the number of network subscribers. As a result, for a given total number of subscribers, the value of a single network is much greater than the total value of several smaller unconnected networks (Geradin and Kerf, 2003).

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<sup>1</sup> The installation of cables, microwave transmitters, and switches is capital intensive, so this activity involves significant economics of scale. The large fixed cost discourages market entry, but once the network of lines and cables had been laid out, marginal cost declines rapidly. A single telephone cable provides all the telecommunications capacity demanded by most households and business. Therefore, it seems wasteful to have more than one network to serve consumers.

The major visible exception to these observations has been the case of the United States (US), where telecommunications was considered as a service to be supplied by private business in normal markets (Drake, 2001). Interestingly, however, the American Telephone and Telegraph Company (AT&T), a private telecommunication company, dominated the provision of telecommunications services (Hudson, 1997). The author argues, therefore, that both Europe and the United States essentially adopted the monopoly model in different forms; public monopoly and private monopoly respectively.

### *3.2. The PTT: An Etatist Telecommunications Regime*

In most European countries the operation of the telecommunications system was exclusively assigned to a government department or a public enterprise, generally known as the PTT model, with responsibility for the postal, telegraph and telephone monopolies. These PTTs were part of the traditional public administration apparatus and as such were subject to strong government influence and regulation through the polity (Noam, 1992). The telecommunications administration of European colonies in Asia, Africa, and the Middle East generally were branches or affiliates of the European PTTs (Drake, 1999). What all this means is that the European PTTs have provided the dominant model applied in most countries in the world, and that it became the most representative model for the traditional telecommunications regime.

The PTT regime did not emerge overnight, but was the result of centuries of struggle (Noam, 1992). Indeed, historical investigation reveals that the regime was derived from the postal monopoly system implemented by European emperors since the 15<sup>th</sup> century (Noam, 1992). The nuances of absolutism of the imperial system were transformed into the PTT regime in the form of state monopolies over the telecommunications sector. In the words of Noam (1992), “the PTT regime was born as a creation by the absolutist state for the absolutist state”.

During its development the nuances of absolutism within the regime were rationalized through more democratic idioms such as national sovereignty or national interests. An economic argument that considered telecommunications as a typical natural monopoly also contributed to the establishment of the regime. In other words, absolutism and natural monopoly provided the political and economic underpinnings for the establishment of the PTT regime.

These arguments justified the operation of PTTs as monopolistic telecommunications enterprises owned, operated and regulated by the government. These determined the typical role of government in the sector - playing a tripartite role as owner, operator and regulator of telecommunications. More specifically, this took the form of monopoly rights, a lack of an independent regulatory body and state ownership. These were common characteristics of the regime able to be observed in both developed and developing countries.

The PTT's anti-competition policy maintained an extensive monopoly over nearly all networks, equipment and services. The lack of an independent regulatory body is a direct consequence of the government's positions as both owner of the operator and its primary regulator. State ownership is the most distinctive character of the PTT regime, which mostly takes the form of the establishment of a State Owned Telecommunications Enterprise (SOTE). The argument is that only by possessing the majority share of a SOTE will a state be able to protect the sector from possible economic, political or legal action that may cause harm to the national economy and security. As a result, private ownership including foreign ownership is restricted or even prohibited under the regime. To sum up, all of the above characteristics lead the PTT to appear as typical of the *etatist* telecommunications regime.

## **4. Telecommunications Reform**

The present wave of telecommunications reforms now sweeping the globe began in the 1980s (Pisciotta, 2001). This is a response to the traditional protectionist-*etatist* regime, which is essentially aiming at the liberalization of the sector. Here, liberalization is defined as de-monopolization of states over the telecommunications sector, or in the words of Hills (1989), “...is a transfer of markets from a system based on rules made by governments to one based on competition between private entities”. In other words, the telecommunications reform movement aims at freeing the telecommunications sector from state monopoly, by moving it towards market forces, decentralization, deregulation, privatization and competition.

The rationales of telecommunications reforms differ across countries, but can be broadly grouped as follows: ideology, debt crises and global recession, technological revolution, under-performance of the sector, and participation in multilateral trading system. The combination of these factors resulted in support for a new approach to the telecommunications sector. It was increasingly believed that telecommunications services would be supplied in a better, more efficient manner if the markets were opened up to competition and were privatized SOEs (Ospina, 2002). This constituted precisely the main objective of the reforms - the dismantling of the state's monopoly production of telecommunications services.

## **5. Privatization of Telecommunications: A Review of International Experience**

In reviewing the experience of telecommunications privatization, case studies will be outlined for the United Kingdom (UK) as an example of a developed country, and Malaysia as an example of a developing country. The UK privatization telecommunications program served as a pioneer and has been widely recognized as an important reference for both developed and developing countries undertaking such programs. Malaysia was the first Southeast Asian country to privatize its telecommunications sector and as Petrazzini (1995) observed, it possessed a successfully privatized and liberalized telecommunications sector. In view of this, Malaysia's experience is likely to be important for Indonesia both as a developing country and because of its geographical proximity. Valuable lessons for the Indonesian privatization process may possibly be learnt from that experience.

### *5.1. The United Kingdom*

The provision of telecommunications services within the UK started at about the same time as the invention of the telephone itself in 1876 and was largely linked to the General Post Office (GPO), the oldest public monopoly in the UK (Vogel, 1996 and Vogelsang & Mithcell, 1997). This integrated telecommunications services under the responsibility of the GPO made its monopoly position more powerful (Al-Shurman, 2001). This monopoly structure followed the typical European model - the PTT model.

Researchers have used different perspectives to identify the main motives and objectives of the UK's privatization program. These range from short term budgetary goals concerning the form of pressure for reduced public sector borrowings, to a political theme of widening share ownership. The author, however, agrees with Kirkpatrick (1988) who concluded that both political ideology and pragmatism have been the main drivers of the UK privatization program.

The process of privatizing and liberalizing the entire telecommunications industry within the UK involved three phases. The first started with the separation of telecommunications services from the Post Office, which was effected by the 1981 British Telecommunications Act. The Act paved the way for further liberalization of the industry. The second phase started in 1984 with the introduction of the 1984 British Telecommunications Act, which laid down the process of selling British Telecom (BT). The third phase was the post-privatization period where a new regulatory framework for the industry was established by the Act. This was embodied in the Office of Telecommunications (OFTEL). After about twenty years of carrying out its function as the UK's telecommunications regulator, OFTEL ceased its function in December 2003 and was replaced by a new body called "OFCOM" (Office of Communications).

The main point to note here is that the privatization of BT has introduced a new relationship between government and telecommunications operators. Privatization created a new stakeholder in the telecommunications sector: the private shareholder. As a result, governments were no longer the sole owner of the telecommunications operators. Before privatization, governments could easily exert pressure on telecommunications operators through the simple reason that they owned them. This practice became difficult or even impossible after privatization. The UK's experience reveals that privatization has directed the focus of the government's role to that of a regulator, with governments aligning the idea of telecommunications companies to both private shareholders and citizens in the community.

In addition, for the purpose of protecting national interests the British government established golden shares in its privatized companies. Unlike conventional shares, which strongly represent the commercial motives of the shareholders (control-based ownership), the government has created golden shares primarily for policy objectives (control-based regulation). Through the possession of the golden share, the government apparently put emphasis on making policies (in the form of certain special rights), and not on holding equity to protect its national interests in privatized companies. In the case of British Telecom (BT) the reason was the protection of "national interests" and "stability" for UK citizens (Seven, 2002).

### *5.2. Malaysia*

As a former British colony, Malaysia's telecommunications applied the PTT model – a typical model for most former European colonies. Like most developing countries, pragmatic and economic considerations were the main motives behind Malaysia's privatization program. However, Malaysia's privatization program was a unique one, as it also was driven by a clear ideological foundation not shared by many developing countries. In this regard, Petrazzini (1995) pointed out that Mahathir Mohammad who came into power in 1981 and introduced the idea of privatization borrowed a philosophy and a considerable number of ideas and strategies for state reform from the UK. Aside from pragmatic and ideological motives, the government sought to increase the participation of the indigenous community (or "Bumiputeras") in mainstream economic activities (Dewenter and Malatesta, 1996).

Like the UK, although the resemblance is not complete, the entire process of Malaysia's privatization telecommunications involved three steps. The first was a limited liberalization of the sector. The second was the partial privatization of JTM (Jabatan Telekom Malaysia, a government department under the Ministry of Works, Telecommunications and Post), and the third was a liberalization of post-JTM privatization.

The limited liberalization was mainly driven by a shortage of terminal equipment as well as the private sector's ability to convince the government they could remedy the problem. This policy attracted private telecommunications firms to enter the market. Several locally-owned as well as foreign companies took advantage of the new market environment (Kennedy, 1993). Using this momentum, within two years, liberalization was extended to other telecommunications markets such as value-added network services/VANs (1984), radio paging (1985), and mobile cellular services (1988). This further liberalization was driven by among other things, JTM's inability to devote sufficient physical or management resources to the development of value-added services (Lee, 2004).

In January 1987, the operation of Malaysia's telecommunication services was transferred from JTM to Syarikat Telekom Malaysia Berhad or Telekom Malaysia (TM). Subsequently, the government sold 25 per cent of TM's equity to the public via a public listing exercise in 1990 and TM became Telekom Malaysia Berhad or TMB (Petrazzini, 1995). To date, the government continues to own more than 60 per cent of TMB's equity through various agencies.<sup>2</sup> In addition, the government owns a single unit "golden share". This concept, operates in principle as an entrenched provision allowing the holder powers of veto over fundamental decisions of the company irrespective of the special shareholder's ordinary shareholding. This arrangement was common amongst other major Malaysian privatized utilities, for example, Malaysia Airlines (MAS) and Tenaga Nasional Berhad, the incumbent power utility(Lee, 2004).

Liberalization in the post-privatization era mainly took the form of entry into major markets, fixed line and cellular services. The issuance of five additional licenses between 1993 and 1995 to compete with the incumbent TMB indicated further liberalization in the fixed line market services.<sup>3</sup> In addition, four licenses had been issued for cellular service operators.<sup>4</sup> Another important telecommunications market liberalized was that of the Internet Service Provider (ISP). After partial privatization of JTM, seven additional licenses were issued to the other major firms in the sector (Lee, 2004).<sup>5</sup>

Unlike the UK, where the government regulatory function was handed over to OFTEL following the privatization of BT in 1984, the JTM remained as regulator of Malaysia's telecommunications. However, at the end of 1998 the government took a clearer position on the state's post-privatization involvement in the telecommunications sector by establishing Communications and Multimedia Commission (CMC) separate from the government department.<sup>6</sup>

### *5.3. Key Characteristics of International Telecommunications Privatization: Some Lessons for Indonesia.*

Privatization of telecommunications has been a global phenomenon and both developed and developing countries have initiated such a program. Countries have taken different approaches due to economic, social, political and legal differences. The preceding discussion, however, reveals two main characteristics of telecommunications privatization that can be observed internationally. First, privatization is intended as a policy reversal to the *etatist* traditional telecommunications regime, which is primarily based on state ownership and state monopoly. For this reason, it generally takes the form of reducing state ownership in State-Owned Telecommunications Enterprises (SOTEs) and the de-monopolization of the state's involvement in the sector. Secondly, privatization entails new methods of state control (state intervention) in the telecommunications sector.

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<sup>2</sup> The shareholding structure of TMB as of 31 January 2006 is as follows: Khazanah Nasional Berhad (35.12 per cent), Employees Provident Fund Board (14.12 per cent), Bank Negara Malaysia (7.42 per cent) and Permodalan Nasional Berhad (5.68 per cent). For detail see [http://www.telekom.com.my/about\\_TM/corporate/about\\_IR\\_share.htm](http://www.telekom.com.my/about_TM/corporate/about_IR_share.htm). Retrieved February 28, 2006.

<sup>3</sup> Maxis Communications Sdn Bhd (1993), TIME dot Com Bhd (1994), PrismaNet (M) Sdn Bhd (1994), DiGi Telecommunications Bhd (1995), Celcom (M) Sdn Bhd (1994).

<sup>4</sup> Celcom (M) Sdn Bhd (1989), Maxis Communications Sdn Bhd (1993), DiGi Telecommunications Bhd (1994), TIME dotCOM Bhd (1993).

<sup>5</sup> TM Net, Maxis, Time, Celcom, PrismaNet, Digi, and NTT MSC.

<sup>6</sup> See Suruhanjaya Komunikasi dan Multimedia Malaysia (SKMM), available at [http://www.cmc.gov.my/about\\_us/history.asp](http://www.cmc.gov.my/about_us/history.asp). Retrieved March 30, 2006.

## 6. Privatization and the Meaning of “State Control”.

Privatization, for the many definitions and rhetoric associated with it, entails changing the nature of state intervention in the economy. In the Indonesian context it relates, among other things, to the issue of state control over strategic economic sectors such as telecommunications. Article 4 (1) of the Telecommunications Act 1999 states: “Telecommunications is controlled by the state under the guidance of the government”. This provision is obviously a material elaboration of Article 33 (2) of the Indonesian Constitution of 1945 (henceforth referred to as the Constitution of 1945), that provides:

“Sectors of production that are important for the country and affect the life of the people **shall be controlled by the state**”. (Emphasis added).

The notion of state control, its history and ideology pertain to the state’s (government) intervention or its role in the economy, particularly in relation to the strategic economic sectors. In its development it has become a controversial term as it has been subjected to different approaches and applications. Historical investigation reveals that ‘state control’ is a legal term that justifies state intervention in the economy. This finding, however, leaves a question: how does the state intervene in the economy? The contextual approach concludes that the notion of state control essentially refers to the authority of the state to utilize strategic economic sectors for the greatest benefit of most people. The constitution does not specify a specific means of control.

The government appears to follow this approach. The author has observed that the government’s approach appears to indicate a dynamic interpretation as the government tries to ensure the term’s relevance in dealing with contemporary issues in the global economy. However, this risks ‘state control’ becoming a mere “rubber stamp” rather than a “constitutional provision” used as the guiding force behind the legislation. This is then exacerbated by the absence of any authoritative forums for judicial review of whether legislation complies with the constitutional provision. The uncertainty of the meaning of the term “state control” will lead to a privatization program free to proceed arbitrarily, while at the same time the term may be used as a legal weapon to decry privatization as contravening the Constitution of 1945.

The establishment of the Indonesian Constitutional Court has ended this controversy, which among other functions has the task of reviewing whether an act contravenes the Constitution.<sup>7</sup> In its judicial review of the Mining and Electricity act,<sup>8</sup> the Constitutional Court contended that the term “state control” is a concept of public law that derives from the principle of sovereignty of the people. Under this concept, the term state control is actually an instrument for the state to achieve general welfare. In other words, the forms of state control may vary and change but the purposes do not. The Court, therefore, does not reject a narrow meaning of the term that is limited to state ownership or regulation. However, at the same time, the Court also insists that this is one interpretation, but by no means the only one.<sup>9</sup>

The author agrees with the Court’s opinion. The Court has combined both historical and contextual approaches, and in doing this, has been able to minimize the risk that an interpretation will be trapped by the past or plunged into an arbitrarily contemporary approach. The Court has successfully discovered the actual intention of the constitution. The author, therefore, is of the opinion that the term state control should be understood as a constitutional mandate to the state to make economic policies with the main purpose of utilizing the strategic economic sectors for the greatest benefit of the people. The state has the right to choose the appropriate means of control for achieving such a purpose. In this context, the privatization program is not only constitutionally acceptable but also is a method of control, which the government believes is able to respond to socio-economic development at both national and international level.

## 7. Privatization of the Indonesian Telecommunications Industry

### 7.1. Pre-privatization Regime

Indonesia was a Dutch colony. Following its independence in 1945, the country inherited many Dutch laws including the Telecommunications Law. Subsequently, Indonesia took over the Dutch Post, Telephone and Telegraph Service (PTT) and became the Indonesian PTT Service - the government agency for the provision of

<sup>7</sup> See Article 24 ( c ) of the Constitution 1945.

<sup>8</sup> Judgement of the Indonesian Constitutional Court No. 002/PUU-I/2003 and No. 001-021-022/PUU-I/2003.

<sup>9</sup> Judgement of the Indonesian Constitutional Court No. 002/PUU-I/2003, p 108 and KMK No. 001-021-022/PUU-I/2003, p 333.

post and telecommunications services (Misdiyono, et al, 2000). The country also continued to employ the European PTT regime, a system that had been used by the Dutch colonial government in Indonesia since 1931.

The government enacted Act No. 5/1964 on Telecommunications, which constituted the first Telecommunications Law established after independence. The Act provided a legal framework for the operation of telecommunications, which among other things stipulated that telecommunications was a strategic sector with economic, political and military importance; hence all operations and services were to be provided solely by the state. To this end, the government established *PN. Postel* as the sole operator of telecommunications (Depparpostel, 1989).

To improve service provision, the government decided in 1965 to separate posts and telecommunications services and organized these under two different companies: *PN. Pos dan Giro* and *PN. Telekomunikasi* respectively (Sugondo and Bhinekawati, 2004). Ten years later, through the issuance of government regulation No.36/1974, the government transformed *PN. Telekomunikasi* into a new form of SOE – *Perumtel*. This company was established with mixed responsibilities, both for providing public services as well as making profits. In its operation, the government granted *Perumtel* an exclusive right to provide telecommunications services throughout the country. The government transferred *Perumtel* in 1991 into a limited liability company – *PT. Telkom*, with the government as the sole owner of the shares of the company.

The state's monopoly over the sector was more vigorous when the government in 1980 established another state-owned telecommunications enterprise – *PT. Indosat*, which was responsible for the provision of international telecommunications (Sugondo and Bhinekawati, 2004). This company was previously a subsidiary of ITT (International Telephone and Telegraph Corporation), an American telecommunications company, which had operated in Indonesia since 1967 following the enactment of the Foreign Investment Law (Act No.1/1967). The government took over *PT. Indosat* in December 1980 through an acquisition and after this point wholly owned the company's shares (BPAB, 2003). Following the establishment of *PT. Indosat*, there was a separation of international and national telecommunications services: *PT. Indosat* became the sole provider of international services, and *PT. Telkom* became the monopoly supplier of domestic services (Sugondo and Bhinekawati, 2004).

As can be seen, the Indonesian telecommunications pre-privatization regime relied on the concept of state ownership, mainly taking the form of the establishment of SOEs. Moreover, the SOEs operated under a monopoly scheme (duopoly policy), which was not open for private sector participation.

Four main reasons were behind the establishment of this regime. First, the concept of state ownership seems to have been intended as a material elaboration of Article 33 (2) of the Constitution of 1945, particularly of the term "state control". Secondly, the Indonesian telecommunications system inherited the Dutch PTT, which was a state-based monopoly regime. Thirdly, state monopoly had been a mainstream of world telecommunications regimes from the 1900s to the end of 1980s. Most countries, including Indonesia, followed such a regime for their telecommunications system. Finally, telecommunications was considered as a strategic sector that should be controlled by the state.

## 7.2. Process of Telecommunications Privatization

The main reasons that urge the Indonesian government to privatize its telecommunications industry were pragmatic motive, international pressures, international commitments and improvement of service provision. Privatization was seen as the way to resolve the financial crisis faced by the government. In other words, it emerged as a major revenue earner. Hence, privatization of telecommunications mainly took the form of selling SOEs to one or more private sector firms, particularly foreign investors, because local capital markets had a very limited absorption capacity (Latipulhayat, 2006).

Indonesia's privatization was also a condition imposed by international lending institutions such as the IMF and the World Bank to overcome the financial crisis at the end of 1997. The Indonesian government stated: "...among the larger enterprises, the two publicly listed telecommunications enterprises, *PT. Telkom* and *PT. Indosat*, are strong candidates for further rapid privatization".<sup>10</sup> Privatization of the telecommunications has also been part of Indonesia's commitment to the WTO. The main mission of this organization is liberalizing international trade as well as eliminating barriers on global trade and investments (Bobjoseph, 2003). The lack of investment was a major problem in achieving the telecommunications target. Privatization is one of the solutions.

Privatization of the Indonesian telecommunications industry involved both the transfer of activities to private hands and the transfer of state ownership (privatization in the broad sense). More specifically, it was carried out in two steps: the liberalization of telecommunications and the divestment of SOEs. These steps are discussed further below.

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<sup>10</sup> Letter of Intent of the government of Indonesia with the IMF, January 20, 2000.

7.2.1. *The Liberalization of Telecommunications*

7.2.1.1. *From Duopoly to Private Sector Participation*

The enactment of the Telecommunications Act of 1989<sup>11</sup> marked the liberalization of the Indonesian telecommunications industry, as it allowed for the first time participation of private operators in the provision of telecommunications services. This included both domestic and, to a more limited extent, foreign investors (Sugondo and Bhinekawati, 2004). The provision of most relevance to private sector involvement is Article 12 that categorizes telecommunications services into two types: basic services<sup>12</sup> that include domestic and international telephony, telex, telegram and mobile services, and non-basic services<sup>13</sup> such as paging and Internet access. In addition, the provision determines that the “operating body” (Badan Penyelenggara - Indonesian) is to be the sole operator of both domestic and international telecommunications services.

For its operation, the government authorized the two state-owned incumbents, PT. Telkom and PT. Indosat to be the sole “operating bodies” for the provision of basic services. To this end, the government granted PT. Telkom in 1996 two exclusive rights: providing fixed wire line local telephone services until the end of 2010 and providing fixed national long-distance telephone services until the end of 2005. Moreover, PT. Indosat received an exclusive right to provide international services until the end of 2004. In other words, the provision of basic services is the exclusive right of “the operating body” operating under a duopoly scheme.

However, a third “operating body”, PT. Satelindo, was created in 1994 as a joint venture between the two incumbents and a private company (Bimagraha Group), for the provision of international and mobile basic services (Sugondo and Bhinekawati, 2004). This meant that PT. Indosat’s monopoly over the international service was ended and followed by the establishment of a duopoly scheme in the provision of the service.

Regarding private sector participation, the Act provided two schemes as shown in table 1.

Table 1

Telecommunications Services under the Telecommunications Act of 1989		
Service Categories And Examples	Market Structure	Public-Private Partnership (PPP)
<b>Basic Services</b> Domestic and international Telephony, telex, telegram and mobile services	State monopoly through 'operating bodies' (Badan Penyelenggara)	required: through PBH (Pola Bagi Hasil), JVC/Joint Venture Companies (mobile) KSO Kerjasama Operasi-Joint Operations (fixed line)
<b>Non-Basic Services</b> Manufacturing, paging, Internet access and data	Both public and private operators	Not required.

Source: Lee and Findlay (2005), p 343.

First, there was a limited privatization scheme in which private sector firms were permitted to participate in the provision of basic services under cooperative partnership arrangements with the operating body. Private participation in the international service market was not permitted. Secondly, private sector firms could provide non-basic services independently but not in conjunction with the operating body.

In theory, the schemes allow the private sector to provide basic telecommunications services in cooperation with either PT. Telkom or PT. Indosat. But in practice, PT. Telkom was so dominant that there was little room for the others to maneuver (Sugondo and Bhinekawati, 2004). It was only after the government introduced new liberalization measures in 1993 that the private sector started to enjoy the scheme. The government created various public-private partnership (PPP) arrangements depending on the services to be provided. For domestic fixed-line services, the KSO (Kerjasama Operasi – Joint Operations) scheme was the only option available, while PPP structures for the mobile sector could be in the form of either the PBH (pola bagi hasil - a revenue-sharing) agreement or a joint-venture company (JVC).

<sup>11</sup> This Act revoked the previous Telecommunications Act of 1964.

<sup>12</sup> Basic services are telecommunications services conveying information in which the content and message of the information sent and received is of a purely permanent, neutral and transparent nature with regards to the telecommunications network and facilities used.

<sup>13</sup> Non-basic services are valued-added services resulted from the use of certain telecommunications tools such as computers in processing and storing data and information.

### *7.2.1.2. Open Competition*

The government issued the “Blueprint on the Telecommunications Sector Reforms” in 1999. The main objective of this strategy was to move telecommunications operations away from the traditional PPP model so that private operators were no longer required to cooperate with a state-owned incumbent in all service categories. This reform appeared to pave the way for further liberalization of the sector. More importantly, this was elaborated further in the Telecommunications Act of 1999, which revoked the previous telecommunications law, Act No 36/ 1989. Under the new Act, the concept of the “operating body” no longer existed, thus ending PT. Telkom’s and PT. Indosat’s monopolies in the provision of domestic and international services respectively. In other words, the Act marked the beginning of open competition, and ended the state monopoly over the sector.

Unlike the Telecommunications Act of 1989, which conferred on the two state-owned “operating bodies” an exclusive right in the provision of the telecommunications services, the Act of 1999 stipulated that services may be provided by a mix of partly privatized state-owned companies, as well as foreign and domestic private companies.

The fixed-line was the first service that was subject to open competition policy. To this end, the government launched an early termination policy of the exclusive rights granted to PT. Telkom, PT. Indosat and PT. Satelindo in their respective service segments. The exclusive right of PT. Telkom in the provision of local telephone services, which was originally to have expired in 2010, was terminated in 2002 (DGPT, 2004). This was followed by the issuance of a license to PT. Indosat for the provision of such services. Initially, PT. Indosat was allowed to operate only in the metropolitan areas of Jakarta and Surabaya, but its license was extended to cover the entire country in 2004.

In 2003 the government licensed PT. Telkom to provide international services and that move terminated the earlier exclusive right of PT. Indosat for the provision of this service, which was to have ended in 2004. In turn, PT. Indosat obtained a national long distance license which was previously the exclusive right of PT. Telkom until 2005 (DGPT, 2004). In an unprecedented move, the government also agreed to compensate both firms for the loss of their monopolies: it promised to pay 478 billion rupiah to PT. Telkom and 178 billion rupiah to PT. Indosat.

To avoid any potential conflicts of interests in a more competitive environment, the government encouraged PT. Telkom and PT. Indosat to eliminate joint shareholding in their subsidiary companies. As a response, in 2003 PT. Telkom and PT. Indosat eliminated the cross-shareholding structures in PT. Satelindo and several mobile operators through a series of share swaps. Subsequently, PT. Satelindo became a wholly owned subsidiary of PT. Indosat (Telkom Annual Report, 2002). In addition, the government licensed new operators, PT. Ratelindo (private company) and PT. Batam Bintan Telekomunikasi (private company) for the provision of local telephone services. In the cellular services, as of 2003, 3 national operators, Telkomsel, Excelcomindo, and Satelindo controlled more than 70 per cent of the market share (DGPT, 2004). As with fixed-line services, the government issued new licenses to 5 cellular operators,<sup>14</sup> making the market fully competitive.

### *7.2.3. The Divestment of SOEs*

The partial privatization of the incumbent operators (PT. Telkom and PT. Indosat) began in 1991 with the transformation of the domestic carrier, *Perumtel* (public corporation), into a state-owned limited liability corporation with a commercial purpose, named PT. Telkom. A gradual privatization process then ensued, with shares of both PT. Telkom and PT. Indosat being made available on stock exchanges. The main aim was to improve telecommunications facilities and to reduce the State budget deficit (Sugondo and Bhinekawati, 2004).

To accomplish these objectives, the government decided to divest PT. Indosat in 1994 by selling 35 per cent of its shares through a dual listing of which 25 per cent were sold on the New York Stock Exchange and another 10 per cent on the Jakarta Stock Exchange (Indosat Annual Report, 2001). For a similar purpose, the government divested 35 per cent of its share in PT. Telkom in 1995 and a further 11 per cent in 1999 through initial public offerings on the Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange and the London Stock Exchange (Sugondo and Bhinekawati, 2004).

PT. Indosat and PT. Telkom were not totally privatized companies, but have evolved from exclusive state ownership into private companies with multi-ownership structures ( Nugraha, 2004). The government remained the majority shareholder in both companies, with more than 60 per cent of the issued capital. The Articles of Association of PT. Indosat and PT. Telkom established one special golden share, which provided the government with exclusive powers, including a veto right to block a take-over of the company and power to nominate and to appoint the board of directors of the companies. The golden share was designed as a new method of government control over privatized companies.

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<sup>14</sup> These are: PT.Mobisell, PT.Natrindo Telepon Seluler, PT.Telkom, PT.Mobile-8 Telecom, PT.Bakrie Telekom.

Following the resignation of former President Soeharto in 1998, Indonesia experienced multiple economic crises. To resolve the problem, the Megawati Government decided to sell government shares in several SOEs including PT. Indosat. The government sold 41.94 per cent of PT. Indosat's shares to STT (Singapore Technologies Telemedia) in 2002. It raised about US\$ 631 million, of which most was used to reduce the budget deficit. This transaction, however, left the government as minority owner, while STT became the majority shareholder of PT. Indosat (BPAB, 2003).<sup>15</sup> Unlike the first one, the second divestment of PT. Indosat sparked strong opposition from various groups ranging from university intellectuals to politicians. This seemed to be the most controversial privatization that had ever been conducted in Indonesia.

Opponents argued that this divestment contravened Article 33 (2) of the Constitution of 1945 governing state control over strategic sectors such as telecommunications. They claimed that this transaction had left the government with insufficient power to control PT. Indosat, as the government held only a minority share in that company. The main argument was that "state control" means state ownership, which takes the form of a government majority shareholding in the SOEs (Syahdeini, 2003). Laksamana Sukardi (2001), the minister for SOE affairs, however, contended that state ownership is just an interpretation, not the one and only interpretation of the term "state control". He argued that the term had to be interpreted as the utilization (the principle of benefit), not the possession of strategic economic sectors.

Furthermore, the opponents argued that the divestment had made STT not only the majority shareholder but also one of the main players in the provision of cellular services due to the fact that PT. Indosat through its subsidiary companies controlled 30 per cent of the cellular market share. This, according to them, was very capable of creating monopoly practices and that violated the anti monopoly provisions stipulated in both the Telecommunications and Anti Monopoly and Unfair Competition Laws.

## **8. Implications for the meaning of "State Control"**

The Indonesian telecommunications privatization involved both divestitures and non-divestiture activities. According to Al-Shurman (2001), divestiture undertakings deal with selling the SOEs to the private sector, and non-divestiture undertakings do not necessarily lead to a transfer of ownership into private hands. More importantly, this has certain implications for the meaning of "state control", as privatization ideologically opposes state intervention, whilst state control entails state intervention.

Privatization of telecommunications has been designed as an act of dismantling the state monopoly over the sector. By privatization, the government reduces its ownership role, but increases its regulatory function due to the fact that privatization creates new actors in the provision of telecommunications services – private sectors firms. In short, privatization changed the meaning of state control from state ownership to state regulation.

This study found that the notion of state control, its history and ideology all pertain to the state's (government) intervention or its role in the economy, particularly in relation to the strategic economic sectors. In its development "state control" has become a controversial term as it has been subjected to different approaches and applications. This is more complicated in relation to the concept of privatization. On the one hand, privatization entails changing the nature of state intervention or control in the economy. On the other hand, the concept of "state control" indicates a constitutional justification of state intervention in the economy. Both of these interpretations are inter-related and also opposite in nature.

Telecommunications privatization proved that the establishment of SOEs was intended as a tool for state control over the strategic sector rather than a goal. On this matter, Mohammad Hatta, former first Vice President of the Republic of Indonesia and also known as the drafter of Article 33 of the Constitution of 1945 stated (Rice, 1983):

...state ownership was limited to certain upstream industries only (e.g. electricity and basic industries) while leaving the production of basic goods to the other sectors under the supervision of the government.

Hatta stated further (Swasono and Ridjal, 1992): "...to be controlled by the government does not mean that the government runs enterprise through its bureaucracy. [But] the enterprises management shall be given to professionals who will be accountable to government". To sum it up, state control does not necessarily mean state ownership.

Another important implication is that the meaning of state control reflects the political and economic policies of the government in power. As mentioned above, when the government favored direct state intervention in the economy, state ownership and state monopoly seemed to be the "official interpretation" of the term state

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<sup>15</sup> Since 2008, STT is no longer the majority shareholder of PT. Indosat as STT has sold out its shares to Q-Tel (Qatar Telecom).

control. The private sector was not allowed to take part in certain industries including telecommunications. In contrast, the private sector was encouraged to be involved when the government moved its economic policy from a direct to an indirect interpretation of state intervention. Consequently, the meaning of state control also changed.

## **9. State Control after Privatization**

Privatization is both a political and a legal tool, which mainly aims at paradigm shift in the telecommunications operations from state monopoly to competition (multi-operator systems). One of the most important consequences of this is that privatization has led governments no longer being able to play traditional tripartite roles of owner, operator and regulator of telecommunications. The international experience indicates that in the wake of privatization, governments play more prominent roles only as policy makers and regulators. Privatization therefore emphasizes the state's regulatory function. There has been a paradigm shift of the state's control from ownership to regulatory based-control – from direct into indirect state control.

Regarding the methods of state control after privatization of telecommunications, this study has found that in both the international and Indonesian context, governments introduce new methods of control to ensure that all markets (operators) are treated fairly and equally. These methods include the creation of golden shares, the establishment of an independent regulatory body and the introduction of new licensing regimes.

### *9.1. Golden Shares*

Empirical investigation shows that states are often reluctant to relinquish control of privatized companies, and this reluctance appears particularly strong in the so-called strategic sectors such as telecommunications. In other words, privatization of strategic sectors actually pertains to what writers call "sectors ineligible for privatization". Hence, privatization of the sector needs a legal device to enable states to retain some degree of control over the strategic sectors.

There are two main reasons for governments to adopt such a legal device; first, it is believed to be the most suitable means for protecting national interests. Secondly, governments also believe that this device is a form of protection in privatization that is acceptable to foreign investors. By adopting the golden share system, governments retain the power to protect national interests. As a system of protection, however, it does not harm the interests of new owners /private sector (Nugraha, 2004). The device confers special rights, which enable the government to retain its control over privatized industries (Al-Shurman, 2001). Because of the special rights the holder of the share possesses, the device has become popular and has been adopted by many countries undertaking privatization programs, including Indonesia.

Unlike the objectives and functions of conventional shares, which emphasize commercial benefits, golden shares primarily play a controlling role in privatized companies. In European countries, for instance, governments have used golden shares as protection clauses to veto any important decision taken by the newly privatized enterprise. The specific national interests the golden shares are designed to protect are varied and subject to the national law of the country in question. However, they may be classified into three main categories: (i) industries "strategic" to the national economy, (ii) industries "politically sensitive" to the spheres of the economy, and (iii) industries of "symbolic national importance" (Baev, 1995).

For these reasons, the Indonesian government created golden shares as a control mechanism for strategic sectors including telecommunications when these were privatized. The government used this device because conventional shares were considered an inadequate means for protecting national interests. On this matter, the government stated:<sup>16</sup>

If Company Law is deemed to provide insufficient protection, the government will consider use of a 'golden share' to ensure that it is able to review certain key decisions made by the new owners.

In this context, the golden share appeared to be designed as a legal device to accommodate the interests of the state (policy objectives) and new owners (commercial objectives). Hence, it may be concluded that there is an interaction between the golden share and privatization. Here, the golden share is intended to be a legal requirement for an acceptable privatization of the strategic sectors.

PT. Telkom and PT. Indosat have golden share clauses in their Articles of Associations. However, both of the privatized telecommunications companies golden shares only confer upon the government approval and nominating rights of board of directors. Aviliani (2006) argues that this is a strong indication that the government's special shares in the companies have become "barren" golden shares. She suggests that this correlates with the government's weaker bargaining position in the company as a minority shareholder. As a result, the government considers golden shares to be rights in the figurative sense only. If so, the government has

<sup>16</sup> Republic of Indonesia (1998), "Masterplan for the Reform of State-Owned Enterprises".

failed to understand the essence of golden shares, which are contingent upon the government policy position rather than equity.

Until now, there have been no cases that test the efficacy of golden shares in Indonesia. However, a deeper analysis of its profile confirms that existing golden shares in the telecommunications sector exist only for appearance's sake, and are not a functional state control mechanism by any means. Irrespective of whether golden shares in both companies permit the government to approve a number of their key decisions, this device has one serious drawback. Golden shares in Indonesia do not grant the government the right to make policies concerning telecommunications for the benefit of the public. This is rather surprising given that this constitutes one of the main reasons why telecommunications should be controlled by the state. To make the existing golden shares a truly functional state control mechanism, they should be designed in such a way as to secure the public benefit and not harm the commercial interests of new owners, because they focus on making policies.

### *9.2. The Independent Regulatory Body: The State as a Policy Maker*

Privatization has also led to re-organization of the government institutions involved in the telecommunications sector. More specifically, it has moved the telecommunications structure from government-based supply to market based-supply. One of the important consequences of this is that the government's involvement in the sector has focused more on its role as a policy maker. The government's involvement in detailed management of the telecommunications operation may create negative impacts in the competitive market. Hence, the establishment of an independent regulatory body has been essential in changing the regulatory mechanism from a political to a professional orientation.

To this end, the Indonesian Government established the Indonesian Telecommunications Regulatory Body (*Indonesian: Badan Regulasi Telekomunikasi Indonesia/BRTI*) in 2003 through the issuance of the Decree of the Ministry of Transportation No. 31/2003. The government needed to ensure an equal treatment of market participants and fair competition in telecommunications operations. The establishment of an independent regulatory body, therefore, was essential.

The government contended that an independent regulatory body did not necessarily have to be separated completely from the government ministry or department. Furthermore, the government insisted that the Reference Paper of the WTO to which the government had made a commitment, did not specifically require that the regulator be separate and distinct from government ministries or departments. BRTI consists of the Telecommunications Regulatory Committee (henceforth referred to as the Regulatory Committee) and the Directorate General of Post and Telecommunications (DGPT). Hence, BRTI structurally is part of the government ministry,<sup>17</sup> because the DGPT functions as a policy maker on behalf of the government. However, the BRTI is functionally separate from the government ministry, as the Regulatory Committee members are not public servants under the DGPT.

The establishment of the BRTI appeared to be intended as an independent telecommunications regulatory body. However, some have observed that BRTI was afflicted by at least three weaknesses that may reduce its independence (Sugondo and Bhinekawati, 2004). These were: a lack of legitimacy; it was part of a government ministry and therefore lacked independence; and its source of funding.

The establishment of BRTI has changed the Indonesian telecommunications structure from government-based supply to market-based supply as applied in most developed market economies. Separation from state-owned telecommunications operators increases the ability of regulators to act impartially toward all market participants, for example in matters involving competition policy or interconnection (Intven, 2000). In summary, the establishment of BRTI regardless of several drawbacks on this regulatory body has changed not only the Indonesian telecommunications structure but also granted the government a clearer role as policy maker.

### *9.3. Licensing: State Control-Based Regulation*

Licensing is another legal tool to maintain state control after privatization of telecommunications. It can be used as a tool to implement important national priorities, be it opening the markets for equipment, services, and networks to immediate or gradual competition, or to preserve a monopoly for the time being so as to permit investors to recoup their expenditures or to continue a source of revenue for the government.

In this vein, licensing therefore becomes a crucial policy tool for governments. Interestingly, the implementation of a licensing regime for a privatized telecommunications market encourages governments to more clearly adopt a pro-active and explicit telecommunications role. And these policy and licensing roles, together, form the new method of state control.

Licensing is a key aspect of telecommunications regulation. At a basic level, a license permits a telecommunications provider to provide specified equipment, networks, and/or services, and often conditions that

<sup>17</sup> Ministry of Communication and Information.

permission on certain requirements. Licensing, however, can control market entry and, therefore, can be used to shape the market by limiting the number of players or the types of services that they are able to provide. It can create legal certainty for new entrants in markets where the telecommunications regulatory regime or general legal framework is not comprehensive or where there is not much history with telecommunications regulation. Under these circumstances, conditions imposed and rights accorded in license can serve as a substitute for such frameworks (Walden and Angel, 2005).

As a binding contract, a license can guarantee exclusivity or ensure due process as well as impose performance obligations, e.g. in the form of enhanced market penetration or network roll-out requirements. Without the performance obligations, countries might be unwilling to involve private parties in the running of the state-owned incumbent. Licensing can also be used as a tool to create competitive markets by imposing obligations on incumbents in order to level the playing field (Walden and Angel, 2005).

After privatizing and liberalizing the telecommunications sector, SOEs are not the sole provider of telecommunications. As a result, the regulatory framework should move from protecting the incumbent's monopoly to enhancing competition. In this context, the state is no longer able to employ a direct control in the form of establishing SOEs as the sole provider of telecommunication (state ownership). After privatization, the state has little choice but to employ an indirect control in the form of establishing a regulatory framework with a competitive orientation. To this end, establishing a licensing regime is essential. This enables the state to control markets by specifying the rights and obligations of operators, and provides investors with some certainty as to the business in which they are investing. The license provides all stakeholders, including consumers, competitors and the government with a clear understanding of what the operator is and is not permitted or required to do.

Indonesia should take a clear position regarding the state role should play after privatization. The author suggests that the government should focus on the policy making function while the regulatory function including licensing should be transferred completely to the Telecommunications Regulatory Body (BRTI). In addition, Indonesia should consider establishing a new licensing regime that technology neutral in nature. This is to ensure that it does not go out of date when new technology is used to provide the same service. Furthermore, Indonesia should consider adopting a general authorization or class license approach as applied in the UK, except for the use of scarce resources. This will invite more operators to be involved in the provision of telecommunications services and thereby provide more choices to consumers. More importantly, the removal of licensing procedures may substantially reduce the level of corruption in the bureaucracy.

## **10. Concluding Remarks**

Privatization, state control and telecommunications industry are the three main themes investigated by this paper in the context of Indonesia. Privatization and telecommunications industry have been interacting since the 1980s and state control in the sense of government involvement in the sector has been a central issue. Telecommunications is one sector historically subject to state monopolies in both developed and developing countries for many reasons. The Indonesian legislation stipulates that the telecommunications sector is of national strategic importance and must therefore be controlled by the state. Not surprisingly, the Indonesian government has tended to interpret the term "state control" as state or government ownership. The privatization of the Indonesian telecommunications industry, therefore, raises a critical question; in what ways might the government maintain its control over the sector when privatization reduces state ownership in SOEs?

In the telecommunications sector, privatization has been as policy response to the shortcomings and the failures of the *etatist* traditional telecommunications regime in providing services efficiently and in adjusting to rapid technological advances in telecommunications. Privatization is both a political and a legal tool, which mainly aims at paradigm shift in the telecommunications operations from state monopoly to competition (multi-operator systems).

This study argues that the term state control should be understood as a constitutional mandate to the state to make economic policies with the main purpose of utilizing the strategic economic sectors for the greatest benefit of the people. The state nonetheless has the right to choose the appropriate means of control for achieving such a purpose. In this context, the privatization program is not only constitutionally acceptable but also implies a method of control, which the government believes is able to respond to socio-economic development at both national and international level.

Regarding the methods of state control after privatization of telecommunications, this study has found that in both the international and Indonesian context, governments introduce new methods of control to ensure that all markets (operators) are treated fairly and equally. These methods include the creation of golden shares, the establishment of an independent regulatory body and the introduction of new licensing regimes. Together, these aim to reduce monopoly and enhance competition. In summary, by privatization, there has been a paradigm shift of the state's control from ownership to regulatory based-control.

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