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The Indonesian Construction Law: Challenges toward Globalization (Conference Paper)

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Abstract

Construction industry has for long been the backbone of Indonesian economic and social development. Since the early days of modern era of 1900s, during the colonization, the Dutch engineers has brought in and introduced the technology as well as professional practices of the industry to the area. Until 35 years after proclaiming its independence in the 1945, Indonesia has virtually yet to have its own national regulation concerning the construction industry, during which the only known construction legal reference was the colonial inheritance of the Dutch's AV41. In that period the construction industry was dominated by the government role in both providing the infrastructure and regulating the industry. The political reform of 1998 put Indonesia into a new governance paradigm, which in turn also affected practices of the construction Industry. The first Indonesian Construction Law was put into effect in 1999, which was then followed by three government decrees. The three government decrees address issues relating to the business and role of construction society, the practices of construction industry, and construction industry development. This new set of legal construction standard of practices was established in response to increasing demand of local autonomy and global competition challenges. Under this regulation the role of centralized government in infrastructure and construction industry has shifted to allow more participation of private sector and the community. Among important issues addressed in this regulation includes governance, professionalism, and the role of society. This paper discuss the rationale behind the development of the Indonesian Construction Law, the threats and challenges that follow during the last decade of implementation, as well efforts that have been carried by the government and the industry. In particular this paper will discuss three government decrees and their impact to the national construction industry. © RICS.

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The Indonesian Construction Law: Challenges toward Globalization

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Abstract:

Construction industry has for long been the backbone of Indonesian economic and social development. Since the early days of modern era of 1900s, during the colonization, the Dutch engineers has brought in and introduced the technology as well as professional practices of the industry to the area. Until 35 years after proclaiming its independence in the 1945, Indonesia has virtually yet to have its own national regulation concerning the construction industry, during which the only known construction legal reference was the colonial inheritance of the Dutch's AV41. In that period the construction industry was dominated by the government role in both providing the infrastructure and regulating the industry.

The political reform of 1998 put Indonesia into a new governance paradigm, which in turn also affected practices of the construction Industry. The first Indonesian Construction Law was put into effect in 1999, which was then followed by three government decrees. The three government decrees address issues relating to the business and role of construction society, the practices of construction industry, and construction industry development. This new set of legal construction standard of practices was established in response to increasing demand of local autonomy and global competition challenges. Under this regulation the role of centralized government in infrastructure and construction industry has shifted to allow more participation of private sector and the community. Among important issues addressed in this regulation includes governance, professionalism, and the role of society.

This paper discuss the rationale behind the development of the Indonesian Construction Law, the threats and challenges that follow during the last decade of implementation, as well efforts that have been carried by the government and the industry. In particular this paper will discuss three government decrees and their impact to the national construction industry

Keywords:

Construction law, Indonesia, governance, globalization

1. Introduction

Construction industry has for long been considered as the backbone of Indonesian economic and social development. In 2008, the construction industry's direct contribution to the gross national product was around 6%, and employing more than 4.5 million people, which is around 7-8% of the country's overall labor force. Currently the industry consists of more than 134.000 registered construction companies spread out in the country's 33 provinces, where more than 120.000 among them are classified as small-scale business enterprises. In contrast, the largest 900 construction companies have been entrusted with the 80%-90% of the country's US\$ 17 billion national construction market. In order to widen the market, in recent years the government has encouraged the construction companies to go global to include the international market. Consequently, in the last ten to fifteen years, more international construction companies have also joined the market. Such condition has created additional threats and challenges to the growth of the industry. One of many challenges faced by the Indonesia construction industry is availability of sound and effective legal framework.

This year marked the 10th anniversary of the Indonesian Construction Law. Yet, many problems still arise and what was envisioned in that law is yet to be realized. Complaints such as lack of fairness and professionalism, and even the often conflicting regulations, are among the problems faced by the industry. In addition, globalization also requires the national construction industry to respond to the world progress in international contract and regulations. In response, the government and other stakeholder are currently working together to improve the construction regulations.

This research is part of that work that aims at measuring the effectiveness of current legal framework of the Indonesian construction industry, as well as identifying the potential solution on how the regulation can be improved. In particular, the work emphasis on the role and function of Construction Service Development Board – CSDB Indonesia, as the main body responsible for development of the national construction industry. This work is mainly based on the analysis of the Indonesia Construction Service Law and the three Government Decrees against critical issues that have been raised by many stakeholders of the industry. This research will also include group discussion involving academia, government officials, and practitioner of the industry.

2. Method of Study

This study aims at determining the effectiveness of the current construction regulatory framework in catering and advancing the national construction industry. In general this work will consist of three steps. This study started with the review of historical development of Indonesian construction law and regulation, and in particular identifying the significant progress made and its relevant condition during certain period of time. This part of study will be used to gain better understanding the contextual setting of the regulation. Next step will be to identify problems often encountered or cited by various players and stakeholders of the construction industry. This process will be done in two ways. The first one is by reviewing publications in public media, notes of group discussion and meetings, whereas the other method is by conducting survey to construction practitioners, government officials, as well as academia, and officials from central and local Construction Service Development Board offices.

A series of focus group discussions will be held to refine and elaborate finding from the previous steps. This group will consist of representatives from construction practitioners, professional associations, government officials, academia, and NGOs. The focus group will also review similar regulations such as Building and Construction Industry Improvement Act no 113 from Australia (BCII, 2005) or Act 520 - Lembaga Pembangunan Industri Pembinaan Malaysia ACT (CIDB Malaysia, 1994) as references for improvement of the current law. The objective of the discussions is to accurately identify the problems and threats faced by the industry, as well as weakness of current legal framework, and ultimately making recommendation for future revision of the construction laws and regulation.

3. Historical Progress on the Indonesian Construction Law

The Indonesian construction law cannot be separated from its historical progress of the industry. With regard to construction law and regulations, the industry's historical development can be divided into three periods; before independence or colonial period, development period, and reform period.

3.1 Colonial Period

Until 35 years after proclaiming its independence in 1945, Indonesia has virtually yet to have its own national regulation concerning the construction industry, during which the only known construction legal reference was the colonial inheritance of the Dutch's AV41 (*Algemene Voorwaarden Voor De Uitvoering Bij Aaneming Van Openbare* – 1941). During that period the construction industry was dominated by the government role in both providing the infrastructure and regulating the industry. Construction contracts were also drawn from colonial civil law of Dutch's *Burgelijk Wetboek* 1848.

After the independence into the late 1960s, Dutch's own construction companies were nationalized. During that period virtually no private company were involved, and those state-owned companies became the sole engine of the construction industry. There were no bidding involved, and the construction projects were appointed directly to the state-owned contractors using cost plus fee contract. Most of these state-owned construction companies are still exist today and become the top construction companies in Indonesia. Their long experience has proven to be effective in adapting themselves in changing construction regulations.

3.2 Development Period

This period span from 1967 to late 1990s, where the new order government regime was in power. The Indonesian construction industry started experiencing growth, providing significant contribution to the nation's gross domestic product. Despite still inexistence of standard construction regulation, the construction industry manage to grow and expand; involving private sectors and successfully adopting various modern construction practices and standards, such as open bidding procurement process and FIDIC or JCT standard of contracts.

In 1980 the government has started to regulate its state-funded projects, including those in construction sector. Presidential decree no 14 – 1980 has set standard process and requirement for procurement of all projects under government budget (including those

funded by overseas agencies). Through that decree, in order to maintain fairness and accountability, the government also regulated the requirements for all construction and consultant companies to be licensed, and grouped the companies according to their classification and qualification. This decree was then revised and perfected several times to accommodate changing practices and needs in procurement methods. At present Presidential Decree no 29 – 2003 is used as guideline for procurement of all government funded projects.

3.3 Reform Period

The political reform of 1998 put Indonesia into a new governance paradigm, which in turn also affected practices of the construction Industry. The first Indonesian construction law was put into effect in 1999 (*Construction Services Law*), which was then followed by three government decrees. The three government decrees address issues relating to the business and role of construction society, the practices of construction industry, and construction industry development. This new set of legal construction standard of practices was established in response to increasing demand of local autonomy and global competition challenges. Under this regulation the role of centralized government in infrastructure and construction industry has shifted to allow more participation of private sector and the community. Among important issues addressed in this regulation includes governance, professionalism, and the role of society at large.

The Construction Service Law no 18 (Indonesia, 1999) was established in 1999 to response concerns over the fact that high construction growth was not accompanied by effective governance, which was reflected in, among others: a) low quality of product, on time construction, and inefficient use of resources, b) lack of enforcement and compliance to laws and regulations, and c) lack of fairness and synergic partnership amongst providers and users of construction services in terms on rights and responsibilities. Among many significant aspects, the law in particular has set the foundation for establishment of an independent body that would shift most roles of the government in leading and guarding the development and growth of the Indonesian construction industry.

Following the establishment of Construction Service Law no 18, in 2000 the government issued three Government decrees: 1) Government Decree no 28 on Business and Society Role in Construction Services, 2) Government Decree no 29 on Execution of Construction Services, and 3) Government Decree no 30 on Development of Construction Services. In principle, the first Government Decree regulates the professional requirements for entities to operate and the role of society in construction industry. The Government Decree 29 essentially regulates how the construction industry works in terms of contract, covering from selection of provider to execution of work, to construction failure and dispute. The Government Decree no 30 emphasis on the regulation concerning the role of government (both central and local) and construction society in regulating, empowering, and monitoring the construction operation.

Table 1. Summary of Indonesian Legal Framework for Construction Services

Legal Document	Year Effective	Purpose	Remarks
Presidential Decree no 80	2003	Guideline for Procurement of Goods and Services within government jurisdiction	Developed based on Presidential Decree no 14, 1980
Law no 18: Construction Services	1999	Guideline for promotion and development of construction services To maintain order of construction practices that would provide assurance of fairness and adherent to law and order To realize and promote the role of society in construction services	Foundation for Government Decree no 28, 29, and 30 - 2000
Government Decree no 28: Construction Business and Construction Society	2000	Regulation of construction business and role of construction society	The scope includes: business construction, construction workers, construction society, and sanctions
Government Decree no 29: Execution of Construction Services	2000	Guideline for Procurement and Contract of Construction Services	The scope includes regulation concerning procurement of construction services, construction contract, and construction failure and disputes
Government Decree no 30: Implementation of Construction Service Development Guidance	2000	To provide guideline for regulation, empowerment, and control of construction services.	The scope of this regulation includes guidelines for central and local government

4. Finding and Discussion

The successful implementation of Construction Service Law no 18 and its three accompanying government decrees depends on how effective they are to address various issues. Certainly there are other aspects to be considered. However the following discussion describes only some issues that are considered as the most influential ones.

4.1 Balancing the Demand for Local Needs and Challenge for Globalization

Liberalization of international trades in goods and services such as in WTO and AFTA in 2000 has forced the construction industry to open its market for foreign competition. Although these agreements have been taken into effect for some years, the industry is still not fully prepared to cope with the challenges. In this industry only a very limited

number of construction companies are ready for international market opportunities. In addition to lack of international professional practices, many of them are also not familiar with international contract standards such as FIDIC and alike. On the other hand, supported with their advancement in technology, superior experience and strong capital, the competition threat from foreign companies to local construction market is growing significantly.

Although it is commonly acknowledged that such threat is mostly true only for large projects, local competition is also faced with tough challenges. Statistic shows that almost 90% of 134.00 registered construction companies are of small scale companies, each with average annual market less than US\$ 25.000. Of more than those 120.000 companies, it is estimated that only less than one-third are actively involved in construction works, whereas the rest are listed as inactive or fictitious with inadequate or no business and technical resources. The majority of these small-scale companies are located in small cities across Indonesia's 33 provinces. Within such limited local market, these conditions eventually may lead to risk of illegal and unlawful practices such as corruption and collusion.

4.2 Local Autonomy

The main spirit of Construction Service Law no 18 is to lessen the role and control of government over the construction industry. In 1999 the government also established Law no 22 in Local Autonomy and Law no 23 on Financing Balance between Central and Local Government; which was then replaced by Local Government Law no 32, 2004. These two laws have string influence on the development of local construction industry. Under these laws, local governments have more control over planning, budgeting and execution of construction works, which in turn will help strengthening the local construction industry. However, the capacity of local government and construction industry is still limited. Thus, the needs to exercise more autonomic rights are not balanced with adequate capacity to execute. Lack of adequate managerial and technical skills, coupled with low professionalism attitude are among the factors often cited as the low quality of construction practitioner and officials in local government. It seems that what was envisioned in Government Decree no 30 has yet to be realized.

On the authority of local autonomy, in order to protect the interest of local construction industry, many local governments established regulation that created a set of new additional bureaucratic mechanism. Yet, this new set of regulation is often proven to be ineffective and even contradict with other law and regulations.

4.3 Increasing Role of Private Sector and Public Private Partnership

In Jakarta and other major cities, where most commercial building construction works took place, the capacity of the construction companies are among the best in the nation. While state-owned construction companies can benefit from its long experience in construction industry, some newer private companies are also able to compete due to their more professional skills, and more flexible and less bureaucracy in adopting technology and business practices. Unfortunately the largest part of the construction industry does not possess those kinds of capacity. The majority of the Indonesian construction industry consists of medium and small-scale private-owned construction

companies, which mostly work in small scale building and commercial estate constructions. Amongst these small-scale contractors it is not considered uncommon practice where the winning bidders are not the ones who will execute the work but rather act as construction broker. Due to lack of access to project information, this group of companies often works without direct contract with the owner but rather as second or third tier contractor at lower cost than what the winning bidder has initially offer. Pre-arranged tendering process and puppet bidder are frequently cited as the sample of bad practices involving construction companies. This condition certainly causes inefficiency in construction industry.

Decreasing capacity of the government in providing adequate funding for construction has improved the changes for the private sector to play larger role in the construction industry. Like in many other countries, private sector is starting to take larger part in infrastructure constructions, such as toll roads and ports, through public-private partnership initiatives. Although this trend of partnership is expected to grow in the future, where more and more infrastructure investment will be offer to private sector, there are still some legal issues which are not yet specifically accommodated in the current construction laws and regulations. This includes major issues such as standard form of agreement and the responsibility and accountability of private sector to the public.

4.4 Institution and Governance

One of the important initiatives in Construction Service Law no 18 deals with the concept of good governance. Under this law, the central role of government was limited and shifted to a more independent entity representing the interest of all stake holders of the construction industry. The introduction of the notion of construction society put the construction society and the society in general in the central role of the construction industry.

Perhaps the most debated issue regarding the implementation of Construction Service Law no 18 is section VII that regulates the role and responsibility of the construction society. According to this regulation, construction society is defined as part of overall society who has interest to and/or performs activities that are related to construction business or construction works. Further in Government Decree no 28, the role of construction society is to be formulized in the forms of Construction Service Forum and an independent board. Based on those regulations, the government established Construction Service Development Board – CSDB as the independent board that bear the responsibility for development and enhancement of the Indonesian construction services. This body consists of representative of professional associations, as well as representatives or government and academia.

The Construction Service Forum is an informal body consisting of representatives from construction business associations, professional associations, intellectual society, NGOs, the government, and other necessary element. The objective of this forum was to absorb society aspiration, formulize the direction for construction development, providing advice the government, and encouraging society control over the construction. On the other hand, the independent board is the manifestation of the forum which has executive power to exercise its duty: a) to inspire and performed

research and development of construction services, b) performed education and training in construction services, c) conduct registration for all construction workers, d) conduct registration for construction business entities, and e) encourage and improve the role of arbitration, mediation, and expert judgment in construction service. The board is a body similar to CIDB of Malaysia (CIDB Malaysia, 1994) or BCA Singapore (BCA, 2009). The structure of Construction Service Development Board – CSDB consists of one national CSDB at central level and one local CSDB in each of 33 provinces in Indonesia.

In reality, the Construction Service Forum, which is supposed to be the highest body of the board has only insignificant role in the society, whereas the board on the other hand plays very dominating role in the construction industry. Since the law requires any entity (individual or organization) working in the construction industry to be registered and certified, then the certification becomes very crucial issues. So far, most of the debate and complaints concerning the registration evolve around the role and function of the CSDB.

Under the Government Decree no 28, certification is given as acknowledgement to the classification and qualification of competence and capability possessed by individual or construction business entity (Indonesia, 2000a). This certification can only be given by CSDB. Alternatively, certification can also be given by construction associations that have been accredited by the DCDB. Due to limited of capacity of CSDB to certify such a huge number of individuals and construction business entities, the certification process become an enormous burden to the industry. On the other hand, lack of control by CSBD causes the certification by construction associations to face other problems. In practice there is no enforced standard certification employed by association, as each construction association may employ its own standard and mechanism. This condition may lead to improper application of certification process, where certification becomes a trade commodity. Individual person or company which failed the certification can form its own association and, thus conduct its own certification for those who are willing to pay.

4.5 Human Resources

Construction workers are the main player in the construction industry. The quality of construction workers not only depends on the skill and competency of individual workers but also on other factor such as regulation and system. In general, the quality of human resource in Indonesian construction industry is considered low and inadequate for modern construction. Low productivity and high rate of accident is often mentioned to reflect lack of competency and professionalism.

Although has stated showing encouraging trend, the rate of construction accident in Indonesia remains the highest amongst neighboring countries. This condition indicates that the current system and regulation concerning construction safety and health has proven to be ineffective to cope with this alarming condition. In particular, in a highly competitive job market, the attitude of workers toward construction safety is generally disappointing, as they are willing to take risk in return for simply being able to work. Similarly, the current business practice of construction service has not been able to convince the construction companies to start using productivity as factor to improve

competitiveness in the industry. Lack of understanding on the importance of productivity and construction safety by both the workers and the management often considered as the major influencing factor. The majority of the industry still considers safety and productivity improvement program as additional burden to construction cost with no apparent benefit. (Soemardi *et al*, 2009)

5. Conclusion and Recommendation

Preliminary assessment to the effectiveness of legal framework for Indonesian Construction Service has identified some issues that may be taken into consideration for improving the current law and regulations.

Expanding the Scope of “Construction” and Restructuring the Construction Industry

According to Construction Service Law no 18 – 1999, the term construction service includes planning, execution, and monitoring and supervision of construction works. This scope is considered to narrow and should be expanded to accommodate more comprehensive scope of construction works. The term construction should not be limited to that scope but should also be able to accommodate wider applications of construction arrangement, such as those found in BOT contract. A full life-cycle construction process must also include the operation, maintenance and refurbishment and demolition. In addition, the new law should be able to accommodate other players in the overall construction service supply chain, and should not limit itself into contractors and consultants.

To assure the fairness and equal opportunity in the industry, the construction service needs to be restructured. Classification and qualification of construction business entity should be redefined as to accommodate and compatible with international standard, such as CPC (central product classification).

Restructuring the Construction Human Resources System

Under the current law and regulations Construction Service Development Board holds strategic position in relation to construction human resource development. To improve the capacity and competence of the construction workers, CSDB must be more active to promote and conduct training for construction workers of all levels. CSDB is also expected to learn from success of similar organization in other countries, and to develop programs which are more appropriate for national construction condition, as well as capable to meet with global challenges.

According to Construction Service Law no 18, construction workers are categorized into expert and skill workers. Meanwhile the Ministry of Labor and Transmigration has already developed Framework for Indonesian National Qualification, a system of qualification and career path which consists of nine levels of qualification. For that reason, to ensure compatibility and equality amongst the workers in the construction the classification and qualification of construction workers needs to be synchronized. Further, CSDB must play larger role in enhancing the national construction industry by actively promoting and enforcing the professional role and good governance of the construction associations as the center for professional development at all levels.

Reposition and Revitalization of Construction Institution

The capacity and governance of the Construction Service Development Board must continuously be improved. While in the past this organization was often found itself trapped within conflict of political interest of various parties, in the future this organization should be able to play greater role in guiding the development of the construction industry. In order to do so, the organization needs to be able to distance itself from politic and transform its character from a bureaucratic licensing board into a professional organization serving and guiding the advancement of the construction industry through advocating, education, and research.

It is apparent that under the current legal structure the responsibility for developing and improving the national construction industry lies heavily on CSDB. However, due to the lack of professional maturity of the industry, it is widely acknowledged by the industry that the government should not distance itself from the current structure. While the current CSDB structure has liberated the construction industry from government dominated control, the need for strong government leadership and responsibility remains imperative. As opposed to being a totally independent body, many in the industry is considering to restructure CSDB to be more of a government controlled agency, like those in Malaysia and Singapore.

Globalization and internationalization is something that the industry cannot avoid. The ever growing participation of international construction companies must be responded effectively. CSDB should play leading role in enhancing the capacity of local companies to compete with their foreign counterparts. On the other hand, the construction law and regulations should accommodate the demand for international contracts as well as regulation concerning international partnerships.

6. Acknowledgement

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