

# CHAPTER I

## INTRODUCTION

### A. Context of Study

In a number of developed countries, the depreciation of exchange rate cause the increase of demand in domestic market, but in the case of Indonesia, research show the opposite result,<sup>1</sup> where the depreciation of Rupiah's exchange rate cause the decrease of demand. This is because the structure of industry in Indonesia, in export and in domestic market, have a high import content.<sup>2</sup> A low and stable inflation is a requirement to establish a welfare society.<sup>3</sup> In the other hand, the cause of inflation pressure in Indonesia is not only from the demand that can be managed by the Bank of Indonesia.<sup>4</sup> Research shows that the characteristic of inflation in Indonesia have a tendency to be unstable especially affected by supply, regarding turbulances in production, distribution and government policies.<sup>5</sup> Indonesia urgently needed a way out of its vulnerability to the fragile exchange rate that cause inflation.

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<sup>1</sup> Fajar Madjardi, *Dampak Pergerakan Nilai Tukar Rupiah Terhadap Laju Inflasi Indonesia*, BI, 2000.

<sup>2</sup> Untill next five years, Agency for Industrial Policy (Badan Pengkajian Kebijakan, Iklim, dan Mutu Industri /BPKIMI) projecting the dependence on imported raw materials and auxiliary fixed 60% - 70% of the requirement, see <http://www.imq21.com/news/print/259639/20141013/160058/Pertumbuhan-Industri-Non-Migas-2015-Ditargetkan-Capai-6-.html> the impact on inflation is driven by changes in the price of imported raw materials, accessed 30 December 2014.

<sup>3</sup> Kelompok Kerja Nasional Tim Pengendali Inflasi Daerah, *Buku Petunjuk TPID*, BI-kementerian Koordinator Bidang Perekonomian-Kementerian dalam Negeri, 2014.

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

Miranda Swaray Goelton<sup>6</sup> in 2007 suggested the need for the existence of some sort of fund called “Sovereign Wealth Funds” (SWF) which has stabilizing function, investment, and saving. It is very relevant to the challenges of the global economy for the Indonesian economy in the form of higher uncertainty, especially in the financial sector.<sup>7</sup> The Head of Fiscal Policy Agency (Ministry of Finance RI) defines *Sovereign Wealth Funds* (SWF) as a financial vehicle own by the country that have or organize public fund and invest it to vast and various assets.<sup>8</sup> The purpose or function of it is to stabilize economy,<sup>9</sup> especially investment and saving. In a simple words, SWF is the government saving, or the excess that is owned by the government which is invested for higher *return*.<sup>10</sup> With the existance of SWF it is expected that there will be no more idle and unused government revenue.<sup>11</sup> The revenue can be invested in a precise and high quality manner so that it can give high *return*.<sup>12</sup>

There are 2 source of fund of SWF, they are;

1. Those originated from unrenewable resources (oil and gas), and

<sup>6</sup> Senior Deputy Governor of Bank Indonesia at that time (2004-2009)

<sup>7</sup> See more <http://www.antaraneews.com/berita/87045/no-state-firm-to-conduct-ipo-this-year-minister> accessed 30 December 2014.

<sup>8</sup> Bambang Brodjonegoro (Kepala Badan Kebijakan Fiskal 2011-2014) <http://www.fiskal.depkeu.go.id/2010/m/edef-konten-view-mobile.asp?id=20130626101158316341541> accessed 2 January 2015.

<sup>9</sup> In a national economy, economic stability is related to the proportional relationship between the expenses and the income as well as lots of other conditions. Each one of the internal indicators, inflation, budget deficit, financial growth, unemployment which are facilitated from in determining whether the economic stability is enabled or not, are dynamic elements which change during the process. See more Hilal Yildiz, Farhang Morady and Ismail Siriner, *Globalization: Dimensions & Impact Global Studies Vol.2*, IJOPEC PUBLICATION, London, Istanbul, 2015, p. 108.

<sup>10</sup> *Ibid.*

<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

2. Those originated from fund in the form of financial assets such as: stocks, bonds, properties, precious metals and financial instruments.<sup>13</sup> For example, Qatar Investment Authority (Qatar) and Abu Dhabi Investment Authority (UEA) are SWF with the source of fund originated from unrenewable resources which is oil. Temasek (Singapore) and Khazanah (Malaysia) are SWF with the source of fund originated from financial assets.<sup>14</sup>

The International Monetary Fund defines sovereign wealth funds as “special purpose investment funds or arrangements owned by the general government”.<sup>15</sup> They originate from both commodities and non-commodities, typically made up of either earnings made from selling natural resources to foreign countries, excess money resulting from surpluses in balances of trade, and/or exchanging assets from various foreign exchange reserves.<sup>16</sup>

SWFs are a heterogeneous group and may serve various purposes.<sup>17</sup> Five types of SWFs can be distinguished based on their main objective:<sup>18</sup>

1. *stabilization funds*, where the primary objective is to insulate the budget and the economy against commodity (usually oil) price swings;

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<sup>13</sup> *Ibid.*

<sup>14</sup> *Ibid.*

<sup>15</sup> Cadet R. V. Demson, *The Effect of Sovereign Wealth Funds on Free Market Economies*, Virginia Military Institute.

<sup>16</sup> *Ibid.*

<sup>17</sup> Prepared by the Monetary and Capital Markets and Policy Development and Review Departments in Collaboration with Other Departments, *Sovereign Wealth Funds – A Work Agenda*, Approved by Mark Allen and Jaime Caruana, International Monetary Fund, february 29, 2008.

<sup>18</sup> *Ibid.*

2. *savings funds* for future generations, which aim to convert nonrenewable assets into a more diversified portfolio of assets and mitigate the effects of Dutch disease;
3. *reserve investment corporations*, whose assets are often still counted as reserve assets, and are established to increase the return on reserves;
4. *development funds*, which typically help fund socio-economic projects or promote industrial policies that might raise a country's potential output growth; and
5. *contingent pension reserve funds*, which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government's balance sheet.

Many SWFs are used as additional investment tools to provide governments with the means to fund social projects and promote economic growth for the aggregate benefit of the citizenry.<sup>19</sup> They are also used to stifle threatening shocks to national economies by dissipating excess liquidity and controlling inflation.<sup>20</sup>

Indonesia shows its interest in SWF by establishing Indonesia Investment Agency (PIP) as the operator of government investment. As it is regulated in Government Regulation Number 1 Year 2008 concerning the authority of organizing government investment is conducted by the Minister of Finance as the State General Treasurer. Minister of Finance establish a government investment agency with the name Indonesia Investment Agency (PIP) in the form of a unit

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<sup>19</sup> Demson, loc.cit.

<sup>20</sup> *Ibid.*

that apply Financial Management for Public Service Agency. It is in line with the reformation in the field of state finance in early 2000 which was marked by the passing of Law concerning State Finances, Law concerning State Treasury, and Law on Audit, Management and Accountability of the State Finance, government has a role of doing investment.<sup>21</sup>

This role is mainly related with the market failure in the provision of public goods with the ultimate purpose to promote the general welfare.<sup>22</sup> Article 41 Law concerning State Treasury gave mandate to government to conduct long term investment that gave economic benefit, social benefit, and other benefit.<sup>23</sup> This mandate is followed by the issuance of Government Regulation Number 8 Year 2007 concerning Government Investment (PP 8/2007) as it is amended with Government Regulation (PP) Number 1 Year 2008 concerning Government Investment.<sup>24</sup> The change is conducted as the development of situation in order to give a bigger opportunity of cooperation in investment by adding the form of government investment.<sup>25</sup>

The important point in the change of PP 1/2008 is the accomodation of the form and type investment that is always evolve according to the condition of world economy, its function as the legal protection of investment cooperation between the government and foreign country, and the wish to improve the

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2015. <sup>21</sup> [http://www.fiscuswannabe.web.id/2013/03/PIP\\_11.html](http://www.fiscuswannabe.web.id/2013/03/PIP_11.html) last accessed 2 January

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*

country's economy through government investment realized through Government Investment Agency can be more developed and advanced like the investment agency of other countries such as Temasek and Khazanah.<sup>26</sup> The establishment of Indonesia Investment Agency is conducted with Regulation of the Minister of Finance of the Republic of Indonesia (PMK) No.52/PMK.01/2007 concerning Organization and Working Procedures of Government Investment Agency.<sup>27</sup>

The organization of Indonesia Investment Agency is in the form of Public Service Agency as it's stated in the regulation.<sup>28</sup> After the establishment of Indonesia Investment Agency and also improvement of performance, status as Public Service Agency gradually that is attached to SKS-BIP advanced to Full Public Service Agency.<sup>29</sup> The change in status of this Public Service Agency (BLU) is regulated by the Minister of Finance through Ministry of Finance of the Republic of Indonesia Decree No.91/KMK.05/2009 concerning Establishment of Indonesia Investment Agency in the Ministry of Finance as the Government Institution that Apply Financial Management for Public Service Agency.<sup>30</sup>

In committing investment activities, Indonesia's Investment Agency is based on these regulations:<sup>31</sup>

- a. Constitution RI, 1945
- b. Law No. 17 Year 2003 concerning State Finances.

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<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid.*

<sup>28</sup> *Ibid.*

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

<sup>31</sup> Soritaon Siregar, *Pembiayaan Investasi Melalui Pusat Investasi Pemerintah Sebagai Upaya Percepatan Penyelenggaraan Infrastruktur Berkelanjutan*, 2013, <http://pusbinsdi.net/file/1328010933PembInvest%20Natsir.pdf> accessed 2 January 2015.

- c. Law No. 1 Year 2004 concerning State Treasury.
- d. Government Regulation (PP) No. 23 Year 2005 concerning Financial Management of Public Service Agency.
- e. Government Regulation (PP) No. 1 Year 2008 concerning Government Investment.
- f. Regulation of the Minister of Finance of the Republic of Indonesia (PMK) No. 135 Year 2011 concerning Organization and Working Procedures of Government Investment Agency.

Event though the Indonesia Investment Agency (PIP) was given autonomous and adequate discretion by the Law and regulation in order to conduct government investment, but still has the constraints on mechanism and deliberation process of State Budget (APBN) where the role of executive and Commission/Budget Agency of House of Representatives (DPR) in State Budget (APBN) that stipulated in Law Number 17 of 2003 on State Budget and Law Number 27/2009 concerning The People's Consultative Assembly of the Republic of Indonesia (Majelis Permusyawaratan Rakyat Republik Indonesia / MPR RI), House of Representatives (Dewan Perwakilan Rakyat Republik Indonesia / DPR RI), The Regional Representative Council (Indonesian: Dewan Perwakilan Daerah, DPD), and Regional House of People's Representatives (Dewan Perwakilan Rakyat Daerah, DPRD). These Law are the obstacles for Public Service Agency, particularly Indonesia Investment Agency (PIP) conducting their job as Sovereign Wealth Fund.

This thesis presents research in the form of an analytical study of sovereign wealth funds (SWFs) and the context of the thesis is to identify financial, management and legal issues of Indonesia Sovereign Wealth Fund where it was still in form of Indonesia's Investment Agency (PIP) as the operator of government investment, to analyze the structure of BLU whether or not it's suitable for Indonesia's Investment Agency to perform its function in doing investment according to the law and International principles,<sup>32</sup> and practices of government investment, also analyzing the reformation of Indonesia Investment Agency (PIP) and PT SMI into Indonesian Infrastructure Financing Agency.

This thesis also review SWF's operations in detail and comparing SWF operations in some of countries to give further recommendation of the development of investment strategies and policy issues for future actions of Indonesia.

## **B. Statement of Problems**

There is few Indonesian legal literature that discussed about the sovereign wealth fund, let alone the problems that faced by the Indonesia Investment Agency or PIP as Sovereign Wealth Fund. Therefore the researcher trying to discussing the issues through answering the following questions:

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<sup>32</sup> According to Santiago Principles that established by International Working Group of SWF (IWG) since it have recently been recognized as well-established institutional investors and important participants in the international monetary and financial system.



1. Does the form of Public Service Agency (BLU) appropriate for the Indonesia Investment Agency (PIP) acting as Sovereign Wealth Fund?
2. What should Government do to make a better concept of Indonesia Sovereign Wealth Fund?

### C. **Research Objective**

The overriding objective of this study is to develop an understanding Sovereign Wealth Fund in Indonesia. Ultimately, two specific research objectives were established, namely:

1. The objective of this thesis to have a clear understanding of Sovereign Investor in the global investment.
2. To give recommendations for Indonesian Government to create a better Sovereign Wealth Fund.

### D. **Theoretical Framework**

Law development has an interdependent relationship with various disciplines like economy and politics.<sup>33</sup> Therefore, law development is not an autonomous process, it is an heterogeneous development instead, this means law

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<sup>33</sup> See more Phillip Areeda, COMMENT - ALWAYS A BORROWER: LAW AND OTHER DISCIPLINES, delivered at Duke Law School on April 7, 1988. available at <http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3054&context=dlj> last accessed 14 April 2016

development could not be disengage from the others.<sup>34</sup> That is why the basis for the theoretical development in this thesis is the depiction of the research problem and the review of literature not merely concern the legal aspects but includes theories of investment strategies, portfolio management, economic policy formulation, organizational structure and environmental dimensions such as trade and legal aspects generated from literature are reviewed and used in the analysis.

The theoretical framework based on the illations and gaps established from literature review in the area of Sovereign Wealth Funds management, Agencification and their links to existing theories. Especially the agencification which is relevant to the form of Indonesia Investment Agency status as Public Service Agency which is affected by the development of ideology and doctrine of the New Public Management and agencification that has inspired a lot of countries in the world to form government organization unit, where its structure and function separated from the primary ministry. Policy-making organization is separated from the policy-executing organization or government organization with more specific duties and provide as well as directly in touch with public services. New Public management has becoming a developing trend for these last two to three decades started by United Kingdom, Australia, New Zealand and other European countries.<sup>35</sup>

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<sup>34</sup> See more Richard A. Posner, "The Decline of Law as an Autonomous Discipline: 1962-1987," 100 Harvard Law Review 761 (1987), available at [http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2801&context=journal\\_articles](http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2801&context=journal_articles) last accessed 14 April 2016

<sup>35</sup> See more Larbi, G.A., United Nations Research Institute for Social development, Discussion paper 112, 1999, updated 2003. available at

Government management transformation in the New Public Management is started from Institutional Arrangement, Civil Servant Reform, and Government Budget Management Reform/New Management Reform.<sup>36</sup> In that New Public Management doctrine, Government is advised to leave the classic public organizations, which is based on vertical communication channels that are ineffective, dogmatic decision-making mechanisms, and other rigid constructs that restraint the innovative process.<sup>37</sup>

Indonesia has been adapting the New Public Management by doing state budgeting reform that started in the end of 2003, in the form of publishing 3 packages of new state budgeting regulations, Law Number 17 Year 2003 concerning State Budgeting, Law Number 1 Year 2004 concerning State Treasury and Law Number 15 Year 2005 concerning State Budget Auditing. These 3 packages of regulation about government budgeting has changed the mindset to be more efficient, professional, accountable, and transparent by changing traditional budgeting into performance based budgeting that open the corridor for the implementation of the performance based budgeting in government environment. With this performance based budgeting, the use of government fund is clearer, it changed from only funding the input and process into output-

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[http://siteresources.worldbank.org/INTROADSHIGHWAYS/Resources/338993-1115316483571/3-public\\_sector\\_mgmnt\\_reform.pdf](http://siteresources.worldbank.org/INTROADSHIGHWAYS/Resources/338993-1115316483571/3-public_sector_mgmnt_reform.pdf) last accessed 14 april 2016.

<sup>36</sup> Mahmudi, 2003. New Public Management (NPM): Pendekatan Baru Manajemen Sektor Publik. Jurnal. Sinergi Vol. 6 No. 1. Hal: 69 – 76.

<sup>37</sup> Golembiewski, Robert T., and Eran Vigoda, Organizational Innovation and the Science/Craft of Management. In Current Topics in Management, vol. 5, edited M.A. Rahim, R.T. Golembiewski, and K.D. Mackenzie, 263–80. Greenwich, CT: JAI Press, 2000.

oriented. This change is very important considering the need of fund is getting higher while government resources are limited.<sup>38</sup>

Based on the Law, government institution whose primary function and task is to provide service to the society can implement a flexible financial management pattern in the form of freedom to do healthy business practices in order to maximize services to the society with still upholding productivity, efficiency and effectiveness through the Public Service Agency.

Law No. 1 year 2004 about State Treasury on article 1 stated that the Public Service Agency is a government institution made to provide services for the society in the form of goods and/or service that are sold without prioritizing profit and in doing its activities is based on the principle of efficiency and productivity. This definition is adopted its conducting regulation in the Article 1 of PP No. 23 year 2005 about Public Service Agency Management.

#### **E. Definition of Terms**

Since there is few Indonesian legal literature that discussed about the sovereign wealth fund, researcher searched the literature and other materials in form of journals and articles from foreign authors and most of the literature language in English, therefore researcher would like to give some explanation related with the unfamiliar terms;

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<sup>38</sup> Abdul, Ahmad Hag, Ensiklopedia Perbendaharaan Badan Layanan Umum, 2009.

**Sovereign Wealth Fund (SWF)** is a special purpose investment funds or arrangements, owned by the general government.<sup>39</sup> Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets.<sup>40</sup> The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.<sup>41</sup>

The **Santiago Principles** are a voluntary set of principles and practices developed by the International Working Group of Sovereign Wealth Funds during 2008.<sup>42</sup> The Principles identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practices by Sovereign Wealth Funds (SWFs) on a prudent and sound basis.<sup>43</sup>

**Stabilization Funds** are usually set up by countries rich in natural resources to provide budgetary support as well as to insulate the national economy from volatile international commodity prices.<sup>44</sup> These funds are commonly set up during the boom times and drawn upon when the commodity prices are lower or

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<sup>39</sup> Generally Accepted Principles and Practices, IMF International Working Group of Sovereign Wealth Funds.

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

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[http://www.futurefund.gov.au/data/assets/pdf\\_file/0015/4209/Santiago\\_Principles\\_implementation.pdf?mode=results&queries\\_field\\_query=Santiago+principles](http://www.futurefund.gov.au/data/assets/pdf_file/0015/4209/Santiago_Principles_implementation.pdf?mode=results&queries_field_query=Santiago+principles) accessed 10 January 2015.

<sup>43</sup> *Ibid.*

<sup>44</sup> Kavaljit Singh, Frequently Asked Questions about Sovereign Wealth Funds, This paper is a part of joint research collaboration between Public Interest Research Centre and The Corner House, UK, 2008.

there is a shortage of reserves.<sup>45</sup> The Reserve of Fund of Russia is an example of stabilization funds.<sup>46</sup>

**Savings / future generation funds** are set up by government for longer term wealth creation to meet future needs.<sup>47</sup> The sources of these funds are commodity based or fiscal. For commodity exporting countries, savings funds help in transferring non-renewable assets (such as oil) into financial assets, thereby preserving the country's wealth for future generations.<sup>48</sup> One prominent example of savings funds is Alaska Permanent Fund of US.<sup>49</sup>

**Indonesia Investment Agency / Pusat Investasi Pemerintah (PIP)** is an agency doing operational authority in the management of Central government Investment according to the policy determined by the Minister of Finance, and based on the prevailing legislation.<sup>50</sup> It's a unit that implementing Public Service Agency Financial Management (Pola Pengelolaan keuangan Badan layanan Umum – PPK-BLU), established in 2007 as a provider-based government investment under the Ministry of Finance.<sup>51</sup>

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<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*

<sup>47</sup> *Ibid.*

<sup>48</sup> *Ibid.*

<sup>49</sup> *Ibid.*

<sup>50</sup> Ministry of Finance Regulation Number 52/PMK.01/2007, see also Ministry of Finance of the Republic of Indonesia Decree No.91/KMK.05/2009 concerning Establishment of Indonesia Investment Agency in the Ministry of Finance as the Government Institution that Apply Financial Management for Public Service Agency.

<sup>51</sup> see more <http://www.pip-indonesia.com/staticcontent/history> accessed 10 January 2015.

**Government Investment** is the placement of funds and/or goods in a long term investment for purchase of securities and direct investment to gain economic benefit, social benefit, and / or other benefits.<sup>52</sup>

## **F. Research Method**

### **1. Object of Research**

- A. Law and regulations concerning Indonesia Investment Agency (Pusat Investasi Pemerintah) legal status.
- B. State-Owned Enterprises, particularly PT SMI
- C. Sovereign Wealth Funds

### **2. Data Source / Legal materials**

Primary legal material, Law and regulations that also suppose to be the basis for PIP to implement the government investment, such as:

- a. Law No. 17 Year 2003 concerning State Finances.
- b. Law No. 1 Year 2004 concerning State Treasury.
- c. Government Regulation (PP) No. 23 Year 2005 concerning Financial Management of Public Service Agency.

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<sup>52</sup> Ministry of Finance Regulation Number 1/PMK.01/2008,  
<http://www.flevin.com/id/Igso/translations/MoF/No%2003%20PMK%20011%202012.pdf>  
accessed 10 January 2015.

- d. Government Regulation (PP) No. 1 Year 2008 concerning Government Investment.
- e. Regulation of the Minister of Finance of the Republic of Indonesia (PMK) No. 135 Year 2011 Concerning Organization and Working Procedures of Government Investment Agency.
- f. Law No.19 year 2003 concerning the State Owned Enterprises.
- g. Government Regulation No.44 year 2005 concerning the Procedure and Administration of the State Capital Investment in State-Owned Enterprises and Company Limited.
- h. Government Regulation No.6 year 2006 concerning Management of State Assets/Region Assets.
- i. Generally accepted principles and practices “Santiago Principles“ by International Working Group of Sovereign Wealth Funds (IWG) aims at supporting the institutional framework, governance, and investment operations of SWF’s that are guided by their policy purpose and objectives, and consistent with a sound macroeconomic policy framework. Publication of the GAPP should help improve understanding of SWFs as economical and financial oriented entities in both, home and recipient countries.

This research uses secondary legal data, which consist of:

Books and Journals related to Government investment and the analysis of the existence of SWF in Indonesia.



### 3. Method of Gathering Legal Materials

The method in obtaining legal material used library research and searching data on internet. The data were collected from books, news, journals, and articles which discussed the issue of SWF implementation and Government Investment.

### 4. Approach Method

This study used statute approach by analyzing the issues from the perspective of regulations, and other relevant rules concerning the legal problems faced by Indonesia Investment Agency (PIP) as Indonesia Sovereign Wealth Fund and the issues related with transfer of assets of PIP to PT SMI, also about the government plan to establish LPPI.

### 5. Method of Legal Materials Analysis

In analyzing the legal materials, the descriptive qualitative method was employed. The obtained data was descriptively presented and analyzed in accordance with relevant regulations that govern on the topic of the use of Sovereign Wealth Fund in Indonesia and the legal status of Indonesia Public Agency (PIP) as well as the issues related with transfer of PIP assets to PT SMI and the government plan to establish LPPI, from the perspective of bureaucratic obstacles, Law and demands from PT SMI.

## **G. Systematic of Writing**

Chapter I contains the Introduction that encompasses these following parts: Context of Study, Statements of Problem, Objectives of Research, Theoretical Framework, Research Procedure, and Systematization of Writing.

Chapter II contains theoretical review on Sovereign Wealth Fund and the legal structure of Sovereign Wealth Fund.

Chapter III contains of analysis of Indonesia Sovereign Wealth Fund, State Position in Investment and legal issues related with establishment of Indonesian Infrastructure Financing Agency (LPP)

Chapter IV provides the conclusion and recommendation which are made based on the previous analysis that had been done.

