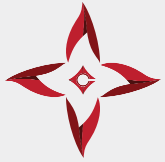


CIPS
Center for Indonesian Policy Studies

# POLICY BRIEF

May 2020

Policy Brief No. 4

# Attracting FDI Post Covid-19 by Simplifying Indonesia's Regulatory Framework

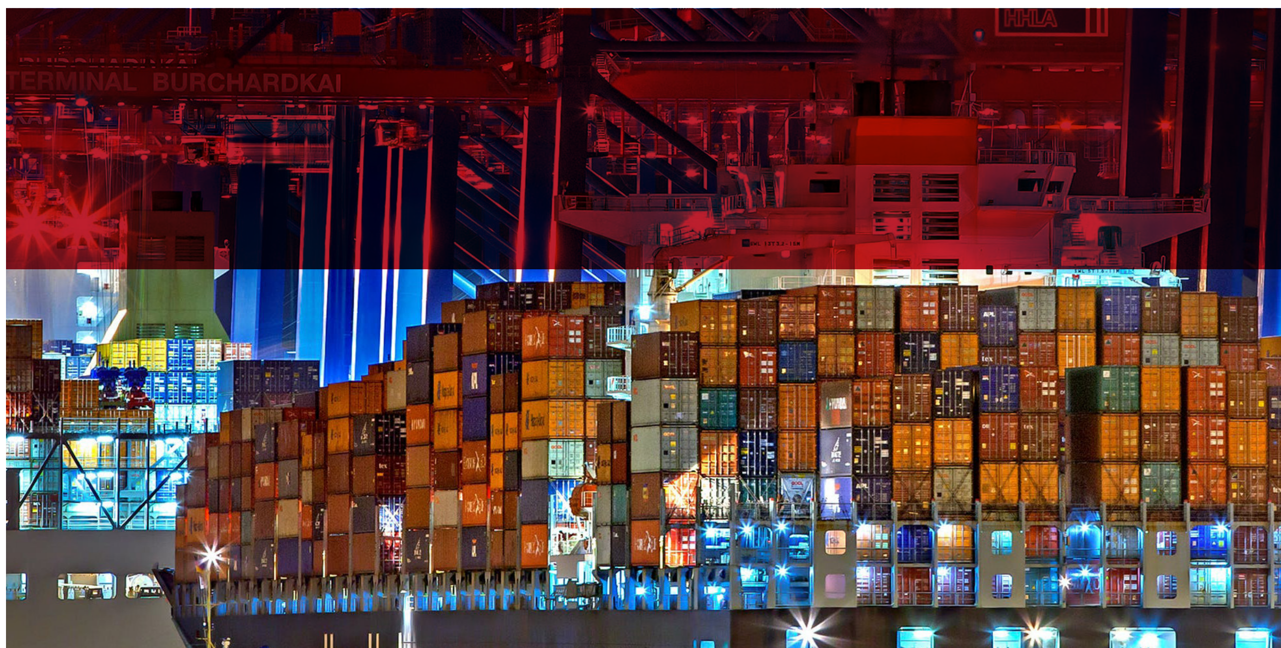
**by** Arianto Patunru* & Andree Surianta**

## Key Messages

- Restrictions to control Covid-19 spread have put immense pressure on international trade and investment. Global trade is predicted to fall by 13 – 32%, while foreign direct investment (FDI) may sink even deeper with estimates ranging between 30% and 40%.
- Global value chains (GVC) are reorganising to reduce dependence on China. Southeast Asia can attract a share of these relocations, but Indonesia is relatively unattractive to foreign investors due to its highly complex regulatory environment.
- To simplify the regulatory landscape, the President proposes an Omnibus Bill, but its reach is limited. Moreover, it requires 400 new implementing regulations, which are supposed to be drafted within an ambitious one-month deadline, and it may lead to thousands other regulations.
- Instead of rushing the reform, the President and his cabinet should focus on improving the quality of these implementing regulations by allowing 3-6 months for research and public consultations.
- The President should also exert discipline on ministers by attaching simplification standards to budget allocations. A mapping of the regulatory framework should support the targeting and monitoring of reforms.
- In the longer-term, it is necessary to revise Article 8 of Law 12/2011 on the establishment of laws and regulations, which bestows regulatory authority to a broad range of government agencies. The Law should also stipulate periodic regulatory reviews to abolish laws and regulations that have become irrelevant or inapplicable.

*Fellow of Arndt-Corden Department of Economics; Policy Engagement Coordinator of ANU Indonesian Project; and Board Member of Center for Indonesian Policy Studies.
** PhD scholar at Crawford School of Public Policy, ANU, and a research associate at the Centre for Indonesian Policy Studies.

# Silver Lining for Investment in Southeast Asia




Covid-19 pandemic began as a public health crisis but has now developed into one of the greatest challenges to international trade and investment. The need to restrict interactions has gone against the interconnectedness which is the foundation of the Global Value Chains (GVC). With international trade predicted to contract by 13 – 32% in 2020 due to the pandemic, corporations simply have less cash available to invest in new ventures or to expand existing facilities. Consequently, FDI is predicted to fall even deeper, reducing by as much as 40% depending on how long the outbreak lasts (UNCTAD, 2020; WTO, 2020).

China's economies of scale which were central to its role in the GVC have caused concerns even before the pandemic hit. The US-China trade war forced many corporations to explore other locations to circumvent the escalation of tariffs. As the pandemic reduces supplies from China, multinational enterprises (MNEs) are under increasing pressure to diversify their supply chain beyond China.

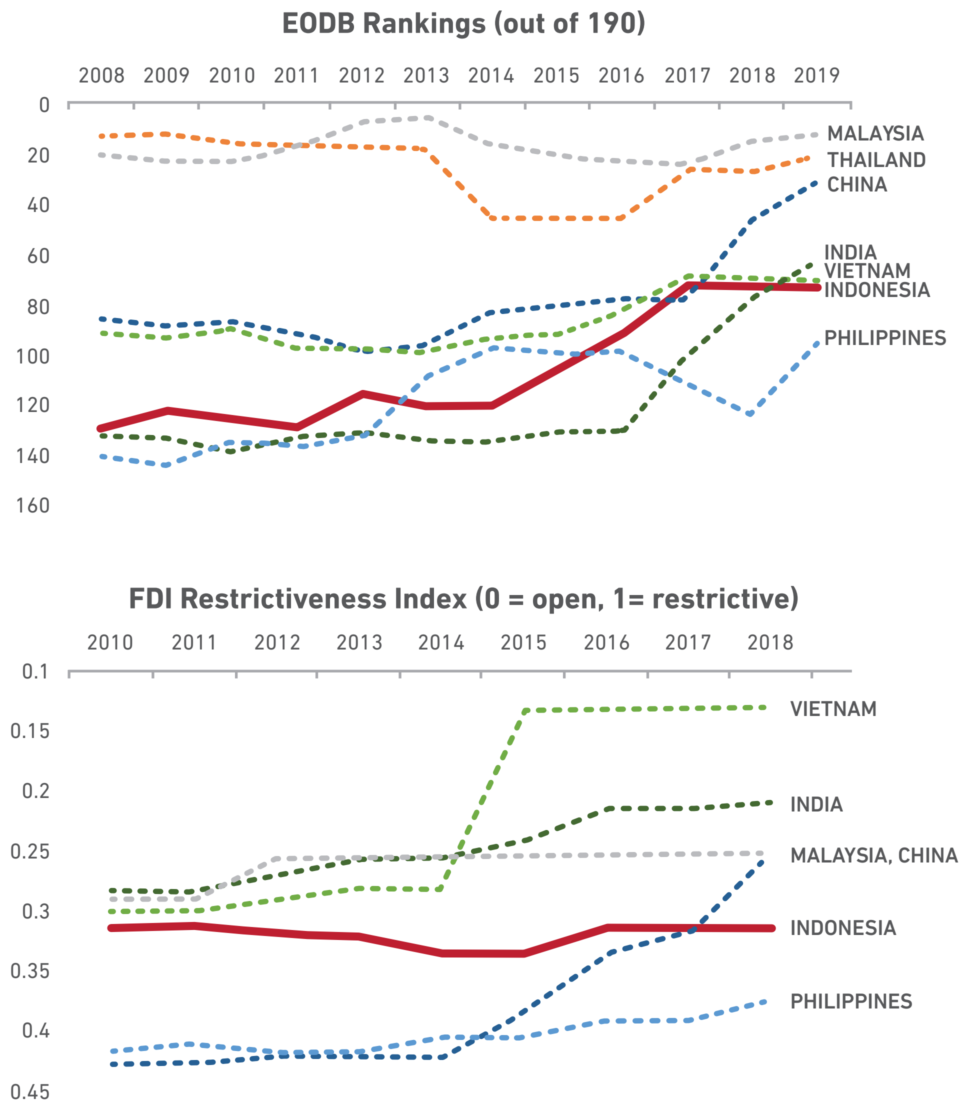
UNCTAD and others have predicted that in order to improve their supply chain resilience, many MNEs will return facilities home in a move called "reshoring". Indeed, China's major trade and investment partners are actively encouraging their corporations to return home. Reported actions include the US mulling the possibility of government absorbing all reshoring costs, South Korea offering over US$3.6 billion of reshoring loans, and Japan allocating US$2 billion in its rescue package to help companies reshore (Jung, 2020; Landay, 2020; Reynolds & Urabe, 2020).

Meanwhile, the trade war experience demonstrated that many MNEs prefer relocating their Chinese facilities to Southeast Asia (The World Bank, 2018). Reports have stated that Apple and Google have been exploring Vietnam and Thailand as alternative locations since mid-2019 and are now spurred on by the pandemic (Chatterjee, 2019; Cheng & Li, 2020a, 2020b). Nearly one thousand Japanese manufacturers are diversifying procurement outside China, backed by their government which allocates over US$200 million for diversification into Southeast Asia (Reynolds & Urabe, 2020). Amid the dark clouds rolling in on global investment, Southeast Asia economies may actually be the beneficiaries of an exodus from China.

# Indonesia Investment Challenges

As the largest economy in Southeast Asia, such GVC diversion should be welcome news for Indonesia. However, Indonesia is relatively unattractive to foreign investors compared to its neighbours. As Figure 1 shows, although its Ease of Doing Business rankings has improved significantly since 2014, this has been insufficient to catch up with most of its peers. In fact, openness to FDI has been declining before reversing in 2015. Both indicators show no improvement since 2017, which is rather unfortunate considering gains made by its neighbours in the same period (OECD, n.d.; Trading Economics, n.d.).

**Figure 1.**
**Ease of Doing Business and FDI Restrictiveness**



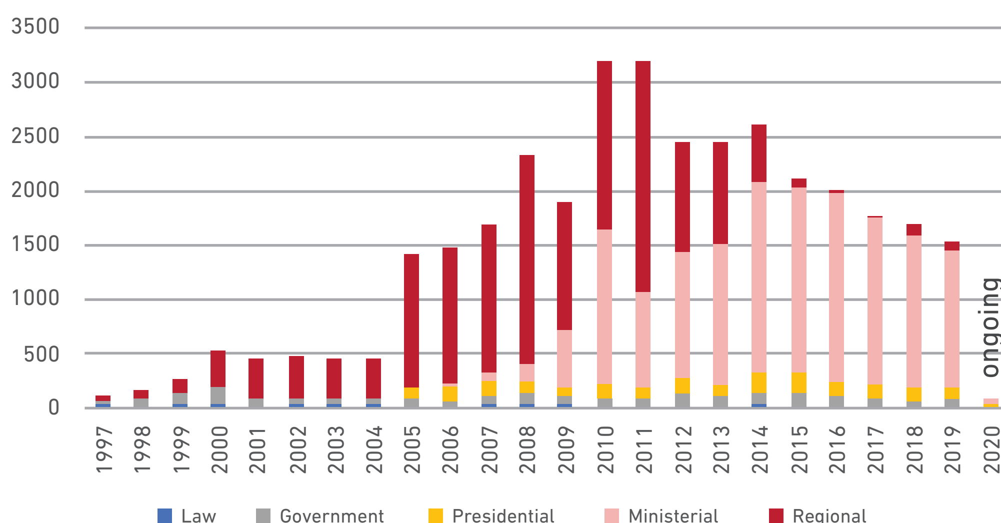

Source: The World Bank via Trading Economics database, OECD

Due to this restrictiveness, Indonesia was largely bypassed when 33 Chinese-listed companies were looking for other locations in 2019. Prior to that in 2017, Indonesia only managed to attract 10 out of 137 Japanese companies moving into Southeast Asia (The World Bank, 2019). Early signs of pandemic-led investment slowdown have been reported in Indonesia's Special Economic Zones due to limited access to capital and physical distancing policies (Waseso, 2020). Palu SEZ, for example, has had two Chinese manufacturers postponing their investment plans despite already carrying out some preparatory works there (ANTARA News, 2020). Since SEZs offer investors special conditions and incentives, their problems to attract investments can be seen as a precursor to a general downturn of investment in Indonesia. Serious efforts to increase Indonesia's attractiveness for FDI are necessary to allow for a speedy economic recovery when Covid-19 subsides.

When highlighting the relocation cases, the World Bank (2019) asserted that a major deterrent for foreign investors here is the highly complex regulatory landscape. It points to the sheer number of ministerial and regional regulations, and the many inconsistencies they cause. Indeed, there are over 15 thousand ministerial regulations in Indonesia, 95% of which issued since 2010 (Ministry of Justice and Human Rights, n.d.). On top of that, each province, city and district (regency) can issue their own regulations as well (Figure 2). If this "regulatory obesity" is not addressed thoroughly, Indonesia will continue to struggle attracting foreign investors.

To illustrate how burdensome this can be, when an investor wants to setup a factory in Indonesia to supply the domestic market, it will have to navigate over 900 rules of the Manpower and Industry Ministries. If it plans to link up to the GVC and import intermediate goods or export final products, another 695 trade rules enter the picture. Added to this are sector-specific policies, issued by Ministers of Transportation, Education, Agriculture, Energy and Mineral Resources, Construction, ICT, and Tourism. After escaping this central-regulation labyrinth, investors need to overcome the hurdle of hundreds of regional regulations, depending on where their investment is located.

**Figure 2.**
**Number of Regulations Issued in Indonesia Anually**




Source: Ministry of Justice and Human Rights

# Current Reforms

Signalling its commitment to simplify regulatory complexities, the President of Indonesia submitted a draft Omnibus Bill on Job Creation (the "Bill") to the legislative assembly (*Dewan Perwakilan Rakyat*/DPR) in February 2020. If passed, it revokes or revises over 1,200 articles in 79 laws deemed problematic for investors. Drafted in approximately two months, it covers a broad swathe of policies from licensing to economic zones (Coordinating Ministry of Economic Affairs, 2020). As a flagship reform effort, it sends a positive signal to the investment community. However, the Bill encounters staunch public opposition due to its perceived lack of transparency and rushed process. This has led to obstacles in the legislative process and even possible rebranding when labour unions mobilized against it (Akhlas et al., 2020; Katadata, 2020a, 2020b).

An analysis of the Bill's content casts some doubt over its simplification effects. Firstly, the Bill trims the highest level of regulation, i.e. the laws; but the obesity appears far below at the ministerial level. It revokes nearly 300 articles in existing laws and revises over 900 more, but it also requires the drafting of over 400 new Government and Presidential Regulations. This may seem like a good simplification exercise, but the real challenge lies in maintaining regulatory discipline at lower levels.

Article 8 of Law 12/2011 on establishing laws and regulations allows ministries and equivalent government agencies to issue legally binding regulations based on instructions by higher regulations or by their own authority. This latter part is understood as providing ministers and agencies with the authority to issue sector-specific regulations. Such "proactive regulating" is the main contributor to regulatory obesity. In investment, for example, Law 25/2007 foresees the implementation through 5 regulations[1] but it is being cited by 39 ministerial and agency regulations.[2] Without tight discipline, the 400 rules intended by the Omnibus Bill can easily become thousands; negating its simplification effort.

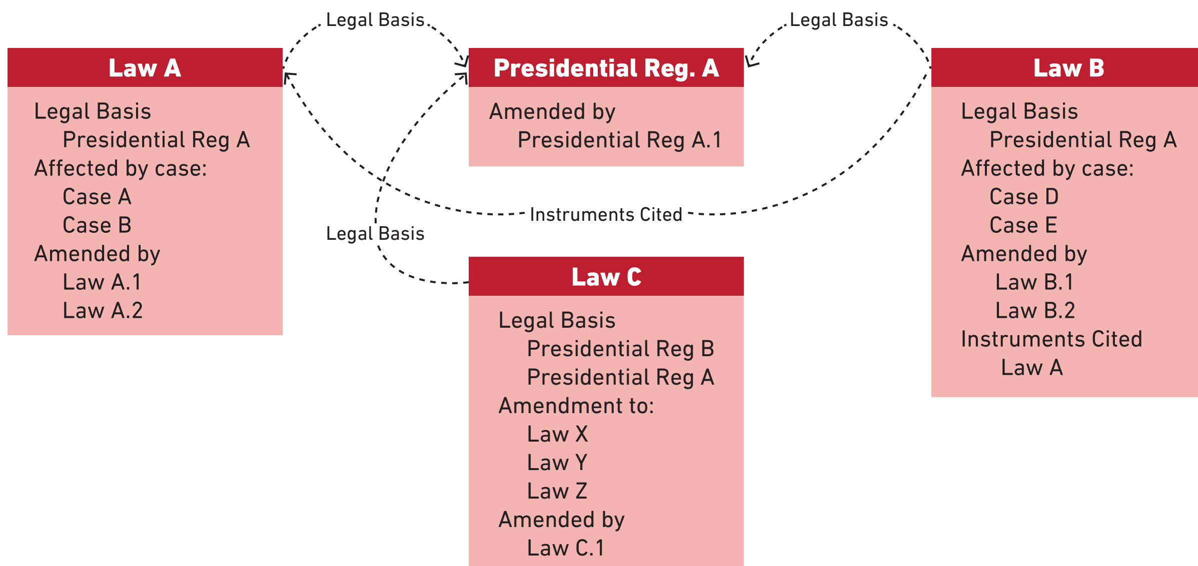
To complicate matters further, revoking an article in a law does not automatically void the pre-existing law and its implementing regulations. In fact, the Bill's article 173b expressly maintains validity of pre-existing regulations with an allowance of one month for "adjusting inconsistencies". Investment Law, for example, the Bill revises 5 out of 40 articles of this Law No. 25/2007. One article requires a new Presidential Regulation, while the other four require regulatory adjustments. Meanwhile, the rest of Law No. 25/2007 remains valid and that would include its implementing regulations. Hence, future investments will have to follow two laws, i.e. the new Omnibus Law and Law No. 25/2007, each with their own implementing regulations. This increases complexity and the risk of overlap which can create further confusion.

Secondly, the Bill sets a very ambitious timeline for the regulatory follow-up process. The one-month deadline includes not only the adjustment of existing implementing regulations (art. 173b) but also drafting new ones (art. 173a). Past research has highlighted the limited policy-making capacity in Indonesia which can take years to issue implementing regulations after a law is passed (Pramusinto, 2016). As an example, Presidential Regulation on the use of Indonesian language has been issued ten years after the law was passed.[3] Rushing revisions and 400 new regulations in a month will impact their quality and end up creating further uncertainty in the investment landscape. Hence, this whole simplification exercise can backfire and deter investors even more.

Lastly, there are regulations that pose unnecessary burdens to businesses but have not been covered by this reform. A report by the National Development Planning Agency (BAPPENAS) points out that Indonesia needs to embark on a holistic regulatory reform to improve its global competitiveness (Sadiawati, 2015). This report highlights regulatory reforms in South Korea after the 1997 crisis as a prime example: from 11,125 regulations identified, nearly half were revoked and over 20% were revised within 11 months. In Indonesia, the government regulatory database (peraturan.go.id) records all regulations, their history, and linkages mainly for harmonisation purposes (Ministry of Justice and Human Rights, n.d.). However, these data are still presented in table format, which makes it difficult to conduct a comprehensive review of all regulations in Indonesia. It should be converted into a visual format, as done by Koniaris et al. (2017) to measure the complexity of EU regulations based on EUR-Lex database (Figure 3).

[1] These are three Presidential Regulations and two Investment Coordination Board Regulations
[2] Including regulations from the Minister of Home Affairs, Agriculture, Trade, Industry, Energy and Mineral Resources, Transportation, Fisheries, Forestry, Social, and the Investment Coordination Board
[3] Law 24/2009 on National Flag, Language, Emblem and Anthem was passed in July 2009 and stipulated a Presidential Regulation to be drafted for the language component. Presidential Regulation 63/2019 on Indonesian Language Use was issued in September 2019.

**Figure 3.**
**A Legislation Network Example**




Presidential Reg: Presidential Regulations

Source: Koniaris et al. (2017)

To truly improve ease of doing business and attract more investment, the Indonesian government should not consider the Bill as the only goal of reform, but as a breakthrough momentum that must be carried forward to usher more economic openness in the future.

# Policy Recommendations for Indonesian Government

**The following recommendations seek to improve chances of attracting FDI to Indonesia:**

- **Extend the deadline for follow-up regulations in the Omnibus Bill**
  The President or the DPR should consider revising the one-month deadline for adjusting and issuing new regulations. Considering public rejection on grounds of lack of transparency and rushed timeline, the Cabinet should ensure that each implementing regulation is backed by extensive research (Academic Script / *Naskah Akademik*) and intensive public consultations. To allow for these, the deadline should be extended to 6 months or set a rolling deadlines of 3 months per cluster. Priority should be given to clusters which impact sectors deemed important for economic recovery, such as agriculture and manufacturing.

- **Exert tighter control over ministerial regulations**
  The President should adjust ministerial budget allocations to favour revoking or revising existing regulations over creating new ones. This can be done by specifying a certain simplification ratio that is linked to budget drawdown. In the long run, the President should propose a revision to Law 12/2011, especially on Article 8, to limit proactive regulating by ministers.

- **Conduct periodic review of regulations**
  To address resources and capacity limitation, an ongoing review and simplification process needs to complement major reform efforts like the Omnibus Bill. The Regulatory Flexibility Act of the United States can provide some guidance here (National Oceanic and Atmospheric Administration, 2019). It requires US federal agencies to specify a review milestone for every regulation issued, so that there is a constant flow of reviews coming up yearly. Similar stipulations can be added to Law 12/2011 to ensure that all regulations are reviewed, perhaps a decade after issuance, to evaluate their relevance.

- **Conduct periodic review of regulations**
  To facilitate broad regulatory reforms and periodic reviews, a Legislation Network mapping can be useful. As briefly mentioned above, this technique was introduced to measure the complexity of EU legislations (Koniaris et al., 2017). A similar mapping can be done based on the Indonesian government's peraturan.go.id database. A visual map of the whole regulatory framework exposes relationships between nodes that are not apparent in a table format. This tool should be used for reform targeting and monitoring.

# References


Akhlas, A. W., Ghaliya, G., & Aritonang, M. S. (2020, April 25). Indonesia delays deliberations over labor issues in omnibus bill amid backlash. *The Jakarta Post*. https://www.thejakartapost.com/news/2020/04/24/govt-house-delay-deliberations-over-labor-issues-in-omnibus-bill-amid-backlash.html

ANTARA News. (2020, February 18). Several investment agendas in Palu SEZ delayed due to coronavirus [Sejumlah agenda investasi di KEK Palu tertunda karena virus corona]. *ANTARA News*. https://www.antaranews.com/berita/1304182/sejumlah-agenda-investasi-di-kek-palu-tertunda-karena-virus-corona

Chatterjee, R. (2019, August 28). Google to move Pixel smartphone production to Vietnam: Nikkei. *Reuters*. https://www.reuters.com/article/us-google-vietnam/google-to-move-pixel-smartphone-production-to-vietnam-nikkei-idUSKCN1VI11L

Cheng, T.-F., & Li, L. (2020a, February 26). Google, Microsoft shift production from China faster due to virus. *Nikkei Asian Review*. https://asia.nikkei.com/Spotlight/Coronavirus/Google-Microsoft-shift-production-from-China-faster-due-to-virus

Cheng, T.-F., & Li, L. (2020b, May 8). Apple to produce millions of AirPods in Vietnam amid pandemic. *Nikkei Asian Review*. https://asia.nikkei.com/Business/Technology/Apple-to-produce-millions-of-made-in-Vietnam-AirPods-amid-pandemic

Coordinating Ministry of Economic Affairs. (2020). *Infographics - Job Creation Bill* (*Infografis - RUU Cipta Kerja*). Coordinating Ministry of Economic Affairs. https://ekon.go.id/info-sektoral/15/7/infografis-seputar-ruu-cipta-kerja

Jung, S. (2020, February 21). South Korean Government to Promote Reshoring for Less Dependence on China. *Businesskorea*. http://www.businesskorea.co.kr/news/articleView.html?idxno=41645

Katadata. (2020a, April 28). As Controversy Arises, Will Govt Change the Name of Job Creation Bill? *D-Insights*. https://dinsights.katadata.co.id/read/2020/04/28/as-controversy-arises-will-govt-change-the-name-of-job-creation-bill

Katadata. (2020b, April 30). Postponing Labor Issues, Is It A Political Compromise? *D-Insights*. https://dinsights.katadata.co.id/read/2020/04/30/postponing-labor-issues-is-it-a-political-compromise?utm_source=Dinsights&utm_campaign=61e45dee4c-RSS_EMAIL_CAMPAIGN&utm_medium=email&utm_term=0_c3092b0f90-61e45dee4c-127930761

Koniaris, M., Anagnostopoulos, I., & Vassiliou, Y. (2017). *Network Analysis in the Legal Domain: A complex model for European Union legal sources*. https://arxiv.org/pdf/1501.05237.pdf

Landay, J. (2020, April 10). Full immediate expensing would lure U.S. firms back from China: Trump adviser Kudlow. *Reuters*. https://www.reuters.com/article/us-usa-china-kudlow/full-immediate-expensing-would-lure-u-s-firms-back-from-china-trump-adviser-kudlow-idUSKCN21R387

Li, L., & Cheng, T.-F. (2019, June 19). Apple weighs 15%-30% capacity shift out of China amid trade war. *Nikkei Asian Review*. https://asia.nikkei.com/Economy/Trade-war/Apple-weighs-15-30-capacity-shift-out-of-China-amid-trade-war

Ministry of Justice and Human Rights. (n.d.). *Peraturan.go.id Homepage*. Retrieved May 5, 2020, from http://peraturan.go.id/

National Oceanic and Atmospheric Administration. (2019). Plan for Periodic Review of Regulations. *Federal Register, 84*(170), 45929–45930. https://www.federalregister.gov/documents/2019/09/03/2019-18486/plan-for-periodic-review-of-regulations

Pramusinto, A. (2016). Weak central authority and fragmented bureaucracy: A study of policy implementation in Indonesia. In *The Role of the Public Bureaucracy in Policy Implementation in Five ASEAN Countries* (pp. 98–170). Cambridge University Press. https://doi.org/10.1017/CBO9781316340653.004

OECD. (n.d.). FDI restrictiveness (indicator). OECD Data. https://doi.org/10.1787/c176b7fa-en

Reynolds, I., & Urabe, E. (2020, April 8). Japan to Fund Firms to Shift Production Out of China. *Bloomberg*. https://www.bloomberg.com/news/articles/2020-04-08/japan-to-fund-firms-to-shift-production-out-of-china

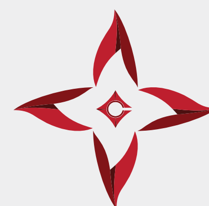
Sadiawati, D. (Ed.). (2015). National Strategy for Regulatory Reform (*Strategi Nasional Reformasi Regulasi*). Ministry of National Development Planning (BAPPENAS). https://www.bappenas.go.id/files/9814/4419/3082/Buku_Reformasi_Regulasi.pdf

The World Bank. (2018). *Indonesia Economic Quarterly 2018: Strengthening competitiveness*.

The World Bank. (2019). *Global Economic Risk and Implications for Indonesia*. The World Bank. https://cepagram.com/index.php/2019/10/07/global-economic-risk-implications-indonesia-world-bank/#

Trading Economics. (n.d.). *Ease of Doing Business*. Trading Economics. Retrieved May 5, 2020, from https://tradingeconomics.com/country-list/ease-of-doing-business

UNCTAD. (2020). *Investment Trends Monitor: Impact of the COVID-19 pandemic on global FDI and GVCs*. https://unctad.org/en/PublicationsLibrary/diaeiainf2020d3_en.pdf?utm_source=World+Investment+Network+%28WIN%29&utm_campaign=b80b397835-EMAIL_CAMPAIGN_2017_05_22_COPY_01&utm_medium=email&utm_term=0_646aa30cd0-b80b397835-70651257



CIPS

Center for Indonesian Policy Studies

The Center for Indonesian Policy Studies (CIPS) is dedicated to providing policy analysis and practical policy recommendations to decision-makers within Indonesia's legislative and executive branches of government.

As a strictly non-partisan and non-profit think tank, CIPS promotes social and economic reforms that are based on the belief that only civil, political, and economic freedom allow Indonesia to prosper.

Center for Indonesian Policy Studies

contact@cips-indonesia.org

Jalan Terogong Raya No. 6B Cilandak,
Jakarta Selatan 12430, Indonesia

www.cips-indonesia.org

Our works relies on your support. Visit
**www.cips-indonesia.org/donate**
to support CIPS.