Improving Investment Climate in Indonesia

- Improve consistency of policies and create better design of their implementations, to provide certainty for foreign investors.
- Determine specific Key Performance Indicators, and employ reward and punishment mechanism in fiscal relations between central and local government. Therefore, local government will have incentives to perform bureaucracy, administration, and regulatory management more efficiently, thus creating certainty for business sector.
- Make Negative Investment List (DNI) as a single reference for regulations on foreign investment. Every restrictions to foreign investment found in other regulations must be incorporated into DNI. It is even better if foreign investment restrictions are not covered in sectoral regulations, but rather, they are listed only in DNI.
- Create a more comprehensive and transparent process of arranging DNI, based on objective studies and Regulatory Impact Assessment (RIA), that involve various institutions and stakeholders.

Ease of Doing Business

The main challenge of the Indonesian economy under the leadership of Jokowi-Jusuf Kalla is job creation. 7.5 million open unemployment, along with the expected addition of 8 million labor forces from 2014-2019, will require a creation of 15 million jobs in the next 5 years. This can only be provided through private investments.

However, the investment climate in Indonesia is not very conducive. **In starting a business**, investors generally complain about the difficulty and high cost needed to set up a legal entity. The difficulties also arise from the obligation to put as collateral a certain amount of fund while establishing a company, in addition to the time uncertainty to obtain a business permit.

In realizing the investment, many investors complain on the difficulties to comply with sectoral business licenses, to gain access for land, and of the high cost of compliance to regulations. In addition, investors are also having difficulties in obtaining licenses due to the overlapping of authorities, at both central and local government level.

In running the business, investors face numerous difficulties, such as the lack of certainty and law enforcement, labor issues, and high-cost economy due to the poor quality of regulations and public services.

Most of the constraints for doing business in Indonesia stem from the inconsistencies between one policy/regulation with other policies and/or regulations. For example, the spirit of openness found in Investment Law should also be reflected in all the other regulations, including national and local regulations, and sectoral regulations in industry, trade, agriculture, mining, etc. However, many of those regulations impose restrictions that are in contrary to the spirit of openness in the Investment Law.

Other problem comes from the frequent change of policies and regulations, which creates uncertainty for business sector. One example is the enactment of Government Regulation No. 78 in 2015 on Remuneration, which in reality is not applied in all provinces. There are still some local governments setting their own provincial minimum wage, with no regard to the formula prescribed in the aforementioned Government Regulation.

Another problem is the overlapping and confusing institutional design. To obtain a business license, there are numerous steps and requirements, which involve various government institutions at various levels. As a result, business sector experiences more uncertainty and finds it more costly to do business.

Negative Investment List (DNI)

As a developing country, Indonesia still requires capital formation as a source for development. Currently low capital-to-labor ratio means that capital formation from investment can yield big impact. Unfortunately, Indonesia's ability to raise capital from domestic source is very limited. Therefore, Indonesia still needs foreign investment. Foreign investment can provide Indonesia with benefits and improvement in technology, labor skill, and network, while at the same time create new jobs and increase our government revenue.

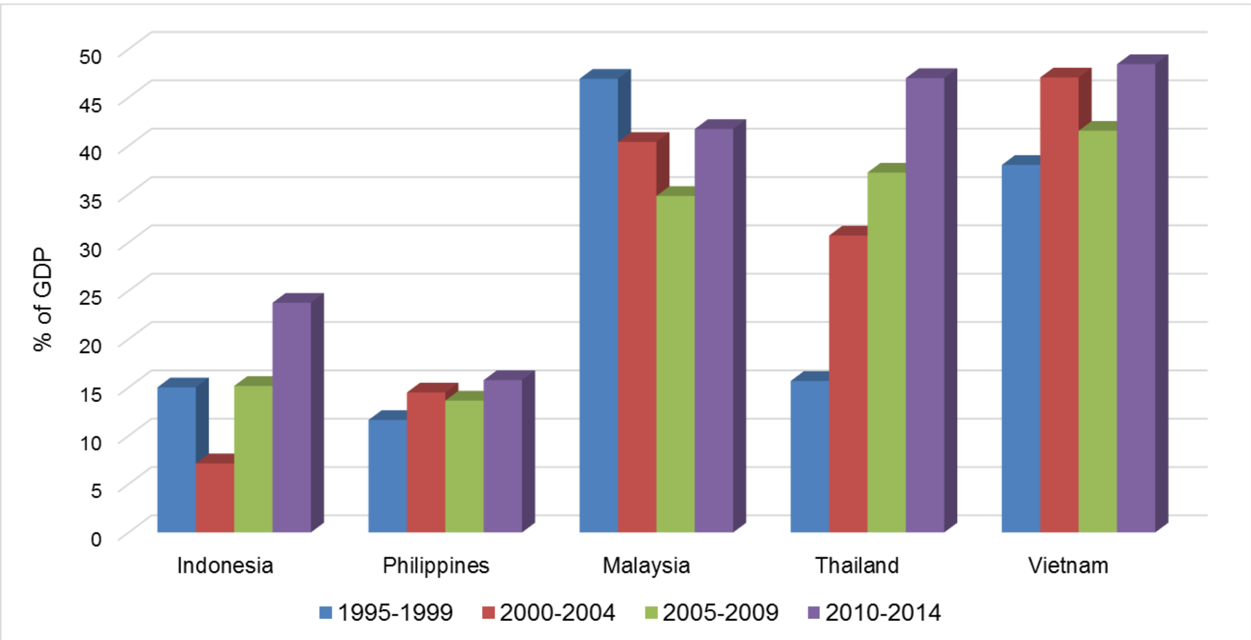
The stock amount of foreign investment in Indonesia in 2014 was only about 28% of the total GDP. This figure is far below the FDI stock in Malaysia or Thailand, which is more than 40% of their GDPs, and Vietnam, with almost 50% of its GDP. A study by Lipsey and Sjoholm (2010) shows that in 2005, the amount of foreign investment in Indonesia was only about 40% of its potential. Meanwhile, other neighboring countries, except for the Philippines, could attract higher amount of foreign investment than their potentials.

Currently, foreign investment is regulated in the Negative Investment List (DNI). DNI regulates the openness of a business sector to investment, whether fully closed for any investment, or partially closed (investments are allowed with certain requirements). Such arrangement is commonly practiced by the governments of various countries.

The problem with DNI in Indonesia is that it is not the only source of reference to regulate foreign investments. Some sectors are highly restricted for investment by other sectoral regulations, despite their absence in DNI. This has caused uncertainty for foreign investors. It is extremely important for the Indonesian government to make DNI as the only source of reference for foreign investment restrictions.

In addition, the formulation of the DNI often more reflects the interests of a group of businessmen, rather than the interest of the economy as a whole. Consultation activities in the formulation process of DNI only involves business players in the sector rather than involving various other parties and obtaining or considering their differing views as well. As a result, many people have a misperception that DNI is a policy instrument for protecting domestic businesses from surges of foreign investment.

Ratio of Foreign Investment Stock to GDP in 5 ASEAN Countries



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