NEGATIVE INVESTMENT LIST

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This policy brief is the result of an activity entitled "Economic Policymaking in Indonesia' which is jointly conducted by Centre for Strategic and International Studies (CSIS) and Economic Research Institute for ASEAN and East Asia (ERIA). This activity is a contribution from research community that is expected to assist the government in formulating more effective economic policies in the future. In this activity, CSIS and ERIA invited 16 economists with specific fields of expertise from some leading research institutions to conduct in-depth discussions on seven strategic issues facing Indonesian economy (infrastructure development, competitiveness, investment climate, food policy, services sector policy, fiscal policy, and social protection policy), which is then summarized into policy briefs covering each of the topics.

Dissemination of the findings and recommendations produced by this activity is conducted through several channels. First, this activity has made efforts to engage the relevant government officials through some Focus Group Discussions (FGD), the publication of High Level Policy Notes, and hearings with some strategic policymakers with regard to each of the strategic issues mentioned above. Secondly, this activity also conducts widespread public disseminations through Public Seminars on each of the strategic issues, along with publications of the Policy Briefs and supporting multimedia that can be accessed online through www.paradigmaekonomi.org.

GENERAL OVERVIEW:

1. ***Investment, whether domestic of foreign, is one of the most important pillars in Indonesia's economic development.***
2. ***As a means for the government to regulate foreign investment through policies, the Negative Investment List, or* Daftar Negatif Investasi *(DNI) must reflect a balance between economic development goals and national interests. The DNI must also dynamically follow the conditions of national economic development, as well as consider the development of global economic (and business) conditions.***
3. ***As the country's economic development level increases, the list of businesses should decreases and/or the easier the DNI requirements.***
4. ***The process of drafting the DNI should be done comprehensively, transparently, and should be participated by various stakeholders of the DNI.***

BACKGROUND

Apart from consumption, investment (Gross Domestic Fixed Capital Formation – GFCF) is another source of economic growth in Indonesia. Over the past decade, investment has contributed to about 20% - 30% of Indonesia's total Gross Domestic Product (GDP), second to consumption, which contributed to 56% of GDP. As a country that is currently encouraging the acceleration of economic growth so as to not get stuck in the "middle income trap", Indonesia is starting to realize the important role of investment, both domestic and foreign. Amidst the limited availability of sources for financing domestic investment, namely the level of domestic savings, the role of foreign investment has become increasingly necessary.

The Negative Investment List, or known as *Daftar Negatif Investasi* (DNI), is one of the tools of government policy that serves to regulate investment in Indonesia. Essentially, the DNI includes the business fields (within the business sector) which are fully closed or partially open to investment, or investment with certain requirements. These business sectors (business sector) and the requirements aforementioned refer to the requirements listed in the Presidential Decree on Negative Investment List, which is periodically revised according to the needs and interests of national development. In preparing the DNI, the government used a negative approach, wherein business sectors excluded from the list are by default fully open to foreign investment[1]. This approach is commonly used by governments in various countries in order to regulate investment. Some countries with this similar regulation include: Executive Order 184 on 10th Foreign Investment Negative List (Philippines)[2], List of Businesses Prohibited for Foreign Investment (Saudi Arabian General Investment Authority - SAGIA)[3], and the Special Administrative Measures

1 Article 3 of Presidential Regulation No 39/2014 stipulates "Business fields not contained in Appendix I (business fields closed to investment) and Appendix II (business fields open to investment, with requirements) as referred to in Article 2 are declared open without conditions for investment.

2 http://www.gov.ph/2015/05/29/executive-order-no-184-s-2015/

3 http://www.sagia.gov.sa/en/InvestorServices/InvestorLibrary/SubCategory_Library/Business_not_permitted.pdf

(Negative List) on Foreign Investment Access in the Shanghai Pilot Free Trade Zone (Shanghai Municipal Government).[4]

Best practice experiences from several countries showed that the more advanced a country's economic development level, the more open that country is to foreign investment. As such, over time, the list of businesses included in the DNI for foreign investment should become automatically shorter, or the terms should become easier. Ideally, the regulation for foreign investment in countries such as this is would become relatively similar to the regulation on domestic investment. Some developed countries such as the USA, Germany, and Japan, no longer enforce rules such as the DNI.

As a country that is still in need of investment, the government will surely make every effort to open up expansive investment opportunities, particularly for foreign investment, especially in essential business fields that are not yet controlled by the Indonesian nation. Hopefully, the influx of foreign investment will contribute to Indonesia in terms of technology upgrading through the transfer of technology (spillover), improved skills and knowledge, and business network expansion. Besides that, it will also create new jobs, has the potential to increase state revenues, and many other positive benefits. In practice, several of the benefits aforementioned has not been produced in an optimal fashion. In many cases, the process of the transfer of technology, skills and knowledge (spillover) to Indonesian human resources did not go as smoothly as expected. Hence, the hope of local companies to increase its wide network of business was not necessarily accomplished with ease. Therefore, rules and regulations that support these things need to be made and implemented strictly and consistently.

As a country of a rather interesting investment destination[5], The DNI drafting process should be in line and consistent with national economic development goals and interests including: the development of SMEs and cooperatives, equitable development, social protection and public health, environmental protection, and strategic business field for Indonesia etc. In order to accommodate the objectives and interests aforementioned, the list of business fields in the DNI is classified in two ways, namely: (a) business fields fully closed to investment (both domestic and foreign)[6], and (b) the business fields partially open to investment but with requirement[7]. The requirements include: (i) reserved for small-medium enterprises (SMEs) and cooperatives, (ii) the amount of foreign capital ownership, (iii) through partnerships, (iv) requires a special permit, (v) must stand in the location specified, or (vi) a combination of requirements above.

Apart from applying various requirements, the Government also needs to seek a balance between national interests and the need for high investment in order to stimulate economic growth. In order to do that, certain breakthrough steps should be pursued. For example, in their effort to encourage the development of SMEs and cooperatives, the government could provide incentives (in various forms) for large-scale investments (both foreign and domestic) to enter into certain business fields as long as they are in partnerships with local SMEs and cooperatives. As a result, SMEs and cooperatives will be integrated with a wider production/distribution network both nationally and internationally. This step

4 http://www.nortonrosefulbright.com/knowledge/publications/118112/new-2014-negative-list-reduces-restrictions-for-foreign-investment-in-the-shanghai-free-trade-zone

5 At least according to several of the global rating agencies such as Fitch Rating, Moody and Japan Credit Rating, Indonesia has been classified within the category of *Investment Grade.*

6 Presidential Regulation No 39/2014, Appendix I

7 Op.cit, Appendix II

has been conducted under the Economic Policy Package Volume X, which was launched on February 2016, even though the legal product is not yet available (see Box below).

The most recent regulation on DNI issued by the government is the Presidential Decree No. 39/2014. This regulation is a revision of the preceding regulation, Presidential Decree No. 36/2010. There are a few differences between the two regulations, the main one being that the Presidential Decree No. 39/2014 tightened the rules by closing off certain sectors to foreign investments, including: oil and gas services, retail trade (except for large-scale businesses, transport, small-scale energy generation, security services, trade and logistics. On the other hand, the Presidential Decree No. 39/2014 also opened up and/or simplified existing requirements for foreign investments in several business fields, including: port facilities, energy, pharmaceuticals/medicine, fixed line telecommunications, marine, and venture capital.[8]

Revision of the Presidential Decree No. 39/2014 on Negative Investment List and the Economic Policy Package Volume X, February 2016

The government recently revised the Presidential Decree No. 39/2014 on the DNI, where the main objective is to promote and increase both domestic and foreign investment, while also improving the protection for SMEs and cooperatives. To that end, Indonesia's Investment Coordinating Board (IICB) and the Coordinating Ministry of Economic Affairs, as the authorized institutions, invited various stakeholders, including ministries/agencies, businesses, business associations, foreign chambers, non-governmental organizations (NGO, CSO) to provide their input and responses. The result of the DNI revision is contained within the Economic Policy Package Volume X, which was launched on February 11, 2016. In essence, the economic policy package contains: (i) the business sectors that were excluded from the DNI (35 business fields), (ii) business sectors opened to foreigners within a certain scale, as opposed to all business sectors being opened only to domestic investors (20 business fields), (iii) the addition of business sectors in order to domestic and foreign investments are required to partner with SMEs and cooperatives (62 business fields), (iv) simplification (reclassification) of business sectors for SMEs and Cooperatives, (v) expansion of the value of the work of business fields reserved for SMEs and cooperatives (39 business fields), (vi) the addition of reserved business fields for SMEs and cooperatives (19 business fields). A majority of the business fields aforementioned are services, such as: construction consultancy services, tourism services, e-commerce services, cold storage services, cinema/film services and only two in the form of manufacturing industry. Although it has been announced, the legal product (Presidential Decree) has not been published

8 https://www.kpmg.com/ID/en/IssuesAndInsights/ArticlesPublications/Documents/Investing%20in%20Indonesia%202015.pdf

until now. According to the head of IICB, the rule already exists but is still undergoing the process of confirmation by the relevant ministries/agencies.

Source: Abstracted from
http://www.kemenkeu.go.id/Berita/paket-kebijakan-ekonomi-jilid-x-tingkatkan-investasi-lindungi-umkmk
http://www.merdeka.com/uang/bkpm-sebut-regulasi-revisi-NIL-diterbitkan-pertengahan-april.html

KEY ISSUES IN PREPARING THE NEGATIVE INVESTMENT LIST (NIL)

There are at least three important issues within the drafting process of the DNI that requires attention. If not handled inadequately, it will lead to confusion and uncertainty of the business by investors, especially foreign investors, which could in turn result in their departure from Indonesia. Such issues are:

1. In practice, many emerging inconsistencies occur on the field. These inconsistencies arise as there are different legal interpretations of whether the DNI rules are more cross-sectoral (generalist) or has more specific sectoral rules (specialist), and of which rules should be followed, in case there are any conflicts between the rules, especially with the emergence of the legislation order (hierarchy) issue, whereby Laws (UU) hold a higher level than Presidential Decrees. As a result, sectoral policy makers often do not heed the DNI rules. Therefore, there needs to be coordinated effort from lawmakers to solve this problem. For example: (1) to make DNI rules the sole benchmark for foreign investment in preparation of drafting rules for sectoral implementation, (2) to reinforce the functions of control and coordination of the Coordinating Ministry of Economic Affairs as the only authorized institution when it comes to DNI rules.
2. The other issue that often appears in the field is the misunderstanding of some stakeholders who think that the DNI is a regulation that protects certain sectors from foreign investment. Driven from the idea in question, lobbyists and certain concerned parties often insist that certain sectors incorporated into the DNI are free from foreign investment, or at the very least have special requirements for foreign investment. Various reasons and justifications, including the issue of nationalism were stated for not allowing foreign investment from entering, or at least for being restricted in certain areas. On the other hand, there are several other parties who want the business field to be completely open to foreign investment. They generally assume that protection through the DNI would only cultivate unsound business practices and benefit only a handful of domestic manufacturers. Oftentimes, this tug of war that occurs between opposing interests developed this process into a tough and time-consuming one. As a result, the revised rules on the DNI, which has been long awaited by investors, will be published at a later date.
3. There have been many complaints, especially by investors, regarding the lack of transparency within the process of preparing the DNI. A reason for this is that there are certain sectors that are included or excluded from the Negative Investment list, without any notification or explanation

from authorities. Undoubtedly, this will greatly affect any interest to invest in these sectors. Procedurally, the first proposal for a certain business sector to enter/exit the DNI is derived from the relevant ministries/agencies, who generally receive input from business association within the business sector. Although there is a verification process at the ministry/agency, it could be said that almost all of these proposals are not equipped with any cost benefit analysis. Then, the IICB and the Coordinating Ministry for Economic Affairs, as the authorized cross-sectoral institutions, will also conduct a screening of the proposals from these ministries/agencies. However, this process also does not include an in-depth review using adequate analytical instruments such as the Regulatory Impact Assessment (RIA). As a result, there are no well-defined criteria for the entry/exit of any one business sector into the DNI, which is assumed to sometimes be the result of a bargaining process.

RECOMMENDATION

1. The socialization and dissemination of the understanding that Indonesia still needs investment in order to stimulate economic development. Considering the perpetual low source of domestic investment financing, the crucial role of foreign investment is increasingly felt. The higher a country's rate of investment growth, the better its economic development and, by default, the increasingly prosperous its society. It should also be noted that foreign investment brings other benefits to the people of Indonesia at the microeconomic level, such as the transfer of technology, knowledge, and expertise (spillover), business network expansion, job creation, etc.
2. The socialization and dissemination to various sectoral stakeholders of the understanding that the DNI is a tool/policy that will regulate investment, and NOT inhibit foreign investment. The purpose of this arrangement is to be in line and consistent with public interest and national development goals. This policy will dynamically follow Indonesia's economic condition and development, and will also pay attention to the development of global economic and business conditions. Best practice experiences from several developed countries show that the more advanced a country's economic development level, the more open that country is to foreign investment.
3. In drawing up the rules for the DNI, the government needs to consider the issue of the consistency and harmonization of rules and regulations across all sectors, including the hierarchy of rules and regulations. For that, coordinated effort to organize the law across sectors is required under the Coordinating Ministry of Economic Affairs. Examples of this effort includes: (1) to make DNI rules the sole benchmark for foreign investment in preparation of drafting rules for sectoral implementation, (2) to reinforce the functions of control and coordination of the Coordinating Ministry of Economic Affairs as the only authorized institution when it comes to DNI rules.
4. An improvement in the drafting process of the DNI so that it is more comprehensive and transparent.
   a. Ministries/Agencies, as the institutions that proposes certain business sectors to join the DNI, needs to conduct objective and sincere studies, such as cost-benefit analyses or analyses of the impact of inputs received from various stakeholders (ie. business associations) before submitting their proposal to the IICB and the Coordinating Ministry for Economic Affairs

b. The IICB and the Coordinating Ministry for Economic Affairs, as the institutions responsible for drafting the DNI rules, also need to conduct objective assessments, such as the Regulatory Impact Assessment (RIA) for the input received from various stakeholders, including the technical ministries.
c. Since it involves national interests, in addition to conducting studies, ministries/agencies, the IICB, and the Coordinating Ministry for Economic Affairs, all need to open up as large a space as possible for the participation of other stakeholders, such as the Indonesian people/community, CSO, etc. during the drafting process of the DNI. A consultation mechanism or the dissemination of the proposed draft rules through various public media channels (e.g. internet, newspapers, TV) is a good way of doing so.