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Repositioning Indonesia in the post-COVID-19 global value chains

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Repositioning Indonesia in the post-COVID-19 global value chains

Andree Surianta[1] and Arianto A. Patunru[2]

Abstract

As the Global Value Chains (GVC) struggle to restructure around COVID-19 transport restrictions and its economic fallout, Indonesia faces an uphill battle to restart its economy and stave off ballooning unemployment. With stagnant economic growth now turning into recession, President Joko "Jokowi" Widodo pushes for the biggest regulatory reform in recent history through the Omnibus Law on Job Creation. Many have hoped that the amendment to thousands of articles in old laws will finally remove barriers to foreign direct investment; however, this legislation seems to have morphed from one seeking to bolster inward investment into one extending massive support to micro and small enterprises. In a rudimentary nod to the GVC model, the law urges supply chain partnerships between small businesses and large corporations. However, an overreaching implementing regulation may turn this partnership push into a new investment barrier for large multinationals, undermining the goal of deeper integration into the global production networks.

JEL Codes: O14, O19, O53, F23

Key words: Indonesia, COVID-19, global value chain, foreign direct investment

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1. Introduction

At the end of 2019, a pandemic caught the world unprepared. The SARS-CoV-2 virus began spreading in Wuhan, China, before exploiting the interconnectedness that lies at the heart of the globalised economy. To halt the spread of COVID-19 many countries began closing their borders and restricting movements within. The integrity of Global Value Chains (GVCs) which was already strained by the US-China trade war took further blows when countries went into isolation. Multinational enterprises are beginning to rethink their dependence on China and governments are calling their corporations to return home (reshore) or move nearby (nearshore). With Southeast Asia potentially receiving the bulk of nearshoring in Asia, Indonesia is pushing for the biggest regulatory reform since the 1998 Asian Financial Crisis to benefit from this trend. This paper will begin with an overview of the push for reshoring spurred on by the pandemic. It will then continue with an overview of Indonesia's economic condition and GVC participation prior and during the pandemic. The section afterwards will highlight the complex Indonesian regulatory system which deters foreign investors and the reform efforts leading up to one of the most controversial legislation in the past twenty years: the omnibus law on job creation. It is then followed with several sections analysing the law, focusing on two parts of the law which tries to balance large investment with small businesses through a budding GVC model. Finally, a brief consideration of potential complications which may undermine the law's investment and GVC goals.

2. Global Value Chains: the unravelling

GVCs drive approximately half of global trade and their activities boosted foreign direct investment (FDI) since 1990.[3] Led by multinational enterprises, they depend on open borders and lean production methods to keep their production cost low. With international transport heavily restricted, some GVCs face difficulty in securing the flow of materials and are forced to

[3] World Bank, "World Development Report 2020: Trading for Development in the Age of Global Value Chains," 2020, 19, 33.

stop or reduce their activities. Furloughing and retrenchment soon followed, causing demand to contract as well. This combined supply and demand shock has been estimated to shrink international trade by 13 – 32 per cent and FDI by 30 – 40 per cent during 2020 and 2021.[4]

As a central link in the GVCs, China lockdowns disrupts supply chains almost everywhere. Concerned governments are encouraging their companies to reduce their dependence on China by nearshoring or reshoring. France is looking to reshore paracetamol manufacturing within three years.[5] Across the Atlantic, the US government is extending a multimillion dollars loan to rebuild domestic pharmaceutical manufacturing capacity.[6] South Korea is following suit with a USD 3.6 billion loan offered for reshoring.[7] Japanese government even subsidizes such plans through an over-subscribed USD2.07 billion manufacturing reshoring fund.[8]

Aside from reshoring, the Japanese government is also encouraging diversification by earmarking around USD 200 million for supporting diversification beyond China. Thirty corporations received the first round of funding, all going to Southeast Asia. Vietnam receives the most interest with 15 corporations. Six Japanese corporations will receive subsidy to go to Thailand, four to Malaysia, three to Philippines, and two to Laos. Myanmar and Indonesia each receive one relocation interest.[9] For Indonesia, such low interest as a relocation destination is the third episode in a series of failure which began in 2017.[10] In fact, Indonesia seems to have lost much of its FDI luster and has been increasingly disengaging from the GVCs prior to that, as shown in the next section.

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[4] WTO, "Trade Set to Plunge as COVID-19 Pandemic Upends Global Economy," *WTO Press Release* (Geneva, 2020), https://www.wto.org/english/news_e/pres20_e/pr855_e.htm; UNCTAD, "Investment Trends Monitor: Impact of the COVID-19 Pandemic on Global FDI and GVCs" (Geneva, 2020), 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.

[5] Leila Abboud and Michael Peel, "Covid-19 Hastens French Push to Bring Home Medicines Manufacture," *Financial Times*, July 29, 2020, https://www.ft.com/content/80a4836b-ca25-48e0-996d-458186e968dc.

[6] Clare Duffy, "How Kodak Went from Photography Pioneer to Government-Appointed Pharmaceutical Producer," CNN, August 4, 2020, https://edition.cnn.com/2020/08/04/business/kodak-history-pharmaceutical-production/index.html.

[7] Suk-yee Jung, "South Korean Government to Promote Reshoring for Less Dependence on China," *Businesskorea*, February 21, 2020, http://www.businesskorea.co.kr/news/articleView.html?idxno=41645.

[8] Hiroyuki Akiyama, "Japan Companies Line up for 'China Exit' Subsidies to Come Home," *Nikkei Asia*, September 9, 2020, https://asia.nikkei.com/Economy/Japan-companies-line-up-for-China-exit-subsidies-to-come-home.

[9] JETRO, "Overseas Supply Chain Diversification Support Project," JETRO Service, July 17, 2020, https://www.jetro.go.jp/services/supplychain/kekka-1.html.

[10] "Indonesia Vulnerable to Economic Downturn," Asia Sentinel, September 27, 2019, https://www.asiasentinel.com/p/indonesia-vulnerable-economic-downturn.

3. Indonesia: decelerating and disconnecting

Indonesia was well into the commodities downcycle when President Joko "Jokowi" Widodo took the helm for the first time in 2014. With commodities being its biggest export, this downtrend causes Indonesia's GDP growth to contract from over 6 per cent in 2010 to 5 per cent in 2014. This subdued growth means that jobs were created at a slower pace than the growth of working-age population and so unemployment remains at approximately 7 million since 2012. Analysts estimated that 7 per cent growth will be needed to start chipping away on the persistent unemployment level and so this number became one of the goals of Jokowi's first term.[11]

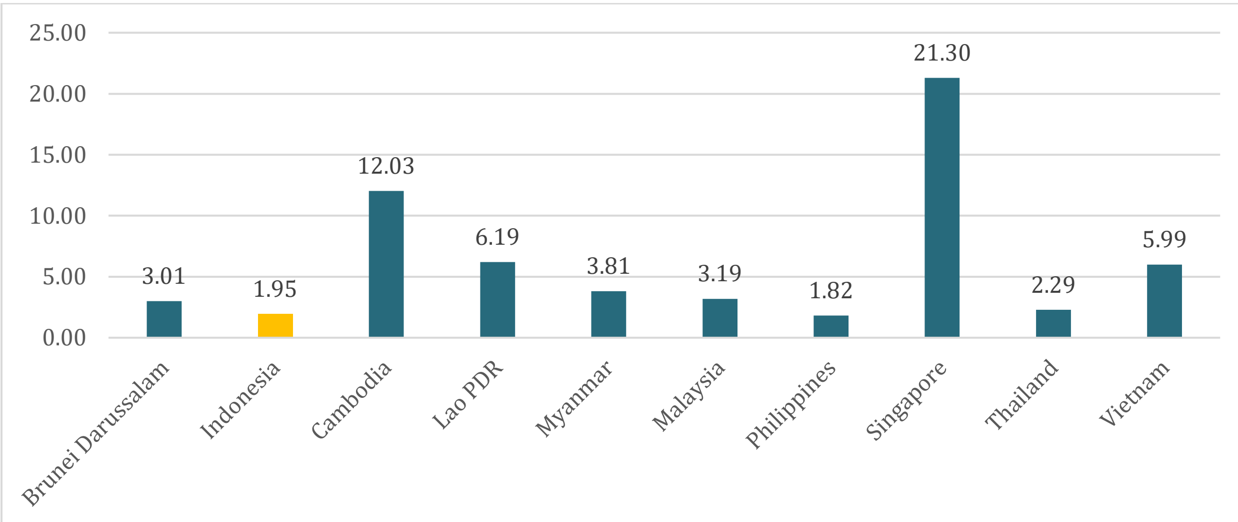
To achieve this goal, a slew of infrastructure projects and sixteen Economic Policy Packages were launched. The former was largely aimed at improving connectivity and has resulted in Indonesia's rank for Logistics Performance Index improving from 75 to 46 between 2010 and 2018. The latter, released between 2015 and 2018, was aimed at simplifying procedures to encourage investment, especially from foreign sources. This appears to work at first, as Indonesia's Ease of Doing Business (EODB) ranking improved from 106 to 72 between 2015 and 2017; however, this stagnated afterwards. The rapid-fire policy strategy may have backfired as businesses commented on the lack of coordination and contradicting regulations.[12] It seems that simplification has turned into complication instead.

Such high regulatory complexity increases compliance costs and made Indonesia comparatively unattractive for FDI. Despite being the largest economy in ASEAN, its average net FDI inflows as a proportion of GDP is among the lowest in the group (Figure 1). These inflows have also been rather stagnant for the past decade (Figure 2). In fact, when corporations begin relocating

[11] Timothy Cheston, "Indonesia and the Quest for 7% Growth: Overpromise or Underperformance?," Atlas of Economic Complexity, accessed June 22, 2020, https://atlas.cid.harvard.edu/stories/indonesia/; Wilmar Salim and Siwage Dharma Negara, "Infrastructure Development under the Jokowi Administration: Progress, Challenges and Policies," *Journal of Southeast Asian Economies* 35, no. 3 (2018): 386–401, https://doi.org/10.2307/26545320.
[12] Muhamad Wildan, "Evaluasi 16 Paket Kebijakan Ekonomi, Ini Kata Dunia Usaha [Evaluation of the 16 Economic Policy Packages, This Is What Businesses Says]," *Ekonomi Bisnis.Com*, October 1, 2019, https://ekonomi.bisnis.com/read/20191001/9/1154190/evaluasi-16-paket-kebijakan-ekonomi-ini-kata-dunia-usaha; Siwage Dharma Negara and Arief Ramayandi, "Laying the Foundations for Future Growth Acceleration?," *Bulletin of Indonesian Economic Studies* 56, no. 1 (January 2, 2020): 14, https://doi.org/10.1080/00074918.2020.1743014.

out of China in 2017 and 2019, Indonesia only managed to attract 10 companies while Vietnam welcomed 96.[13]

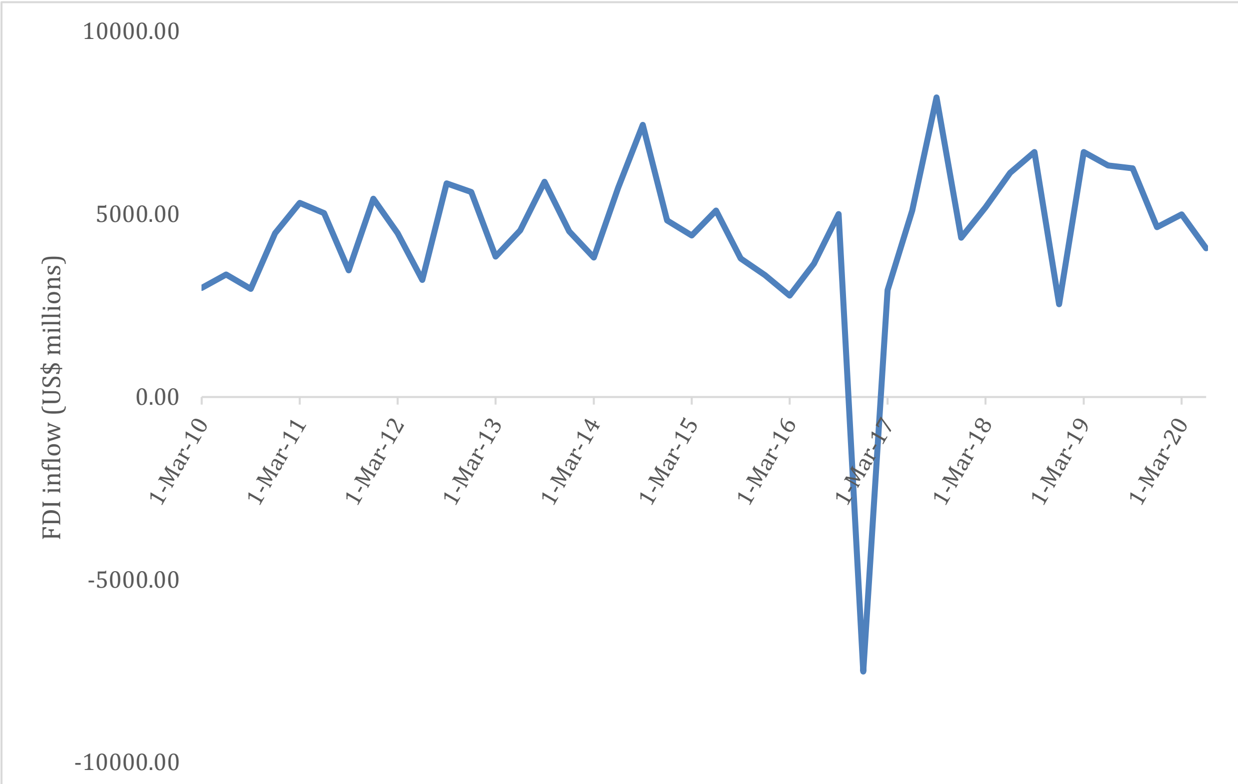
Figure 1. Average FDI net inflows 2009 - 2018 (per cent of GDP)



Source: World Development Indicators

[13] "Indonesia Vulnerable to Economic Downturn."

Figure 2. Quarterly FDI inflows since 2010 (in USD million)



Source: Bank Indonesia via CEIC

Indonesia is also poorly linked with the GVCs, with overall participation rate lower compared to many of its smaller neighbours in ASEAN. This is partly a consequence of it being heavily skewed towards natural-resources exports.[14] This low rate is on further decline across virtually all business sectors. Out of 23 industrial and services sectors monitored by OECD between 2005 and 2015, only four sectors recorded an increase in its domestic value add in foreign final demand.[15]

These difficulties are amplified by the pandemic. With disruption in logistics and restriction measures imposed on businesses, Indonesia, like many countries practically relies on government boosted spending. However, even as the 3%-of-GDP cap on budget deficit has been relaxed, disbursement of social assistance and other relief packages is very slow. The country is officially in recession now, after the second and third quarter recorded -5.32 per cent and -3.49

[14] ASEAN-Japan Centre, "Global Value Chains in ASEAN" (Tokyo, 2017), 14–15, http://www.asean.or.jp.
[15] OECD, "Trade in Value Added: Indonesia," December 2018, https://www.oecd.org/industry/ind/TIVA-2018-Indonesia.pdf.

per cent GDP growth y-o-y, respectively. Six months into the pandemic, more than 2.5 million people are entering the unemployment ranks.[16] FDI growth during the first nine months of 2020 is 5.1 per cent lower than the same period last year.[17] This has improved slightly, with seven manufacturers – three of which Japanese – planning to set up in Indonesia.[18] Nevertheless, it is unclear whether these are actual pandemic relocations as the Japanese government's diversification support program only recorded one company nominating Indonesia and it was not among this three.[19] What is clear, though, is that Indonesia is a very complex market and simplification is sorely needed to encourage more FDI into the country and improve its linkages with the GVCs.

4. Untangling the regulatory mess

The Indonesian regulatory system is notorious for its complexity among international investors. At the central government level, there are nearly 1700 Laws implemented by more than 4600 Government, 2000 Presidential, and 15000 Ministerial Regulations. In addition, there are nearly 16000 Local Regulations at the sub-national level. The Economic Policy Packages was supposed to be the diet pills for such regulatory obesity; however, progress was slow with a mere 164 regulations being revoked, revised, or merged by 2017.[20]

The lack of regulatory discipline at the lower levels of bureaucracy is the main cause of this obesity. Since 2011, ministers are authorised to proactively issue sectoral regulations, but they are not required to review existing regulations for consistency or relevance.[21] This has caused

[16] Gayatri Suroyo and Tabita Diela, "Indonesia Suffers First Recession in over 20 Years, Finmin Says 'Worst Is Over,'" *Reuters*, November 5, 2020, https://www.reuters.com/article/us-indonesia-economy-gdp-idUSKBN27L0GL.

[17] BKPM, "Investment Realization in Indonesia: Quarter III and January - September 2020" (Jakarta, October 23, 2020), https://www.bkpm.go.id/images/uploads/file_siaran_pers/Paparan_Realisasi_Investasi_Triwulan_III_2020_Bahasa_Inggris.pdf.

[18] BKPM, "President: 'I'm Pleased 7 Companies Have Confirmed Relocation'" (Jakarta, July 30, 2020), https://www.bkpm.go.id/images/uploads/file_siaran_pers/Press_Release_BKPM_30062020_President_I'm_Pleased_7_Companies_Have_Confirmed_Relocation.pdf.

[19] JETRO, "Overseas Supply Chain Diversification Support Project."

[20] "Joko Widodo - Jusuf Kalla 3rd Year Report [Laporan 3 Tahun Pemerintahan Joko Widodo - Jusuf Kalla]," January 4, 2017, 17, http://ksp.go.id/wp-content/uploads/2017/10/LAPORAN-3-TAHUN.pdf.

[21] Arianto Patunru and Andree Surianta, "Attracting FDI Post Covid-19 by Simplifying Indonesia's Regulatory Framework" (Jakarta: Center for Indonesian Policy Studies, 2020), https://www.cips-indonesia.org/post/policy-brief-attracting-fdi-post-covid-19-by-simplifying-indonesia-s-regulatory-framework.

overlap and contradictions that often confuse businesses.[22] Unfortunately, this lack of discipline has gotten worse in recent years. During his first term alone, Jokowi's cabinet issued over 7500 Ministerial Regulations, outnumbering higher-level regulations by 6 to 1. This massive quantity also means that during these five years ministers are making as many rules as the accumulation of 69-years prior.[23] The large number of regulations creates more procedures for businesses to go through and the presence of contradictory regulations left corporations at the mercy of law enforcements' discretion.

Similar issues also permeate by-laws or Local Regulations. Ever since the decentralisation process began in early 2000s, 508 districts/cities can make their own regulations independently. This adds another layer of rules which businesses must be aware of. This delegation of authority, unfortunately, was not accompanied with the tools to ensure regional-central policy alignment. President Susilo Bambang Yudhoyono (SBY) attempted to address this by passing a law which authorises governors or the Minister of Home Affairs to revoke conflicting regional regulations. While this had enabled Jokowi's administration to revoke over 3000 regional regulations, it was annulled in 2017 by the Constitutional Court which ruled that only the Supreme Court can cancel regulations. Once again, the central government is left with no devices to address regional regulatory obesity.[24]

Perhaps frustrated with the hobbled reform during his first term, President Jokowi announced a brand-new legal approach during his second-term inauguration speech, i.e. the omnibus laws.[25] Two omnibus laws were proposed to revise dozens of laws hampering job creation and encumbering Micro, Small, and Medium Enterprises (MSMEs). Eventually, these two were merged into a single Job Creation Law and three new omnibus laws on tax, pharmacy, and new

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[22] Rizky Argama, "Can Jokowi Clean up Indonesia's Legal Mess?," Indonesia at Melbourne, May 9, 2019, https://indonesiaatmelbourne.unimelb.edu.au/can-jokowi-clean-up-indonesias-legal-mess/.

[23] Ministry of Justice and Human Rights, "Peraturan.Go.Id Homepage," accessed November 21, 2020, http://peraturan.go.id/.

[24] Abdul Aziz, "The Minister of Home Affairs No Longer Authorized to Revoke Problematic Regional Regulation [Mendagri Tak Lagi Berwenang Batalkan Perda Bermasalah]," *Tirto.ID*, June 15, 2017, https://tirto.id/mendagri-tak-lagi-berwenang-batalkan-perda-bermasalah-cqJ4.

[25] President of the Republic of Indonesia, "Inauguration Speech of the President of the Republic of Indonesia Elected for the Period 2019-2024 (Pidato Presiden RI Pada Sidang Paripurna MPR RI Dalam Rangka Pelantikan Presiden Dan Wakil Presiden Teripilih Periode 2019-2024)" (Jakarta: Ministry of Foreign Affairs, October 20, 2019), https://kemlu.go.id/download/L3NpdGVzL3B1c2F0L0RvY3VtZW50cy9QaWRhdG8vTGFpbm55YS9QaWRhdG8lMjBQcmVzaWRlbiUyMFJJJTIwMjAlMjBPa3QlMjAyMDE5LnBkZg==.

capital city emerged. It is also interesting to note that although the speech lists the omnibus law and investment as two separate reform priorities, these became synonymous in future public discourses. Even the World Bank emphasises on how the structural reform brought by the Job Creation Law potentially boost FDI and integration with GVCs.[26]

Although it is a new initiative, this law has the same goal with the Economic Policy Packages preceding it: trimming down unnecessary bureaucracy and streamlining regulations to attract investment and create jobs. Unlike its predecessors; however, it later carries a much greater sense of urgency due to the economic fallout of the COVID-19 pandemic. Unfortunately, this urgency generates much controversy and public opposition. Critics generally cite a rushed, secretive process that is insensitive to the public's plight due to the pandemic. In the eight months leading to its passing, there are no shortages of negative coverage in the media: from inaccessible draft, closed-door deliberations, multiple "final" versions, violent street protests, "fatal" typos, to court challenges.[27] Perhaps the most paradoxical is the critique levelled on this investment-friendly law from a group of global investors.[28]

5. Job Creation Law

The Job Creation Law was officially enacted as Law 11/2020 on 2 November 2020. It is arguably the most complicated legislation in Indonesia to date, amending 76 existing laws and adding new provisions in 186 articles spanning over 700 pages with a further 400 pages for elucidations. The provisions are broadly grouped into ten subjects: 1) improvement in investment ecosystem and ease of licensing, 2) protection and empowerment of MSMEs and cooperatives, 3) labour, 4) research and innovation, 5) ease of doing business, 6) land procurement, 7) economic zones, 8) Central Government investment and National Strategic

[26] The World Bank, "The Long Road to Recovery" (Jakarta, July 2020), 43, http://documents1.worldbank.org/curated/en/804791594826869284/pdf/Indonesia-Economic-Prospects-The-Long-Road-to-Recovery.pdf.
[27] Rizky Argama, "Major Procedural Flaws Mar the Omnibus Law," Indonesia at Melbourne, October 9, 2020, https://indonesiaatmelbourne.unimelb.edu.au/major-procedural-flaws-mar-the-omnibus-law/; Marchio Irfan Gorbiano, "Jobs Law, Week 2: Critics Slam President's Response, Unions Seek Legal Avenues," The Jakarta Post, October 17, 2020, https://www.thejakartapost.com/news/2020/10/16/jobs-law-week-2-critics-slam-presidents-response-unions-seek-legal-avenues.html; Ardila Syakriah and Budi Sutrisno, "'Fatal' Errors Found as Job Creation Law Enters into Force," *The Jakarta Post*, November 4, 2020, https://www.thejakartapost.com/news/2020/11/03/fatal-errors-found-as-job-creation-law-enters-into-force.html.
[28] "Open Letter on the Omnibus Bill on Job Creation," accessed November 21, 2020, https://www.greencentury.com/wp-content/uploads/2020/10/Indonesian-Omnibus-Investor-Letter.pdf.

Projects, 9) Government Administration Support, and 10) Sanctions.[29] According to its article 185, Government and Presidential Regulations must be issued within three months to implement it. As of 18 November 2020, 30 of these drafts are available for public comments at the Job Creation Law's official website.[30]

As noted, the World Bank lauded the potential of the law to boost Indonesia's FDI inflow and GVC linkages. It specifically highlights the benefit of removing foreign equity limits and streamlining import-export licensing.[31] Foreign businesses have also expressed the hope that the law will finally liberalise FDI broadly by discontinuing the Negative Investment List (*Daftar Negatif Investasi*).[32] This 'open for business' expectation is reasonable, with much of the rhetoric before it was passed centering around welcoming investment.

However, an analysis of some core articles in the law shows an evolution from its initial draft into one that embraces the GVC framework to build closer links between MSMEs and FDI in Indonesia, instead of just an open invitation for foreign capital. This new position is seemingly influenced by the outsized impact of the pandemic to MSMEs; however, it remains consistent with FDI policy history in Indonesia and affirmed by commentaries from government officials during recent public outreach activities.

The elucidation part of the Job Creation Law states that the objective of this law is to create jobs through increased investment and MSMEs empowerment. It singles out regulatory complexity and obesity as the main barrier in achieving this.[33] Indeed, the breadth of the law shows that the issues surrounding investment and MSMEs in Indonesia are complex and goes beyond these two core subjects. Nevertheless, analysing the amendments to Law 25/2007 on Investment (2007 Investment Law) and Law 20/2008 on MSMEs (2008 MSMEs Law) shows that the main goal of

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[29] Susiwijono Moegiarso, "Job Creation Bill Ratified, MSMEs and Workers' Protection Is Priority [RUU Cipta Kerja Disepakati, Perlindungan UMKM Dan Pekerja Jadi Prioritas," *Press Release* (Jakarta: Coordinating Ministry of Economic Affairs, October 4, 2020), https://www.ekon.go.id/publikasi/detail/545/ruu-cipta-kerja-disepakati-perlindungan-umkm-dan-pekerja-jadi-prioritas.

[30] "List of Implementing Regulations Drafts for Job Creation Law [Daftar Rancangan Peraturan Pelaksanaan UU Cipta Kerja]," Job Creation Law Official Portal [Portal Resmi UU Cipta Kerja], November 23, 2020, https://uu-ciptakerja.go.id/678-2/.

[31] The World Bank, "The Long Road to Recovery," 43.

[32] Adrian Wail Akhlas, "Government to Liberalize Investment in Omnibus Bill on Job Creation," Amcham in the News, February 17, 2020, https://www.amcham.or.id/en/news/detail/government-to-liberalize-investment-in-omnibus-bill-on-job-creation.

[33] "Elucidation of Law 11/2020 on Job Creation [Penjelasan UU No. 11 Tahun 2020 Tentang Cipta Kerja]," Pub. L. No. 11 (2020), 2.

this law is to encourage MSMEs integration into the GVCs by simplifying investment procedures for all businesses big and small, domestic and foreign.

To dismantle investment barriers, the Job Creation Law revokes over 200 articles and amends over 900 articles in the aforementioned 76 laws. This is supposed to streamline licensing process by removing redundant procedures. However, the original laws are still valid since not all articles are changed and the Job Creation Law may actually add new provisions. So, there are now two laws on every subject it covers. For example, the Job Creation Law article 87 changes six articles in the 2008 MSMEs Law. Since the other 38 articles are untouched, the 2008 MSMEs Law is still valid. Aside from these six, the Job Creation Law carries another 15 new articles (article 88 – 102) on MSMEs. So, a full view of MSMEs legislation would include the 38-artices in the 2008 MSMEs Law and the 21-articles in the Job Creation Law simultaneously. More potential complication arises further down the regulatory hierarchy. The Job Creation Law requires a new Government Regulation to implement its MSMEs section. This will be in addition to the existing Government Regulation 17/2013 implementing the 2008 MSMEs Law. Then comes the Presidential and Ministerial Regulations. The former was optional in the 2008 MSMEs Law but four was eventually made. Ministerial Regulations was never mentioned in the 2008 MSMEs Law, yet there are 30 of those derived from this law. The MSMEs section of the Job Creation Law did not specify any Presidential or Ministerial Regulations, but this does not stop regulators from creating new ones in reference to the law; as illustrated in Appendix. This 'parallel rules' situation heightens overlap risk and may nullify the simplification effort altogether.

The Job Creation Law's article 181 tries to address this by mandating a review of contradicting lower level regulations; a process called 'harmonisation'. However, this must be triggered by a submission by an Indonesian individual, company, institutions or by the Minister of Justice and Human Rights.[34] The review will be done by a committee convened by the Ministry of Justice and Human Rights (MoJHR) who either rejects the submission or recommends revision or revocation to the President. So, this process is largely reactive and virtually the responsibility of a single ministry. Such an approach may leave contradictory rules untouched for a long time.

[34] "Draft Government Regulation on Harmonisation and Synchronisation of Regulations under Law [RPP Sinkronisasi Peraturan Perundang-Undangan Di Bawah UU]," November 12, 2020, 4, https://uu-ciptakerja.go.id/rpp-sinkronisasi-peraturan-perundang-undangan-di-bawah-uu/.

At the end of the day, it appears that the Job Creation Law still did not address the lack of regulatory discipline which is the root cause of regulatory obesity.

Moving on to the investment front, article 77 of the Job Creation Law made amendments to six articles in the 2007 Investment Law.[35] Although this law applies to both domestic and foreign investors, the amended article 12(1) is often discussed in the context of FDI as it supposedly removes a discriminatory practice usually imposed on foreign investment. In the 2007 Investment Law this article stated that, "All business fields are open for investment, except business fields that are specified as closed and *open with conditions*" (our emphasis). The phrase 'open with conditions' is often thought of as the basis for the Negative Investment List. The Job Creation Law replaces this part with 'activities that only the Central Government is allowed to do'. Many believe that the absence of 'open with conditions' now means that all sectors – aside from the six specified as closed – will be fully open to foreign investors.

Unfortunately, this interpretation is doubtful. Indeed, the idea of replacing the Negative Investment List with a Positive Investment List has been discussed even before the omnibus law plan took hold.[36] However, such belief ignores the revised article 12(3) that says, "Further terms and conditions for investment as outlined in (1) and (2) will be stipulated in a Presidential Regulation". Not surprisingly, the Negative Investment List has always come in the form of Presidential Regulation since 2007. Regulations specifying local-foreign joint venture for FDI companies has been around even longer; since 1992.[37] Somewhat ironically, the 2007 Investment Law now being 'liberalised' was thought to allow full foreign equity back in April 2007; before it was overturned by the then-Negative Investment List issued just three months later.[38] Considering the long habit of restricting foreign ownership, it is unlikely that the upcoming Presidential Regulation carries no such restrictions at all.

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[35] "Law 11/2020 on Job Creation [UU No. 11 Tahun 2020 Tentang Cipta Kerja]," Pub. L. No. 11 (2020), 527–31, https://peraturan.bpk.go.id/Home/Details/149750/uu-no-11-tahun-2020.

[36] Marchio Irfan Gorbiano, "Government to Replace Negative Investment List with 'Positive List' for Priority Industries ," *The Jakarta Post*, November 12, 2019, https://www.thejakartapost.com/news/2019/11/12/government-to-replace-negative-investment-list-with-positive-list-for-priority-industries.html.

[37] President of the Republic of Indonesia, "Government Regulation 17/1992 on Shareholding Requirements in Foreign Direct Investment Company [PP No. 17 Tahun 1992 Tentang Persyaratan Pemilikan Saham Dalam Perusahaan Penanaman Modal Asing] ," Pub. L. No. 17 (1992), https://peraturan.bpk.go.id/Home/Details/57682/pp-no-17-tahun-1992.

[38] J. Thomas Lindblad, "Foreign Direct Investment in Indonesia: Fifty Years of Discourse," *Bulletin of Indonesian Economic Studies* 51, no. 2 (August 24, 2015): 229, https://doi.org/10.1080/00074918.2015.1061913.

As a matter of fact, a presentation from an official from the Coordinating Ministry of Economic Affairs confirms that foreign equity restrictions will likely persist. In a public outreach session arranged by the ministry, the upcoming Presidential Regulation is expected to specify 'open for investment' as regulated business sectors which are either reserved for domestic direct investment, regulated for FDI, or requiring special licenses. 'Regulated' is the catch-all phrase under which foreign equity restrictions will fall under. While this may be disappointing news, the Presidential Regulations – once issued – will revoke foreign equity restrictions currently specified by any Ministerial Regulations, thereby centralising them into one regulation and reducing complexity.[39] Nevertheless, the government maintains its right to impose other conditions on FDI.

In fact, there are hints of an additional condition in the other amendments to the 2007 Investment Law. It seems that a welcome FDI is one that involves MSMEs more closely. Compared to the original, the revised article 13 of the 2007 Investment Law now outlined in the Job Creation Law shows a stronger commitment to MSMEs upgrading. For example, the government is now adding support for human resources training and access to financing. This is enhanced further by article 18(3) which incentivise investors who partner up with MSMEs. Finally, the new article 13(4) added by the Job Creation Law to the 2007 Investment Law explicitly references the 2008 MSMEs Law for the said partnership formats. As shown next, one of these formats is a supply chain partnership which effectively infuses a GVC flavor into this law.

Although the phrase "Global Value Chains" was not used explicitly, article 87 inserted "supply chain" as partnership model (f) in article 26 of the 2008 MSMEs Law.[40] This is specified further in the new article 32A, which lists goods transportation, product distribution, and/or raw materials supply as minimum activities for a supply chain partnership. This specification will likely inform the incentive stipulated in the amended article 18(3), explained above. Intriguingly, although the original partnership models in article 26 were explained in article 27-31, the new article explaining the supply chain partnership is not placed immediately after article 31. It is positioned after article 32 which deals with MSMEs-foreign investors joint venture.

[39] Coordinating Ministry of Economic Affairs, "Draft of Presidential Decree on Business Sectors for Investment," in *Public Outreach for Omnibus Law Implementing Regulations* (Jakarta: AmCham Indonesia, 2020), 6, 8, https://drive.google.com/drive/folders/1niXh8UWLt-eSu0UvEGiOnN2bjbvRGgFv.
[40] Law 11/2020 on Job Creation [UU No. 11 Tahun 2020 tentang Cipta Kerja], 576–79.

This hints at the idea of nurturing MSMEs as a partner for foreign corporations operating in Indonesia, albeit a rather rudimentary one.

Perhaps the most intriguing point here is how most of these MSMEs-related amendments were not in the draft that was submitted to legislators. Firstly, there were no explicit linking between the 2007 Investment and 2008 MSMEs Law. Then, the draft amendment to 2008 MSMEs Law only changes one article, while the final law amends six. The addition of supply chain partnership also only appears in the final version. The new articles for MSMEs in the law are also more fleshed out than in the draft; especially those for micro and small businesses. Lastly, the law has three new articles on incubators for generating new enterprises. Such evolution of the MSMEs section is likely triggered by the COVID-19 pandemic which has been especially tough on small businesses in Indonesia. Arguably, it was also affected by the increasing criticism towards the bill, especially by workers unions and NGOs.

6. The devil is in the implementing regulations

The Job Creation Law is arguably the most anticipated reform since the Asian Financial Crisis. Its effectiveness, however, hinges on the details set out in its implementing regulations. Assuming its legitimacy is upheld by the court, the government must prepare 40 Government Regulations and 4 Presidential Regulations by February 2021.[41] For the two sections of the Job Creation Law discussed in this paper, only the draft Government Regulation on MSMEs has been completed so far. Containing 91 articles, it outlines the huge support that the Indonesian government will extend to MSMEs. However, medium enterprises may feel shortchanged by this regulation, only receiving approximately a third of the support micro and small enterprises receive. Furthermore, some of these supports seems to come at the expense of large corporations and thus can turn into new investment barriers and undermine GVC integration. This regulation possibly will have the unintended effect of incentivizing the creation of many new micro and

[41] Coordinating Ministry of Economic Affairs, "Government Accelerating the Completion of Job Creation Law Implementing Regulations, Preparing Socialisation and Public Consultation [Pemerintah Kebut Penyelesaian Aturan Turunan UU Cipta Kerja, Siapkan Sosialisasi Dan Konsultasi Publik]," November 15, 2020, https://ekon.go.id/info-sektoral/15/222/berita-pemerintah-kebut-penyelesaian-aturan-turunan-uu-cipta-kerja-siapkan-sosialisasi-dan-konsultasi-publik.

small enterprises rather than creating an environment that allows the existing small firms to grow big.

According to article 66(5) of this regulation, supermarkets are another eligible supply chain partner for MSMEs. However, it then goes to specify the payment terms and even mandating fine for late payments. Such minute specification in a high-level regulation highlights the underdeveloped knowledge on GVCs and misidentification of the real problem. Late payments are indeed a critical issue for MSMEs; however, the difficulty of enforcing payments is symptomatic of the weak commercial law system in Indonesia. If going to court over payment dispute continues to take more than a year and costing 70 per cent of the claim value, even large fines will be insufficient to help MSMEs. [42] Instead of helping MSMEs, this rule may just add to the list of business risks foreign investors need to consider.

Ministerial Regulations present another challenge that may reduce the effectiveness of the Job Creation Law. Without a way to compel ministers to ensure synergy with existing regulations and alignment with the broader government policy, the problem of regulatory overlap will continue to plague Indonesia. Such overlap, once again, leaves businesses at the mercy of the unpredictable court system. Unfortunately, the Job Creation Law did not have any provisions to address this problem aside from the 'internal harmonisation' it has specified. One way to do this would be to retract the proactive regulating authority of ministers and build in a periodic review requirement for all regulations into the legislation.[43]

Furthermore, the Job Creation Law itself allow ministers to specify restrictions to foreign businesses, as long as it is not on equity. The most likely candidate for this is localisation rules, either local production or local content requirement (LCR). LCR has been a favourite industrial policy since 1950 and has reemerge in the past decade in various sectors from defense to traditional markets. [44] In fact, the COVID-19 crisis has emboldened the Ministry of Industry to

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[42] World Bank, "Doing Business 2020: Economy Profile of Indonesia ," 2020, 4, https://www.doingbusiness.org/content/dam/doingBusiness/country/i/indonesia/IDN.pdf.
[43] Patunru and Surianta, "Attracting FDI Post Covid-19 by Simplifying Indonesia's Regulatory Framework."
[44] Siwage Dharma Negara, "The Impact of Local Content Requirements on the Indonesian Manufacturing Industry," 4 (Singapore, October 2016), 6, www.iseas.edu.sg; Arianto A Patunru and Sjamsu Rahardja, "Trade Protectionism in Indonesia: Bad Times and Bad Policy," 2015, 21.

issue LCR for pharmaceuticals, despite history showing localisation rules to be ineffective in encouraging FDI or GVC linkages in this sector.[45]

7. Conclusion

As the world struggles from the greatest global public health and economic crisis, many countries are looking at ways to encourage their corporations to exit China and reshore or nearshore. In Asia, a nearshoring program subsidised by the Japanese government has singled out ASEAN member states as the preferred destination but Indonesia was not among the favourites. Repeated failures in attracting corporate relocations has contributed to the stagnation in FDI inflows and retreat from the GVCs over the past decade; a problem now exacerbated by the COVID-19 pandemic.

Much of Indonesia's economic woes are caused by its overbearing regulatory system. Indonesia is an attractive market for foreign investors due to its size, however a complicated regulatory system makes it very unpredictable and tough to navigate. President Jokowi 's attempt on deregulation during his first term was ineffective and, in fact, his ministers created more regulations under his watch than any other presidency. Added to the problem is the highly fragmented regional regulations which is virtually impossible to manage.

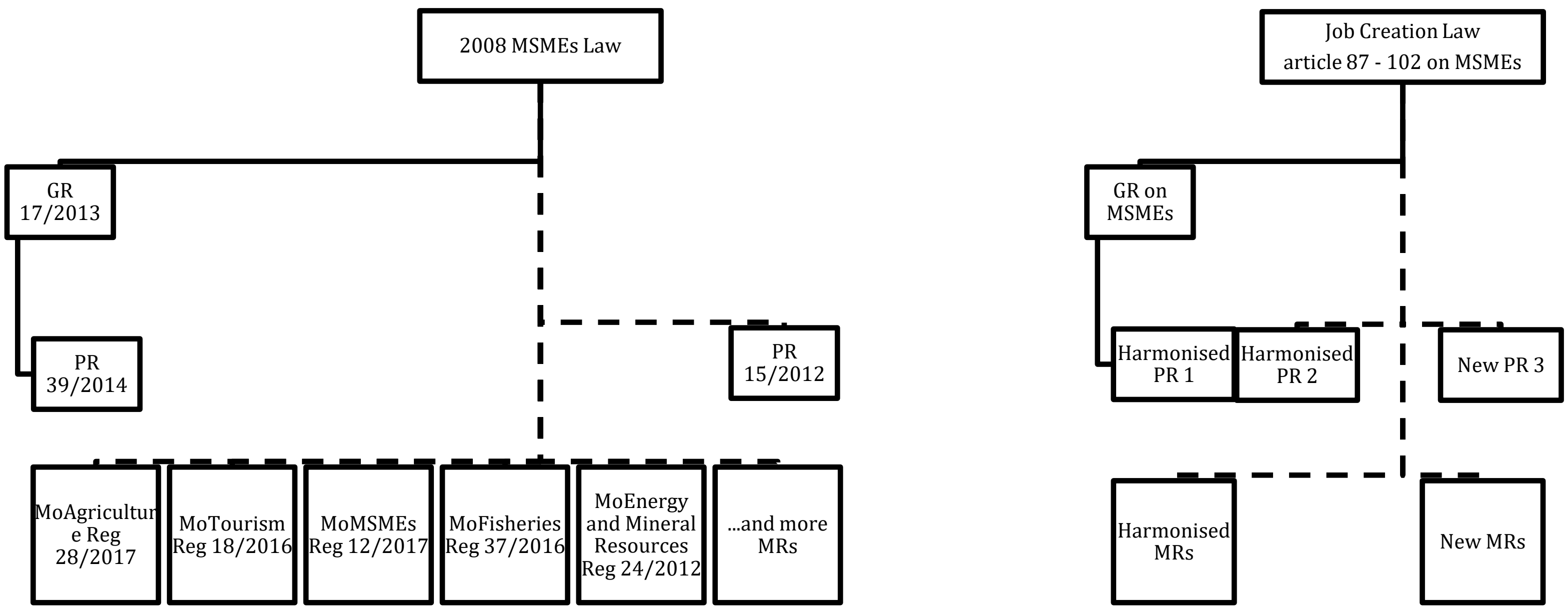
Doubling down on the reform bet, Jokowi chose an entirely new legal approach to the situation: the omnibus laws. This legal tool was selected for its ability to change multiple laws in one go. The first of these – dubbed the Job Creation Law – amends over 70 laws with the focus of removing investment barriers to create more jobs. Both highly anticipated and controversial, even the pandemic did not dampen the push to pass this massive law in record time. Initially believed to be all-about-investment, the law has evolved into all-about-MSMEs in its final form. Interestingly, this final form also contains a kernel of GVC thinking which may colour future investment policies. This FDI-MSMEs bifocal might create more complications and internal contradictions.

As revolutionary as it may seem, the law's impact will depend on its implementing regulations. These regulations will have to carefully balance the urgency of attracting capital into Indonesia

[45] Andree Surianta, "Primum Non Nocere : A Policy Approach for Pharmaceutical Investment in Indonesia," *Asia's Path Forward* (Washington DC, 2020), https://www.cipe.org/wp-content/uploads/2020/09/AndreeSurianta_09012020.pdf.

with the push to help micro and small businesses to grow. The law also did little in addressing the root cause of Indonesia's investment troubles, i.e. obesity at the lower level of regulations. While it may not fulfill the expectation of foreign investors entirely, it does usher in an acknowledgement of the Global Value Chains into the Indonesian policymaking space. If nothing else, this law may represent a small contemporary step to align Indonesian economic policymaking with the reality of the globalised world post COVID-19.

Appendix. Regulations on Micro, Small, and Medium Enterprises



Note: GR = Government Regulations, PR = Presidential Regulations, MR = Ministerial Regulations

———— denotes regulations created based on instructions by higher-level regulations

———— denotes regulations proactively created by claiming higher-level regulations as basis (without instructions)

Source: peraturan.go.id and Job Creation Law