INITIATIVE INDONESIA

Progress and Greater Promise Ahead

2023 US-Indonesia Investment Report

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US-Indonesia Investment 2023

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Writer
Jet Damazo-Santos
Research
Dyah Kusumaningtyas
Peter Lie
Patricia Puspitasari
Jennifer Reva Anton
Chief Editor
A. Lin Neumann
Editors
Hayat Indriyatno
Paul Goddard
Graphic Designer
Fajar Nugraha

I. The Jokowi Era

President Joko Widodo inaugurates an infrastructure project in Temanggung, Central Java, in June 2017 (Gunawan AB/ Shutterstock.com)

In 2014, when Joko Widodo rose from being a small businessman, city mayor and Jakarta governor to president of the fourth most populous country in the world, the media quickly painted him as a unique phenomenon, a game-changing political figure. The iconic video clip of CNN celebrity anchor Christiane Amanpour riding around the presidential grounds with him on a bicycle cemented the international image of a presumably simple soul thrust into leadership.

But what we have learned after nearly 10 years of President Joko "Jokowi" Widodo is that far from being simple or naïve, he is the most skilled and determined Indonesian politician of his generation. He came to office saying he would tackle Indonesia's dire infrastructure deficit, and he did. He acted to improve the investment climate through reforms, he opened up the immigration system, and he began the process of allowing investments in previously closed sectors. Perhaps most tellingly, he enforced discipline on an unruly cabinet and got the legislature to follow his directions. Exercising power comes naturally to him.

> Undoubtedly, Indonesia is headed in the right direction, largely due to Widodo's leadership, but it cannot simply continue with business as usual.

Those enthusiastic supporters who might have seen him as a democratic reformer, human rights campaigner or corruption fighter may feel disappointed, but it is hard to argue with his track record. With public approval ratings still at around 70 percent at the end of his term, it is clear that his approach is warmly endorsed by his people. When he leaves office around a year from the time this report is published, Indonesia will be, in many ways, a land much changed – and his vision drove that change.

In this, our 11th annual US-Indonesia Investment Report, we attempt a snapshot of the country's economic health at the end of the Jokowi Era. It is an encouraging, if incomplete, picture. Across the archipelago, paved roads, fast trains and gleaming airports stand testament to the largest infrastructure development program in the country's history. In many regions, smelters and other manufacturing plants will be processing nickel ore, bauxite and other raw materials that can no longer be exported. And if all goes as planned, the new government will be holding office in the ambitious new capital of Nusantara in rural Kalimantan. It doesn't matter if Nusantara is a good idea or not. It is *his* idea and it would be foolish to bet against it, even once Widodo is formally out of office.

On the social front, Indonesia now boasts the world's largest national single-payer health insurance system. Foreign healthcare and education institutions and specialists will soon become more accessible following key regulatory changes. From 2015-2019, the number of the extremely poor in Indonesia went down from 7.2 percent to 3.7 percent, a trend disrupted only by the Covid-19 pandemic.[1]

2015-2019

7.2%

3.7%

rate of extreme poverty

Within the halls of corporate Indonesia, change is evident too. Major legislative reforms have made the country more welcoming to foreign investors and experts. The embrace of technological advancements and digitization has begun streamlining much of the paper-based red tape that used to bog down business processes. And following the tone from the top, government agencies are becoming more open to engaging companies and other stakeholders in policymaking.

But in many ways, too, Indonesia is still the same. Powerful and often-opaque state-owned enterprises still dominate major sectors of the

[1] Badan Riset dan Inovasi Nasional, "Accelerating Elimination of Extreme Poverty in Indonesia," Press release, Sept. 20, 2022. https://brin.go.id/en/press-release/110410/accelerating-elimination-of-extreme-poverty-in-indonesia

economy, leaving little space for the private sector to contribute. Corruption remains a major challenge, evidenced by headlines announcing the arrest of one minister after another. Regulatory uncertainty continues to be a fact of life for companies operating in the country.

Despite all the improvements and reforms, Indonesia is still struggling to reach the 7 percent annual economic growth rate – a goal of Widodo's when he first came to office in 2014 – it needs to join the elite club of countries that have escaped the middle-income trap. Since 2014, the economy grew at its fastest pace of 5.31 percent only in 2022, as it bounced back from the Covid-19 pandemic.

Indonesia's reform efforts, while commendable, have so far failed to help the government break away from its deeply ingrained instincts to protect national interests at the expense of economic growth. The deep and difficult structural reforms that economists have long said are needed to reach high-income status by the independence centennial in 2045 remain elusive.

Undoubtedly, Indonesia is headed in the right direction, largely due to Widodo's leadership, but it cannot simply continue with business as usual. Reforms must deepen and accelerate, particularly in the face of even steeper challenges in the coming years from the weakening global economy, climate change pressures, superpower rivalry, and other concerns. Education, healthcare and other services lag behind Indonesia's neighbors and slow down investment.

In line with AmCham Indonesia's tradition in these investment reports, we critically assess Indonesia's policy approach in a number of sectors and we respectfully offer recommendations for the administration that will emerge from the 2024 elections. We are encouraged to say that many of the recommendations we made in previous reports were acted upon favorably by the current government through the omnibus law process. Our goal in this is simple: empower the international business community to assist Indonesia in realizing its potential and achieving its aspirations.

"Since 2014, the economy grew at its fastest pace of 5.31 percent only in 2022.

II. Progressive Strides

In our 2014 US-Indonesia investment report,[2] issued the year President Joko Widodo assumed office, the top challenge cited by business executives across various sectors was the lack of dialogue between the government and the private sector during policy formulation.

By the following year, changes in this area were already noticeable; our 2015 report already noted that consultation and engagement had improved under the new administration.[3]

[2] AmCham Indonesia (2014), Indonesia's New Path: Promoting Investment, Nurturing Prosperity. https://www.amcham.or.id/file_upload/Indonesias-New-Path-Promoting-Investment-Nurtur-05Jun2018114850.pdf

[3] AmCham Indonesia (2015), Taking Stock: US-Indonesia Investment 2015. https://www.amcham.or.id/file_upload/Taking-Stock-05Jun2018114710.pdf

People cross the road in Jakarta's central business district. (Lin Kumala/Shutterstock.com)

That same report recommended that the government take three key steps to grab the attention of investors: eliminate the Negative Investment List, eliminate currency controls, and lift burdensome restrictions on hiring expatriate personnel.

Today, Indonesia has made substantial progress on two of these fronts, largely due to President Widodo's commitment to seeing through the passage of the omnibus Job Creation Law in 2020. This demonstrates the current administration's willingness to expend political capital on regulatory reforms and listen to industry inputs.

Improved foreign investment climate

Among many provisions, the pivotal omnibus law repealed the Negative Investment List and replaced it with a Priority Investment List, which lists 245 priority business fields where investments are eligible for fiscal and non-fiscal incentives.[4] The law opened up numerous areas to 100 percent equity control for foreign investors and also allows investment in several sectors previously closed to investors, like healthcare and higher education. While the details can still be difficult, the message is clear: the government is now emphasizing growth and opportunity for investors, instead of limitations

[4] U.S. Department of State (2023), 2023 Investment Climate Statements: Indonesia. https://www.state.gov/reports/2023-investment-climate-statements/indonesia/

AmCham Indonesia advocated for these changes for many years and we were gratified to see the progress.

and restrictions. This more positive and inviting message reflects a sea change in government attitudes toward foreign investors.

Beyond mere rhetoric, the Job Creation Law — which was finally ratified in March 2023 after being temporarily suspended by a Constitutional Court ruling — backs up this invitation by lifting most of the foreign ownership caps that have deterred investors for decades. AmCham Indonesia advocated for these changes for many years and we were gratified to see the progress. All business sectors are by default now open for foreign investment, unless stated otherwise. The number of restricted business fields dropped from 350 in the Negative Investment List to just 46 under the Priority Investment List. Only a handful of sensitive areas are off-limits to foreign investment.

The same law addressed another major obstacle for foreign investors: restrictions on the employment of expatriates. For years, foreign companies had explained the need to be able to make their own staffing decisions, especially when it comes to crucial executive and expert positions.

The Job Creation Law's implementing regulations, which have been released in stages since 2021, relaxed several stringent rules on foreign workers and simplified the process to hire expatriate workers. Companies are also no longer required to have an Expatriate Placement Plan (RPTKA) for foreign commissioners or executives with a certain amount of ownership in the company. New categories for temporary foreign workers, such as specialized experts needed for short-term work like film production or factory installations, and for those working in special economic zones, were introduced. In addition, the process to apply for a Limited Stay Visa or Semi-Permanent Residence Visa for foreign workers was streamlined by reducing the requirements.[5] [6]

These changes came on top of the government's efforts to update a Positive Job List of positions open to expatriates, which was first released in 2019, to accommodate the needs of startups and the fast-growing information and communications technology (ICT) industry. Though there are still several positions off-limits to foreigners, the climate for foreign workers in Indonesia has improved from a decade ago.

[5] SSEK (2021), "New Regulation Looks to Ease Process of Hiring Foreign Workers in Indonesia," Legal Updates, Feb. 26, 2021. https://ssek.com/blog/new-regulation-looks-to-ease-process-of-hiring-foreign-workers-in-indonesia/

[6] SSEK (2021), "Employment of Foreign Workers in Indonesia: Minister of Manpower Regulation No. 8 of 2021," Legal Updates, May 27, 2021. https://ssek.com/blog/employment-of-foreign-workers-in-indonesia-minister-of-manpower-regulation-no-8-of-2021/

[7] AmCham Indonesia (2023), "Jokowi Signs Golden Visa Regulation as Gov't Updates Immigration Policies," AmCham Update Vol. 4 #84, Aug. 11, 2023. https://www.amcham.or.id/en/news/detail/amcham-update-vol-4-84

[8] Director General of Immigration (2023), "Director General of Immigration Issues the First Golden Visa for ChatGPT Founder Samuel Altman," Press release, Sept. 4, 2023. https://www.imigrasi.go.id/en/2023/09/04/dirjen-imigrasi-terbitkan-golden-visa-pertama-untuk-pendiri-chatgpt-samuel-altman/

This year, the government introduced further changes to the immigration system. Under the new regulations, the maximum period for a limited stay permit, including its extensions, was doubled from five to 10 years.[7] The visa and resident permit classification and extension process was also simplified.

These were followed up by the official release of the highly anticipated Golden Visa, which saw OpenAI Chief Executive Officer Samuel Altman receiving the first golden visa ever granted.[8] Designed to attract foreign professionals with special talents, investors and others who will be beneficial to Indonesia's future economic development, the visa is valid for a period of five to 10 years.

Further, the sweeping Job Creation Law, which tackled hundreds of existing regulations, also cut through much of the red tape that tied down businesses, simplified land acquisition and licensing processes, and provided additional incentives for special economic zones.

A major step toward reducing bureaucratic hurdles was the launch of the Risk-Based Online Single Submission (OSS) system in August 2021. Before this system, companies faced a tedious process of engaging with multiple agencies to obtain the necessary information and licenses, which was time-consuming and expensive. The OSS system had a rocky launch, but the government sought out businesses for input on improvements. Once fully integrated across all government agencies, the OSS has the potential to significantly simplify the business license application process.

Greater engagement with businesses

We believe major regulatory improvements are only possible under a government willing to engage in productive dialogue with the private sector.

Over the past decade, businesses have reported increased access to government officials and more consultations on draft regulations. AmCham has noted that meetings with top policymakers have become occasions to discuss solutions on both sides, and not just air grievances as in the past. Though Indonesia still has a way to go in terms of creating open and transparent policymaking throughout the government, a number of examples under the Widodo administration give us confidence that the bureaucracy is slowly turning over a new leaf.

For instance, when outgoing legislators at the end of the

Susilo Bambang Yudhoyono administration in 2014 passed the strictest Halal Law in the world, despite Indonesia being a secular republic, worries emanated from many businesses local and foreign, ranging from small local food manufacturers to major foreign pharmaceutical firms.

By making halal certification mandatory for all food, beverages, drugs, cosmetics, chemicals, organic and genetically modified products sold in Indonesia, and for the machinery, equipment, and other facilities involved in processing, storing and delivering these products, the law generated justified concerns over massive costs and red tape. There were significant worries over how foreign halal certification bodies would be handled in countries like the United States that do not regulate religious practices. There were warnings over how a harsh implementation of the law could derail the economy. Pharmaceutical companies, in particular, were worried that innovative and life-saving drugs might effectively disappear from the Indonesian market given their extremely intricate manufacturing process and supply chains.

After years of discussions between government officials, industry stakeholders and associations like AmCham Indonesia, many of these concerns were eventually addressed. The halal certification process has been simplified, with the Halal Product Assurance Agency (BPJPH) setting a lead time for the whole process. The law's implementing regulations also include grace periods of up to 15 years before all drug and medical device manufacturers have to comply, and rules on recognizing certifications by foreign halal bodies were also eased. The omnibus Job Creation Law further allowed halal certificates to remain valid indefinitely, unless there are changes to the manufacturing process or inputs used.

"The halal certification process has been simplified, with the Halal Product Assurance Agency (BPJPH) setting a lead time for the whole process.

Though worries over the Halal Law still remain, especially ahead of the certification deadline next year for food and beverage products, the almost decade-long discussions between the government and the private sector to reduce these concerns stand as an example of productive dialogue. AmCham Indonesia was pleased to be involved in many useful discussions with the government over the halal certification process.

To a certain extent, the same productive dialogue has also been seen in Indonesia's regulatory approach to the digital economy over the past decade.

For example, our 2014 investment report showed that one of the biggest information technology concerns was a requirement for companies that provide any kind of electronic services to place their data centers and disaster recovery centers inside the country. Aside from being incompatible with the global trend toward free data flows, the requirement would increase operating costs and reduce data security and competitiveness.

In 2019, private electronic system operators (ESOs) were finally given the option to choose where they will manage, process and store their data, through a revision of the 2012 regulation that called for sweeping data localization. Though more stringent requirements still apply to financial institutions, recent actions from the sector's supervisory authorities now allow banks to operate their electronic data processing systems and disaster recovery centers outside of Indonesia. Concerns over data localization and restrictions on cross-border data flows still remain, such as in the healthcare sector, but we are hopeful the government will continue to listen to industry inputs.

Though the changes took time, they demonstrate a shift toward greater engagement and inclusive policymaking. In fact, public consultations for major policies have now become standard. All the draft implementing regulations for the Job Creation Law were published on a website for consultation, as with the draft implementing regulation for the Personal Data Protection Law passed last year. Frequently, AmCham Indonesia is also asked by various ministries to assemble input from our member companies on draft regulations.

These progressive strides reflect the current government's commitment to improving the investment climate. We urge the next government to not just continue, but to accelerate the reform momentum.

III. Building on the Momentum

Given what the government has already done to make Indonesia a more attractive investment destination, the country must keep moving forward, not just during President Widodo's final year in office but in succeeding administrations as well.

Indonesia's vision to become one of the world's top five economies by its centennial in 2045 looms ever closer, while its fabled demographic bonus will reach its peak in 2030. According to the National Development Planning Agency (Bappenas), for Indonesia to reach its target GDP of $9.8 trillion by 2045, the economy needs to grow by an average of 7 percent annually, a figure the country has not achieved in the last 20 years. Given current growth rates, that means Indonesia's economy will have to

Target GDP
$9.8
trillion
by 2045

expand by 7.8 percent each year from 2030 to 2044.[9]

The momentum of reform therefore should not just continue, but accelerate to avoid the risk of Indonesia becoming mired in the middle-income trap.

To do this, it is crucial to address the remaining regulatory barriers hindering the flow of investments, which can only be achieved through even closer consultation with the private sector.

The following section discusses these hurdles, focusing on specific aspects related to long-term issues such as red tape and protectionism, as well as concerns in a number of key sectors.

By understanding and working together to address these barriers, policymakers, the private sector and other stakeholders can not only sustain the current positive trajectory but potentially accelerate Indonesia's journey toward becoming a preferred destination for global investors.

A. Cross-sectoral issues

a. Inefficient bureaucracy

Efforts to untangle Indonesia's massive bureaucratic red tape often start out with the best of intentions, but falter when it comes to implementation because of insufficient planning and attention to details, weak intra-government communication and coordination, and the vested interests of entrenched officials.

This is true for both the highly touted Risk-Based Online Single Submission (OSS) system and the lesser-known Commodity Balance system intended to regularize import needs. It might also be the case for the upcoming Core Tax Administration System.

OSS system

The OSS system was supposed to be a major step toward reducing bureaucratic hurdles, allowing companies to obtain all the permits they need in under an hour on one website. But two years after its launch, its potential has yet to be fully realized.

The system's problems stem from it being launched before it was fully integrated with other ministries and local government bodies, while maintaining strict deadlines for businesses. For example:

- Companies have been unable to obtain the Spatial Utilization Activity Compliance Approval (PKKPR), a prerequisite to apply for environmental approval and other licenses, as the Ministry of Agrarian Affairs and Spatial Planning's application system is not yet aligned with the OSS system.
- Delays have been experienced in the issuance of the complete Industrial Business Permit (IUI), as the Ministry of Industry's system has yet to fully integrate with the OSS system.
- The transition of issuing production certifications for household health products (PKRT) from the Ministry of Health to the Ministry of Industry has also faced challenges, as the Ministry of Industry is still adapting its system to issue these certifications.

[9] Ghifari, D. (2023), "2045 GDP target unreachable without big changes: Experts," The Jakarta Post, Oct. 12, 2023. https://www.thejakartapost.com/business/2023/10/12/2045-gdp-target-unreachable-without-big-changes-experts.html

The lack of coordination between different government bodies has resulted in instances where businesses have had to stop running because they could not renew their permits through the OSS system, in direct contrast to the central goal of the initiative.

The OSS system was also aimed at reducing the burden of reporting to multiple ministries. However, in practice, companies are still required to provide reports to various government offices. The lesson: wait until new systems are fully operational. The OSS is a good concept, but the hurried rollout led to massive problems for both local and foreign companies.

Commodity Balance system

The recently introduced Commodity Balance system is another initiative aimed at enhancing and streamlining the licensing process, but so far it has not worked as intended.

Importers used to go through a time-consuming process of obtaining import recommendations from multiple ministries in order to obtain import licenses. The Commodity Balance system, instituted through a 2022 presidential regulation, creates a unified platform to manage and regulate import and export activities based on supply and demand dynamics. The idea is to aggregate and centralize domestic supply and demand data for certain key commodities. This would then provide the government with real-time commodity balances that would serve as the basis for granting export and import permits.

Despite the noble intentions, companies have instead faced challenges such as limited access to imported raw materials, inability to request additional import quotas, and overall system uncertainty. Ambiguity over the handling of data has led to restrictions and shortages of both consumer goods and raw materials, creating uncertainty for both local and foreign investors. In some cases, entire industries nearly ground to a halt because of raw material shortages. AmCham Indonesia has brought these problems to the attention of the government on behalf of numerous companies that experienced difficulties.

> **“The lesson: wait until new systems are fully operational.**

As with the OSS, the problems with the Commodity Balance system stem from a lack of coordination between ministries and agencies and attention to detail. For example:

- Initially, only small- and medium-sized general importers were able to apply for the Commodity Balance for raw materials and auxiliary products. Large general importers were unable to obtain a quota, especially for iron or steel commodities. Fortunately, the language of the regulation has since been changed.

- The system only allows businesses to apply for additional quotas during the first quarter of the year, which is not realistic given that companies often only determine whether they need to add or reduce a quota toward the end of the year. This disparity can constrain the supply of raw materials needed for business growth.

The OSS and Commodity Balance systems are both reasonable initiatives, but their rushed implementation has instead created new problems due to a lack of sufficient preparation and consultation. Developing comprehensive industrial data as the basis for granting permits

requires understanding the complexity of each industry. There is a world of difference, for example, between the needs of consumer manufacturers and those of raw material processing, and one size does not fit all.

Tax issues

Another bureaucratic issue that consistently ranks high among foreign investor concerns here is taxation, particularly the tax audits that are obligatory if a company requests a tax refund, which often lead to protracted and disruptive disputes. Despite numerous tax law reforms aiming for better engagement between the Directorate General of Taxes (DGT) and business, challenges persist.

Comparatively, multinational companies find tax audit procedures in places like China, Singapore and Malaysia to be more streamlined, with a clearer resolution pathway and less financial strain on taxpayers. Given the bureaucratic hurdles, it is not surprising that Indonesia's tax-to-GDP ratio ranks among the lowest in the region. In 2021, it stood at just 10.9 percent, well below the 19.8 percent average for the Asia-Pacific region.[10]

Under a 2018 presidential regulation on tax modernization, a new Core Tax Administration System (CTAS) is set to digitize and replace the current aging and

[10] OECD (2023), Revenue Statistics in Asia and the Pacific 2023 - Indonesia. https://www.oecd.org/tax/tax-policy/revenue-statistics-asia-and-pacific-indonesia.pdf

limited legacy system by next year. This modern and integrated system is designed to simplify the tax administration process and increase transparency.

However, if the current online tax submission process is any indication, a lack of proper testing to ensure the system is robust could instead make things more complicated. The DGT's electronic form (e-form) for filing tax returns has been plagued with errors and confusion since it was rolled out, and a system change last year to make it more user-friendly has so far done little to address the problems.

Given this, there are concerns among the business community that, as with the OSS and Commodity Balance systems, insufficient preparation can derail the DGT's ambitions for the new CTAS if it is rolled out next year.

All these challenges underscore the importance of improving intra-government coordination and increasing consultations with affected industry players to ensure that the goal of truly easing the business environment is achieved.

b. Restrictive nationalist measures

The tug-of-war between a country's need to attract more foreign direct investment (FDI) and its desire, largely for political reasons, to protect local industries is a challenge most governments struggle with. Encouraging local industry to flourish is a justifiable policy goal, but too often uncompetitive local companies, often from the public sector, have been given unfair advantages over foreign investors. This has been a source of tension for both manufacturing and trade.

In addition to long-standing concerns over import substitution, local content requirements, and the administration's expanding downstreaming policy in natural resources, two recently issued policies have generated concerns that the government is increasingly swinging back toward protectionism: the new export earnings retention rule that came into force on Aug. 1, and the $100 import threshold for foreign goods sold on e-commerce sites introduced at the end of September.

On one hand, the objectives behind some of these policies are understandable. However, they also come with downsides, exacerbated by the government's tendency to roll them out with insufficient planning and limited consultations.

Local content rules

Requiring products to contain a certain percentage of local content could in theory boost demand for local manufacturers and even provide better protection from external shocks. While this policy may seem to generate short-term gains, it has been found to lead to higher production costs and consumer prices, according to a new study from the Jakarta-based Centre for Strategic and International Studies.[11]

The study found that local content rules are associated with lower levels of production in general, because companies are obliged to employ inputs from less-competitive local companies. At the same time, these rules also discourage investment or expansion if foreign manufacturers are unable to find suitable local suppliers of needed inputs, especially for high-end manufacturing.

To mitigate these risks, economists recommend identifying industries where local content rules will be more beneficial than detrimental, such as those with competitive upstream producers, and access to sufficient infrastructure and qualified labor. We also believe that it is better to encourage investment using the "carrot" of incentives rather than the "stick" of local content rules.

[11] CSIS Indonesia (2023), "Economic Impacts of Local Content Requirements in Indonesia."

> A $100 import threshold for foreign goods sold on e-commerce sites was introduced at the end of September.

Downstreaming policy

The government has touted the benefits to Indonesia's economy from prohibiting the export of unprocessed minerals and agricultural commodities. Indonesia says the value of its nickel exports ballooned to IDR 326 trillion ($21.8 billion) in 2021 from just IDR 17 trillion at the end of 2014, largely due to the export ban on nickel ore that started in January 2020.

Indonesia's blanket export bans on unprocessed commodities have drawn the ire of trading partners around the globe and burdened companies with unclear rules and changing deadlines. In 2022, for example, the government suddenly revoked an export ban on crude palm oil after less than a month. The year before, an unexpected coal export ban was also lifted after less than a month.[12]

While the government has touted the success of its downstreaming policy on the nickel sector due to the boom in electric vehicle battery demand, there is no guarantee that the same approach will work for other commodities such as bauxite, which is not as important an export commodity for Indonesia as nickel. Blanket restrictions on raw materials exports and forcing the development of domestic mineral smelters that may not be needed globally can impose undue burdens on companies.

[12] The Jakarta Post (2023), "Build those smelters!" June 19, 2023. https://www.thejakartapost.com/opinion/2023/06/19/build-those-smelters.html

E-commerce import threshold

The new $100 import threshold[13] for foreign goods sold on e-commerce sites is supposed to help small local manufacturers compete with cheap goods from China.

However, this threshold would also restrict the access of Indonesian consumers to a wide variety of affordable products, and could create markets for illicitly imported goods. Therefore, while the new e-commerce regulation would do little to stem the flow of cheap goods into the country through various other channels, it creates an impression that Indonesia is discriminating against foreign e-commerce players.

This unprecedented market access restriction targeting foreign businesses could also violate obligations Indonesia has accepted in its international trade agreements, and could even invite retaliatory measures against local businesses seeking to expand their activities overseas.

Export earnings retention

The new requirement for exporters to keep at least 30 percent of their export earnings in the country for a minimum of three months might help cushion the rupiah against severe fluctuations, but it can also disrupt existing business arrangements and violate existing contracts.

It can be perceived as restrictive by investors who often keep earnings from exports in overseas bank accounts to take advantage of higher interest rates, but disruptive by smaller local exporters who cannot afford to keep the requisite 30 percent of their earnings for three months, as they need the cash for operational costs.

It is evident that the government is striving to walk a tightrope – pleasing some political sensibilities while maintaining growth – but poor planning and limited industry consultations only exacerbate the downside of these policies, raising questions about whether the objectives are worth the accompanying challenges in the first place.

[13] Ministry of Trade Regulation No. 31/2023 on Business Licensing, Advertising, Guidance and Supervision of Business Actors in Trading Through Electronic Systems

Indonesia generates

42%

of ASEAN's digital output

B. Sector-specific issues

a. Digital Economy

Indonesia is the largest digital economy in Southeast Asia, accounting for about 42 percent of ASEAN's digital output. This digital economic potential is difficult to overstate. The country's dynamic startup ecosystem grew by a remarkable 414 percent between 2017 and 2021, spurring innovation and providing an economic lifeline for many small and medium-sized enterprises (MSMEs). Though this pace of growth has since slowed, the sector is still forecast to grow by about 62 percent from 2021 to 2025.[14]

Maintaining and accelerating this trajectory is critical to Indonesia's wider economic goals. In this fast-changing sector, a regulatory regime that encourages innovation and remains consistent with global policy trends and best practices is crucial.

In a speech in September this year, President Widodo noted that regulations always lag behind technological developments.[15] This is precisely why AmCham Indonesia advocates for more consultative policymaking, as the private sector can provide the relevant expertise and technical knowledge needed to create policies that achieve the difficult balance of promoting innovation while protecting the rights of Indonesians and promoting fair competition at the same time.

[14] Sapulette, M.S., P. Muchtar (2023), "Redefining Indonesia's Digital Economy," *ERIA Policy Brief* 2022-06: Economic Research Institute for ASEAN and East Asia. https://www.eria.org/uploads/media/policy-brief/FY2022/Redefining-Indonesia%E2%80%99s-Digital-Economy.pdf

[15] Presiden Republik Indonesia (2003), "Presiden Tekankan Pentingnya Regulasi Transformasi Digital yang Lebih Holistis," Sept. 25, 2023 https://www.presidenri.go.id/siaran-pers/presiden-tekankan-pentingnya-regulasi-transformasi-digital-yang-lebih-holistis/

> **"Regulations should both protect the right to privacy and facilitate business activity and innovation.**

For instance, the draft implementing regulation for the Personal Data Protection (PDP) Law contains an unreasonably tight window for personal data controllers to respond to requests from data subjects. Regardless of the scope or complexity of a request to provide a data subject with access to or copies of their personal data, update or correct errors, and restrict or stop processing, personal data controllers will have to respond within "3 x 24 hours."

This can create obvious issues when requests are made on a Friday, or ahead of a holiday. It is also unusually short when compared to the month-long window provided in jurisdictions such as neighboring Singapore or the European Union, with allowances for reasonable extensions. The draft regulation also contains other provisions that are not in line with global best practices, such as a requirement to publish the results of comprehensive audits, and for data processors to ensure the accuracy of personal data.

As Communications and IT Minister Budi Arie Setiadi said when the draft regulation was released for public consultation, the PDP Law should both protect the fundamental right to privacy while facilitating business activities and encouraging innovation.[16] We are hopeful that the government will consider the inputs of the private sector to create a final version that achieves all these goals.

It is these same goals that AmCham wants to help Indonesia achieve through regulations that enable the trusted free flow of data. After years of advocacy and discussion, the government finally revised the controversial Government Regulation (GR) 82/2012, which calls for sweeping data localization, and replaced it with GR 71/2019, removing a key regulatory constraint by allowing private companies to maintain their data centers offshore in most cases.

However, concerns still remain, specifically with regard to the implementing regulations of GR71. The ministerial regulation on private electronic system operators, for instance, contains unclear provisions and technical mechanisms. A draft ministerial regulation on public sector electronic service providers likewise creates restrictions on the use of cloud service providers, which can limit the government's access to advanced security and data protection capabilities.

A bigger source of concern, though, was the Ministry of Finance's surprise issuance last year of a ministerial regulation that requires all importers of digital goods and software products to fulfill customs obligations — an unprecedented measure that introduces uncertainties and potentially onerous costs. After all the improvements we have seen over the years in terms of the government's engagement with the private sector, we were surprised

[16] Kementerian Komunikasi dan Informatika (2003), "Menteri Budi Arie: Pemerintah Libatkan Semua Pihak Rumuskan Aturan Turunan PDP", Press release, Aug.30, 2023. https://www.kominfo.go.id/content/detail/51129/siaran-pers-no-253hmkominfo082023-tentang-menteri-budi-arie-pemerintah-libatkan-semua-pihak-rumuskan-aturan-turunan-pdp/0/siaran_pers

to see the regulation issued with no consultation period, nor clarity on its coverage, timeline, and implementation.

As research from the Indonesian Services Dialogue (ISD) demonstrates, digitalization has so far bolstered monthly MSME profits and revenues by 20 percent, expanded consumer bases by 31 percent, and created three new jobs per company. More than 90 percent of surveyed MSMEs have integrated digital products or services into their operations. With the burgeoning sectors of e-commerce and financial technology, it's clear that digitally enabled services and goods are invaluable assets to Indonesia's economy. All of these gains can be maintained and even accelerated with the right balance of policy responses, which can only be achieved in close coordination with all relevant stakeholders.

b. Creative Economy

Film Production Could Be Indonesia's Next Big Thing

When it was announced that Hollywood stars George Clooney and Julia Roberts were teaming up for *Ticket to Paradise*, a 2022 family comedy set in Bali, it seemed like a perfect occasion for Indonesia to show off its beauty and hospitality in much the same way that *Eat Pray Love*, the 2010 film also set in Bali and also starring Roberts, gave a boost to the local economy and the country's image.

Sadly, *Eat Pray Love* is one of just a few big-budget Hollywood movies that managed to film in Indonesia in recent years. The producers of *Ticket to Paradise* reportedly saw Indonesia as too difficult to use as a location, and opted to make the picture in Australia. Paul Fletcher, the Australian Minister for Communications and the Arts, was quoted as saying the production generated at least 270 jobs and $36.2 million for the local economy.

Filmmakers have long agreed that Indonesia is a tempting prize for moviemaking, but the complex gauntlet of agencies, permits, offices and ministries required to film here have made it a daunting task. The more welcoming New Zealand, as an example, has gone from roughly $200 million a year 20 years ago to now over $3 billion in direct economic benefit, according to many reports.

There is no reason Indonesia, given its size, diversity and scenic locales, could not easily eclipse New Zealand as a destination for film and streaming productions. But what is needed is a concerted effort to put forward a "one government" approach to the industry, something that both Malaysia and Thailand have also done. In essence, the government needs to understand the peculiarities of film production and the unique needs of the industry for assistance with special working visas, permits and incentives, and to turn that knowledge into a one-stop shop for film producers. Many countries have film offices to assist productions – the result being money spent in-country on everything from drivers and catering to local film crews and hotel rooms.

Indonesia already has its unique geography. We only need to make it easier for outside producers to put that geography on screen.

c. Healthcare & Pharmaceuticals

In June, President Widodo lamented once again that almost 2 million Indonesians travel abroad each year to seek medical treatment in other countries, leading to IDR 165 trillion (over $10 billion) in foreign exchange losses due to capital outflow. Many of these Indonesians fly to neighboring Singapore, Malaysia or Thailand for the simple reason that they doubt the quality of the healthcare system at home.

A month after the president's complaint, lawmakers passed a measure that they hope can change this dismal reality: An omnibus law revising some 11 existing health laws to transform the landscape of Indonesia's healthcare system.

With a number of provisions relaxing restrictions that have long held back development and innovation in healthcare and pharmaceuticals, the Health Law has the backing of major companies. Among its key changes, the law will allow foreign doctors, specifically specialists and subspecialists, to practice in the country for up to two years. This will help address the country's severe shortage of doctors and improve the quality of health services. The new law

> **The new Health Law also limits the stranglehold on the sector that the powerful Indonesian Doctors' Association has exercised for decades.**

also limits the stranglehold on the sector that the powerful Indonesian Doctors' Association has exercised for decades, and will hopefully result in a more welcoming environment for foreign expertise. As a result of these changes, a number of foreign healthcare companies have begun looking seriously at Indonesia as an investment destination.

But there are still a number of areas that need to be addressed, particularly in terms of protectionist measures related to drugs and other health products.

First, the Health Law prioritizes the use and procurement of locally manufactured and sourced products. While we recognize the objective of supporting domestic manufacturers and reducing dependence on imports, the fact is that a number of health products — especially innovative and high-tech ones — still do not have suitable local substitutes. Prioritizing local products should take into account the needs of patients and hospitals, as well as the government's roadmap for resiliency in domestic health supplies.

To reap the benefits and avoid the pitfalls of local content requirements (TKDN) for pharmaceutical products and medical devices, assessments should be based not just on cost components, but process as well. This would allow Indonesia to benefit from high-tech, life-saving products that are more focused on process-based aspects, such as research and development. Greater recognition should also be given to companies that manufacture innovative products, which can encourage further research and development as well as investment in the sector.

As with many Indonesian laws, the details in the Health Law's implementing regulations will largely determine whether the government's ambitious healthcare reform agenda will be realized.

The Ministry of Health's recently released draft implementing regulation authorizes the government to regulate and control the price of health supplies. It is important to clarify, however, that this price control power would apply only to public procurement and the government's National Health Insurance (JKN) program, and would not extend to the broader consumer market.

> **Apart from the Health Law, there are still concerns from the business sector over how the Patent Law will be implemented.**

Another important change needed in this area is for fair prices to be reflected in the JKN program. This can be done by recognizing medical innovations from multinational companies, as well as by taking into account several other criteria that affect the usefulness of a drug — treatment outcomes, quality, safety, efficacy, supply availability, and overall investment in research and development — instead of just costs.

The draft implementing regulation also states that the health minister's approval is needed for cross-border data transfers in the public health sector, which is not aligned with the cross-border data provisions in the Personal Data Protection Law passed last year.

Apart from the Health Law, there are still concerns from the business sector over how the Patent Law will be implemented, particularly with regard to the Presidential Regulation on Government Use of Patent. As the government's decision is final and cannot be challenged, this gives rise to worries that "unilateral" decisions could cause negative, unintended results to the public. Compounding this concern is the potential lack of data that could support the government's decision to implement patents.

Finally, the 2014 Halal Law is still not free of concerns, despite many improvements and amendments achieved over years of discussions between the government and industry.

In July, the Ministry of Health published draft guidelines covering an extensive halal certification procedure for drugs, biological products and medical devices that encompasses both upstream and downstream stages, covering aspects from raw materials sourcing, processing and storage, to monitoring and evaluation.

This rigorous halal certification mandate is expected to not just increase the cost of doing business, but could also create market access issues especially for the intricate supply chains of medicines, medical devices, and other high-tech, complex products. It would be helpful if the government exempted products that are not derived from animal-related materials, particularly medical devices, from this certification requirement. The private sector's apprehensions over this are compounded by the progress of government-to-government (G2G) agreements on halal standards recognition, sanctions, and other technical dimensions entailed in the certification process.

d. Education and Human Resources

Much has been written about Indonesia's fabled demographic dividend, but there is a growing risk that the country will not be able to take full advantage of this


High school students in Banyumas, Central Java, working on their final test online on smartphones. (Agewib/Shutterstock.com)

opportunity if it fails to elevate the skill level and educational acumen of its workforce.

With over 4,500 higher education institutions, Indonesia has a broad educational framework. Yet, fewer than 100 of these institutions have clinched the highest accreditation level nationally. The international standing of these institutions paints a grimmer picture; not a single Indonesian university features among the top 800 globally, according to the latest Times Higher Education World University Rankings.

As with healthcare, this glaring gap in quality education drives numerous students to pursue higher education abroad, manifesting in a significant brain drain detrimental to the nation's progress. Outcomes of the 2018 Program for International Student Assessment (PISA) diagnostic tests further underline the imperative of educational reform; Indonesia secured the 71st position out of 77 countries, trailing neighboring nations like Malaysia and Brunei.

> Indonesia secured the 71st position out of 77 countries in the 2018 PISA diagnostic tests.

The Ministry of Education, Culture, Research and Technology has already made efforts to put in place an updated school program to catch up with the educational lag, particularly with the launch of the Freedom to Learn–Independent Campus (Merdeka Belajar–Kampus Merdeka, or MBKM) policy in 2020. The Freedom to Learn program revolutionizes Indonesia's primary and secondary education system by introducing a more emancipated learning approach and provides flexibility in curriculum planning to adjust to student needs. This is supplemented by the Independent Campus program at the tertiary level, which provides more opportunities for students to hone skills suited to their interests and needed for their prospective careers. However, the new curriculum has been met with some criticisms from parents, perhaps indicating a need to better communicate the program and conduct more training for teachers.

Recognizing the need for knowledge transfer in this space, the government has introduced legislative reforms over the years to open the door to foreign stakeholders. These allowed a few foreign universities to establish a foothold in Indonesia, such as Australia's Monash University and the Melbourne Institute of Business and Technology, and laid the groundwork for international universities like Western Sydney University and Curtin University to begin planning to establish campuses in Indonesia.

There are still, however, a number of restrictions that complicate this process. Foreign institutions either have to establish a non-profit foundation to be able to set up a branch campus, which means profit cannot be distributed or repatriated; or they must partner with a local institution. In July, Western Sydney University announced plans to open a campus in Surabaya after receiving approval from the Indonesian Ministry of Law and Human Rights to establish a foundation.[17]

Aside from this, issues over curriculum freedom, difficulties in obtaining student visas, and limitations on access to foreign educators also reduce the attractiveness of Indonesia as a market for foreign educational institutions.

Indonesia has less than a decade left before its demographic bonus reaches its peak, making the need for more progressive reforms to the country's education system increasingly urgent. While the demographic peak presents a golden opportunity for economic growth, the lack of a holistic education system that can produce the kind of highly skilled workers the country needs could turn this potential advantage into a series of challenges for Indonesia.

[17] Western Sydney University (2023), "Western Sydney University takes first step to establishing presence in Indonesia," Press release, July 4, 2023. https://www.westernsydney.edu.au/newscentre/news_centre/more_news_stories/western_sydney_university_takes_first_step_to_establishing_presence_in_indonesia

Sidrap Wind Farm project in Sidenreng Rappang Regency, South Sulawesi (Beddai/Shutterstock.com)

e. Renewable Energy

In light of the pressing global urgency to address the climate crisis, AmCham supports the Indonesian government's energy transition ambitions aimed at curtailing fossil fuel dependency and nurturing the renewable energy sector. This ambition, however, demands translation into decisive and comprehensive actions.

A substantial level of public-private investment is imperative to propel these aspirations from blueprint to reality. But the path to increasing the involvement of foreign stakeholders in the renewable energy space faces challenges from uncertainties in the current regulatory environment and the monopoly of state electricity company PLN in the energy sector.

The first concern is the anticipation for clear net-zero emission plans, with investors gauging the government's commitment to its energy transition goals based on whether it can deliver on its stated targets. The 2060 net-zero horizon may seem distant, but the journey toward it requires well-articulated short- and near-term targets. Indonesia has so far been trailing behind its own objectives, with the share of renewable energy in Indonesia's energy mix at a modest 12.3 percent in 2022 — far behind the ambitious 23 percent goal envisioned for 2025.

Second, the energy landscape in Indonesia is dominated by PLN and its subsidiaries. This monopoly not only compounds policy and regulatory complexities, but also curtails efforts to scale. A glaring example was PLN's hesitance to fully implement a ministerial regulation on rooftop solar photovoltaic panels, restricting their installations to just 10-15 percent, far less than the 100 percent stipulated in the regulation. This conservative approach, aimed at countering surplus energy generation in Java and Sumatra, stifled the growth of solar energy initiatives.

While the launch in September of Indonesia's first carbon exchange marks an important step toward the country's carbon neutrality goal, a number of overlapping regulations and lack of clarity on technical aspects might render it ineffective.[18]

Indonesia has ample natural resources to meet its renewable energy aspirations, but achieving these goals will require a deeper commitment than we have seen so far. There needs to be greater consultation and cooperation with various stakeholders as well as flexible regulations.

Energy transition

$20 Billion

pledged for Indonesia's renewable switch

The Just Energy Transition Partnership (JETP), a US-led global initiative to move from coal to cleaner energy, announced an ambitious $20 billion funding program for Indonesia at the G20 Summit in Bali in November 2022. But the launch of projects under the program is time-consuming and it remains to be seen whether the JETP headlines from Bali will result in the kind of game-changing support that some expect. Regardless of where the funding comes from to move from dirty energy to cleaner alternatives for Indonesia, engaging with the private sector is crucial to ensure that Indonesia's regulatory framework accommodates the needs of both the government and the investors.

[18] Christiawan, R.(2023), "Why harmonization of laws on carbon trading is urgent," *The Jakarta Post*, Aug. 22, 2023. https://www.thejakartapost.com/opinion/2023/08/22/why-harmonization-of-laws-on-carbon-trading-is-urgent.html.

IV. Conclusion & Recommendations

The changes in the recommendations we have listed in these investment reports over the past decade illustrate how President Widodo's government has fostered an environment increasingly conducive to foreign investment. From the removal of the Negative Investment List and the relaxation of foreign worker restrictions, to the palpable shift toward greater engagement and inclusive policymaking, we are gratified to see many of the reforms we have advocated for over many years finally being implemented.

However, the reform agenda is far from finished. Addressing the remaining challenges is even more urgent in light of Indonesia's looming demographic peak and the increasingly alarming threats posed by the climate crisis. These include the need to:

- Streamline the bureaucracy: Address challenges in the implementation of the Online Single Submission (OSS) system and the Commodity Balance system. Ensure better intra-government coordination between ministries and between the national and sub-national governments. Increase and deepen consultation with industry for effective implementation.

- Simplify tax procedures: Revise tax administration processes and improve clarity in tax audit procedures to make them more investor-friendly. Increase private sector engagement to ensure that tax policies are well understood and aligned with global best practices.

- Reassess restrictive measures: While supporting the growth of local industries is important, it is crucial to strike a balance to ensure that policies do not deter foreign investments. This includes re-evaluating local content rules, export bans, and other protectionist non-tariff trade barriers.

- Foster a conducive environment for the digital economy: Promote a regulatory environment that encourages innovation in the digital sector. Engage in consultative policymaking with the private sector to ensure regulations align with technological advancements.

- Engage in productive dialogue: Continue the trend of meaningful dialogue with the private sector. This will ensure that policies are not only well-informed but also address the actual needs and concerns of businesses.

- Deepen education reforms: Foreign investors remain concerned about the availability of qualified graduates in Indonesia. The school system, from primary through university, needs to focus on problem-solving and independent thinking while moving away from rote learning focused mostly on passing exams.

“President Widodo’s government has fostered an environment increasingly conducive to foreign investment.

Many of these recommendations have appeared in our previous reports, and their inclusion in this year’s list again emphasizes how critical they are to the foreign business community.

There is no question that Indonesia has made significant progress in creating an investment-friendly environment, but there is still substantial room for improvement. It is imperative for the nation to accelerate its forward momentum. The government’s commitment to reform must not be limited to President Widodo’s final year, but should be a guiding principle for subsequent administrations.

By addressing the highlighted challenges and implementing the recommended measures, Indonesia — as the largest economy with the biggest population in one of the fastest-growing regions of the world — can truly become a top destination for global investors.

US-Indonesia Investment 2023

INITIATIVE INDONESIA