

# FOREIGN DIRECT INVESTMENT RESTRICTION POLICY AS AN EFFORT TO EMPOWER MICRO, SMALL AND MEDIUM ENTERPRISES

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## Abstract

*Foreign Direct Investment is one of the important means to increase a country's economic growth through equitable development. However, countries such as Indonesia, often put restrictions on their foreign investment policies. The purposes of this research are: 1) to explain the restrictive policies which are imposed upon foreign investments in Indonesia and to compare them to those of other countries in Asia; 2) to explain the practical impact of such restrictive policies on foreign investments in Indonesia. The author uses a qualitative-descriptive research method. The research is also conducted through a juridical normative approach. This research shows that: 1) Restrictions on foreign investment is regulated under the Presidential Regulation of the Republic of Indonesia No. 76 of 2007 on Criteria and Requirements for Formulation of Business Fields Closed to Investment and Business Fields Conditionally Open to Investment; 2) In its implementation, Presidential Regulation No. 76 of 2007 has not yet been able to boost sustainable economic growth evenly via the empowerment of MSMEs or domestic investors.*

**Keywords:** *Foreign Direct Investment, Negative List of Investment, MSME Empowerment.*

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## I. INTRODUCTION

Foreign Direct Investment (FDI) is defined in the 2007 OECD Benchmark and the 2007 UNCTAD World Investment Report as “a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor.” The definition of FDI can also be found in the Encyclopedia of Public International Law as: “A transfer of funds or materials from one country (called capital exporting country) to another country (called host country) in return for a direct participation in the earnings of that enterprise.” Meanwhile, IMF defines FDI as “an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. Further, in cases of FDI, the investor’s purpose is to gain an effective voice in the management of the enterprise.”

The activity of FDI often involves the host state, the investor, and the home state or the investor. Each of these three parties would play an active role in regulating Foreign Direct Investment activity through various legal instruments and institutions. From an economic perspective, the benefits of investment can be evaluated from whether or not the business sector is being opened by the host country. According to Richard A. Posner, the function of the economy is to explore the initial assumption of rational human beings utilizing things for the purpose of maintaining their lives. In this case, the activity of investment by a capital exporting country must also be highly utilized for the purpose of maximizing profit that would benefit all parties, including the host country. Therefore, it is the obligation of the host country to protect the interests of foreign investors from the capital exporting country. These assumptions is in line with the economist's notion of a particular investment activity.

In order to ensure that capital investment will be in line with national interest, the Indonesian Government has issued Law No. 25 of 2004 on National Development Planning System ("Law No. 25 of 2004"). Its purpose is to provide Indonesia with an effective, efficient and targeted national development planning system. Article 2 of Indonesian Law No. 25 of 2004 states that National Development is to be implemented based on democracy with principles of togetherness, justice, sustainability, environmentally sound, as well as independence in preserving the balance of National progress and unity.

In addition, to preserve the Indonesian national interest, the Government has issued Investment Restrictions Policy or known as Negative List of Investment (NLI), which is a part of the currently prevailing investment legal system. Article 12 of Law No. 25 of 2007 on Capital Investment ("Indonesian Law No. 25 of 2007") states that "all business fields or types are open to investment activities, except those which are declared to be closed and conditionally open". The exception contained in Article 12 will be further regulated in a Presidential Regulation. The Presidential Regulation on the determination of business fields that are "closed and conditionally open" is also known as the "Negative List of Investment" (NLI).

In general, Foreign Direct Investment activity in a particular host

country is restricted by regulations from the foreign investor's home country ("governance by the home nation"), the country where the foreign investor has invested his capital ("governance by the host nation"), as well as the relevant international law ("governance by multi national organizations and international law"). Although limited by international conventions such as the World Trade Organization's Agreement on Trade-Related Investment Measures (TRIMS), the sovereign host country has the authority to issue these restrictive regulations.

The criteria for restrictions on Foreign Direct Investment in Indonesia is stipulated under Presidential Regulation No. 76 of 2007. The regulation on the criteria and requirements in compiling the list of business fields "closed to investment and conditionally open to investment" is, in principle, aimed at fulfilling national interests for the protection of natural resources, protection and development of micro, small and medium enterprises and cooperatives, supervision of production and distribution, growth of technological capacity, participation of domestic capital, and cooperation with Government-appointed business entities. Based on the criteria set forth in Presidential Regulation No. 76 of 2007, the Government issued an NLI policy which has been set forth in Presidential Regulations, whereby most recently the Government issued Economic Policy Package XVI on February 16, 2018, which includes a new NLI regulation replacing and/or renewing Presidential Regulation No. 44 of 2016 on List of Business Fields Closed to Investment and Business Fields Conditionally Open to Investment, dated May 12, 2016 ("Presidential Regulation No. 44 of 2016").

Presidential Regulation No. 44 of 2016 categorizes several types of business fields that can be carried out by foreign investors based on business fields that are conditionally open, which consist of:

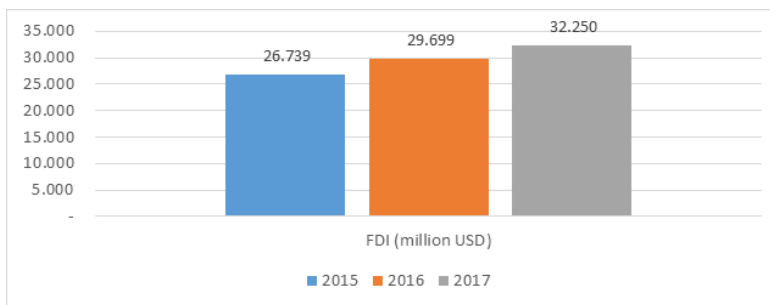
- 1) Business fields subject to the protection of the development of MSMEs and Cooperatives;
- 2) Business fields that are open subject to partnership requirement;
- 3) Business fields that are open subject to limited capital ownership;
- 4) Business fields that are open subject to certain location requirements; and
- 5) Business fields that are open subject to special licensing/permit

requirements.

Besides the above-mentioned restrictions, there is also a restriction in the value of investment for foreign direct investment companies (Penanaman Modal Asing – PMA), which must be above at least IDR 10,000,000,000.00 (ten billion Rupiah). Its aim is to boost investment activities which are above the investment values for MSMEs as stipulated in Law No. 20 of 2008 on Micro, Small and Medium Enterprises (MSMEs) (“Law No. 20 of 2008”) through cooperation programs or joint ventures.

For the last 3 (three) years the Investment Law, has experienced a “positive trend”, in which the target of inward FDI has been increasing each year. The inward FDI in 2017 has reached Rp430.5 trillion. In 2017, the FDI acceptance rate has exceeded the inward FDI target of 100.3% (from the target of Rp429 Trillion). While in 2016, the target has reached Rp396.5 trillion, also exceeded the achievement target of 102.7%:

**Table 1. Data on FDI in Indonesia**

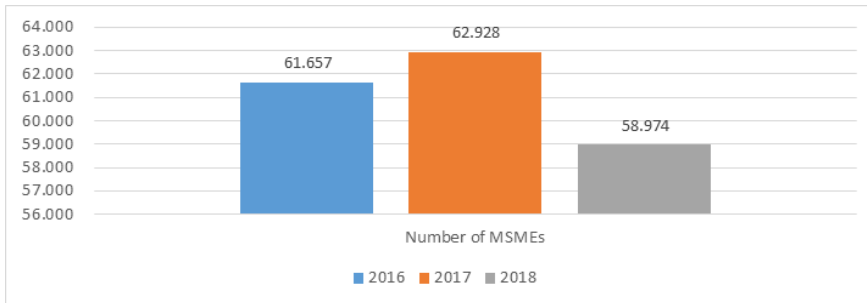


Source: Santander, processed from data from Indonesian Investment Coordinating Board (*Badan Koordinasi Penanaman Modal – BKPM*)

The increase in FDI value did not affect the development of MSMEs, bearing in mind that the number of MSMEs within the period of 2016 to 2018 has only experienced a 2% increase if compared to 2016. Meanwhile, investment realization in 2017 has experienced a quite significant increase, 117% with an FDI value of USD 23 billion or equivalent to IDR 332.8 trillion. In fact, in 2018, the number of MSMEs as revealed by the Ministry of Cooperatives and MSMEs was

58,910,000 units, consisting of 58,910,000 units of micro-enterprises, 59,260 units of small enterprises, and 4,987 units of large enterprises. Therefore, if we were to refer to such data, there is in fact a decline in the number of MSMEs compared to the 2017 FDI realization.

**Table 2. Number of MSMEs in Millions**



Source: Processed from data from the Indonesian Ministry of Cooperatives and Small and Medium Enterprises.

Based on the chart above, the NLI Policy has not been able to boost an increase in populist economic growth as mandated by Law No. 25 of 2007. The integrated disbursement of bank loans to MSMEs does not seem to utilize cooperation between the populist economic sector and the foreign direct investment companies, whether in the form of partnership with foreign direct investment companies or joint ventures. This issue has also been emphasized by a statement from the Deputy of Financing at the Ministry of Cooperatives and Small and Medium Enterprises (SMEs), which is that most MSMEs utilize market place platforms such as Blibli, Tokopedia, Lazada and Bukalapak to market its products, not through partnership cooperation with foreign direct investment companies.

Below, the author will continue to discuss on whether or not the NLI Policy within the investment legal system is already in accordance with the national economic politics as mandated in People's Consultative Assembly Decree No. XVI/MPR/1998 on Politics of Economy in the Framework of Economic Democracy, which states that the national politics of economy is aimed at creating a national economic structure that generates strong and large numbers of middle entrepreneurs,

and forms mutually beneficial connections and partnerships between economic actors involving small and medium enterprises, cooperatives, private large enterprises, and state-owned enterprises that mutually strengthen each other to create a highly competitive and efficient national economic democracy.

## II. DISCUSSION AND ANALYSIS

Based on Law No. 25 of 2007, investment activities basically adhere to an open system for all investors. Article 12 paragraph (1) of Law No. 25 of 2007 states that all business fields or business types are open to investment activities, except those business fields that are declared to be closed to or conditionally open to investment. Business fields or business types that are closed to and that are conditionally open to investment are determined through a Presidential Regulation. Through the regulation, a standard has been set up based upon classification of business fields or business types. The standard is also known as the Indonesian Standard of Industrial Classification (*Klasifikasi Baku Lapangan Usaha Indonesia – KBLI*) and/or the International Standard Industrial Classification (ISIC).

Restrictions on investment activities are based on the basic policy of investment as stipulated in Article 4 paragraph (1) of Law No. 25 of 2007, which is aimed to boost the creation of a national business climate that is conducive to investors in order to strengthen the national economy's competitiveness and accelerate the increase in investment. Such basic policy on investment, in accordance with the mandate set forth in People's Consultative Assembly Decree No. XVI/MPR/1998 on Politics of Economy in the Framework of Economic Democracy should always be based upon a populist economy which involves the development of micro, small and medium enterprises, and cooperatives.

Consequently, as an implementation of Article 12 paragraph (4) and Article 13 paragraph (1) of Law No. 25 of 2007, the Government issued Presidential Regulation No. 76 of 2007 on Criteria and Requirements for Formulation of Business Fields Closed to Investment and Business Fields Conditionally Open to Investment ("Presidential Regulation No. 76 of 2007"), which stipulates the formulation of the criteria to

determine business fields that are conditionally open, which are:

- a) protection of natural resources;
- b) protection and development of Micro, Small and Medium Enterprises and Cooperatives;
- c) supervision of production and distribution;
- d) growth of technological capacity;
- e) participation of domestic capital; and
- f) cooperation with Government-appointed business entities.

Aside from the regulation of criteria of business fields as set forth in the Negative List of Investment, there is also an investment value requirement, stipulated in the Regulation of the Head of the Investment Coordinating Board No. 6 of 2018 on Guidelines and Procedures for Investment Licensing and Facilities (“BKPM Head Regulation No. 6 of 2018”), which is that there is a minimum investment value of more than IDR 10 billion, excluding land and building. As such, foreign direct investment companies would be categorized as large enterprises because they would own net assets that are worth more than IDR 10 billion. This restriction on an investment value of at least IDR 10 billion constitutes an operational requirement for Foreign Direct Investment.

With the grouping of large enterprises and MSMEs, it is hoped that foreign direct investment companies can be involved in business sectors which are carried out by MSMEs through partnership and joint ventures, as well as increasing the effectiveness of investment promotional strategies and efforts, facilitating the utilization of international economic cooperation for national interests, and increasing the role of planning as a nerve activity in BKPM units so as to be more effective and integrated.

The grouping plan is in line with the mandate of People’s Consultative Assembly Decree No. XVI/MPR/1998 on Politics of Economy in the Framework of Economic Democracy, which requires that investment policies should always be based upon a populist economy that involves the development of micro, small and medium enterprises, and cooperatives. Additionally, investment activities that can foster economic growth and equitable development are also very much dependent upon the formation of rules and regulations that can accommodate the aim and purpose of national development, which is

also in line with Martin Molinuevo's and Sebastian Saez's opinion, which is that they have to be fully beneficial to the people, not just to certain groups or sectors.

Furthermore, based on Article 7 of Law No. 20 of 2008, the Central Government and the Regional Governments are required to generate a growth in business climate for MSMEs by setting regulations and policies that include, inter alia, aspects of funding, partnership and business opportunities. In an effort to protect MSMEs and domestic investors, Presidential Regulation No. 44 of 2016 has provided a way to encourage the participation of MSMEs and domestic investors through the requirement of partnership with MSMEs and formation of joint ventures that require the capital participation of domestic investors. The participation of MSMEs and domestic investors will have an impact on the domestic economy and absorb a productive workforce. As such, the number of business fields allocated for MSMEs or that are subject to partnership requirements as set forth in the NLI policy is as set forth in the following table:

**Table 3. Criteria of Closed and Conditionally Open Business Fields**

No.	Business Fields	No. of Fields
1.	Business Fields reserved for MSMEs	96
2.	Business Fields subject to Partnership requirement with MSMEs	49
3.	Business Fields subject to requirement of a portion of ownership by domestic shareholder	350
	Total	495

The efforts to organize investment activities which involve MSMEs through partnership structures is in line with the Investment Coordinating Board's 2015-2019 Strategic Plan, through:

- a) Fostering partnerships between foreign direct investment companies and MSMEs by prioritizing the principles of mutual needs, mutual reinforcement, and mutual benefits; and
- b) Reinforcing the partnership process, from the introduction of potential business partners, the understanding of business strengths and weaknesses, the development of partnership strategies, the facilitation of business partnerships implementation, to the



monitoring and evaluation of the partnerships between foreign direct investment companies and MSMEs.

In its implementation, the increase in FDI growth did not have a direct impact upon the growth of MSMEs, despite the fact that the NLI polices issued by the Government in the last ten (10) years have given space for MSMEs involvement, as seen in the following table:

**Table 4. List of Closed and Open Business Fields**

No.	Business Fields	Presidential Regulation No. 77 of 2007	Presidential Regulation No. 36 of 2010	Presidential Regulation No. 39 of 2014	Presidential Regulation No. 44 of 2016
1	MSMEs	43	38	36	95
2	Partnership with MSMEs	36	36	31	50
3	Open to foreign investors subject to the requirement of a portion of domestic share ownership	141	132	129	350
4	Closed	25	24	20	20
	<b>Total</b>	<b>245</b>	<b>230</b>	<b>216</b>	<b>515</b>

The chart above shows that MSMEs' portion in certain business fields has declined from 2007 to 2014, and in 2016 has increased by 65% to encompass 95 sectors. Meanwhile, the portion of partnership with MSMEs between 2007 and 2010 has not increased, and in fact has decreased in 2014. An increase in the portion of partnership with MSMEs has occurred in 2016, i.e. up to 50 business sectors. Meanwhile, due to the condition of restriction on foreign capital as a requirement to form joint ventures, ownership has in fact increased from 120 business sectors to 350 business sectors, or an increase of 63%.

The number of MSMEs at the Ministry of Cooperatives and SMEs is unknown. The data on MSMEs is based on statistical data from the Centre of Statistics (*Badan Pusat Statistik – BPS*). The statistics showed that the number of MSMEs in 2016 and 2017 are still temporary in nature. Similar data has been revealed by the Ministry of Cooperatives and SMEs in 2018, where the number of MSMEs which have been

recorded consisted only of 58,910,000 units. Accurate data regarding MSMEs can be obtained from loan provisions to the MSME sector in 2017 issued by Bank Indonesia. Based on the data, it can be deduced that MSMEs which has received these loans are dominated by the Wholesale and Retail Trade sector (51.1%), followed by the Processing Industry sector (9.9%), then the Agriculture, Hunting and Forestry sector (8.9%).

Meanwhile, Jakarta constitutes as the province with the largest contributor of loans to MSMEs, with IDR 143.9 trillion (14.5%), followed by East Java with IDR 136.9 trillion (13.8%) and then West Java with IDR 133.6 trillion (13.5%).

Nevertheless, the overall Non-Performing Loans (NPL) of MSMEs at the end of 2017 Quarter was recorded at 4.35%. This proves that with a high level of NPL of 4.35% (IDR 43 trillion), the MSMEs' performance was not very good in terms of business productivity due to the difficulties in repaying loans or credit that has been channeled from banks. This issue has also been highlighted by the Ministry of Cooperatives and SMEs who stated that MSMEs or domestic investors face liquidity difficulties, and in fact several MSMEs have potential problems in loan repayment or non-performing loans.

The lack of partnership between MSMEs and joint venture companies which use foreign capital flow in developing countries creates too large of a gap between MSMEs and joint ventures companies. In other words, some MSMEs are oriented towards the growth of large enterprises, while others are oriented towards micro enterprises. In line with the principle of fairness in investment, it is the task of foreign direct investment companies to boost the reinforcement of MSMEs by synergizing with them so as to strengthen the economic structure of the host country.

Based on the arguments above, the NLI Policy in the investment legal system is not effective enough in enhancing participation in a populist economy. The lack of efficiency in empowering the people's participation in Foreign Direct Investment activities can occur due to several factors. According to Lawrence M. Friedman, the efficiency of law enforcement depends upon three elements of the legal system, i.e. the structure of law, the substance of law and legal culture. The structure

of law refers to law enforcement officials, meanwhile the substance of law correlates to regulatory tools, and legal culture is the living law which is adhered to in a society.

In terms of the structure of law, the issue is whether or not the Investment Coordinating Board (BKPM) or other institutions that oversee the economic sector and are authorized to implement the investment laws and regulations can do so effectively in order to create a conducive investment climate. In terms of substance of law, the issue is whether or not Law No. 25 of 2007 as legal instrument, which also regulates the NLI Policy, already has enough binding power and can become a guideline for law enforcement officials in realizing investment activities that are in accordance with the mandate of Article 33 of the Indonesian Constitution (UUD 1945). Meanwhile in terms of legal culture, the issue is whether or not the community's behavioral pattern (including the legal culture of the law enforcement officials) can already form a culture that is better prepared in realizing competitive investment principles in order to create fairness for all parties involved in investment.

In terms of substance, the NLI has given an opportunity for the host state to protect MSMEs and domestic investors. This can be seen from the increase in the number of business fields allocated for MSMEs from only 36 business fields according to the 2014 NLI policy, to 25 business fields based on Presidential Regulation No. 44 of 2016. In addition, the requirements for foreign investors to partner MSMEs have resulted in an increase of relevant business fields from 31 in 2014 to 50 business fields in 2016. The same outcome applies also towards the requirements of domestic investors to participate in joint ventures, in which relevant business fields have increased from 129 to 350. These increasing numbers in relevant business fields as stated by the NLI Policy demonstrates the Government's support for the empowerment of MSMEs and domestic investors.

However, the NLI policy is by its nature a negative list of investment as there are certain business fields which are not specifically regulated in the NLI. As a consequence, some foreign investors may engage in several business activities without any restrictions or additional requirements. These types of business activities has been categorized

in the Indonesian Standard of Industrial Classification (*Klasifikasi Baku Lapangan Usaha Indonesia – KBLI*) and/or the International Standard Industrial Classification (ISIC). The grouping of economic activities based on KBLI has been regulated by the Regulation of the Head of Statistics Indonesia (BPS) No. 95 of 2015 as amended by Regulation of Head of BPS No. 19 of 2017, consisting of 21 categories of business fields.

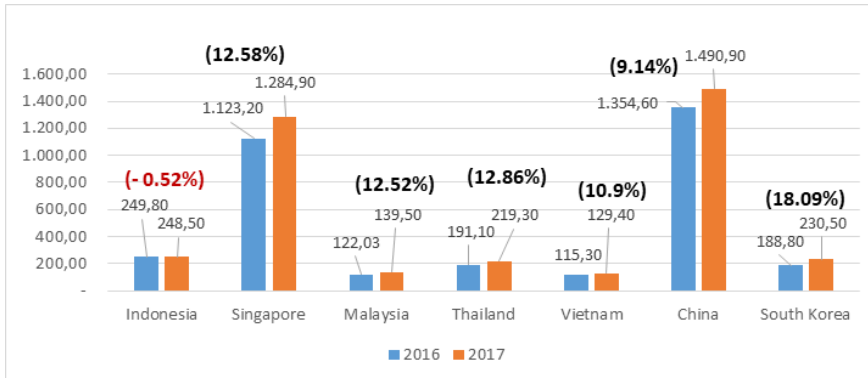
Therefore, outside of the NLI, foreign investors can engage in investment activities in Indonesia without any restrictive investment requirements. Referring to the number of business fields based on KBLI, there are 1,647 business fields with breakdown as follows:

**Table 5. List of Business Sectors based on KBLI**

No.	Business Sectors	Number	Percentage
1.	Business Sectors that are not regulated in the NLI Policy	1,132	68.7%
2.	Business Sectors based on NLI Policy (Presidential Regulation No. 44 of 2016)		
3.	Closed	20	1.2%
4.	MSMEs	95	5.8%
5.	Partnership with MSMEs	50	3%
6.	Open with Conditions	350	21.3%
	Total Business Sectors based on KBLI	1,647	100.0%

From the chart above, one can conclude that based on KBLI, there were only 95 business fields required to be in partnership with MSMEs (5.8%). Meanwhile, there were only 350 business fields required to be established as joint venture companies (21.3%). Therefore, the number of business fields which has fulfilled the requirements of KBLI is actually not very large. Hopefully, through these numbers, the NLI Policy can create synergic cooperation between foreign direct investment companies and MSMEs or domestic investors.

The cumulative FDI stock in ASEAN countries, China and South Korea, can be seen in the following table:

**Table 6. Cumulative FDI Stock (in millions)**

Source: Santander, data processed from BKPM

Based on the chart above, the cumulative FDI Stock in Indonesia experienced a negative 0.52% equity if compared to other countries that experienced positive equity. This proves that foreign investors' ownership in the form of stocks, which include retained profits and net receivables of the parent enterprises against the affiliated companies in the host country, such as Indonesia, has resulted in higher profits compared to other countries, despite its value being higher compared to other countries in 2017. The difference between the inflow of foreign capital in 2017 of 23,063 million US Dollars and the cumulative FDI Stock Value that experienced a decline of -0.52% demonstrates that there was no growth in FDI stock value during such period.

Compared to Vietnam, Indonesia is an agrarian nation where the FDI stock value has increased by 12.52%. In addition, FDI activities in Vietnam has an indirect impact on other business sectors. The Vietnamese government realized the significance of indirect effect of FDI flow in the agricultural sector where foreign investors are required to invest in the production and processing of dairy products, vegetable oils, sugar, as well as wood production, to develop sources of raw materials. Likewise, in the manufacturing sector, which has an impact on the development of supporting industries to fulfill the demand for materials and spare parts by foreign direct investment companies. As such, the Vietnamese government's role was able to boost a good

synergy between other business enterprises carried out by the MSMEs and foreign direct investment companies.

The inter-relationship between foreign direct investment companies and MSMEs is very important in investment activities for development. The so-called spillovers from the company where foreign investors places their capital to business sectors are one of the benefits of FDI. Recent economic theory shows that FDI can result in a positive spillover for domestic companies in the host countries as multinational companies (MNCs) are important sources of international capital and technology. The presence of foreign direct investment companies can facilitate a transfer of technology and business knowledge that could result in an increase of productivity and competitiveness between local MSMEs. This spillover effect fosters through the creation of relationship between foreign companies and domestic companies becoming suppliers or customers, or through the transfer of skilled workers from foreign companies to domestic companies. The entry of foreign direct investment companies can also increase competition and force domestic companies to imitate and innovate. The specific attribute of foreign direct investment companies is a transfer of technology from the parent company to its affiliates in the host country and an economic spillover effect by such domestic company.

As commonly known, domestic investors and MSMEs hold an important role in increasing economic growth and development, and in the eradication of poverty in the host country, through the creation of employment from the MSMEs' activities.

Based on the analysis of the implementation of investment activities, there are several obstacles that can cause FDI activities to be as of yet effective in empowering the business activities of MSMEs and domestic investors, which are among others:

#### **A. BUSINESS ACTIVITIES WITH MSME SCALE ARE NOT YET ACCURATELY IDENTIFIED.**

In Indonesia, source of living is highly dependent on the MSME sector. Most of these small businesses concentrate in the sectors of trade, food, processed food, textile and garment, wood and wood

products, and the production of non-metallic minerals. They operate in a highly competitive and uncertain condition; and are also influenced by the macro economic situation. A bad business environment has a greater negative impact on MSMEs than on large businesses. Overall, the MSMEs sector is predicted to contribute to approximately more than 50% of GDP (mostly in the trading and agricultural sectors) and about 10% from exports. Although reliable data is not available, there is an indication that the number of middle-scale industrial workers have relatively declined from 10% of the total workforce in mid 1980s to about 5% at the end of 1990s. Compared to developed countries, Indonesia has lost its medium industry in its industrial structure. As a result, on the one end there is a small number of large businesses and on the other end there is plenty of small businesses that oriented towards domestic market.

**Table 7. Small Businesses Data**

<b>Business Category</b>	<b>% Number of Companies</b>	<b>% Number of Workers</b>
House hold businesses ( $< 4$ workers)	90.85	38.10
Small businesses (5-19 workers)	8.32	17.86

However, the Ministry of Cooperatives and SMEs data on MSMEs are not well identified; the figure in 2015 is recorded to be 60.7 million units, but in 2018, the number of MSMEs recorded has declined to only 58,975 units. In fact, for the periods of 2016 and 2017, the number on record at the Ministry of Cooperatives and SMEs is stated to be only temporary in nature. The inaccuracy of data regarding MSMEs can indeed occur considering that the establishment of a company that is not categorized as an investment activity has not been recorded with the Investment Coordinating Board (BKPM). In terms of investment activities, BKPM has a role of coordinating investment and performing investment services. In addition, each investor is obligated to create a report on its investment activities and submit it BKPM. The requirement on submitting an Investment Activity Report (*Laporan Kegiatan Penanaman Modal* - LKPM) is emphasized in Article 63 of BKPM

Head Regulation No. 6 of 2018. Therefore, companies that engaged in investment activities, whether in the form of foreign direct investment (PMA) or domestic investment company (PMDN), are obligated to convey their investment realization, so that BKPM can accurately identify the number of foreign direct investment companies that have been approved and the investment realization carried out by foreign direct investment companies, and even the sectors or business activities that are carried out by such foreign direct investment companies.

As for companies of MSME scale, there are no obligations to report their investment activities to BKPM or other institutions. The activities or business sectors of companies with MSME scale can only be identified if such MSME companies obtain a loan from a bank, because the bank would ask for the purpose of their use of the loan. Meanwhile, there are many MSMEs that do not have access to the banking sector, making it difficult to collect data on the number of MSMEs. Therefore, the issue is how the government can realize partnerships between MSMEs and foreign direct investment companies if the government does not have the data on the number of MSMEs and the sectors or business activities that they engage in, which can support the synergy between MSMEs or domestic investors and foreign direct investment companies. The synergy between MSME actors and foreign direct investment companies can be carried out in the form of core-plasma, sub-contractor, general trade, agency, and other forms, without changing the ownership of the MSMEs and cooperatives, implemented based on written agreement.

## **B. THERE IS A LACK OF TRANSPARENCY AND STUDY IN THE IMPLEMENTATION OF INVESTMENT RESTRICTIONS POLICIES**

The criteria for restrictive investment policies as set forth in Presidential Regulation No. 76 of 2007, whereby the determination of NLI is not only based on recommendation from BKPM, but also based on recommendation from Ministries or heads of relevant institutions is in accordance with the criteria for determining business fields that are conditionally open as stipulated in Article 11 of Presidential Regulation No. 76 of 2007. The recommendations regarding business sectors that



are closed and conditionally open can come from business actors, whether through public hearings or forum group discussions, or inputs or suggestions from the Ministries or heads of relevant institutions.

Investment Restrictions Policy through NLI is determined by the government on a regular basis through the mechanism set forth in Article 17 paragraph (4) of Presidential Regulation No. 76 of 2007, i.e. the Coordinating Ministry for Economic Affairs has formed a team to assess, formulate, evaluate and finalize the list of business fields closed and conditionally open. However, in its implementation, coordination between BKPM, the ministries and the heads of institutions in compiling the NLI is not quite effective. For example, the announcement made by the government on November 16, 2018 regarding the Economic Policy Package XVI, which revealed the NLI relaxation program by removing 95 business fields that can be 100% owned by foreign investors, i.e. including fabrics printing industry, nature tourism business, oil and gas construction services, offshore oil and gas drilling services, clove cigarette and others, crumb rubber, art gallery, pharmacy, and health equipment. And yet, only thirteen (13) days after the government revised the Economic Policy Package XVI by removing MSME activities from the NLI relaxation. This shows that the evaluation phase was not based on in-depth studies and findings that reflect the needs of the potential economy in the community.

Another NLI policy issue is, for example, related to the restriction on ownership of shares by foreign investors at a particular percentage between 30% and 95% or in other words it is the foreign investor's obligation to establish a joint venture with a domestic investor. It is not easy for an investor to look for a domestic partner that has comparable capital ability and human resources.

Another example is with the crumb rubber processing industry, which experienced numerous revisions, from being open, closed and open again. Such inconsistencies in the policies give rise to legal uncertainty, considering that at the time the NLI policy regarding crumb rubber was issued, Presidential Regulation No. 76 of 2007, which forms the basis of such NLI, has not undergone any changes.

### **C. THE SUPERVISION AND IMPLEMENTATION OF INVESTMENT RESTRICTION POLICIES HAVE NOT BEEN CARRIED OUT EFFECTIVELY**

Based on Attachment II to Presidential Regulation No. 44 of 2016 there are 50 business fields that are subject to partnership with MSMEs, whereby such form of partnership is allocated to the forestry, marine affairs and fisheries sector, the industry sector and the trade sector. The partnership is implemented through a written agreement, which can be in the form of core-plasma, sub-contractor, general trade, agency, and other forms. When applying for approval of business license, the foreign investor signs a deed of establishment and registers in accordance with the business field that is based on KBLI. The granting of such license is carried out by an OSS institution, whether in the form of Business License and Commercial License or Operational, in the form of electronic document in accordance with the provisions of the laws and regulations in the field of electronic information and transactions. After all the registration documents have been submitted onto the OSS web page, the OSS institution will issue a Single Business Number (*Nomor Induk Berusaha* - NIB) as well as a Tax Identification Number (*Nomor Pokok Wajib Pajak* - NPWP). The NIB is also valid as a (i) Company Registration Certificate (*Tanda Daftar Perusahaan* - TDP) as referred to in Law No. 3 of 1982 on Mandatory Company Registration; (ii) Importer Identification Number (*Angka Pengenal Importir* - API); and (iii) customs access rights as referred to in the laws and regulations on customs. In addition, foreign capital business actors who have obtained NIBs are simultaneously registered as a participant of the government's health welfare program and employment welfare program.

In its implementation, business fields that are required to have partnerships with MSMEs or MSME-scale companies, are also obliged to submit a requirement in the form of written agreement to show that there is a cooperation with an MSME or a MSME-scale company. BKPM does not have the authority to check the validity of such written agreement or whether or not such written agreement is only a formality while in reality the partnership agreement is not carried out effectively, such that the purpose of partnership requirement is not achieved. This practice is currently happening in the crumb rubber processing industry whereby many businesses are closing down because of a crisis in rubber

raw materials. The same also occurs in the fishery product processing industry, where there is a lack in the supply of fish and the food and beverage industry, where there is a lack in the supply of raw materials, such as coffee, tea and cocoa products with main target countries such as the United States, Japan and Middle Eastern countries, such that the food industry's competitiveness is hampered. Meanwhile, the supply of raw materials for such industries can be fulfilled if there is certainty as to the implementation of the partnership agreements with domestic businesses and MSME-scale businesses.

In Attachment III of Presidential Regulation No. 44 of 2016, there are 350 business fields required to have domestic shareholders, given that there is a restriction on foreign ownership of between 30% and 95%. This requirement means that for such business fields joint ventures must be formed, whereby the foreign investor and the domestic investor(s) enter into a written agreement regarding the formation of a joint venture company. Based on research, the Indonesian Investment Coordinating Board (BKPM) also does not have the authority to examine the validity of joint venture agreements. BKPM merely checks that the deed of establishment of the joint venture companies reflects the shareholding composition that is in accordance with the NLI. As such, although there is a restriction requirement, it does not show as to whether or not the local investors have comparable or equal standing with foreign investors. Domestic investors are often 'silent partners' who do not have voting rights as mandated by Law No. 40 of 2007 on Limited Liability Companies. This is in spite of the fact that according to Article 33 of Law No. 25 of 2007, an agreement or an undertaking which stipulates that ownership of shares in a foreign direct investment company for and on behalf of another person will be declared as null and void by law. Therefore, the efforts of creating a synergy between foreign investors and domestic investors to empower MSME-scale entrepreneurs are not realized.

The aforementioned problems can be overcome by establishing or empowering a government institution that can supervise the efforts of empowering domestic investors in terms of investment activities.

The government has issued Presidential Regulation No. 91 of 2017 on Business Implementation Acceleration ("Presidential Regulation

No. 91 of 2017”) and Government Regulation No. 24 of 2018 on Electronically Integrated Business Licensing Services (“Government Regulation No. 24 of 2018”). These two regulations are formulated in an effort to increase domestic and Foreign Direct Investment, and as such the government launched the electronically integrated business licensing also referred to as Online Single Submission (OSS). OSS is an online business licensing system which is created by institutions under relevant Ministries, head of institutions, governors, or regents/mayors, even business actors through an integrated electronic system. With the OSS system in place, business registrations is easier; cutting through bureaucratic red tapes that often takes a significant amount of time, because the entire registration process is done through an online integrated system. This OSS system is supported by several ministries in Indonesia and governmental institutions that are authorized to issue business licenses, such as the Indonesia National Single Window (INSW) system at the Directorate General of Legal Administrative Affairs of the Ministry of Law and Human Rights, and the Population Administration Information System at the Ministry of Home Affairs.

Under Presidential Regulation No. 91 of 2017, a Task Force for Business Implementation Acceleration has been formed, consisting of (i) National Task Force; (ii) Ministerial/Institutional Task Force; (iii) Provincial Task Force; and (iv) Regency/Municipal Task Force. The Task Force was formed to improve services, control, issue resolution, simplification and development of an online system to accelerate the business licensing process, including for micro, small and medium enterprises after obtaining the investment approval. The task forces are assigned to accelerate the completion of business licensing process through the Electronically Integrated Business Licensing System (OSS), as stipulated in Government Regulation No. 24 of 2018. Electronically Integrated Business Licensing System Services (*Pelayanan Sistem Perizinan Berusaha Terintegrasi Secara Elektronik - PBTSE*) that was previously managed by the Coordinating Ministry for Economic Affairs is now managed by BKPM as of January 2, 2019.

For the management of the OSS, BKPM has the task of coordinating policies and services in the field of investment based on the prevailing laws and regulations. One of BKPM’s functions is to develop the

investment business sector through investment guides. These include increasing partnerships, increasing competitiveness, creating healthy business competition, and disseminating information as widespread as possible related to investment implementation.

Nonetheless, in its implementation, the above-mentioned efforts in coordinating and accelerating business licensing by the Task Force and/or BKPM must be able to support the implementation of Investment Restrictions Policy that involves the development of MSMEs and cooperatives, as mandated by People's Consultative Assembly Decree No. XVI/MPR/1998, in order to realize an economy that is developed as a joint effort based on kinship as stipulated in Article 33 of the Constitution. The NLI relaxation should not only function to open business sectors for foreigners, as was done by the Government when issuing the NLI policy, but should also be able to boost the involvement of MSME-scale entrepreneurs or domestic investors such that Foreign Direct Investment activities not only benefits the foreign investors themselves, but also the Indonesian community.

As one of the renowned drafters of Article 33 of the Indonesian Constitution, Mohammad Hatta, once said:

*“To build our country, we do not have capital, that's why we use foreign capital for our interests. We are anti capitalism but we are not anti-capital. We also do not hesitate using foreign labor, because we are indeed lacking in skilled labor. We pay them, according to the international payment scale that is indeed high, compared to payment to our skilled labor. It shouldn't be envied upon, because they do not have a duty to our country, while we have a duty to our country and nation...”*

Therefore, the restrictive regulation on foreign direct investment that is aimed at fostering economic growth and equitable development, according to Mochtar Kusumaatmadja, must be based upon the Indonesian Constitution and imbued by the philosophy of Pancasila. The concept of a welfare state is aimed at the public. A state is a tool to achieve a common goal, which is prosperity and social justice for the entire nation. Thus, the concept of a legal state (*rechtsstaat*) must also be geared towards realizing a welfare state, which is a concept that places state role in every aspect of its people's life for the sake of realizing social welfare for the entire nation.

In light thereof, to overcome those three problems, it is necessary to have an institution, whether in the form of a task force or the function that currently exists at BKPM, to engage in law enforcement or implementation of investment activities so as to ensure the involvement of MSMEs and/or domestic investment companies as required by Indonesian Law No. 25 of 2007 *jo.* NLI Policy. For the NLI policy to run effectively, the following need to be done: (i) centralization of data collection and reporting on the realization of MSME business activities as has been done with investment activities in the form of LKPM, so as to make it easier in identifying the groups of MSME businesses that can be synergized with foreign direct investment companies, whether wholly or partially owned by foreign investor; (ii) a study on the compilation of the NLI that not only rely on suggestions put forth by business actors, but that also must be based on philosophical and sociological studies that involve proposals in tiers from the regional governments as well as the relevant ministries or institutions at the central level, while paying attention to the economic potential of each region; and (iii) giving strict sanctions if a foreign direct investment company that go around the system by submitting the written agreements related to partnership or joint ventures only as a formality without actual and correct implementation.

### **III. CONCLUSION AND RECOMMENDATION**

Based on the discussion and analysis elaborated above, the following conclusions can be drawn:

- 1) Regulation on foreign direct investment restrictions based on Presidential Regulation No. 76 of 2007 for the determination of business fields closed to investment and conditionally open to investment is commonly known as “Negative List of Investment” (NLI). The currently applicable NLI Policy is based on Presidential Regulation No. 44 of 2016.
- 2) One of the criterias in regulating the NLI requirements is the protection and development of Micro, Small and Medium Enterprises (MSMEs) and Cooperatives as mandated by the People’s Consultative Assembly Decree No. XVI/MPR/1998 on

Politics of Economy in the Framework of Economic Democracy. However, in its practice, investment activities are not effective enough in boosting the involvement of MSMEs and domestic investors. The relationship between foreign direct investment companies and MSMEs is very important in investment activities for development so as to create spillovers from companies that are invested on by foreign investors to other business sectors that are carried out by MSME-scale businesses.

- 3) Therefore, in order to overcome the problems on the involvement of MSMEs and/or domestic investors in foreign direct investment, a task force or a function at BKPM, which has the authority to engage in law enforcement, has to be established to ensure the involvement of MSMEs and/or domestic investment companies as required in Law No. 25 Tahun 2007 *jo.* NLI Policy. This can be done through: (i) the centralization of data collection and reporting on the realization of MSME business activities as has been done with investment activities in the form of LKPM, so as to make it easier in identifying the groups of MSME businesses that can be synergized with foreign direct investment companies, whether wholly or partially owned by foreign investor; (ii) philosophical and sociological studies on the compilation of the NLI based on suggestions put forth by business actors, which also involve proposals in tiers from the regional governments as well as the relevant ministries or institutions at the central level, while paying attention to the economic potentials of each region; and (iii) imposing strict sanctions towards foreign direct investment companies that go around the system by submitting the written agreements related to partnership or joint ventures only as a formality without actual and correct implementation.

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