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In This Issue

So Indonesia Wants to Join the TPP-What's Next?

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At long last the question of whether Indonesia will join the Trans-Pacific Partnership (TPP) has apparently been answered by President Joko Widodo (Jokowi) himself during a recent high-level visit to the United States (US). As covered by numerous media outlets, he made clear that Indonesia planned to join the 12-nation TPP trade agreement. This follows a statement by Indonesian Trade Minister Tom Lembong, who earlier this month declared that Indonesia would join the Trans-Pacific Partnership within two years. These announcements herald an optimistic outlook for promoters of free trade in Indonesia, and a defensive one for the many domestic proponents of protectionism.

Early this year, a sense of pessimism hovered over foreign investors concerned that Indonesia planned to return to the protectionist era of 1980s, sparked by the emergence of several recent nationalistic regulations. Presiden Jokowi has sought to dispel such doubt by providing a series of economic packages and now the confirmation of TPP participation to boost investor confidence. Before the conclusion of the TPP this year, Indonesia appeared to overlook the TPP completely, arguing that the nation has its own competing free trade agreement in form of the Regional Comprehensive Economic Partnership (RCEP). In hindsight, perhaps, this has proven to be a naïve and limited view by Indonesia to primarily focus its scope locally and in the region. In contrast, Indonesia's ASEAN neighbors, such as Malaysia and Vietnam have long been on the TPP bandwagon, while Thailand and the Philippines have kept their sights on inevitable global realities, declaring that they would join the TPP even before its conclusion. Not to mention that South Korea and Taiwan haven't been shy to show their eagerness to join the TPP.

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The conclusion of RCEP is surrounded by uncertainty and a lack of progress; it is supposed to be completed by the end of this year. The delay is likely connected to the South China Sea conflicts and the difficulty to compromise by certain members. As such, the signaled intention to join the TPP comes at the right time for Indonesia to seize its opportunity before being left behind in the global market.

Overcoming resistance and implementing reforms are needed at home

Intending to join the TPP and actually joining, however, are two very different things. Domestically, the signing of the TPP is sure to face stiff resistance. The TPP is not without its flaws. Almost all of the TPP negotiating parties face opposition and valid criticisms from their legislators, domestic stakeholders, civil society and the public in general. Australia, for example, with its Investor-State Dispute Settlement (ISDS) clause; Canada with its concern for the dairy market; and Japan with its protected agricultural sectors and rules of origin especially for automobiles. Even the US faces a mountain of domestic critics and protestors who argue that the TPP will only benefit multi-national corporations at the expense of small/medium enterprises, and US workers. Non-transparency and lack of information about the TPP text also does not help its case. At least Indonesia's delay in joining the TPP will give the country the chance to peruse the much-awaited text and thoroughly analyze its benefits and potential issues.

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Admittedly, Indonesia's capacity to comply with the TPP's standard is questionable. This was suggested by US Trade Representative Michael Froman who, while welcoming more countries who could meet the standards of the TPP, stated that Indonesia still had to address measures such as local content requirements, import and export restrictions, the protection of intellectual property rights and eliminating red tape. The complexity of the emergence of these measures, including the strong stance of local interests and the complexity and wide range of domestic regulations, means that Indonesia has a lot of homework. The public at large does not generally have a favorable view on any FTA, as these agreements tend to be painted by domestic interests as having a negative affect on the economy, being harmful to small local players.. The TPP is seen by some as having a hidden US agenda to rebalance the economic power in the Asia Pacific, by stiff-arming China from controlling the terms of trade in Asia. As such, Jokowi should expect a roller-coaster of public protects similar to the previous China-ASEAN Free Trade Agreement on his return. Communicating the benefits of the TPP to the Indonesian public will be essential.

TPP is not About Tariff Reduction but Institutional Reforms

Most of the TPP members, in practice, already have low import tariffs, thus the TPP actually aims to eliminate the non-tariff barriers to trade. Hence one of biggest challenges for Indonesia to overcome is the potential erosion of national sovereignty that could come as a result of agreeing to rules that go above and beyond the WTO agreement. National laws that cover a variety of industries would have to be completely rewritten to accommodate the high standards of the TPP.

For instance, implementing the TPP has the potential to put an end to the practice of the government favoring its State-owned Enterprises (SOEs), in order to level the playing field between foreign companies and the SOEs. The elimination of support for Indonesia's SOEs could stand to be in conflict with the 1945 Constitution. Inherent in the Constitution is the government protection of public sector interests, such as water, electricity and land. These have traditionally been overseen by Indonesian SOEs, and subsidized by the Central Government. A major concern for implementing the TPP would be the effect on these important SOEs. There is no doubt that Vietnam will have a similar headache as Indonesia in reforming their SOEs as there are potentially 4000 Vietnamese SOEs that would be affected by the TPP. That being said, it is very likely that several strategic sectors would be exempted from the TPP standards. The Government of Indonesia will have to determine where its red line stands. Perhaps its absence from initial negotiations of the TPP may prove a hindrance in this regard.

Political Challenge by the House of Representatives (DPR)

A large part of domestic resistance to Indonesia implementing the terms of the TPP will come from the DPR. In this, Indonesia is not alone. Despite the conclusion of the TPP this month, each implementing country will need to find a way for the TPP to pass through their legislature for ratification. Separating political issues from economic matters will be a necessary challenge to achieving domestic ratification. Indonesia is not used to having this ratification issue. Previously, the President essentially had the sole power to sign and ratify international trade agreements. However, since the enactment of the new Trade Law (Law No. 7 of 2014), approval of the DPR is now required. In cases where international trade agreements have a widespread and significant effect on the public interest and those related to state finance and law making, as the TPP would, the DPR must now ratify or issue laws, in order to comply with the trade agreement commitments. With the current polarization of political parties, between the Koalisi Indonesia Hebat (KIH) and the Koalisi Merah Putih (KMP), and each member having their own vested interest in protective regulations, the certainty of the TPP passing the DPR at present is doubtful.

Judicial Challenge

Beyond legislative challenges, non-governmental organizations may take the law implementation of the TPP to the Constitutional Court. There have been many examples of this already, albeit separate to TPP considerations. The Water Resources Law 7/2004, for instance, was challenged by a prominent civil society organization last year. The idea of the private sector managing an essential commodity like water was indigestible by civil society and, as it turns out, unconstitutional. The Constitutional Court accordingly revoked that law. Similar challenges will undoubtedly arise if Indonesia is compelled to reform SOE law under the TPP.

Moving Ahead

As Jokowi returns home, there is still hope in addressing these TPP implementing issues over the next few years. One way is by taking small steps forward. The negotiation of other important bi-lateral agreements is one way to move closer. Trade Minister Lembong has flagged that Indonesia is currently focusing on the European Union – Comprehensive Economic Partnership Agreement (EU-CEPA). He stated that, "*about 80 percent to 85 percent of the provisions in the CEPA deal with the EU are also applicable to the TPP*". Thus, Concluding the EU-CEPA will definitely help Indonesia to gradually reform its state institutions and regulations to uphold TPP Commitments.

As it moves towards the path of joining the TPP, Indonesia must also not fool itself into believing that it will not lose something by joining the TPP. Still, Indonesia should keep its sights on the long-term benefits of adhering to the TPP standard. Indonesia could gain a lot in terms of economic prosperity if it can utilize the TPP to penetrate a market that has been said to include 40 percent of the world's economy. This is because Indonesia has the tools and potential to gain maximum benefits from TPP membership, provided that the country is able to comply with the high standards required from joining the TPP.

President Jokowi's job is not over by simply declaring that Indonesia will participate in the TPP. He must now lead Indonesia until the successful acceptance of Indonesia into TPP is realized. This stands to be a signature moment for Jokowi's presidency, and one that will be etched in the annals of Indonesian economic history, for better or worse.

Evaluating the Costs of Economic Nationalism for Indonesia

Michelle Limenta, LLM, PHD*

A group led by the former Chair of Muhammadiyah, Din Syamsuddin, has filed judicial reviews to overturn several provisions of laws concerning investment, foreign exchange and electricity. Early this year, their judicial review request on the Law concerning Water Resources was granted by the Constitutional Court. The Court revoked the law and reinstated the 1974 Water Law until a new measure is adopted. They are also planning to bring other claims against some one hundred and fifty laws which they believe to be in contrary with an Indonesian Constitutional economic principle that land and other natural resources must be controlled by the state for the welfare of Indonesian people in general. The group has dubbed their lawsuit actions, "constitutional jihad".

In their legal suit against the foreign exchange regime, the group tries to remove Article 2 of Law 24/1999 which states that every resident is free to possess and use foreign exchange. The Explanatory Text of the Law provides that "free to possess foreign exchange" means that Residents who obtain and own foreign currency are not required to sell it to the government. "Free to use foreign exchange" means that Residents can freely carry out activities using foreign exchange for, among other things, international trade, transactions in the money market and transactions in the capital market. The group's view is that this provision has turned the Indonesia's foreign exchange regime to pro-free market economy, which is contrary to the Indonesian constitutional tenet. The group is also challenging Articles 4.2, 11.1 and 17.2 of Law 30/2009 concerning Electricity. They seek to eliminate any role for private entities to supply electricity and operate power plants. Previously, the Constitutional Court annulled the 2002 Electricity Law which enabled the government to liberalize the power sector in Java and Bali and allowed private entities to produce and distribute electricity to the public. The revised 2009 Law continues to allow private entities to generate and supply power, and the group aims to strike down these provisions. They also challenge Article 12 of Law 25/2007 concerning Investment. In doing so, they attempt to limit the types of business sectors that foreign investors may enter.

One may argue that these judicial review claims and actions are motivated by the notion of economic nationalism. Routledge Encyclopedia of International Political Economy defines economic nationalism as, "an ideology which has been used as the motive force for national development strategies". Michael Heilperin in his book *Studies in Economic Nationalism* suggested the concept of economic nationalism can

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be understood as "a body of economic policies aimed at the loosening of the organic links between economic processes taking place within the boundaries of a country and those taking place beyond the boundaries." Additionally, according to William Rappard, an influential diplomat and academic of the interwar period, economic nationalism has been portrayed as "the policy of self-sufficiency".

The rise of economic nationalism in the 20th century was the result of several concurrent phenomena including globalization and economic insecurity and inequality. The vast pace of globalization is often perceived by certain elements to constitute a threat to national autonomy and cultural identity. Economic insecurity and inequality might also revive nationalist sentiments in a country. Such sentiments are often carried out in the form of restrictive economic measures such as trade barriers, policies that favour local workers and industries, and reaction against foreign direct investment. Sometimes, the failure of solving global economic crises is attributed to an over-reliance on major international economic bodies such as the IMF and World Bank.

Economic instability often opens the door to protectionist policies, blaming the bad performance of the domestic economy to imports and the influx of foreign workers. Income inequality leads to the view that only the elites enjoy the benefits generated by globalization. Such circumstances make economic nationalism an appealing and popular dogma for domestic constituents. It delivers promises on preserving cultural heritage, defending national interests and upholding national autonomy in this increasingly globalized world.

Economic nationalism can be manifested in a number of forms. One common way is economic patriotism, for example, "buy local" campaign. We often hear the phrases "buy American", "buy Swiss made", "locally produced", "locally grown", and so forth. People generally tend to assume that they serve their patriotic duty and help their domestic economy by choosing local products over foreign ones. However, it is unclear how these campaigns are still relevant. Today, economies are more interconnected with global value chains (GVCs). They are a significant feature of trade, investment and production patterns in the global economy. According to the OECD Report, *Interconnected Economies: Benefiting from Global Value Chains*, more than half of the world's manufacturing imports and 70 percent of the world's services imports are intermediate goods and services. In other words, most goods and a share of services are "Made in the World" rather than "Made in America" or "Made in China".

" Economic instability often opens the door to protectionist policies... "

The primary concern arising from the judicial review actions brought by the interest group led by Muhammadiyah is that such actions could be seen as, a sort of extreme form of, economic nationalism. These actions impose constraints on how Indonesia can interact economically and commercially with other countries. Benjamin Cohen in his book, *Crossing Frontiers: Explorations in International Political Economy*, uses the terms, "malign and benign economic nationalism", to describe the spectrum of economic nationalism. Aggressive/malign types of economic nationalism, from high protectionist barriers to the exclusion of foreign investment and technology, are often recognized to have negative impacts on a nation's economy and the poor way to solve poverty and income inequality problems.

The 2012 United Nations Conference on Trade and Development (UNCTAD) discussion paper, *Trade, Income Distribution and Poverty in Developing Countries: A Survey*, suggests that the rules that restrict the movement of goods and services, the choice of an exchange rate regime and the governance of economic performance, will have negative effects on the different channels and mechanisms through which trade is expected to play a significant role on the improvement of welfare. The same UNCTAD discussion paper also states that most studies and factual evidence seem to suggest that trade liberalization generally improves aggregate welfare, although gains might be small and unequally distributed. Constraints on income distribution tend to come from various factors such as infrastructure, people skills and policy. Of course, trade liberalization alone is insufficient to permit growth. It should be sustained by robust institutional elements, such as the rule of law and good governance.

To date, it is still unclear how the Justices in the judicial review cases will rule on these issues. If they strike down the law entirely or decide to annul certain provisions of these laws, the rulings would have far-reaching implications for the Indonesian economy. Adverse rulings would not only weaken the business and investment climates in Indonesia, but also undermine the rule-making authority of the executive and legislative branches to test private-public business models or attract private investors from home or abroad.

In any case, we need to recognize that pursuing aggressive forms of economic nationalism insistently would pose a huge risk to our economy. As Benjamin Cohen put it in his book: "malign nationalism seeks national goals relentlessly, even at the expense of others; benign nationalism, by contrast, is prepared to compromise national policy priorities where necessary to accommodate the interests of others. The difference between these two types of nationalism lies in the willingness of a country to identify its own national interest with an interest in the stability of the overall international system. Benign nationalism acknowledges a connection between self-interest and systemic interest; malign nationalism ignores or denies it…" Every country maintains some form of economic nationalism on Cohen's spectrum, from economically free countries such as Singapore to the most restricted ones such as North Korea. Let's reconsider which form is best for Indonesia.

The 3-Hour Policy at BKPM: Panacea for a Sluggish Investment Licensing Process?

John Lumbantobing & Valery Sarumpaet

In an effort to boost Indonesia's ailing economy, since September this year the Indonesian government has unveiled a series of policy packages. The focus of these packages is to create a conducive economic environment, especially for the real sector[1]. As such the policies touch on a vast number of issues and sectors – from trade, tax, diesel and electricity price, employment, banking and many more. In this article we zoom in on one aspect, namely the supposed streamlining and acceleration of obtaining an investment permit for industrial estates at BKPM (Indonesia's Investment Coordination Board). That process is slated to be shortened from 8 days to just 3 hours. This fast track will be available for those who will invest at least IDR 100 billion (approximately USD 7 million) in an industrial estate and plan to employ at least 1,000 Indonesians.

At first glance, this may sound like a fantastic development. But as sometimes said: if something is too good to be true, it usually is. While any improvement is a step in the right direction, this 3-hour licensing does not address the essential problems often found by potential investors at BKPM. Furthermore, much more still needs to be done by the government to boost investment especially in implementing the single-window investment licensing through BKPM. These issues are discussed below.

At the outset, there may be questions why the government restricts this service to just a select group of mega-investors. While we are not able to obtain specific data, our experience in legal practice – even in top Jakarta law firms – shows that investment applications of such scale (IDR 100 billion employing 1,000 people) do not come everyday. Therefore, this 3-hour licensing may end up affecting only a certain small percentage of investments in Indonesia.

When it comes to the scope of the 3-hour licensing, we also must not lose sight of the fact that the documents obtained through this service only make up a fraction of the long and arduous process of going through various regulatory requirements. In those 3 hours the investors will only obtain the Principal License (*Izin Prinsip*), the Deed of Establishment, the Minister of Law's Decree of Incorporation, Tax Registration Number (NPWP) and the booking for the land where the investment will operate. There are many further steps and obstacles to clear before an investment can actually start operating. The entire process until actual operation is summarised in Figure-1 below, while Figure-2 below shows the process of applying for an investment license within BKPM.

[1] The 'Real Sector' refers to industries that are actually producing goods or services, as opposed to industries that are concerned with financial/capital markets.

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INVESTMENT STAGES IN INDONESIA
(Figure – 1)

PREPARATION Establishing Foreign Investment Company (PMA)

- Research on line of business that are open for investment
  - ➢ Reference: Negative Investment List
- Obtaining Principal License
  - ➢ Authority: Investment Coordinating Board/BKPM
- Establishing of Limited Liability Company
  - ➢ Authority: Minister of Laws and Human Rights/MOLHR *with help of notary

PRE – OPERATION Obtaining facilities, site/land acquisition

- Obtaining Import Identification Number (API-P) for manufacturing companies, if needed
  - ➢ BKPM
- Submitting investment activities report (LKPM) every 3 months.
  - ➢ BKPM
- Obtaining facilities such as Machinery Import Duty Exemption and approval of tax facilities.
  - ➢ Director General of Taxation Ministry of Finance
- Obtaining licenses from local government such as building permit, domicile certificate, environmental licenses.
  - ➢ Local Government.
- Obtaining recommendation(s) from relevant sectoral ministries, such as plantation permits
  - ➢ Sectoral Ministries

COMMERCIAL OPERATION Securing Business License (sectoral)

- Obtaining Business License (IU) before the start of commercial operation.
  - ➢ BKPM
- Obtaining General Import Identification Number (API-U) and material import duty exemption, if needed
  - ➢ BKPM
- Obtaining facilities such as Machinery Import Duty Exemption and approval of tax facilities.
  - ➢ BKPM
- Submitting investment activities report (LKPM) every 6 months.
  - ➢ BKPM
- Obtaining periodic operational permits, such as construction services permits.
  - ➢ Sectoral Ministries

*There are only 2 forms of legal entity permitted for foreigners in Indonesia: (i) Limited Liability Company with foreign shareholders (PMA) and (ii) Representative Office (not a tax object).

Figure-1: BKPM, http://www7.bkpm.go.id/contents/general/117127/investment-step-by-step#.VjBGL6TOy00

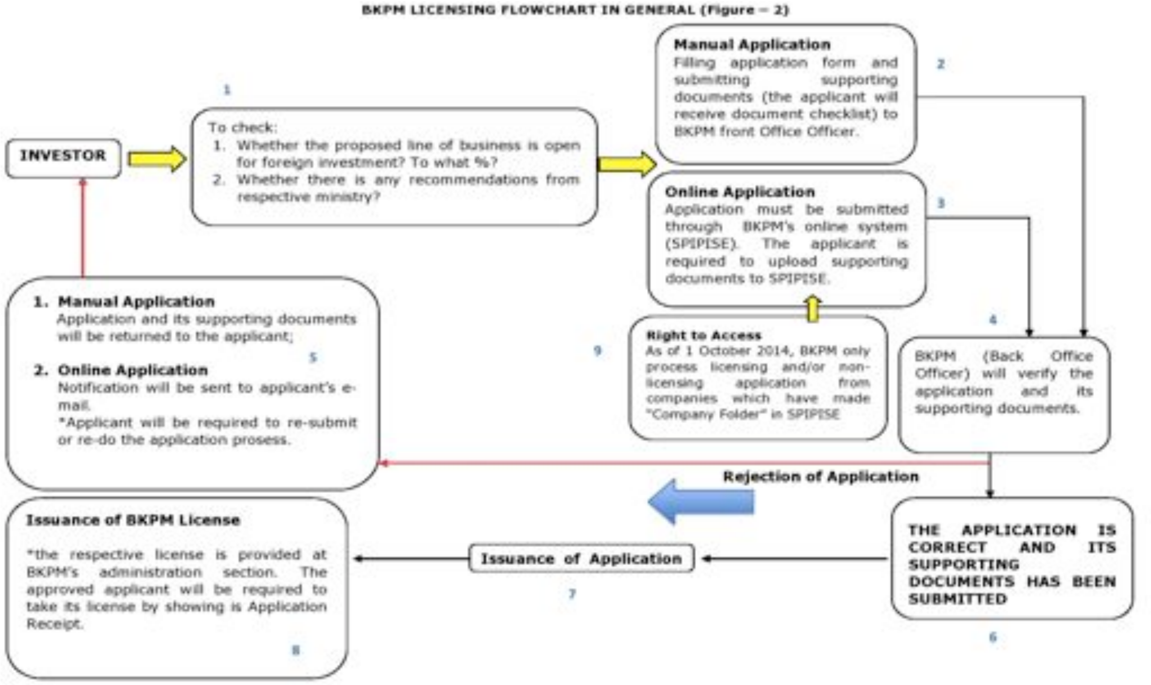

Figure-2 source: Embassy of Indonesia, http://www.indonesia.hu/userfiles/image/flowchart.jpg

In Figure-1 above, the Principal License and the establishment of an Indonesian company as an investment vehicle both fall into the Preparation stage. Afterwards, numerous licenses must still be obtained. Some of those licenses are also obtained from BKPM, but many crucial sectoral licenses are still handled by the relevant ministries as well as regional governments. Since the administration of President Susilo Bambang Yudhoyono, the government has professed a single-window policy for investment licensing. However, its implementation has been lacklustre. Even among the ministries which have formally delegated their licensing procedure to BKPM pursuant to ministerial decrees, in practice some of them (such as the Ministry of Energy and Mineral Resources and the Ministry of Manpower) have simply continued to process their own licenses.

Meanwhile, in Figure-2 above the crucial point is the verification stage, marked in points 3 through 5, where a given application for license must be completed – often by consulting with officers at BKPM's application desk. It is, in fact, the opaque or ever-changing requirements or policies imposed by BKPM during the verification stage that often prolongs the licensing process. This issue usually turns up during applications at the post-Principal License stage. For example, currently BKPM requires an applicant to enclose evidence of spending (based on the Principal License) before it can apply for a Business License to operate commercially – previously this had not been required by BKPM. Another example would be the added requirement to enclose the Deed of Establishment of the law firm representing the investor and an assignment letter from the firm for the particular lawyer appearing at BKPM.

" the 3-hour service will not have far-raching effect if not accompanied by some measures to address the issues often encountered by investors in practice. "

Given all the practical issues above, the 3-hour service will not have far-reaching effect if not accompanied by some measures to address the issues often encountered by investors in practice. Firstly, the uncertainty and unclear policies during the verification stage at BKPM must be addressed. Second, sectoral permits must as far as possible be brought within the single-window process at BKPM.

Furthermore, some of the items included in the 3-hour process are not particularly problematic. Many investors, especially foreign investors and those who invest in the tens or hundreds of millions of US Dollars, often already have a fairly clear and specific idea about the content of their deed of establishment and coordinate this with their preferred notary. The deed and the subsequent Minister of Law's decree and NPWP can nowadays take only very few days to finish. On the other hand, issues may arise about the ability of a BKPM-provided notary to deal with various requests for a tailored deed of establishment by the investors. It is easy to imagine that those investors will not be satisfied with a standard deed of establishment, at least this would likely be the case if they are bringing in investments worth IDR 100 billion; there will most likely be specific revisions to cater to the investor's particular circumstances.

In summary, the 3-hour licensing procedure at BKPM may be an improvement. As always, any improvement is to be welcomed. But without coordination and streamlining with other relevant ministries or governmental authorities, this new policy is not essential and may in fact present certain complications in practice. Some corporate lawyers in Jakarta that we have spoken with are still doubtful that the 3-hour licensing procedure would lead to a less bureaucratic investment process, and they believe that the back-and-forth-inquiry with BKPM will remain. The attitude is, at best, to wait and see how the policy is implemented. The government, and BKPM in particular, still has a lot on its checklist. Topping this list is the need for a follow-up agenda to ensure that the documentary and substantive requirements in order to complete an investment license application are made very clear, as well as including as many sectoral permits as possible within the BKPM process. This would enable a true single-window investment licensing process.

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Founded in 1994 with the vision of educating a new generation of leaders for Indonesia and the wider ASEAN region, University Pelita Harapan is the number one private university in Indonesia according to the QS World University Ranking 2013. UPH was the first University in Indonesia to introduce programs entirely taught in English, the first to offer a liberal arts curriculum, and the first to introduce a multi-disciplinary approach to its programs. While consistently underlining the vision of “knowledge, faith and character”, UPH, in cooperation with overseas partner universities, has developed a very rich curriculum in many areas of study, ensuring that its graduates are respected globally and appreciated by modern business and industry.

The Center for Trade and Investment - CITI

Established in September 2014, CITI’s objective is to raise awareness in Indonesia of the importance of an outward-looking and liberal trade and investment policy, so as to ensure the country’s continued commercial competitiveness and support its economic development goals. CITI runs a number of research, education and outreach initiatives with the generous support of both the Swiss State Secretariat for Economic Affairs (SECO) and the WTO Secretariat (WTO Chairs Program).

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This quarterly newsletter seeks to provide updates, insights and analysis on current developments in trade and investment law and policy in Indonesia. Constructive feedback and comments are always welcome.

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