INDONESIA FOCUS

Opportunities And Challenges Of Indonesia's Omnibus Law

The House of Representatives of the Republic of Indonesia and the Indonesian government passed the Omnibus Law on 5th October 2020, after spending approximately 8 months period of deliberation. The law is by far the most ambitious and complicated piece of legislation in Indonesia.

The law provides new provision and amendments to the 76 existing sectoral laws aimed to enhance investment ecosystems to draw more foreign direct investment (FDI) and much improve the ease of doing business in Indonesia, which may in turn create more job opportunities.

The bill, which consists of 1,187 pages, had been delivered to the President Joko Widodo on 16th October; who has signed the bill into Law No. 11/2020 on 2nd November. The law would cover and streamline 10 critical areas shown below.

10 Important Points Covered In Omnibus Law

1. Investment growth and licensing leniency
2. Protection and enforcement of small-medium scale enterprises and cooperative
3. Investment growth and licensing leniency
4. Research and Innovation Support
5. Ease of Doing Business
6. Land procurement
7. Economic Area
8. Central government investment and national strategic projects
9. Government administration
10. Sanctions

Source: The House of Representatives (Indonesia), UOB Global Economics & Markets Research

The Omnibus Law is to enable and empower the central government to set robust regulation standards and criteria for local and ministerial-level regulations that are likely to improve the Indonesian investment landscape.

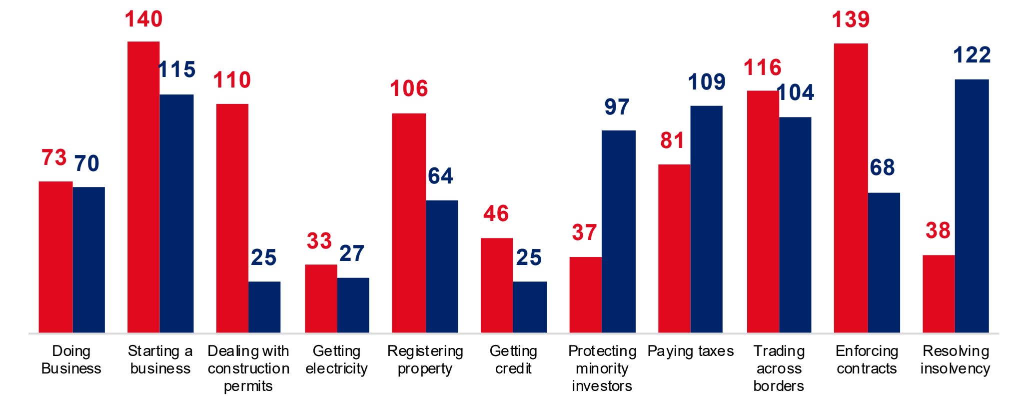
To realize the vision of becoming one of the top 5 world economies in 2045, the Indonesian government realize that it must address the problem of over-regulation to improve the ease of doing business and boost the country's investment climate.

Under the "doing business" category, Indonesia is currently ranked #73 out of 190 countries in 2020, which is close to its ASEAN peer, Vietnam, at #70 (Figure 1) who has been enjoying the global supply chain relocation in the past few years. While both countries are comparable to some extent, Vietnam seems to have gained more advantage in earlier stage of doing business which are (i) starting a business, (ii) dealing with construction permits.

Hence, Omnibus Law seeks to address the early investment stage and doing business issue, among others, through several key points. Therefore, the major idea of passing the Omnibus Law is to enabling and empowering the central government to set robust regulation standards and criteria for local and ministerial-level regulations that are likely to improve the Indonesian investment landscape. As such, it also means that a local regulation cannot be inconsistent with the regulations above it.

Figure 1. Indonesia vs. Vietnam Doing Business 2020 Rank Comparison

Source: Doing Business 2020 Report, UOB Global Economics & Markets Research



Note: Lower better

Enhancement Of Investment Ecosystem (Early Stage) Under Omnibus Law

Risk-Based Business Licensing

It introduces a new concept of business license called "Perizinan Berusaha" which should accelerate the process of establishing business activities, particularly business under low and medium risk category.

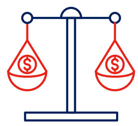
This new approach of "Perizinan Berusaha" also amends the previous approach to business licensing in which each 15 different sectors was regulated under separate laws.

Required Business License

- **Low Risk**: Business Identification Number ("Nomor Induk Berusaha" – NIB)
- **Medium Risk**: NIB and a standard certification (sertifikat standar)
- **High Risk**: NIB and specific business license (from relevant government institution)

Amendment To Spatial Planning Law

The Omnibus Law amends the Spatial Planning Law and replace the need to obtain location permit with the confirmation of conformity issued by the central government. It requires the spatial plan prepared by local governments to be integrated with the Online Single Submission (OSS) system. This will grant business players easier access to the plan and enable them to apply for suitability of space utilization approval through the system. By using this integrated system, the law will centralize the control over regional spatial plan to prevent misuse of power and bribery at regional level.



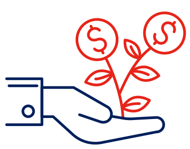
Environmental Permit Is No Longer Needed

Retains the environmental assessment of

a. "Analisis Mengenai Dampak Lingkungan" (AMDAL)

b. "Upaya Pengelolaan Lingkungan Hidup dan Upaya Pemantauan Lingkungan Hidup" (UKL-UPL)

c. "Surat Pernyataan Pengelolaan Lingkungan" (SPPL)



Businesses have one less document to process in order to meet its environmental licensing requirement.

Land Procurement Acceleration

Increases the number of types of public facilities that may be developed with public land procurement scheme to 24 (from 18 previously). In addition, to the accelerated land acquisition process, the government also establishes a land bank*, as stipulated in Omnibus Law.

* is a special agency that manages land and carries out planning, acquisition, procurement, management, utilization, and distribution of land.

Open New Business Sectors To Foreign Investment

To open new business sectors to foreign investment except for that are stipulated otherwise or activities that are reserve only for the Central Government.

The central government will introduce a priority list through a presidential decree to replace the existing negative list.

Source: Law No. 11/2020 (Indonesia),
UOB Global Economics & Markets Research

Why Is This Law Contentious?

The Omnibus Law has attracted criticisms due to its controversial deliberation process. While the Omnibus Law address multiple aspects with regards to Indonesia investment climate, the most contentious issue is the revision of labour law No. 13/2003.

The opposition came mostly from labour groups and unions whom had expressed their rejection through a series of mass rallies and filed a judicial review to the Constitutional Court. From the employer perspective, both domestic and foreign, Indonesia's previous labour law was considered to be one of the most rigid employment regulations among the lower-middle-income economies. Among others, key amendments that received the most critical feedback are related to (a) reduction of severance payment for permanent employee, (b) the removal of the limitation for fixed- term contracts, and (c) the removal of the limitation on the type of work that may be outsourced.

Key Contentious Changes In Omnibus Law From Labour Law No. 13/2003

Severance Payment For Permanent Employee

Under Omnibus Law, the maximum severance package for workers who works more than 24 years is a total of around 25 months' salary (previously 32 months of salary) - plus unused leave and repatriation cost).

Calculation:

- 1 x maximum severance payment (1 x 9) = 9
- 1 x service pay (1 x 10) = 10
- Unused leave and repatriation cost (if any)
- 6 months salary benefit of a new social security program i.e. job loss security / "BPJS Jaminan Kehilangan Pekerjaan" ➡ newly added

Fixed-Term Employment Contracts

The Omnibus Law revoked the maximum time limits on fixed-term contracts. The Law stated that the government to regulate the type and nature of work activity, the period of time, and the deadline for the extension of fixed-term contract via separate Government Regulation.

Outsourcing

The Omnibus Law removed the prohibition of using outsourced workers to carry out the main business activities or activities directly related to the production process. This might provide additional flexibility to employers but not so much for the employees.

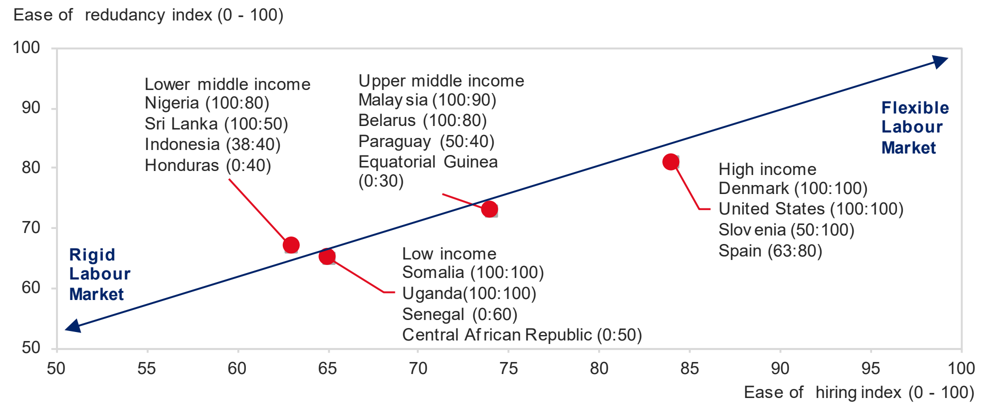
Nevertheless, It was stated in Omnibus Law that outsourcing companies are required to protect the rights of the employees. The details will be set out in a separate Government Regulation.

The Positive Side Of Amended Labour Law

Governments face challenges when it comes to balance worker protection and labour market flexibility. While it might not be the only problem, rigid employment regulation has arguably been one of the Achilles' heels faced by Indonesia and other low- and lower-middle-income economies. Figure 2 shows comparison of the rigidity of employment regulation between countries. This is true for Indonesia as the labour market experiences clear obstacles in hiring new employees or in making legal redundancies (Indonesia does not allow employer to terminate employment unilaterally). In the previous Indonesia Labour Law, it stated that there are limitations for fixed-term employment in terms of time limits and kind of work or activity to do, in comparison to 124 economies which allowed fixed-term employment for permanent tasks (according to doing business database).

Figure 2. Labour Market Flexibility Comparison

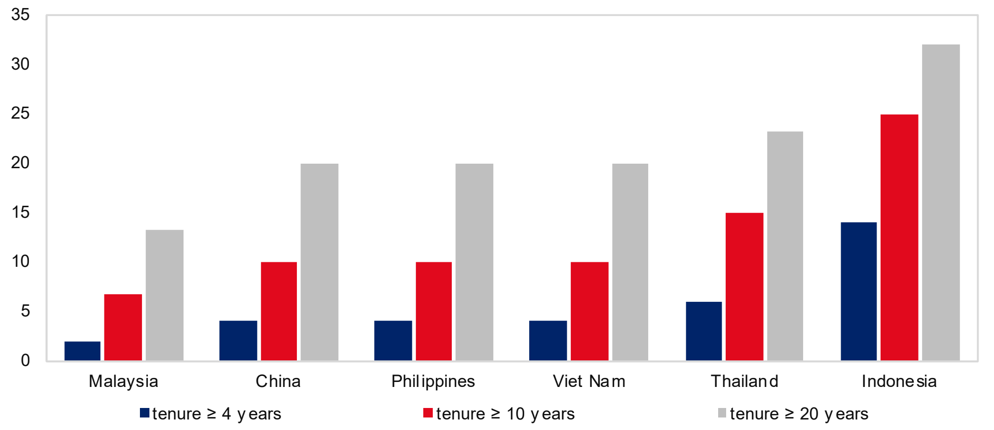
Source: Doing Business 2020 Report, UOB Global Economics & Markets Research



Another variable such as severance pay also showed that Indonesia's is considered high compared to its peers. Vietnam, which has been seen as the leader in attracting foreign direct investment (FDI) within the region, provides severance payment of half a month pay for every year of service. It means, Vietnamese workers would have to work more than 60 years to get around 30 months of severance pay while Indonesian could get those by working around only 20 years (Figure 3).

Figure 3. Severance Pay in No. of Monthly Wages Comparison

Source: ILOSTAT, UOB Global Economics & Markets Research



The rigid Indonesia labour law might result in higher unemployment.

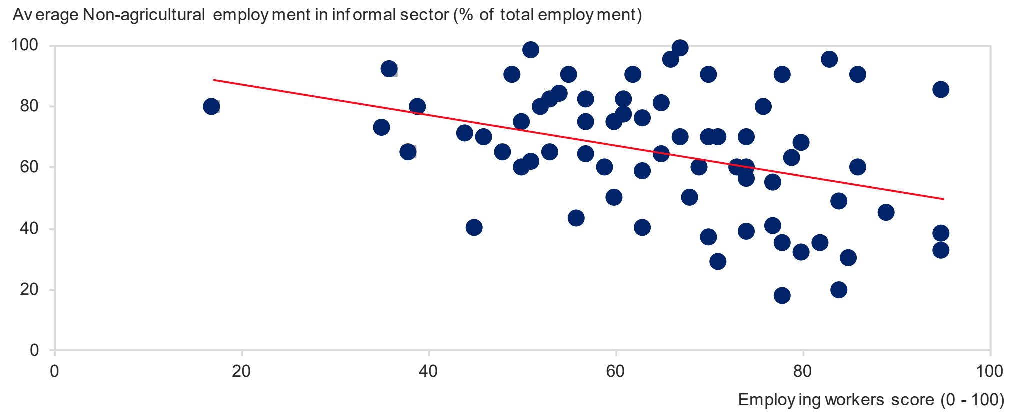
While the protection to labour is important for their welfare, we believe that there should be a better balance between protection and labour market flexibility. According to doing business data base, when companies encounter a rigid employment law, they lose some of the ability to conduct business efficiently. The alternative way to return the loss in efficiency is often hiring workers informally (Figure 4). These large informal sectors, reduced productivity and economic development. If left unchanged, the rigid Indonesia labour law might result in higher unemployment or leave out the younger and less experienced worker to informal sector with no social protection.

Omnibus Law is essential and an important step to increase the labour market flexibility and in turn drawing in much higher FDI, especially for Indonesia which currently has high informal employment share.

Therefore, we are in the view that Omnibus Law is essential and an important step to increase the labour market flexibility and in turn drawing in much higher FDI, especially for Indonesia which currently has high informal employment share (Figure 5); and to be able create more job opportunities, taking advantage of the demographic bonus, while other countries i.e. Japan, China, Korea, Thailand and Singapore wrestle with a different challenge of an ageing population (Figure 6).

Figure 4. Economies With Flexible Labour Regulation Tend To Have Smaller Informal Sector

Source: Doing Business 2020, UOB Global Economics & Markets Research



Note: the dots are the sample comprises of 68 countries (2003-2018 average data).
The higher employing worker score represent more flexible employment regulation.

Figure 5. Indonesia Currently Has High Share Of Informal Employment Compared To Peers

Source: ILOSTAT, UOB Global Economics & Markets Research

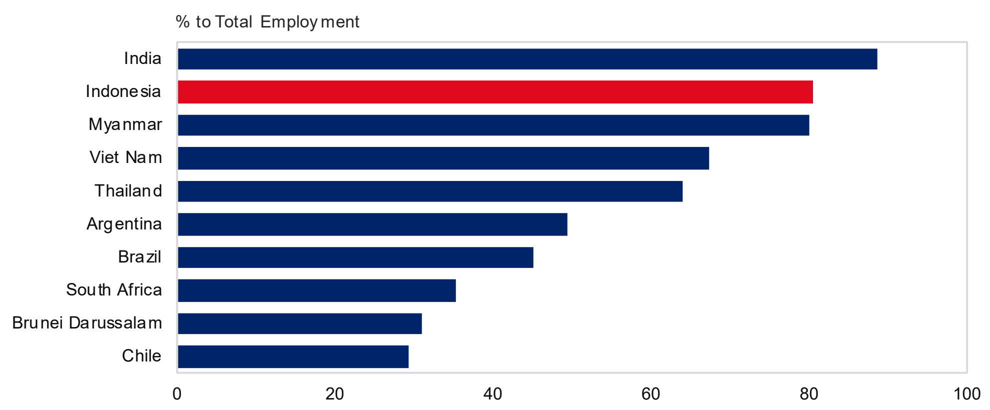
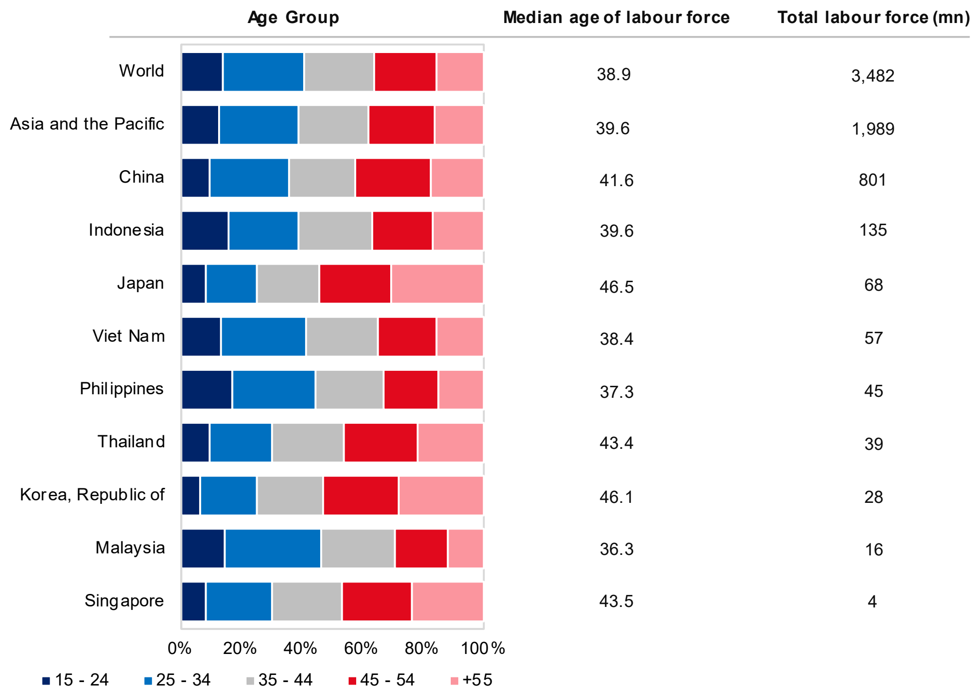


Figure 6. Labour Supply: Indonesia Must Be Able To Take Advantage Of Demographic Bonus

Source: ILOSTAT, UOB Global Economics & Markets Research



Omnibus Law May Considerably Grow Net FDI: What Does It Mean For Indonesia External Stability

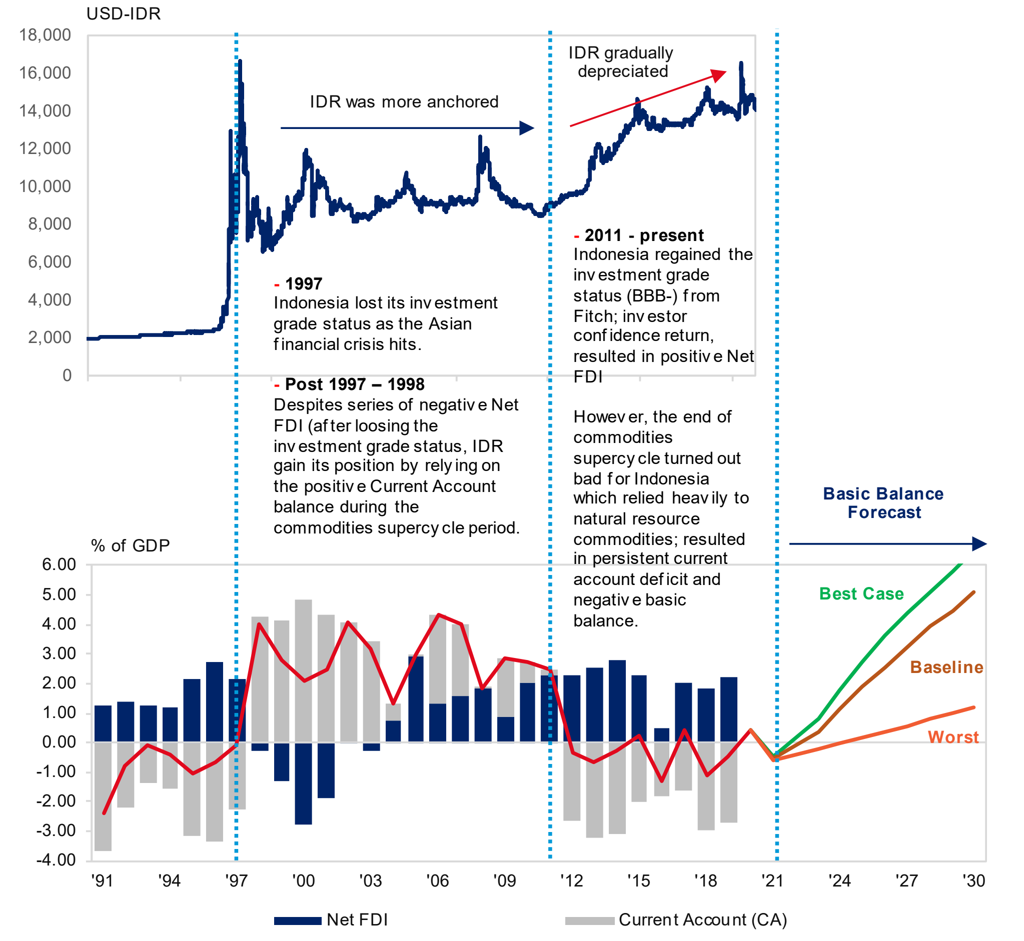
If implemented consistently, we believe that Omnibus Law would be able to bear fruit of higher FDI inflows as many would expect. This would bring Indonesia at least comparable to Vietnam in terms of net FDI as a percentage of Gross Domestic Product (GDP) in the future. We expect, through our simulation exercises that in our baseline to best-case scenarios, net FDI could eventually reach around the 4.7% to 5.7% of GDP levels in the medium- to long-term (Figure 7). This is a very important outcome that Indonesia would like to achieve, especially considering its current external position of having the so-called persistent current account deficit (CAD)

For the past decade, the country's (CAD), while not at unsustainable levels, has added to Indonesia's gross external financing needs. This could be one of the key fundamental issues over the medium to long-term if Indonesia does not begin its consistent structural reforms as early as possible because the country insofar has been importing much of the goods and services to grow the economy. While it takes arguably longer time for the country to turn its external position from an import-driven economy into an export-oriented one, it is well hoped that as Indonesia can draw in more FDI with the passing of the Omnibus Law, our gross external financing needs can be offset to some degree from the drawing in of more FDI.

Furthermore, ever since the end of commodities' super-cycle, IDR has been gradually and structurally depreciating even until now, leaving the currency to remain a hostage of volatile portfolio investment flows. By riding on the positive prospects that is highly hoped to be brought about by the Omnibus Law in attracting the much needed FDI , which is also seen as a reliable source of long-term financing, that eventuality will render Indonesia's external stability to be stronger and for the exchange rate to behave less volatile–a very crucial element in reducing business uncertainty.

Figure 7. Indonesia Basic Balance Going Forward

Source: ILOSTAT, UOB Global Economics & Markets Research



Challenges And Opportunities Ahead

In general, we view that Omnibus Law should improve the ease of doing business and investment climate in Indonesia (to a certain degree). Nevertheless, challenges remain such as the need for substantial additional regulation and of course the ground implementation that is currently yet can be seen. In addition, Indonesia's incremental capital output ratio (ICOR – which explains the relationship between the level of investment made in the economy and the consequent increase in GDP) remains high at around 6.8x according to the data by Statistics Indonesia; which means to increase an output by 1, it requires 6.8 investment.

We are cautiously optimistic that with the passing of the Omnibus Law, the better prospects of Indonesian investment climate and environment may be able to draw in higher FDI and in turn bring about higher labour productivity and increase its GDP growth near its sustainable potential.

This is understandable, considering the country's labour productivity is low compared to peers. Hence, further reform in education and its collaboration with industrial needs is essential. On the other hand, Indonesia also need to balance the allocation of its investment fund, both into (a) priority sector that could produce higher labour employment as well as (b) to machinery/technology that further enhance business productivity. Therefore, we are cautiously optimistic that with the passing of the Omnibus Law and soon after its implementing regulations, the better prospects of Indonesian investment climate and environment may be able to draw in higher FDI and in turn bring about higher labour productivity and increase its GDP growth near its sustainable potential.