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The Investment Negative List: One Year Later

Indonesia's Law No. 25/2007 on Investment. In March of 2007, Indonesia's Parliament approved a landmark law on investment. The objective of this Law is to increase investment by, *inter alia*, providing greater certainty for investors. The new Law replaced separate laws on foreign and domestic investment dating back to 1967 and 1968, and thereby provides a single legislative framework for domestic and foreign investment. The Law also states that all business sectors are open to foreign investment unless specified in a Presidential Regulation (Perpres) containing Indonesia's investment negative list. This marks the first time that an Indonesian law has required a single, comprehensive negative list that is issued by the President. It is also the first clear statement in law that activities not included on the list are fully open to investment.

The Situation before 2007. Previous negative lists were fairly short documents that lacked detail and clarity. As a result, line ministries and government agencies could create their own restrictions, and often issued overlapping and sometimes contradictory regulations. Since it was difficult to determine whether or not a particular business activity was restricted, potential investors had to hold multiple consultations with the Investment Board and line ministries. Even then, the results were not always clear.

The Investment Negative Lists of 2007. The new investment negative list was issued in July 2007 (Perpres 77/2007) and then subsequently revised in December 2007 (Perpres 111/2007). One goal of the new list was to make all restrictions on direct investment clearly available in a single easy-to-use document. This would effectively remove the power of line ministries to make their own rules on investment, and prevent *ad hoc*, discretionary decisions by officials in charge of investment approval and licensing.

The Objectives of the Study. This study was undertaken to review implementation of the Investment Law and Investment Negative List and to provide recommendations for future revisions. Four services sectors were selected as examples: express delivery, telecommunications, higher education, and hospitals. Foreign investment plays an important role in developing these sectors; Indonesia is a large net importer of some services provided by the sectors; and some are a priority for economic integration in ASEAN.

The Response of Investors. Although meant to clarify rules on investment, the new investment negative list received an unfavorable response from investors. The Indonesian Chamber of Commerce criticized the list for creating eleven levels of restrictions on foreign equity, as opposed to the old list which had only two. Also, rather than documenting existing restrictions on foreign investment, the new list in fact created new restrictions (Table 1).

Implementation of the Investment Law and negative list has also resulted in confusion and increased the legal uncertainty surrounding investment. This uncertainty may be far more detrimental to investment than the negative investment list itself. Major uncertainties surround the grandfather clause, the treatment of publicly listed companies, descriptions of the sectors included in the negative investment lists, previous regulations requiring divestiture of foreign investment, the hierarchy of laws and regulations in Indonesia, and the transparency and ease with which investors are able to obtain information and legal interpretations of the Investment Law and the investment negative list.

Indonesia's International Obligations. Indonesia has very few obligations for the sectors covered by this report in either the WTO or ASEAN. However, a major goal of the ASEAN Economic Community is the full integration of ASEAN service industries by 2015. The process of integration starts in 2008 and is being accelerated for certain priority sectors. By December 2008, Indonesia must allow 51% foreign ownership in telecommunications, air transport and health. Indonesia must also allow 49% foreign equity in courier services. The implementation of these commitments would require a new Presidential Decree with changes to Indonesia's negative investment list.

Express Delivery Services. Express delivery service (EDS) consists of the time sensitive, door-to-door delivery of letters, packages, and goods. Modern EDS can be distinguished from traditional courier services by its use of advanced track and trace technologies. EDS is utilized by an extraordinarily wide range of manufacturing and service industries to deliver not only documents, but also samples, spare parts, and high technology inputs. In Indonesia, cross border EDS is carried out by the agents of four international companies. The local market is served primarily by domestic courier companies.

Indonesia's regulations treat courier and EDS as identical services. The regulations on foreign investment, package weight limits, and types of packages appear to reflect outdated concerns about competition with the postal service. The regulations have also been changed frequently, causing tremendous uncertainty for investors. Between 2003 and 2007, there appear to have been few foreign investment restrictions on courier services. Under the new negative investment list, however, courier services are reserved for small and medium scale enterprises.

Since international EDS companies are large enterprises, new foreign investment in courier is effectively forbidden. Other ASEAN countries are less restrictive or have no foreign equity limits on EDS.

Telecommunications. Indonesia's penetration rates for telecommunications have historically been very much behind those in neighboring countries, even after taking into account lower income levels. Also, the availability of international bandwidth is extraordinarily low, and Internet access costs are excessively high. This leads to low Internet use and high communication costs for business. Recently, however, the market has improved dramatically. Cellular telephone use, including high bandwidth 3G, has been expanding by 30% per annum during the past five years.

Before 2007, Government restrictions on the number of licenses were more important to investment than foreign equity limits, which were set at 99%. Now, the Government continues to restrict the number of number of international and fixed line providers to three, but has liberalized the market for cellular. There are now eleven cellular companies, most with substantial foreign backing. This is a major reason for the growth of cellular in recent years.

The negative investment list of 2007 imposes new limits on foreign investment at the very time when investment is booming. For communications networks, foreign equity limits vary from 49% to 65%. For communication services, the limits vary from 49% to none at all. In addition to a more restrictive investment environment, the equity limits vary with the type of technology and are contrary to the notion of convergence. Other countries are developing technology neutral licensing systems under which companies can offer any service on any network. Indonesia's investment negative list lacks such neutrality. It thus limits the ability of companies to adapt new technologies that allow networks to work seamlessly together and to move into new high valued services. The latter is necessary if companies are to maintain their profitability in the face of increased competition for basic services.

Other factors have caused increased regulatory uncertainty for investors in communications. These include contradictory interpretations of the new investment law, a ministerial decree banning foreign investment in cell towers, and recent decisions by the courts and Indonesia's Anti-Monopoly Commission that require Temasek Holdings of Singapore to divest in Indosat. The ban on cell towers has had a particularly chilling affect since it runs contrary to a higher order Presidential decree and since it closes off one source of funding for telecommunications expansion.

Higher Education. Indonesia is falling behind other Asian countries in higher education spending and enrollments. There are no international ranked universities in Indonesia, in spite of its large population. One result is that Indonesia is a significant importer of higher education services with a large number of students abroad. This mode of trade is the least beneficial to the country. It results not only in an outflow of foreign exchange, but also has no spill over affects in terms of laboratories, libraries, and other forms of infrastructure. Other Asian countries aim to be centers of educational excellence for the region and are aggressive about attracting foreign universities to their markets.

In all countries, there is political sensitivity about: 1) public versus private education services; 2) profit versus non-profit education; and 3), foreign providers of education. In Indonesia, the current law on National Education System, and a new draft law on Education Legal Entity now before Parliament, both permit foreign providers to cooperate with local providers in non-profit educational "legal entities". The draft law is also explicit about a foreign equity limit of 49% on this cooperation, even though the concept of "equity" in a cooperative legal entity is not well defined. In contrast, the negative investment list allows for-profit limited liability companies with 49% foreign equity.

Hospital Services. Indonesia is very much behind other Asian countries in terms of medical spending and the availability of hospital services. One consequence is that an estimated 200,000 Indonesians travel abroad for medical treatment each year, mainly to Malaysia and Singapore, where they spend approximately $600 million.[1] Some hospitals in Singapore and Malaysia depend on Indonesia for over 50% of their patients. Other Asian countries are attracting foreign investment in order to compete for medical travel and for medical tourism. Foreign investment not only reduces medical travel abroad by locals, but also leads to higher salaries for local medical personnel, less brain drain, higher technology equipment, and reduced pressure on local doctors to work in multiple hospitals.

Before 2007, there were no foreign equity limits on hospitals and there was significant foreign investment in the cities of Jakarta, Bandung, Surabaya and Medan. As a result, there are several major, foreign-owned hospitals operating in Indonesia. It is also probable that limits on the ability of foreign doctors to practice in Indonesia were more important to investors than equity limits, especially in high-end hospitals where brand image is critical.[2] Other countries also restrict foreign medical personnel, but without the outright ban that effectively exists in Indonesia.

The new negative investment list is far more restrictive on foreign investment in hospitals. For "specialized" clinics and hospitals, foreign equity is limited to 65% and is only allowed in the cities of Surabaya and Medan. Foreign investment is not allowed in general clinics and hospitals. The reasons for the regional restrictions in Surabaya and Medan are unclear, and may date back to Indonesia's WTO commitments of 1994.

Other Countries. Many other countries in Asia face the same economic and political difficulties as does Indonesia when opening up to foreign investment in sensitive sectors. Prime examples are education and healthcare, where few countries have made international commitments. Nevertheless, other

[1] Jakarta Post, "Govt set to internationalize hospitals, Tuesday, September 23, 2008.

[2] Foreign medical personnel can also be important for medical tourism, which has not yet developed in Indonesia.

countries appear to be moving faster than Indonesia in opening up these sectors. Some members of ASEAN are also becoming exporters of services and are targeting Indonesia as a major market. To the extent that Indonesians can consume these services abroad, there is little that the Government can do to offset the losses in foreign exchange other than allow foreign establishments within Indonesia.

Table 1: Comparison of 2007 Investment Negative List with Pre-existing Regulations for Selected Sectors and Indonesia's International Commitments

Sectors	Regulations Before 2007	Regulations After 2007	International Commitments
Hospitals	Open to foreign investment as joint venture with 99% foreign equity and a minimum of 200 beds.	Closed to foreign Investment except in specialist services in Medan and Surabaya, where the foreign equity ceiling is 65%.	Must allow 51% foreign equity by the end of 2008.
Higher Education	Foreigners may cooperate with local partners in non-profit foundation.	Foreign investment permitted in limited liability companies with 49% foreign equity limit.	No commitments as of yet.
Telecommunications	Open to foreign investment with 99% foreign equity limit.	Foreign equity limits vary from 49% to 100% depending on the type of service.	Must allow 51% foreign equity by the end of 2008.
Courier Services	Open to 100% foreign equity with some divestment after 15 years.	Reserved for small and medium scale businesses. Effectively closed to foreign investment.	Must allow 49% foreign equity by the end of 2008.

Q) What is the reason for the lack of progress in implementing reforms?

A) Since Suharto's departure, the rules for doing business have changed and it is necessary to put the new rules on paper. That is taking time. Also economic nationalism and the prospective elections are complicating the reform efforts.

Q) Are non-western foreign companies affected to the extent that western companies have been affected by the investment law?

A) I would make no distinction between those two groups.

Q) Is the BKPM still the approving authority for investments?
A) BKPM is the first step in the approval process. Depending on the investment, the ministries would be come involved.

Q) The Investment Law apparently covers the national investments, but do other laws take precedence?

A) A clause in the Law says that "except where (other) laws apply" It is not clear whether all other laws will apply, or only past or future laws.

Q) When do you anticipate the first report?

A) Possibly in 2-3 months.

Q) Do you consider the "Negative List" an improvement for the process?

A) The negative investment list could be considered an improvement in the sense that restrictions are (more or less) contained in a single document, and the principle that restrictions must be stated in a Presidential Regulation has been enshrined in law. However, it is not an improvement in substance, in the sense that many new restrictions have been created. Furthermore, implementation has led to increased uncertainty for investors.