withersworldwide

Indonesia's Omnibus Law: A magic wand amidst a global pandemic?

09 DECEMBER 2020

CATEGORY:
ARTICLE

In this article, Joel Shen and Christian Siagian explore the significance and effects of Indonesia's Omnibus Law. Read more about our Indonesia practice here.

Our story has the makings of a palace intrigue – a piece of breakthrough legislation meant to create jobs during the most difficult economic downturn in Indonesia's modern history; a false announcement to distract the bill's most vociferous detractors as they plotted mass demonstrations across Jakarta; a sudden decision by the Indonesian legislature to pass the controversial bill ahead of schedule, amidst a city-wide lockdown and road closures around the legislative building; and the eventual enactment of the Omnibus Law by President Jokowi, while the capital reeled from massive protests.

Much has been said about the controversial law, although recent discourse has shed more heat than light on one of the largest (1,187 pages) and most complex pieces of legislation in modern Indonesian history.

What is the significance of the Omnibus Law?

To understand why the Omnibus Law is so significant, a little context is helpful.

Indonesia is the largest economy in Southeast Asia and is expected to be the seventh largest in the world by 2030, overtaking Germany and the UK. It is the fourth most populous country in the world and home to the world's largest Muslim population. Its digital economy, only USD 8 billion in 2015, is expected to grow exponentially to USD 124 billion by 2025.

However, Indonesia punches below its weight in economic performance, and is traditionally characterised by a complex and difficult investment environment environment. It sits somewhere in the middle of the pack in the World Bank's Ease of Doing Business Rankings for 2020. Other analysts are less charitable – global professional services firm TMF Group say it is the most complex country in the world to do business.

In other words, Indonesia is a country of immense potential and, the cynics add, it always will be.

Most observers point to the same impediments to growth and foreign investment: bureaucracy and red tape, excessive foreign ownership restrictions, onerous labour laws, and one of the most complex tax regimes in the world.

The following points summarise the current regulatory bugbears, and the provisions in the Omnibus Law that seek to address such issues:

1. Bureaucracy and red tape

Indonesia's decentralised system of government has resulted in one of the most convoluted in the world, and investors and entrepreneurs require dozens of applications and business permits and licences to set up even simple businesses.

Provision: Simplified business licensing regime

The Omnibus Law streamlines Indonesia's notoriously convoluted business licensing regime into four risk categories, and relaxes licensing requirements for businesses in all but the highest category of risk.

2. Excessive foreign investment regulation

The Negative Investment List, which restricts the percentage of foreign ownership within each industry sector, is regarded as one of the primary obstacles to foreign investment in Indonesia.

Provision: Liberalisation of foreign investment regime

The Omnibus Law liberalises all businesses sectors except those that are reserved for the Indonesian government (e.g. weapons manufacture) or prohibited entirely (i.e. production of narcotics; gambling activities); and promises fiscal and non-fiscal inventives (such as licensing, location, supply of infrastructure and energy) for prioritised business sectors.

3. Onerous labour laws

Onerous labour laws Indonesia's labour laws are designed to protect the workforce from exploitation, and make it very difficult to take disciplinary action, or to sack underperforming employees.

Employers lament (only half-jokingly) that they cannot fire an employee in Indonesia if the latter were a convicted axe murderer – an employee would have to be a convicted serial axe murderer to warrant dismissal.

Complicated work permit application processes also discourage foreign workers from working in Indonesia, leading to a manpower shortage in sectors such as technology and professional services.

Provision: Labour law reform

Labour law reform The Omnibus Law expands the grounds on which an employee might be dismissed and reduces statutory severance packages from a maximum of 30 months' salary to no more than 19 months' salary.

The Omnibus Law also simplifies work permit application processes, and relaxes work permit requirements for foreign workers in various sectors including, notably, technological startups and scientific research. Foreign directors and commissioners who own shares in the employer also enjoy relaxed work permit requirements.

The Omnibus Law has eased regulations relating to the use of fixed-term contracts and outsourcing arrangements (both of which were highly regulated under the previous regulatory regime), thereby allowing employers greater flexibility in planning for their manpower needs.

4. Tax

Indonesia's tax regulations are complex and onerous. It imposes high rates of personal and corporate income tax, and a global taxation regime.

Provision: Reduction on corporate income tax

Corporate income was recently reduced to 22% for private companies and 19% for Indonesia-listed companies. This will be eventually be stepped down to 20% for private companies and 17% for Indonesia-listed companies. Under the Omnibus Law foreign workers may also be exempt from paying personal income tax on income derived outside Indonesia.

In short, the Omnibus Law reforms almost 80 existing laws, including some of the most onerous tax and labour regulations in the world, in an attempt to encourage foreign direct investment.

In particular, the Omnibus Law is expected to benefit Indonesia's economy by streamlining bureaucracy and business licensing processes, and liberalising foreign ownership restrictions.

The Omnibus Law is expected to increase funding opportunities for Indonesian businesses, and facilitate knowledge and technology transfer by relaxing work permit requirements for foreigners.

Will the Omnibus Law work?

Having said that, we need to understand that the regulatory changes promised in the Omnibus Law remain subject to constitutional challenge, and to Indonesia's notorious "implementing regulations". In other words, they will take time to materialise, if they ever do.

Seasoned observers of Indonesian politics and economic affairs will be cognizant of this:

Fitch Ratings, for example, expects that the Omnibus Law will "(mark) a significant enhancement of the business climate and a step forward for labour market flexibility… provided the changes are well implemented".

This sentiment was echoed by Citi, which thought that the regulatory reforms "if implemented well, could move Indonesia towards a new regime of reduced policy uncertainties".

Conversely, OCBC cautioned against excessive market sanguinity because although the Omnibus Law is a "positive catalyst to investment activities… the measures will take time to implement" and still others like Nomura limited their "optimism on the prospects for these structural reforms in boosting growth over the medium term" because Indonesia's "record of implementing major pieces of legislation has been less impressive".

Whatever their views on the potential ramifications of the Omnibus Law, observers seem to agree on one thing: the impact of the Omnibus Law on the Indonesian economy will be determined by its implementation in the coming months and years.

Perhaps the most incisive comment of the Omnibus Law to date comes from Richard Borsuk, journalist, writer, and adjunct senior fellow of the S. Rajaratnam School of International Studies: the Omnibus Law, he says, is not a "magic wand" that will make Indonesia's problems miraculously disappear.

So what's the big deal?

So if the Omnibus Law does not currently affect business in any meaningful way, why are people so excited about it?

To answer this question, allow me to transport you to a closed-door conference in 2014 organised by one of the foreign chambers of commerce in Indonesia. Held in the ballroom of a luxurious five-star hotel in central Jakarta, it was an opportunity for representatives of the foreign business and investment community to meet senior Indonesian government officials, and for the Indonesian government to court foreign investors.

At one of the sessions, it was suggested that Vietnam had made great strides in attracting foreign investment by liberalising business sectors, developing critical infrastructure, instituting economic reform and rolling out tax incentives. Annoyed by what he perceived to be excessively effusive praise for Indonesia's Southeast Asian neighbour, a senior government official suggested that if the businessmen present were so enamoured with Vietnam, they should go and invest in Vietnam instead.

The above response is symptomatic of a broader attitude among Indonesian regulators: that if you wanted to do business in Indonesia, then you did it Indonesia's way. As such, the Omnibus Law represents a remarkable departure from the hitherto entrenched mindset of the Indonesian government, and suggests (dare we hope) a willingness by the Indonesian government to listen, and respond to, grievances from foreign investors.

While it is not a magic wand that makes Indonesia's problems miraculously disappear, it does send a strong message to the international business and investment community: that Indonesia is open for business.

About our Indonesia practice

With our long-standing experience in Indonesia, our strength is in advising you whether you are looking to invest in Indonesia, or if you are based in Indonesia and looking to invest globally. Read more about our Indonesia practice here.

Our experience includes:

- Foreign investments into Indonesia
- Outbound Indonesian investments
- Private client and tax
- Immigration
- Dispute resolution (Commercial litigation and International arbitration)
- Financial services regulations
- Projects
- Financing
- Restructuring, refinancing and workouts
- Capital markets
- Intellectual property

This article was first published by Singapore Global Network here on 9 Dec 2020.

About Singapore Global Network

At Singapore Global Network, we are passionate about building connections and creating opportunities. As a community, we aim to grow Singapore's overseas networks by building meaningful and lasting relationships with family and friends across the globe. Whether you're considering a move to Singapore, a Singaporean living abroad, or just curious about opportunities here, we want to help connect you with the right people or resources to get you started. Join the Singapore Global Network here for industry news, insights from members of the network, networking opportunities.

Authors

Joel Shen

SPECIAL COUNSEL | SINGAPORE

Corporate

+65 6238 3031

joel.shen@witherskhattarwong.com

Christian Siagian

ASSOCIATE | SINGAPORE

Corporate

+65 6922 4104

christian.siagian@witherskhattarwong.com