

# INDONESIA

## TRADE SUMMARY

The U.S. trade deficit with Indonesia was \$7.0 billion in 2003, a decrease of \$88 million from \$7.1 billion in 2002. U.S. goods exports in 2003 were \$2.5 billion, down 1.4 percent from the previous year. Corresponding U.S. imports from Indonesia were \$9.5 billion, down 1.3 percent. Indonesia is currently the 37<sup>th</sup> largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Indonesia were \$1.0 billion in 2002 (latest data available) and U.S. imports were \$285 million.

U.S. exports of agricultural products to Indonesia totaled \$984 million in 2003. Leading categories include: soybeans (\$324 million), and cotton (\$232 million). U.S. imports of agricultural products from Indonesia totaled \$1.2 billion in 2003. Leading categories include: rubber and allied products (\$596 million), cocoa beans (\$194 million), and spices (\$120 million).

The stock of U.S. foreign direct investment (FDI) in Indonesia in 2002 was \$7.5 billion, down from \$8.2 billion in 2001. U.S. FDI in Indonesia is concentrated in the mining, manufacturing, and banking sectors.

## OVERVIEW

Although Indonesia's economy weathered the 2002 global economic slowdown relatively well, the country still has not fully recovered from the effects of the 1997-98 financial crisis. President Megawati Soekarnoputri's government has maintained a measure of political stability during its tenure, despite an ongoing conflict with separatists in the gas-rich province of Aceh. In 2004, Indonesians will go to the polls for legislative elections and for direct elections for the President and Vice President, who will be inaugurated in October. However, the nation's most serious problems -- building effective democratic institutions, establishing the rule of law, restoring private capital inflows, and combating corruption -- continue to prove to be difficult to tackle. Terrorist bombings on October 12, 2002 in Bali and August 6, 2003 at the Marriott Hotel in Jakarta harmed Indonesia's tourist sector. However, the economy proved resilient enough to bounce back. Indonesia's non-oil and gas exports to the world remained strong in 2003, growing 5.2 percent over 2002.

The Indonesian government generally has adhered to its long-term trade liberalization program, although some backsliding occurred in 2002 and continued through 2003. Indonesia fully implemented the final stage of its commitments under the ASEAN Free Trade Agreement (AFTA) on schedule January 1, 2002. However, the Indonesian government has expressed reservations about the pace of liberalization within AFTA, and noted an interest in pursuing emergency exit clauses from AFTA commitments in general. Indonesia has a mixed record in the WTO. In the current Doha round of negotiations, Indonesia continues to advocate special product exemptions for rice, sugar, soybeans, and corn. 2002 textile regulations advantaged domestic textile fabrics over imports, violating WTO commitments. However, in 2003 the government developed WTO-compliant mechanisms, like safeguards, as an alternative to protectionist measures.

Indonesia's relationship with the International Monetary Fund (IMF) provided the framework for the country's economic policies since November 1997. IMF-supported economic reforms helped stabilize the macro economy, restructure the financial sector, and reinforce existing policies of trade and investment liberalization. Indonesia concluded its IMF program at the end of 2003.

The Indonesian government issued an economic policy White Paper in September 2003 detailing its plans to continue forward with the economic reform agenda in three areas: maintaining macroeconomic stability; continuing financial sector reform; and increasing investment, exports and employment. The

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first two sections followed closely the reform agenda already in progress with IMF support. The private sector (foreign and domestic) welcomed the ambitious third section on improving the investment climate, but expressed concern about implementation and stressed the need for prioritization. They also urged more government consultation with the private sector before announcing policies or issuing regulations. Additionally, they cited legal reform as key to improve the overall business environment, and offered specific suggestions of priority measures in the areas of Small and Medium Enterprise Development, Taxation, Customs, Labor, Energy, Electricity, Telecommunications and Transportation.

These suggestions reflect U.S. industry's continuing concern over the wide range of business problems, including the lack of contract enforceability, discriminatory taxation, the absence of a transparent and predictable regulatory environment, arbitrary and inconsistent interpretation and enforcement of laws, irregularities in government procurement tenders, and ineffective enforcement of intellectual property rights. These cause great uncertainty, which combined with widespread corruption, an ineffective judicial system, non-existent credit reporting, and underdeveloped capital markets, hinders commercial dealings in Indonesia.

### IMPORT POLICIES

#### Tariffs

As of January 2003, about 70 percent of Indonesia's tariff lines were assessed import duties ranging between zero percent and five percent. Indonesia's average unweighted tariff is 7.3 percent, compared to 20 percent in 1994.

In the late 1980's the Indonesian government began long-term trade reform to wean the economy away from its dependence on oil and gas and to increase Indonesia's industrial competitiveness. In the early 1990's, it began a series of annual deregulation packages designed to gradually lower applied tariff rates, convert non-tariff barriers into tariffs, and remove restrictions on foreign investment. The January 11, 2001 tariff reduction package cut five percentage points on 1,279 tariff lines. The majority, 769 lines, had tariff rates reduced to 10 percent or below. Effective January 1, 2002, Indonesia, along with the other five original ASEAN members, implemented the final phase of the ASEAN Free Trade Agreement (AFTA). Indonesia has reduced tariffs for all products included in its original commitment (7,206 tariff lines) to five percent or less for products of at least 65 percent ASEAN origin. The government released a new tariff reduction package in January 2004. The new tariff book categorizes tariffs into International Non-ASEAN Tariffs and ASEAN Tariffs. Most Non-ASEAN Tariffs fall into 0 percent, 5 percent, and 10 percent tiers, except for sensitive items such as automotive goods and alcohol. ASEAN Tariffs fall into three tiers, 0 percent, 2.5 percent, and 5 percent, for all goods covered by the ASEAN Free Trade Agreement (AFTA).

In the Uruguay Round market access negotiations, Indonesia committed to bind 94.6 percent of its tariff schedule; most tariffs are bound at 40 percent. Products for which tariff bindings exceed 40 percent, or which remain unbound include automobiles, iron, steel, and some chemical products. Indonesia committed to remove import surcharges on items bound in the Uruguay Round by the year 2005, and had done so by the end of 1996. In accordance with the WTO Agreement on Agriculture, Indonesia agreed to eliminate non-tariff barriers on agricultural products, and replace them with tariffs. In the agricultural sector, 1,341 tariff lines have bindings at or above 40 percent, including the most sensitive and heavily protected sectors. Local content regulations on dairy products were eliminated on February 1, 1998. In the current Doha round of negotiations, Indonesia has been advocating special products exemptions from tariff reductions for rice, sugar, soybeans, and corn.

Beginning in 2002 and intensifying in 2003, domestic agricultural interests put pressure on the Indonesian

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Government for protection from international competition. However, with some notable exceptions, the Indonesian Government has resisted such pressure. Since late 1999, rice imports have been subject to a specific tariff of 430 rupiah per kilogram (5.1 cents per kilogram or approximately 30 percent on an ad valorem basis). The Ministry of Agriculture continues to propose increasing the tariff further in order to protect local farmers, but the Indonesian Government has not implemented this measure. Local agriculture interests also have lobbied the government to increase bound tariff rates on sensitive agricultural products, such as sugar and soybeans.

### **Non-Tariff Barriers**

Since 1997, Indonesia dismantled many formal non-tariff barriers. In September 1998, the Indonesian Government sharply curtailed the role of the National Logistics Agency (Bulog), which had a monopoly on importing and distributing major bulk food commodities, such as wheat, rice, sugar, and soybeans. Bulog now maintains the status of a state-owned enterprise with responsibility for maintaining stocks for distribution to military and low-income families, and for managing the country's rice stabilization program. The agency has floated the idea of again becoming a state trading enterprise with monopoly import rights for some products, but the Indonesian Government has not taken action on this proposal. Bulog is no longer entitled to draw on Bank Indonesia credit lines, a privilege it long enjoyed under the Soeharto regime, and must use commercial credit and pay import duties. In conjunction with the minimization of Bulog's authority and role, some designated private companies are now permitted to import rice, wheat, wheat flour, soybeans, garlic, and sugar.

The Indonesian government continues to maintain a ban on imports of chicken parts originally imposed in September 2000 by the Directorate General of Livestock Services in the Ministry of Agriculture. The U.S. government has raised concerns about this issue, but the Ministry of Agriculture continues to insist on the necessity to assure consumers that imports are halal (produced in accordance with Islamic practices). U.S. imports comply with Indonesia's established requirements for halal certification, and several ministries have sought to repeal the ban, so far without success. U.S. industry estimates the value of lost trade from this ban at roughly \$10 million.

The Indonesian government also imposes de facto quantitative restrictions on imports of meat and poultry products by requiring an Importer Letter of Recommendation ("Surat Rekomendasi Importir"). In approving requests for such letters the Indonesian Government can arbitrarily alter the quantity allowed to enter, raising concerns that these Letters of Recommendation are being used to limit imports. U.S. industry estimates the trade impact of this restriction to be between \$10 million and \$25 million.

Domestic rice producers continue to lobby the government for protection. In addition to tariff protection, other proposed options include banning imports during harvest season (February - May), employing a tariff-rate quota scheme, or limiting ports of entry. The Indonesian government thus far has not exercised any of these proposed options. Meanwhile, U.S. rice exports increased from \$5 million in 2001 to \$18.5 million in 2002. Most of these exports were linked to two P.L. 480 Title I concessional loan programs in each respective year. Although the Indonesian government rejected the program for 2003, U.S. rice exports reached \$16.3 million, 12.2 percent lower than in 2002.

The U.S. government has received reports that the Indonesian Customs Service uses a schedule of arbitrary "check prices" rather than actual transaction prices on importation documents for assessing duties on food product imports. While Indonesian government officials defend this practice on the basis of combating underinvoicing, they do not publicize the list or the methods used to arrive at those prices. As a result, although most food product import tariffs remain at five percent, the effective level of duties can be much higher.

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Other quantitative limits apply to wines and distilled spirits. In addition to the regular import duty of 170 percent, a 10 percent VAT and 35 percent luxury tax, the Indonesian Government restricts imports of alcoholic beverages to three registered importers, including one state-owned enterprise.

### **Import Licensing**

The Indonesian Government has continued to reduce the number of products subject to import restrictions and special licensing requirements. Currently, 141 tariff lines are subject to import licensing restrictions, down from 1,112 tariff lines in 1990. Alcoholic beverages, lubricants, explosives, and certain dangerous chemical compounds, among other items, are subject to these requirements.

In March 2002, the Minister of Industry and Trade issued a decree on Special Importer Identification Code Numbers (NPIK). This decree requires importers of certain product categories to apply for a special importer identity card, without which products can be detained at port. These goods include: corn, rice, soybeans, sugar, textile and related products, shoes, electronics and toys. There have been no complaints concerning NPIK.

On October 23, 2002, the Minister of Industry and Trade issued a decree concerning Textile Import Arrangements. Only companies that have production facilities to use imported fabrics as inputs for finished products, such as garments or furniture, may obtain import licenses. The United States has raised serious concerns that the import licensing requirements severely restrict and distort trade, violating Indonesia's commitments in various GATT and WTO agreements. The Indonesian government insists the regulations are designed to help curb smuggling. The U.S. Government has recommended that the decree be rescinded.

### **STANDARDS, TESTING, LABELING AND CERTIFICATION**

In July 2000, the Indonesian government began to implement the Consumer Protection Law of 1998 by requiring registration of imported food products. Importers must apply for a registration number from the Agency for Drug and Food Control (BPOM). After complaints from Indonesian importers and retailers of overly complex, time consuming, and costly requirements, BPOM drafted revised procedures that would simplify the process. However, those draft regulations have stalled in the President's Office without approval or further comment.

All imported food products must be tested by BPOM. Fees for such testing range from Rp 50,000 (\$6.00) to Rp 2.5 million (\$300) per item, and between Rp 1 million (\$120) to Rp 10 million (\$1200) per product. Some U.S. producers have expressed concerns that the extremely detailed information on product ingredients and processing they must provide may infringe upon proprietary business information. This has led some U.S. exporters to discontinue sales. However, the government has not fully implemented these regulations, and enforcement is weak and inconsistent. If fully implemented the level of trade affected by this requirement is estimated by U.S. industry at between \$10 million and \$25 million.

The Indonesian government also has been gradually implementing a strict food labeling law that requires labels written only in the Indonesian language on all consumer products. Labels may not include any other languages. U.S. companies, who generally design labels to accommodate several export markets (often in several languages), have concerns about this requirement, which makes it cost ineffective to export smaller volume products. However, as of December 2003, the government had not issued implementing rules or enforced the food labeling requirement.

Beginning January 2001, Indonesian regulations required labels identifying food containing "genetically engineered" ingredients and "irradiated" ingredients. However, the Indonesian government has not

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implemented these new requirements, because it has yet to establish minimum threshold-presence levels. According to U.S. industry the new regulation could affect sales of approximately \$411 million in soybeans and soybean meal from the United States.

### GOVERNMENT PROCUREMENT

Indonesia is not a party to the WTO Government Procurement Agreement. Indonesia's government procurement regime is governed by a number of overlapping laws, regulations, and presidential decrees. Most important is a presidential decree issued in February 2000, which updated the Law on Government Procurement of 1994. The decree simplified procurement procedures and enhanced transparency, but also granted special preferences to domestic sourcing. In addition, Construction Law 14/1999 governs procurement of civil engineering services and related consulting services. Regional decentralization also may introduce additional barriers as local and provincial governments adopt their own procurement rules.

Bilateral or multilateral donors finance many large government contracts and often impose special procurement requirements. For large, government-funded projects, international competitive bidding practices must be followed. The Indonesian government seeks concessional financing for most procurement projects. Since late 1999, the Indonesian government has conducted audits of the state-owned electricity company (PLN), the state oil and gas company (Pertamina), and the State Logistics Agency (Bulog), which identified serious irregularities in procurement. However, no legal action has been taken.

Foreign firms bidding on high value government-sponsored construction or procurement projects have been asked to purchase and export the equivalent value in selected Indonesian products. Government departments, institutes, and corporations are expected to utilize domestic goods and services to the maximum extent feasible, with the exception of foreign aid-financed goods and services procurement projects. State-owned enterprises that publicly offer shares through the stock exchange are exempted from government procurement regulations. The new oil and gas upstream authority, BP Migas, regulates the import of all materials used by the oil and gas sector.

### EXPORT SUBSIDIES

The Indonesian government, through Bank Export Indonesia, maintains several credit programs that provide subsidized loans, primarily to agriculture and small and medium businesses. The subsidized credit structure is undergoing significant change as economic reforms proceed.

### INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The United States placed Indonesia on the "Priority Watch List" again in 2003, due to continued weak IPR enforcement. Previous Special 301 Annual Reviews in 2002 and 2001 identified a range of IPR concerns, including rampant software, audio, video disk and book piracy; pharmaceutical patent infringement; counterfeiting; trade secret protection; data protection; apparel trademark counterfeiting; an inconsistent and corrupt law enforcement regime; and an ineffective judicial system. The lack of effective IPR protection and enforcement are major disincentives to foreign investment in Indonesia, particularly in high technology sectors.

The government agency responsible for IPR legislation works closely with industry groups to combat abuses. However, prosecution of violators has been difficult due to inadequate police action, prosecutor and judge unfamiliarity with the new law, as well as the Indonesian public's limited understanding of the importance of IPR protection, and rampant corruption. In 2001, the Indonesian judiciary began to try certain IPR cases in the Commercial Courts. In a landmark case that year, a U.S. software company won

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a civil suit against five retailers for selling computers bundled with pirated software. In its first two years, the Commercial Courts have concluded over 150 cases. Nonetheless, U.S. companies often find the Indonesian court system frustrating, unpredictable, and ineffective in punishing violators. Industry representatives say the vast majority of criminal prosecutions must be dropped due to poor evidence documentation and maintenance, as well as widespread corruption within the justice system.

Indonesia is a member of the World Intellectual Property Organization (WIPO) and has acceded to numerous international conventions on IPR. These include the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works (with a reservation on Article 33), the WIPO Copyright Treaty, the Patent Cooperation Treaty, the Trademark Law Treaty, the Nice Agreement for the International Classification of Unclassified Goods and Services, and the Strasbourg Agreement Concerning International Patent Classification.

### Copyrights

The new copyright law came into force in July 2003, one year after it passed Parliament. The law contains a number of important provisions long sought by U.S. and Indonesian copyright holders, including authorization for the Indonesian government to issue optical disk (OD) regulations, criminal penalties for end-user piracy and the ability of right holders to seek civil injunctions against pirates. The Indonesian government completed draft optical disk regulations in November 2003. The Ministry of Justice has approved the OD regulations, but approval by the Ministry of Industry and Trade is pending. Once the Ministry of Industry and Trade approves the draft, the OD regulations will be submitted to the President's office for final approval.

The Copyright Law establishes rights to license, produce, rent or broadcast audiovisual, cinematographic, and computer software. It also provides protections for neighboring rights in sound recordings and for the producers of phonograms. It stipulates a 50-year term of protection for many copyrighted works, meeting TRIPS Agreement requirements. A 1989 copyright agreement between the United States and Indonesia extends national treatment for copyright protection to works created by citizens of each country.

The Indonesian government enforcement of copyrights is uneven, although it periodically intensifies actions against copyright piracy and regularly consults with copyright holders and associations. However, piracy of video compact disks in Indonesia is widespread, undermining the sale and rental of legitimate products. Periodic raids result in the seizure of sizable caches of pirated OD products. However, none of these cases has resulted in meaningful penalties or permanent impoundment or destruction of equipment used to manufacture pirated products. In recent years, movies on high-quality pirated digital video disks (DVDs) have become increasingly available alongside video compact disks (VCDs). According to U.S. industry estimates, total losses from copyright piracy in Indonesia during 2002 were over \$250 million.

### Patents

Indonesia enacted its Patent Law on August 1, 2001. The law consolidated three previous laws covering patents, and established an independent commission to rule on patent disputes and appeals. The law transferred jurisdiction over IPR civil cases to the Commercial Court from the District Court and raised the maximum fine for patent violations to Rp 500 million (\$60,000). The term of protection remains 20 years with a possible two-year extension. A patent is subject to cancellation only in the event the patent holder fails to pay annual fees within specified periods. Unauthorized use of a product or process invention that is the subject of a pending application constitutes patent infringement.

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Despite these measures, there remains a lack of effective enforcement of patents and pending patents. The patent law does not correct some of the weaknesses that concern foreign rights holders. Chief among these is the requirement that an inventor must produce a product or utilize a process in Indonesia to obtain a patent for the product or process. The standard for excluding inventions contrary to the public interest from patentability appears broader than the standards enumerated in the TRIPS Agreement.

### **Trademarks**

Indonesia enacted its trademark law on August 1, 2001. The trademark law consolidated three prior laws enacted over 20 years. The law raised the maximum fine for trademark violations to Rp 1 billion (\$120,000) and slightly reduced the maximum possible prison term. The Indonesian government justified this move by claiming that financial penalties were a greater deterrent to IPR violators than imprisonment. Foreign rights holders, arguing that most IPR cases never result in the maximum sentence, had pushed for minimum sentencing guidelines rather than higher fines.

The trademark law provides for the determination of trademark rights by priority of registration, rather than by priority of commercial use. The law also provides for the protection of well-known marks, but offers no administrative procedures or legal grounds under which legitimate owners of well-known marks can cancel pre-existing registrations. Indonesian trademark officials' requirement that all trademark modifications be registered, appears to violate the Treaty of Paris. Currently, the only avenue for challenging existing trademark registrations in Indonesia is through the courts, an often-burdensome undertaking that must be initiated within five years from the date of the disputed registration. Faster processing (within 180 days) of trademark cases by the Commercial Courts has benefited some trademark holders. However, industry representatives had hoped courts additionally would use injunctions, especially in cases where a lower court eventually invalidates a false trademark registration.

### **SERVICES BARRIERS**

Despite relaxation of some restrictions, particularly in the financial sector, trade barriers to services continue to exist in many sectors.

#### **Legal Services**

A few local law firms currently dominate the legal market, and foreign law firms cannot operate directly in Indonesia. In order to practice legally, lawyers must hold Indonesian citizenship and a degree from an Indonesian legal facility or other recognized institution. Foreign lawyers can only work in Indonesia as "legal consultants" and must first obtain the approval of the Ministry of Justice and Human Rights. A foreign law firm seeking to enter the market must establish a relationship with local firm.

#### **Distribution**

In 1998-99, Indonesia liberalized portions of the distribution services sector under terms of its agreements with the IMF. The Indonesian government eliminated restrictive marketing arrangements for cement, paper, plywood, cloves and other spices. Indonesia has opened the wholesale and retail trade sectors to foreign investment. Since 1998, it has allowed up to 100 percent foreign equity in the distribution and retail sectors, with the condition that the investor enter into a "partnership agreement" with a small-scale Indonesian enterprise. This partnership agreement need not involve an equity stake in the project. The film sector is not covered by this regulation. The entire film sector, including film distribution and exhibition, remains closed under provisions of the 1992 Film Law (see Audio-Visual section below).

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In October 2001, Indonesia passed a new Oil and Gas Law to deregulate downstream activities. Presidential Decree 86/2002 and Government Regulation 67/2002 establish a new Oil and Gas Downstream Business Regulating Board (Badan Pengatur Kegiatan Usaha Hilir Migas, or BPH Migas) to control downstream activities. Although the day to day activities of the board must still be defined through implementing regulations, BPH Migas will be an independent government institution that reports directly to the President. Its primary functions include regulating the supply and distribution of oil fuel, allocating sufficient fuel oil to meet national fuel oil reserves, stipulating conditions on fuel oil transportation and storage, setting tariffs for natural gas pipeline use, setting the price of natural gas for households and small consumers, and regulating the transmission and distribution of natural gas.

### **Financial, Accounting and Banking Services**

Under the WTO Financial Services Agreement, Indonesia committed to allow 100 percent foreign ownership for non-bank financial services companies that are publicly listed, including insurance and securities firms. Indonesia also guarantees the access of existing financial services firms in its market. It lifted restrictions on branching and sub-branching for joint venture banks and foreign branches in 1998.

In 2002, the Indonesian Bank Restructuring Agency (IBRA) sold majority shares of Bank Niaga and Bank Central Asia, formerly the largest private sector bank in Indonesia. In 2003, it continued the reprivatization program with the sale of majority shares of Bank Danamon and Bank BII. IBRA acquired these banks in return for government takeover of debts held by the controlling families. Foreign investors or foreign-led consortia purchased majority stakes in all four banks. The government also successfully launched two IPOs for 20% of Bank Mandiri and 40% of BRI in 2003.

Paid-in capital requirements are twice as high for multi-finance companies with foreign partners than for domestic multi-finance companies. However, in November 1998, Parliament passed amendments to the 1992 banking law that allow 100 percent foreign ownership of Indonesian banks. All insurance policies in Indonesia must be purchased from either domestic or joint venture companies unless specific coverage is unavailable in Indonesia or if the insured is a wholly foreign-owned entity.

### **Accounting Services**

Foreign firms cannot practice under international firms' names, although terms such as "in association with" are permissible. Foreign accounting firms must operate through technical assistance arrangements with local firms. Foreign agents and auditors may act only as consultants and cannot sign audit reports. Licensed accountants must hold Indonesian citizenship.

### **Securities**

In 1998, the Indonesian government removed restrictions on foreign ownership of securities firms, pursuant to Indonesia's commitments under the WTO Financial Services Agreement.

### **Audio-Visual**

Indonesia prohibits foreign film and videotape distributors from establishing branches or subsidiaries. Under the Film Law, provision of importation and distribution services is limited to wholly-owned Indonesian companies. Importation and in-country distribution of U.S. films must be handled through a single organization, the European and American Film Importers' Association (AIFEA). Duties, taxes, licensing, and other required payments also act as barriers to the importation of films.

### **Construction, Architecture and Engineering**

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Foreign consultants working under government contract are subject to government billing rates. Foreign construction firms are only permitted to be subcontractors or advisors to local firms in areas where the government believes that a local firm is unable to do the work. In addition, for government-financed projects, foreign companies must form joint ventures with local firms.

### **Telecommunications Services**

The provisions of Indonesia's Telecommunications Law 36, which came into force in 2000, have guided reforms to end monopolies and open basic telecom services to majority foreign ownership. Telecom Law 36 lays out goals that exceed many of the modest commitments Indonesia agreed to under the WTO Basic Telecommunications Agreement (maximum foreign investment limit of 35 percent for telecommunications services companies) and the WTO Pro-Competition Annex in 1997 (transparent regulatory procedures, nondiscriminatory licensing, and competitive safeguards for companies operating in Indonesian markets).

In 2002, subsequent implementing regulations for Telecom Law 36 established conditions for a new policy of duopoly and accelerated reforms. The government ended the exclusive rights of PT Telkom for domestic long distance service and local fixed-line service in 2002, and of PT Indosat and Satelindo for international calling service in 2003. Indonesia formed a telecommunications regulatory body in July 2003 to improve transparency in regulation development and dispute resolution.

Telecom Law 36 removed previous requirements that prospective foreign investors partner or enter into a revenue-sharing arrangement with a state-owned enterprise. In January 2002, to attract investors the government committed to raise telephone tariffs each year for three years to achieve market levels, however popular resistance prevented the second round of price increases in 2003. Indonesia has undertaken partial privatizations of its telecommunication companies. In July 2002 government ownership of PT Telkom was reduced to 51 percent, after a public offering of 3.1 percent. In December the same year, the government reduced its ownership of PT Indosat to 15 percent, after it sold 41.9 percent to Singapore Technologies Telemedia.

### **INVESTMENT BARRIERS**

Indonesia's investment climate is poor. The World Economic Forum's 2003 competitiveness rankings scored Indonesia 97th of 102 countries. Foreign direct investment (FDI) has declined steeply since the 1997-98 financial crisis and in the last few years the numbers have been inflated by the inclusion of state-owned firms that were partially privatized. Government approvals for investment proposals reached \$14.6 billion in 2003, \$9.8 billion in 2002, an adjusted \$9 billion in 2001, and \$16 billion in 2000. Groups of investors from Tanzania and Mauritius taking advantage of special bilateral tax treaties with Indonesia proposed a third of the \$14.6 billion in approved investments purchasing mostly state-owned companies. Investment proposals from Asia, North American and Europe - traditionally large investors - declined from 2002. Most of this investment is never realized.

On January 1, 2001, Indonesia began to implement a large-scale decentralization of authority and budget from the central government to the provincial and district-level governments. Differences of opinion between the central and local governments about which has authority on certain issues has added to the level of uncertainty facing foreign investors. In many areas, even though contrary to law, local governments have instituted revenue-raising measures ("retribusi"), which are trade distorting.

Decentralization has complicated government efforts to improve Indonesia's investment climate and reduce burdensome bureaucratic procedures and other requirements on foreign investors. Indonesian law

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provides for both 100 percent FDI projects and joint ventures with a minimum Indonesian equity of five percent. Government officials have drafted a new investment law, which may be enacted in 2004. The proposed law would overhaul existing regulations dating back to the Foreign Capital Investment Law of 1967 and confer significant new approval powers to the Investment Coordination Board (BKPM). Currently, BKPM and other relevant agencies in certain sectors must approve proposed foreign investments, but under the proposed law BKPM would be responsible for approvals in all sectors, including licenses, tax incentives, and business registrations.

Indonesia blocks or restricts foreign investment in some sectors in addition to those service sectors mentioned above. These restricted sectors are described in the "negative list." The most recent version, issued in August 2000, is based on Presidential decree 96, which opened some sectors, particularly certain medical services, to foreign investment. The negative list restricts foreign investment in industries producing marijuana, certain environmentally harmful chemicals, chemical weapons, and alcoholic drinks. And it closes to foreign investment casino and gambling facilities, air traffic and marine vessel certification and classification systems, and radio frequencies. However, various infrastructure, airline, medical services, marine and fisheries, industrial, and other trade sectors are open to investment subject to joint venture or other conditions.

### **ELECTRONIC COMMERCE**

Despite the proliferation of Internet service providers in recent years, several factors hinder the growth of electronic commerce in Indonesia. These include the lack of a clear policy in support of an open telecommunications infrastructure, monopoly provision of fixed land-line service by PT Telkom, a low level of computer ownership by both businesses and individuals, lack of funding, and weak IPR protection. U.S. industry has identified the lack of a legal framework for ensuring security of on-line transactions as a particularly significant impediment.

Parliament has been debating a cyber law to address issues related to electronic commerce for more than a year. Lack of a cyber law was cited by an Indonesian court in the October 2001 acquittal of a "cyber squatter" who had improperly registered a domain in the name of a competitor. Indonesia has also experienced an explosion of credit card fraud in recent years that may hinder development of electronic commerce. Express delivery companies complain of increasing difficulties and higher costs as a result of fraudulent on-line transactions originating in Indonesia. Many internet companies now blacklist Indonesia among other countries, because of the rampant credit card fraud.

### **OTHER BARRIERS**

#### **Transparency**

A lack of transparency and widespread corruption are significant problems for companies doing business in Indonesia. Corruption was endemic under the former Soeharto regime, and still remains an enormous problem for foreign companies. These companies complain about demands for irregular fees to obtain required permits or licenses, government awards of contracts and concessions based on personal relations, and an often arbitrary legal system.

Many laws passed since late 1997 have established new institutions and agencies to respond to popular demands to address corruption, collusion, and nepotism, but poor implementation has undermined that effectiveness. The Indonesian government established stiffer penalties for corruption as well as an independent commission to investigate and audit the wealth of senior government officials. In December 2003, it also established an Anti-Corruption Commission. However, no one has been prosecuted yet to indicate the effectiveness of these measures.

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## Automotive Policies

On June 24, 1999, the Indonesian government announced a major revision of its national automotive policies in order to rely on market forces to foster a more efficient and globally competitive automotive industry. The new policy eliminated extensive tariff and tax incentives for local content. The Indonesian government reduced the maximum tariff on automobiles from 200 percent to 80 percent. Tariffs on passenger car kits imported for assembly, which had ranged from zero to 65 percent, were reduced to 25, 35, 40, or 50 percent depending on engine size. Tariffs on non-passenger car kits were reduced to a uniform 25 percent. Tariffs on auto components and parts imported for local assembly of passenger cars and minivans were changed to a uniform rate of 15 percent. Imports of motor vehicles are no longer restricted to registered importers or sole agents of foreign automakers, but are open to any licensed general importer.

Despite the steps taken to improve access to the automotive sector, U.S. motorcycle manufacturers complain of the high tariff of 60 percent (25 percent on knockdown kits), the luxury tax of 75 percent, and the prohibition on motorcycle traffic on tollways as barriers to the Indonesian market. The Indonesia government restructured the way luxury sales taxes are imposed on motor vehicles in December 2000. The luxury sales tax on 4,000cc sedans and 4x4 Jeeps or vans was raised from 50 percent to 75 percent. The luxury tax on automobiles with engine capacity between 1,500cc and 3,000cc was increased from 15 percent to 20 percent. This decision had a significant negative impact on the market since 65 percent of the market share belongs to automobiles with engine size between 1,500cc and 3,000cc.