

# INDONESIA

## TRADE SUMMARY

The U.S. goods trade deficit with Indonesia was \$9.9 billion in 2008, a decrease of \$181 million from \$10.1 billion in 2007. U.S. goods exports in 2008 were \$5.9 billion, up 39.6 percent from the previous year. Corresponding U.S. imports from Indonesia were \$15.8 billion, up 10.5 percent. Indonesia is currently the 37th largest export market for U.S. goods.

U.S. exports of private commercial services (*i.e.*, excluding military and government) to Indonesia were \$1.6 billion in 2007 (latest data available), and U.S. imports were \$444 million. Sales of services in Indonesia by majority U.S.-owned affiliates were \$1.4 billion in 2006 (latest data available), while sales of services in the United States by majority Indonesia-owned firms were \$73 million.

The stock of U.S. foreign direct investment (FDI) in Indonesia was \$10.0 billion in 2007 (latest data available), up from \$9.9 billion in 2006. U.S. FDI in Indonesia is concentrated largely in the mining sector.

## IMPORT POLICIES

### Tariffs

Indonesia's simple average bound tariff remained at 37 percent in 2008, while its simple average applied tariffs are around 7 percent to 8 percent. Most tariffs are bound at 40 percent, although tariff bindings exceed 40 percent or remain unbound on automobiles, iron, steel, and some chemical products. U.S. motorcycle exports are severely restricted by the combined effect of a 60 percent tariff, a luxury tax of 75 percent, a 10 percent value added tax, and the prohibition on motorcycle traffic on Indonesian highways.

In the agricultural sector, tariffs on more than 1,300 products have bindings at or above 40 percent. Tariffs on fresh potatoes, for instance, are bound at 50 percent, although applied rates are 25 percent. Local agriculture interests continue to lobby the government to increase tariff rates above bound WTO levels on sensitive agricultural products, such as sugar, soybeans, and corn.

### Import Licensing

In late 2008, the Indonesian government announced that sweeping new non-automatic import licensing procedures on a broad range of products – including electronics, household appliances, textiles, footwear, toys, and food and beverage products – would enter into force in 2009. The measure, known as Decree 56, includes a requirement for preshipment verification by designated surveyors at importers' expense and a restriction on imports to five designated ports and airports. The Indonesian government is considering extending these licensing provisions to additional products. The United States and other foreign countries have expressed concern about the decree and sought its withdrawal.

In May 2008, Indonesia introduced new import restrictions for plantation white sugar. The United States has raised concerns with Indonesia that the new regulation will further limit sugar imports, which already are highly restricted as a result of existing regulations.

Indonesia maintains non-automatic licensing requirements on textiles, although it is unclear if these will be replaced or altered by Decree 56, which also covers many textile and footwear products. These textile

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licensing requirements date back to 2002 and limit market access for a wide range of imported fabric. Only approved local garment or textile producers are authorized to import fabrics covered by the regulation, and these fabrics are permitted to be used only as inputs in domestic production, not for resale or transfer. Approval must be obtained for both the quantity and timing of imports. The United States will continue to raise concerns about these requirements.

### **Pharmaceutical Market Access**

The United States has serious concerns about new barriers to Indonesia's pharmaceuticals market. Following a 2008 Health Ministry decree requiring foreign pharmaceutical companies operating in Indonesia to manufacture locally in order to get drug approvals, the Indonesian food and drug agency has been rejecting or delaying the approval of new applications for drug registrations by some companies, including wholesalers and distributors that do not have manufacturing operations in Indonesia. If these rules are not modified, some foreign firms may be forced to leave the market as their drug approvals, generally valid for two years, gradually expire. The United States and other countries have expressed their serious concern about this regulation and will continue to urge Indonesia to resolve the issue so that the affected firms can continue to operate in Indonesia. Indonesia has indicated some willingness to consult with the U.S. Government and pharmaceutical companies about these restrictions.

### **Quantitative Restrictions**

The Indonesian government requires an import permit from the Directorate General of Livestock Services for imports of animal-based food products. In approving requests for such permits, the Indonesian government arbitrarily may alter the quantity it allows to enter. U.S. industry estimates the annual trade impact of this restriction to be between \$10 million and \$25 million.

Indonesia bans salt imports during the harvest season. It requires salt importers to be registered and to source products locally.

Indonesia applies quantitative import limits to imported wines and distilled spirits. Only one registered importer, a state-owned enterprise, is authorized to import alcoholic beverages, with an annual quota set by the Ministries of Trade and Industry.

As a result of new mining legislation, mining firms operating in Indonesia will face new restrictions in exporting unprocessed ore. The legislation will require them to process the ore in Indonesia before shipping it abroad. The United States will closely monitor implementation of the law to ensure that it does not constitute an export ban on raw materials.

### **Customs Barriers**

U.S. firms continue to report that Indonesia's Customs Service uses a schedule of "check prices" rather than actual transaction prices to assess duties on food product imports as it committed to do under the WTO Customs Valuation Agreement. Customs makes an assessment based on the perceived risk status of the importer and the average price of the same or similar product imported during the previous 90 days. In addition, the U.S. Government has received complaints from importers about costly delays in customs processing and requests for unofficial payments to customs officers. The United States will continue to raise its concerns on these issues with the Indonesian government.

## **Luxury Taxes**

The luxury sales tax on 4,000 cc sedans and 4x4 Jeeps or vans is 75 percent, compared with the luxury tax on automobiles with smaller engine capacities of 1500 cc or less, which ranges from 10 percent to 30 percent. Passenger cars with engine displacement less than 1500 cc comprise 40 percent of the market, including a large group of vehicles predominantly produced in Indonesia that are taxed at a rate of 10 percent.

In addition to a 10 percent VAT and an import duty of 150 percent, Indonesia charges luxury taxes on imported distilled spirits of 40 percent to 75 percent. The combined effect of these measures, which produces an effective rate of protection of more than 200 percent, is to place imports at a significant disadvantage in Indonesia's market.

## **Value Added Tax Exemptions**

The Indonesian government is considering new value added tax exemptions for selected industries and products, including locally produced raw materials. The U.S. Government will monitor this issue to ensure that any new policies do not discriminate against imports.

## **State Trading**

In April 2008, the Indonesian government announced that the National Logistics Agency (BULOG) would have exclusive authority to import rice for purposes of food security and price management. Imports are not permitted before, during, and immediately after the main harvest period, effectively the first quarter of the year. Private firms can import rice for special purposes only, such as for seed and specialty rice, but they must obtain a special importer identification number issued by the Ministry of Agriculture.

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

In early 2008, the Indonesian government agreed to allow full market access for imports of all U.S. beef and beef products from animals of all ages, but it requires each plant's *halal* processes to be approved prior to their exporting to Indonesia. Indonesia's requirements to obtain these approvals are not transparent and the approval process has not been conducted in a timely manner. The Indonesian government issues import permits to only one importer of U.S. beef. The United States continues to work with Indonesia to address these concerns.

Indonesia continues to enforce a ban on imports of chicken parts, which has been in place since 2000. The U.S. Government has repeatedly raised concerns about this issue, but Indonesia continues to insist that the ban is needed to assure consumers that imports are *halal*. U.S. industry estimates the value of foregone exports at \$10 million or more per year.

The Indonesian government requires that Indonesia's food and drug agency (BPOM) approve every shipment of processed food, food raw materials, and other food-related ingredients. These requirements are burdensome and costly to U.S. exporters. In addition, traders have expressed concern that the regulations covering import packaged food products require testing and disclosure of information on product ingredients and processing that effectively forces them to reveal proprietary business information. Some companies have discontinued or reduced sales to Indonesia as a result of BPOM's enforcement of this requirement.

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In 2007, Indonesia notified its Draft Decree Concerning Food Safety Control for the Import and Export of Fresh Food of Plant Origin to the WTO. To date, the United States has provided four sets of comments expressing concerns with these measures, which require prior notification as well as inspection at point of entry and food safety certificates for imports of fresh food of plant origin. While Indonesia has made changes to some of the provisions in the decree, the United States has outstanding concerns regarding the burdensome nature of the requirements and will continue to work with Indonesia to ensure that implementation of this decree does not hinder U.S. exports.

In 2006, Indonesia issued Decree 37 covering fresh fruit and vegetable imports. The decree inaccurately reflects the presence of pests in the United States and requires imports of fruit fly host commodities to originate from fruit fly free areas or to be treated as a condition of entry. The decree covered 11 U.S. fruit exports, including apples and grapes. In December 2006, following a Ministry of Agriculture inspection visit, Indonesia declared California as a pest-free area for the Mediterranean fruit fly for grapes, opening the way to renewed grape exports.

However, Indonesia still maintains requirements for U.S. apples that do not take into account pest-free production areas in the Pacific Northwest. The United States has raised the issue bilaterally and in WTO meetings, noting that Indonesia still requires treatment for pests that do not exist in the exporting regions or which cannot become established in Indonesian territory. While continuing to argue against the decree, the U.S. Government obtained an interim solution permitting in-transit cold treatment as a pest mitigant and which has led to a resumption of trade. The United States continues to press the Indonesians to agree to a long-term solution. Indonesia is the seventh largest market for U.S. apples, worth over \$24 million in 2007.

### **Biotechnology**

Indonesia has established policies on biotechnology, but it does not appear to have a unified science-based framework to implement its regulations and there is little progress on biotechnology policy development. While some field testing is underway, there are no transgenic seed crops approved for release and Indonesia does not produce any biotechnology crops. The Biosafety and Food Safety Committees are responsible for implementing regulations for biotechnology and initiating assessments for product approvals and it has completed biosafety assessments for biotechnology corn and cotton, and herbicide tolerant corn and soybeans. These products cannot be released into the market until a food safety assessment is completed, but final approval may be given soon, since BPOM issued the Guidelines of Food Safety Assessment on Genetically Modified Product in July 2008.

Indonesia issued a regulation in 1999 requiring a label and a special logo on packaging of food containing transgenic ingredients, but so far it has not enforced it. To date, Indonesia has not issued implementation guidelines due to limited testing capabilities and ongoing discussions about practicalities of implementation. U.S. companies exported about \$800 million in biotechnology products to Indonesia in 2007. With the exception of certain soybean products (soy flour), no trade constraints based on biotechnology content have been introduced or enforced. The United States will continue to highlight the value of biotechnology to Indonesia officials.

### **GOVERNMENT PROCUREMENT**

Indonesia grants special preferences to encourage domestic sourcing and to maximize the use of local content in government projects. Foreign companies are eligible to bid on government procurement projects as part of a joint partnership or as a subcontractor to a domestic firm, but participation is limited to \$5 million. State-owned enterprises that publicly offer shares through the stock exchange are exempt

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from government procurement regulations. Foreign firms bidding on high-value government-sponsored projects report that they have been asked to purchase and export the equivalent value of 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 procurement of goods and services. Over time, the ongoing decentralization of procurement decisions to local and provincial governments may create additional barriers as these authorities adopt their own procurement rules and manage their own procurements. Indonesia is not a signatory to the WTO Agreement on Government Procurement.

## **INTELLECTUAL PROPERTY RIGHTS (IPR)**

Indonesia has been on the Special 301 Watch List since 2006, when it was moved from the Priority Watch List. The United States continues to have serious concerns about IPR protection and enforcement in Indonesia, as widespread optical disc piracy and counterfeiting of consumer goods, including pharmaceuticals, cause significant economic losses and pose serious health and safety concerns for Indonesians. According to some industry estimates, as much as 25 percent of the drugs available for sale in Indonesia are counterfeit. Other problems, including cable piracy and the illegal downloading of copyright works using mobile devices, remain pervasive. The United States continues to raise these concerns with Indonesia and to work with it to strengthen its IPR regime.

### **Intellectual Property Laws**

Indonesia is a member of the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty. However, the Copyright Law of Indonesia includes only minimal provisions dealing with digital copyright issues and it would likely be difficult for rights holders to enforce their rights under these provisions in an Indonesian court.

Despite some improvements to its patent regime, Indonesia continues to need to address issues related to obtaining patent protection, in particular requirements that impose special burdens on foreign rights holders. Chief among these issues is the requirement that an inventor must physically produce a product or utilize a process in Indonesia in order to obtain a patent for that product or process invention.

The U.S. pharmaceutical industry continues to express concerns that Indonesia does not provide protection against unfair commercial use for undisclosed test and other data.

Indonesian law also provides for the protection of well known marks, but lacks effective administrative procedures or legal grounds under which legitimate owners of well known marks can cancel preexisting registrations. 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.

### **Enforcement**

An Optical Disc (OD) Regulation became effective in 2005. The Ministry of Industry leads an interagency OD factory monitoring team that has registered more than thirty factories and, in the last quarter of 2008, launched unannounced inspections of factories.

In recent years, police have been increasing enforcement activities against pirate OD vendors, distributors, and factories. The Jakarta and Surabaya police have been particularly active, seizing and destroying millions of illegal ODs, arresting hundreds of suspects, seizing related equipment, and closing

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production lines. However, the police and prosecutors rarely rely on the copyright law in their enforcement efforts, choosing instead to rely on the film and censor laws or OD regulations, which provide for less stringent sanctions and do not provide for seizure and destruction of related equipment. Despite more than twenty raids on factories between 2003 and 2008, none of the cases successfully prosecuted have resulted in the seizure of related equipment.

In 2007, the Attorney General's Office raised the profile and priority of IPR issues by authorizing the Terrorism and Transnational Crime Task Force to handle IPR cases. These activities have yet to produce a significant increase in prosecutions, deterrent fines and prison sentences, or the permanent impounding or destruction of large scale production equipment used to manufacture pirated products. While the success of recent police enforcement activities has resulted in some decrease in the quantity, quality and availability of pirated ODs, the rate of piracy in Indonesia remains high.

Indonesia's 2001 trademark law raised the maximum fine for criminal trademark violations to 1 billion Rp (\$120,000), but slightly reduced the maximum possible prison term. The Indonesian government continues to justify this change by claiming that financial penalties are a greater deterrent to IPR violators than imprisonment. Foreign rights holders, however, are seeking minimum sentencing guidelines, arguing that IPR cases never result in the maximum possible sentence.

## **SERVICES BARRIERS**

Indonesia maintains significant and far-reaching trade and investment barriers in many key services sectors.

### **Legal Services**

Only Indonesian citizens may practice as lawyers. 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 a local firm.

### **Health Services**

Hospital services are mostly closed to foreign investment according to Indonesia's Negative List for Foreign Investment, though Indonesia does allow for a maximum of 65 percent foreign ownership in hospital services in the cities of Medan and Surabaya. Indonesia also restricts foreign health care professionals from practicing in Indonesia. Foreign-trained physicians only are allowed to supervise and perform procedures in the course of educating Indonesian physicians.

### **Distribution**

Some U.S. direct selling companies have complained that Indonesia's market is generally closed to investment in the direct selling industry. Although Indonesia allows up to 100 percent foreign equity in the distribution and retail sectors, investors must enter into a "partnership agreement" with a small-scale Indonesian enterprise.

### **Financial Services**

Indonesia now allows 99 percent foreign ownership in the banking sector, but Indonesia has not revised its WTO services commitments; financial services remain bound at 52 percent in its GATS schedule.

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Financial service providers may not establish as a branch. In the insurance sector, the 2007 investment law introduced a new foreign equity cap of 80 percent for new investors.

### **Audit and 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. Foreign directors, managers, and technical experts/advisors, unless mentioned otherwise, are allowed a maximum stay of two years, with a possible one year extension. Licensed accountants must be Indonesian citizens. A Ministry of Finance decree requires a five year limit on general audits by a single accounting firm. While many countries require the rotation of an audit partner, many U.S. companies consider the mandatory audit firm rotation overly burdensome. Auditors practicing in the capital markets are prohibited from delivering specified non-audit services such as consulting, bookkeeping, and information system design.

### **Audiovisual**

In late 2008, the Minister of Culture and Tourism issued a regulation requiring all local and imported movies – both theatrical prints and home video copies – to be duplicated locally with penalties on exhibitors for failing to do so. Foreign investment is prohibited in broadcast and media sectors, including film and video production and distribution, and cinema construction and operation. Foreign investment in the provision of radio and television broadcasting services, radio and television broadcasting subscription services and media print information services also is prohibited.

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

Foreign construction firms only are 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**

Indonesia permits up to 65 percent foreign ownership in value added and mobile telecommunications services and up to 49 percent for fixed networks. While this foreign ownership level goes beyond Indonesia's current commitments in its WTO GATS schedule, the new limits on fixed services represent a step backward from recent practice where up to 95 percent ownership was permitted.

A Ministry of Communications and Informatics decree issued in early 2008 restricts the construction, management, and ownership of cell towers to domestic companies and would force existing investors to exit the market within two years. The United States has registered its serious concerns to Indonesia about the decree and is seeking its withdrawal.

### **INVESTMENT BARRIERS**

Indonesia maintains significant and far-reaching foreign investment restrictions despite some improvements in recent years. Its investment climate continues to be characterized by legal uncertainty and economic nationalism, and influential domestic interests continue to tightly control many profitable sectors and business opportunities. In recent years, an ongoing process of decentralization, intended to reduce burdensome bureaucratic procedures by moving decisions from the central government to

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provincial and district-level governments, has produced uneven results. Some local governments have capitalized on decentralization to attract foreign business and improve social services, while others have imposed new restrictive practices and taken actions that conflict with national laws.

In an attempt to improve its foreign investment climate, Indonesia introduced a new investment law in 2007 that provided much-needed improvements in transparency, as well as a range of investor protections, including nondiscriminatory treatment, protection against expropriation, and recourse to international arbitration in disputes against the government. At the same time, however, the new law significantly increased the number of sectors in which foreign investment is restricted, and increased foreign equity limitations in sectors of interest to U.S. investors, including in telecommunications, pharmaceutical manufacturing, and construction.

The 2007 investment law and "negative list" of restricted sectors remain under review. Although Indonesian officials have provided assurances that the investment law would only apply to new investments, Indonesia appears to be allowing for retroactive effect in practice. Moreover, despite the fact that one of the intended purposes of the new law was to enhance transparency regarding Indonesia's investment regime, it is unclear whether the negative list represents the full range of sectors where investment restrictions apply. Several ministries, including the Ministries of Communications and Informatics, Health, and Culture and Tourism, have issued decrees in recent months that introduce new investment restrictions in their respective sectors. The United States continues to urge Indonesia to enhance the transparency and openness of its investment regime, and to address specific problems and concerns of U.S. investors.

### **Pharmaceuticals**

The United States has serious concerns about the deteriorating business climate in Indonesia's pharmaceutical sector. Although the new investment law states that companies doing business in Indonesia prior to the introduction of the negative list should be covered by grandfathering provisions, there is concern that Indonesian authorities may take the position that any changes in the shareholding capital or ownership structure of an existing company will trigger new foreign equity restrictions, meaning foreign equity in the firm must be reduced to 75 percent and a domestic partner identified to acquire the remaining 25 percent.

### **Energy and Mining**

Several regulatory changes have been introduced to increase government control of the sector and generate greater royalties to the government.

Indonesia enacted a new mining law in December 2008, replacing the current "Contract of Work" system with a system of mining licensing. The legislation creates new risks and burdens for investors. The new law makes investment subject to all future changes in tax and royalties and allows central and local governments to cancel licenses. Mining companies must give preference to hiring local subcontractors and service companies, and are required to process and smelt ore domestically. The new law also reintroduces divestment requirements on foreign investment, a practice which has led to investment disputes in the past. Although the new legislation does not require the conversion of existing contracts to licenses, it does mandate unspecified changes to existing contracts to comply with the new law.

Also in 2008, some foreign coal purchasers saw their long-term contracts nullified when the Energy and Mineral Resources Department ordered private Indonesian coal mining firms to renegotiate sales contracts with foreign buyers if the contracts involved long-term fixed price arrangements and the sale

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prices were below a government-determined benchmark price. Indonesian coal mining firms have stopped shipments in cases where foreign buyers have been unwilling or unable to renegotiate their contracts. In addition, throughout the mining sector, companies report problems importing exploration and production equipment free of duties or VAT, as per the terms of their contracts.

#### **OTHER BARRIERS**

The Indonesian government and in particular the Corruption Eradication Commission, which coordinates anticorruption efforts and has the authority to investigate and prosecute high-level corruption cases, continues to address the widespread corruption problem in the country. Still, foreign companies continue to report corruption-related difficulties in Indonesia, including demands for unwarranted fees to obtain required permits or licenses, expedite processes, or to influence government awards of contracts and concessions. The integrity of the legal system remains a concern, particularly for investors and companies drawn into disputes with local partners. The foreign investors and companies complain that the courts can be inefficient and corrupt.

U.S. industry reports that illegal logging activity in Indonesia results in lost trade opportunities for U.S. producers in Indonesia and third-country markets. In addition, the illegal activity results in lost revenue to the Indonesian government as well as significant environmental damage. Indonesia recognizes the seriousness of the issue and is taking steps to address it, including by working with the United States under the auspices of a 2006 Memorandum of Understanding on Combating Illegal Logging and Associated Trade. Under this agreement, the two governments held three meetings last year and are developing a multi-year action plan to address the trade aspects of the illegal logging problem.