

INDONESIA

TRADE SUMMARY

In 2000, the U.S. trade deficit with Indonesia was \$7.8 billion, an increase of \$264 million from the U.S. trade deficit of nearly \$7.6 billion in 1999. U.S. merchandise exports to Indonesia totaled nearly \$2.6 billion, an increase of \$608 million (31.4 percent) from the level of U.S. exports to Indonesia in 1999. The stock of U.S. foreign direct investment (FDI) in Indonesia at the end of 1999 was \$10.5 billion, an increase of 32.7 percent from the level a year earlier. U.S. FDI in Indonesia is concentrated largely in the petroleum, finance and banking sectors.

U.S. exports of private commercial services (i.e., excluding military and government) to Indonesia were 1.56 billion in 1999, and U.S. imports were \$338 million. Indonesia was the United States' 37th largest export market in 2000. U.S. imports from Indonesia totaled \$10.4 billion in 2000, an increase of \$872 million (9.2 percent) from the level of imports in 1999.

OVERVIEW

Economic growth returned to Indonesia in 2000, after two years of economic and political turmoil. Real gross domestic product (GDP) grew more than 4 percent in 2000, after contracting 13.2 percent in 1998 and growing a mere 0.10 percent in 1999. Nonetheless, doubts remain about the sustainability of Indonesia's economic recovery. New investment has lagged considerably as continuing political turbulence and growing politically related violence have kept investors away. Economic growth in 2000, was largely the result of buoyant consumer demand and booming exports.

Early in the economic crisis, the Government of Indonesia (GOI) turned to the International Monetary Fund (IMF) for assistance. Since late 1997, IMF-supported economic reform programs have promoted internal restructuring and reform. The latest GOI Memorandum of

Economic and Financial Policies (MEFP) with the IMF was signed on September 7, 2000. However, implementation of commitments under the MEFP has fallen behind schedule. As of the end of 2000, the GOI and IMF had not completed the third (since October 1999) review of Indonesia's three-year, \$5 billion program. Key program topics included monetary and fiscal sustainability, financial sector reform and supervision, corporate debt restructuring and governance, central bank independence and development of sound regulatory regimes. Immediate concerns included rising inflation expectations and implementation of political and fiscal decentralization introduced on January 1, 2001.

On the trade side, protectionist habits have begun to revive. Powerful economic interests have begun to push the government to reinstate policies that were dismantled in the early stages of the crisis. Notable among these, were policies related to rice and sugar (see section on Quantitative Restrictions). Other major concerns recently articulated by U.S. industry include: the absence of a transparent and predictable regulatory environment, including with respect to the issuance of licenses and administrative rules; arbitrary and inconsistent interpretation and enforcement of laws by governmental authorities and entities; irregularities in certain government procurement tenders; and ineffective enforcement of intellectual property rights. Other problems include widespread corruption and an ineffective judicial system. Commercial dealings in Indonesia are impaired by a host of uncertainties, including an underdeveloped legal system, non-existent credit reporting, and underdeveloped capital markets.

IMPORT POLICIES

As of January 2000, more than 60 percent of Indonesia's tariff lines were assessed import duties ranging between zero and five percent. Following tariff rate reductions on 708 tariff lines, Indonesia's average unweighted applied

INDONESIA

tariff was 8.3 percent in 2000, compared to 20 percent in 1994. As part of the January 1998 IMF program, Indonesia committed to reduce tariffs and eliminate all existing non-tariff barriers, except those established for health or safety reasons, by the end of the program period in November 2001. Indonesia further committed to establish by the end of 2003 a three-tier tariff structure (zero, five and ten percent) for all goods, except automobiles and alcoholic beverages.

In the Uruguay Round market access negotiations, Indonesia committed to bind 94.6 percent of its tariff schedule and most tariffs are bound at 40 percent. Products for which tariff bindings exceed 40 percent, or which are unbound, include certain agricultural products, 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 1999. In accordance with the WTO Agreement on Agriculture, Indonesia agreed to eliminate non-tariff barriers on agricultural products, and replace them with tariffs. Many agricultural products have bindings above 40 percent, including the most sensitive and heavily protected sectors. Local content regulations on dairy products were eliminated on February 1, 1998.

Effective January 1, 2000, Indonesia implemented another stage of its commitments under the ASEAN Free Trade Agreement (AFTA) reducing tariffs on 7,176 tariff lines to five percent or less for products of at least 65% ASEAN origin. AFTA is to be fully implemented by January 1, 2003. In June 2000, the government also implemented the next stage of its multi-stage 1996 tariff reduction program, cutting tariffs on 708 tariff lines in 22 product sectors. This package implemented Indonesia's final commitments under the 1996 WTO Information Technology Agreement (ITA).

On January 11, 2001, the GOI reduced tariffs by 5 percentage points on 1,279 more tariff lines. Of those, the majority, or 769, were reduced to 10% or below. Nevertheless, some products continue to attract high imports duties, often exacerbated by additional taxes or charges. For example, motorcycles face customs duties of 60% and luxury taxes of 50%.

One U.S. company has expressed its strong concerns over the possible impact of new regulations for the import and distribution of a long list of dangerous items on their continued access to the Indonesian market. Although a stated purpose of the new regulations is to protect the public's health, Indonesia's implementation essentially eliminates the option U.S. companies previously had to export through the Indonesian importers/distributors of their own choosing—a restriction unrelated to legitimate health concerns. By funneling those imports through a state-owned trading company, PT Dharma Niaga, the regulations increase Dharma's control over the market. The U.S. company fears that the increased opportunity of the state-owned enterprise to dominate imports and to set market prices will diminish the market access they previously enjoyed. This regulation will affect only sales to smaller consumers. Large-scale consumers may still import directly for their own use.

Quantitative Restrictions

Prior to the conclusion of Indonesia's initial stabilization program with the IMF in 1997, the sole importer and distributor of major bulk food commodities, such as wheat, rice, sugar, and soybeans, was the National Logistics Agency (BULOG), a state trading entity. Prices for these commodities were often higher than world market prices. Effective September 1998, the role of BULOG was sharply curtailed. BULOG's major remaining responsibility is to maintain the country's rice stabilization program. In late 1999, the government further minimized BULOG's role by removing and

INDONESIA

replacing its temporary monopoly over importation of rice with a temporary tariff of 430 Rupiah per kilogram, which corresponded to an effective tariff rate of 30 percent, based on January 2000 exchange rates. The GOI also placed a 20-25 percent tariff on sugar. Under the MEFP, the government committed to reviewing this tariff after six months. As of year-end 2000, it remained in place. In conjunction with the minimization of BULOG's authority and role, private companies are now permitted to import rice, wheat, wheat flour, soybeans, garlic, and sugar. Tariffs are now zero except for sugar and rice as mentioned above.

New restrictions on agricultural trade were of increasing concern in 2000. In late September, the GOI, through its Directorate General of Livestock Services, issued a directive banning imports of chicken parts. The Ministry of Agriculture stated that the ban was necessary to protect the domestic industry, and to assure consumers that imports were halal (produced in accordance with Islamic practices). The United States has worked closely with Indonesian religious authorities to license specific U.S. meat producers as halal and disputed the evidence presented in support of the ban. It requested the ban be lifted but the GOI has not done so.

The GOI imposes de facto quantitative restrictions on imports of meat and poultry products by requiring an Importer Letter of Recommendation ("Surat Rekomendasi Importir") before importers can import these products. In approving such a request the GOI can arbitrarily alter the quantity allowed to enter. The United States believes the government uses this procedure as a way to limit imports.

In the MEFP, Indonesia reaffirmed its commitment to phase out all quantitative import restrictions (except those established by international agreement) by November 2001.

Remaining quantitative restrictions apply to wines and distilled spirits, of which the majority of imports are allocated for duty-free stores. In addition, a 170% import duty and 35% VAT are imposed on wine and spirits.

Import Licensing and Customs Procedures

Indonesia continues to use import restrictions and special licensing requirements, but it has reduced the number of products subject to these restrictions. For example, approximately 141 tariff lines are subject to import licensing restrictions, which is a concrete reduction from 261 tariff lines in 1994, and 1,112 tariff lines in 1990.

For imported goods that continue to be regulated, import licenses for specific categories of products are allocated to certain types of importers, as follows (the number of tariff lines within a product category for which licenses are required are reflected in parentheses): "registered importers" are eligible to seek licenses to import alcoholic beverages (27 lines) and hand tools (6 lines); "producing importers" are eligible to seek licenses to import artificial sweeteners (3 lines), dangerous goods (30 lines), metal bromide (1 line), salt and plastic raw material (8 lines), and scrap materials (59 lines). Pertamina, the state oil company, alone may import lube oil (3 lines); and PT Dahana, a state-affiliated company, alone may import explosives (4 lines).

Indonesia's obligations under the WTO Customs Valuation Agreement took effect on January 1, 2000, but WTO records show that Indonesia has not yet notified its legislation nor the Customs Valuation Checklist to the WTO Committee on Customs Valuation.

STANDARDS, TESTING, LABELING AND CERTIFICATION

A May 1990, decree requires that the Ministry of Health respond to applications to register

INDONESIA

new, foreign pharmaceuticals within one year of receipt of an application. In practice, however, the registration process takes much longer. In response to complaints from foreign pharmaceutical firms about the pace of new registration approvals, the GOI implemented new procedures allowing accelerated registration of products approved for use by U.S., European, or Japanese health safety authorities. Industry is still evaluating the impact of the new regulations. Pirated pharmaceutical products sometimes become available in the local market before legitimate products are registered and approved for sale.

As of July 2000, under provision of the Consumer Protection Law of 1998, all consumer foods, including distilled spirits, must undergo a product registration process with the Ministry of Health. U.S. industry reports the process is costly, complex and barrier-laden. Further, requirements to provide extremely detailed information on product ingredients and processing infringe upon proprietary information and are leading exporters to discontinue sales.

Under provisions of the same law, the GOI issued new food labeling and advertising regulations that came into force in January 2001. The regulations require labeling in the Indonesian language on all consumer products. U.S. exporters do not believe such labeling will be cost effective for smaller volume products. Industry estimates that less than \$10 million in exports of canned fruits and vegetables, juices, and other consumer items could be affected.

New Indonesian regulations, which took effect on January 25, 2001, will require labels identifying food containing "Genetically Engineered" ingredients and "Irradiated" ingredients. Industry estimates that sales of around \$210 million in soybeans and soybean meal would be affected.

GOVERNMENT PROCUREMENT

Indonesia is not a party to the WTO Government Procurement Agreement. In February 2000, the government issued presidential decree No. 18/2000, which updated the current Indonesian law on government procurement of 1994. The decree reaffirmed the special preferences given to domestic sourcing, implemented new ethics guidelines for procurement officials (although the decree lacks detailed enforcement rules), established set asides for small- and medium-sized enterprises, and special rules for consulting services to government agencies.

Most large government contracts are financed by bilateral or multilateral donors, each of which imposes its own procurement requirements. For large, government-funded projects, international competitive bidding practices must be followed. The government seeks concessional financing for most procurement projects. Since the fall of the Soeharto government in May 1998, there have been a number of investigations of possible procurement and contracting irregularities in response to domestic demands to eradicate corruption, collusion, and nepotism. 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). Irregularities in procurement procedures were identified as major problems, but no legal actions have been taken against alleged perpetrators. The GOI has committed to gradually expand the audit process to encompass other major state enterprises.

Foreign firms bidding on high value government-sponsored construction or procurement projects are periodically 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

INDONESIA

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. Pertamina regulates the imports of all materials for use by the oil and gas sector.

There are periodic complaints about irregularities in the administration of certain Indonesian government tenders. In 2000, complaints were received about tenders for the purchase of banknote paper by Bank Indonesia and for telecommunications equipment by the state-owned telecommunications companies PT Telkom and Indosat. Industry estimates of the trade impact of these cases is \$10 million per year in the bank note paper case, \$70 million in the PT Telkom case, and \$110 million in the Indosat case.

EXPORT SUBSIDIES

From 1992 to 1999, the Indonesian government offered rediscount facilities for "special exporters." The program had previously been restricted to certain industries; however, in January 1999, its coverage was extended to exporters from all industries. The program lapsed in 1999, amid administrative disagreements between Bank Indonesia and the Ministry of Finance, and has not been revived. The government grants duty exemptions on capital equipment imports that are contingent on export and also maintains several credit programs that provide subsidized loans, primarily to agriculture and small and medium businesses. The entire structure of subsidized credits is undergoing significant change as economic reforms proceed.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

Under the "Special 301" provisions of the 1974 Trade Act, as amended, the U.S. Trade

Representative placed Indonesia on the "Watch List" in April 2000. Indonesia missed the January 1, 2000, deadline to be fully compliant with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Nevertheless, in June 2000, Indonesia underwent a TRIPS council review of its IPR regime and Indonesian IPR authorities spent much of the year working to pass new laws in the areas of trade secrets, industrial design and integrated circuits to move the country toward full TRIPS compliance. The Indonesian parliament passed those laws in December 2000. As of the end of 2000, the United States was reviewing them to determine whether they are TRIPS-compliant. The GOI is also considering amendments to existing patent, trademark and copyright laws, and a law on plant varieties.

IPR protection shortcomings raised by industry include: rampant software, audio, and video disk piracy; pharmaceutical patent infringement; apparel trademark counterfeiting; an inconsistent and ineffective IPR enforcement regime; and an ineffective legal/judicial system. The Indonesian government has on several occasions responded to U.S. companies that raise specific complaints about IPR infringement. However the judicial process and remedies cannot be relied upon to enforce intellectual property rights or to deter future violations. The lack of effective IPR protections and enforcement serves as a considerable disincentive for foreign investment in high technology projects in Indonesia.

Indonesia is a member of the World Intellectual Property Organization (WIPO) and has acceded to numerous international conventions on intellectual property. 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

INDONESIA

Unclassified Goods and Services, and the Strasbourg Agreement Concerning the International Patent Classification. Indonesia is not a party to the WIPO Performances and Phonograms Treaty.

Copyrights

In 1997, Indonesia enacted amendments to its copyright law that brought it into closer conformity with international standards for copyright protection. The law currently includes provisions that establish a rental right in the areas of audiovisual, cinematographic, and computer software, which are protected as literary works. The law also accords licensing rights, new protections for neighboring rights in sound recordings, and rights to producers of phonograms. It also increased the term of protection for many copyrighted works to 50 years, as required by the TRIPS Agreement. A bilateral copyright agreement between the United States and Indonesia that entered into force in August 1989, extended national treatment for copyright protection to works created by citizens of each country.

The Indonesian government periodically steps up enforcement efforts against copyright piracy and consults with copyright holders and associations in order to prioritize its efforts. Nevertheless, Indonesia's overall record for copyright enforcement is poor. Piracy of video compact discs (VCDs) in Indonesia is rampant and this has disrupted the market for cinemas and for the sale and rental of legitimate products. Periodic raids result in the seizure of sizable amounts of pirate optical disc (OD) products; one at a factory on Batam island in January 2000, included large amounts of Microsoft software intended for export. However, none of these cases resulted in meaningful penalties on pirates, or even permanent impoundment of equipment used to manufacture pirated products. According to U.S. industry estimates, total losses from copyright piracy in Indonesia during 2000 were

approximately \$200 million. U.S. book publishers, in particular, remain concerned over book piracy in Indonesia. Of primary concern is commercial pirates that run large operations, which produce and market unauthorized translations of U.S. books and copy shops in and around universities, which have dramatically increased the volume of their piracy.

Patents

Indonesia's first patent law went into effect on August 1, 1991. Amendments enacted in 1997, improved patent protection in key respects. The term of protection has been extended to 20 years with a possible two-year extension. The amendments provided that 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. Indonesia provides product patent protection for foods and beverages.

Some aspects of Indonesia's patent law confer rights that are not required by the TRIPS Agreement. For example, the definition of the term "patent examiner" was expanded to include examiners in other industrial property offices. This could facilitate work-sharing in the search and examination process. Also, the exclusion from patentability for plant and animal varieties was rescinded. The Indonesian government is now drafting a specific law to protect animal and plant varieties.

Unfortunately, some of the weaknesses in the previous law, which were not corrected by the 1997 amendment, have presented new problems. Importation still does not appear to satisfy the requirement that a patent holder must "work" or exploit the invention domestically. The right to prevent importation of products made by patented processes is available only if the process is also worked in Indonesia. The rules on content of voluntary patent licenses appear to

INDONESIA

be more restrictive than is permitted by the TRIPS Agreement. Moreover, government use of patented inventions is an additional concern. Inventions that are contrary to Indonesian laws and regulations are excluded from patentability, and the standard for excluding inventions contrary to the public interest appears to be inconsistent with TRIPS requirements.

Trademarks

The April 1993 trademark law provides for determination of trademark rights by priority of registration, rather than by priority of commercial use. The law provides for protection of well-known marks, but offers no administrative procedures or legal basis by which legitimate owners of well-known marks can cancel pre-existing registrations. Currently, the only avenue for challenging existing trademark registrations in Indonesia is to bring a court challenge, which is an unreliable and burdensome undertaking that must be initiated within five years from the date of the disputed registration. U.S. companies have found it difficult to protect their well-known marks, since judicial and administrative processes can be very time-consuming and unreliable. Injunctive relief is not provided, even when a lower court invalidates false trademark registrations.

The 1997 amendments to the trademark law enhanced protection by providing for administrative cancellation of registrations competing with well-known marks. However, as a practical matter, rights-holders continue to have difficulty enforcing this provision, either administratively or judicially.

SERVICES BARRIERS

Despite relaxation of some restrictions, particularly in the financial sector, services trade barriers continue to exist in many sectors. Foreign accounting firms must operate through technical assistance arrangements with local

firms, and citizenship is a requirement for licensing as an accountant. Foreign agents and auditors may act only as consultants and cannot sign audit reports. Foreign law firms cannot establish a legal practice in Indonesia. Indonesian citizenship, as well as graduation from an Indonesian legal facility or other recognized institution, is required for admittance to the bar. Foreign consulting engineers can operate only by forming a joint venture with local partners in Indonesia.

Distribution

Indonesia has been gradually liberalizing the distribution services sector, and its agreement with the IMF calls for elimination of restrictions on trade in the domestic market. In February 1998, restrictive marketing arrangements for cement, paper, cloves and other spices, and plywood were eliminated. Indonesia has begun opening the wholesale and retail trade sectors to foreign investment. In September 1998, the government issued a decree eliminating the former 49 percent ceiling on foreign equity and allowing up to 100 percent foreign equity in the distribution and retail sectors, under the condition that the investor enter into a "partnership agreement" with a small scale enterprise. This partnership agreement need not involve an equity stake in the project. The film sector is not included in 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.)

The state oil and gas company, Pertamina, controls all refining, distribution and marketing of final products to consumers. The Indonesian government, however, has stated its intention to deregulate the downstream sector.

Indonesia's Hardwood Plywood Marketing Board (APKINDO) was abolished as a marketing cartel on February 1, 1998. There are

INDONESIA

no longer any restrictions on pricing, product mix or shipping arrangements.

Financial Services

In the December 1997 WTO Financial Services Agreement, Indonesia committed to allow 100 percent foreign ownership for non-bank financial companies that are publicly listed, including insurance and securities firms. The government also guaranteed the access of existing financial services firms in its market. Restrictions on joint venture banks, where the foreign ownership limit was 85 percent, were retained in the WTO offer. Multi-finance companies with foreign partners are required to deposit 100 percent more paid-in capital than domestically owned multi-finance companies. However, in November 1998, amendments to the 1992 banking law were enacted that allow 100-percent foreign ownership of Indonesian banks. All insurance policies in Indonesia must be purchased from either a domestic or joint venture company. The only exceptions to this requirement are where specific coverage is unavailable in Indonesia or where the insured is a wholly foreign-owned entity.

Banking

The Government completed its Rp 476 trillion (\$53 billion) bank recapitalization program in October 2000, with the recapitalization of Bank Bali. Sixteen banks received recapitalization bonds, with the four state banks (Bank Mandiri, BNI, BRI, and BTN) receiving more than 58 percent of total bonds issued. That same month, the Government announced that, because of weak market conditions, it would postpone its divestment of two other banks nationalized in the early days of the financial crisis, Bank Central Asia and Bank Niaga. The Indonesian Bank Restructuring Agency took over both formerly private banks in 1999, and recapitalized them after they fell below capital adequacy standards. Divestment of the two banks by the end of 2000, is a key performance

criterion in Indonesia's IMF program, and the GOI and IMF continue to discuss how to proceed with the divestments. The government lifted restrictions on branching and sub-branching for joint venture banks and foreign branches in 1998.

Securities

In 1998, the 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 reserved to 100-percent Indonesian-owned 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 necessary payments also act as barriers to the film industry. In October 1999, the government abolished the Ministry of Information, which had previously regulated market access for foreign motion pictures.

Film imports at present are undertaken by around 30 local companies (increased from the eleven members of the Government approved Film Import Association after the closure of the Ministry of Information) that import Western, Chinese and other Asian films. Importer companies or their nominees who are licensed by the GOI as distribution companies undertake film distribution. The Film Law prohibits importers from distributing the product they import although this regulation is not being enforced and many importers directly distribute the product they import.

INDONESIA

Telecommunications Services

Indonesia's commitments under the WTO Basic Telecommunications Agreement were modest. The government committed to a maximum foreign investment limit of 35 percent for telecommunications services companies, but did adopt the WTO Reference Paper on pro-competitive regulatory principles.

Indonesia's new Telecommunications Law took effect on September 8, 2000. It phases out the exclusive rights of PT Indosat and Satelindo for international calling service and PT Telkom for domestic long distance service and local fixed-line service. The Ministry of Communications announced implementing regulations for the new law, and under the decree, the current domestic basic service monopoly would become a duopoly. PT Telkom would lose its monopoly over local fixed-line service eight years ahead of schedule early in 2002, and the long distance providers would lose their exclusive rights in 2003, rather than 2005. The new law drops the previous requirement that prospective foreign investors partner with a state-owned enterprise or enter into a revenue-sharing arrangement.

INVESTMENT BARRIERS

The Indonesian government states that it is interested in attracting and increasing foreign investment, which it hopes to accomplish by reducing burdensome bureaucratic procedures and other requirements on foreign investors. Indonesian law provides for both 100-percent direct foreign investment projects and joint ventures with a minimum Indonesian equity of five percent. In 1998, the government opened several previously restricted sectors to foreign investment, including harbors, electricity generation, telecommunications, shipping, airlines, railways, roads, and water supply.

Indonesia maintains restrictions on investment in some sectors and closes others completely to foreign investment. These restrictions are

implemented through a "negative list." On August 4, 2000, the GOI released the most recent version of the negative list. Although the new list opened some sectors, particularly certain medical services, to foreign investors, the biggest surprise was the extension of the prohibition on foreign investment in print and broadcast media to include "multimedia services", defined as Internet services and e-commerce. Since all of the major Indonesian-language Internet portals in operation are joint ventures with significant foreign equity, this provision caused substantial uproar from current investors. The government rescinded the ban two weeks later. The film industry remains off limits to foreign investors.

The new list does open the medical services industry to projects that are 95-percent foreign owned, and specifies that foreign ownership is allowed under certain very restrictive circumstances in other sectors that were previously closed to foreign investors.

Foreign equity investment is primarily governed by the Foreign Capital Investment Law of 1967, as well as by presidential and ministerial decrees. The Capital Investment Coordinating Board (BKPM) and other relevant agencies must approve most proposed foreign investments in Indonesia. Obtaining the required permits, however, can be cumbersome and time-consuming, as BKPM lacks centralized authority to issue such permits, requiring investors to deal with considerable red tape. Specific laws and regulations that are administered by various specialized technical agencies, rather than BKPM, cover investment in petroleum extraction, mining, forestry, and banking. Joint ventures with a majority Indonesian share, or in which Indonesians own 45 percent of shares with at least 20 percent of total stock sold through the Indonesian stock market, are treated as domestic companies for certain purposes. This arrangement provides the ability to borrow short-term working capital in rupiah from state banks.

INDONESIA

On January 1, 2001, Indonesia began to implement a large-scale decentralization of authority and finances from the central government to the province and district level governments. This policy was established under Laws 22/1999 and 25/1999. Many foreign investors are concerned about the impact of decentralization on their operations.

In the MEFP, the Indonesian government committed to rationalizing its policies toward tax holidays and tax-free zones, and to eliminate “unnecessary” exemptions to the value-added tax (VAT).

Investors view resolution of contract issues as an important sign of how foreign direct investment will be treated. The sectors in which contract disputes are most prominent are electricity and telecommunications.

Trade-Related Investment Measures

In 1995, pursuant to the WTO Agreement on Trade Related Investment Measures (TRIMS), Indonesia notified the maintenance of local content requirements to promote investment in several sectors, including the fresh milk and cream, utility boiler equipment, and soybean cake industries. Proper notification allowed developing-country WTO members to maintain such measures for a five-year transitional period, ending January 1, 2000. Indonesia eliminated measures applicable to soybean cake in 1996 and to dairy products in 1998.

Automotive Policies

On June 24, 1999, the Indonesian government announced a major revision of its national automotive policies, designed to use market forces to foster a more efficient and globally competitive automotive industry. The government, in particular, seeks to promote a component sector geared to supply both local and foreign manufacturers.

The new policy eliminates tariff and tax incentives for local content from the now defunct 1993 and 1996 “national car” policies. The Indonesian government substantially lowered tariff rates in all market segments for motor vehicles. The maximum tariff was reduced from 200 to 80 percent. Tariffs on kits imported for assembly, which had ranged from zero to 65 percent, are now a flat 25 percent for all but passenger cars, which are 35, 40 or 50 percent depending on engine size. The tariff schedule for auto components and parts imported for local assembly has also been simplified to a flat rate 15 percent for imported parts for passenger cars and minivans. Like tariffs, luxury taxes have generally been lowered across the board. The Indonesian government has also lifted the previous regulations under which only registered importers or sole agents of foreign automakers could import vehicles. The current policy framework permits any licensed general importer to import automobiles without special permission, and relaxes certain regulations related to bonded warehouse zones for the automotive industry.

In January 2001, Indonesia raised the luxury taxes on sedans and 4x4's with engine sizes above 4000 cc from 50 to 75 percent. The GOI has been concerned with the rising number of luxury imports in the midst of the continued economic crisis.

ELECTRONIC COMMERCE

While there has been a proliferation of Internet service providers in recent years, several factors hinder the growth of electronic commerce in Indonesia. These include: the limited availability of access to fixed land lines controlled by the monopoly domestic telecommunication provider; a low level of computer ownership, by both business and individuals; and the lack of a regulatory infrastructure to support electronic commerce. In particular, U.S. industry has identified the lack of a legal framework for ensuring security

INDONESIA

of on-line transactions as a major impediment to the growth of electronic commerce. The GOI is currently drafting a cyber law to address issues related to e-commerce.

OTHER BARRIERS

Transparency

A pervasive lack of transparency and widespread corruption are significant problems for companies doing business in Indonesia. Corruption was endemic under the former Soeharto regime, and remains an enormous problem for foreign companies in the new reform era. Demands for irregular and non-transparent fees to obtain required permits or licenses, government awards of contracts and concessions based on personal relations, and a legal system that is often arbitrary and for sale are frequently cited problems. Much of the substantial deregulation introduced since late 1997, and popular demands for investigations into corrupt, collusive, and nepotistic practices are aimed at tackling some of the problems that either countenance these problems or have arisen from them. There is concern that political and fiscal decentralization will increase the problem both quantitatively and geographically.

Since the fall of Soeharto, the Indonesian government has made efforts to address these concerns. It passed a number of laws designed to address corruption, in particular among government officials. The most visible action was the passage of Law No. 28/1999, which established stiffer penalties for corruption and an independent commission with the power to investigate and audit the wealth of senior government officials. The law came into effect in November 1999, but has yet to be fully implemented. Another law, which established an Anti-Corruption Commission, is to take effect in March 2001. Although a newly freed press has reported a number of high profile corruption cases from several administrations, to

date, few individuals have been prosecuted and of those, even fewer have been convicted.