INDONESIA

TRADE SUMMARY

The U.S. goods trade deficit with Indonesia was $9.0 billion in 2005, an increase of $832 million from $8.1 billion in 2004. U.S. goods exports in 2005 were $3.0 billion, up 14.0 percent from the previous year. Corresponding U.S. imports from Indonesia were $12.0 billion, up 11.2 percent. Indonesia is currently the 39th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Indonesia were $1.1 billion in 2004 (latest data available), and U.S. imports were $323 million. Sales of services in Indonesia by majority U.S.-owned affiliates were $1.1 billion in 2003 (latest data available), while sales of services in the United States by majority Indonesia-owned firms were $28 million.

The stock of U.S. foreign direct investment (FDI) in Indonesia in 2004 was not available, $10.5 billion in 2001. U.S. FDI in Indonesia is concentrated largely in contracted largely in the mining sector.

OVERVIEW

Since taking office on October 20, 2004, President Susilo Bambang Yudhoyono, Indonesia's first directly-elected leader, has pursued plans to improve Indonesia's business climate and regional competitiveness; attract greater foreign and domestic investment, especially in infrastructure and export sectors; and generate high-quality job growth needed for sustained economic development. In support of this effort, President Yudhoyono has called for Indonesia to reassert itself within bilateral, regional and multilateral trade forums and negotiations with the aim of expanding international markets for Indonesian products and supporting global efforts to liberalize trade while protecting Indonesia's economic interests. A Presidential Decree revitalized the National Team for Increasing Exports and Investment (PEPI), established in 2003, with President Yudhoyono as its Chairman. An October 18, 2005, Presidential Decree established an interagency Indonesian National Trade Negotiation Team, with the Coordinating Minister for the Economy and the Minister of Trade as its chair and deputy chair, respectively. Both teams have overarching goals to improve coordination of Government of Indonesia (GOI) strategies and positions in trade dialogues and negotiations, and to facilitate the development of strategic sectors.

Minister of Trade Mari Pangestu announced in the early days of the Yudhoyono Administration a comprehensive trade policy review aimed at dismantling protectionist measures of previous administrations, rationalizing and harmonizing tariffs, and gradually removing bans and quotas and lowering tariffs. As part of this review, Indonesia's Team Tariff, an interagency body responsible for reviewing tariff and non-tariff measures, announced in December 2004 the completion of the first phase of a comprehensive Tariff Harmonization Program.

President Yudhoyono’s focus on improving Indonesia’s business climate and competitiveness address some of U.S. industry's continuing concerns over the wide range of business problems it encounters in Indonesia, 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 business problems 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. The Yudhoyono Administration has focused its reform agenda first on revising Indonesia’s investment, tax, customs and labor laws; undertaking an effective anti-corruption campaign; and laying the foundation for judicial and civil service reform. President Yudhoyono’s anti-corruption campaign has netted several high-ranking government officials and is widely viewed as the first credible effort of its kind in Indonesia. Two other priorities for Indonesia in 2005 were recovery from a massive earthquake and tsunami that struck the nation on December 26, 2004, and the successful negotiation of a peace agreement with rebels in the Aceh region.

Investment gradually replaced consumption as a driver of growth in the first half of 2005, a sign that the business climate was beginning to improve. In August 2005, however, record world fuel prices raised concerns about the cost of Indonesia’s domestic fuel subsidy program and doubts about underlying fiscal budget assumptions. Subsequent declining foreign exchange reserves and a depreciating currency caused the government to tighten monetary policy and dramatically reduce the fuel subsidy, which increased fuel prices. In the short term, these measures could dampen economic growth and create political difficulties. In the long-term, the reduction and eventual abolition of fuel subsidies should allow for greater public sector investment in basic social services and infrastructure.

The Indonesian government generally has adhered to its long-term trade liberalization program, and the Yudhoyono Administration has actively pursued greater access to global markets through bilateral, regional and multilateral agreements. For example, Indonesia and Japan held three rounds of Economic Partnership Agreement talks in 2005, and Indonesia is in FTA talks with Australia and China. Indonesia fully implemented the final stage of its commitments under the ASEAN Free Trade Agreement (AFTA) on schedule on January 1, 2002, and has been active in ASEAN’s efforts to pursue free trade agreements with China, Japan, South Korea, India, Australia and New Zealand.

The U.S. and Indonesia reenergized Trade and Investment Framework Agreement (TIFA) talks in 2005, holding three productive meetings to discuss outstanding trade concerns and to explore areas for future cooperation. Intellectual Property Rights (IPR) protection and enforcement remains a serious concern in Indonesia, where widespread optical disc piracy and counterfeiting of consumer goods, including automotive parts and pharmaceuticals, cost U.S. firms and the GOI hundreds of millions of dollars in lost revenues and pose serious health and safety concerns for Indonesians.

IMPORT POLICIES

Tariffs

In the late 1980s, the GOI 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 1990s, 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.

By January 2003, about 70 percent of Indonesia's tariff lines were assessed import duties ranging between zero percent and five percent. Indonesia's unweighted applied tariff average is 6.9 percent, compared to 20 percent in 1994. Indonesia's average WTO bound rate is 37.1 percent. 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 December 2004, Team Tariff announced the results of the first phase of its Tariff Harmonization Program. The new rates went into effect on January 1, 2005. This first phase covered 1,964 tariff lines with actual changes to 239 lines: 96 tariff increases and 143 tariff reductions. Of particular note are tariff increases for agricultural (rice, fish, chicken quarters, mangos, carrots, mandarin oranges and flowers) and ceramic products and tariff decreases for some mining related products. Indonesia's Parliament has urged the Ministry of Finance and Team Tariff to complete the second phase of the Tariff Harmonization Program, covering the remaining 9,200 tariff lines as soon as possible.

Most Indonesian 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. In the agricultural sector, 1,341 tariff lines have bindings at or above 40 percent, including the most sensitive and heavily protected sectors. In the current WTO Doha negotiations, Indonesia, as leader of the G-33, has been advocating special products exemptions from tariff reductions for rice, sugar, soybeans, and corn.

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). In 2004, the Indonesian government instituted bans on imports of rice, sugar and salt, and in 2005, the GOI increased import duties on corn and soybeans from zero percent to 5 percent and 10 percent, respectively.

Local agriculture interests continue to lobby the government to increase tariff rates above the levels bound in the WTO on sensitive agricultural products, such as sugar, soybeans and corn. However, the Minister of Trade has announced plans for a comprehensive trade policy review to, among other things, identify and rectify onerous bureaucratic and ill-conceived trade policies.

Non-Tariff Barriers

During the Soeharto era, the National Logistics Agency (Bulog), previously had a monopoly on importing and distributing major bulk food commodities, such as wheat, rice, sugar, and soybeans, but now has 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. Bulog 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 (MOA). The U.S. Government has raised concerns about this issue, but the MOA 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 unsuccessfully sought to repeal the ban. U.S. industry estimates the value of lost trade from this ban at roughly $10 million per year.

Indonesia’s 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 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 annual trade impact of this restriction to be between $10 million and $25 million.

Due to the June 2005 finding in the United States of a case of Bovine Spongiform Encephalopathy (BSE) or “mad cow disease”, Indonesia’s MOA banned imports of U.S. meat and other ruminant products on July 1, 2005. The MOA has yet to specify what information they will need to reinstate this trade, nor has any timeline been given for when they would be ready to reconsider U.S. beef imports. U.S. beef exports had been growing rapidly and approached a record $15 million in 2005 prior to imposition of the import ban. This action also stopped U.S. exports of the ruminant meat and bone meal, which had been valued at $50 million annually.

Indonesia's government has imposed a rice import ban since February 2004, which was only eased somewhat in November 2005, when the Ministry of Trade issued import permits to Bulog allowing for imports of about 70,000 tons of rice. However, this decision was met with sharp criticism from other Ministries, producer groups, and Members of Parliament. Observers expect the GOI to extend the ban on rice imports through at least for the first six months of 2006. Historically, the United States has not exported significant quantities of rice to Indonesia commercially; most shipments have occurred through the P.L. 480 Title I concessional loan program.

In June 2004, the Ministry of Trade banned the importation of salt during the harvest season from July through the end of each year. Under the regulations, salt importing companies must be registered and source 50 percent of their raw materials locally. A September 2004 Ministry of Trade decree allows five companies to import sugar. It also states that the Ministry of Trade decides which companies can import sugar and how much.

The U.S. government has received reports that Indonesia's Customs Service uses a schedule of arbitrary "check prices" rather than actual transaction prices on importation documents to assess duties on food product imports. Indonesian Customs officials defend this practice by arguing it combats under-invoicing. They claim that 80 percent of all Customs applications, electronic or paper, are accepted without extraordinary review. Importers are notified, however, when an application appears to be suspicious and, if the matter is still not solved, Customs makes an assessment based on an average of the price of the same or a similar product imported during the previous 90 days. Indonesian Customs, however, does not publicize this methodology or a current list of such reference prices. As a result, although most food product import tariffs remain at five percent, the effective level of duties can be much higher. For example, industry estimates that application of arbitrary check prices adds up to $2,000 per shipment of U.S. table grapes to Indonesia, leading to an estimated annual loss of around $3.5 million per year in potential trade for this one product alone. The U.S. government also has received many complaints from importers about costly delays and requests for unofficial payments from a variety of actors when importing goods through Indonesian ports.

The GOI is in the process of amending the Customs Law of 1995 to provide stricter penalties on smuggling, under-invoicing and trading in prohibited goods. The proposed new law would also establish a code of ethics for customs officers and a set of penalties and incentives to punish corrupt behavior and reward good performance. The GOI hopes to enact the new law in 2006. Enforcement will be key to its ultimate effectiveness.

Other quantitative import 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, Indonesia's government restricts imports of alcoholic beverages to three registered importers, including one state-owned enterprise.

In June 2005, the Ministry of Agriculture announced plans to implement a new certification and testing program for imported fruits. The U.S. Government has reviewed this proposed plan and provided comments to the GOI. The United States exports about $30 Million to $40 million of fruit annually to Indonesia. The regulation in its proposed form could jeopardize this trade.

Import Licensing

Indonesia's government continues 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.

On October 23, 2002, the Minister of Industry and Trade issued a decree concerning Textile Import Arrangements. Only companies that have production facilities using imported fabrics as inputs for finished products, such as garments or furniture, may obtain import licenses. The United States has raised concerns that the import licensing requirements restrict and distort trade and has recommended that the decree be rescinded. Indonesia's government insists the regulations are designed to help curb smuggling. The increasing gap between GOI import statistics for 4-digit (HS) fabric items and partner country export figures for those same items, however, contradicts this assertion.

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). This has proven to be an overly complex, time consuming, and costly procedure.

All imported food products must be tested by BPOM. 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. It is worth noting, however, that Indonesia's government has not fully implemented these regulations, and enforcement is weak and inconsistent. If fully implemented the annual level of trade adversely affected by this requirement is estimated by U.S. industry at between $10 million and $25 million.

Beginning January 2001, Indonesia's regulations required labels identifying food containing "genetically engineered" ingredients and "irradiated" ingredients. However, the government has not implemented these new requirements because it has yet to establish minimum threshold-presence levels. U.S. industry estimates that the new regulation could affect sales of approximately $411 million annually in soybeans and soybean meal from the United States. The U.S. government is closely monitoring these situations.

GOVERNMENT PROCUREMENT

Indonesia is not a party to the WTO Government Procurement Agreement (GPA). In November 2004, the GOI issued a Presidential Decree on government procurement aimed at simplifying procedures and increasing efficiency and transparency in the procurement process. However, the new rules grant some special preferences to encourage domestic sourcing and call for the maximization of local content in government projects, regardless of their source of funding. According to the decree, foreign companies are eligible to bid for government contracts as part of a joint partnership or as a subcontractor to a domestic firm, and permissible foreign participation increased from $1 million to $5 million. Nevertheless, regional decentralization 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 with respect to these irregularities.

Foreign firms bidding on high value government-sponsored 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 procurement of goods and services. 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

In 2004, the Indonesian government ended several credit programs that offered subsidized loans to agriculture and small and medium sized businesses to support exports.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Copyrights

A 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 provision for the issuance of an implementing regulation on optical disks (OD), criminal penalties for end-user piracy, and the ability of rights holders to seek civil injunctions against pirates. The OD regulation entered into force in October 2004. The outgoing Minister of Industry and Trade issued two ministerial decrees necessary to implement the OD regulation. These new regulations included a six-month transition grace period and became effective in April 2005. However, little has been done to properly implement the OD regulations and, despite assistance provided to the competent authorities by international organizations and trade associations, many unregistered factories with OD production capability continue to operate in Jakarta and other key cities.

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.

The government's enforcement of copyrights is uneven. Piracy of optical media in Indonesia remains widespread, undermining the sale and rental of legitimate products. The GOI regularly consults with copyright holders and associations. Periodic raids result in the seizure of sizable caches of pirated optical disk 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 2005 were roughly $191.6 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.

Despite these measures, Indonesia continues to suffer from a lack of effective enforcement of patent rights. The patent law does not address some of the weaknesses that concern foreign rights holders. Chief among these is the requirement that an inventor must physically produce a product or utilize a process in Indonesia in order 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 law raised the maximum fine for criminal trademark violations to Rp 1 billion ($120,000), and slightly reduced the maximum possible prison term. The 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. Indonesia's trademark officials' requirement that all trademark modifications be registered raises concerns under the TRIPS Agreement and the Paris Convention. 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 provided relief to some trademark holders. However, industry representatives had hoped courts additionally would impose injunctions, especially in cases where a lower court eventually invalidates a false trademark registration.

SERVICES BARRIERS

Despite relaxation of some restrictions, 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. A foreign law firm seeking to enter the market must establish a relationship with a local firm. In order to practice, all 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.

Distribution

In 1998-99, Indonesia liberalized portions of the distribution services sector under the 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. Indonesia allows 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.

In the energy sector, Indonesia passed an Oil and Gas Law, in November 2001, to deregulate the downstream oil and gas sectors, which includes refining, distribution, storage and retail activities. Under the law, the state oil and gas company Pertamina was converted into a limited liability company (Regulation No. 31/2003) and ended its public service obligation (PSO) two years after passage of the law. The law also stipulates the formation of a new Oil and Gas Downstream Business Regulating Board (Badan Pengatur Kegiatan Usaha Hilir Migas, or BPH Migas) that effectively took control of Pertamina's former regulatory function over the downstream industry. Although the day-to-day activities of the board must still be defined through implementing regulations, BPH Migas is 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. The downstream sector is further regulated with President Regulation No. 46/2004 on Oil and Gas Downstream Activities, issued October 14, 2004, which outlines the general procedures, activities and licenses for downstream activities.

The GOI has postponed removal of Pertamina's PSO until December 31, 2006. In October 2005, Shell was the first private investor to open a non-Pertamina retail fuel station in Indonesia. About 25 local and international investors, including Malaysia's national oil and gas company Petronas, are reported to have obtained initial licenses for downstream operation.

Financial Services

While Indonesia allows 100 percent foreign ownership of Indonesian banks, the banking sector is still subject to many restrictions. The minimum paid-in capital requirement for multifinance companies was previously regulated by Minister Decree number 488/2000, which included capital requirements of Rp 5 billion for domestic companies and Rp 10 billion for companies with a foreign joint venture partner. However, in 2002, Indonesia issued Minister Decree number 172/2002, which changed the minimum paid-in capital requirement to Rp 10 billion for both domestic and joint venture companies.

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.

Audio-Visual

There is a ban on all foreign investment in media businesses, including cinema construction or operation, video distribution and broadcast services. Foreign investment is prohibited in broadcast and media sectors, including the film industry (film making, film technical service providers and movie house operations). The decrees also prohibit foreign investment in the provision of radio and television broadcasting services, radio and television broadcasting subscription services and media print information services.

Construction, Architecture and Engineering

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

In all but basic services delivery, the GOI has recently made progress in making the telecommunications playing field more transparent and competitive. Today, there is very little that would impede a foreign investor from coming into the Indonesian value-added telecommunications market. However, the requirement that a foreign satellite operator must have an Indonesian partner perpetuates inefficiency, raises costs to Indonesian consumers, and constitutes a serious trade barrier.

Indonesia formed a telecommunications regulatory body in July 2004 to improve transparency in regulation development and dispute resolution. To date, this body has been largely inactive and the Ministry of Communication and Information has been more effective in pushing through sector reforms.

The provisions of Indonesia's Telecommunications Law 36, which came into force in 2000, have guided reforms to end monopolies and open basic telecommunications services to majority foreign ownership. Telecommunications 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 Telecommunications 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 August 2003 and of PT Indosat and Satelindo for international calling service in 2003. Instead, PT Telkom and PT Indosat were established as Indonesia's only full service providers, a move that ensured PT Telkom's survival in the face of increasing competition from Voice-Internet Protocol (VIP) services. Since 2002, however, PT Telkom has focused most investment in the value-added cellular market and added very few new lines to remote areas. Although homes and businesses in Indonesia that are wired enjoy world class telecommunications services, only 5 percent of homes have even basic connectivity.

Telecommunications 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. Popular resistance, however, prevented the second round of price increases in 2003. Indonesia has undertaken partial privatization of its telecommunications 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.

Despite the liberalization that Indonesia has implemented, the government has yet to submit a revised telecommunications offer in the Doha Development negotiations in the WTO.

INVESTMENT BARRIERS

The Yudhoyono Administration has made improving Indonesia's investment climate a priority and has focused its reform agenda first on revising investment, tax, customs and labor laws; undertaking an effective anti-corruption campaign; and laying the foundation for judicial and civil service reform.

A World Bank study found that it takes on average 151 days to establish a business in Indonesia. Foreign direct investment (FDI) declined sharply after the 1997-98 financial crisis, but realized foreign investments topped $1 billion in 2004, a sign that investor confidence is on the mend. Government approvals for investment proposals reached $10.3 billion in 2004, compared to $14.6 billion in 2003 and $9.8 billion in 2002. Investment proposals from Asia, North American and Europe – traditionally large investors – declined from 2002. Most of this proposed investment is never realized.

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

In an effort to help alleviate this problem, under proposed revisions to the law, local governments would be granted the authority to tax based upon a "positive" list indicating affirmative local authority, rather than a "negative" list indicating areas where the central government retains authority.

Decentralization has complicated government efforts to improve Indonesia's investment climate and reduce burdensome bureaucratic procedures and other requirements on foreign investors. Indonesian law provides for both 100 percent FDI projects and joint ventures with a minimum Indonesian equity of five percent. Currently, Indonesia's Investment Coordinating Board (BKPM) and other relevant agencies in certain sectors must approve proposed foreign investments, but under the new Investment Law proposed by the Yudhoyono Administration and being debated in Parliament,, Indonesia would move from an investment approval to an investment registration system and BKPM's new mission would be investment promotion.

Indonesia blocks or restricts foreign investment in some sectors in addition to those service sectors mentioned above. These restricted sectors are included 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. Yet other sectors remain closed to foreign investment, such as casino and gaming facilities, air traffic and marine vessel certification and classification systems, and radio frequencies. However, various infrastructures, airline, medical services, marine and fisheries, industrial, and other trade sectors are open to investment subject to joint venture or other conditions. One aim of the proposed new investment law is to provide greater clarity on which sectors are closed and which sectors are open to foreign investment.

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 landline 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 online transactions as a particularly significant impediment. Indonesia's government completed drafting of cyber crime and electronic transactions legislation in September 2005 and the measures are currently being debated in the legislature.

OTHER BARRIERS

Transparency

Corruption has been endemic, and remains an enormous problem for foreign companies. According to a January 2005 World Bank study, the costs associated with crime, corruption, regulation, unreliable infrastructure and poor contract enforcement can amount to 20 percent of a firm's sales in Indonesia. A University of Indonesia August 2005 survey found that bribes account for an average of 1.8 percent of a firm's production costs. Companies continue to be concerned about demands for irregular fees to obtain required permits or licenses, and government awards of contracts and concessions based on personal relationships. Legal uncertainty is also a frequent complaint, and courts at several levels are perceived as inefficient and corrupt. Tax and customs administration in Indonesia, while improving, are still viewed by the business community as widely corrupt and arbitrary.

President Yudhoyono has stated repeatedly that eliminating corruption is one of his Administration's top priorities. The President has established and empowered several institutions to fight corruption. The Anti-Corruption Commission, established in 2003, had close to 200 investigators and other personnel in 2005. The media has joined the effort to expose graft, and investigators are more aggressively pursuing cases. Several corruption probes have led to investigations, indictments and/or convictions of election commission members, a number of governors, Supreme Court justices, the president of the largest bank in Indonesia, and senior police officials. In 2005, President Yudhoyono appointed new officials as Attorney General and Chief of Police and expressed public support for key officials in visible anti-corruption positions. The Supreme Audit Board (BPK) and the Financial Intelligence Unit (PPATK) are building capacity to fight corruption with help from the U.S. Government and other donors. While the Administration's efforts are beginning to produce results, major challenges remain as it is a complex task to make improvements among relevant key personnel. This includes government officials at all levels, auditors, police, prosecutors, judges, and the military. Civil service reform, including better salaries and codes of conduct for all public officials, is a significant policy and budget challenge.

Automotive Policies

The maximum tariff on automobiles is 80 percent. Tariffs on passenger car kits imported for assembly are 25 percent, 35 percent, 40 percent, or 50 percent depending on engine size. Tariffs on non-passenger car kits are a uniform 25 percent. Tariffs on auto components and parts imported for local assembly of passenger cars and minivans are 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. U.S. motorcycle manufacturers are concerned about the high tariff of 60 percent (25 percent on knockdown kits), the luxury tax of 75 percent, as well as the prohibition on motorcycle traffic on tollways as barriers to the Indonesian market.

The luxury sales tax on 4,000cc sedans and 4x4 Jeeps or vans is 75 percent. The luxury tax on automobiles with engine capacity between 1,500cc and 3,000cc ranges from 20 percent to 40 percent, depending on the size of the engine. The December 2000 decision to restructure the way luxury sales taxes are imposed on motor vehicles had a significant negative impact on the automotive market, since 65 percent of the market share belongs to automobiles with engine sizes between 1,500cc and 3,000cc.