

INDONESIA

TRADE SUMMARY

The U.S. goods trade deficit with Indonesia was \$10.0 billion in 2012, down \$1.7 billion from 2011. U.S. goods exports in 2012 were \$8.0 billion, up 8.1 percent from the previous year. Corresponding U.S. imports from Indonesia were \$18.0 billion, down 5.8 percent. Indonesia is currently the 34th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Indonesia were \$1.7 billion in 2011 (latest data available), and U.S. imports were \$437 million. Sales of services in Indonesia by majority U.S.-owned affiliates were \$2.7 billion in 2010 (latest data available), while sales of services in the United States by majority Indonesia-owned firms were \$87 million.

The stock of U.S. foreign direct investment (FDI) in Indonesia was \$11.6 billion in 2011 (latest data available), up from \$10.6 billion in 2010. U.S. FDI in Indonesia is primarily concentrated in the mining sector.

IMPORT POLICIES

In recent years, Indonesia has enacted numerous regulations on imports that have increased the burden for U.S. exporters. Besides tariffs, import licensing procedures and permit requirements, product labeling requirements, pre-shipment inspection requirements, local content and domestic manufacturing requirements, and quantitative import restrictions impede U.S. exports. Numerous other measures have been adopted or are being considered in the context of draft legislation, including a new food law and a new trade law. The Indonesian government has increasingly adopted such measures as it pursues self-sufficiency objectives. These measures are also being adopted as Indonesia reduces tariffs as part of implementing preferential trade agreements with countries such as China, Australia, Japan, South Korea, New Zealand, and India. The United States will continue to press Indonesia to resolve U.S. concerns regarding these measures.

Tariffs

In 2012, Indonesia's average most favored nation (MFN) applied tariff was 7.7 percent. Indonesia periodically changes its applied rates. In December 2011, the Ministry of Finance increased applied import duties for designated grain and oilseed products from 0 percent to 5 percent. In August 2012, the Ministry of Finance temporarily reduced import duties on soybeans from 5 percent to 0 percent through the end of 2012 to counter rising international soybean prices. In 2009, 2010, and 2011, Indonesia increased its applied tariff rates for a range of imported goods that compete with locally manufactured products, including electronic products, electrical and non-electrical milling machines, chemicals, cosmetics, medicines, iron wire and wire nails, and a range of agricultural products including milk products, animal or vegetable oils, fruit juices, coffee, and tea.

Indonesia's simple average bound tariff of 37 percent is much higher than its average applied tariff. Most Indonesian tariffs are bound at 40 percent, although bound tariff levels exceed 40 percent or remain unbound on automobiles, iron, steel, and some chemical products. 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 the applied rate is 20 percent. The high bound tariff rates, combined with unexpected changes in applied rates, create uncertainty for foreign companies seeking to enter the Indonesian market.

U.S. motorcycle exports remain 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 of motorcycle traffic on Indonesia's highways. In 2010, Indonesia converted its applied tariff on imported distilled spirits from 150 percent *ad valorem* to 125,000 rupiah (approximately \$15) per liter.

Indonesia has extensive preferential trade relationships with other countries. Under the ASEAN Free Trade Agreement, duties on imports from ASEAN countries generally range from 0 percent to 5 percent, except for products specified on exclusion lists. Indonesia also provides preferential market access to Australia, China, Japan, Korea, India, Pakistan, and New Zealand under regional ASEAN agreements and to Japan under a bilateral agreement. In accordance with the ASEAN-China FTA, in August 2012 Indonesia increased the number of goods from China receiving duty-free access to 10,012 tariff lines. Indonesia is currently negotiating bilateral agreements with Iran, India, Australia, New Zealand, and European Free Trade Association, studying potential FTAs with Chile, Turkey, South Korea, Tunisia, Mexico, South Africa, and Egypt.

Indonesia imposes a progressive export tax on cocoa and palm oil exports. The cocoa export tax rate ranges from a minimum of 5 percent to a maximum of 15 percent and is calculated based on a monthly average of export prices. The minimum palm oil tax rate is 1.5 percent, and the maximum rate is 25 percent. The Indonesian government is also considering imposing export taxes on other products, including coconut, base metals, and coal.

Import Licensing

Exporters to Indonesia must comply with numerous and overlapping import licensing requirements that impede access to Indonesia's market. In 2009, the Indonesian government implemented a sweeping regulation imposing non-automatic import licensing procedures on a broad range of products, including electronics, household appliances, textiles and footwear, toys, and food and beverage products. The measure, known as Decree 56, was extended by Ministry of Trade Regulation 57/M-DAG/PER/12/2010 in December 2010, and again in December 2012 through Ministry of Trade Regulation 83/M-DAG/PER/12/2012. Regulation 83/2012 will remain in effect until December 31, 2015. The original extension expanded the scope of licensing restrictions to additional products, including cosmetics. The amended decree also retains a requirement for pre-shipment verification by designated companies (known in Indonesia as "surveyors") at the importers' expense and a restriction that limits the entry of imports to designated ports and airports. Indonesia has informally limited application of the decree to "final consumer goods." The Indonesian government also appears to be exempting select registered importers from certain requirements of this decree. Still, the approval process to qualify as a registered importer is opaque, ill-defined, and potentially discriminatory. The United States continues to seek the measure's withdrawal.

Ministry of Trade Regulation No. 45/M-DAG/PER/9/2009, as amended and clarified by Regulation No.17/M-DAG/PER/3/2010, introduced a requirement that companies can only import goods for further distribution or for their own manufacturing, but not for both. Under these regulations, companies are permitted only one kind of license, and those that need both kinds of licenses need to separate into manufacturing and trading businesses. Effective January 1, 2011 through Regulation No. 39/MDAG/PER/10/2010, Indonesia introduced a new type of importer license, dubbed a PI License, which permits companies to import certain finished products not used in the production process provided such imports also support the development of the company's business in Indonesia.

However, in early 2012, the Supreme Court annulled Regulation No. 39. In response, the Ministry of Trade issued Decree 27/MDAG/PER/5/2012 in May 2012 and amended it with Decree 59/MDAG/PER/9/2012 in September 2012. Under the new 2012 decrees, companies that operate under

an import license for their own manufacturing are allowed to import finished products provided they are market test products or complementary goods. However, the new regulations again limit companies to only one kind of license. The decrees also require companies to demonstrate a “special relationship” with the foreign company. The “special relationship” must be authenticated by the Indonesian Embassy located in the country in which the foreign company is located. Only then may the companies import products from more than one section of the HS tariff code. The Ministry of Trade delayed full implementation of Decree 59 until March 31, 2013; until then both the old system and the new system will co-exist.

Import Licensing for Agricultural Products

Import licensing requirements also apply to horticultural products. In September 2012, Indonesia adopted two ministerial regulations on the importation of horticultural products. While the two regulations were separately issued by the Ministry of Trade and the Ministry of Agriculture respectively, both were numbered 60/2012. Both the Ministry of Agriculture’s Regulation 60 (replacing Regulation No 3/2012) and Ministry of Trade’s Regulation 60 (amending Regulation No 30/2012) regulate the importation of horticultural products into Indonesia. All horticultural products shipped after September 28, 2012 must comply with these two regulations. Ministry of Agriculture’s Regulation 60 requires Indonesian importers to obtain an Import Recommendation of Horticulture Products (RIPH) as a prerequisite for applying for an Import Permit Letter (SPI) from the Ministry of Trade. One RIPH application is valid for one HS code, one country of origin, one port of entry, one port of loading, and one supplier. The Ministry of Agriculture has discretion on whether to issue an RIPH and makes decisions based on an evaluation of multiple considerations, including its assessment of national demand analysis. After securing an RIPH from the Ministry of Agriculture, Ministry of Trade Regulation 60 requires the importer to obtain an SPI from the Ministry of Trade before horticulture products can be imported into Indonesia. In addition, the horticultural products to be imported must be verified by Indonesian surveyors and/or their authorized agents in the country of origin and Bahasa Indonesia labels must be attached to the packaging before the products enter the Indonesian customs area.

Before applying for a RIPH, an Indonesian importer must be recognized by the Ministry of Trade as a Registered Importer (IT) and/or a Producer Importer (IP). Before applying to the Ministry of Trade for recognition as an IT or IP, importers must first apply for and receive an API-U (Importer Identification Number – General) or API-P (Importer Identification Number – Producer), and must also prove they meet certain criteria. For example, IT importers (which import for retail) must prove they own “appropriate” cold storage facilities.

Indonesia imposes a similar non-automatic import licensing regime for animals and animal products imports. An importer must first receive an Import Approval Recommendation from the Ministry of Agriculture to import animals and animal products. The importer then must seek an import license from the Ministry of Trade, who grants the licenses based on domestic production and supply considerations.

These licensing regimes for horticulture and animal and animal products have significant trade restrictive effects on imports and the United States has repeatedly raised its concerns with Indonesia in discussions in Jakarta, Washington, Bali, and Geneva. Indonesia failed to address these concerns. As a result in January 2013, the United States requested consultations with Indonesia under the WTO dispute settlement procedures challenging the regimes consistency with obligations under the WTO. After the consultations failed to resolve the concerns, the United States requested the establishment of a WTO dispute settlement panel in March 2013.

Additional opaque, complex, and prohibitive product-specific import licensing and registration requirements apply to other agricultural products, including animal and animal products, sugar, and dairy.

Other Import Licensing Requirements

Indonesia maintains other additional non-automatic licensing requirements on textiles, clothing, and other “made-up goods” such as curtains and blankets, which limit market access for a wide range of products. Only approved local producers are authorized to import products, and these products are permitted for use 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 continues to press Indonesia to eliminate these requirements.

New import restrictions on cell phones, laptop computers, and tablets impose burdensome licensing requirements and may prevent U.S. hardware companies from becoming importers of record. Ministry of Trade Regulation 82 and Ministry of Industry Regulation 108 went into effect in January 2013, shortly after their release in late 2012. Under Regulation 82, importers of cell phones, laptop computers, and tablets can no longer sell directly to retailers or consumers, must have at least three years of experience, and must use at least three distributors to qualify for a Ministry of Trade importer license. Under Regulation 108, importers must provide product identification numbers for each imported item in order to receive a Ministry of Industry importer license. Companies are unable to provide identification numbers months in advance and, as such, may need to apply for both licenses on a per shipment basis.

Pharmaceutical Market Access

The United States continues to have serious concerns about barriers to Indonesia’s market for pharmaceutical products. Ministry of Health Decree No. 1010/MENKES/PER/XI/2008 requires foreign pharmaceutical companies either to manufacture locally or to entrust another company that is already registered as a manufacturer in Indonesia to obtain drug approvals on its behalf. Under this policy, foreign companies can be barred from the Indonesian market even if they are market leaders in globally recognized good manufacturing and distribution practices and provide high quality pharmaceutical products to Indonesian patients. Among its requirements, Decree 1010 requires local manufacturing in Indonesia of all pharmaceutical products that are five years past patent expiration. It also contains a technology transfer requirement. A subsequent regulation, Regulation 1799 and BPOM’s (Indonesian Food and Drug Regulatory Agency) updated regulation on drug registration, provided additional information about the application of the local manufacturing requirements and lays out several exceptions to local manufacturing and technology transfer requirements. In September 2012, Indonesia issued Presidential Regulation 76/2012 granting compulsory licensing for nine HIV/AIDS and Hepatitis B treatment drugs. The United States will continue to monitor the implementation of these regulations.

A bill on *halal* certification, currently under discussion in Indonesian Parliament, would require mandatory *halal* certification of pharmaceuticals as well as other products. Such a policy could have significant adverse consequences on U.S. and other foreign companies as well as Indonesian patients.

Quantitative Restrictions

Indonesia maintains quantitative restrictions, particularly on imports of agricultural products such as beef, where annual import quantities are determined by Indonesian agencies in nontransparent processes. The U.S. Government has raised its strong concerns regarding these quantitative restriction issues and will continue to press the Indonesian government to address them.

The Ministry of Agriculture sets the quantities of animals and animal products that may be imported into Indonesia, both in the aggregate and by each importer. The Ministry of Trade issues permits for the import and export of these products after receiving a recommendation approval from the Directorate General of Livestock and Animal Health Service of the Ministry of Agriculture per Ministry of Trade

regulation No. 24/M-DAG/PER/9/2011 and Ministry of Agriculture regulation No. 50/PERMENTAN/OT.140/ 9/2011 dated September 7, 2011. Both regulations were put into effect on October 1, 2011. These regulations now effectively ban the importation of any chicken product, as well as turkey and duck parts. Importers are required to have a registered importer of animal and animal products number from Ministry of Trade before they are allowed to import animals and animal-based food products.

Ministry of Agriculture Regulation 60 also establishes a mechanism that provides Indonesia with the discretion to apply quantitative restrictions on imports of fresh and processed fruits and vegetables. According to the regulation, the quantity of imports that Indonesia will allow will be based on estimates of domestic production, availability of similar products domestically, and domestic demand, as well as harvest and production periods. The United States included these effective quota measures in its January 2013 WTO consultation request to Indonesia, as well as in its request for the establishment of a WTO dispute settlement panel in March 2013.

Indonesia also recently imposed an “unofficial” restriction on the importation of corn. Unofficially, only feed millers can import corn as of December 2012. They must apply for an import permit from the Ministry of Agriculture. The import permit will specify the volume of corn that can be imported. The volume will be set based on the levels of domestic feed production. A similar unofficial restriction is also being imposed on the imports of alfalfa from the United States.

Indonesia bans salt imports during the harvest season. It requires salt importers to be registered and to purchase domestic supplies as well as imports. Indonesia also maintains a seasonal ban on imports of sugar, in addition to limiting the annual quantity of sugar imports based on domestic production and consumption forecasts.

Indonesia applies quantitative limits on the importation of wines and distilled spirits. Companies seeking to import these products must apply to be designated as registered importers authorized to import alcoholic beverages with an annual company-specific quota set by the Ministry of Trade.

Mining firms operating in Indonesia may not export unprocessed ore unless they have the government’s prior approval to do so *via* a contract of work or plans to build a smelter in Indonesia to process that ore. A 2009 mining law requires companies to process ore locally before shipping it abroad. Although scheduled to enter into force in 2014, Indonesia started implementing the law in 2012. Indonesia asserts the earlier implementation was necessary to prevent what it described as accelerated exporting of raw mineral ore to avoid the 2014 effective date. The policy is intended to support the expansion of value-added activities, including the smelting industry. A Supreme Court ruling made public in January 2013, which struck down the unprocessed ore export ban provisions of the Ministry of Energy and Mineral Resources regulation, as well as a Ministry promise to continue with the ban, have further confused the situation. Indonesia also effectively bans the export of steel scrap.

In late 2011, Indonesia banned exports of raw and semi-processed rattan. This ban is still in effect.

Product Registration

Beginning in late 2008 and continuing through 2011, Indonesia’s food and drug agency (BPOM) slowed its process for reviewing applications for the registration of processed foods, beverages, and other products, including health supplements. Although there are reports that BPOM has improved the efficiency of its product registration system since 2011, concerns remain about changes BPOM proposed to the registration requirements and submission process in 2012 that would further complicate the process.

Combined with onerous Bahasa language labeling requirements, the process for registering products has become increasingly burdensome and costly to U.S. and other foreign exporters. The United States will continue to monitor developments in this area.

Customs Barriers

U.S. firms continue to report that Indonesian Customs relies on a schedule of reference prices to assess duties on some imports, rather than using actual transaction prices. Customs makes a valuation assessment based on the perceived risk status of the importer and the average price of a same or similar product imported during the previous 90 days.

In late 2010, Indonesian customs changed its methodology for assessing import duties on motion pictures, from import duties “per meter” to a calculation based on royalties, significantly increasing duties payable. Following a disruption in trade and as a result of bilateral consultations between the U.S. and Indonesian Governments, the Ministry of Finance adopted a new specific tariff based on a “per minute” calculation rather than royalties. The Finance Ministry also changed the application of its value-added tax on movie imports. Overall, the incidence of duties and taxes under the current system continues to be higher than it was in 2010, though trade has resumed.

In January 2012, the Ministry of Agriculture announced that, in order to comply with priorities set by the Ministry of Trade, the port of Jakarta and several other major ports would be closed to horticulture imports beginning in March 2012. More than 90 percent of Indonesian imports of U.S. fresh fruits and vegetables (more than \$200 million annually) move through the port of Jakarta, Tanjung Priok, and are destined for the Jakarta market. Despite this announcement, since June 2012, U.S. horticulture exports were able to continue using Tanjung Priok port as a result of the U.S. country recognition status, approved by the Ministry of Agriculture. Australia, New Zealand, and Canada have also been allowed to continue using Tanjung Priok. In January 2013, the Ministry of Agriculture renewed the U.S. country recognition status.

Luxury Taxes

Luxury goods (defined as goods not considered necessities), imported or locally produced, may be subject to a luxury tax of up to 200 percent, although the current range is 10 percent to 75 percent for goods listed in the implementing regulations as subject to the luxury tax. The luxury tax on 4,000cc sedans and 4x4 Jeeps or vans is 75 percent, compared with the luxury tax on automobiles with engine capacities of 1500cc or less, which ranges from 10 percent to 30 percent. Passenger cars with engine displacement less than 1500cc 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. The luxury tax on motorcycles with a cylinder capacity of 250cc up to 500cc is 60 percent.

Although Indonesia has eliminated its luxury tax on imported distilled spirits, the current excise tax regime imposes higher excise taxes on imported spirits than on domestic spirits.

State Trading

In April 2008, the government of Indonesia granted the National Logistics Agency (BULOG) exclusive authority to import standard unbroken rice. Indonesia cited “food security” (with the Indonesian government separately detailing its aspirations for food self-sufficiency) and price management considerations as the principle objectives of the authorization. BULOG is not allowed to import rice before, during, or immediately after the main harvest period (January/February annually). This requirement effectively prohibits any rice imports during the first quarter of the year. Private firms are

only allowed to import broken rice for processing and specialty rice varieties, such as basmati, jasmine, and sushi rice for retail or food service. Importers of broken and specialty rice must obtain a special importer identification number from the Ministry of Agriculture.

GOVERNMENT PROCUREMENT

Indonesia grants special preferences to encourage domestic sourcing and to maximize the use of local content in government procurement. It also instructs government departments, institutes, and corporations to utilize domestic goods and services to the maximum extent feasible. Presidential Regulation 54/2010 requires procuring entities to seek to maximize local content in procurement, use foreign components only when necessary, and designate foreign contractors as sub-contractors to local companies. Presidential Regulation 2/2009 stipulates that all state administrations should “optimize” the use of domestic goods and services and give price preferences for domestic goods and providers. Ministry of Industry Regulation 15/2011 provides for the creation of an Accelerated Use of Local Product National Team to optimize local product use in goods or services procurement.

Indonesia’s 2012 Defense Law, passed in October, mandates priority for local materials and components and requires defense users to use locally produced defense and security tools whenever available. In addition, when procurement from a foreign defense supplier is made due to lack of availability from an Indonesian domestic supplier, there is a requirement for countertrade, local content and/or offset production. Initially this domestic value requirement is 35 percent of the total contract value and will increase by 10 percent every year for the next 5 years, after which 85 percent of the value should be accounted for by countertrade, local content or offset production. It is expected that the local content/domestic offset requirement may be met in several forms such as coproduction, joint venture, buyback, knowledge transfer, and training. U.S. defense firms have already been meeting existing informal Indonesian government policy on the defense industry that 35 percent of the contract value be sourced domestically.

In 2012, Indonesia became an observer to the WTO Committee on Government Procurement, but is not a signatory to the WTO Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

Indonesia remained on the Priority Watch List in the 2012 Special 301 report. Key concerns in Indonesia include continuing widespread copyright piracy and trademark counterfeiting, an inadequate number of criminal prosecutions, and non-deterrent penalties for those who are convicted. U.S. industry reports that one of its most significant frustrations remains the nontransparent and non-deterrent court system, which also impedes the ability of rights holders to obtain information about cases directly affecting their interests. Rates of physical counterfeiting and piracy, as well as online piracy, are extremely high (an estimated 86 percent of business software was unlicensed in 2011) while piracy rates at malls and in the retail sector are also high. Enforcement efforts were insufficient to keep pace with broad-based piracy and counterfeiting in Indonesia. The Indonesian government also is in the process of amending intellectual property laws, including with respect to industrial designs, trademarks, copyrights, and patents.

SERVICES BARRIERS

Indonesia maintains significant and far-reaching trade and investment barriers in many key services sectors. The United States will continue to press its concerns on these issues with Indonesia.

Legal Services

Only Indonesian citizens may be licensed as lawyers in Indonesia. Foreign lawyers may only work in Indonesia as “legal consultants” upon approval of the Ministry of Justice and Human Rights. A foreign law firm seeking to enter the market must establish a partnership with a local firm.

Express Delivery and Logistics Services

In September 2009, the Indonesian legislature passed a new law with restrictions on the provision of postal services, broadly defined to include courier, express delivery, and other logistics services. The law requires that postal service providers be majority-owned by Indonesians and that foreign providers limit their activities to provincial capitals with international airports and seaports. The Ministry of Communication and Information Technology has said that joint ventures will be able to service cities with international airports and seaports, as well as supporting provincial capitals with international airports and seaports, although the draft implementing regulations do not include this clarification. The current draft is with the State Secretary’s office awaiting final signature by the President. Ministry of Communication and Information Technology officials state that the Minister will issue further decrees to clarify outstanding issues. The United States will continue to press Indonesia on this issue.

Health Services

Changes to the negative list of foreign investment restrictions in 2010 allow for 67 percent foreign ownership of private specialist hospitals in all regions of Indonesia, in contrast to the previous regulation which limited foreign investors to the cities of Medan and Surabaya. However, foreign ownership is prohibited for health research centers, private maternity hospitals, and general or public hospitals.

Most foreign healthcare professionals may act only as consultants to Indonesian healthcare professionals. Although the Doctors Practice Law 29/2004 and Minister of Health Regulation No. 512/2007 allow foreign doctors to practice in Indonesia, a 2004 technical note by Indonesia's Investment Coordinating Board (BKPM) banned foreign doctors from practicing in Indonesia, creating uncertainty in the market. In practice, it is nearly impossible for foreign doctors to obtain a license due to strong opposition from the Indonesian Doctors Association.

Financial Services

Nonbank financial service (NBFS) providers may do business in Indonesia as a joint venture or be partly owned by foreigners. NBFS providers cannot operate in Indonesia as a branch of a foreign entity. A single entity, either foreign or Indonesian, may own no more than 40 percent of an Indonesian bank. Bank Indonesia may grant exceptions and allow for greater than 40 percent ownership of Indonesian banks in certain cases. In the insurance sector, the 2007 Investment Law limits foreign equity to 80 percent for new investors.

Energy Services

Article 79 of Presidential Regulation No. 35/2004, which regulates contractor activities in the upstream oil and gas sector, provides that contractors must “prioritize” the use of domestic services, technologies, and engineering and design capabilities. Foreign energy and energy services companies have noted that these local preference policies severely undermine their ability to make successful contract bids and make decisions about sourcing and personnel that allow them to function efficiently and profitably in the Indonesian market. Implementation of Indonesia’s local preference and local content policies in this sector is also becoming more restrictive.

In 2011, Indonesia's then upstream oil and gas regulator, BP MIGAS, tightened rules relating to how such content is measured with respect to oil and gas projects. The tightened criteria, once fully implemented, are meant to achieve an average of 91 percent local content by 2025, up from 61 percent in 2012. Under the new rules, the goods and services of companies without majority-ownership Indonesian shareholding can no longer qualify as "local" content. Foreign-owned energy services companies would have to divest majority ownership in their Indonesian subsidiaries in order for their sales to qualify as "local" content in a project. As a result, foreign energy service companies have been placed at a disadvantage *vis-à-vis* majority Indonesian-owned companies, which can more easily meet local content requirements but are often less able to meet the technical requirements of a project, often complicating and delaying project tendering processes.

In November 2012, Indonesia's Supreme Court issued a ruling to disband BP Migas, saying the upstream regulator allowed foreign companies too much control over the nation's natural resources. This ruling has created uncertainty in the Indonesian market as the government of Indonesia moves to comply with the Supreme Court ruling. As a result of the Supreme Court ruling, Indonesia established an Interim Working Unit for Upstream Oil and Gas Business Activities (SKSP Migas) in the Ministry of Energy and Mineral Resources to take over the duties and functions of BP Migas. The regulator remains under pressure from the Indonesian House of Representatives to maintain or increase the local content requirements. The United States will monitor developments in this area.

Maritime Cabotage

Indonesia's 2010 Law No. 17 on Shipping requires all vessels operating in Indonesian waters to be Indonesian flagged. However, the Indonesian shipbuilding industry does not have the capacity to build the variety of specialty ships its economy requires and is unlikely to have such capacity in the near to medium term. Full implementation of the law would be particularly problematic for foreign investors in Indonesia's energy and telecommunications sector, which would no longer be permitted to bring in the sophisticated rigs and specialized vessels needed to develop large upstream projects. In response to concerns raised by the United States and others, the Ministry of Transportation issued Regulation No. 22/2011 allowing certain classes of non-transportation vessels to be eligible for a three-month renewable waiver from the domestic flagged vessel requirements when there is no suitable Indonesian-flagged vessel available. The three-month waivers are often not long enough to cover the duration of a project, adding to investor uncertainty. Furthermore, the exceptions themselves are time limited and scheduled to phase out starting in December 2012. The United States will continue to press Indonesia on this issue.

Audit and Accounting Services

Foreign public accounting firms must be affiliated with a local public accounting firm to conduct business in Indonesia. A foreign accounting firm must use the name of its local affiliate in addition to the foreign firm's name in presentation and disclosures. Indonesia allows a maximum of 10 percent foreign national staff for each level of management in the affiliated local accounting firm. Foreign accountants can operate in the country if they have a license from the Ministry of Finance and are a member of the Indonesian Institute of Certified Public Accountants. In affiliated accounting firms, the ratio of foreign audit signing partners to local signing partners cannot exceed one to four.

Film

A September 2009 Law on Film imposed a 60 percent local content requirement for local exhibitors and included, the authority to implement unspecified import restrictions to achieve that quota, prohibitions against the dubbing of foreign films, and prohibitions against foreign companies distributing or exhibiting films. The law also restricted vertical integration across segments of the film industry, which could have

unintended consequences, reducing business efficiency and making the market a less attractive destination for foreign investment. The law has not been fully implemented to date.

The temporary postponement of a 2008 regulation requiring all local and imported movies, both theatrical prints and home video copies, to be replicated locally, with penalties on exhibitors for failing to do so, was replaced by consecutive one-year suspensions issued by the Minister of Culture and Tourism. In January 2013, Tourism and Creative Economy Minister Pangestu issued a decree suspending implementation until January 1, 2014. The United States continues to advocate for the permanent suspension and repeal of this regulation.

Construction, Architecture, and Engineering

Foreign construction firms are only allowed to be subcontractors or advisors to local firms in areas where the Indonesian government believes that a local firm is unable to do the work. For government-financed projects, foreign companies must form joint ventures with local firms.

Education

Indonesia limits foreign investment in primary, secondary, and tertiary educational institutions through special licenses. Foreign investment in non-formal education is limited to 49 percent. Law 12/2012 on Higher Education, passed in July, liberalized the tertiary education sector and allowed foreign universities to operate in Indonesia if they are accredited in their country of origin, collaborate with local universities, are non-profit, support national interests, and prioritize the appointment of Indonesian citizens as faculty and staff. In order for foreign nationals to provide educational services, they must be authorized by the Ministry of Education and the Ministry of Manpower. Authorization is granted on a case-by-case basis and only when there are no Indonesian instructors capable of filling the position.

Franchising

Indonesia's Ministry of Trade recently made two major regulatory changes in the franchising sector that threaten to have a significant chilling impact on future operations of foreign franchisors. First, in August 2012, Indonesia promulgated Ministry Regulation No. 53/2012. That regulation establishes a local content requirement obliging an Indonesian franchisee to domestically source 80 percent of its equipment and inventory, unless a waiver is granted. While implementing rules remain vague, this sourcing requirement could have a significant negative impact in the development of new franchising agreements in Indonesia. This new requirement is not expected to be fully enforced against existing licensed franchisees until 2017.

Second, in October 2012, the Ministry of Trade issued regulation 68/2012 restricting the number of outlets that can be owned by a master franchisee to 150 before they must sub-franchise a portion of additional units to another local sub-franchisee. This new rule could force some major U.S. and other foreign firms to divest a large number of outlets. It remains unclear as to when enforcement of this regulation will commence.

INVESTMENT BARRIERS

Indonesia's investment climate continues to be characterized by legal uncertainty, economic nationalism, and the disproportionate influence of local business interests. Government requirements often compel foreign companies to do business with local partners and to purchase goods and services locally.

Indonesia's 2007 Investment Law was intended to improve transparency and protections for foreign investors including nondiscriminatory treatment, protection against expropriation, and recourse to international arbitration in the event of a dispute with the government. At the same time, however, that 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. These sectors include telecommunications, pharmaceuticals, film and creative industries, and construction. While the ongoing process of transferring investment-related decisions from the central level of government to provincial and district level governments has helped to reduce some burdensome bureaucratic procedures, that process has led to inconsistencies between national and regional or local laws.

Indonesia continues to review the 2007 Investment Law and its negative list of restricted sectors. In 2010, Presidential Regulation 36/2010 introduced changes to the negative list, including modest changes to investment limits in individual sectors, such as construction, health care, film technical services, and electricity generation. The revisions also increased restrictions in some sectors, such as postal services, and closed other markets, such as the telecommunications tower sector, to foreign investment. The 2010 Presidential Regulation also addressed retroactive implementation of the list and called for continuous review of those sectors closed to investment.

In 2010, the Indonesian legislature introduced a new horticulture law, which reduced permissible foreign equity in horticulture-related business activities from 95 percent to 30 percent.

Energy and Mining

Over the past several years, other regulatory changes have been introduced to increase government control, government income, and local content levels in the energy and mining sectors. The changes have increased the cost of doing business in Indonesia's energy and mining sectors. The regulatory changes have also raised questions about the sanctity of contracts already in force with the Indonesian government.

Mandatory changes to contract terms remain a serious concern in the oil and gas sector. Government Regulation 79, signed in December 2010, allows the Indonesian government to change the terms of some existing production sharing contracts, eliminates the tax deductibility of certain expenses, changes the terms and criteria for cost recovery, and places limits on allowable costs for goods, services, and salaries.

Indonesia's 2009 Mining Law replaced a system based on contracts between a company and the central government with a system based on mining licenses issued by – and subject to – local agencies. The law and its implementing regulations impose onerous requirements on companies doing business in this sector, including local content requirements, domestic demand requirements, and a requirement to process raw materials in Indonesia prior to export. A requirement was introduced in 2012 that foreign license holders must divest a 51 percent stake to Indonesian investors within 10 years after the start of production. The law also reduces the maximum mine work area, diminishing a mining company's ability to fully recover any resource it discovers. Because the licenses are subject to future regulatory, permit, and tax changes, they provide less certainty than the contract of work system. The Indonesian government is forcing renegotiation of those contracts in order to increase government royalty rates, increase local content requirements, require that smelters be built and operated in Indonesia, decrease the size of mining areas, and make further changes that significantly alter the economic potential of these projects.

Telecommunications

Telecommunications providers face myriad investment restrictions. Foreign ownership of up to 65 percent is generally permitted for suppliers of value-added and mobile telecommunications services and up to 49 percent for suppliers of fixed networks. Foreign ownership of up to 95 percent is allowed for suppliers of certain data communication system services, and foreign firms have obtained licenses in this sector. While these ownership limitations are higher than Indonesia's current GATS commitments, the ownership limitation on suppliers of fixed services represents a step backward from past practice, which allowed up to 95 percent ownership.

A Ministry of Communication and Information Technology regulation issued in 2008 closed the construction, management, and ownership of cell towers to foreign investment. Some foreign firms were forced to exit the market. The President signed regulations in November 2012 to implement the Electronic Transactions Law that may require telecommunications companies operating in Indonesia to build data and disaster recovery centers inside Indonesia, although the specific language of the regulation is vague on the scope of "service providers". If strictly implemented, such a requirement would create a significant hurdle to companies seeking to do business in Indonesia.

In addition, Indonesia has local content requirements that raise concerns. Ministry of Communication and Information Technology Regulation 07/2009 Article 17 states that equipment used in wireless broadband services should contain local content of at least 30 percent for subscriber stations and 40 percent for base stations. It also states that all wireless equipment should contain 50 percent local content within 5 years. Regulation 19/2011 Article 6 has the exact same provision. Decree 41/2009 required Indonesian telecommunication operators to expend a minimum of 50 percent of their total capital expenditures for network development on locally sourced components or services.

OTHER BARRIERS

While the Indonesian government and the Corruption Eradication Commission continue to investigate and prosecute high-profile corruption cases, many investors consider corruption a significant barrier to pursuing business in Indonesia. Other barriers to trade and investment include poor government coordination, the slow rate of land acquisition for infrastructure development projects, poor enforcement of contracts, an uncertain regulatory and legal framework, and lack of transparency in the development of laws and regulations. U.S. companies seeking legal relief in contract disputes have reported that they are often forced to litigate spurious counterclaims.