CHAPTER 7, INVESTMENT CLIMATE STATEMENT

Overview
----

1. The administration of President Megawati Soekarnoputri has made important strides in its first year in reducing political instability, strengthening Indonesia's relationship with the International Monetary Fund (IMF), and reinvigorating the country's economic reform program. These developments led to increased confidence in the economy during the first half of 2002, with both the rupiah and Jakarta Stock Exchange performing strongly. Consumer confidence and exports have begun to rise from their very low levels of late 2001. However, the Megawati Administration has made much less progress in improving Indonesia's troubled investment climate, and several adverse court rulings against foreign companies brought investment issues to the forefront of GOI policymaking in 2002.

2. Existing and potential investors cite a number of concerns with respect to Indonesia's investment climate: security, the lack of legal certainty, confusion over regional autonomy policies and fiscal decentralization, uneven implementation of economic reform commitments, and tax and labor issues.

3. Security: Security is a major concern for investors, particularly those in the extractive industries. Plantations and mining operations have experienced looting, occupation of land by squatters, and illegal mining. These events reflect opportunism by local interests as well as a lack of effective law enforcement. Outbreaks of sectarian violence in Maluku, Lombok, Central Sulawesi and other areas, as well as separatist movements in Aceh and Papua, continue to challenge national unity. A perceived breakdown in law and order undermines the government's guarantees regarding the security of foreign and domestic investments.

4. Legal Uncertainty: Foreign investors have major concerns about the lack of legal certainty, the difficulties of enforcing contracts, and differential treatment of domestic versus foreign companies. Indonesian courts have repeatedly issued rulings ignoring binding arbitration clauses in contracts. Indonesia's Bankruptcy Law, which was amended in 1998 to establish a separate Commercial Court, has been a disappointment to creditors. In a serious abuse of the bankruptcy law, the Commercial Court declared bankrupt a local subsidiary of the Canadian insurance firm Manulife Financial, even though the Ministry of Finance declared the subsidiary solvent. Manulife successfully appealed to the Supreme Court; however, few observers rule out the occurrence of similar cases in the future. Parliament in considering amendments to the bankruptcy law that may pass by the end of 2002.

5. Decentralization: The process of devolving administrative authority to the regions as outlined under laws 22 and 25 began on January 1, 2001, remains incomplete and has achieved mixed results. Local authorities have the right to impose certain new local taxes and levies; however some of these new taxes have impeded commerce and targeted investors. Local communities, impatient for the financial benefits of decentralization, have sought to obtain extra-contractual concessions

from companies operating in their areas. The central government has been slow to use its explicit authority to overturn burdensome taxes that violate the law.

6. Economic reform: The GOI's progress on structural reform issues has improved under President Megawati. The GOI has completed four quarterly IMF reviews since September 2001. However, a sharp rise in anti-IMF sentiment among Jakarta politicians and commentators in mid-2002 has called into question the degree of political support for further reforms.

7. Tax and Labor Issues: In April 2002, the DPR enacted a new law creating a tax tribunal to replace the Tax Disputes Settlement Board (BPSP), a special government institution. The tax tribunal will hold public hearings on tax disputes to combat irregularities and closed-door deals previously done between taxpayers and the judges. Labor management relations in Indonesia have undergone sweeping change since the fall of former President Suharto. The GOI has tried to better define worker rights, but most business observers believe the GOI has not struck a balance between protecting worker rights and the competitiveness concerns of business. A controversial set of new labor laws remained mired in the legislature as of December, 2002.

Note: The following discussion summarizes the legal, regulatory, and de facto investment framework as of mid-2002. The FY 2002 budget assumes an average exchange rate of Rp. 8500/USD. However, the exchange rate used throughout this report is Rp. 9,000/USD, the prevailing rate at the time of publication. However, the GOI uses its own formula to calculate the rupiah value of U.S. dollar investment projects.

Openness to Foreign Investment

----

8. Indonesia encourages private sector-led growth and foreign investment. It has maintained a relatively open foreign investment regime. President Megawati frequently appeals for greater foreign investment during her trips abroad, and investment law reform comprises one of the objectives of the GOI’s IMF-supported economic reform plan.

9. However, these efforts have fallen far short of investor expectations, and new investment has slowed substantially. Investment statistics show that in 2001 investment approvals fell to USD 9.03 billion from USD 15.41 billion in 2000. However, the actual foreign investment realized in 2001 amounted only to USD 70 million. For the first five months of 2002 foreign investment approvals were only USD 1.67 billion, a 58% decline from USD 3.97 obtained over the same period in the prior year.

10. Under Indonesia’s current investment law, Capital Investment Coordinating Board (BKPM) plays a key role in promoting foreign investment and approving many project proposals, including investments in Bonded Zones (Kawasan Berikat) and Integrated Economic Zones (KAPET). However, in practice a plethora of often-competing approval bodies leads to confusion among potential investors. The relevant technical government departments handle investment approvals in oil and

gas, banking, and insurance industries. Investors may also apply for investment approvals with Indonesian Embassies abroad or provincial Regional Capital Investment Coordinating Boards (BKPMDs). Regional autonomy legislation permits each province, district and city to accept and approve applications, and many have been doing so since 2000. It is still unclear whether investors will in the future need approvals from both central and local governments.

Sectoral Restrictions
----

11. Indonesia's investment law allows the establishment of wholly owned foreign companies, except for sectors on the GOI's "negative investment list." Presidential Decree 96/2000 sets out the most recent list of sectors with investment restrictions of some sort. These include the following:

A. Sectors closed to all investors: businesses that produce, process, or develop any of the following: marijuana, sponges, harmful chemical products, weapons, alcoholic drinks, casinos, air traffic systems.

B. Sectors closed to foreign investors only:
--germ plasm cultivation;
--forest concessions;
--lumbering contractors;
--taxi/bus transport and small-scale water transport services;
--print media, TV, radio, film and cinema, including distribution and exhibition;
--small-scale retail trade.

C. Industries with restricted ownership limits for foreigners:
--airport/seaport construction and operation;
--electricity production, transmission and distribution;
--atomic power plants;
--shipping;
--drinking water;
--railway service;
--certain medical services.

In addition, a variety of industries are open to foreign investment under certain limitations, usually restrictions on business locations and scope of operation. Projects in these industries require special licensing.

D. Other sectors are reserved for domestic small-scale enterprises, or large or medium-scale foreign companies on condition that they partner with local small businesses or cooperatives before investment applications are approved, such partnerships need not include explicit domestic share ownership (See Appendix).

12. Government Regulation No. 20/1994 and Decree No. 15/1994 requires foreign investors with wholly owned companies to divest partial ownership to an Indonesian partner after fifteen years of commercial operations. The regulation does not specify the required divestment percentage, and may lead GOI officials to

make arbitrary rulings in the future. BKPM officials maintain that foreign investors will only need to divest between one and five percent of ownership, but no companies are required to divest prior to 2008.

Distribution
----

13. The GOI has eliminated many restrictions on foreign investment in retail and wholesale operations. Foreign firms are now allowed to invest directly in both wholesale and large-scale retail trade sectors (generally interpreted as shopping centers, malls, supermarkets, and department stores), with the condition that they enter into a cooperative agreement with a small-scale enterprise. Such an agreement, in practice, has not required equity participation by the small-scale enterprise. In addition, many foreign firms use franchising, licensing, and technical service agreements to distribute their goods. Indonesia has lifted many restrictions on foreign participation in domestic distribution services.

14. Under current regulations, foreign companies manufacturing in Indonesia may distribute their locally produced goods at the wholesale level and may apply for permits to import and distribute other products as well. These licensing processes may be substantially affected by decentralization. Companies engaging in wholesale distribution may not conduct retail operations directly, but must form a separate retail company.

Investment Approval Process
----

15. Investment in Indonesia is categorized as either domestic (PMDN) or foreign (PMA). An investment with any degree of direct foreign ownership is defined as PMA. A foreign investor may be an individual or a corporate entity. A PMA must have a minimum of two managers/shareholders, and at least one director and chairman. There are no minimum or maximum total investment (debt plus equity) requirements, however investors in the manufacturing sector typically are expected to have a debt to equity ratio of 3:1 or less, while those in the agricultural or mining sectors may have ratios of 6:1 or greater.

16. Private entities may establish, acquire, and dispose of interests in business enterprises. Current regulations permit foreign firms to acquire domestic firms in sectors open for foreign investment after receiving approval from BKPM. When reviewing applications from foreign firms seeking to acquire locally established firms, BKPM frequently requires the buyer to reserve a small stake for a local buyer or the original owner. In cases where a foreign buyer is buying out a troubled Indonesian firm, BKPM frequently requires the investor to inject capital, not just provide management expertise, technology or assume outstanding loans. The approval process to take over a troubled firm may take as long as two months.

17. BKPM claims to require only ten days to process the initial investment approval (IIA) (or investment license) once the applicant has furnished all requested information and documentation. In practice, however, this process can easily be

delayed for two to four weeks depending on the availability of officials and complete submission of documents. The IIA serves as a temporary operating license for a period up to three years (the IIA can be extended), and it enables the PMA company to start its commercial activities.

18. The IIA allows the parties to form a limited liability company (Perseroan Terbatas, or P.T.) by executing through an Indonesian notary a Deed of Establishment. The Articles of Association of the PMA company are included in the Deed of Establishment and must comply with Law No. 1/1995 on Limited Liability Companies. With the Deed of Establishment executed, the company may obtain a taxpayer registration number from the Directorate General of Taxation of Foreign Companies. This requires about one week. The PMA company must open a special foreign investment account at an approved foreign exchange bank in Indonesia. Should the PMA company's IIA indicate plans to hire expatriates, it will need to file an application for approval of its manpower plan with BKPM.

19. A PMA company becomes a limited liability company after the Ministry of Justice and Human Rights (MOJHR) grants approval. The process takes a maximum of two months after the MOJHR receives the Deed of Establishment, tax ID number, PMA bank account information from the notary who initially prepared the Deed of Establishment. After obtaining approval from the MOJHR, the PMA should submit its Deed of Establishment to the Ministry of Industry and Trade (MOIT) within thirty days. Following registration at the MOIT, the Deed of Establishment should be published in the Supplement to the State Gazette (Tambahan Berita Negara), a process normally handled by the notary. During the time between receiving approval from the MOJHR and Deed of Establishment's publication in the Gazette the founding shareholders are personally liable for all obligations undertaken in the company name. If importing, BKPM may require the firm to seek an additional license, and the PMA company may need to enroll employees in JAMSOSTEK's mandatory employees social insurance program. If the PMA employs more than 25 people, the Manpower Department must also give approval.

20. The IIA can be used until the PMA company reaches the state of commercial operation or commercial production. At that point, the PMA company must submit an application for a Permanent Business License (Ijin Usaha Tetap, or IUT) with a recommendation letter from BKPMD to BKPM. Each IUT is valid for 30 years and subject to renewal. The investor must submit semi-annual reports to BKPM and BKPMD.

Draft Investment Law

----

21. President Megawati has encouraged the BKPM to complete and submit to parliament a new investment law to replace the current 1967 law. The draft law promises equal treatment to domestic and foreign investors and a range of incentives, including tax holidays. The law also creates a "one-stop shop" which would concentrate investment approvals for all sectors within BKPM. However, other ministries have strongly resisted this dramatic increase in BKPM's authority to approve investments. Regional governments, which under regional autonomy legislation have investment approval authority, also oppose the concept.

IBRA Asset Sales and Privatization
----

22. Sales of equity stakes and loans by the Indonesian Bank Restructuring Agency (IBRA) represent an opportunity for foreign investors. IBRA plans to raise approximately USD 3.9 billion in cash through the sale of assets in 2002. It plans to sell several hotels and real estate companies, a canning company, and several textile and wood-based firms. In early 2002 IBRA completed the sale of one of Indonesia's largest retail banks, BCA, and is scheduled to sell Bank Niaga and Bank Danamon before the end of the year. The GOI has also published a list of state-owned firms it plans to sell in 2002, including the long distance provider PT Indosat, in order to meet a Rp 6.5 trillion (USD 720 million) privatization budget target. Difficulties establishing the valuation of the state-owned firms, labor resistance, nationalism, and the challenge of attracting buyers in an uncertain investment and security environment have slowed the program.

Oil and gas
----

23. The Indonesian government passed a new petroleum law in October 2001 that deregulates the upstream and downstream sectors in two years. The law removes Pertamina's monopoly over downstream oil distribution and marketing of fuel products, and makes no procedural distinction between foreign and domestic oil and gas companies. Pertamina's responsibility to manage Production Sharing Contracts (PSCs), which authorize investors to produce oil and gas, will shift to the central government.

24. The oil and gas law creates two new governmental bodies: the Executive Body that takes over Pertamina's functions in the upstream and the Regulatory Body that will supervise downstream operations. The Regulatory Body will license downstream operators to assure sufficient domestic supplies and the safe operation of refining, transport and distribution of petroleum products. The new law extends the Domestic Market Obligation (DMO) to natural gas producers and will require them to allocate 25 percent of their production to the domestic market. Previously, the DMO required only crude oil producers to allocate 25 percent of their production to domestic markets. The GOI must still establish the implementing regulations for the new law.

Services
----

25. In 1999, in keeping with its commitments under the World Trade Organization's (WTO) Financial Services Agreement, the government equalized the capital requirements for domestic and foreign insurance firms. In 1998, the GOI amended the 1992 Banking Law to allow Bank Indonesia, instead of the Ministry of Finance to issue banking licenses.

26. 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, and many foreign law firms enter into a cooperative work agreement with local firms. Indonesian citizenship, as well as graduation from an Indonesian legal facility or other recognized institution, is required for admittance to the local bar. Foreign engineering consultants can operate only by forming a joint venture with local partners in Indonesia.

Conversion and Transfer Policies
----

27. The rupiah has stabilized significantly from trading at the Rp 11,440/USD level in July 2001 when President Megawati took office. After an initial surge following Megawati's election, the rupiah weakened again in the last half of 2001. Since then it has strengthened slowly to the Rp 8,800/USD level, an increase of 23 percent. Previously, the rupiah was very volatile ranging from Rp 2,500/USD prior to the Asian Financial Crisis to a low of Rp 17,000/USD after President Soeharto resigned in June 1998. Although the stability of the rupiah has returned, the approach of elections in 2004 and slower economic growth combined with high levels of debt have made exchange rate risk a major concern of investors.

28. Indonesia has no system of capital controls and foreign exchange flows freely in and out of the country. No prior permits are necessary to transfer foreign exchange and foreign investors have the right to repatriate capital and profits at the prevailing rate of exchange. The government does not place restrictions on outward direct investment. Since April 2000, Indonesian residents are required to report all foreign exchange transactions above USD 10,000 or the equivalent. Bank Indonesia introduced regulations prohibiting banks in Indonesia from transferring Rupiah to non-residents in January 2001 to control speculative trading of the Rupiah. The regulations also limit the quantity of derivative transactions against the rupiah by onshore banks to USD 3 million.

Expropriation and Compensation
----

29. Article 21 of the 1967 Foreign Capital Investment Law stipulates that the government shall not initiate nationalization of foreign investments except by law and when such action is necessary in the interest of the state. According to BKPM, the GOI has not expropriated any foreign investment since the passage of the 1967 law. In 1999, however, the Overseas Private Investment Corporation (OPIC) paid a claim by a US investor after the GOI failed to honor an arbitration award. The GOI subsequently repaid OPIC. The GOI also paid USD 15 million compensation to the Multilateral Investment Guarantee Agency (MIGA) for its insurance payment to the Pasuruan Power project.

Dispute Settlement
----

30. The court system does not provide effective recourse for solving commercial disputes, however, it has been effective in the majority of cases where the courts have been asked to implement arbitration decisions. The judiciary is nominally independent under the law, but there is inadequate protection in place to assure the accountability of judges and court staff. Legal practitioners say irregular payments and other collusive practices often influence judicial outcomes. The GOI has recognized that there must be judicial reform, but implementation has been very slow. Indonesian parties have in several instances taken commercial disputes to local courts, which have accepted jurisdiction despite contractual arbitration clauses calling for adjudication of disputes in foreign venues.

31. Indonesia is a signatory to the Convention On The Settlement Of Investment Disputes Between States And Nationals Of Other States (ICSID). Only one case has been brought to the ICSID by a US investment company, which was successfully settled in its favor. Indonesia's Arbitration Law recognizes the right of parties to apply any rules of arbitration procedure they may mutually agree upon, and provides default procedural rules that apply if no other rules have been designated. An Indonesian commercial arbitration board, BANI, is available if both parties agree. Ad hoc arbitrations have been held in Indonesia using the United Nations Commission on International Trade Laws (UNCITRAL) arbitration rules, as well as others. ICC arbitrations have also been held in Indonesia.

32. In 1981, Indonesia joined the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, but since that time Indonesian courts have registered fewer than two dozen foreign awards for enforcement. Prior to the passage of the new Arbitration law in 1999, enforcement lay with the Supreme Court, which was slow to act on decisions. Since 1999, the Central Jakarta District Court has been responsible for enforcement of awards and the process is improving. There are a few aberrant cases still outstanding, but for the most part awards are being enforced. The new law has greatly reduced instances where district courts have failed to apply the law, and the legal practitioners predict the process should improve as more judges educate themselves about arbitration. The relative success with arbitrations may be explained primarily the desire of both parties not to completely sever their business relationship.

33. Indonesia enacted laws on consumer protection, anti-corruption, and anti-monopoly/competition in 1999; however, the regulatory frameworks to enforce these new laws remain incomplete.

Performance Requirements and Incentives
----

34. The GOI has notified the WTO of its compliance with Trade-Related Investment Measures (TRIMS) Notification.

35. The MPR revoked tax holiday incentives in 2000. However, a BKPM sponsored draft investment bill, under cabinet review, aims to reestablish such incentives. Various fiscal incentives are available to both foreign and domestic investors. A company producing for the domestic market may apply for import duty exemptions on all required machinery and equipment as well as on raw and supporting materials needed during the first two years of commercial production. A company producing for export markets may apply for restitution of import duties paid on inputs subsequently re-exported in finished form.

36. Indonesia expects foreign investors to contribute to the training and development of Indonesian nationals, allowing the transfer of skills and technology required for their effective participation in the management of foreign companies. Under Manpower regulations, any expatriate who holds a work and residence permit must contribute USD 1,200 per year to a fund for local manpower training at regional manpower offices. As a general rule, a company can hire foreigners only for positions that the government has deemed open to non-Indonesians. Employers must have manpower-training programs aimed at replacing foreign workers with Indonesians.

37. At present, Indonesia does not have formal regulations granting national treatment to U.S. and other foreign firms' participating in GOI-financed and/or subsidized research and development programs. The State Ministry for Research and Technology handles applications on a case-by-case basis. However, the Ministry is currently drafting regulations to enable interested parties to pursue their interest in a clear and systematic manner.

38. Indonesia does not have rules requiring investors to purchase from local sources or export a certain percentage of output. Rules that encouraged investors to locate in industrial estates were diluted in June 1998. Foreign firms are not required to disclose proprietary information to the government before investing.

Right to Private Ownership and Establishment

----

39. Indonesia recognizes the right to private ownership and establishment and has relied heavily on the private sector (albeit at times heavily protected), as the principal engine of economic growth. At the same time, State-owned Enterprises (SOEs) play a dominant role in many sectors, including oil and gas retail and distribution, electric power generation and transmission, civil aviation, banking, and fertilizer production and wholesale. Their role has declined as private sector activity grew and privileges awarded to SOEs have decreased. The Parliament formed the State Ministry for SOEs in 1998; privatization is an important part of its mandate.

Protection of Property Rights

----

40. In July 2002 the GOI announced its intention to restart previously suspended private infrastructure projects, especially in the field of private power generation. The change in policy stems from greater economic stability, growth in electricity

demand, as well as GOI efforts to honor internationally binding contracts. The U.S. government has urged that the GOI conduct all project reviews and contract negotiations in a rule-based, consistent, objective, and transparent manner.

41. GOI regulations allow mortgages to be registered against real property and seagoing vessels in their appropriate registries, as well as security interests in chattels, equipment, accounts receivables and insurance proceeds. A search facility is currently in place for only mortgages. The extreme uncertainty inherent in Indonesia's courts means there is no assurance that security interests will be recognized by the courts in a specific case and enforced. Foreign entities have no freehold rights to land ownership in Indonesia. Foreign investors' land holdings are often obtained through long-term lease agreements (normally for 30 years) with the government or private parties. These lease holdings can be used as collateral. Foreign companies may also establish a limited company under Indonesian law that can legally obtain rights to land, mostly in the form of Right to Cultivate (HGU) or Right to Build (HGB). However, there are contradictory regulations which could undermine a foreign company's HGU.

42. The court system does not provide effective recourse for settling property disputes. Indonesia's decentralization process has unleashed a flurry of new land claims by local residents against companies, often operating on government-granted concessions located in their communities. Again the problem is not only incomplete or inaccurate record keeping, but also an ineffective and corrupt enforcement system.

43. In April 2002, the USG placed Indonesia on the Special 301 Priority Watch List in response to continued problems in the enforcement of intellectual property rights. Since 2000, Indonesia has made progress in improving the regulatory and legal framework for protection of intellectual property rights. Indonesia has enacted new laws providing protection for industrial designs, integrated circuits, trade secrets and plant varieties, in accordance with TRIPs obligations. In 2001, Indonesia significantly amended its existing patent and trademark laws and began plans to draft optical media regulations. The amended laws establish provisions for commercial courts to process intellectual property rights cases within the country's civil commercial courts. Effective enforcement of IP rights through Indonesia's justice system is still very difficult.

44. Indonesia is a member of the World Intellectual Property Organization and has acceded to numerous international conventions on intellectual property rights, including the Paris Convention for the Protection of Intellectual Property; the Berne Convention for the Protection of Literary and Artistic Works (with a reservation on Article 33); and signed the Trademark Law Treaty. Other international agreements to which Indonesia is a party include: the Nice Agreement for the International Classification of Unclassified Goods and Services, and the Strasbourg Agreement Concerning International Patent Classification.

45. Patents: The current patent law dates from 2001, which amended and consolidated in a single text all previous legislation. In 1997, Indonesian law extended the term of patent protection to 20 years from 14 years, and maintained the provision for a two-year patent extension. The amendment allows for the patenting of plant and animal varieties. Unfortunately, the GOI requires that to qualify for protection a

patented item or chemical entity be “worked” or produced in Indonesia. Companies importing a patented item will not qualify for protection and the GOI would not block the import of similar unpatented products. The rules on content of voluntary patent licenses appear to be more restrictive than is permitted by the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement. Inventions that are contrary to Indonesian laws and regulations are excluded from patent ability, and the standard for excluding inventions contrary to the public interest appears to be inconsistent with TRIPS requirements. Indonesia provides product patent protection for foods and beverages and is a signatory of the Patent Cooperation Treaty.

46. Trademarks: Indonesia’s current trademark law dates from 2001, when Parliament amended and consolidated all previous texts. Trademark rights are determined on a first-to-file basis rather than on a first-use basis. After registration, the mark must actually be used in commerce, and protection is for ten years. The law offers protection for service marks, collective marks and sets forth a procedure for opposition to registration of similar marks prior to examination by the trademark office. The law covers well known trademark protection, however, procedures are not yet in place for registering well known trademarks. The law provides for administrative cancellation of registrations competing with well-known marks, but rights-holders continue to have difficulty enforcing this provision. Indonesia is a joint signer of the Trademark Law Treaty, and the Nice Agreement for the International Classification of Unclassified Goods and Services.

47. Copyright: Indonesia enacted a new copyright law in July 2002, which incorporates all existing provisions of previous legislation, including rental rights to audiovisual, cinematography, and computer software. It also, for the first time includes criminal penalties for end-user piracy. The law will also make possible enhanced regulation of global disc production facilities once the Ministry of Industry and Trade issues implementing regulations. The law will not fully come into force until July 2003. The current law provides for licensing rights for sound recordings, and for producers of phonograms. The duration of copyright protection is for 50 years or in the case of an individual’s work, the duration of life and then 50 years after his death. Indonesia has acceded to the WIPO Copyright Treaty, but enforcement of copyright laws is weak.

48. Business Software Alliance reported that 90 percent of all CDs (audio, video, and software) for sale in Indonesia are pirated and ranks Indonesia just behind Vietnam and China as the world’s worst offenders. According to US industry estimates, in 1999 total losses from copyright piracy exceeded USD 170 million. At the urging of the film and entertainment industry, the GOI has plans to draft optical disc regulations that require all CD production facilities to be licensed. On a positive note, in July 2002 Microsoft reported improved sales following a successful prosecution of local software pirate dealers in 2001.

49. New technologies: Indonesia passed a law protecting plant varieties in December 2000. Patent holders may file an application for protection at the Plant Variety Protection Office in the department of Agriculture. The U.S.-Indonesia Science and Technology Agreement ensures protection for intellectual property derived from cooperative activities under the agreement's umbrella.

Transparency of the Regulatory System
----

50. Indonesia has a tangled regulatory and legal environment where most firms, both foreign and domestic, attempt to avoid the justice system. Laws and regulations are often vague and require substantial interpretation by implementing offices, leading to business uncertainty and rent seeking opportunities. Deregulation has been somewhat successful in removing barriers, creating more transparent trade and investment regimes, and has alleviated, but not eliminated, red tape. U.S. businesses routinely cite transparency problems and red tape as factors hindering operations.

51. In April 2002, the DPR enacted a new law creating a tax tribunal to replace the Tax Disputes Settlement Board (BPSP), a special government institution. The tax tribunal will hold public hearings on tax disputes to combat irregularities and closed-door deals previously done between taxpayers and the judges. Some businesses fear such hearings will force the release of confidential business information.

Efficient Capital Markets and Portfolio Investment
----

52. Indonesia's capital market expanded rapidly during the 1990s, led by growth of the equity market. The Jakarta Stock Exchange (JSX) is the dominant securities market in the country. Although the JSX has performed strongly so far in 2002, transaction volumes in 2002 remain well below their pre-crisis levels. Corporate bond issues increased in 2002 as interest rates declined; nonetheless the lack of a well-developed corporate bond market limits financing options for key firms.

53. In February 2001, the GOI liberalized foreign ownership in Joint Venture Securities Company allowing foreigners to own up to 85% of paid-up capital in joint venture companies engaged in finance, other than securities. Licensed foreign entities involved in the securities business are now allowed to own up to 99 percent of paid-up capital of joint venture securities companies.

54. Foreign firms generally enjoy good access to the Indonesian securities market. Financial reforms introduced in 1987 allow foreign firms to form joint ventures with Indonesian partners in the securities market as underwriters, broker-dealers, and investment managers. In 1997, MOF lifted the 49-percent restriction on foreign purchases of shares in non-bank listed firms, and in 1999 lifted those restrictions for banks. In 1998, MOF lifted discriminatory capital requirements on foreign securities. Portfolio investment is regulated by BAPEPAM, which the GOI formed in 1976 to regulate and supervise capital and stock market activity.

55. The large amount of non-performing corporate debt, estimated in late 2000 at USD 65 billion, is a major factor limiting capital markets growth in Indonesia. Although debtors and creditors have reached agreement on a substantial number of restructuring terms sheets through IBRA and the Jakarta Initiative Task Force, few of these agreements have reached legal closing. As a result, few of Indonesia's

corporations are creditworthy.

Political Violence
----

56. Foreign investors in Indonesia, particularly in the oil, gas, and mining sectors have been the victims of a number of acts of political violence in recent years. There were attacks and bombings by a separatist group against a major LNG facility in Aceh. Mines and oil production facilities in North Sulawesi and Riau provinces have been subject to blockades by local groups. Labor disputes have also turned violent in several instances.

57. In June 2002, a bomb exploded outside a Jakarta nightclub and two others placed in public locals were defused and removed, renewing fears of another wave of bombings in the capital. During an earlier wave in late 2000, there were explosions at the Jakarta Stock Exchange, diplomatic facilities and a shopping mall. On Christmas Eve that same year, a bombing campaign struck churches throughout Indonesia, leaving 16 dead and over one hundred injured.

58. The Department of State warns citizens to defer non-essential travel to Indonesia. In particular the Department warns American citizens to avoid all travel to the regions of Aceh, Papua (formerly Irian Jaya), the Moluccas (North Maluku and Maluku), West Timor, Central and West Kalimantan, and Central and South Sulawesi due to recurring violence in those areas. The Department of State encourages American citizens considering travel to Indonesia to review carefully the information available in the State Department's Consular information sheet, available on the Internet at http://www.usembassyjakarta.org or on the Bureau of Consular Affairs' home page http://travel.state.gov. This public announcement contains information concerning specific locations in Indonesia which should be avoided or where extra caution is warranted.

Corruption
----

59. In recent years, considerable attention has focused on the increasing costs of corruption and influence peddling to local and foreign businesses, and the economy as a whole. In early 2002, Indonesia was rated as the most corrupt economy in Asia in an annual survey conducted by a risk consultancy company. Since the fall of Suharto, eliminating government corruption and collusive business practices has become a national issue. However, Indonesia's judicial branch is underfunded and recent legislation strengthening judicial independence appears to have reinforced the impunity of judges from effective accountability. Experienced court observers say all participants in the justice system from police to Supreme Court Judges augment their incomes through bribes, fees, or other unofficial means. Although a free press provides extensive coverage of past and current corruption investigations, successful prosecutions have been rare. In November 2001, the GOI passed new anti-corruption legislation to clarify sections of the 1999 Law on the Eradication of Corruption, including gratuities received by public employees. The 1999 law provided for the creation of the Commission for

Eradication of Corruption (KPTPK), however, this commission has yet to be established and will require additional legislation. In 2002, a court convicted the head of the House of Representatives, Akbar Tandjung, on corruption charges, However, he retained his leadership position in the House and in his political party, GOLKAR, pending an appeal.

60. University of Indonesia research conducted in the third quarter of 2001 reported bribes to the government bureaucracy increased total business costs by 10 percent. Bribes increased costs by a greater amount in less advanced regions outside of Java. Common business complaints include: frequent demands for "facilitation fees" to obtain required permits or licenses, government award of contracts and concessions based on personal relations, and an arbitrary legal system. In addition, foreign companies continue to report difficulties in obtaining and renewing necessary immigration permits for expatriate staff.

Bilateral Investment Agreements

----

61. Indonesia has signed investment protection agreements with 54 countries, but an Agreement with the United States is still in draft form as of June 2002. GOI bilateral investment agreements exist for Argentina, Australia, Bangladesh, Belgium, Cambodia, Chile, Cuba, Czech Republic, Denmark, Egypt, Finland, France, Germany, Hungary, India, Italy, Jamaica, Jordan, Kyrgyzstan, Laos, Malaysia, Mauritius, Mongolia, Morocco, Mozambique, North Korea, Norway, Pakistan, People's Republic of China, Poland, Qatar, Romania, Singapore, Slovak Republic, South Korea, Spain, Sri Lanka, Sudan, Suriname, Syria, Sweden, Switzerland, Thailand, The Netherlands, Tunisia, Turkey, Turkmenistan, Ukraine, United Kingdom, Uzbekistan, Vietnam, Yemen, and Zimbabwe. As of November 2001, Indonesia has also signed treaties for the avoidance of double taxation with 51 countries, of which 43 have come into force, including the treaty with the United States.

OPIC and Other Investment Insurance Programs

----

62. Since 1967, Overseas Private Investment Corporation (OPIC) has provided insurance to U.S. investors in Indonesia covering: inconvertibility, expropriation, and war, revolution and insurrection. In 1987, OPIC extended coverage to bid bonds on service contracts. OPIC has also provided project financing to companies with at least 25 percent U.S. ownership.

Labor

----

63. Labor management relations in Indonesia have undergone sweeping change since the fall of former President Suharto. Since 1998 unions have become more active in organizing and asserting their rights, bringing them into conflict with management and GOI plans for SOE privatization. After years of neglecting labor,

the House of Representatives passed legislation in 2000 that provided greater protection for workers than found in many countries. The GOI has tried to better define worker rights, but most business observers believe the GOI has not struck a balance between protecting worker rights and the competitiveness concerns of business.

64. Indonesia now has over 60 labor federations, and thousands of plant-level unions registered with the Ministry of Manpower. The process of union formation is detailed in law 21/2000 on trade unions, which allows ten or more individuals to form a union and permits multiple unions in a company. There is considerable confusion about interpretation and enforcement of existing labor laws and regulations due to their need for revision and their limited dissemination. Moreover, there is a lack of understanding and uncertainty surrounding proposed changes in labor law. Since 2000 the MPR has been considering additional draft laws to clarify the rights of workers and create guidelines for labor relations. Controversial draft laws on the protection of workers' rights and the resolution of industrial disputes were debated in 2002 Parliament sessions but failed to pass.

65. There has been no progress in revising the controversial Labor Ministerial decree 150/2000. This decree makes it difficult to terminate a worker, even those who have committed major violations or crimes, and provides for severance payments to workers who resign, or are fired. The GOI abandoned attempts to revise Decree 150 in the face of major labor protest in early 2001. GOI efforts to establish a national tripartite committee to revise the decree have failed due to confusion over which worker's federation would represent labor.

66. Official statistics for 2000 show Indonesia has a working age population (those above the age of 15) of 141 million and a labor force of 96 million. The Ministry of Manpower claims that as much as 65 percent of the total number of workers is employed in the informal market. A labor market study reports that Agriculture, Services, and Industry employ 43 percent, 43 percent, and 14 percent of the labor force, respectively. The lack of job training opportunities and the low quality of government educational institutions have created a large number of workers whose skills do not match market demand. Indonesia has a shortage of qualified managerial and professional personnel. In 1999, 55 percent of the labor force had an elementary school education, 15 percent finished junior high school, 17 percent completed high school, 2 percent obtained a college degree and 2 percent graduated from university.

67. The Ministry of Manpower claims 30 million are underemployed and about 8 million more are unemployed or work less than 15 hours a week. Most observers believe these estimates understate the true number of unemployed and underemployed workers. A report by the Asian Development Bank estimated that Indonesia's economic growth would have to reach 7-8 percent to absorb all the new graduates and workers entering the workforce each year. However, in 2000 and 2001 economic growth rates only reached 4.8 percent and 3.3 percent, respectfully.

68. Foreign and domestic investors are increasingly concerned about the impact of rising minimum wages on the competitiveness of their businesses. Regional governments set the minimum wage for their localities. The governor of Jakarta hiked the minimum monthly wage by 38 percent in 2002 to RP 591,266 (USD 68 at

RP 8700/USD 1). This increase followed a 30 percent hike in minimum wages in 2000. Monthly minimum wages in Indonesia wary from USD 35 – 65. Wages remain very low in absolute terms and many workers still do not receive the minimum wage.

69. Indonesia has signed ILO Convention No. 138 and incorporated it into law 20/1999, which bans the employment of children under 15 year old. Nevertheless, the Central Bureau of Statistics reports that 3.8 million Indonesian children between the ages of 5 and 18 must work to support their families, an underestimate according to many observers.

70. The United States has traditionally been a top choice for Indonesians wishing to study abroad. In the 2000-2001 academic year, there were an estimated 11,625 Indonesians studying in the United States, representing a growth of 2.9 percent from the previous year. Indonesia now ranks seventh in the total number of students attending colleges and universities in the United States, according to statistics of the Institute for International Education (IIE). Approximately 68.5 percent were enrolled in 2-year or 4-year programs and, 25.1 percent in graduate programs, and the remaining 6.4 percent in non-degree programs, including English language studies.

Foreign Trade Zones/Free Ports

----

71. The GOI offers incentives to foreign and domestic industrial companies that locate in any of Indonesia's seven designated bonded zones. The largest bonded zone is on the island of Batam, located just south of Singapore. Investors in bonded zones are not required to apply for additional implementation licenses (location, construction, and nuisance act permits and land titles), and foreign companies are allowed 100 percent ownership. These companies do not pay import duty, income tax (Article 22), value added tax (VAT), and sales tax on imported capital goods, equipment, and raw materials until the portion of production destined for the domestic market is "exported" to Indonesia, in which case fees are owed only on that portion. Companies operating in bonded zones may also lend machinery and equipment to subcontractors located outside of the bonded zone for a maximum two-year period. The companies have also enjoyed exemption from VAT and sales tax on luxury goods on the delivery of products to subcontractors for further processing outside of bonded zones.

Foreign Direct Investment Statistics

----

72. For the first five months of 2002 investment approvals fell 58% to USD 1.67 billion from USD 3.97 billion over the same period in 2001. Although project totals for the first five months have not been announced, in the first quarter of 2002 the number of projects fell to 189 from 281 for the same period in 2001. The amount of foreign investment approvals have declined every year since 1997 with the exception of 2000, when approvals rose to USD 15.4 billion, or 41 percent over prior year, helped by economic growth of 4.8 percent, and strong oil and commodity prices.

73. Except as noted, the Capital Investment Coordinating Board (BKPM), the central processing point for most investment applications, collected the data below. The data does not include investments in the following sectors: oil and gas, finance, banking, non-bank finance, insurance, and leasing. BKPM approval reports should be treated with caution, because the agency performs little monitoring of investment project implementation. Some investors may inflate the value of their investments to maximize GOI incentives. For example, the mid-1990's approvals were inflated for several years by a surge of interest in oil product refineries, most of which were never constructed. In addition, year-on-year comparisons of domestic approvals after the rupiah began to decline in mid-1997 are difficult because of the currency's fluctuating value.

Table 1. Leading Foreign Investors With Cumulative Investment Totals, 1996-2000

Rank	Country	Number of Projects	Total Investment Amount (USD Million)
1.	United Kingdom	480	17,762
2.	Japan	269	17,762
3.	Singapore	743	7,965
4.	Germany	126	5,750
5.	Taiwan	467	5,740
6.	South Korea	719	3,795
7.	Netherlands	172	3,269
8.	Australia	291	3,225
9.	USA	226	2,607
10.	Hong Kong (SARC)	96	2,088

Table 2. Foreign Investment Approvals & Actual Investment Value Realized, 1996-2001

Year	Number of Projects	Total Value (USD Million)	Actual Value Realized (USD Million)
2001	1,317	9,027	70
2000	1,524	15,413	2,600
1999	1,174	10,891	1,340
1998	1,034	13,563	1,210
1997	783	33,833	2,080
1996	948	29,940	4,670

Table 3. Top Ten Sectors By Value Per Year, 1996-2000

Sector		Projects	Total Value (USD Million)
2001			
1.	Chemicals	33	2,310
2.	Other services	213	1,521
3.	Hotel/Restaurant	48	892
4.	Paper & Printing	13	742
5.	Basic Metal	103	652
6.	Transportation/Telecom	85	373
7.	Motor Vehicles	43	355
8.	Trade	44	340
9.	Textiles	58	328
10.	10. Food Industry	27	279
2000			
1.	Chemicals	89	7,448
2.	Trade	499	1,411
3.	Transportation/Telecom	61	1,218
4.	Metal Goods	132	1,005
5.	Basic Metal	8	824
6.	Food Industry	39	701
7.	Textiles	107	401
8.	Food Crops	17	311
9.	Real Estate	21	302
10.	Hotel/Restaurant	48	260
1999			
1.	Chemicals	75	3,266
2.	Electricity/Gas/Water	2	2,310
3.	Paper	15	1,412
4.	Food Industry	48	681
5.	Metal Goods	85	593
6.	Basic Metals	9	501
7.	Plantations	17	284
8.	Trade	348	279
9.	Textiles	121	240
10.	Food Crops	10	224

1998			
1.	Chemicals	73	6,173
2.	Electricity	6	1,795
3.	Real Estate	19	1,271
4.	Metal Goods	119	891
5.	Plantations	22	725
6.	Hotel/Restaurants	56	451
7.	Basic Metals	13	394
8.	Food Industry	32	342
9.	Non-Metal Minerals	15	237
10.	Food Crops	10	224
1997			
1.	Chemicals	93	12,563
2.	Transportation/Telecom	36	5,900
3.	Paper	14	5,353
4.	Metal Goods	190	2,332
5.	Electricity/Gas/Water	8	1,840
6.	Non-Metallic Minerals	17	1,457
7.	Real Estate	20	1,394
8.	Food Industry	26	573
9.	Textiles	5	373
10.	Food Crops	3	234

Table 4. Foreign Investment Approvals by Region
1996-2000

Year	Region	Total Investment (USD Million)	% Year-on-Year Change
2001	Java	4,146	(61)
	Sumatra	3,939	31
	Kalimantan	242	77
	Sulawesi	70	0
	Maluku/Irian	105	102
	Bali	519	299
	Nusa Tenggara	6	(99)
	TOTAL	9,027	(42)
2000	Java	10,613	303
	Sumatra	2,999	(61)
	Kalimantan	137	40
	Sulawesi	70	(50)
	Maluku/Irian	52	108
	Bali	130	(33)
	Nusa Tenggara	1,413	9320
	TOTAL	15,431	42

1999	Java	2,636	(76)
	Sumatra	7,653	440
	Kalimantan	227	(69)
	Sulawesi	141	26
	Maluku/Irian	25	78
	Bali	193	(38)
	Nusa Tenggara	15	(79)
	TOTAL	10,891	(20)
1998	Java	10,840	(47)
	Sumatra	1,416	(87)
	Kalimantan	723	(32)
	Sulawesi	193	(55)
	Maluku/Irian	14	(97)
	Bali	309	167
	Nusa Tenggara	70	367
	TOTAL	13,565	(60)
1997	Java	20,535	15
	Sumatra	11,164	160
	Kalimantan	1,056	(63)
	Sulawesi	426	(83)
	Maluku/Irian	522	(1)
	Bali	155	(70)
	Nusa Tenggara	15	(99)
	TOTAL	33,833	13

Table 5. Foreign Investment Approvals by
Top Ten Counties of Origin, 1996-2000

Country		No. of Projects	Total Value (USD Million)
2001			
1.	Malaysia	104	2,240
2.	Saudi Arabia	5	1,502
3.	Singapura	154	1,139
4.	Japan	99	762
5.	UK	72	723
6.	Mauritius	18	524
7.	South Korea	283	369
8.	Australia	48	256
9.	Netherlands	35	88
10.	U.S.	36	73

2000			
1.	UK	79	3,645
2.	Japan	93	1,954
3.	Netherlands	43	1,159
4.	Germany	28	960
5.	South Korea	284	688
6.	Singapore	218	536
7.	Somalia	1	260
8.	U.S.	51	241
9.	Malaysia	74	168
10.	China	43	160
1999			
1.	Saudi Arabia	5	3,007
2.	Australia	61	2,458
3.	Taiwan	91	1,489
4.	Singapore	147	731
5.	Japan	70	644
6.	UK	72	507
7.	South Korea	201	263
8.	Malaysia	50	186
9.	U.S.	46	136
10.	Germany	38	87
1998			
1.	UK	49	4,745
2.	Japan	78	1,331
3.	Singapore	126	1,268
4.	Malaysia	63	1,060
5.	U.S.	46	568
6.	Hong Kong	18	549
7.	Netherlands	33	412
8.	South Korea	112	202
9.	Taiwan	91	165
10.	Australia	69	85
1997			
1.	UK	31	5,477
2.	Japan	94	5,421
3.	Germany	15	4,468
4.	Taiwan	101	3,419
5.	Singapore	118	2,299
6.	Malaysia	59	2,289
7.	South Korea	67	1,410
8.	U.S.	32	1,018
9.	Netherlands	22	320
10.	Hong Kong	17	251

Appendix

Areas Reserved For Small–scale Businesses Under Presidential Decree DEC/2001
----

1. Farming of *buras* chicken;
2. Trawler fishing using small ships within a 12 miles coastal radius;
3. Seeding and caring of fish;
4. Fishing of fresh water aquarium fish;
5. Cultivation of honeybees;
6. Cultivation of forests for sugar palm, sago, rattan, candlenut, bamboo, and sweet wood;
7. Cultivation of swallows in the wild;
8. Cultivation of forests for tamarind, coal, syrup, wood oils;
9. Very small-scale mining;
10. Manufacture of traditional processed foods;
11. Processing of fibers into cloth using hand-operated equipment;
12. Manufacture of textile products using hand-operated equipment;
13. Processing of non-food plantation and forest products;
14. Manufacture of manual or mechanic hand tools for handicraft or cutting;
15. Manufacture of farming hand tools;
16. Manual or semi-automatic maintenance and repair services for cars, boats under 30 Gross Ton (GT), electronic and home appliances;
17. Manufacture of cultural heritage handicrafts;
18. Manufacture of pottery products for household use;
19. Rural transport services on land and inland water (for ships up to 30 GT);
20. Telecommunication booth services and cable installation for houses and buildings;
21. Single-professional health practice;
22. Health practice by a group of professionals;
23. Provision of basic health services;
24. Health research Center;
25. Apothecary services;
26. Maternity house;
27. Traditional medical services;
28. Drug stores;
29. Retail of traditional drugs;
30. Collection of “simplisia”.

Areas Open to Medium and Large-scale Business in Cooperation With Small–scale Businesses Under Presidential Decree DEC/2001

----

1. Cultivation of roots;
2. Farming of white snappers “kerapu”, “bandeng”, “labi-labi”, “nila”, “sidat” fish, bull frogs and pearl oysters;
3. Cultivation of industrial forests;
4. Small-scale mining;
5. Manufacture of powder and thick sweet milk and processed foods from roots, sago, “melinjo” and Copra;
6. Manufacture of *Batik* cloth by printing technique;
7. Processing of raw rattan and leather goods;
8. Manufacture of pottery products for building materials and chalk products;
9. Manufacture of silver handicrafts;
10. Manufacture of wooden boats for tourism and fishing;
11. Manufacture of farming machinery using primary technology;
12. Manufacture of hand pumps, bicycle equipment, electronic equipment and other components and water meters;
13. Large scale retail services;
14. Combined hotel, restaurant and holiday resort services;
15. Tourism services;
16. Taxi services, ship loading services, freight forwarding services, courier services, people’s sailing services;
17. Vocational training services.