

INDONESIA: INVESTMENT CLIMATE STATEMENT 2000

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2. Overview

With the right policy framework and a strong commitment to reform, Indonesia should be able to capitalize on its fundamental economic strengths to restore investor confidence. Indonesia offers a large domestic market and a correspondingly large workforce, abundant natural resources, reasonably modern telecommunications and other infrastructure, a strategic location along some of the world's major trade routes, and substantial experience with market-based economics and the international trade and payments system. Three years after the onset of its economic and political crisis, Indonesia has a new government led by President Abdurrahman Wahid and Vice President Megawati Soekarnoputri. Their economic team negotiated a new Memorandum of Economic and Financial Policies with the IMF that was signed in January 2000. The following month, multilateral and bilateral donors pledged USD 4.7 billion in assistance for fiscal year 2000 through the Consultative Group on Indonesia (CGI). The Government negotiated a second rescheduling of official bilateral debt through the Paris Club in April.

With reaffirmation of Indonesia's market-based economic policy orientation and generous support from the international community, the stage was set for a recovery of the investment climate. Investor confidence has, however, remained depressed, with existing and potential investors citing a number of concerns: political uncertainty; upcoming political and fiscal decentralization; uneven implementation of economic reform commitments; the unreliable judicial system; security issues; and treatment of existing investors.

Political uncertainty: President Wahid drew cabinet members from several parties that had supported his election; the resulting "rainbow coalition" has proven an uneasy and quarrelsome combination. The President has fired several cabinet members; a major cabinet reshuffle is anticipated after the session of the People's Consultative Assembly (MPR) scheduled for August 2000. Continued power jockeying among parties and between the executive branch and the legislature, central bank, and other institutions has further complicated investors' assessments of Indonesia's political outlook.

Decentralization: In April 1999, the Indonesian Parliament (DPR) passed two laws devolving authority to regions (primarily to regencies rather than provinces) and establishing principles of fiscal decentralization. Both laws are scheduled to enter into effect in 2001. The impact of decentralization on investment rules and procedures -- including the taxing authority of the regions, new investment approval criteria, and licensing -- remains unclear. Many provincial governments have criticized the central government's slow pace and lack of consultation in formulating the decentralization laws' implementing regulations.

Economic reform: The GOI's major economic policy challenges remain to increase budget revenues, including through the privatization of state-owned enterprises (SOEs); to complete bank recapitalization, including disposing of assets held by the Indonesian Bank Restructuring Agency (IBRA) to reduce the program's budgetary burden; to promote debt restructuring between Indonesia's corporate debtors and their foreign and domestic creditors; to redefine the fiscal relationship between the central, provincial, and sub-provincial governments; to increase transparency and accountability of government operations; and to attract private investment in order to generate employment. In June 2000, an IMF representative enumerated three major structural problems that hampered Indonesia's economic recovery: its huge public debt (about USD 70 billion); the large number of private assets under state control that have been neither restructured nor sold; and the massive amount of unstructured foreign corporate borrowing.

Although the GOI has been successful in stemming inflation and interest rates have dropped dramatically, exchange rate volatility has re-emerged as a potential problem. The GOI has articulated a strategy for rebuilding the banking sector, restructuring corporate debt, and undertaking other structural reforms, particularly in the justice sector, but implementation has been uneven. Of particular concern have been slowness in disposing of IBRA-held assets and forcing debtors and former bank owners to court and unwillingness to privatize SOEs.

Judicial system: The GOI has taken some steps to foster judicial independence by the promulgation of a new Law on the Judiciary (No. 35/1999) which transfers most of the administrative and regulatory functions related to the court system from the former Ministry of Justice (now styled the Ministry of Law and Legislation) to the Supreme Court, and by forming an independent National Law Commission in December 1999. Nevertheless, the government still has not announced a thoroughgoing plan for justice sector reform, substantial steps toward reforming the courts have yet to be taken, and the judicial system still does not offer reliable recourse for investors.

Indonesia still ranks in the lower reaches of transparency and corporate governance assessments of Asian countries. Perpetrators of Soeharto-era corruption and the Habibie-era Bank Bali campaign finance scandal have not yet been brought to account, although a multitude of investigations into these and other (human rights, for example) cases is under way. Indonesia's Bankruptcy Law, which was amended in 1998 to establish a separate Commercial Court, has been a disappointment to creditors. The lack of legal certainty surrounding contract enforcement and differential treatment of domestic versus foreign companies are major concerns of foreign investors. The courts have issued rulings that ignore binding arbitration clauses in contracts, for example, in cases involving independent power producers and a Swiss pharmaceutical firm.

Existing investors: In addition to enduring the more general problems affecting the investment climate, existing investors -- particularly in extractive industries -- have suffered considerable specific problems at the hands of central and regional government officials. Some have been criticized by cabinet officers and other members of the government, who have alleged that contracts concluded under the Soeharto government were impaired or who have accused companies of environmental, labor, human rights, and other abuses. These allegations have not been accompanied by evidence or followed up by legal action. Local communities, impatient for the benefits of decentralization, have sought to obtain extra-contractual concessions from companies operating in their areas. Some non-governmental groups, which have enjoyed unprecedented freedom since former President Soeharto's fall, have also criticized foreign investors. Various foreign investors have also experienced labor unrest. Some mining ventures have been forced to suspend operations as a result of these and related problems.

Security: Plantations and mining operations in particular have been affected by security issues. Looting, occupation of land by squatters, and illegal mining are among the problems investors face. Outbreaks of sectarian violence in Maluku, Lombok, Central Sulawesi and other parts of the archipelago, as well as separatist movements in Aceh and Papua, continue to challenge national unity. A perceived breakdown in law and order tasks the government's ability to guarantee the security of foreign and domestic investments. Filling the security void are a growing number of vigilante groups, who have made security concerns more acute.

Despite its economic and political difficulties, Indonesia has maintained a relatively open foreign investment regime and has even taken some concrete steps to streamline

its investment application and permit processes and to facilitate foreign investment. The sharp drop in investment approval values has started to show some signs of turnaround in 2000. According to the most recent statistics covering January 1, 2000 through June 15, 2000, foreign investment approvals were up about 17 percent, rising from USD 1.8 billion for the same period in 1999 to USD 2.1 billion in 2000.

Note: The following discussion summarizes the legal, regulatory, and de facto investment framework as of mid-2000. Further shifts in President Wahid's cabinet may occur following the August MPR session. The FY 2000 (April–December 2000 budget assumes an average exchange rate of Rp 7000/USD.) The exchange rate used throughout this report is Rp 9,000/USD1, the rate prevailing at the time of publication.

A.1. Openness to Foreign Investment

Indonesian government policy is to encourage private sector-led growth and foreign investment. President Wahid has adopted increasing foreign investment as a personal cause, and since taking office has carried a message of welcome in his foreign travels. In 1998 and 1999, the GOI issued several new regulations to ease the entry of foreign firms and capital into Indonesia. However, the Foreign Capital Investment Law of 1967, which provides the basic framework for foreign investment, is still in effect. The law has been under revision for almost two years and its reform comprises one of the objectives of the GOI's IMF-supported economic reform program.

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. The Capital Investment Coordinating Board (BKPM) -- now subsumed under the Board of Investment and State-Owned Enterprises (BPM-PBUMN) -- plays a key role in promoting foreign investment and approving project proposals. The relevant technical government departments handle investments in the oil and gas, banking, and insurance industries. BKPM, or the corresponding provincial board (BKPMD), approves foreign and domestic investment in all other sectors.

While BKPM/BKPMD aims to function as a one-stop investor service, investors are routinely required to work closely with relevant technical government departments, such as Finance, Manpower, Land Affairs, and Justice, as well as regional and local authorities, unless they investing in Bonded Zones (Kawasan Berikat) or in Integrated Economic Zones (KAPET). Recent reforms have freed investors from some cumbersome documentary requirements resulting from the need to work with other departments and local governments. One significant change is that master lists of capital goods and basic material imports for both foreign and domestic investments are approved by BKPM/BKPMD and no longer need clearance from the Directorate General of Customs and Excise.

The GOI has also made efforts to streamline and simplify foreign investment application processes. For example, approvals for foreign investment over USD 100 million no longer must be approved by the President of Indonesia, but can now be

approved by the Chairman of BKPM. Currently there are no restrictions on the investment level (below USD 100 million) that can be approved by a BPKMD. Starting in January 2000, some provinces, among them the Jakarta District, West Java, West Kalimantan, and East Kalimantan, started accepting foreign investment applications. Plans are afoot to permit Indonesian embassies and consulates abroad to accept and process foreign investment applications.

Obtaining initial investment approval (IIA) now takes an average of 10 to 15 working days, a marked improvement from the past when application processing could take months. The IIA serves as a temporary operating license for a period of 12 months (the license can be extended), and it enables the PMA company to start its commercial activities. 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. Once executed, the Deed of Establishment is submitted to the Ministry of Law and Legislation (MOLL). Approval usually takes more than the 60-day statutory maximum, and until companies receive formal approval, the founding shareholders are personally liable for all obligations undertaken in the name of the company. Once the permission has been received, the PMA company must be registered in the Company Registry under the Department of Industry and Trade and the Deed of Establishment published in the Supplement to the State Gazette (Tambahan Berita Negara). The time between formal MOLL approval and publication in the Supplement can take more than a year, during which the directors of the company are jointly and severally liable for actions taken in the name of the company.

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 apply through BKPM or the appropriate BPKMD for a Permanent Business License (Ijin Usaha Tetap, or IUT). This licensing process can take months.

A foreign investor may be an individual or a corporate entity. 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 and, in cases where the local firm is being "rescued" by a foreign buyer, to inject capital, not just provide management expertise, technology or assume outstanding loans. The approval process to take over a "sick" firm may take as long as two months. In 1998, the GOI established the Jakarta Initiative, with a mandate to eliminate obstacles to corporate debt restructurings. In May 1999, the government issued regulations providing incentives for corporate debt restructurings that could address some of the obstacles to foreign investment in existing, but distressed, firms.

Some sectors are closed to all private or foreign investment. According to the July 1998 "negative list", published by the Ministry of Investment and State-Owned Enterprises,

16 business fields are closed to both foreign and domestic investment, while nine business fields are closed only to foreign investment. Sectors that remain closed to foreign investment include freshwater fishing, forest utilization, taxi/bus transport, local shipping, private television and radio broadcasting, cinema operation, management of radio and satellite frequencies, domestic trade and support services (except for large-scale retailing, distributing and wholesaling services, restaurants, quality certification, market survey services, and sales services), and medical services. (Copies of the negative list are available from U.S. Commercial Center in Jakarta and on the Internet at WWW.USEMBASSYJAKARTA.ORG - see Commercial Center). The GOI has missed several deadlines in its IMF-supported economic reform program for issuing a new, shorter negative list. Officials anticipate issuing the revised list soon.

In June 1994 and May 1995 several previously restricted sectors were opened, some conditionally, to foreign investment, including harbors, electricity generation, telecommunications, shipping, airlines, railways, and water supply. Foreign investment opportunities in many services remain restricted, however. The government is continuing to develop policies on the private provision of infrastructure through build-own-operate and build operate-transfer schemes, particularly for electric power, telecommunications, and roads. Full foreign ownership is not permitted in these sectors. Local partners are required to own anywhere from five to 51 percent of these investments. Electric generating plants that were developed as independent power projects ran into difficulties when the sharp depreciation of the rupiah led the Indonesian Government to postpone projects or seek renegotiation of the terms of Power Purchase Agreements.

Other sectors are reserved for small-scale enterprises. Large or medium-scale foreign companies must partner with small businesses or cooperatives before investment applications are approved. Presidential Decree No. 99/1999 on Small-scale Enterprises details sectors open only to small businesses and those open to medium and large-scale companies in partnership with smaller firms.

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. In addition, many foreign firms use franchising, licensing, and technical service agreements to distribute their goods. Indonesia has also lifted many restrictions on foreign participation in domestic distribution services. 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, like many other processes, may be substantially affected by decentralization. However, companies engaging in wholesale distribution may not conduct retail operations directly, but must form a separate retail company. Further, the number of expatriate employees granted visas to work in any single wholesale and retail business remains limited.

Current legislation (Government Regulation No. 20/1994 and Ministry of Investment Decree No. 15/1994) mandates a fifteen-year time limit after which foreign companies must divest a percentage (usually one to five percent) of their shares to allow Indonesian citizens to take up minority holding in the company. The new draft law on investment proposes to remove the fifteen-year time limit and leave the determination of time to the discretion of the Ministry of Investment and State-Owned Enterprises. U.S. firms are urging the GOI to eliminate the condition altogether as a means to further improve Indonesia's investment climate.

Oil and gas: The Indonesian government, through state oil and gas company Pertamina, owns all oil and hydrocarbons in the ground. Oil contractors (mainly foreign) operate under production sharing contracts (PSCs) and variations of PSCs to explore and produce hydrocarbons from a licensed area. The contractor is reimbursed for allowable expenditures. In return, the contractors have certain rights to split oil and gas production with Pertamina.

The Indonesian government plans to resubmit an oil and gas bill to Parliament in 2000. A first bill, submitted to Parliament in early 1999, was rejected. Like the original, the current draft contemplates a shift in management of PSC contractors from Pertamina to the central government and gradually phases out Pertamina's responsibility for PSCs. The draft law may also call for an end to Pertamina's monopoly over downstream oil distribution and marketing of fuel products.

Mining: Foreign investors operate under coal contracts of work (CCOW) and contracts of work (COW) for general mining. The contractor conducts all stages of the operation and assumes all financial and operational risks. The government's latest eighth-generation COW and fourth-generation CCOW contain significant new provisions that give regional governments greater input in mining companies' community development plans and a larger share of royalties and taxes. Both of these new contractual arrangements, however, have not been finalized pending promulgation of regulations to implement the 1999 Fiscal Decentralization Law.

Banking, Securities and Insurance: A 1988 deregulation package partially opened the banking, securities and insurance industries to foreign investment. In 1998, 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 a move that exceeded its WTO commitments, in 1998 the GOI also amended the 1992 Banking Law to allow full foreign ownership of banks. The GOI also removed restrictions on foreign banks opening additional branches outside of Jakarta. The Department of Finance licenses new securities and insurance ventures; Bank Indonesia, the central bank, licenses banks and regulates banking activity.

Privatization

To enhance the efficiency of state-owned enterprises and as part of the Indonesia's ongoing IMF-supported economic reform program, the Habibie government set an ambitious timetable to divest majority ownership in SOEs. Difficulties establishing the

valuation of the state-owned firms, domestic resistance to selling key national assets, and the challenge of attracting buyers in an uncertain political and economic environment slowed the program down.

The FY 2000 (April-December 2000) has a budget target of Rp 6.5 trillion (USD 722 million) to be raised from privatization. On June 29, 2000, the GOI launched a revised State-Owned Enterprise Masterplan in response to concerns about lagging privatization and continuing “high-cost” practices in the 164 enterprises. The revised plan aims to accelerate SOE restructuring and privatization and to establish good governance practices (transparency, independence, and accountability) within the parastatals. The government has slated 10 companies from a variety of sectors, including mining, plantations, airport operations and fertilizer, to be fully or partially privatized before the end of 2000. Nine SOEs are on “standby” for privatization in 2000, and the others for more gradual privatization through 2004.

A.2. Conversion and Transfer Policies

In July 1997, the Indonesian rupiah began to weaken in the face of regional currency instability. Indonesia opted to float the currency in August 1997 rather than spend large amounts of reserves to defend it. The rupiah depreciated sharply from 2,500/USD in July 1997 to a low of 17,000/USD in June 1998. By December 1998, the rupiah had strengthened to Rp 8,000/USD. Following the election of President Wahid on October 20, 1999, the rupiah strengthened further to Rp 6,700/USD. More recently, however, the rupiah has shown signs of weakening, hovering around Rp 9,300 per USD in early July 2000.

The Indonesian rupiah is freely convertible and is traded in the Jakarta and offshore (principally Singapore) interbank markets. Indonesia maintains no capital controls and foreign exchange may flow freely in and out of the country. No prior permits are necessary to transfer foreign exchange. 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. Foreign Exchange Law No. 24/1999, which entered into force in April 2000, requires the reporting of all foreign exchange transactions above USD 10,000. The new law does not change the system of free currency convertibility.

A.3. Expropriation and Compensation

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, no foreign investment has been expropriated since the passage of the 1967 law. In one case, however, OPIC paid a claim by a U.S. investor after the Indonesian Government failed to honor an arbitration award. Although there has been concern that a post-Soeharto government might nationalize projects or abrogate contracts awarded to firms connected to the family of former President Soeharto, Indonesian government officials have stated that foreign firms will not be expropriated in the process of dismantling the business

empires of former first family members. However, several foreign companies who signed contracts during the Soeharto era have had their contracts challenged by provincial and local governments and NGOs.

A.4. Dispute Settlement

The Indonesian government has agreed to submit any investment disputes to the International Center for the Settlement of Investment Disputes (ICSID) in Washington, D.C. A long-pending investment dispute involving a U.S. investor was resolved through the ICSID in 1993. Indonesia has signed on to UNCITRAL (United Nations Commission on International Trade Laws) arbitration rules. Foreign firms have entered arbitration hearings in Indonesia under UNCITRAL administration. An Indonesian investment arbitration board, BANI, is available when both parties to a dispute agree to submit to its arbitration.

Indonesia is also party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. The record of enforcement of foreign arbitral awards is, however, negative. In practice, foreign companies have had great difficulty enforcing foreign arbitration awards or getting the judicial system to honor arbitration clauses in contracts involving foreign investors. In 1999, Indonesia enacted a Law on Arbitration that addresses many concerns, but the new law's impact has yet to be felt.

Disputes between Independent Power Producers (IPPs) and the state electric company PLN and lack of respect for arbitration rights clauses in contracts, as in the Swiss pharmaceutical company's case, have been cited by many foreign chambers of commerce operating in Indonesia as major causes for alarm and strong deterrents to further investment in Indonesia.

The court system does not provide effective recourse for solving commercial disputes. The judiciary is nominally independent, but irregular payments and other collusive practices often influence judicial outcomes. The GOI has recognized that the legal system must be modernized. Legal and judicial reform is an important part of Indonesia's economic reform program. Amendments to the Bankruptcy Law entered into effect in August 1998, but the court's performance has been extremely weak.

Aiming to make the Bankruptcy Law more effective, the GOI has announced it will submit a new amendment to the law to Parliament in August 2000. 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.

A.5. Performance Requirements and Incentives

The GOI has notified the WTO of its compliance with TRIMS' Notification.

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 65 percent for export has additional incentives. It may apply for restitution of import duties paid on inputs that are subsequently re-exported in finished form. Special investment incentives in the form of income tax, value-added tax, and luxury tax facilities are made available on a case-by-case basis by BKPM.

The tax holiday system is under review and may be abolished. The GOI re-introduced basic tax holidays with Government Regulation No. 45 of 1996. According to Regulation 45, specific sectors, including capital goods manufacturing, agribusiness, infrastructure, sea and air transport, engineering, and professional personnel training may be eligible for tax holidays. In 1999, Presidential Decree No. 7/1999 laid out evaluation criteria for tax facilities for new investors entering designated "pioneer" industries. According to the decree, the basic incentive period is three years, with an additional two years for investments outside of Java and Bali. The incentive period can be extended for investments that employ more than 2,000 Indonesian workers, are at least 20 percent held by an Indonesian cooperative, and/or whose total investment is US\$ 200 million or more excluding land and buildings. Tax exemption for qualifying investments begins at the start of commercial operations or after the project is licensed, whichever comes first. Time beyond five years to achieve startup will be deducted from the period of the tax incentives. In January 2000, following the signing of its new Letter of Intent with the International Monetary Fund, the GOI announced it would withdraw all or at least some of its tax facilities for new investors as listed in Decree No. 7. Tax holidays are covered by tax laws bills currently under consideration by Parliament.

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. 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.

At present, Indonesia does not have formal regulations concerning U.S. and other foreign firms' participation in GOI-financed and/or subsidized research and development programs on a national treatment basis. 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.

Indonesia does not have rules requiring that investors 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.

A.6. Right to Private Ownership and Establishment

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 its economic growth. Parastatals have traditionally played an important role as well. Their role declined as private sector activity grew and privileges awarded to state-owned enterprises decreased. A State Ministry for State-Owned Enterprises was formed in 1998; privatization was an important part of its mandate.

The Indonesian Bank Restructuring Agency (IBRA), established in 1998, is assigned responsibility for banks that have been closed or taken over by the government. In addition, under the bank recapitalization program, it has assumed custody of non-performing loans. IBRA's mandate is time-bound and its stewardship of formerly private assets is to be temporary. IBRA has suffered numerous delays in meeting its mandate. Currently IBRA controls assets with a face value of about Rp 600 trillion (about USD 66 billion). The GOI has tasked IBRA with disposing of USD 18.9 trillion (about USD 2.1 billion) in assets during FY 2000, but progress has been slow. IBRA's biggest success story to date was the sale of its shares in the publicly listed automotive giant PT Astra International. It also launched an initial public offering (IPO) for Bank Central Asia (BCA). IBRA plans to sell 14 to 20 additional companies by the end of 2000, many through IPOs.

A.7. Protection of Property Rights

Indonesia has suspended many private infrastructure projects, especially in the field of private power generation, for economic and political reasons. The U.S. Embassy and other U.S. government entities have vigorously emphasized to the Indonesian government the importance of honoring internationally binding contracts and urged that all project reviews and contract negotiations be conducted in a rule-based, consistent, objective, and transparent manner.

Mortgages and secured interests in chattel and real property are recognized, but a comprehensive and efficient recording system is not in place. Foreign entities have no freehold rights to land ownership in Indonesia. Foreign investors' land holdings are often obtained through long-term lease agreements with the government. Leases are generally for 20 or 25 years and are renewable up to 100 years. These lease holdings can be used as collateral. Enforcement of secured interests is problematic.

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.

In April 2000, the USG downgraded Indonesia to the Special 301 watch list from the priority watch list where it had been for four years. Indonesia has made progress in improving the regulatory and legal framework for protection of intellectual property rights. Effective enforcement of IP rights through Indonesia's justice system is still very difficult. Indonesia is a member of the World Intellectual Property Organization and a party to the Paris Convention for the Protection of Intellectual Property. In March 1997, the Parliament passed amendments to Indonesia's patent, copyright and trademark

laws designed to bring them into compliance with the TRIPS agreement of the Uruguay Round. In 1997, Indonesia also reaccessed to the Berne Convention and signed the Trademark Law Treaty. Other international agreements to which Indonesia is party include the Nice Agreement for the International Classification of Unclassified Goods and Services, the Strasbourg Agreement Concerning International Patent Classification, and the Budapest Treaty on the International Recognition of the Deposit of Microorganisms. New laws to protect industrial design, trade secrets, and integrated circuits are expected to be in place by the end of 2000.

Patents: Indonesia's first patent law entered into effect on August 1, 1991. The law and its implementing regulations outline patent application procedures, application fees, registration of patent consultants, and patent announcements. Products and production processes are in principle patentable for a period of 14 years commencing from filing of the patent application, subject to certain requirements. The patent may be extended for another two years. In addition to this relatively short period of patent protection, other drawbacks in the law include compulsory licensing provisions, and a provision allowing importation of 50 specific pharmaceutical products by non-patent holders, and patent protection granted only to pharmaceutical products manufactured in Indonesia. The government has proposed amendments to the patent law to increase the patent protection period among other things.

Trademarks: The current trademark law took effect on April 1, 1993. This act states that 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. The law offers protection for service marks and collective marks and sets forth a procedure for opposition prior to examination by the trademark office. It also provides well-known trademark protection, although, to the detriment of several foreign marks, procedures for registering trademarks as well-known have not been fully developed. Cancellation actions must be lodged within five years of the trademark registration date.

Copyright: Parliament passed amendments to the 1982 copyright law in 1987 and March 1997. The amended law affords protection to foreign works, expands the scope of coverage and raises the terms of protection to international standards. The United States and Indonesia concluded a bilateral copyright agreement extending reciprocal protection in 1989. In May 1997, Indonesia reaccessed to the Berne Convention on copyright protection. The government has proposed new legislation that will increase penalties for copyright infringement.

New technologies: Indonesian law does not include specific protection for biotechnology. Legislation covering integrated circuits is being drafted for presentation to Parliament. The U.S.-Indonesia Science and Technology Agreement ensures protection for intellectual property derived from cooperative activities under the agreement's umbrella.

A.8. Transparency of the Regulatory System

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. Deregulation has been somewhat successful in removing barriers, creating more transparent trade and investment regimes, and has alleviated, but not eliminated, red tape. Transparency problems and red tape are routinely cited by U.S. businesses as factors hindering their operations in Indonesia. Please refer to Overview and Corruption sections for information on GOI reform efforts.

A.9. Efficient Capital Markets and Portfolio Investment

The key institution managing Indonesia's bank restructuring effort is the GOI's Indonesian Bank Restructuring Agency (IBRA), set up in January 1998), with the counsel of the international financial institutions. To date, the restructuring effort has entailed the closure of over 60 private banks, Government takeover of 11 others including the two largest private banks, and recapitalization of 7 banks in May 1999 (with Government providing up to 80 percent of the required capital and banks owners the other 20 percent). Restructuring of the state-owned banks, which held the largest non-performing loan portfolios, began in late 1999 after merger of four of the state banks into a new bank called "Mandiri."

Scandals and mismanagement have interfered with Indonesia's efforts to reform and restructure its banking sector. The Bank Bali scandal was uncovered in mid-1999. Suspects have been named in the scandal but to date, none has been sentenced by the courts. On June 21, 2000, the Attorney General's office detained Central Bank Governor Syahril Sabirin for his alleged involvement in the Bank Bali scandal.

Individual banks determine deposit and lending rates, although the blanket government guarantee on banks' payment obligations covers interest on deposits up to a stipulated percentage only. As of mid-2000, very little new lending had occurred. Interbank overnight interest rates averaged 10.3 percent per annum as of late June 2000.

Underlying problems remain. For example, all the major international accounting firms operate in Indonesia under arrangements with domestic accounting firms, but accounting standards and practices are not considered consistent with international norms.

Indonesia's capital market expanded rapidly over the last decade, led by growth of the equity market. The Jakarta Stock Exchange is the dominant securities market in the country. The lack of a well-developed bond market remains a limiting factor for Indonesia's financial sector.

Foreign firms generally enjoy good access to the Indonesian securities market. Financial reforms introduced in 1987 allowed foreign firms to form joint ventures with Indonesian partners in the securities market as underwriters, broker-dealers, and investment managers. The 49-percent restriction on foreign purchases of shares in non-bank listed firms was lifted in 1997, and for banks in 1999. Discriminatory capital requirements on foreign securities were removed in 1998. Portfolio investment is

regulated by BAPEPAM, the Indonesian equivalent of the Securities and Exchange Commission.

As of June 2000, Indonesia's USD 67 billion offshore corporate debt still remained largely unresolved, though a framework was in place for debt workouts: the Jakarta Initiative, launched in November 1998, was available to provide debt workout facilitation; the Indonesian Debt Restructuring Agency (INDRA) offered borrowers access to foreign exchange at a stable exchange rate; and a commercial court to hear bankruptcy cases had been established.

A.10. Political Violence

American citizens traveling to Indonesia and East Timor should exercise caution. Political activity, demonstrations, and localized hooliganism in Jakarta have increased recently and are expected to continue throughout the lead-up to and during the People's Consultative Assembly (MPR) session, which will take place in August 2000.

Indonesia welcomed its first democratically elected government in October 1999. The government's widespread support led to a general decrease in the level of civil unrest. At the same time, however, unrest in various regions of Indonesia continues and security forces have had difficulties maintaining law and order.

East Timor voted for independence from Indonesia in an August 30, 1999 referendum and is currently under the authority of the United Nations' Transitional Administration in East Timor (UNTAET). UNTAET was established by a unanimous vote of the UN Security Council on October 25, 1999 for the purpose of rebuilding East Timor and helping to establish a new government. Violence erupted throughout East Timor after the August 30, 1999, United Nations-sponsored ballot in that province. Although stability has largely returned to the territory following the arrival of international forces, crime and lawlessness remain a major problem. American citizens are strongly encouraged to exercise caution in East Timor and to avoid areas along the border between East and West Timor.

The western half of the island has been the scene of several physical assaults on foreigners by disgruntled pro-integration Timorese militia forces. American citizens are encouraged to defer non-emergency travel to West Timor, especially in areas where East Timorese refugees are concentrated.

In Maluku (also known as the Molucca Islands or the Moluccas), serious communal violence broke out on the island of Ambon in January 1999 and has now spread throughout this island group. The intensity of the violence compelled the Government of Indonesia on June 26, 2000, to declare a "Civil State of Emergency." American citizens are urged to avoid all travel to Maluku, including the provinces of both Maluku and North Maluku, and to depart immediately if they are already there. Although anti-Christian sentiment is not widespread in Indonesia, inflammatory statements by community leaders, as well as violence in Maluku, have sparked some tension between Moslem and Christian communities elsewhere in Indonesia. Serious communal violence

has also broken out in the province of Central Sulawesi.

On January 17, 2000, anti-Christian violence broke out on the resort island of Lombok, leading to looting and the burning of a number of churches. Although there has not been a recurrence of major violence since January, American citizens should take this earlier unrest into account when planning travel. Lombok is about 25 miles from the island of Bali.

Political changes have given new impetus to aspirations for independence in Aceh and Papua (formerly known as Irian Jaya). Violent incidents continue to occur in Aceh and American citizens are strongly urged to defer all travel to that province. Violence has targeted American companies with growing frequency. American citizens resident in Aceh should consider departing. In Papua, violence has been less frequent. The government of Indonesia has restricted the travel of U.S. and other foreign government officials to the provinces of Aceh, Papua, and Maluku. Security concerns are cited as the reason for this prohibition. American citizens should take this into account when planning travel to these regions. As of mid-2000, this restriction remained in effect.

The Department of State encourages American citizens considering travel to Indonesia to review carefully the information available in the State Department's , available on the Internet at or on the Bureau of Consular Affairs' home page at . All Americans resident or traveling in Indonesia are encouraged to register with the U.S. Embassy in Jakarta (tel: 62-21-344-2211), the U.S. Consulate General in Surabaya (tel: 62-31-568-2287), or the U.S. Consular Agency in Bali (tel: 62-361-233-605) and to obtain updated information on the security situation. Registration may be completed in person, by fax or through the U.S. Embassy homepage. Although a U.S. liaison office will open in East Timor in the coming months, there is currently no official presence there.

A.11. Corruption

In recent years, considerable attention has focused on the costs of corruption and influence peddling to local and foreign businesses, and the economy as a whole. Since the fall of Soeharto, the identification and elimination of corruption, collusion and nepotism (KKN) have become national issues with a newly freed press providing extensive coverage of past and current corruption investigations. In 1999, the Parliament passed two landmark laws designed to fight corruption, particularly in government activities. The first, Law No. 28, requires senior government officials to disclose their wealth and subjects them to audits. A commission is to be established, with enforcement powers, to review those audits and take appropriate action. The second, Law No. 31, widens the definition of corruption, increases penalties and establishes an anti-corruption commission. That commission is to be operational by early 2001.

Surveys of business executives working in Asia have ranked Indonesia among countries where corrupt practices are most pervasive and act as a disincentive to direct foreign investment. Demands for "facilitation fees" to obtain required permits or licenses, government award of contracts and concessions based on personal relations, and a legal

system that is often perceived as arbitrary are frequently cited problems. Despite President Wahid's pronouncements against corruption, progress on individual cases has been slow. A number of high-profile corruption cases have been widely reported in the press although none of the accused has been brought to trial. Meanwhile, petty corruption appears to be flourishing. Foreign companies have little success in filing formal complaints through either legal or administrative channels. Foreign companies continue to report difficulties in obtaining and renewing necessary immigration permits for expatriate staff based in Indonesia. In some cases, unsubstantiated corruption allegations have been made by government officials against foreign companies, particularly those operating in the resources sectors, but there has been no evidence presented or prosecution of corruption cases against foreign investors.

B. Bilateral Investment Agreements

Indonesia has signed investment protection agreements with 52 countries, including the United States (Agreement on Investment Guarantees), Argentina, Australia, Bangladesh, The Netherlands, Belgium, Chile, People's Republic of China, Czech Republic, Denmark, Finland, Hungary, United Kingdom, Italy, India, Jamaica, Germany, Jordan, Cambodia, South Korea, Cuba, Kyrgyzstan, Laos, Malaysia, Morocco, Mauritius, Mozambique, Egypt, Mongolia, Norway, Pakistan, France, Poland, Romania, Singapore, Slovak Republic, Spain, Sri Lanka, Sudan, Suriname, Syria, Sweden, Switzerland, Thailand, Tunisia, Turkey, Turkmenistan, Ukraine, Uzbekistan, Vietnam, Yemen, and Zimbabwe. Indonesia has also signed treaties for the avoidance of double taxation with 50 countries, including the United States. On February 1, 1997, an amendment to the U.S.-Indonesia tax treaty went into effect that reduced withholding rates to 10 percent, on par with rates accorded by Indonesia to Japan and major European countries.

C. OPIC and Other Investment Insurance Programs

Since 1967, all three types of Overseas Private Investment Corporation (OPIC) insurance -- inconvertibility, expropriation, and war, revolution and insurrection -- have been provided to U.S. investors in Indonesia. OPIC coverage was extended to bid bonds on service contracts in 1987. OPIC has also provided project financing to companies with at least 25 percent U.S. ownership.

D. Labor

The labor force is estimated at about 95 million, of which about 75 percent are between the ages of 15 and 34. The labor force has grown by an average of 2.5 percent over the past 30 years, though this rate is decreasing with the drop in fertility rates, increasing urbanization and lengthening school attendance. Women make up approximately 40 percent of the work force. Before the economic crisis began in 1997, the Indonesian government estimated "open" unemployment (defined as a person who is working less than one hour a week) to be roughly 5 percent. As recently as March 2000, the Indonesian Minister of Manpower estimated that 36 million persons (38 percent of the labor force) were unemployed or underemployed. However, the government's August

1999 annual Labor Force Survey reported that only 6.03 million persons over age 15 (6.4 percent of the labor force) were unemployed (i.e., worked less than one hour the previous week). In 1998, the Labor Force Survey reported that 34.3 million persons (39 percent of the labor force) were working less than 35 hours per week. The Labor Force Survey includes workers employed in the informal sector, while government estimates focus on job losses from formal sector employment. Some economists, unions, and other non-governmental observers have criticized the Labor Force Survey as understating real unemployment; these other sources estimate that more than half of the population is under-employed.

Before the economic crisis, the educational level of Indonesia's labor force had risen to the point that some 26 percent of non-agricultural workers had graduated from high school, and about five percent had educational achievement at a university level. Only 25 percent of the non-agricultural workers had not completed primary school, although this figure reached almost 50 percent within the agricultural work force. However, high inflation and large-scale layoffs have squeezed family incomes and caused four to five percent of all students to drop out of school during the last year, according to Indonesian government and World Bank estimates.

The United States has traditionally been a top choice for Indonesians wishing to study abroad. In the 1998-1999 academic year, there were an estimated 12,142 Indonesians studying in the United States, marking a 8.6-percent decline from the 1997-1998 academic year (Institute for International Education (IIE) statistics). Approximately 68 percent were in undergraduate programs, 26 percent in graduate programs, and the remaining 6 percent in non-degree programs, including English language studies. The decline in enrollment of Indonesian students in U.S. colleges, universities, and other institutes of higher education is largely attributed to the drop in the rupiah's value in relation to the dollar. While Indonesian students are the eight largest foreign national group studying at the higher education level in the United States, they are the fourth largest group studying at community colleges. Community colleges offer more affordable academic programs, an attractive advantage to students whose financial resources may have declined with the devaluation of the rupiah.

Job creation and the alleviation of underemployment are targets of economic policymaking, especially in light of the massive layoffs caused by the economic crisis. The unemployment rate for higher education graduates was much higher than the overall unemployment rate even before the crisis. Nonetheless, Indonesia is experiencing shortages of qualified managerial and professional personnel.

The government sets minimum wages by region. The minimum wage in Jakarta was set at Rp. 286,000 (approx. USD 33.00 at Rp. 8,700 per dollar) per month as of April 1, 2000. Labor strikes have become increasingly common in recent years. There were fewer strikes in 1997-1999 due to the economic downturn, but the frequency of strikes has increased in 2000. Strikes usually relate to failure of employers to pay the minimum wage, denial of benefits, lack of an effective union, and termination of employees. The Indonesian government promulgated a new regulation in September 1998 which makes it easier for labor organizations to register as trade unions, and more

than two dozen new unions have formed as alternatives to the Federation of All-Indonesian Trade Unions (FSPSI), which was the sole government-recognized union prior to 1998.

Indonesia's industrial relations system is in flux. As of July 2000, the Indonesian Parliament was considering two draft laws that would make significant changes in the registration, status, and rights of trade unions and in the industrial dispute resolution system. A third law is being drafted to replace the 1997 law on manpower affairs, which has never been put into effect because workers' and human rights groups have charged that it provides inadequate protection of worker rights. In addition to uncertainties about changes in labor law, there is considerable confusion about enforcement and interpretation of existing law and regulations.

E. Foreign Trade Zones/Free Ports

Foreign and domestic industrial companies located in any of Indonesia's seven designated bonded zones are provided with several incentives. The largest bonded zone is 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.

In April 2000, regulations on VAT and luxury tax exemptions were modified (Tax Department Circular No. SE. 10/PJ.52/2000) as they pertain to Batam. Starting April 1, 2000, all sales of goods for internal consumption in Batam were to now be subject to VAT and luxury taxes. Goods for export would remain exempt from these taxes. However, after Batam authorities and residents protested the change in policy, President Wahid agreed to postpone its implementation to January 1, 2001.

F. Foreign Direct Investment Statistics

Foreign investment interest in Indonesia has fallen substantially since the onset of the economic crisis in mid-1997. According to statistics from the Capital Investment Coordinating Board (BKPM) from 1967 through December 1999, the GOI approved 7,665 foreign investment applications worth more than USD 228.2 billion (excluding investment approvals in oil and gas, banking, and financial services). While foreign investment approvals reached almost USD 34 billion in 1997, they declined to less than USD 14 billion in 1998, and reached only USD 10.89 billion in 1999. However, realized foreign investment showed modest signs of recovery in 1999, rising from USD 2.9 billion in 1998 to USD 7.6 billion in 1999 (USD 3.0 billion of the 1999 total was for

a single proposed project, an oil refinery).

The downward trend of investment approval values continued to show very modest signs of abatement in 2000. According to the most recent BKPM statistics covering January 1, 2000 through June 15, 2000, foreign investment approvals were up 16.7 percent, rising from USD 1.8 billion for the same period in 1999 to USD 2.1 billion in 2000. The number of approved projects rose from 483 to 589.

Through June 15, 2000, the basic metals sector (approvals valued at about USD 700 million) was the most attractive sector for foreign investment applications, followed by textile and chemical sectors (each about USD 200 million), food and trade sectors (each about USD 100 million), property (USD 90 million), and construction (USD 80 million). Through the same period, Japan led in approved foreign investment applications (42 projects worth about USD 900 million), followed by Singapore (96 projects worth USD 200 million), The United Kingdom (28 projects worth USD 200 million), the United States (23 projects worth USD 80 million, and South Korea (105 projects worth 70 million).

Japan is the largest cumulative foreign investor in Indonesia, excluding the oil/gas sector, where the United States is the leading investor. Between 1967 and 1999, BKPM-approved Japanese investment applications reached about USD 35.3 billion, about 15 percent of the total. According to Indonesian government statistics through December 1999, The United States ranked sixth in cumulative BKPM-approved investment since 1967, with a total of USD 10.4 billion, although not all approved investment was realized. Through May 31, 2000 the United States still ranked sixth among foreign investor nations with cumulative BKPM investment approvals of USD 10.5 billion.

Table: BKPM Statistics on Top Ten Investing Countries (Cumulative BKPM Approvals)/Top Five Sectors January 1, 1967-May 31, 2000
(Billions of USD)

Japan Total	36.2
Chemical Industry	10.9
Metal Goods	9.2
Basic Metals	3.6
Paper Industry	2.9
Textile Industry	2.3

United Kingdom Total	21.2
Chemical Industry	13.6
Utilities Electricity, Gas, water)	3.9
Food	1.4
Plantations	1.0
Mining	0.7

Singapore Total	19.2
Paper Industry	4.1
Real Estate /Industrial Estate	3.5
Hotel/Restaurant	1.9
Metal Goods	1.7
Chemical Industry	1.4

Taiwan Total	16.1
Paper Industry	10.6
Textile Industry	1.1
Non-Metallic Minerals	0.9
Wood Industry	0.8
Metal Goods	0.8

Hong Kong Total	14.5
Chemical Industry	4.8
Utilities	1.8
Real state/Industrial Estate	1.5
Textile Industry	1.4
Office Building	0.8

United States Total	10.5
Chemical Industry	3.3
Mining	1.9
Utilities	1.3
Metal Goods	0.8
Non-Metal Minerals	0.7

South Korea total	9.4
Chemical Industry	1.8
Metal Goods	1.7
Basic Metals	1.4
Textiles	1.1
Hotel and Restaurant	1.0

Australia Total	9.4
Mining	3.2
Utilities	2.4
Chemical Industry	1.9
Construction	0.4
Other Services	0.4

Germany Total	8.3
Transport/Storage	5.4
Chemical Industry	1.6
Metal Goods	0.7
Pharmaceuticals	0.1
Office Building	0.1

The Netherlands Total	6.2
Chemical Industry	1.5
Food Industry	1.2
Transport/Storage	1.0
Hotel/Restaurant	0.6
Real Estate/Industrial Estate	0.5

Note: These numbers are approvals only and do not include oil and gas and financial and insurance sectors.

Not included in the BKPM-approved investment figure is substantial U.S. investment in Indonesia's hydrocarbon sector. In 1999, Caltex (Chevron and Texaco) retained its position as Indonesia's number one oil producer, with close to half of crude and condensate output. It was followed by several other U.S. companies including Conoco, Unocal, Arco, Mobil, and Vico. According to Ministry of Mines and Energy data, petroleum companies planned to spend USD 4.8 billion in 2000 on exploration, drilling, and production -- a USD 500 million increase over the actual spending for 1999. The 2000 budget figure includes USD 743 million for exploration, USD 867 million for development drilling, and USD 2,755 million for production.

According to the Ministry of Mines and Energy, investment in Indonesia's mining sector (gold, coal, etc.) totaled USD 15.9 billion over the last 32 years, with U.S. companies accounting for USD 7.1 billion. P.T. Freeport Indonesia, an affiliate of the U.S. mining firm Freeport McMoRan, is one of the largest foreign investors in Indonesia and accounted for the bulk of investment in the mining sector.

Another significant investor in Indonesia's mining sector is Denver-based Newmont Mining Company, which operates a gold mine in North Sulawesi and the Batu Hijau copper and gold mine on Sumbawa Island. According to Newmont, the Batu Hijau mine, operating since December 1999, was the largest greenfield mine operation ever, with USD 1.8 billion invested.

Major U.S. companies produce consumer and other products and provide services for the domestic market. General Motors has built a USD 110 million vehicle assembly plant, and General Electric Capital Corporation and Ford Credit are both active in automobile financing joint ventures. In 1996, General Electric opened the first locomotive factory in Southeast Asia and created the second largest lighting company in Indonesia. In 1998, H.J. Heinz Co. formed H.J. Heinz ABC Indonesia by purchasing a majority share in PT. ABC Central Food company. Also in 1998, Newbridge Capital purchased Astra Microtonic Technology microchip factory in Batam.

Several U.S. independent power producers (IPPs) have invested in Indonesia's electric power sector. Although the government in 1997 put on hold a number of the IPP projects, some, such as Unocal's geothermal plant in West Java and El Paso's gas-fired plant in South Sulawesi, are currently in operation. Edison Mission Energy's large coal-fired plant in Paiton, East Java, has also begun to provide electric power, and will soon

be joined by a Siemens/PowerGen plant at the same site.

In addition to Japan, the UK, and the United States, Indonesia's other major foreign investors include Hong Kong, Singapore, the Netherlands, Taiwan, South Korea, Germany, and Australia.