2013 Investment Climate Statement - INDONESIA

Openness To, and Restrictions Upon, Foreign Investment

Indonesia's growing middle class, strong domestic demand, stable political situation, and conservative macroeconomic policy paired with gross domestic product (GDP) growth of 6.5% in 2011 make Indonesia an attractive destination for Foreign Direct Investment (FDI). In 2012, Indonesian government officials welcomed increased FDI, aiming to create jobs and spur economic growth, and courted foreign investors, notably focusing on participation in a large number of public private partnerships to develop Indonesia's infrastructure. However, vague and conflicting regulations, poor existing infrastructure, rigid labor laws, and corruption continued to be significant concerns for foreign investors. U.S. firms lamented the lack of ministerial coordination but were encouraged with apparent increased accessibility to the Indonesian parliament (DPR) in 2012.

Restrictions on FDI are, for the most part, outlined in presidential decree 36/2010, commonly referred to as the Negative List. The Negative List consolidates FDI restrictions from numerous decrees and regulations to create greater certainty for foreign and domestic investors. The 2010 iteration of the Negative List, the most recent version, clarified that companies are grandfathered-in in the case of increased foreign ownership restrictions. However, exceptions remain; in the case of wholly foreign owned security service companies, their licenses were not renewed, despite grandfathering provisions. In 2010, the share of foreign ownership permitted was increased in health services, creative industries, construction services, and multilevel marketing, but decreased in cell towers, security services, and inspection services. For investment in certain sectors, such as mining and higher education, the Negative List is useful only as a starting point, as additional licenses and permits are required from individual ministries. Foreign capital investment, through the stock market, is not governed by the Negative List. Foreigners may purchase equity in state-owned firms through initial public offerings. Capital investments in publicly listed companies through the stock exchange are not subject to Indonesia's Negative List unless an investor is buying a controlling interest.

The Investment Coordinating Board (BKPM) is responsible for issuing investment licenses to foreign entities and has taken steps to simplify the application process through better coordination between various government institutions. In 2012, BKPM launched the online portal for its National Single Window for Investment which allows foreign investors to apply for and track the status of licenses and other services online. Although BKPM is meant to act as a one-stop service institution, investments in the mining, oil and gas, plantation, and other sectors require further licenses from related ministries and authorities. Likewise, certain tax and land permits, among others, typically must be obtained from local government authorities. Though Indonesian companies only require one approval at the local level, businesses report that foreign companies often must obtain both administrative and *de facto* legislative approval in order to establish a business.

The Coordinating Ministry of Home Affairs, Ministry of Administrative Reform and Bureaucracy Reform, and BKPM issued a circulating letter on September 15, 2010, to clarify investment that crosses provincial and regional boundaries. Investment in one regency is managed by the regency government; investment that lies in two or more regencies is managed by the provincial government; and investment that lies in two or more provinces is managed by central government, or central BKPM.

Natural Resources
Indonesia's vast natural resource wealth has attracted significant foreign investment over the last century, and remains one of the most prospective countries in the world. But a variety of government regulations have made doing business in the resources sector increasingly difficult, and Indonesia now ranks in the bottom 10% among the world's 90+ mining countries in the Fraser Institute's mining Policy Potential Index. In 2012 the Government of Indonesia (GOI) banned the export of raw minerals, dramatically increased the divestment requirements for foreign mining companies, and required major mining companies to renegotiate their contracts of work with the government. The 2009 mining law devolved mining license issuing authority to local governments, who have responded by issuing more than 10,000 licenses, many of which overlap or are unclearly mapped. In the oil and gas sector, Indonesia's Constitutional Court disbanded the upstream regulator, injecting confusion and more uncertainty into the natural resources sector.

Infrastructure
Indonesia's Master Plan for Acceleration and Economic Development (MP3EI), launched in 2011, is an ambitious 15-year, $1 trillion infrastructure development plan that includes several public-private partnership tenders and will require almost $700 billion in private financing. Though the MP3EI is a positive development, implementation has been lacking and project groundbreakings a year after its launch represented just 10% of the total plan's projected value.

Measure	**Year**	**Index/Ranking**
TI Corruption Index	2012	32/118 of 176
Heritage Economic Freedom	2012	56.4/115 of 179
World Bank Doing Business	2012	128 of 185
MCC Gov't Effectiveness	2013	0.20 (66%)
MCC Rule of Law	2013	-0.19 (34%)
MCC Control of Corruption	2013	-0.16 (28%)
MCC Fiscal Policy	2013	-1.3 (83%)
MCC Trade Policy	2013	75.0 (48%)
MCC Regulatory Quality	2013	0.02 (56%)
MCC Business Start Up	2013	0.927 (41%)
MCC Land Rights Access	2013	0.67 (43%)
MCC Natural Resource Protection	2013	99.8 (94%)
MCC Access to Credit	2013	29 (49%)
MCC Inflation	2013	5.4 (59%)

Conversion and Transfer Policies
The rupiah (Rp), the local currency, is freely convertible. Currently, banks must report all foreign exchange transactions and foreign obligations to the Bank of Indonesia (BI). With respect to the physical movement of currency, any person taking cash into or out of Indonesia in

the amount of Rp 100 million ($11,000) or more, or the equivalent in another currency, must report the amount to the Director General of Customs and Excise.

Banks on their own behalf or for customers may conduct derivative transactions related to derivatives of foreign currency rates, interest rates, and/or a combination thereof. BI requires borrowers to conduct their foreign currency borrowing through domestic banks registered with BI. The regulations apply to borrowing in cash, non-revolving loan agreements, and debt securities.

Under the 2007 Investment Law, the GOI gives assurance to investors relating to the transfer and repatriation of funds, in foreign currency, on capital, profit, interest, dividend and other income, funds required for (i) purchasing raw material, intermediate goods or final goods, and (ii) replacing capital goods for continuation of business operations, additional funds required for investment project, funds for debt payment, royalties, income of foreign individual working on the invested project, earnings from selling or liquidation of invested company, compensation for losses, and compensation for expropriation. U.S. firms report no difficulties in obtaining foreign exchange.

Bank Indonesia began in 2012 to require exporters to repatriate their export earnings through domestic banks within three months of the date of the export declaration form. Once repatriated, there are currently no restrictions on re-transferring export earnings abroad. Some companies report this requirement is not fully enforced.

Expropriation and Compensation
The GOI generally recognizes and upholds property rights of foreign and domestic investors, and the 2007 Investment Law opened major sectors of the economy to foreign investment while assuring investors' protection from nationalization, except where corporate crime is involved.

While there have been no overt expropriatory actions forced on investors in recent years, Indonesia's rising resource nationalism and ensuing action in the mining sector has raised concern about the Government's willingness to protect and fairly compensate foreign miners' property rights going forward. Mining companies that hold still-valid contracts of work with the central government are required to renegotiate the terms of those contracts, including higher tax and royalty rates, as well as divestment of equity to Indonesian interests. In 2012, the GOI issued a regulation requiring foreign-owned mining operations to divest majority equity to Indonesian shareholders within 10 years of operational startup. It appears the GOI plans to use cost of investment incurred, rather than market value, for purposes of divestment valuation.

A requirement to refine all ore domestically before it can be exported is another GOI priority advanced under the 2009 Mining Law that could lead to depressed domestic ore prices if enforced. In general, Indonesia's rising resource nationalism supports the idea that domestic interests should not have to pay prevailing market prices for domestic resource interests. The domestic market obligation on oil and gas producers is a longstanding example of this expectation. New investors in Indonesia's mining sector no longer have the security of a long-term contract of work with the central government, but are instead issued mining licenses by the local regent, whose term of office is five years. The security of the mining license, and what compensation the local regent is prepared to offer (if any) in the case of its cancellation, is uncertain.

The Law on Land Acquisition Procedures for Public Interest Development passed in December 2011 seeks to streamline GOI acquisition of land for much-needed infrastructure projects. The law seeks to clarify roles, impose time limits on each phase of the land acquisition process, deter land speculation, and curtail obstructionist litigation, while still ensuring safeguards for land-right holders. However, because the crucial power of revoking land rights rests with provincial governors, the new law's effectiveness – or potential misuse as a tool of expropriation – will depend in part on the inclination of respective governors.

Dispute Settlement

Indonesia's legal system is based on civil law. The court system consists of District Courts (primary courts of original jurisdiction), High Courts (courts of appeal), and the Supreme Court (the court of last resort). Indonesia also has a Constitutional Court. The Constitutional Court has the same legal standing as the Supreme Court, and its role is to review the constitutionality of legislation. Both the Supreme and Constitutional Courts have authority to conduct judicial review.

Judicial handling of investment disputes remains mixed. Indonesia is a signatory to the Convention On The Settlement Of Investment Disputes Between States And Nationals Of Other States (ICSID) and the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards. Thus, foreign arbitral awards are legally recognized and enforceable in the Indonesian courts, but, in practice, are not always enforced. Indonesia's legal code recognizes the right of parties to apply any rules of arbitration upon which they mutually agree. Some arbitration but not all is handled by Indonesia's domestic arbitration agency, the Indonesian National Arbitration Body. District Courts do not have authority to hear disputes where parties are bound by an arbitration agreement. In reality, some claims are still accepted by District Courts on the basis of tort or fraud, but are often reversed upon appeal. Some companies have resorted to ad hoc arbitrations in Indonesia using the UN Commission on International Trade Laws (UNCITRAL) arbitration rules. In 2012, U.S. cotton exporters saw an increase in cotton contract defaults by Indonesian companies. Though doing business in Indonesia remains challenging, there is not a clear pattern of investment disputes involving U.S. or other foreign investors.

The court system often does not provide effective recourse for resolving property and contractual disputes. Judges are not bound by precedent and many laws are open to various interpretations. A lack of clear land titles has plagued Indonesia for decades, although the land acquisition law enacted in December 2011 included legal mechanisms that may begin to resolve some past land ownership issues. Indonesia also has a poor track record on contract sanctity. Government Regulation 79 of 2010 opened the door for the GOI to remove recoverable costs from production sharing contracts. The GOI is also requiring mining companies to renegotiate their contracts of work to require higher royalties, more divestment, more local content, and domestic processing of mineral ore. Indonesia's commercial code, grounded in colonial Dutch law, has been updated to include provisions on bankruptcy, intellectual property rights, incorporation and dissolution of businesses, banking, and capital markets. Application of the commercial code, including the bankruptcy provisions, remains uneven, in large part due to corruption and training deficits for judges, prosecutors, and defense lawyers. The bankruptcy law is decidedly pro-creditor and the law makes no distinction between domestic and foreign creditors. As a result, foreign creditors have the same rights as all potential creditors in a bankruptcy case, as long as foreign claims are submitted in compliance with underlying regulations and procedures. Monetary judgments in Indonesia are made in local currency.

Performance Requirements/Incentives

The Indonesian government notified the WTO of its compliance with Trade-Related Investment Measures (TRIMS) on August 26, 1998. The 2007 Investment Law states that the GOI shall provide the same treatment to both domestic and foreign investors originating from any country pursuant to the rules of law.

In 2011, the GOI announced a tax holiday scheme to exempt certain businesses from paying corporate income taxes for up to ten years under Ministry of Finance Decree No. 130/PMK.011/2011. Businesses must have operated as a legal entity in Indonesia for at least 12 months prior to the issue of the tax holiday regulation, among other requirements. Priority is given to investment in resource extraction, resource refinement, industrial machinery, renewable resources, telecommunications equipment, or pioneer sectors. Government Regulation No. 62 of 2008 provides a tax incentive program for projects conducted in national high-priority sectors which encompass 128 different fields. Businesses may only apply for one tax incentive: either the tax holiday or the tax incentive program.

The GOI 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. If a direct investment enterprise wants to employ foreigners, the enterprise should submit an Expatriate Placement Plan to BKPM to get a Limited Stay Visa or Semi Permanent Residence Visa (VITAS/VBS). Expatriates are issued a Limited Stay Permit (KITAS) and a blue book, valid for two years and renewable for up to two extensions without leaving the country. Under Ministry of Manpower regulations, any expatriate who holds a work and residence permit must contribute $1,200 per year to a fund for local manpower training at regional manpower offices. Some U.S. firms report difficulty in renewing KITASs for their foreign executives.

With the passage of the 2012 defense law in October, the GOI plans to impose offset or local content requirements for procurements from foreign defense suppliers. Currently, U.S. defense equipment suppliers are still competing for contracts with local partners on the basis of an exception in the law that indicates that purchases may be made from non-state owned enterprise (SOE) sources if not readily available on the local market. Further clarification through additional regulation will reveal how rigid the application of the new requirements will be.

The GOI grants special preferences to encourage domestic sourcing and to maximize the use of local content in government procurement. It also instructs government departments, institutes, and corporations to utilize domestic goods and services to the maximum extent feasible. The Negative List seeks to maximize local content in procurement, use foreign components only when necessary, and delegate foreign contractors as sub-contractors to local companies. Foreign firms bidding on high value government sponsored projects report that they have been asked to purchase and export the equivalent value of selected Indonesian products if they are awarded the contract. Some businesses established as Indonesian entities report discrimination as they possess higher foreign equity.

The Ministry of Law and Human Rights' implementation of an electronic business registration filing and notification system has dramatically reduced the number of days needed to register a company. Foreign firms are not required to disclose proprietary information to the government before investing.

At present, Indonesia does not have formal regulations granting national treatment to U.S. and other foreign firms participating in Government-financed or subsidized research and development programs. The State Ministry for Research and Technology handles applications on a case-by-case basis.

Exporters to Indonesia must comply with numerous and overlapping import licensing requirements that impede access to Indonesia's market. In 2012, Indonesia issued new regulations overseeing the importation of finished products. In recent years, the Government implemented a sweeping regulation imposing non-automatic import licensing procedures on a broad range of products, including horticultural and livestock products, electronics, household appliances, textiles and footwear, toys, and food and beverage products. This regulation also include a requirement for pre-shipment verification by designated surveyors at importers' expense and a restriction that limits entry of imports to five designated ports and airports.

In July 2012, Indonesia added to the list of goods prohibited for export. Some of the goods forbidden for export include: natural rubber, rattan and certain types of wood, some live fish, giant tiger prawns, natural sand, precious stones, and antiques.

Indonesia's average most favored nation applied tariff was 7% in 2011. Over the past several years, Indonesia has raised tariffs on a number of products. In August 2012, Indonesia raised tariffs on most metal and mineral ores (but not coal) to 20%. Indonesia also imposes a 40% tariff on unprocessed palm fruit and 20% on oil cake and tiered tariffs for crude palm oil and other oil palm derivatives. In December 2012, the Indonesian government also issued a 20% emergency safeguard tariff on wheat flour imports for 200 days. In August 2012, Indonesia temporarily removed a 5% soybean import tax through the end of 2012. In 2010, Indonesia increased applied tariffs for products including medicines, cosmetics, and energy efficient lights. Most Indonesian tariffs are bound at 40%, although bound tariff levels exceed 40% or remain "unbound" on automobiles, iron, steel, and some chemical products.

Right to Private Ownership and Establishment

Indonesia recognizes the right to private ownership and establishment by both foreign and domestic entities. Foreign investors are restricted from establishing or acquiring businesses in certain sectors as laid out in the Negative List. Private entities have the right to dispose of interests in business enterprises under Indonesia's bankruptcy law, although it may take several years to do so. Likewise, terminating employees is associated with high costs and a lengthy process that requires bipartite negotiation, non-binding mediation, and Labor Court approval unless settled by agreement in writing at any time during the process.

To establish a business, one must: obtain the standard form of the company deed; arrange for a notary electronically; obtain clearance for the Indonesian company's name at the Ministry of Law and Human Rights; notarize company documents; obtain a certificate of company domicile from the local municipality; pay the State Treasury for the non-tax state revenue fees for legal services; apply to the Ministry of Law and Human Rights for approval of the deed of establishment; apply at the one stop service for the permanent business trading license and company registration certificate; register with the Ministry of Manpower; apply for the workers social security program; and, obtain a taxpayer registration number and a valued added tax (VAT) collector number. The process takes an average of 47 days.

Protection of Property Rights

The Basic Agrarian Law of 1960, the predominant body of law governing land rights, recognizes the right of private ownership. Indonesia's 1945 Constitution states that all natural resources are owned by the GOI for the benefit of the people. This principle was augmented by the passage of a land acquisition bill in December 2011 that enshrined the concept of eminent domain and established mechanisms for fair market value compensation and appeals. The National Land Agency registers property under Regulation No. 24 of 1997, though the Ministry of Forestry administers all 'forest land'. Registration is sometimes complicated by local government requirements and claims as a result of decentralization. Registration is also not conclusive evidence of ownership, but rather strong evidence of such. Foreigners are not allowed to own land in Indonesia, but can acquire the rights to use, sell, lease, and mortgage land through an Indonesian entity. The Ministry of Housing has proposed foreign ownership rights for properties in the special economic zones of Batam, Bintan, and Karimun. However, these plans have been delayed due to an ongoing revision of the Agrarian Law.

Indonesia is currently on the Special 301 priority watch list for intellectual property rights (IPR) protection. Indonesia's failure to effectively protect intellectual property and enforce IPR laws has resulted in high levels of physical and online piracy. The International Intellectual Property Alliance estimates that 86% of business software is unlicensed, while retail piracy rates are likely even higher.

Indonesia's 2002 Copyright Law and 2001 Trademark Law are currently under review. While not fully adequate, both laws provide a solid foundation for enforcement efforts. However, enforcement has been insufficient. The Copyright Law requires commercial courts to try cases of alleged copyright violations and render judgments within 90 days, though it often takes much longer. Even so, criminal cases against corporate end-user piracy in Jakarta and Semarang have been successfully prosecuted. The GOI has signed and ratified the WIPO internet treaties, but further clarifications in its Copyright Law must be made to fully implement both treaties.

Transparency of the Regulatory System

Indonesia continues to bring its legal, regulatory, and accounting systems into compliance with international norms, but progress is slow. Recent successes include passage of a comprehensive anti-money laundering law in late 2010 and a land acquisition law in December 2011, both of which have positive implications for foreign investment. Although Indonesia continues to move forward with regulatory system reforms, these efforts have not yet created a level playing field for foreign investors nor does the current regulatory system establish clear and transparent rules for all actors. Certain laws and policies, including the Negative List, establish sectors that are either fully off-limits to foreign investors or are subject to substantive conditions. A proposed revision to Indonesia's 2003 labor law may establish more stringent restrictions on outsourcing, currently used by many firms to circumvent some formal-sector job benefits that tend to make the labor market rigid and uninviting to potential investors. Bureaucratic reforms have slowed, and decentralization has introduced another layer of bureaucracy for firms to navigate, resulting in costly red tape. Ineffective management and corruption are among the challenges faced by the GOI in launching bureaucratic reform. U.S. businesses cite regulatory and transparency problems as ongoing factors hindering operations. Government ministries and agencies, including the Indonesian Parliament, continue to publish many proposed laws and regulations in draft form for public comment; however, not all draft laws and regulations are made available in public fora. Laws and regulations are often vague and require substantial interpretation by the implementers, leading to business uncertainty and rent-seeking opportunities. In short, investors remain interested but wary, as Indonesia is not currently making the longer-term regulatory changes to generate substantive domestic or foreign investment.

Efficient Capital Markets and Portfolio Investment

Although there is some concern regarding the operations of the many small, family-owned banks, the banking system is generally considered sound with banks enjoying some of the widest interest rate margins in the region. The ten largest banks, with Rp 2,472 trillion ($256.6 billion) in total assets or 61.7% of the total, dominate the banking sector. Loans grew 23.0% year-on-year as of October 31, 2012, (vis-à-vis 26.0% in 2011) while gross non-performing loans stood at 2.3%, down from 3.0% a year earlier.

Foreigners may purchase up to 99% of the total shares of a domestic bank through private placement or on the stock exchange. Purchases of 25% or more require BI approval. Foreign banks may establish branches if the foreign bank is ranked in the top 200 global banks by assets. To establish a representative office, the foreign bank must be ranked in the top 300 global banks by assets. A special operating license is required from BI in order to establish a foreign branch.

BI is considering limiting bank ownership to no more than 50% by any single shareholder, applicable to foreign and domestic shareholders, and requiring foreign bank branches to become subsidiaries.

The Indonesia Stock Exchange (IDX) index closed at 4,316.69 on December 28, 2012, up 12.9% for the calendar year. As of December 28, 2012, IDX had 454 listed companies with a total capitalization Rp 4,126.99 trillion ($428.3 billion). There were 23 initial public offerings in 2012. Foreigners conducted about 43.0% of the total stock trades in 2012. In 2011, the IDX launched the Indonesian Sharia Stock Index (ISSI), its first index of sharia-compliant companies, primarily to attract greater investment from Middle East companies and investors. The ISSI is composed of 214 stocks that are already listed on IDX's Jakarta Composite Index.

Government treasury bonds are the most liquid bonds offered by the GOI. Treasury bills are less liquid due to their small issue size. Liquidity in BI-issued Sertifikat Bank Indonesia (SBI) is also limited due to the six-month required holding period. As of December 2012, the government's total gross bond sales (including international bond issuance) had reached Rp 820.7 trillion ($85.2 billion). The GOI also issued its first sukuk treasury bills as part of efforts to diversify Islamic debt instruments and increase their liquidity. Indonesia's sovereign debt was upgraded to investment grade by Fitch Ratings in December 2011 and by Moody's in January 2012.

The corporate bond market is dominated by banks and automotive financing companies. Trading in the corporate bond market by value was up 17.0% as of December 28, 2012. For the twelve month period ending December 28, 2012, total outstanding corporate bonds rose 27.0% to Rp 189.4 trillion ($19.7 billion).

The Financial Services Supervisory Authority (OJK) will assume BI's supervisory role over commercial banks as of January 1, 2014. OJK will also oversee the capital markets and non-banking institutions as of January 1, 2013, replacing the Capital Market and Financial Institution Supervisory Board.

Foreigners have good access to the Indonesian securities market and are a major source (29.7% in government securities) of portfolio investment. Foreign ownership of Indonesian companies may be limited in certain industries as determined by the Negative List.

Competition from State-Owned Enterprises (SOEs)

Indonesia has 141 SOEs, 26 of which contributed more than 90% of the total SOE profit. Sixteen are listed on the Indonesian stock exchange and 14 are special purpose entities such as the Indonesian Infrastructure Guarantee Fund. SOEs are present in almost every sector including banking, tourism, agriculture, forestry, mining, construction, fishing, energy, and telecommunications. In 2012, the profits of SOE rose by 11% to Rp 128 trillion ($13.3 billion) compared to 2011. SOEs employ around 780,000 people and contribute an estimated 40% of the country's gross domestic product. Currently, SOEs command around 53% of market share in the cellular telecommunication sector in terms of number of subscribers, hold around 37% of the banking sector's total assets, 52% of the cement sector's total sales, and 50% of the total energy supply.

GOI has stated it will consolidate the number of SOEs in order to increase efficiency and benefits. The consolidation is expected to take place through mergers, privatization, establishing sectoral holding companies, or liquidation. The government expects the number of SOEs to decrease to 78 in 2014 to 25 in 2025.

Private enterprises can compete with SOEs under the same terms and conditions with respect to access to markets, credit, and other business operations. However, some sectors reported that, in reality, SOEs receive increased preference for GOI projects. SOEs publish an annual report and are audited by the Supreme Audit Agency (BPK), the Financial and Development Supervisory Agency (BPKP), and external and internal auditors.

Indonesian SOEs adopt a two-tier Board structure with a Board of Commissioners (similar to an American company's board of directors) and a Board and Directors (similar to an American company's executive management team). Depending on the type of SOE, either the President or the Minister of SOEs has the right to make appointments and to dismiss members of either the

Board of Commissioners or Board of Directors. With such control, board member appointments are subject to government interference. Hence, it is not uncommon for SOEs to have ministers, high-ranking bureaucrats, military generals, or member of political parties, either retired or still active, sitting as Board members. Some SOEs suffer from poor management, which has led to several cases of graft and corruption against former Commissioners and Directors.

The GOI established the Pusat Investasi Pemerintah (PIP) to act as a special purpose investment entity and eventually as a sovereign wealth fund. To date, it has limited its investments to the domestic market in strategic sectors with the goal of stimulating national economic growth. PIP can invest in a variety of asset classes such as equity, debt, infrastructure, and direct investments. PIP is in addition to other GOI SOEs that invest in domestic markets such as PT Sarana Multi Infrastructure, PT Indonesia Infrastructure Guarantee Facility, and Indonesia Infrastructure Finance.

Corporate Social Responsibility (CSR)

While international organizations like the OECD and UN envision CSR as a comprehensive management paradigm that includes concepts like human rights, employee relations, environment and science, bribery and corruption, consumer interests, and taxation, understanding of CSR in Indonesia tends to focus on community and economic development, and educational projects and programs. This is at least in part caused by the fact that such projects are often required in the environmental impact permits ("Amdal") of resource extraction companies, who undergo a good deal of domestic and international scrutiny of their operations. Because much resource extraction activity occurs in remote and rural areas where government services are limited or absent, these companies face very high community expectations to provide such services themselves. Despite significant investments – especially by large multinational firms – in CSR projects, there is limited general awareness of those projects, even among government regulators and officials.

Political Violence

As in other democracies, politically motivated demonstrations occur regularly throughout Indonesia. Such demonstrations on occasion become violent, but are not a major ongoing concern for most foreign investors. Public reaction to events in the Middle East, including anti-U.S. demonstrations, continues to be limited to sporadic protests, mostly nonviolent.

Fighting terrorism remains a top priority for the Indonesian government, and President Yudhoyono has demonstrated a continued strong commitment to combating terrorism. Since the 2009 bombings of two international hotels in Jakarta, Indonesian police and security forces have disrupted a number of terrorist cells, including some affiliated with Jemaah Islamiyah (JI), a U.S. government-designated terrorist organization that carried out several bombings at various times since 2000. In response to terrorist threats and attacks, Indonesia has effectively pursued counterterrorism efforts through legislation and law enforcement. In 2012, the Attorney General's Office handled nearly 50 terrorism related case. Violent elements in Indonesia continue to demonstrate a willingness and ability to carry out attacks with little or no warning. Although U.S. and Western-affiliated interests remain potential targets of terrorists, the focus of terrorists is increasingly on attacks against local governments and law enforcement entities, especially the police.

Foreign investors in Papua face certain unique challenges relative to those operating in other parts of Indonesia. Indonesian security forces are engaged in operations against the Free Papua Movement, an small armed separatist group. Low-intensity communal, tribal, and political conflict also exists in Papua and has caused deaths and injuries. Anti-government protests have resulted in deaths and injuries. Between 2009 and 2012, gunfire from unknown attackers on the private roads from Timika to Tembagapura caused several casualties, including deaths, of government security forces, local workers, and one expatriate

Corruption

President Yudhoyono campaigned and was re-elected in 2009 on a strong anti-corruption platform. However, corruption remains a serious problem, preventing increased FDI, according to some U.S. companies. Although the government has issued detailed directions on combating corruption in targeted ministries and agencies, there has not been a concerted government-led effort to encourage or require companies to establish internal codes of conduct, or effective internal controls, ethics, and compliance programs to detect and prevent bribery of public officials.

Indonesia's ranking in Transparency International's Corruption Perceptions Index in 2012 is 118 out of 183 countries. Corruption remains pervasive despite laws to combat corruption and a strong, independent Corruption Eradication Commission (KPK). The KPK's purview in corruption cases is typically limited to law enforcement and other public officials, cases that exceed $105,000 in value and/or that represent significant loss to the state. Corruption cases are also handled by the Indonesian National Police and Attorney General's Office, neither of which have the same organizational capacity to investigate or prosecute corruption cases. Giving or accepting a bribe is a criminal act, with possible fines ranging from $5,500 to $110,000 and imprisonment up to a maximum of 20 years, depending on the severity of the charge.

Indonesia ratified the UN Convention Against Corruption in September 2006. Indonesia has not yet acceded to the OECD Anti-Bribery Convention, but attends meetings of the OECD Anti-Corruption Working Group. Indonesia is a co-chair along with the United Kingdom of the Open Government Partnership, a multilateral platform to promote transparency, empower citizens, fight corruption, and strengthen governance. Several civil society organizations function as vocal and competent corruption watchdogs, including Transparency International Indonesia and Indonesia Corruption Watch.

Bilateral Investment Agreements

Indonesia has signed investment protection agreements with 60 countries, including: Algeria, Argentina, Australia, Bangladesh, Belgium, Bulgaria, Cambodia, Chile, Croatia, Cuba, Czech Republic, Denmark, Egypt, Finland, France, Germany, Hungary, India, Iran, Italy, Jamaica, Jordan, Kyrgyzstan, Laos, Malaysia, Mauritius, Mongolia, Morocco, Mozambique, North Korea, Norway, Pakistan, People's Republic of China, Peru, Philippines, Poland, Qatar, Romania, Saudi Arabia, 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.

Indonesia has extensive preferential trade relationships with other Asian countries. Under the ASEAN Free Trade Agreement (FTA), import duties from ASEAN countries are applied at 0%

to 5%, except for products specified on an exclusion list. In addition, Indonesia accords preferential market access to Australia, China, Japan, Korea, India, and New Zealand (under ASEAN FTAs) and to Japan and Pakistan (under bilateral agreements). Implementation of the ASEAN-China FTA has been contentious, with domestic industries pressing for more time to implement tariff commitments as well as for the imposition of new non-tariff barriers to offset the reduction in tariff protection. Indonesia is currently negotiating bilateral agreements with Iran, India, Australia, New Zealand, and European Free Trade Association countries, and undertaking studies on potential FTAs with Chile, Turkey, South Korea, Tunisia, Mexico, South Africa, and Egypt.

Non double income taxation between the United States and Indonesia is granted in accordance with the Convention between the Government of the Republic of Indonesia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of the Fiscal Evasion with Respect to Taxes on Income, signed at Jakarta July 11, 1988, and its amending Protocol, signed at Jakarta July 24, 1996.

OPIC and Other Investment Insurance Programs

In 2010, the Overseas Private Investment Corporation (OPIC) updated its 1967 investment support agreement between the United States and Indonesia by adding OPIC products such as direct loans, coinsurance, and reinsurance to the means of OPIC support which U.S. companies may use to invest in Indonesia.

Indonesia has joined the Multilateral Investment Guarantee Agency (MIGA). MIGA, a part of the World Bank Group, is an investment guarantee agency to insure investors and lenders against losses relating to currency transfer restrictions, expropriation, war and civil disturbance, and breach of contract.

The Indonesian Rupiah may be purchased using the exchange rate provided by BI pursuant to the current rate on the date of the transaction. The BI exchange rate can be found at www.bi.go.id. In 2012, the Rupiah depreciated 6% against the USD.

Labor

Labor became a prominent issue for foreign investors in 2012 due to significant increases in the minimum wage for many provinces, including a 44% increase in Jakarta, and significant restrictions on the use of contract workers.

Indonesian labor is relatively low cost by world standards, but the country's education system and rigid labor laws combine to make Indonesia's competitiveness lag behind other Asian competitors. Investors frequently cite high severance payments to dismissed employees, restrictions on outsourcing and contract workers, and limitations on expatriate workers as significant obstacles to new investment in Indonesia. Lack of education is especially problematic among unskilled and semi-skilled workers. Labor contracts are relatively straightforward to negotiate but are subject to renegotiation, despite the existence of written agreements. Local courts are prone to side with local citizens in labor disputes, contracts notwithstanding. On the other hand, some foreign investors view Indonesia’s labor regulatory framework, respect for freedom of association, and the right unionize as an advantage to investing in the country. The GOI established in January 2006 a new Labor Court as part of a broader labor dispute resolution system. U.S. companies expressed disappointment in the GOI's lack of mediation between labor groups and industry during 2012 minimum wage discussions. Expert local human resources advice is essential for American companies doing business in Indonesia, even those only opening representative offices.

Indonesia's highly fractured and largely ineffective labor movement has gained strength in recent years, evidenced by significant increases in the minimum wage. Minimum wages vary throughout the country as provincial governors set an annual minimum wage floor and district heads have the authority to set a higher rate. Many provinces are expected to see large increases in 2013. The governor of Jakarta has agreed to a 2013 minimum wage of $232, a 44% increase over 2012 and an increase of 97 % since 2010. In October 2011, the Indonesian government passed a revised Social Security Law to take effect in January 2014 that will establish a national agency to support workers in the event of work accident, death, retirement, or old age.

Foreign Trade Zones/Free Ports
The GOI offers incentives to over 1,500 foreign and domestic industrial companies that operate in bonded zones throughout Indonesia. The largest bonded zone is the free trade zone 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% ownership. These companies do not pay import duty, income 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 lend machinery and equipment to subcontractors located outside of the bonded zone for a maximum two-year period.

A recent Ministry of Finance Regulation No. 147/2011 stipulates that the delivery of products outside of bonded zones into the domestic market is set at a maximum of 25% (down from 50%) of export realization value of the previous year. If a bonded zone company exceeds the 25% limitation, its domestic quota for the next year will be reduced. The new regulation also restricts subcontract work and requires bonded zones less than 10,000 square meters in size to relocate to industrial estates.

As stipulated by the 2007 Investment Law, the Indonesian Legislature (DPR) passed regulations on special economic zones (SEZ) in 2009. At least 20 areas have submitted applications for SEZ status, but only two were created in 2012: Sei Mangke in North Sumatra and Tanjung Lesung in Banten.

Foreign Direct Investment Statistics
Indonesia has two main sources for FDI statistics: BKPM, which issues permanent business licenses to domestic and foreign investors, and BI, which records international capital flows as part of balance of payments statistics. BKPM records FDI figures based on issued business licenses. Since licenses for oil and gas, mining, banking, non-bank financial institutions, insurance and leasing are issued by other government bodies, these sectors are not covered under

the BKPM statistics. BKPM is expected to increase the sectoral coverage gradually while BI statistics cover all sectors.

BKPM categorizes all investments made into a foreign capital investment company as FDI, even if it is a joint venture with a local partner. This practice tends to inflate BKPM's FDI figures, which may additionally include equity contributions from domestic partners and investments financed from domestic sources. BI instead follows the standard FDI categorization of equity investment, retained earnings and other capital inflows.

Table 1. FDI by industry
in USD million

	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Agriculture & Forestry	3	225	286	197	-52	286	284
Fishing	9	4	19	-25	10	52	61
Mining & Quarrying	1,226	322	1,904	3,610	1,302	1,896	3,882
Manufacturing	5,264	1,691	2,412	2,322	1,573	4,971	8,157
Electricity, Gas and Water	162	-1	-61	-56	53	204	364
Construction	130	85	195	24	7	-49	411
Wholesale & Retail	60	375	215	1,159	73	2,463	2,882
Hotel & Restaurant	0	7	-10	16	0	1	-1
Transport, Storage & Communication	384	592	919	134	1,799	2,389	2,378
Financial Intermediation	780	1,027	1,361	1,927	149	408	559
Real Estate and Business Activity	17	-14	-4	-201	-25	27	687
Others	0	599	37	212	-11	654	-353
TOTAL	**8,338**	**4,914**	**6,928**	**9,318**	**4,876**	**13,303**	**19,242**
% of GDP	**2.9**	**1.3**	**1.6**	**1.8**	**0.9**	**1.9**	**2.2**
Note: Public Administration & Defense, Education, Health, Other Community Services all recorded zero FDI							
Source: Bank Indonesia							

Table 2. FDI by Country of Origin
in USD million

	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Japan	1,542	1,057	1,126	1,144	896	3,728	5,194
U.S.	3,442	-549	1,093	1,040	159	571	-301
Europe	1,581	2,017	2,622	1,966	674	279	4,489
China	300	124	117	531	358	354	226
Korea	239	317	250	186	80	342	618

ASEAN	884	1,354	1,107	3,397	1,381	5,903	8,339
Malaysia	141	278	232	1,018	313	340	-30
Singapore	741	1,077	836	2,297	1,016	5,479	8,229
Other	25	20	436	597	174	950	786
Total	**8,338**	**4,914**	**6,928**	**9,318**	**4,877**	**13,304**	**19,242**
Source: Bank Indonesia							

Table 3. FDI by Country of Origin
in total percentage

	2005	2006	2007	2008	2009	2010	2011
Japan	18.5	21.5	16.3	12.3	18.4	28.0	27.0
U.S.	41.3	-11.2	15.8	11.2	3.3	4.3	-1.6
Europe	19.0	41.0	37.8	21.1	13.8	2.1	23.3
China	3.6	2.5	1.7	5.7	7.3	2.7	1.2
Korea	2.9	6.5	3.6	2.0	1.6	2.6	3.2
ASEAN	10.6	27.5	16.0	36.5	28.3	44.4	43.3
Malaysia	1.7	5.6	3.3	10.9	6.4	2.6	-0.2
Singapore	8.9	21.9	12.1	24.7	20.8	41.2	42.8
Other	0.3	0.4	6.3	6.4	3.6	7.1	4.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Source: Bank Indonesia							

Table 4. FDI by Type of Investment
in USD million

	2005	2006	2007	2008	2009	2010	2011
Equity Capital	5,129	2,451	5,252	8,033	4,358	7,895	10,429
Reinvested Earnings	2,683	2,164	2,294	1,070	621	4,105	3,922
Other Capital	525	298	-619	215	-104	1,303	4,891
Total	**8,338**	**4,914**	**6,928**	**9,318**	**4,877**	**13,303**	**19,242**
Source: Bank Indonesia							

Table 5. FDI by Industry and Country of Origin
in USD million

	2005	2006	2007	2008	2009	2010	2011
Agriculture, Hunting, and Forestry	**2**	**225**	**286**	**197**	**-52**	**286**	**284**
Japan	0	3	0	-4	1	12	20
U.S.	9	-2	5	0	0	0	0
European Union	-36	183	185	10	-157	34	15

China	4	-4	6	7	21	-24	0
ASEAN	2	-2	-8	0	-5	0	237
Other	0	-2	15	7	16	-12	12
Mining & Quarrying	**1,226**	**322**	**1,904**	**3,610**	**1,302**	**1,896**	**3,882**
Japan	182	83	341	546	-78	84	-101
U.S.	165	34	1,262	1,056	177	430	-435
European Union	218	37	405	617	392	404	3,593
China	239	123	170	534	357	354	150
ASEAN	32	-142	113	614	144	186	418
Other	295	277	-50	228	295	272	266
Electricity, Gas, and Water Supply	**162**	**-1**	**-61**	**-56**	**53**	**204**	**364**
Japan	-14	-7	16	0	0	63	253
European Union	176	-13	-76	4	9	135	60
ASEAN	0	19	-1	-66	31	4	14
Other	0	0	0	8	1	8	8
Manufacturing	**5,264**	**1,691**	**2,412**	**2,322**	**1,573**	**4,971**	**8,157**
Japan	182	83	341	546	-78	84	4,359
U.S.	165	34	1,262	1,056	177	430	112
European Union	647	819	1,128	991	185	-1,016	-623
China	46	0	8	-4	1	1	33
ASEAN	627	423	397	989	531	1,722	3,013
Other	-90	-49	45	-230	-49	814	500
Wholesale & Retail	**60**	**375**	**215**	**1,159**	**73**	**2,463**	**2,882**
Japan	25	30	-23	86	74	133	385
U.S.	9	-13	-20	-1	-8	0	0
Construction	**130**	**85**	**195**	**24**	**7**	**-49**	**86**
Japan	2	21	6	0	-1	10	94
U.S.	0	-14	-6	0	0	0	88
European Union	125	31	27	0	-1	0	91
China	0	0	0	0	0	2	95
ASEAN	2	35	24	14	-5	-23	97
Other	0	-14	-6	0	0	0	102
Others	**301**	**599**	**37**	**212**	**-11**	**654**	**-353**
Japan	354	166	-123	-13	13	61	85
U.S.	2	-3	-1	8	3	-7	-8
European Union	-32	86	183	6	-86	10	-15
China	0	-1	-62	0	0	0	0

ASEAN	-72	339	27	-4	26	122	121
Other	26	7	18	159	26	419	-619
TOTAL	**8,338**	**4,914**	**6,928**	**9,318**	**4,877**	**13,304**	**19,242**
Source: Bank Indonesia							

Table 6. FDI Realization by Region in Indonesia
in USD Million

	2005	2006	2007	2008	2009	2010	2011
Java	**7,251**	**4,413**	**8,498**	**13,567**	**9,370**	**11,499**	**12,325**
Jakarta	3,272	1,468	4,669	9,928	5,511	6,429	4,824
West Java	2,567	1,619	1,328	2,552	1,934	1,692	3,839
East Java	702	384	1,691	457	422	1,769	1,312
Banten	668	512	708	478	1,412	1,544	2,172
Kalimantan	**182**	**537**	**309**	**115**	**284**	**2,011**	**1,919**
East Kalimantan	39	405	160	13	80	1,092	602
Sumatera	**1,225**	**884**	**1,386**	**1,009**	**776**	**747**	**2,077**
Riau	796	585	724	461	252	87	212.3
Sulawesi	**145**	**14**	**80**	**65**	**142**	**859**	**715**
Nusa Tenggara	**103**	**110**	**57**	**96**	**234**	**503**	**953**
Bali	97	103	51	81	227	278	482
Maluku	**9**	**20**	**0**	**0**	**6**	**249**	**142**
Papua	**0**	**1**	**2**	**19**	**2**	**347**	**1,345**
Total	**8,915**	**5,977**	**10,350**	**14,870**	**10,815**	**16,215**	**19,475**
% of GDP	**3.1**	**1.6**	**2.4**	**2.9**	**2.0**	**2.3**	**2.3**
Source: Investment Coordinating Board (BKPM)							