2001 Country Reports on Economic Policy and Trade Practices
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INDONESIA

Key Economic Indicators
(Billions of U.S. dollars unless otherwise indicated)

	1999	2000	2001e
Income, Production and Employment:			
Nominal GDP	142	153	158
Real GDP Growth (pct)	0.2	4.8	3.0
GDP by Sector:			
Agriculture	27.8	26.5	27.0
Manufacturing	36.2	39.9	40.2
Services	56.9	60.2	61.1
Government	7.2	7.6	7.7
Per Capita GDP (US$)	688	738	742
Labor Force (millions)	94.8	96.5	98.2
Unemployment Rate (pct) 1/	6.4	6.1	6.4
Money and Prices (annual percentage growth):			
Money Supply (M2) (pct)	11.9	15.6	10
Consumer Price Inflation (pct)	2.0	9.3	12
Exchange Rate (Rupiah/US$ annual average)	7,855	8,421	10,500
Balance of Payments and Trade:			
Total Exports FOB (includes oil and gas)	48.6	62.1	62.5
Exports to United States 2/	9.5	10.3	10.4
Total Imports CIF (includes oil and gas)	24.0	33.5	36.0
Imports from United States 2/	2.0	2.4	2.3
Trade Balance	24.6	28.6	26.5
Balance with United States 2/	7.5	7.9	8.1
External Public Debt	85.5	84.0	83.0
Fiscal Deficit/GDP (pct)	3.9	1.5	3.7
Debt Service Payments/GDP (pct) 3/	12.3	12.1	14.0
Current Account Balance/GDP(pct)	4.1	4.8	2.7
Gold and Foreign Exchange Reserves (end of period)	27.1	23.3	29.5
Aid from United States (millions of US$)	139	205	230
Aid from All Other Sources 4/	7.8	4.2	4.5

e = Embassy estimate

1/ Official Government of Indonesia estimate of open unemployment. Does not measure underemployment.
2/ Department of Commerce statistics, customs value basis. Figures for 2001 are estimates based on January to August data.
3/ IBRD Debtor reporting system. External debt only.
4/ 2001 number is amount pledged.
Sources: Government of Indonesia, U.S. Department of Commerce (for trade with U.S.), IMF (exchange rates), U.S. Agency for International Development (for bilateral assistance).

1. General Policy Framework

More than four years after the Asian financial crisis, Indonesia continues to struggle with the wreckage of its 1998 economic collapse. Its efforts to return to the sustained economic growth it enjoyed before 1997 have been made more difficult by the fact that the country is simultaneously undergoing a painful and, so far, incomplete transition to democracy. Government institutions are weak, political competition is robust and often violent, and powerful forces of the old regime retain sufficient influence to block reforms that threaten their privileges.

In July 2001, the People's Consultative Assembly, the nation's highest legislative body removed President K.H. Abdurrachman Wahid and elected Vice President Megawati Soekarnoputri to the Presidency after almost a year of fierce political infighting. The new government's first task was to reverse a slumping economy and reinvigorate the economic reform process. Even if the new government succeeds in establishing much needed coherence in economic policymaking, daunting challenges remain. The Wahid government left most of the nation's problems unresolved, including: building effective, democratic institutions; establishing the rule of law; restoring private capital inflows; resolving violent regional conflicts; and addressing the chronic economic problems of corruption, a heavy debt burden, and a crippled banking system.

Indonesia is the world's fourth most populous nation and the anchor of Southeast Asia politically and economically. The country has a strategic location, a large labor force earning relatively low wages, and abundant natural resources. The country retains its diversified export base of oil, gas, minerals, and agricultural commodities such as coffee, tea, rubber, timber, palm oil, and shrimp. After a nascent economic recovery in 2000, recent signs point to an economic slowdown coupled with increasing inflationary pressures. Observers expect overall real GDP growth in 2001 to be 3 percent, down from 4.8 percent a year earlier. The slowdown was most prominent in the export sector. Indonesia's exports in the first seven months of 2001 fell 3.4 percent over the same period one year earlier due to slower growth in Indonesia's major export markets. Indonesian exports to the United States will be flat this year at about $10.5 billion while imports from the United States, which fell by more than half between 1997 and 1998, will be about $2.3 billion.

The IMF-supported stabilization and recovery program has provided the framework for Indonesia's economic recovery since November 1997. However, the government has been slow to implement its commitments. The Indonesian Bank Restructuring Agency (IBRA) has recapitalized the banking system, but it has not moved quickly to dispose of assets acquired in the debt-restructuring process or to take on uncooperative debtors. Thus it runs the risk of having to inject more funds into the banking system. The Indonesian government has historically maintained a "balanced" budget: expenditures were covered by the sum of domestic revenues and foreign aid and borrowing, without resort to domestic borrowing. Often the government ended the year with a slight surplus, and this remains the government's long-term goal. However, the financial crisis put a heavy burden on government finances. To recapitalize the banking system, the government issued more than Rp 426 trillion (USD 41 billion, at current exchange rates). Almost $25 billion of this debt is at variable rates linked to SBI rates. This limits the government's ability to use monetary policy to fight inflation. Interest payments on domestic debt will reach Rp 55 trillion ($6.4 billion) or 19 percent of total spending in FY-2001. The government's chronic inability to expand domestic tax revenues and delays in sales of government assets held by IBRA means the government's fiscal position will remain precarious. The gap in FY-2002 is targeted at approximately 2.5 percent of GDP.

In parallel with its fiscal policy, the Indonesian government had a reputation for prudent monetary policy that helped keep consumer price inflation in the single digits. However, the massive depreciation of the rupiah that began in mid-1997 and huge liquidity injections into the banking system have fueled inflation. Indonesian monetary authorities tried to dampen pressure on prices and the exchange rate by tightening monetary policy but the money supply has expanded faster than the targets agreed with the IMF (although base money is currently in line with targets). By mid-2001, inflation had reached an annual rate of 13 percent.

2. Exchange Rate Policies

In August 1997, the government eliminated the rupiah intervention band in favor of a floating exchange rate policy.

3. Structural Policies

In October 1997, deteriorating conditions led Indonesia to request support from the International Monetary Fund (IMF). The government signed its first Letter of Intent (LOI) with the IMF on October 31, 1997. The letter called for a three-year economic stabilization and recovery program, supported by loans from the IMF ($10 billion), the World Bank, the Asian Development Bank, and bilateral donors. Apart from financial support, the international community also offered detailed technical assistance to the government. Foreign governments and private organizations also contributed food and other humanitarian assistance.

Indonesia launched its current three-year (EEF) agreement with the IMF in January 2000. A central focus of the IMF program is maintenance of fiscal sustainability and macroeconomic stability. The Government of Indonesia's progress on commitments has been erratic and, as a result, Indonesia has only completed three reviews under the program. (Reviews were originally scheduled on a quarterly basis.) The Government of Indonesia has failed to follow through on a number of crucial commitments that are important for putting public finances on a sustainable footing and maintaining macroeconomic stability. The Government of Indonesia has moved slowly on the sale of assets nationalized during the 1998 crisis, SOE privatization, and restructuring and privatization of the banking system. In addition, during the Wahid administration, the Government of Indonesia pushed for amendments to the central bank that would undermine Bank Indonesia's independence. The new Megawati government resumed discussions with the IMF in August 2001 and concluded a new LOI in September.

4. Debt Management Policies

Indonesia's foreign debt totaled $137.6 billion as of August 2001, with about $74 billion owed by the public sector and $63 billion by the private sector. Indonesia negotiated two successive two-year Paris Club agreements, rescheduling 100 percent of principal, but not interest. Indonesia's current Paris Club agreement expires at the end of March 2002.

In 1999, the government introduced a monitoring system to collect information on all foreign exchange transactions, including foreign borrowing. Borrowing in connection with state-owned enterprises has been regulated since 1991. The government continues to assert that it will not impose capital controls.

5. Significant Barriers to U.S. Exports

In recent years, Indonesia has liberalized its trade regime and taken a number of important steps to reduce protection. Since 1996, the Indonesian government has issued a series of deregulation packages intended to encourage foreign and domestic private investment. These packages have reduced overall tariff levels, simplified the tariff structure, removed restrictions, and replaced non-tariff barriers with more transparent tariffs.

Despite the severe economic crisis of the past four years, Indonesia has maintained its policy of steady long-term tariff liberalization. Indonesia's applied tariff rates range from 5 to 30 percent, although bound rates are, in many cases, much higher. The major exceptions to this are the 170 percent duty rates applied to all imported distilled spirits and the tariffs on motor vehicles and motor vehicle kits. Consecutive IMF programs in which Indonesia committed to implement a three-tier tariff structure (zero, five, or ten percent) on all imported products, except motor vehicles and alcoholic beverages, have reinforced the long-term liberalization policy. Indonesia also committed to eliminate all non-tariff barriers, except those for health or safety reasons, by the end of 2001. The ongoing domestic political crisis and deteriorating relations with the IMF may delay that timetable somewhat. More effective tariff liberalization has come from the ASEAN Free Trade Agreement under which members committed to a Common Effective Preferential Tariff (CEPT) scheme for most traded goods by 2003. Indonesia implemented its second stage of AFTA tariff reductions on January 1, 2001.

Import tariffs on vehicles were lowered in June 1999 to 25-80 percent (depending on engine size), 0-45 percent for trucks, and 25-60 percent for motorcycles. The government also lowered rates for parts to a maximum 15 percent. Luxury taxes for sedans range from 10-75 percent, for trucks 0 percent, and for motorcycles 0-75 percent.

Services trade barriers to entry continue to exist in many sectors, although the Government of Indonesia has loosened restrictions significantly in the financial sector. Foreign law firms, accounting firms, and consulting engineers must operate through technical assistance or joint venture arrangements with local firms.

Indonesia has liberalized its distribution system, including ending some restrictions on trade in the domestic market. For example, restrictive marketing arrangements for cement, paper, cloves, other spices, and plywood were eliminated in February 1998. Indonesia opened its wholesale and large-scale retail trade to foreign investment, lifting most restrictions in March 1998. Some retail sectors are still reserved for small-scale enterprises under another 1998 decree. Large and medium scale enterprises that wish to invest in these sectors must enter into a partnership agreement with a small-scale enterprise, although this may not require a joint venture or partial share ownership arrangement.

The weakness of the central government in a period of significant political upheaval has encouraged special interests, especially in the agricultural sector, to seek to reinstate some former special trade privileges. So far these efforts have had limited success but the trend is worrisome. Food labeling regulations requiring labels in the Indonesian language and expiration date (rather than the standard “best used by” date) are in place, but are not being enforced. A product registration regulation is also in place that requires detailed product processing information that approaches proprietary information. The registration procedure can also be quite lengthy and expensive. Indonesian importers and U.S. exporters have expressed concern that these regulations could act as non-tariff barriers to imports of packaged food products.

New laws on regional autonomy and fiscal decentralization have granted significant new powers to provincial and sub-provincial governments. Local governments have begun to impose new tax or non-tax barriers on inter-regional trade as they seek new sources of local revenue. Implementing regulations have not been issued to fully clarify the authority and responsibility of the different levels of government.

Investment Barriers: The government is committed to reducing burdensome bureaucratic procedures and substantive requirements for foreign investors. In 1994, the government dropped initial foreign equity requirements and sharply reduced divestiture requirements. Indonesian law provides for both 100 percent direct foreign investment projects and joint ventures with a minimum Indonesian equity of five percent. The government most recently revised its so-called "negative investment list" in July 2001. Sectors that remain closed to all foreign investment include taxi and bus transportation, local marine shipping, film production, distribution and exhibition, radio and television broadcasting and newspapers, some trade and retail services, and forestry concessions. The government removed foreign ownership limitations on banks and on firms publicly traded on Indonesian stock markets.

The Capital Investment Coordinating Board (BKPM) must approve most foreign investment proposals. Investments in the oil and gas, mining, forestry, and financial services sectors are covered by specific laws and regulations and handled by the relevant technical ministries. With the implementation of political and fiscal decentralization, provincial investment boards now play a much great role in approving foreign investments in their regions.

Government Procurement Practices: Technical guidelines for government procurement of goods and services are governed by Presidential Decree (Keppres) No. 18/2000. The decree establishes set-asides for small- and medium-sized enterprises according to the size of the procurement. Foreign suppliers are restricted to contracts worth over Rp. 10 billion ($1.2 million) for goods/services and over Rp. 2 billion ($230,000) for consulting services. A foreign supplier is required to cooperate with a small- or medium-sized company or cooperative in the implementation of the contract. Bilateral or multilateral donors, who specify procurement procedures, finance most large government contracts. For large projects funded by the government, international competitive bidding practices are to be followed. The government seeks concessional financing which includes a 3.5 percent interest rate, a 25-year repayment period and seven-year grace period. Some projects do proceed on less concessional terms. Foreign firms bidding on certain government-sponsored construction or procurement projects may be asked to purchase and export the equivalent in selected Indonesian products. Government departments and institutes and state and regional government corporations are expected to utilize domestic goods and services to the maximum extent feasible, but this is not mandatory for foreign aid-financed goods and services procurement. State-owned enterprises that have offered shares to the public through the stock exchange are exempted from government procurement regulations.

6. Export Subsidies Policies

Indonesia joined the GATT Subsidies Code and eliminated export-loan interest subsidies as of April 1, 1990. As part of its drive to increase non-oil and gas exports, the government permits restitution of Value-Added Tax (VAT) paid by a producing exporter on purchases of materials for use in manufacturing export products. Exemption from or drawbacks of import duties are available for goods incorporated into exports. Free trade zones and industrial estates are combined in several bonded areas. Since 1998, the government has gradually increased the share of production that firms located in bonded zones are able to sell domestically, up to 100 percent.

7. Protection of U.S. Intellectual Property

Indonesia is a member of the World Intellectual Property Organization (WIPO) and in 1997 became a full party to the Paris Convention for the Protection of Intellectual Property, the Berne Convention for the Protection of Literary and Artistic Works, the Patent Cooperation Treaty, and the Trademark Law Treaty. Indonesia was the first country in the world to ratify the WIPO Copyright Treaty, but has not ratified the companion WIPO Performances and Phonograms Treaty. In April 2001, the U.S. Trade Representative placed Indonesia on the Special 301 Priority Watch List citing continued lack of effective enforcement of IP rights.

Piracy of software, books, and videos in Indonesia is rampant. U.S. rightholders are concerned about the rapid increase in pirate optical disc (OD) production facilities in Indonesia. The capacity of these facilities far exceeds Indonesia's domestic demand indicating Indonesia is a growing export base for pirated media and software. The U.S. government has urged Indonesia to take quick action to register and control OD production equipment.

As part of its efforts to comply with the WTO TRIPS agreement, in December 2000, Indonesia enacted new laws on protection of trade secrets, industrial design, integrated circuits, and plant varieties. In July 2001, Parliament passed amendments to existing laws on patent and trademarks. The government is also preparing amendments to the existing copyright law. Even with new laws in place, however, inadequate enforcement and a corrupt judicial system pose daunting problems for U.S. companies seeking enforcement of their rights in Indonesia. The Indonesian government has, at times, responded to U.S. companies bringing specific complaints about pirated goods or trademark abuse, but the Indonesian court system can be frustrating and unpredictable, and effective punishment of pirates of intellectual property is rare.

Indonesia’s new Patent Law did not improve several areas of concern to U.S. companies, including compulsory licensing provisions, a relatively short term of protection, and a provision allowing importation of 50 pharmaceutical products by non-patent holders.

8. Worker Rights

a. *The Right of Association:* Private sector workers, including those in export processing zones, are by law free to form worker organizations provided there are at least ten workers who wish to do so. All unions must be registered with the government. In August 2000, the government enacted a new law governing trade unions that continued a trend since 1998 toward removing barriers to freedom of association. Some labor organizations criticized the new law for maintaining some existing restrictions on unions. There are currently 59 national unions registered. The courts may dissolve a union under the 2000 law if union members are convicted of crimes against the state and sentenced to at least five years in prison.

Civil servants are no longer required to belong to KORPRI, a nonunion association whose central development council is chaired by the Minister of Home Affairs. State enterprise employees, defined to include those working in enterprises in which the state has a five percent holding or greater, usually were KORPRI members in the past, but a small number of state enterprises have units of the Federation of All-Indonesian Trade Unions (SPSI). New unions are now seeking to organize employees in some state-owned enterprises. Teachers must belong to the teachers' association (PGRI). All organized workers, except those engaged in public service, have the legal right to strike. Private sector strikes are frequent.

b. *The Right to Organize and Bargain Collectively:* Registered unions can legally engage in collective bargaining and can collect dues from members through a checkoff system. In companies without unions, the government discourages workers from utilizing outside assistance, preferring that workers seek its assistance. By regulation, negotiations must be concluded within 30 days or be submitted to the Department of Manpower for mediation and conciliation or arbitration. Agreements are for two years and can be extended for one year. According to NGOs involved in labor issues, the provisions of these agreements rarely go beyond the legal minimum standards established by the government, and the agreements are often merely presented to worker representatives for signing rather than being negotiated.

Although government regulations prohibit employers from discriminating or harassing employees because of union membership, there are credible reports from union officials of employer retribution against union organizers, including firing, which is not effectively prevented or remedied in practice. Administrative tribunals adjudicate charges of antiunion discrimination. However, because many union members believe the tribunals generally side with employers, many workers reject or avoid the procedure and present their grievances directly to the national human rights commission, parliament and other agencies. Security forces continue to involve themselves in labor issues, despite the Minister of Manpower's revocation in 1994 of a 1986 regulation allowing the military to intervene in strikes and other labor actions.

c. *Prohibition of Forced or Compulsory Labor:* The law forbids forced labor, including forced and bonded labor by children. In 1999 the government ratified ILO Conventions 105 (Forced Labor) and began removing children from the fishing platforms.

d. *Minimum Age for Employment of Children:* Child labor exists in both industrial and rural areas, and in both the formal and informal sectors. According to ILO, over 3.4 million children (under 15 years of age) work ten hours or more per week. Some observers believe that number to be understated, because documents verifying age are easily falsified. The ILO ranks Indonesia as the third worst in Asia on child labor conditions. Indonesia was one of the first countries to be selected for participation in the ILO's International Program on the Elimination of Child Labor (IPEC) and the government and the ILO signed a Memorandum of Understanding in March 2001. The government followed this with Presidential decree No. 12 of 2001 creating a National Action Committee to Eliminate the Worst Forms of Child Labor. Although the ILO has sponsored training of labor inspectors on child labor matters under the IPEC program, enforcement remains lax. The government ratified ILO Convention 138, which establishes a minimum working age of 15, in April 1999 ILO Convention 182 on the Elimination of the Worst Forms of Child Labor in March 2000.

e. *Acceptable Conditions of Work:* Indonesia does not have a national minimum wage. Rather, area wage councils working under the supervision of the national wage council establish minimum wages for regions and basic needs figures for each province, a monetary amount considered sufficient to enable a single worker to meet the basic needs of nutrition, clothing, and shelter. In Jakarta, the minimum wage is about $35 (Rp. 344,000) per month at an exchange rate of Rp 10,000 to the dollar). There are no reliable statistics on the number of employers paying at least the minimum wage. Independent observers' estimates range between 30 and 60 percent.

Labor law and ministerial regulations provide workers with a variety of other benefits, such as social security, and workers in more modern facilities often receive health benefits, free meals, and transportation. The law establishes seven-hour workdays and 40-hour workweeks, with one 30-minute rest period for each 4 hours of work. The law also requires one day of rest weekly. The daily overtime rate is 1-1/2 times the normal hourly rate for the first hour, and twice the hourly rate for additional overtime. Observance of laws regulating benefits and labor standards varies from sector to sector and by region. Employer violations of legal requirements are fairly common and often result in strikes and employee protests. In general, government enforcement and supervision of labor standards are weak. Both law and regulations provide for minimum standards of industrial health and safety. In the largely western-operated oil sector, safety and health programs function reasonably well. However, in the country's 100,000 larger registered companies in the non-oil sector, the quality of occupational health and safety programs varies greatly. The enforcement of health and safety standards is severely hampered by corruption, by the limited number of qualified Department of Manpower inspectors and by the low level of employee appreciation for sound health and safety practices. Workers are obligated to report hazardous working conditions. Employers are forbidden by law from retaliating against those who do, but the law is not effectively enforced.

f. *Rights in Sectors with U.S. Investment:* Working conditions for direct-hire employees in firms with U.S. ownership are widely recognized as better than the norm for Indonesia. Contract labor, although widely used, does not receive the same benefits as direct hire employees. Application of legislation and practice governing worker rights is largely dependent upon whether a particular business or investment is characterized as private or public. U.S. investment in Indonesia is concentrated in the petroleum and related industries, primary and fabricated metals (mining), and pharmaceutical sectors.

Foreign participation in the petroleum sector is largely in the form of production sharing contracts between the foreign companies and the state oil and gas company, Pertamina, which retains control over all activities. All direct employees of foreign companies under this arrangement are considered state employees and thus all legislation and practice regarding state employees generally applies to them. Employees of foreign companies operating in the petroleum sector are organized in KORPRI. Employees of these state enterprises enjoy most of the protection of Indonesia labor laws including the right to strike, join labor organizations, or negotiate collective agreements. Contract workers in the petroleum sector do have the right to organize and have joined independent trade unions. A 1995 Minister of Manpower regulation exempts the petroleum sector from legislation requiring employers to give permanent worker status to workers who have worked for the company under short-term contracts for more than three years. Some companies operating under other contractual arrangements, such as contracts of work and, in the case of the mining sector, coal contracts of work, do have unions and collective bargaining agreements.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category	Amount
Petroleum	8,440
Total Manufacturing	273

Food & Kindred Products	21	
Chemicals & Allied Products	148	
Primary & Fabricated Metals	1	
Industrial Machinery and Equipment	-28	
Electric & Electronic Equipment	3	
Transportation Equipment	(D)	
Other Manufacturing	(D)	
Wholesale Trade		(D)
Banking		249
Finance/Insurance/Real Estate		385
Services		(D)
Other Industries		2,219
TOTAL ALL INDUSTRIES		11,605

(D) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.