Newsletter INDONESIA

INVESTMENT CLIMATE STATEMENT OF INDONESIA

A.1. Openness to Foreign Investment

Indonesia encourages private sector-led growth and foreign investment. It maintained a relatively open foreign investment regime and President Megawati declared 2003 as the "Year of Investment." Official appeals for investment have not been matched by action on serious issues facing investors such as judicial reform and rampant corruption.

Investors reduced investment in the last few years; balance of payment statistics continue to reveal net negative investment flows. Foreign investment approvals in 2002 declined to USD 9.8 billion, from USD 15 billion and USD 16 billion for 2001 and 2000, respectively. Indonesia tracks only investment approvals, which, if they happen at all, may require years to realize. Investment approvals for Indonesian firms trended even more steeply downward amounting in 2002 to only USD 2.8 billion, from USD 5.8 billion and USD 11 billion in 2001 and 2000, respectively. Indonesia counts three categories for investment-new investment, expansions, and changes in status which inflates investment approval figures. Changes in status occur when a foreign investor purchases a domestic company--partially or wholly--in which case the entire equity of the Indonesian firm is added to the investment approval totals. Recent privatization sales greatly increased the amounts in the change in status category and resulted in inflated investment figures for 2002.

Draft Investment Law: Indonesia's cabinet has not yet approved a new investment law to replace the existing law from 1967. The draft law provides for equal treatment of domestic and foreign investors, as well as a range of incentives, including tax holidays. It also creates a "one-stop shop," concentrating investment approvals for all sectors within Capital Investment Coordinating Board's (BKPM). However, some ministries strongly resist this dramatic increase in BKPM's authority to approve investments. Regional governments oppose the bill and want to protect their right to approve investments. The Ministry of Finance opposes the law for budgetary reasons. Private investors, who were not consulted on the draft, oppose the tax holiday provisions and fear greater corruption in the investment approval process.

Under Indonesia's current investment law, the Capital Investment Coordinating Board (BKPM) plays a key role in promoting foreign investment and approving many project proposals, including investments in Bonded Zones (Kawasan Berikat) and Integrated Economic Zones (KAPET). However, the Ministry of Industry and Trade, and relevant technical government departments responsible for oil and gas, banking, and insurance industries also have investment approval powers, leading to confusion among potential investors. Investors may also apply for investment approvals with Indonesian Embassies abroad or provincial Regional Capital Investment Coordinating Boards (BKPMDs). Regional autonomy legislation also appears to permit each province, district and city to accept and approve investment applications. Thus, additional regulations are needed to clarify the situation.

Address:
Anakida Building, 6th Floor
Jl. Prof. Dr. Soepomo, S.H., No. 27
Tebet - Jakarta 12810
Indonesia

Phone: (62-21)8370 5820
Fax: (62-21) 8370 5821
E-mail: dlp@dlplawoffices.com
www.dlplawoffices.com

IBRA Asset Sales and Privatization: The Indonesian Bank Restructuring Agency (IBRA), established in the aftermath of the Asian financial crisis in early 1998, assumed control over bad corporate debts and insolvent banks estimated at USD 76 billion. Although the sale of these assets represent an opportunity for foreign investors, difficulties in asset valuation, labor resistance, nationalism, allegations of corruption and a lack of transparency, and the challenge of attracting buyers in an uncertain investment and security environment have slowed the program. In 2002 IBRA sold bank shares in Indonesia's largest retail bank, Bank Central Asia (BCA), and Bank Niaga. In early 2003, IBRA sold shares in Indonesia's fifth largest retail bank, Bank Danamon. IBRA plans to make an initial public offering for Bank Mandiri and sell shares of Bank Lippo, Bank Internasional Indonesia, Bank Permata, and Bank Rakyat Indonesia before the end of 2003. The government plans for IBRA to cease operations in February 2004. As of 1 January 2003, IBRA collected an estimated USD 13 billion from asset sales. IBRA officials plan to reduce their managed assets to USD 12 billion and transfer this amount to a yet undetermined government entity in the first quarter of 2004.

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

(a) Sectors closed to all investors:

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

(b) Sectors closed to foreign investors:

--germ plasm cultivation; --forest concessions; --lumbering contractors; --taxi/bus transport and small-scale water transport services; --print media, TV, radio, film and cinema, including distribution and exhibition; --small-scale retail trade.

(c) Industries with restricted ownership limits for foreigners:

--airport/seaport construction and operation; --electricity production, transmission and distribution; --atomic power plants; --shipping; --drinking water; --railway service; --certain medical services.
In addition, a variety of industries have limitation on foreign investment, usually restrictions on business locations and scope of operation. Projects in these industries require special licensing.

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

Government Regulation No. 20/1994 and Decree No. 15/1994 requires foreign investors with wholly owned companies to divest partial ownership to an Indonesian partner after fifteen years of commercial operations. The regulation does not specify the required divestment percentage, and may lead government officials to make arbitrary rulings in the future. BKPM officials maintain that foreign investors will only need to divest between one and five percent of ownership, but no companies are required to divest prior to 2008.

Under Indonesia's Coal Contracts of Work (CCOW) foreign shareholders are required to divest up to 51 percent under a fixed timetable. The regulations, however, lack specific guidance on share transfer. This has spurred a major conflict between company management, provincial authorities and the central government over who will receive the shares for a major mining operation in East Kalimantan that represents the first case of divestment of majority ownership.

Distribution: The government has eliminated many restrictions on foreign investment in retail and wholesale operations. Foreign firms are now allowed to invest directly in both wholesale and large-scale retail trade sectors (generally interpreted as shopping centers, malls, supermarkets, and department stores), with the condition that they enter into a cooperative agreement with a small-scale enterprise. Such an agreement, in practice, did not require equity participation by the small-scale enterprise. In addition, many foreign firms use franchising, licensing, and technical service agreements to distribute their goods. Indonesia has lifted many restrictions on foreign participation in domestic distribution services.
Under current regulations, foreign companies manufacturing in Indonesia may distribute their locally produced goods at the wholesale level and may apply for permits to import and distribute other products as well. These licensing processes may be substantially affected by decentralization. Companies engaging in wholesale distribution may not conduct retail operations directly, but must form a separate retail company.

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

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

BKPM claims to require only ten days to process the initial investment approval (IIA) (or investment license) once the applicant has furnished all requested information and documentation. In practice, however, this process can easily be delayed for two to four weeks depending on the availability of officials and complete submission of documents. The IIA serves as a temporary operating license for a period up to three years (the IIA can be extended), and it enables the PMA company to start its commercial activities.

The IIA allows the parties to form a limited liability company (Perseroan Terbatas, or P.T.) by executing through an Indonesian notary a Deed of Establishment. The Articles of Association of the PMA company are included in the Deed of Establishment and must comply with Law No. 1/1995 on Limited Liability Companies. With the Deed of Establishment executed, the company may obtain a taxpayer registration number from the Directorate General of Taxation of Foreign Companies.

This requires about one week. The PMA company must open a special foreign investment account at an approved foreign exchange bank in Indonesia. Should the PMA company's IIA indicate plans to hire expatriates, it will need to file an application for approval of its manpower plan with BKPM.

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

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

Oil and gas: As required under Oil and Gas Law 22/2001 of October 2001, the Indonesian government created two new bodies to take over Pertamina's upstream and downstream regulatory functions. In July 2002, the government formed the Implementing Body for Oil and Gas Upstream Activities (BPMIGAS). This nominally independent body reports directly to the President and is principally responsible for managing the Production Sharing Contracts (PSCs). The government established the downstream regulatory authority, BPHMIGAS, in December 2002. Like its upstream counterpart, BPHMIGAS is also an independent body responsible for regulating the supply and distribution of oil fuel and natural gas, as well as setting tariffs for natural gas pipelines. According to the law, both authorities are termed "state legal entities" and therefore not government bodies. Full details on the functions and responsibilities of both organizations bodies will be contained in government implementing regulations that have not yet been issued.

In June 2003, the government passed a presidential decree changing state oil and gas company Pertamina into a limited liability company. This is the first step towards the complete privatization of Pertamina by 2006. The decree requires the Ministry of Finance and the Ministry of Energy and Mineral Resources to jointly decide which assets the new Pertamina will retain. This important issue includes whether or not Pertamina will retain non-core (i.e., non petroleum-related) assets, as well as core assets such as oil refineries and Liquefied Natural Gas (LNG) plants. The decree also requires Pertamina to transfer all geothermal sector activities to a subsidiary within two years.

Services: trade barriers continue to exist in many sectors, in particular professional services. Foreign accounting firms must operate through technical assistance arrangements with local firms, and only citizens of Indonesia can be licensed as accountants. Foreign agents and auditors may act only as consultants and cannot sign audit reports. Foreign law firms cannot establish a legal practice in Indonesia, so many foreign law firms enter into a cooperative work agreement with local firms. Indonesian law allows only Indonesian nationals who have graduated from an Indonesian legal facility or other recognized institution to join the local bar and practice law. Foreign engineering consultants can operate only by forming a joint venture with local partners in Indonesia.

A.2. Conversion and Transfer Policies

Exchange rate risk remains a major concern of investors, because of the volatility in the rupiah (Rp) since 1997. The rupiah has strengthened recently, but could be undermined should capital that has flowed into short-term bonds quickly reverse and exit Indonesia. The rupiah's strength also depends on future actions by the Indonesian government, as well as overall political or economic stability. As of June 2003, the rupiah traded around 8,100/USD, an increase of over 9 percent since January 2003. At President Megawati's inauguration in July 2001, the rupiah traded at Rp 11,440/USD. Previously, the rupiah was very volatile ranging from Rp 2,500/USD prior to the 1997 Asian Financial Crisis to a low of Rp 17,000/USD in January 1998.

Indonesia has no system of capital controls and foreign exchange flows freely in and out of the country. No prior permits are necessary to transfer foreign exchange, and foreign investors have the right to repatriate capital and profits at the prevailing rate of exchange. The government places no restrictions on outward direct investment. Since April 2000, Indonesian residents must report all foreign exchange transactions above USD 10,000 or the equivalent. Bank Indonesia introduced regulations prohibiting banks in Indonesia from transferring Rupiah to non-residents in January 2001 to control speculative trading of the Rupiah. The regulations also limit the quantity of derivative transactions against the rupiah by onshore banks to USD 3 million.

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, Indonesia respects a company's right to compensation if expropriated; however, the government has not expropriated any foreign investment since the passage of the 1967 law. In 1999, however, the Overseas Private Investment Corporation (OPIC) paid a claim by a US investor after the government failed to honor an arbitration award. Indonesia subsequently agreed to repay OPIC. The government also paid USD 15 million compensation to the Multilateral Investment Guarantee Agency (MIGA) for its insurance payment to a power project.

A.4. Dispute Settlement

The court system does not provide effective recourse for resolving commercial disputes. The judiciary is nominally independent under the law, and legal practitioners say irregular payments and other collusive practices often influence case preparation and the judicial ruling. The government recognizes the need for judicial reform, but has not yet taken action. In several instances the local courts accepted jurisdiction over commercial disputes despite contractual arbitration clauses calling for adjudication in foreign venues.

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

On 12 August 1999 Indonesia's Parliament passed Arbitration Law Number 30, endowing the District Court of Central Jakarta with the power to enforce international arbitration awards. Prior to the passage of the new Arbitration law in 1999, enforcement lay with the Supreme Court, which was slow to act on decisions.

Since 1999, Indonesian courts have swiftly enforced international arbitration awards with some executed within a month of the request for enforcement. The new law greatly reduces instances where district courts fail to apply the law, and legal practitioners predict the process should improve as more judges educate themselves about arbitration. Since 1981 when Indonesia joined the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, fewer than two dozen foreign awards have registered with Indonesian courts (most of which have been enforced). The domestic and international press have widely publicized recent cases where those awards have not been enforced.

A.5. Performance Requirements and Incentives

The government notified the WTO of its compliance with Trade-Related Investment Measures (TRIMS) on 26 August 1998.
The Parliament revoked tax holiday incentives in 2000. However, a BKPM sponsored draft investment bill, under cabinet review, aims to reestablish such incentives. Various fiscal incentives are available to both foreign and domestic investors. A company producing for the domestic market may apply for import duty exemptions on all required machinery and equipment as well as on raw and supporting materials needed during the first two years of commercial production. A company producing for export markets may apply for restitution of import duties paid on inputs subsequently re-exported in finished form.

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

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

Indonesia does not require investors to purchase from local sources or export a certain percentage of output. The government eased rules in June 1998 that encouraged investors to locate in industrial estates. 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 relies on the private sector (albeit often heavily protected), as the principal engine of economic growth. At the same time, State-owned Enterprises (SOEs) play a dominant role in many sectors, including oil and gas retail and distribution, electric power generation and transmission, civil aviation, banking, and fertilizer production and wholesale distribution. In the past three years Indonesia promoted competition in some sectors and has decreased the privileges awarded to SOEs. The Parliament formed the State Ministry for SOEs in 1998; privatization is an important part of its mandate, but political opposition has effectively hindered attempts to privatize. Some provincial governments have improved management and transparency of provincially owned firms (BUMD's) to stem losses and prepare them for privatization.

A.7. Protection of Property Rights

Foreign entities have no freehold rights to land ownership in Indonesia. Foreign investors' land holdings are usually obtained through long-term lease agreements (normally for 30 years) with the government or private parties. These lease holdings can be used as collateral. Government regulations allow mortgages to be registered against real property and seagoing vessels in their appropriate registries, as well as security interests in chattel, equipment, accounts receivable, and insurance proceeds. A search facility currently exists only for mortgages. The lack of transparency in Indonesia's courts means uncertainty whether security interests will be recognized and enforced. Foreign companies may also establish a limited company under Indonesian law that can legally obtain rights to land.

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

The US government in May 2003 again placed Indonesia on the Special 301 Priority Watch List for inadequate protection of Intellectual Property Rights (IPR), where Indonesia has been since the 1980s. The Indonesian government has steadily improved the regulatory and legal framework for the protection of IPR, however, enforcement continues to fall short. US businesses reported that Indonesia ranks as the third largest producer of pirated products. They maintain that 90 percent of all CDs (audio, video, and software) sold in Indonesia are pirated and estimate that industry suffered losses in 2002 of USD 253 million, a 33 percent increase over prior year.

Indonesia's new copyright law (Law 19/2002) takes effect on July 29, 2003. The new law increases fines up to Rp 500 million (USD 62,000) and provides for prison terms of up to five years for dealers of pirated materials. The law directs cases of alleged copyright violations to be tried in commercial courts, and for the rendering of judgments within 90 days. As part of the law's implementation, the Ministry of Industry and Trade plans to issue optical disc regulations that would enhance the government's ability to identify and prosecute producers of pirated products. In an effort to enhance interagency coordination on enforcement, Indonesia's Ministry of Justice recently formed an IPR task force made up of the national police, customs, attorney general, judiciary, and members of the computer software and entertainment industries. The task force has already conducted a few high profile raids.

Indonesia is a member of the World Intellectual Property Organization, but has not yet ratified the related WIPO Performances and Phonograms Treaty (WPPT). The Ministry of Justice prepared a Presidential decree ratifying WPPT last year, and Justice officials expect the President to sign the decree sometime in 2003. Indonesia acceded to numerous international conventions on intellectual property rights, including the Paris Convention for the Protection of Intellectual Property; the Berne Convention for the Protection of Literary and Artistic Works (with a reservation on Article 33); the Patent Cooperation Treaty; Trademark Law Treaty; the Nice Agreement for the International Classification of Unclassified Goods and Services.

Patents: The current patent law dates from 2001, which amended and consolidated in a single text all previous legislation. In 1997, Indonesian law extended the term of patent protection to 20 years from 14 years, and maintained the provision for a two-year patent extension. The amendment allows for the patenting of plant and animals. However, some of the weaknesses of the old law persist.

Chief among these flaws is the requirement that an inventor must produce a product or utilize a value-added process in Indonesia in order to obtain patent protection for the product or process. Inventions that are contrary to Indonesian laws and regulations are excluded from patent ability, and the standard for excluding inventions without domestic content appears to be inconsistent with TRIPS requirements.

Trademarks: Indonesia enacted its new trademark law on August 1, 2001. Like the new patent law, the latest version consolidated into one text a series of trademark laws enacted over the past 20 years. The new law raised the maximum fine for trademark violations to Rp 1 billion (USD 95,000) and slightly reduced the maximum possible prison term. The government justified this move by claiming that financial penalties were a greater deterrent to IPR violators than imprisonment. Foreign rights holders, arguing that most IPR cases never result in the maximum sentence, had pushed for minimum sentencing guidelines rather than higher fines.

The trademark law provides for the determination of trademark rights by priority of registration, rather than by priority of commercial use. The law also provides for the protection of well-known marks, but offers no administrative procedures or legal ground under which legitimate owners of well-known marks can cancel pre-existing registrations. Currently, the only avenue for challenging existing trademark registrations in Indonesia is through the commercial courts, which generally have issued decisions within three months upholding legitimate trademarks.