SUMMARY

Economic Environment

1. Since its previous review in 2007, Indonesia has made steady economic progress with an average annual real GDP growth rate of 5.9%. GDP per capita almost doubled to almost $3,500 and the poverty incidence declined from a post-crisis peak of 24% to 12.4% in 2011. These and other solid fundamentals provided good underlying support in the face of the 2008-09 global recession. Looking ahead, the government's 2011 Master Plan for the Acceleration and Expansion of Economic Development 2011-2025 recognizes that higher and sustainable economic expansion requires that the country diversify sources of growth, accelerate infrastructure development and close the development gap between eastern and western regions. Real GDP has been forecast by the World Bank to grow by 6.1% in 2012, rising slightly to 6.3% in 2013, assuming continued strong consumption and investment growth, supported by a recovery in exports.

2. Indonesia has taken steps to improve its business environment, which is reflected in improvements in its rankings in various global indicators. In addition to positive assessments of Indonesia's macroeconomic climate and FDI regime, some notable reforms include the launch of the Indonesia National Single Window to facilitate online processing of trade and licensing activities and the development of initiatives to improve governance.

3. State-owned enterprises (SOEs) continue to play a key role in Indonesia's economy, estimated to account for around 40% of Indonesia's GDP. There has not been any significant privatization activity over the review period. However, the government has partially divested itself of some of its ownership shares in various industries, including: cement, telecommunications, mining, energy, pharmaceuticals, construction, highways, steel, manufacturing, airlines and banks. An SOE monopoly on the importation of alcoholic beverages was terminated in 2010.

4. Trade remains limited as a share of economic output, with merchandise exports accounting for between 21% and 26% of GDP during the review period and imports for between 15% and 18.5% of GDP. Indonesia continues to trade more energy-related products (fuels) than any other product category on both the import and export sides. A number of measures - including export restrictions and taxes on raw resources, tighter import licensing requirements, point of entry restrictions on imports, ownership limitations on banks and certain divestment requirements for foreign mining companies - have recently raised concerns about the direction of trade and investment policy-making. In this regard, the authorities consider that domestic industrial policy considerations, aimed, *inter alia*, at developing local industries and moving up the value chain, should be balanced with maintaining an open foreign trade and investment regime in order to ensure that Indonesia's external commitments continue to be fully respected.

Trade and investment policy framework

5. Indonesia provides at least MFN treatment to all WTO Members. In order to improve trade and investment policies, Indonesia has enacted new laws relating, *inter alia*, to investment, its SPS regime, export financing, special economic zones as well as in agriculture, fisheries, shipping, mineral and coal mining and tourism. Indonesia is continuing to strengthen its economic ties with countries in the region, both bilaterally and through its participation in ASEAN. Under ASEAN, which is working towards achieving an ASEAN Community by 2015, new goods and investment agreements have recently entered into force.

6. Indonesia's medium-term trade policy objectives are to increase the export of non-oil products, strengthen the domestic market and manage the availability of basic products; and to strengthen national distribution channels. To this end, it has identified ten priority products of key interest in its trade negotiations. Its economic priorities may also be understood within the context of various development plans, which aim to increase the competitiveness of Indonesia's businesses and encourage a shift into higher value-added activities. Central to this is the economic development of six regional economic corridors, each with industrial clusters focusing on priority sectors. These corridors would be connected through an enhanced transport and ICT infrastructure, which is currently poor. The realisation of these objectives will be dependent to a considerable extent on private investment.

7. There have been significant legal and institutional changes to Indonesia's foreign investment regime. A new foreign investment law was enacted in 2007 which represents an improvement to previous rules by doing away, for example, with maximum timeframes for investment in permitted sectors and has provisions on national treatment for foreign investors as well as access to international arbitration. Investment restrictions, including limits to foreign equity participation, are set out in a comprehensive "negative list" which has been revised and liberalised over the review period. Foreign ownership is restricted in a number of sectors which include agriculture, forestry and fisheries; energy-related activities; communications and financial services and health services. Overall, the 2007 Investment law offers greater transparency in terms of the sectors covered and a reduction in administrative burdens.

Trade measures and practices

8. Indonesia has continued to undertake systematic efforts to reduce constraints to trade, investment and production and to streamline procedures at the border. Customs reform is prominent on the government's agenda. This includes the 2007 launch of Indonesia's National Single Window, which allows for the online processing of customs documentation, applications for licences, and duty payments. It is now operational at all of Indonesia's ten main customs entry points, through which an estimated 90% of trade enters and leaves Indonesia. Efforts are also being undertaken to improve risk management and facilitate trade by introducing schemes for reputable importers. The goal of customs reform is to reduce the time and cost of clearing customs and to limit smuggling and customs fraud. The authorities have observed a significant drop in customs-related appeals as a result of guidelines issued to assist customs officers to determine the customs value of imported goods. On the other hand, import procedures tend to be complicated by registration requirements, port of entry restrictions for several products, and extensive pre-shipment inspection and import licensing requirements.

9. The tariff has remained Indonesia's main trade policy instrument, albeit a relatively small source of tax revenue. Indonesia's revenues from taxes on international trade constitute around 4% of total tax revenues, which is considerably lower than the average for developing countries. Nearly half of Indonesia's trade taxes are levied on exports, mainly commodities, the main policy objectives being price stabilization, development of downstream processing facilities and reducing the rate of depletion in non-renewable resources.

10. The Ministry of Finance concluded a five-year tariff harmonization programme in 2010, which has resulted in the lowering of Indonesia's simple average MFN tariff to 7.8% in 2012, down from 9.5% in 2006. The average applied MFN tariff is 7.5% for industrial products and 9.5% for agricultural imports. More than 85% of tariff rates are currently in the range of zero to 10%. In line with long-standing sectoral support, the highest tariffs apply mainly to motor vehicles. As has been the case in previous reviews, 95% of tariff lines are bound but at 37.4% the average bound rate largely exceeds the average applied rate, creating a degree of unpredictability for the tariff. The difference between average applied and bound rates remains much higher for agricultural products (at 9.5% and 47.1% respectively). With the exception of a few tariff lines subject to specific rates, virtually all applied tariff rates are ad valorem, a feature that contributes to the transparency of the tariff. Tariff preferences offered by Indonesia through bilateral and ASEAN FTAs have resulted in significant tariff reductions, ranging from 0.8% to 5.9%, thus widening the gap with its MFN tariff rate. In addition to the tariff, Indonesia levies VAT at a flat rate of 10%, luxury taxes which range from 10% to 75% and excise taxes on alcohol and tobacco products; for alcoholic beverages with an alcohol content of 5% or more excise tax rates on imports are higher than on domestic production.

11. Around 20% of Indonesia's tariff lines are affected by import licensing requirements, which have been expanded since Indonesia's previous review. Many are in place to implement policies designed to protect domestic production, such as rice, sugar, salt, certain textiles and textile products, cloves, animals and animal products and horticultural products. Various concerns have been raised by WTO Members with regard to the complexity, lack of transparency and trade-impairing effects of Indonesia's import licensing requirements.

12. In 2011 Indonesia enacted new rules governing anti-dumping, countervailing and safeguard measures, with the main changes intended to reinforce investigation procedures as well as to bring the regulation of trade remedies under one piece of legislation. Relevant institutional restructuring is in progress. Indonesia has not so far initiated a countervailing investigation. At end-2012, it had

18 definitive anti-dumping measures in force. Since 2010 Indonesia's use of safeguard actions has increased significantly, making it the WTO's second most frequent user of this instrument.

13. National standards are formulated in accordance with international standards, where feasible. About 3% of all standards are mandatory. Indonesia has a transparent approach to the formulation of standards and technical regulations, which allows for the participation of interested members of the public. During the review period, new SPS-related legislation has entered into force relating to animal husbandry and animal health and to horticulture. All imported meat and dairy products must be accompanied by a halal certificate issued by an approved halal certifying body. Regulations to implement horticultural legislation have tightened up import quarantine procedures to prevent the spread of fruit fly, which imits the ports of entry into Indonesia for imports from countries that do not have recognised food safety systems.

14. Public procurement in Indonesia is undertaken by numerous entities at the central and regional levels of government as well as by state owned enterprises. Indonesia became an observer to the WTO Government Procurement Agreement (GPA) in 2012. Government procurement remains an important instrument of industrial policy. Foreign companies may only bid in co-operation with a national company (unless no national company has the ability to provide the goods and services requested) and only on bids that exceed certain thresholds. Procurement rules mandate the use of domestic products in government procurement if there are providers offering goods and services with a local content exceeding 40% of value. Since 2007, transparency in procurement has been improved with the introduction of mandatory e-procurement for public tenders. New procurement regulations require each procuring entity to implement stronger management controls and also set out contracting procedures and timeframes. However, in spite of these reforms, bid-rigging remains a major problem and accounts for around 70% of the Competition Commission's caseload, pointing to the need for a comprehensive procurement law and strengthened audit procedures. Indonesia's competition policy framework has not undergone any significant change in the period under review.

15. Support for production and trade has been provided through a variety of incentives for domestic and foreign investors. These include: corporate tax relief and exemptions; fuel subsidies; customs duty exemptions; as well as various incentives related to free trade zones and special economic zones. Indonesia currently has one FTZ in operation. The Government enacted a Special Economic Zones (SEZ) Law in 2009 to encourage the development of SEZs as centres of economic activity situated in strategic positions and encompassing export processing zones, bonded zones, industrial zones, technology parks, and supporting activities. Two SEZs are currently being developed.

16. Indonesia has export licensing, prohibitions and restrictions in place to ensure protection of natural resources and endangered species, provide an adequate domestic supply of essential products, promote higher-value-added downstream industries, and upgrade the quality of export products. In addition, the government will prohibit mining companies from exporting mineral ore products (currently subject to export licensing and taxes) as of 2014, when they will be required to undertake refining activities onshore. During the review period, new export taxes have been introduced on leather and wood, palm oil, raw cocoa and mineral ore products. The main objective of these measures is to encourage value-added processing within Indonesia. Secondary considerations are to secure domestic supply, safeguard the environment and raise revenue.

17. In 2009 the state-owned Bank Ekspor Indonesia, which had provided pre-shipment and post-shipment financing facilities for exporters was transformed under new legislation into the Indonesia Eximbank. It provides exporting financing, guarantees and insurance in areas not entered into by commercial financial institutions, with enterprises in the areas of crude palm oil, textiles, oil and gas, and mining being among its main clients. Another state-owned enterprise, Asuransi Expor Indonesia offers export credit insurance to exporters for all products other than oil and gas.

18. A net importer of IP-intensive goods, Indonesia has sought to strengthen protection of intellectual property rights by improving its legal framework. Indonesia is at an advanced stage in drafting amendments to legislation concerning copyright, trademarks, patents and industrial designs. Indonesia is a proponent of incorporating into the TRIPS agreement a requirement for the disclosure of origin of genetic resources and/or associated traditional knowledge. Over the review period Indonesia has used compulsory licensing on two occasions to permit Government

use of pharmaceutical patents in order to produce certain antiviral and antiretroviral drugs: in all instances Government use of these patents is until their expiry. IPR infringements, particularly with respect to copyright, remain of concern to Indonesia's trading partners and Indonesia is making efforts to combat IPR violations through inter alia import licensing requirements and upgraded monitoring and investigation efforts.

Sectoral policy developments

19. As a large country with a complex archipelagic structure, Indonesia confronts considerable difficulties in establishing the extensive infrastructure of transport, communications and public utilities that is essential for its economic and social development. Years of under-investment have left Indonesia's infrastructure network crumbling. Roads are congested, ports are bottlenecked, and many Indonesians do not have access to either potable water or reliable electricity. Inadequate infrastructure has also contributed to poor distribution systems, which have resulted in high logistics costs; for example, shipping costs are between an estimated 50% and 80% higher than elsewhere in the region. Efforts to draw up a master plan for port development have been hampered by the decentralized structure of government and the competing interests of provincial and district governments.

20. In terms of the overall sectoral structure of the Indonesian economy, there was little change during the review period. Agriculture, forestry, and fishing contributed 14.7% of GDP in 2011 and engaged an estimated 35.9% of the employed labour force, continuing to provide employment to more than 40 million persons. Agricultural policy priorities are driven by concerns over food self-sufficiency, food consumption and production diversification, value-added and competitiveness, and the welfare of farmers. Rice is the most important food crop and the preferred staple of the great majority of Indonesians, who get nearly half their calories from rice, so maintaining stable and low rice prices has been a major policy aim of the Indonesian Government. Key domestic policy objectives are pursued through a wide range of input subsidies on fertilizer and seeds, and credit is used to support producers. Quantitative import restrictions have been maintained for rice, sugar, and salt and introduced for animals and animal products. Import requirements imposed for food safety, SPS, and cultural reasons appear to have become more stringent. A variable export tax regime has been introduced on crude palm oil and derived products, and more recently on cocoa.

21. Around 70% of Indonesia's land area remains covered by forests but widespread illegal logging practices have led to serious environmental damage. In the face of illegal logging and the smuggling of timber, the government has supplemented its domestic enforcement efforts by signing international agreements with the European Union, Malaysia, Japan, and the PRC to ban the import of illegal logs from Indonesia. Indonesia has instituted a number of policy measures to discourage or ban log exports in order to encourage processing industries within Indonesia. In 2011 Indonesia banned exports of raw and semi-processed rattan (used for traditional furniture). The measure was designed to encourage rattan furniture production but instead seems to be pushing rattan prices down. On the other hand, processed wood and wood manufactures (including finished products such as furniture) make an important contribution to Indonesia's exports.

22. Indonesia continues to be an important supplier in the global mining industry, with significant levels of coal, copper, gold, tin, and nickel production. As a result of the new 2009 Mining Law, mining firms operating in Indonesia will face new restrictions in exporting unprocessed ore. The legislation will require them to process the ore in Indonesia before shipping it abroad. The policy is intended to support the expansion of value-added activities, including the smelting industry.

23. Indonesia's strong recent GDP performance has been driven by services and commodities, not manufacturing, whose share of GDP has fallen to under 25%. Although manufacturing has declined or stagnated in terms of its value added, its share of exports and employment, it nevertheless remains one of Indonesia's biggest contributors to GDP. Citing the country's relatively low labour costs compared with the rest of Southeast Asia, and the large domestic market, the Government has been pursuing investors in sectors such as electronics manufacturing, although inadequate infrastructure remains an obstacle. Indonesia offers numerous incentives to attract foreign direct investment, including bonded or free-trade zones, and exemptions on tax and import duties. To take advantage of these incentives, investors must meet certain conditions stipulated in

the 2007 investment law, such as locating in rural or border regions, employing a large workforce, or undertaking research and development.

24. Services provided 38.1% of GDP in 2011, a share that has remained relatively stable during the review period, and engaged 43.5% of the employed labour force. The engine of economic growth shifted from manufacturing to services during the review period, when the services sector grew at almost twice the rate of manufacturing and agriculture. Trade in services (imports + exports) accounted for 6.3% of GDP in 2011, down from over 12% in 2000. Travel services, which largely represent the tourism sector, dominate exports, with over 37% of Indonesia's services exports. Indonesia has latent comparative advantages in several services sectors, including skilled labour services, technology deployment, and business processing outsourcing.

25. Indonesia's financial system was resilient during the global financial crisis that commenced in 2007. This is in large part attributable to the stability of the banking sector, which remains small relative to Asian neighbours like India and China. Total financial sector assets were 66% of GDP in mid-2012, with the ratio of total bank assets to GDP at 50%. Bank Indonesia (BI) is responsible for supervising and regulating the banking sector although the current supervisory structure is due to change. In 2011, Indonesia established a new financial services authority (Otoritas Jasa Keuangan), which is set to become the sole regulatory agency for all financial services institutions (banks, securities companies, insurance companies, pension funds, and multi-finance companies). Its authority will include bank licensing, bank operations, setting policy on banking liquidity, and banking supervision, all of which it will take over from BI at the end of 2013. The new authority will start supervising and regulating banks in January 2014.

26. The financial system is dominated by banks, accounting for 76% of financial sector assets and other players in the financial industry, such as insurance companies, pension funds, finance companies, securities companies and pawn shops, have small shares within the market. Foreign banks (including branches, joint venture banks, and foreign-owned local banks) play an important role in the sector, with an increasing share in banking assets. Since 1999, up to 99% of a bank’s shares may be held by foreign entities or individuals. Indonesia has revised its WTO financial services commitments to 51% foreign ownership in its GATS schedule (previously 49%); new bank licences are unbound. A 2012 regulation on commercial bank ownership is intended to improve the resilience of banks through better governance. The regulation minimizes ownership dominance in a bank as this may have a negative effect on a bank’s operations. The regulation applies to all shareholders, Indonesians and foreign. Permitted ownership of banks up to 99% by foreign nationals remains unchanged.

27. During the review period, Indonesia's telecommunications market continued to expand and has settled into a healthy development phase. Fixed-wireless technology has provided a fresh basis for expansion in the development of the country's fixed-line network. Wireless has become the dominant component within the fixed-market segment, and by 2011 accounted for an estimated 80% of the total fixed-line subscriber base, with teledensity reaching 17% by early 2012; it has provided much needed basic telephone services to previously unserved communities. The number of mobile subscribers increased from 104 million in 2007 (37% penetration rate) to an estimated 249 million by early 2012, with a penetration rate of over 100%. As penetration passed the important 100% milestone, there was still considerable potential for further market growth, with consumer interest shifting to the 3G services offered by the operators. The rapid growth has attracted a number of foreign investors to the country.

28. The Government’s national transport growth strategy emphasizes enhanced domestic connectivity through major infrastructure development and transport sector reform. The specific objectives for the transport sector development include: improving capacity of transport infrastructure and reducing backlogs and bottlenecks in transport services; achieving a 90% stable road network: increasing domestic sea transport market share to 100%, and railway freight and passenger market shares by 7% and 23%, respectively; and improving the level of transport safety (to reduce transport accidents by 50% by 2014). Transport infrastructure and services are under national, provincial, district, or city agency control, depending on the level of infrastructure or service. Targeting funding to specific purposes is difficult because of the decentralized governance.