
Investment and Intellectual Property Rights

Appropriately regulated, foreign investment can be a powerful force to strengthen Indonesia's role in the global economy. For Indonesia, the significance of an FTA lies in attracting substantially more inward long-term foreign investment.¹

By promoting legal certainty, securing investors property rights, and curbing collusion between established producers, a US-Indonesia FTA could help dispel some of the ghosts that have haunted Indonesia since the Asian financial crisis of the late 1990s. The FTA could encourage more US firms to take advantage of outstanding opportunities in natural resources, creating employment and funding national development.² It could also help struggling sectors—namely, manufactures and services—get back on the radar of US and other foreign investors.³

At the same time, Indonesia's unpredictable judicial process and increasingly autonomous local governments also raise the specter of increased litigation, but records of dispute settlement mechanisms in previous US FTAs, most notably the North American Free Trade Agreement

1. See Hufbauer and Baldwin (2005, appendix D) for a literature review of the connection between FTAs and investment flows.

2. In 2004 the oil, gas, and mining sectors already contributed about 20 percent of government revenues (PWC 2005, 2006).

3. For a recent take on foreign direct investment (FDI) and development, see Moran, Graham, and Blomström (2005), in which Robert E. Lipsey and Fredrik Sjöholm (2005) and Holger Görg and Eric Strobl (2005) present studies of the the impact of FDI on Indonesian manufacturing. Both find strong evidence of spillovers and backward linkages with local production.

(NAFTA), indicate that fears of unbounded litigation or loss of regulatory capacity are unfounded.

The business environment will need to be improved before and after negotiations, but an investment chapter in the proposed FTA will offer Indonesia a chance to become a more investor-friendly economy, in part by improving property rights. Intellectual property rights (IPRs) have become controversial in US FTA negotiations with developing countries, as the United States has an overriding interest in maintaining its position as a leading producer of high-technology goods and services, while developing countries perceive some aspects of the US IPR agenda as costly for their growth prospects. This ongoing debate is likely to arise in US-Indonesia FTA negotiations.

The present chapter traces changes in the investment regime of Indonesia and discusses trends in foreign direct investment (FDI) and portfolio capital over the past decade, identifying major obstacles to a US-Indonesia FTA. It reviews the principal provisions of bilateral investment agreements and suggests specific areas of friction that FTA talks would need to address. It describes the scope of protection for IPRs in current US FTAs, highlighting US concerns about the enforcement of IPR laws in Indonesia and Indonesia's concerns about implementing tougher IPR protection. The chapter concludes with recommendations for successfully negotiating a US-Indonesia FTA while dealing with investment and IPR issues.

Investment Regime and Flows

Over the past 20 years, Indonesia has liberalized access conditions for foreign investment.⁴ Reforms paid off for a brief period. Partly wooed by privatization efforts, average FDI inflows to Indonesia reached \$4.3 billion per year between 1994 and 1997, and similar strong levels were observed for portfolio capital. The inflows were short-lived, but remain a point of reference for foreign investors and policymakers alike.

The 1997 Asian financial crisis drove Indonesia into years of convulsion and change—not an attractive environment for investors. The crisis put a spotlight on the domestic business environment and highlighted the distance between announced reforms and actual changes that resulted from

4. Starting in the mid-1980s, two waves of reform reduced the most severe barriers to foreign investment. The first wave eliminated several sectoral, equity, trade, and sales restrictions; allowed joint ventures; and permitted 100 percent foreign ownership in the newly established export processing zones. The second wave, in the mid-1990s, lifted a mandatory divestment rule that required foreign firms to accept minority ownership (WTO 2003) and partially opened certain strategic sectors to foreign participation, including coal, ports, electricity, telecommunications, shipping, air transport, railways, and mass media (Haggard 2000). By 1994 Indonesia had an open foreign investment policy by Southeast Asian standards (WTO 2003).

them. Behind a façade of reforms, arbitrary decisions and outright corruption facilitated questionable transactions that perpetuated the power of groups with political connections.⁵ The state itself maintained direct control over large sectors of the economy, and state-controlled firms contributed to an atmosphere of shady dealings.⁶ After decades of sustained growth and cozy relations with the government, Indonesian business groups had failed to produce a single renowned multinational firm. In international markets, Indonesia became exhibit A for corruption, nepotism, and cronyism.

In the midst of the crisis of the late 1990s, the newly installed President Bacharuddin Jusuf Habibie liberalized the investment regime by removing equity caps on foreign investment, reducing the list of activities closed to foreign investors, and eliminating price controls and export taxes. These reforms opened several sectors: automobiles, oil, mining, utilities, cement, retail trade, distribution, banking, and major agricultural commodities, such as cloves, wheat, soybeans, sugar, and plywood (see Haggard 2000). Opening proceeded slowly in many instances, but by 1999 Indonesia's investment regime was considered the most liberal among the members of the Association of Southeast Asian Nations (ASEAN) (Felker and Jomo 1999).

Between 1999 and 2001 the government also passed the Decentralization–Regional Autonomy Law and the Forestry Law. Though most investors supported these laws, their implementation was coupled with uncertainty and conflicted with previous contractual obligations. Some of these difficulties remain unresolved to this day.

Political instability and a record of sluggish implementation partly explain the slow recovery of FDI flows to Indonesia. Tables 6.1 and 6.2 show that, while inflows of FDI to neighboring countries remained strong after the Asian crisis, Indonesia experienced net divestment and low inflows of FDI until 2004: FDI stock plummeted to only \$11 billion, just below 5 percent of GDP and less than half of its 1998 value (see table 6.2). In 1996 the FDI stock in Indonesia represented nearly 15 percent of the total for the ASEAN-7 countries, but it dropped to only 4 percent by 2004.

To Indonesia's credit, it never applied foreign exchange controls or restricted outward investment during the financial crisis (US Commercial Service 2005). After 2001, policy openness, coupled with bargain prices for Indonesian firms, privatization of recapitalized banks, and the sale of some state-owned enterprises (SOEs), attracted both foreign and Indonesian capital that was parked abroad. Mergers and acquisitions boomed, reaching an annual average value of almost \$2.5 billion between 2001 and 2004 (UNCTAD 2005b).

5. Claessens, Djankov, and Lang (1999) estimates that just before the Asian crisis, 15 families controlled about 61 percent of all publicly listed companies. The Suharto family controlled nearly 17 percent of stock market capitalization (Patrick 2001).

6. Until the 1990s the state controlled 40 percent of nonagricultural GDP, concentrated in the banking system. State-owned enterprises outside of finance accounted for almost 15 percent of GDP and 10 percent of domestic investment (Dowling 2005).

Table 6.1 Foreign direct investment inflows to selected Asian economies (millions of US dollars, percent of GDP)

Country	1990	1996	1998	2000	2002	2004	2005 ^a
Indonesia	1,092 1.0	6,194 2.7	-241 -0.3	-4,550 -3.0	145 0.1	1,023 0.4	3,500 1.3
Malaysia	2,611 5.9	7,297 7.2	2,714 3.8	3,788 4.2	3,203 3.4	4,624 3.9	4,200 3.2
Singapore	5,575 15.1	9,493 10.3	7,472 9.1	16,485 18.0	5,822 6.7	16,060 15.0	15,900 13.5
Thailand	2,575 3.0	2,338 1.3	7,492 6.7	3,350 2.7	947 0.7	1,064 0.7	3,700 2.2
Vietnam	180 2.8	1,803 7.3	1,700 6.2	1,289 4.1	1,200 3.4	1,610 3.7	1,800 ^d 3.5
ASEAN-7 ^b	12,583	28,939	21,132	21,855	13,254	24,982	29,800 ^d
China	3,487	41,726	45,463	40,715	52,743	60,630	60,300
India	237	2,525	2,633	2,319	3,449	5,335	6,000
Major petroleum exporters ^c	1,266	9,273	10,660	10,384	12,017	14,971	n.a.

ASEAN = Association of Southeast Asian Nations

n.a. = not available

OPEC = Organization of Petroleum Exporting Countries

a. Based on UNCTAD, "Data Show Foreign Direct Investment Climbed Sharply," press release, January 21, 2006. Figures are preliminary.

b. ASEAN-7: Cambodia, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

c. Major OPEC countries excluding Indonesia.

d. Estimated by authors.

Source: UNCTAD, FDI Statistics, www.unctad.org/fdi (accessed July 2006).

Table 6.2 FDI stocks in selected Asian economies
(millions of US dollars, percent of GDP)

Country	1990	1996	2000	2004
Indonesia	8,855 7.7	26,758 11.8	24,780 16.5	11,352 4.4
Malaysia	10,318 23.4	36,028 35.7	52,747 58.6	46,291 39.1
Singapore	30,468 82.6	75,022 81.4	112,571 123.1	160,422 150.2
Thailand	8,242 9.7	19,706 10.8	29,915 24.4	48,598 29.7
Vietnam	1,650 25.5	10,065 40.8	20,596 65.7	29,115 66.3
ASEAN-7 ^a	62,838	175,886	254,998	310,554
Share of Indonesia in ASEAN-7	14	15	10	4

a. ASEAN-7: Cambodia, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

Source: UNCTAD, FDI Statistics, www.unctad.org.

With a reported FDI stock of almost \$10 billion in 2005, US multinationals are among the leading sources of foreign investment in Indonesia. Other prominent sources include the European Union, Japan, and Singapore (table 6.3). EU-based investment focuses on products and services for the domestic market; Asian-based FDI is concentrated in export-oriented manufactures; and US-based FDI centers on oil, gas, and mining. Almost 60 percent of the US FDI stock is located in Indonesia's mining and petroleum sector (table 6.4), in which four US firms lead national production of copper, gold, oil, and gas. The stock of US firms in the Indonesian mining sector has declined (see chapter 2) but new US investors, among them tobacco manufacturers such as Phillip Morris, are increasingly interested in Indonesia.

Recent trends show a more upbeat picture. Approval data indicate a recovery of prospective FDI flows to Indonesia in 2004.⁷ According to the head of Asian investment banking at Merrill Lynch, Sheldon Trainor, 2005 "has been a great year for Indonesia in the regional and international capital markets . . . investors are excited about the current administration's

7. FDI approvals by the Indonesia Investment Coordinating Board also show significant interest by investors. However, FDI approvals significantly exceed actual investment, as table 6.3 indicates.

Table 6.3 US direct investment stocks in Indonesia
(millions of US dollars, historical cost basis)

Sector	1998 ^a	1999	2001	2003	2004
Mining	5,115	6,576	8,163	4,960	6,027
Total manufacturing	275	533	462	(D)	(D)
Food	(D)	15	18	37	47
Chemicals	136	354	363	(D)	(D)
Fabricated metals	8	14	(D)	(D)	36
Machinery	-17	13	9	(D)	181
Computer and electronic products	n.a.	(D)	27	6	-1
Electrical equipment and appliances	31	(D)	15	13	16
Utilities	n.a.	(D)	(D)	728	(D)
Depository institutions	186	252	259	406	440
Finance and insurance ^b	251	120	344	(D)	113
Wholesale trade	(D)	35	27	102	132
Professional and technical services	40	(D)	53	34	39
Information	n.a.	(D)	-55	-186	(D)
Other industries	(D)	(D)	(D)	1,998	(D)
All industries	8,104	8,402	10,511	(D)	(D)
FDI stock in Indonesia from selected sources ^c					
Japan ^d	11,543	4,426	5,029	6,738	6,520
European Union ^e	2,193	13,855	9,668	7,313	n.a.
Singapore	n.a.	3,249	3,122	5,695	n.a.

JETRO = Japanese External Trade Organization

n.a. = not available

(D) = Data in the cell suppressed to avoid disclosure of data of individual companies

a. Bureau of Economic Analysis (BEA) changed classification to record FDI in 1999.

b. Except depository institutions.

c. As reported by each country's responsible authorities.

d. As reported by JETRO. Note that, according to JETRO, Japan's FDI stock in Indonesia amounted to \$17 billion in 1996.

e. As reported by Eurostat, converted into dollars using US Federal Reserve annual exchange rate estimates. Eurostat sources confirmed that the the jump is due to higher investment from the Euro-zone countries in 1999.

Sources: Eurostat, Europe in Figures, epp.eurostat.cec.eu.int; JETRO, Japanese External Trade Statistics, www.jetro.go.jp; Statistics Singapore, Key Indicators of Singapore's Investment Abroad, 1999–2003, www.singstat.gov; US BEA (2006).

Table 6.4 FDI approvals and actual flows to Indonesia from selected sources, 2000–2005
(millions of US dollars)

Country	2000	2002	2004	2005
United States				
FDI flows to Indonesia ^a	683	(D)	(D)	n.a.
Foreign investment approvals ^b	237	469	133	91
European Union (25)				
FDI flows to Indonesia ^c	681	–410	197	n.a.
Foreign investment approvals ^b	5,925	1,315	1,665	2,096
Japan				
FDI flows to Indonesia ^d	420	529	311	n.a.
Foreign investment approvals ^b	1,819	519	1,689	1,176
Singapore				
FDI flows to Indonesia	n.a.	n.a.	n.a.	n.a.
Foreign investment approvals ^b	608	3,377	617	3,933
Korea				
FDI flows to Indonesia ^e	95	72	56	78
Foreign investment approvals ^b	711	378	419	417
Total approvals				
FDI flows to Indonesia ^f	–4,550	145	1,023	3,500
Foreign investment approvals ^b	16,015	9,955	10,416	13,579

(D) = Data suppressed by BEA to avoid disclosure of data of individual companies.

n.a. = not available

a. As reported by US Bureau of Economic Analysis (BEA). Includes FDI in all sectors.

b. As reported by the Indonesia Investment Coordinating Board. Figures exclude FDI approvals in oil and gas, banking, and insurance.

c. As reported by Eurostat, converted into dollars using US Federal Reserve annual exchange rate estimates. Figures for 2001 correspond to EU-15 members.

d. As reported by JETRO.

e. As reported by the Export-Import Bank of Korea.

f. As reported by UNCTAD. Figures for 2005 are preliminary.

Sources: Eurostat, Europe in Figures, epp.eurostat.cec.eu.int; Export-Import Bank of Korea, Foreign Investment Statistics, www.koreaexim.go.kr; Indonesia Investment Coordinating Board (2006); Japanese External Trade Organization, Japanese Trade and Investment Statistics, www.jetro.go.jp; UNCTAD, FDI Statistics, www.unctad.org; US BEA (2006).

strong leadership in steering the economy.”⁸ Foreign investment is growing in export-oriented activities related to natural resources, such as oil and gas, mining, fisheries, timber, and palm oil (table 6.5). Construction and transport services are also attracting larger inflows.

Despite the positive investment trends, however, FDI to Indonesia remains below precrisis levels. Foreign firms are apparently not interested much in manufactures, for which FDI approvals still represent less than 30 percent of the levels seen in the mid-1990s (table 6.5). Manufacturing traditionally attracted the bulk of FDI to Indonesia, but that era may have passed. Slow growth, China’s entrance to the WTO, the emergence of Vietnam, and the end of the Multi-Fiber Arrangement—the textile and clothing quota regime under WTO auspices—have eroded Indonesia’s attractiveness as a manufacturing base. FDI approvals in the service sector are also below levels recorded in the early 1990s (table 6.5).

Obstacles to a US-Indonesia FTA

Indonesia’s business environment is quite difficult, to a large extent due to weak public institutions (WEF 2006).⁹ The Yudhoyono government considers the business environment a top priority and has proposed a reform package that draws praise from corporate leaders.¹⁰ Legislative approval of the reform package may become a precondition to FTA negotiations because the reforms include far-reaching changes in the investment regime. In the past, the United States has often prioritized bilateral FTAs with countries that have a solid reform record.

Corruption and insecurity of property rights top the list of concerns for US investors and heads of multilateral organizations. None of these issues can be solved before FTA negotiations. However, a record of continuing progress—chiefly in high profile cases—will set the right tone for negotiations.

8. See Sheldon Trainor’s opening remarks at the Indonesia Investment Conference: Accessing the Capital Markets, Bali, March 21, 2006. He reports that investors “are also impressed by the increased transparency and maturity evolving among the corporate sector in Indonesia.” However, such optimistic views are not widely shared; observers point to the resurgence of old business groups.

9. Leading complaints of business leaders include corruption, inefficient bureaucracy, tax regulations, policy instability, inadequate infrastructure, and poorly educated labor force (WEF 2006). Other worries are labor rigidities, rising minimum wage rates, overlapping land claims, corporate governance, slow legal reform, and enforcing contracts (Schwartz 2005, World Bank 2006a).

10. The reform strategy includes: infrastructure and investment policy packages; tackling high profile corruption cases; and improving bank lending quality and bank supervision. See H. E. Boediono, keynote address at Indonesia Investment Conference: Accessing the Capital Markets, Bali, March 20, 2006.

Table 6.5 Trends in sectoral composition of inward FDI approvals in Indonesia (millions of US dollars)

Sector	Annual average		
	1994–97	2001–04	2005
Primary sector ^a	1,450	433	1,382
Mining	n.a.	347	776
Food crops and plantation	850	252	434
Forestry and fisheries	128	415	144
Livestock	39	23	28
Secondary sector	22,087	5,392	6,028
Chemical and pharmaceutical	11,732	2,660	2,879
Metal, machinery, and electronic	n.a.	588	695
Food, beverages, and tobacco	957	462	643
Transport equipment	n.a.	298	629
Nonmetallic minerals	792	228	368
Paper and printing	4,887	529	228
Rubber and plastics	n.a.	194	164
Textiles, leather, and footwear	958	284	220
Wood	126	81	108
Other industries	n.a.	69	93
Tertiary sector ^b	9,228	6,639	6,170
Transport, storage, and communication	3,070	2,316	3,107
Construction	221	561	1,777
Trade and repair	43	602	646
Hotel and restaurant	880	2,096	259
Real estate, industrial estate, and business activities	1,662	144	125
Electricity, gas, and water supply	2,899	191	23
Other services	n.a.	728	233
Total	32,765	12,464	13,579

a. The primary sector, as defined here, excludes the oil and gas industry. Additionally, the average for 1994–97 excludes flows to the mining sector for 1994 and 1995.

b. Excludes banking, nonbank financial institutions, and leasing.

Note: FDI approvals consistently exceed recorded inflows of FDI by a large margin.

Sources: Indonesia Investment Coordinating Board (2006); UNCTAD, FDI Statistics, www.unctad.org.

Corruption

For several years, Indonesia has ranked in the lowest quintile of Transparency International's Corruption Perception Index. Democracy has opened room for citizens, religious organizations, business associations, and nongovernmental organizations (NGOs) to join the anticorruption battle. International

agencies and investors have also pledged to help.¹¹ However, democracy has also opened new venues for corruption in legislative bodies and regional governments, afflicting even the allocation of funds for recovery from the tsunami of 2004.

The establishment of the Corruption Eradication Commission (Komisi Pemberantasan Korupsi [KPK]) opens a new chapter in Indonesia's struggle against corruption,¹² and the current government has made a sincere pledge to lead the charge against it. In December 2004 President Yudhoyono mandated public ministries to share information with the KPK and proposed an e-procurement system for public-sector purchases. The government has also made some progress in high-level cases, prosecuting the governor of Aceh, removing the heads of the tax and customs agencies, and accepting international auditors for the Post-Tsunami Relief and Reconstruction Fund. However, members of the new administration, such as the head of the state power utility, Eddie Widiono, have been implicated in fresh scandals. Meanwhile, NGOs have complained about the government's poor record in seizing the assets of those accused of corruption.¹³ Progress in the legal case involving assets of iconic figures, such as General Suharto, could send a very clear message to the international community. A US-Indonesia FTA could add to Indonesia's ongoing fight against corruption by strengthening transparency, for example, in public tenders.

Protection of Property Rights and Existing Disputes

The property rights of foreign investors are particularly precarious in Indonesia as a result of three forces: policy instability in the post-Suharto era, political conflict that endangers personal safety and business assets in certain parts of Indonesia, and the unpredictability of the Indonesian judiciary. Better protection of property rights is high among the concerns of foreign investors. A US-Indonesia FTA can provide more certainty, but additional progress is needed domestically, quite apart from new international agreements.

Establishing a clear record of respect for property rights could begin by solving existing disputes and could prove to be a precondition for FTA talks. High-profile unresolved cases will ultimately create a difficult atmosphere for ensuring congressional ratification in the United States and may lead Indonesians to wrongly conclude that the US-Indonesia

11. See speech delivered by Paul Wolfowitz at Good Governance and Development: A Time For Action, Jakarta, April 11, 2006.

12. For a progress report of the Corruption Eradication Commission, see Organization for Economic Cooperation and Development, "ADB-OECD Anti-Corruption Initiative for Asia-Pacific," www.oecd.org (accessed on December 11, 2006).

13. M. Taufiqurrahman, "Government Faulted for Dragging Feet on Recovering Stolen Assets," *Jakarta Post*, April 5, 2006.

FTA is merely a US strategy to keep US firms outside the hands of Indonesian courts.¹⁴

During his election campaign, General Yudhoyono had pledged to solve three high-profile investment disputes within his first 100 days in office, but strong resistance has delayed these plans. More governmental resolve would help. In March 2006 an agreement was announced on the four-year-old Exxon-Pertamina dispute. Other important US investors are still wrestling with ongoing disputes. For example, several large US firms have been accused of environmental damage, illegal payments to military officers, or tax evasion. Certain US companies may have conducted operations in questionable ways. However, it often happens that corruption or environmental charges are leveled against foreign companies as a means of stirring nationalistic passions or advancing special interest that are seeking a “piece of the action.” This problem is hardly unique to Indonesia and in fact seems most acute in modern Russia. But when corruption or environmental charges are used as a mask for less noble purposes, the damage to the investment climate can be severe.

Enhanced Protection and Access for Foreign Investors

The main contribution of investment agreements consists of providing detailed rules that protect foreign investors. US and other foreign investors will welcome the regulatory certainty and recourse to a dispute settlement mechanism that US FTAs create, particularly because the United States and Indonesia have not concluded a bilateral investment agreement.¹⁵

US FTAs protect investors by requiring prompt, adequate, and effective compensation if property is expropriated. US FTAs cover both direct and indirect expropriation of existing and future investments. To maxi-

14. Five months into the FTA negotiations with the Andean nations, a subcommittee of the US House of Representatives held a hearing on US investment disputes in Peru and Ecuador. See Committee on International Relations, US House of Representatives, testimony by John Murphy, October 6, 2004, www.house.gov (accessed on August 2, 2006). While the Ecuador-Occidental Petroleum dispute may belong in a league of its own, US negotiators also attacked rulings by Peruvian judges who ordered the capture of the CEO of General Electric (“Portman Hopes for Peru FTA Approval This Year; Colombia Resumes Talks,” *Inside US Trade* 24, no. 4, January 27, 2006).

15. Since 1967, US investors have qualified for risk insurance under the auspices of the Overseas Private Investment Corporation (OPIC), which operates within the framework of the Investment Guaranties Agreement between the United States and Indonesia. Due to favorable tax laws, some US investors often choose to invest in Southeast Asia through their regional headquarters, such as Hong Kong or Singapore. As a result, these US firms in principle enjoy indirect protection under the ASEAN Investment Agreement or Indonesia’s bilateral investment treaties.

mize the credibility of these commitments, the parties to an FTA also grant private investors the right to seek binding international arbitration of their claims against the host government. US FTAs also ensure that an investor will be treated according to the most favorable standard—national treatment, most favored nation (MFN) treatment, or fair and equitable treatment. The agreements facilitate repatriation of profits and original capital and ban or limit performance requirements, such as minimum export requirements and local content requirements. Finally, they constrain nationality requirements concerning senior management of foreign firms. In nearly all of these areas, US FTAs go beyond the obligations of the WTO Trade-Related Investment Measures (TRIMs) agreement.

Critics of NAFTA have argued that the investor-state provisions of chapter 11 protect US firms better than US domestic law does. In response, and reflecting lessons from the NAFTA experience, the US government has adopted more restrictive language in the US-Chile and US-Singapore FTAs, the Central American Free Trade Agreement–Dominican Republic, and its new bilateral investment treaty (BIT) model.¹⁶ That said, a careful analysis of the NAFTA dispute settlement mechanism indicates that this body has in most cases upheld the right of governments to legislate on public interest.

The differences between NAFTA and the later agreements relate to new, stricter definitions of indirect expropriation and minimum standard of treatment, both now set at levels established under customary international law.¹⁷ The new provisions aim to safeguard the capacity of governments to regulate in the public interest. The recent agreements also increase the transparency of procedures in investor-state disputes by mandating public hearings, allowing input of interested third parties (e.g., NGOs), imposing penalties for investors that pursue frivolous demands,¹⁸ and preventing investors from using the investor-state dispute under the agreement if they have already presented the claim in a national court.

The Indonesian government wants to create an investor-friendly regulatory framework for foreign investment but also wants to avoid overly ambitious commitments. Hence, a few key areas will demand careful crafting from negotiators: selection of arbitration options between the International Center for Settlement of Investment Disputes or United Nations

16. The investor-state arbitration mechanism was excluded under the US-Australia FTA, but this reflected special circumstances and does not set a precedent for US negotiations with developing countries. Gilbert Gagné and Jean F. Morin (2006) argue that the Australian FTA signals a “differentiated” US approach towards investment negotiations with Organization for Economic Cooperation and Development (OECD) countries and developing countries.

17. Two annexes provide guiding principles on the interpretations of indirect expropriation. Of particular relevance to a US-Indonesia FTA is the clarification that nondiscriminatory regulatory actions designed and applied to protect public health, safety, and the environment do not constitute indirect expropriation.

18. Claimants presenting frivolous demands risk paying court costs and fees.

Commission on International Trade Law; scope of covered measures (to what extent do commitments apply to provincial, state, and other regional governments?); the requirement of exhaustion of local judicial remedies; the determination of parties that have standing to make a legitimate claim for damages; and specific sectors that each country may want to carve out. The respective positions of the United States and Indonesia may differ greatly for many of these issues, but they can be bridged if both countries recognize that a major objective of the FTA is to improve the environment for foreign investors.

Barriers to Foreign Direct Investment in Indonesia

The Indonesian investment regime is already quite open (Soesastro 2004), but the government of Indonesia is committed to further liberalize access to sectors that are currently either closed to foreign investment or open only under specific conditions. Such liberalization measures are included in the proposed investment package now being debated in the Indonesian parliament.

Investment agreements are often more focused on protecting existing and future investment than obtaining access to new sectors. However, the United States will likely seek to loosen the following barriers to access: the ban on foreign investment in the film industry, from production to film distribution and theatre operations; similar barriers against foreign entry into print media; restrictions on foreign investment in natural forests, lumbering, sawn timber, and plywood; and mandatory joint-venture requirements on electricity, medical, and telecommunications services.¹⁹ The United States may question whether investment restrictions in alcoholic drinks are applied on a nondiscriminatory basis. Other barriers may be less contentious.²⁰

Besides access barriers, other sources of friction remain, such as screening mechanisms applied to foreign investment,²¹ visa requirements for foreign-born workers, and overlapping jurisdiction in the investment approval process. The government plans to address many of these issues

19. Restrictions on forestry products protect the entrenched interests of downstream domestic producers and often stand in the way of new technologies and management practices that could minimize and even reverse the damage to forests. While government policies have enriched many private Indonesian firms, most domestic companies have failed to adopt modern conservation and labor-saving technologies.

20. We have not listed Indonesian barriers in sectors that coincide with US barriers, such as airlines, coastal maritime services, TV and radio broadcasting services, and fishing.

21. US investors would welcome a move to investment project registration rather than the current system of project approval.

through its new investment law. However, domestic interests vigorously resist some areas of the proposed investment package. Unions, for example, oppose liberalizing visa permits for foreign workers.

Competition Policy

Along with protecting property rights, the absence of a culture of competition is a major difficulty for foreign investors in Indonesia.²² Lack of competition coupled with large state involvement in the economy fosters corruption, cronyism, and collusion. In recent years, however, Indonesia has made significant progress.²³ Meanwhile, protecting US investors against anticompetitive practices has been an important objective for US negotiators in FTA negotiations. The US-Singapore FTA ensures transparency in the operations of state-owned companies and guarantees that those firms operate under nondiscriminatory commercial considerations. Similar goals will be of critical importance during FTA talks with Indonesia.

Collusion is particularly endemic in Indonesian government procurement. Some 70 percent of the 40 cases that were reviewed by the Business Competition Supervisory Commission between 2000 and 2001 corresponded to tender collusion involving an SOE or a government agency (WTO 2003). Major SOEs implicated in cartel practices include Pertamina, Bulog, PTTelekom, and SIMDUK. The commission has also targeted cartels in the transportation sector,²⁴ beef and chicken, movie distribution, the battery market, and large retailing. Malcolm Dowling (2005) argues that Indonesia is still plagued by cartels in cement, plywood, paper, and fertilizer, all manufacturing areas in which SOEs continue to operate. The US-Indonesia Business Council has called on the Indonesian government to make procurement and tendering processes more transparent. On a positive note, Pertamina's monopoly on downstream activities (distribution and retail) ended in October 2005, allowing investors to play a role in oil refining and distribution. US firms, including Chevron-Texaco, expressed a desire to participate in distribution and retailing.

22. In 2005 Soy Pardede, member of the Commission for the Supervision of Business Competition, argued: "Competition is [a] relatively new concept for Indonesian business after many years enjoying privileges and protection. The new approach has not yet internally embedded in the business behavior, government policy or the people" (Pardede 2005, 13).

23. In 1999 Indonesia enacted its competition law, creating an agency charged with investigating collusion in producer markets. The law was a step forward, but the agency faces problems of interpretation and enforcement. Pangestu et al. (2002) argue that improvements in competition are particularly noticeable in the manufacturing sector. However, Dowling (2005) notes that there is less evidence of increased competition in the 1980s and 1990s in agriculture, services, infrastructure, and certain manufactures and mining activities.

24. Such cartels include those in cargo services, Garuda Airways, City Bus service, and the Jakarta International Container Terminal.

The Privatization Program

Privatization of SOEs and public-private partnerships for infrastructure development could stimulate interest from foreign investors. A US-Indonesia FTA could help dispel foreign investors' concern with the legal system in Indonesia and allow US firms to compete on an equal footing with domestic firms and third-country bidders. The result could be larger proceeds for Indonesia. Despite some hesitation,²⁵ the Yudhoyono administration has decided to include an ambitious privatization program in its reform agenda. In July 2006 the government established a privatization committee to establish a strategy for selling SOEs. The Ministry of SOEs has prepared various plans to privatize firms, setting a goal of selling 20 SOEs by the end of 2006. To date, progress has faltered.

Indonesia's grand announcements of privatization are often subsequently wrecked by a combination of vocal nationalistic opposition and a political establishment accustomed to using SOEs as a cash cow to finance political parties (McLeod 2002). Past privatization programs have involved partial sales of SOEs (table 6.6) that often precluded a real transfer of control or risks (McLeod 2002). In some instances, the government backtracked on liberalization commitments, deliberately intending to enhance the upper hand of an incumbent SOE (Lee and Findlay 2005). As a result, a 2003 WTO review concluded that "widespread state involvement in the economy has continued with a view to assisting domestic production/or promoting exclusively controlling/restraining trade in virtually all sectors" (WTO 2003, 44). Not much has changed since that assessment. Proceeds from privatization have decreased to around \$350 million annually, or less than 1 percent of SOE assets, in 2004 and 2005. In 2001 the government owned 161 SOEs and held minority positions in 21 joint ventures. Total SOE revenues represented about 12 percent of GDP. By early 2006, the government still owned 158 firms and held minority positions in 6 firms (Ministry of SOE 2002; 2006).²⁶

25. In early 2006 Vice President Jusuf Kalla requested a public buyback of a majority stake in Indosat even though the current owner has no intentions of selling. This led Minister H. E. Boediono to recognize that "[the government had] not come up with a solid privatization program." See "Indonesia's VP Says Telkom May Acquire Indosat" and "Indonesia Government Slows Pace of Privatization Amid Political Risks," AFXAsia, April 20, 2006.

26. In 2006 Cemex, the world's second-largest cement company, sold its minority shares in the state-owned PT Semen Gresik (SG) at a profit. Cemex had previously threatened to pursue a case in the ICSID tribunal if the government capitulated to pressure from local politicians to exercise the right to block the sale. Cemex considered that the government had not honored its investment commitments or allowed the company to gain majority ownership, as was originally agreed. The Cemex purchase of minority shares in SG was the first partial privatization in Indonesia since the Asian crisis.

Table 6.6 Full and partial privatization of state-owned enterprises in Indonesia, 1991–2003 (millions of US dollars)

Year	Sector	Company	Proceeds
1991–93			
1991	Manufacturing and services	PT Aneka Usaha Perkebunan	11
1991	Manufacturing and services	PT Bojonegoro	11
1991	Manufacturing and services	PT Leppin	11
1991	Manufacturing and services	PT Semen Gresik	146
1991	Manufacturing and services	PT Tatar Anyar	11
1992	Manufacturing and services	PT Intirub	8
1992	Manufacturing and services	PTK Padalarang	6
1993	Manufacturing and services	PT IMIT	11
1993	Manufacturing and services	PTK Basuki Rachmat	10
1993	Manufacturing and services	PTK Blabak	10
	<i>Subtotal</i>		235
1994–97			
1994	Infrastructure	PT Indonesian Satellite (Indosat)	1,162
1994	Infrastructure	Satelit Palapa Indonesia (Satelindo)	586
1995	Manufacturing and services	PT Semen Gresik	127
1995	Primary	PT Tambang Timah	224
1995	Infrastructure	PT Telekomunikasi Indonesia	1,680
1996	Financial	PT Bank Negara Indonesia	397
1996	Infrastructure	PT Telekomunikasi Indonesia	611
1997	Primary	PT Aneka Tambang Tbk (Antam)	141
	<i>Subtotal</i>		4,928

1998–2003

1998	Manufacturing and services	PT Semen Gresik	122
1999	Manufacturing and services	PT Indofood Sukses Makmur Tbk	22
1999	Manufacturing and services	PT Indofood Sukses Makmur Tbk	179
1999	Infrastructure	Jakarta International Container Terminal (JICT)	243
1999	Infrastructure	PT Telekom	406
2000	Financial	Bank Central Asia	115
2002	Infrastructure	PT Transportasi Gas Indonesia	188
2003	Manufacturing and services	Indoement Tunggal Prakarsa PT (Heidelberger Zement AG)	97
2003	Financial	Bank Danamon Tbk PT	135
2003	Financial	Bank Rakyat Indonesia PT	429
2003	Other	Wisma Nusantara International PT	30
	<i>Subtotal</i>		1,966

Note: Figures could understate the actual extent of privatization. In 2002 the Indonesian government divested about 40 percent of its shares in Indosat, but that transaction was not recorded because the government still retains a controlling interest. Does not include the Indonesian Bank Restructuring Agency (IBRA) privatizations undertaken in the wake of the Asian financial crisis, after many Indonesian firms defaulted on their bank debt and became wards of the state. Proceeds are defined to include all monetary receipts to the government resulting from transactions involving partial and full divestitures, concessions, management contracts, and leases. Thus, only those transactions that generated revenue for the government from privatization or private-sector participation in an existing state-owned enterprise or other government assets (such as wireless license sales) are included.

Source: World Bank (2006a).

Based on 2001 assets and ownership structure, five banking firms—Ekspor, Mandiri, Negara, Rakyat, and Tabungan—control 60 percent of total SOE assets and 30 percent of total SOE revenues. Other important sectors include plantation agriculture, telecommunications, transportation, construction, and some manufacturing (see table 6.7).

Infrastructure Development

Accelerating infrastructure development through foreign and domestic private-sector participation is a basic goal of the Yudhoyono administration.²⁷ So far, private capital has responded to only 15 of 91 infrastructure projects that the government launched in 2005.²⁸ According to Hirokazu Hiratsuka (2006), uncertainties regarding profitability, failure to obtain a government guarantee, and lack of progress in legal reform explain the private sector's cold response. A sour record of past private-public initiatives (PPIs) may also contribute. About one-third of the 61 PPIs listed by the World Bank's Private Participation in Infrastructure database for Indonesia between 1990 and 2004 were cancelled before the fulfillment of the contract term. Most often it was the private partner that pulled out, scaled down operations, or froze new investment.²⁹

A key problem is how to interest foreign investors when completed projects entail large sunk costs and political leaders disagree on the proper approach for regulating infrastructure rates. The Indonesian government refuses to back private participation by extending guarantees,³⁰ but the World Bank has offered limited-risk guarantees to foreign investors in infrastructure, power, and oil and gas projects.³¹ FTAs with the United States

27. Investment in infrastructure in Indonesia has decreased steadily since the mid-1990s, as Indonesia faced a difficult fiscal situation after the Asian crisis. Contracting public investment motivated a freeze in new projects and a decay of existing infrastructure. Poor infrastructure has now become a serious obstacle to attracting foreign investment.

28. On November 1, 2006 President Yudhoyono appealed to international investors to inject \$22 billion into Indonesia's infrastructure to accelerate the country's growth and reduce poverty. According to President Yudhoyono, infrastructure is "on top of the list" of difficulties facing Indonesia.

29. All of these cancellations affected PPIs granted before the Asian crisis hit Indonesia in late 1997, when the sharp devaluation of the rupiah created a balance-sheet disaster for firms that had borrowed in US dollars to finance their investments. The financial disaster was worsened because the state delayed the upward adjustment of rupiah charges to infrastructure users. Some cancellations involved US investors and triggered OPIC involvement or arbitration proceedings in the International Chamber of Commerce. Ross H. McLeod (2002) explores cases involving civil aviation and electrical power generation.

30. See keynote speech by Miranda Goeltom at a conference in Washington, Indonesia's Financial Outlook: Stable or Slipping? on June 21, 2006.

31. In addition to World Bank guarantees, some developed countries offer political risk guarantees for foreign investment projects by their national firms.

Table 6.7 State-owned enterprises in Indonesia, 2001
(millions of US dollars)

Sector	Number of SOEs	Total assets	Revenue
Services	91	57,702	11,987
Banking	5	43,982	5,937
Telecommunication	5	5,018	1,487
Other finance and insurance	15	3,758	1,174
Transport services ^a	19	3,524	2,348
Construction ^b	16	920	539
Logistics, trade, and tourism	11	351	411
Other services ^c	20	149	91
Agriculture, forestry, and fishing	29	1,760	1,320
Plantations and agriculture	17	1,335	1,034
Forestry and pulp	8	415	275
Fisheries	4	10	11
Mining, oil, and gas	7	8,201	3,328
Energy	4	7,756	3,099
Mining	3	446	229
Manufacturing	34	3,811	2,554
Fertilizers	2	1,278	892
Cement	3	915	434
Steel and steel construction	3	673	500
Technology-based industries	5	422	183
Pharmaceuticals	3	209	303
All other industries ^d	18	315	241
Total ^e	161	71,475	19,189
Original total reported in billions of rupiah		772,501	207,390

a. Includes ports, docks, shipping, airports, and aviation.

b. Includes construction services, consulting, and support.

c. Includes 13 public hospitals for which no estimate of assets, revenue, or profits are reported.

d. Includes companies in textiles, defense, printing, industrial zones, and other industries.

e. Dollar value at 2001 annual average of central bank exchange rate ("sell" rate), roughly 10,808 rupiah per US dollar.

Source: Ministry of State-Owned Enterprises (2002).

and Japan could create a more promising environment for foreign investors and diminish their insistence on public guarantees.

Large infrastructure projects will require considerable amounts of financial capital and political consensus, but Indonesia may also reduce trade costs through trade facilitation reforms. The Organization for Economic Cooperation and Development (OECD 2005a) establishes a direct link between friction-free cross-border movement of goods, a country's

ability to attract FDI, and the integration of production supply chains. The Yudhoyono administration's investment package suggests movement in the right direction by identifying bottlenecks and proposing customs reforms. A record of continuous implementation of reforms will foster Indonesia's competitiveness.³²

FDI Barriers in the United States

With a few sectoral exceptions, the United States maintains a liberal foreign investment regime, providing national treatment for FDI (WTO 2006b). The United States considers that its liberal foreign investment regime has helped it rank among the top recipients of foreign investment in the world. It has brought benefits in terms of jobs, research and development (R&D), competition, and productivity growth, and has helped finance large US trade deficits.

As stated in the US Trade Act of 2002, the United States also considers that "the United States law on the whole provides a high level of protection for investment, consistent with or greater than the level required by international law" (Biggs 2004). Previous US FTAs have focused on establishing rights for investors comparable to those available under US legal principles and practice. Hence, they have not dealt with lingering US barriers, among which we identify some of the most important.

Screening and Registration

In certain instances, foreign investment in US companies has become controversial, reflecting real and imaginary "national security" concerns. The Exon-Florio Amendment of 1988 encourages foreign firms to submit for examination their proposed takeovers of US firms to ensure that the acquisitions will have no adverse effect on US national security. Apart from blocking a handful of transactions, this screening mechanism entails some delay, often around three months. In some instances, illustrated by the Dubai Ports World debate, Congress can jump into the case, and even reverse a favorable determination made by the Committee on Foreign Investment in the United States (CFIUS). The CFIUS statute is now under congressional review, and it seems likely that, in the future, when firms controlled by a foreign government make US investments, they will be subject to mandatory CFIUS review. Senior-level political officials, not just career civil servants, will have to sign off on the approval process.

32. For a good discussion of the importance of trade costs from an Asian perspective, see De (2006).

Other Barriers

The United States puts certain sectors off limits to foreign investors, prohibiting investment entirely or limiting it to a minority interest. The best-known sectors confronted with these limits are in defense contracting, fishing, coastal shipping, aviation, broadcasting, telecommunications, and certain energy industries. In addition, important social services are traditionally confined to the public sector—that is, primary and secondary education, health care, and social security. Private firms are making inroads in all of these areas, though the barriers are difficult to surmount. In previous FTAs, the United States has reserved wide scope for protecting the above-mentioned sensitive sectors by excluding them from MFN, national treatment, and other standard investment provisions.

Intellectual Property in US FTAs

IPRs are of paramount importance for US firms that produce high-technology goods and services, print and electronic media, and trademark consumer goods. The United States ranks among the world's leading producers of knowledge-intensive goods, such as microprocessors, pharmaceuticals, biomedical products, and computer software. In 2003 the US share of global high-technology production amounted to 39 percent.³³ In 2005 the total value of US shipments of physical and digital recordings topped \$12 billion. To provide an incentive for private R&D outlays and innovations, the United States maintains one of the toughest IPR protection regimes in the world. By contrast, many developing countries view themselves as purchasers rather than generators of intellectual property, and they believe that the US system confers excessive benefits on IPR owners. Reflecting these tensions, IPRs have become a sticking point in US FTA negotiations with developing countries. The United States demands IPR protection so far beyond what is offered in the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement the US stance has come to be called "TRIPS plus."³⁴ In TRIPS plus, the central goal is to ensure that the IPR regime of the US trade partner is on a similar plane as the US system. But most developing countries want to preserve the escape hatches in the WTO TRIPS agreement, such as provisions that enable access to

33. See National Science Foundation, appendix table 6.2 in chapter 6 on Industry, Technology, and the Global Marketplace," www.nsf.gov (accessed on December 12, 2006).

34. In TRIPS, all WTO members must provide specified minimum standards of IPR protection in a range of sectors, but the agreement allows some flexibility for developing countries in implementing their commitments. TRIPS plus raises the standards and curtails the flexibility of enforcement priorities.

high-technology products on inexpensive terms when public health and welfare demands it.

Pharmaceuticals, information software, and education materials are among the contested items: For developing countries, they are important ingredients to meet health and growth objectives; at the same time, they are sensitive for the United States, especially because private firms in the affected industries derive significant revenues from their IPR portfolios.

Although individual US FTAs differ in the details of their IPR provisions, certain common obligations go beyond these enunciated in the WTO TRIPS agreement (Fink and Reichenmiller 2005). A brief sketch follows.

Protecting Patents and Pharmaceutical Test Data

US FTAs call for patent extensions to compensate for delays in granting a patent. For pharmaceuticals, US FTAs limit competition from generic products by limiting the use of compulsory licenses for generic manufacturers to narrow circumstances, prohibiting the sale of a generic version of a drug that is still under patent without the consent of the patent holder, and providing additional years of protection against competing manufacturers using clinical test data.

Copyright Protection

All US FTAs after the US-Jordan FTA grant copyright protection for 70 years beyond the life of the author or creator. For digital products, US FTAs include provisions that prevent unauthorized copying and make Internet service providers (ISPs) liable if the ISP network is used to distribute unauthorized works. Some US FTAs also grant copyright holders the right to block parallel importation of pharmaceuticals, printed media such as books and journals, and digital products.³⁵ Under the US-Singapore FTA, patent holders can limit parallel imports of pharmaceutical products through the terms of their license contracts.

IPR and Investment Protection

IPRs are explicitly enumerated as a form of property entitled to the benefits of investment chapters in USA FTAs, meaning that aggrieved parties have recourse to independent state-investor dispute mechanisms. This can

35. Parallel imports are products that were legally made or distributed in one country under license and then exported to another country outside the geographic scope of the license.

have a profound impact on the policies of a partner government. A government that grants compulsory licenses or does not adequately enforce IPR laws may face a lawsuit initiated by the aggrieved patent holder.

Enforcement Commitments

The WTO TRIPS agreement does not require allocation of resources to enforce IPR laws. By contrast, several US FTAs contain specific obligations to enforce and uphold IPRs. Provisions in the US FTAs with Chile, Morocco, and Singapore specifically exclude resource constraints from among the possible excuses for not meeting enforcement obligations.

Apart from these TRIPS-plus dimensions, other issues will likely make IPR protection contentious in a US-Indonesia FTA. Indonesia has been on the priority watch list in the Section 301 report of the US Trade Representative (USTR) for problems in enforcing IPRs.³⁶ The United States is concerned about the scale of pirated goods made and sold in Indonesia, particularly digital products manufactured locally or transshipped from elsewhere. The report urges Indonesia to adopt more active measures, including criminal penalties, to curb such theft. Indonesian measures already curb street sales of pirated goods and forbid the use of counterfeited software by government agencies.³⁷ Indonesia has also cracked down on the manufacture of pirated goods and has tried to ensure that Internet cafes use licensed products. The United States acknowledges that Indonesian authorities have improved their IPR enforcement, elevating Indonesia's status off the priority watch list and onto the watch list.³⁸ Despite this improvement, according to an estimate by Business Software Alliance (BSA), counterfeited software makes up about 87 percent of software in Indonesia.³⁹ In the context of an FTA, the United States would expect more vigorous enforcement from Indonesia.

Apart from the pirating question, some IPRs issues are sensitive for Indonesia because they can have a significant impact on public health and economic growth. Indonesia is concerned about the costs of implementing TRIPS plus in pharmaceuticals and education materials. The government's ability to meet public health needs may be limited if Indonesia is unable to

36. See USTR, "2006 Special 301 Report," www.ustr.gov (accessed on December 12, 2006).

37. In 2005 the Indonesian government and Microsoft agreed that the government would purchase licensed products in return for amnesty for counterfeit operating systems already used in the computers of government agencies.

38. On November 6, 2006 the USTR announced its decision to improve Indonesia's standing on the Special 301 Watch List after completion of an out-of-cycle review.

39. See BSA, "Indonesia PC Software Piracy Rate Remains at 87%," www.bsa.org (accessed on December 12, 2006).

make licensing compulsory, permit parallel imports, or grant local pharmaceutical firms the right to conduct clinical trials on patented medicines.⁴⁰ Delaying the availability of generic medicines for more than 30 million poor persons could be costly. Strict copyright protection on digital products for educational purposes might curtail offerings in schools and colleges. TRIPS plus could also limit the flexibility of private breeders of rice seed, affecting small farmers in Indonesia.⁴¹

Recommendations

Indonesia has an open investment regime and friction levels are generally low with respect to investment, but improving the confidence of foreign investors remains a paramount objective. This chapter suggests several possible recommendations.

- The Indonesian legislature should approve and implement the proposed investment package; together with reducing corruption, this would set a very positive stage for FTA negotiations.
- With US cooperation where relevant and appropriate, Indonesia should resolve the major outstanding investment disputes involving US investors.
- As part of the FTA text, treaty benefits should be denied to an investor (or investee) that engages in significant corrupt practices. This provision will put foreign firms on notice that, if they procure license rights or other benefits corruptly, they stand to lose the protection that the bilateral treaty affords.
- Increased transparency and competition for Indonesian SOEs are an important reassurance for foreign investors. Jumpstarting the process of privatization and allowing foreign companies to bid for the assets could increase competition in some industries. In strategic industries, ensuring transparency in bidding processes could also help.

40. Illustrating the importance of these issues to US firms, the Pharmaceutical Research and Manufacturers of America (PhRMA) has petitioned the US government to withdraw Andean Trade Promotion and Drug Eradication Act benefits for Peru and Ecuador because they have not enacted data exclusivity laws.

41. Although Indonesia is not yet a signatory of the 1991 Convention of Union for the Protection of New Varieties Of Plants (UPOV), Indonesia Law Number 29, enacted in 2000, provides similar protection for IPRs for new plant varieties. However, US FTAs require IPR protection for plant breeds exceeding those mandated in the UPOV convention or Law Number 29. TRIPS plus invalidates some flexibility allowed in the UPOV convention and Indonesian law, such as seed exchange among farmers, and the exemption for experimental breeding without the consent of the patent holder.

- Given Indonesia's questionable business environment and unreliable judiciary, an investor-state dispute mechanism will be an essential element in a US-Indonesia FTA. In addition to reflecting all recent developments in US policy on investment protection, both countries should ensure that the arbitration mechanism conveys a high degree of confidence to potential foreign investors.
- Indonesia should consider improving protection for IPRs as part of improving the business climate more broadly. In particular, Indonesia should continue to strengthen the enforcement of its IPR laws. At the same time, the United States should display some flexibility on educational and pharmaceutical issues by allowing Indonesia to apply a transparent process for compulsory licensing and parallel imports. Under the TIFA umbrella, the United States and ASEAN—led by Indonesia—should cooperate in cracking down on the manufacture and transshipment of pirated goods.

The Yudhoyono administration's confidence-building agenda has captured the attention and support of foreign and domestic investors. However, the slow pace of follow-through in implementing fundamental reforms, coupled with high expectations, is discouraging; the slowness reflects the government's inability to tackle sensitive issues. FTA negotiations that improve the investment landscape could help to restore investors' optimism in the Indonesian government and bring capital to Indonesian firms.

