

Towards a U.S.-Indonesia Free Trade Agreement

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ABSTRACT

This paper examines the main issues in designing a FTA between Indonesia and the United States. The first section briefly examines current trade relations and issues between Indonesia and the United States. It also addresses the strategic and economic impact of a possible FTA between Indonesia and the United States for Indonesia. The second section examines elements of a possible Indonesia-United States FTA with a view on similar agreements concluded between Singapore and the United States and between Thailand and Australia. The third and concluding section discusses the kind of preparations needed on the Indonesia side to successfully negotiate a FTA with the United States.

Keywords: *Indonesia, United States, free trade agreement*

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TOWARDS A U.S.-INDONESIA FREE TRADE AGREEMENT

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Introduction

Bilateral free trade agreements (FTAs) are not a major element of Indonesia's trade diplomacy and policy. Indonesia has thus far promoted bilateral trade relations through efforts other than forming FTAs. It is only rather recently that Indonesia begins to contemplate more seriously the role of bilateral FTAs in promoting trade and economic cooperation with a number of countries. On 23 October 2003 the Ministry of Industry and Trade formed a FTA Team to undertake studies on a number of possible bilateral FTAs.

It may be useful to categorize possible FTA partners into two groups of countries. The first group consists of developing countries such as Pakistan, Bangladesh, Iran, Chile and South Africa. Indonesia's trade relations with these countries are insignificant. Therefore, the economic impacts of FTAs with these countries are likely to be insignificant as well. However, they are being contemplated for one or more of the following reasons: (a) developing new markets for Indonesian exports; (b) strengthening political and overall relations; and (c) as a training for negotiating FTAs with other countries. In early May 2004, Indonesia and Iran agreed to form a Free Trade Area as part of a comprehensive economic and trade partnership.

The second group consists of advanced industrial countries such as Japan and the United States. Indonesia has extensive economic and trade relations with these countries. Japan and the United States are Indonesia's two most important trade and economic partners. A FTA with these countries could have a major impact, not only in the enhancement of Indonesia's market access to these countries but also in the improvement of Indonesia's competitiveness due to the economic reforms undertaken in relation to the

implementation of the FTA. Greater attractiveness of Indonesia to investors from these countries is another major objective. Strengthening political and overall relations with these countries could also be a major factor in forming a FTA.

Concluding a FTA with Japan and the United States will be more difficult than with other developing countries. It will involve wider coverage, and the commitments will be deeper as they will encompass not only cross-border problems but many “behind the border” issues, including domestic regulations.

In a sense Indonesia is a newcomer in forming bilateral FTAs. It may now be examining this trade policy option more seriously largely in response to offers by a number of countries. It will definitely give priority to FTAs with countries that it regards as politically and economically important, namely Japan and the United States. These two countries have made the approaches to Indonesia at the highest level. President Bush launched the Enterprise for ASEAN Initiative (EAI) at the APEC Summit in Mexico. This was followed up by a visit by U.S. Trade Representative Robert Zoellich to the region, including Indonesia. A Japan-Indonesia FTA was proposed during President Megawati’s official visit to Japan in 2003.

To a large extent, Indonesia’s interest in bilateral FTAs has been aroused by the recent upsurge of FTA negotiations involving its closest neighbors. It was rather indifferent when Singapore began the process, and later concluded a number of agreements, because it did not see this as threatening. In fact, some in Indonesia thought that Indonesia could benefit from Singapore’s FTA as it might use Singapore as a back door to penetrate other markets. Of course Singapore’s FTA partners will prevent this from happening, among other things by insisting on rather restrictive rules of origin (ROO) provisions. This certainly appears to be the case with the Singapore-Australia FTA.

When Thailand began to show interest in negotiating a host of FTAs, including with the main markets for Indonesia (China, Japan, etc.), a sense of unease began to sip in, leading to more serious consideration on the need for Indonesia to do the same, essentially for

defensive reasons.

Unlike Singapore or Thailand, Indonesia does not pro-actively select countries as its potential FTA partner. Its agenda is largely driven by the offers made by other countries to form FTAs with Indonesia.

Indonesia can draw on a number of free trade agreements that have been concluded by Singapore (with Japan, the United States, and Australia) and Thailand (with Australia). The Singapore-Japan agreement largely left out agriculture, which will be an important component in an agreement between Indonesia and Japan. The U.S.-Singapore FTA covers sectors and areas beyond goods trade that Indonesia may still be least prepared to address.

Thus the learning process will be the most important aspect of the negotiations. In fact some kind of facilitation or technical assistance by Japan or the United States should be built into the negotiating process itself.

It is not immediately clear whether Indonesia should negotiate these bilateral FTAs in some sequence or simultaneously. It is also not clear how its on-going negotiations with China under the ASEAN-China framework agreement will affect other negotiations. Indonesia-China trade relations are full with contradictions. Some quarters in Indonesia are greatly alarmed by the prospects of a radical opening up of the Indonesian market to Chinese products. Others see great opportunities being created by a FTA with China for entering the Chinese markets. It remains to be seen which side can exert the stronger pressures on policy makers. However, Indonesian negotiators should not simply react to or accommodate the pressures from the business community and other interest groups. They must be guided by an overall strategic framework for Indonesia's role and place in the global economy. Should market penetration be achieved through preferential access or enhanced international competitiveness? Is competitiveness of Indonesian industries achieved solely through national efforts or should this also be strengthened by regional initiatives to promote regional production networks? Should there be a common approach

for the different bilateral FTAs, and how do they relate to region-based FTAs (ASEAN-China, ASEAN-Japan, and ASEAN-India), as well as to AFTA and the ASEAN Economic Community (AEC). There is yet no such overall strategic framework. In its absence, each bilateral FTA is likely to be approached in a piecemeal fashion.

In the domestic arena, immediate efforts need to be made to gain a better understanding as to which sectors are likely to benefit most from the FTAs and which sectors will be adversely affected by the FTAs. The former is necessary so that Indonesia can focus its efforts on those areas. The latter is important so that ways could be devised to lessen the likely negative impact. Domestic adjustments and reforms will have to be undertaken. It is often also the case that bilateral or regional FTAs can help promote domestic reforms. Indeed, an agreement with the U.S. is likely to have the greatest effect on Indonesia's economic reform agenda.

This paper examines the main issues in designing a FTA between Indonesia and the United States. The first section briefly examines current trade relations and issues between Indonesia and the United States. It also addresses the strategic and economic impact of a possible FTA between Indonesia and the United States for Indonesia. The second section examines elements of a possible Indonesia-United States FTA with a view on similar agreements concluded between Singapore and the United States and between Thailand and Australia. The third and concluding section discusses the kind of preparations needed on the Indonesia side to successfully negotiate a FTA with the United States.

Indonesia-United States Trade Relations and Issues

Trade and economic relations between Indonesia and the United States have always been asymmetrical in nature in the sense that the United States is much more important to Indonesia than is Indonesia to the United States. The United States is Indonesia's second largest export market and its second largest source of imports. Indonesia is a small trade partner of the US. Exports to Indonesia account for 0.4% of U.S. total exports, and imports from Indonesia constitute 0.8% of U.S. total imports.

Nonetheless, the state of trade and economic relations between the two countries has been good and mutually beneficial (Soesastro, 2003). The last few years saw a decline in the value of trade between the two countries. Investments from the United States into Indonesia have also declined since the financial crisis in 1997/98.

The past few years have seen a shift in the direction of Indonesia's trade towards East Asia. The fastest growth of its exports and imports is with East Asia. East Asian countries have also become a major source of foreign direct investment (FDI). Indonesia's overall capacity to export has been declining. It is losing competitiveness in a number of sectors, particularly labor-intensive manufacturing. Compared with the other East Asian economies, Indonesia's supply response to strong global and regional economic recovery has been weak (Pangestu, 2004). Supply constraints are being felt in a number of industries, in large part because of the drying up of FDI. In fact, there is increased talk about the "de-industrialization" of Indonesia (Aswicahyono, 2004).

In 2002, Indonesia's exports to the United States amounted to US\$ 7.6 billion, down from US\$ 8.5 billion in 2000. Indonesia's imports from the United States declined from US\$ 3.4 billion in 2000 to US\$ 2.6 billion in 2002.

Table 1 shows the top 20 exports of Indonesia to the United States in 2002. At the three-digit SITC, Indonesia's exports to the United States comprised 247 items. The top 20 items constituted 74.3% of total export value. In terms of groups of products, the picture in 2004 may not be different from that in 2002. The most important groups are: textiles and apparel; footwear; electronics, processing machines, and telecommunication equipments; shrimp, cocoa, and rubber; and wood products, including furniture.

Table 1 **Top 20 Indonesian Exports to the US – 2002**

Nr.	SITC	Description	Value (fob) US\$	%
1	842	Women's coats, jacket, not knitted	649656005	8.59
2	821	Furniture and parts thereof	490373760	6.49
3	851	Footwear	475491341	6.29
4	841	Men's coats, jacket, not knitted	447144584	5.92
5	763	Sound recorders or reproducers	404936996	5.36
6	231	Natural rubber latex, natural rubber & similar natural gums	398775474	5.28
7	845	Articles of apparels, n.e.s	387018055	5.12
8	333	Petroleum, oil, crude	375222942	4.96
9	764	Telecommunications equipment, n.e.s & parts	356425911	4.72
10	036	Crustaceans moluscs & aquatic invertebrates	215391400	2.85
11	752	Automatic data processing machines & units thereof	203435910	2.69
12	634	Veneers, plywood, improved or reconstituted wood, worked, n.e.s	201403331	2.66
13	072	Cocoa	196399624	2.60
14	762	Radiobroadcast receivers	150264379	1.99
15	635	Wood manufactures, n.e.s	153035718	2.02
16	844	Women's coats, jacket, knitted	139499740	1.85
17	894	Baby carriages, toys, games & sporting goods	104540043	1.38
18	843	Men's coats, jacket, knitted	89652500	1.19
19	898	Musical instruments, parts & accessories thereof	88769182	1.17
20	899	Other miscellaneous manufactured articles, n.e.s	87872099	1.16
		Sub-total	5615308994	74.29
		Other exports (227 items)	1943327276	25.71
		Total (247)	7558636270	100

Source : BPS, *Indonesian Foreign Trade Statistics*, Exports 2002

Some of these exports items are facing problems in entering the U.S. market. On textiles and apparel, there is the problem of quotas. Indonesia had been requesting for higher quotas for some product categories for which the orders were high. But the quotas will be removed from 1 January 2005 onwards. Indonesian exporters of textiles and apparel will be faced with greater competition in maintaining their market shares. They definitely see some advantages in gaining preferential access to the U.S. market (Interview with the respective Association). They may constitute a strong proponent of a free trade agreement. However, Indonesia on its part may also need to remove the licensing of imports of textile as inputs into other products to “producer-importers” (*importer produsen*), affecting 18 items at the four-digit SITC. This is seen as a trade barrier by U.S. Textile Manufacturers Association.

A number of primary commodity exports face difficulties to enter the U.S. market. Standards are a main problem. Many fisheries products, cocoa and spices experienced Detention Without Examination (DWE) for failure to meet FDA's standards. The United States is the largest market for Indonesian cocoa. The U.S. has imposed so-called "automatic detention" of cocoa imports from Indonesia due to concerns about pests. Shrimp and tuna exports also face many problems. Shrimp exporters currently have *uncertified* status. In addition, Indonesia and a number of countries have been accused by the Southern Shrimp Alliance in the United States of dumping cultivated shrimp. Processed food also faced hurdles. Export of instant coffee (3 in 1) is under quota because it includes sugar. Since 1 January 2004, exports of juices to the United States require certification (Interview with the respective Association). To overcome these problems the Indonesian side has raised the possibility of mutual recognition agreements (MRAs) as well as technical assistance to improve quality, strengthen standards as well as sanitary and phytosanitary (SPS) measures. In addition, security concerns have penalized the exportation of agricultural products and processed food. The Bioterrorism Act (BTA) and the Container Security Initiative increase cost to Indonesian exporters. Due to BTA, exports of food and feedstuff become difficult and complicated. All agricultural products from Indonesia must undergo security inspection in Singapore.

In 2002, Indonesian imported from the United States 236 different items at the three-digit SITC. The top 20 imports amounted to about 61% of the total value of imports. Oil seeds constituted about 10%; cotton and textile yarn another 10%, and feedstuff, wheat, and fruits & nuts also another 10%. Civil engineering and contractor plants & equipment & parts constituted about 5%. Pulp and waste paper plus paper and paperboard also amounted to 5% of total imports.

Table 2 **Top 20 Indonesian Imports from the US – 2002**

Nr.	SITC	Description	Value (cif) US\$	%
1	222	Oil seeds used for extraction of soft fixed vegetable oils	245949461	9.32
2	263	Cotton	222486068	8.43
3	081	Feeding stuff for animals	145928583	5.53
4	723	Civil engineering and contractor plants & equipment & parts	126224617	4.78
5	251	Pulp and waste paper	102006564	3.86
6	743	Palms & compressor, fans & blowers, centrifuges & parts	84107000	3.19
7	742	Palms for liquid & parts	81790980	3.10
8	597	Additive for mineral oils	75722645	2.87
9	782	Motorvehicles for the transport of goods	64454151	2.44
10	598	Miscellaneous chemical products, n.e.s	60906564	2.31
11	792	Aircrafts & associated equipments & parts thereof , n.e.s	49757821	1.88
12	057	Fruits & nuts, fresh or dry	44487441	1.69
13	523	Metallic salts & peroxy salts	44237745	1.68
14	041	Wheat and meslin, unmilled	43257019	1.64
15	793	Ships, boats & floating structures	38724756	1.47
16	874	Measuring, checking, analyzing & controlling instrument & apparatus	35319524	1.34
17	713	Internal combustion piston engines & parts	35100643	1.33
18	679	Tubes, pipes, hollow profiles, pipe fitting of iron or steel	34211862	1.30
19	651	Textiles yarn	33322627	1.26
20	641	Paper & paperboard	30490351	1.15
	Sub-total		1598486422	60.55
	Other exports (216 items)		1041376606	39.45
	Total (236)		2639863028	100

Source : BPS, Indonesian Foreign Trade Statistics, Imports 2002

On the import side the problems also involve agricultural products. The United States has raised the problem related to the importation of chicken parts. The Indonesian government has imposed de facto quantitative restrictions on the import of meat and poultry products by requiring a certain certification. The other issue is a policy of allowing the government to maintain a ban on the import of chicken parts for not meeting the *halal* certification requirement. The *halal* certification requirement is regarded by some quarters as a form of disguised protectionism. Pressures to protect the domestic poultry industry are strong. Imports of chicken parts are still small but have increased rapidly in the past few years. Indonesian producers have been alarmed by this especially because the U.S. export price of CLQ (chicken leg quarter) is much lower than the cost of domestic production. The Indonesian Chamber of Commerce (Kadin Indonesia),

represented by Soy Pardede, stated that “the Government needs to admit that many of the existing trade policies are too complicated and should be replaced by simpler ones”.

On the importation of chicken parts, for instance, it was pointed out that under the existing regulations, the authority to issue the certificate lies with the Indonesian Ulemas Council (MUI), the Ministry of Religious Affairs and the Food and Drug Monitoring Agency. Instead, Kadin suggested that the policy should be executed by the Ministry of Industry and Trade. The other bodies should only issue the *halal* criteria (*The Jakarta Post*, 5 April 2004).

Soybean imports are another sensitive issue. According to the Institute of Agriculture and Trade Policy in Minnesota, there is dumping of wheat, soybean, corn, cotton and rice to Indonesia.

In addition to the issues of chicken parts and textiles referred to above, the US government has cited a number of trade barriers (*The Jakarta Post*, 5 April 2004), which include the following:

1. High rice import tariffs. At present the tariff is Rp 430 (5US c) per kilogram, but the Ministry of Agriculture keeps proposing to raise it.
2. The customs service uses arbitrary “check prices” on food imports rather than actual transaction prices on importation documents.
3. The government restricts the importation of and requires special licensing for the importation of alcoholic beverages, explosives and certain dangerous chemicals. This violates WTO rules.
4. The requirement for food product producers to register their products at BPOM.
5. The requirement for all consumer products to have labels written in Indonesian.
6. Weak enforcement of IPR.

Intellectual property protection is a major sticking point in the relationship. The following statement is contained in the USTR’s *2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements Program*: “The U.S. Government has continued to urge Indonesia to take steps to strengthen its IPR

regime. USTR placed Indonesia on the Special 301 Priority Watch List in 2003 due to concerns over continued optical media piracy and weaknesses in Indonesia's IPR enforcement. Indonesia took some noteworthy steps to strengthen its IPR regime over the past year, but significant problems remain. The Indonesian government enacted an extensive revision of its copyright law in July 2002 that came into effect in July 2003 and addressed a number of the United States' concerns. Over the last year it initiated public awareness campaigns and began addressing problems of interagency coordination. In addition, in November 2003 it submitted new draft regulations governing optical media production For Presidential approval. However, these proposed regulations, if signed, still would not firmly commit Indonesia to seize and destroy machinery and materials used in piracy. Overall, protection of intellectual property rights remains weak and U.S. industry continues to report increases in illegal optical media production lines for both domestic consumption and export. U.S. industry also raised serious concerns about counterfeiting and trademark violations of a wide range of products. While a limited number of raids against retail outlets for pirated optical media products have occurred, long delays remain in prosecuting intellectual property cases. Sentences continue to be light and insufficient to deter intellectual property piracy, further undermining the criminal penalties established by the new copyright law.”

The above issues have been the subject of discussions and consultation between officials of the two countries for a number of years. Progress to overcoming them has been slow. The forum for discussion has been provided by the Trade and Investment Facilitation Agreement (TIFA), signed between Indonesia and the United States in October 1997. There is now a Trade and Investment Council between Indonesia and the United States. The first meeting of this bilateral forum took place in Jakarta in October 1988, the second in September 2001, and the third in Bali in November 2002. Under the TIFA the United States provided an IPR action plan to Indonesia in May 2002. The implementation of the specific recommendations in the IPR action plan, including steps to improve the legal framework and enforcement mechanisms to protect IPR has been dissatisfactory.

The above is an illustration of the difficulties that will be encountered in creating a FTA with the United States, namely the lack of policy development, weak capacity to implement commitments, and lack of transparency. This is in part caused by a serious problem of interagency coordination. It may well be that the process of forming a FTA with United States will help focus the attention on the main issues to be covered under the FTA and to organize the bureaucracy to develop coherent policies on the various sectors included in the FTA. The exercise a few years ago initiated by the Ministry of Industry and Trade to draft a hypothetical FTA (with Chile) has contributed to intensified exchanges amongst various government agencies (Interview with a government official).

However, it appears that some groundwork will need to be prepared by the Indonesian side. There is only so much “learning by doing” that can be accommodated by the process. The USTR is not willing to be dragged into a protected process of negotiations, and many of the issues discussed before will have to be resolved satisfactorily before the process of negotiating the FTA can actually begin (Interview with a U.S. Embassy official).

It is critically important that the creation of a FTA with the United States be seen as a national project, and not merely a matter of trade diplomacy. Therefore, the formulation of an overall strategic framework is required. Broad based exchanges of views within the country are essentially. Perhaps a national commission of sorts should be established to formulate this framework.

On the U.S. side, the possibility of a FTA was briefly discussed in the *Report of the National Commission on U.S.-Indonesian Relations*. The National Commission was co-chaired by Honorable George Schultz, Honorable Lee Hamilton, and Mr. George Russell. It stated that a FTA would go along way to demonstrate the special relationship. A FTA not only helps deal with certain interest groups in the United States that advocate restrictions on imports from Indonesia of tuna, shrimp, steel, and possibly coffee. It might overcome exports restrictions in the United States in areas where Indonesia has a competitive advantage: textile and apparel, footwear and agriculture. But perhaps most

importantly, it can contribute to consistent U.S. engagement with Indonesia (USINDO, 2003).

The Enterprise of ASEAN Initiative (EAI) is an important pillar of U.S. engagement in the region (US-ASEAN Business Council, 2004). The other pillar of this framework for engagement is the ASEAN Cooperation Plan (ACP). EAI provides the building blocks for US-ASEAN Free Trade. The ACP involves a comprehensive partnership between the US and ASEAN and its members with three broad objectives, namely: (a) support for ASEAN integration; (b) addressing transnational issues; (c) strengthening the ASEAN Secretariat.

The USTR *2004 Trade Policy Agenda and 2003 Annual Report* clearly stated that the EAI “is intended to further enhance the already close U.S. relationship with this strategic and commercially important region”. However, in the view of DeRosa (2003), the main reason for forming bilateral FTAs with individual ASEAN countries might differ from one ASEAN country to another ASEAN country. He suggested that Malaysia and Thailand are attractive to the United States on economic ground, while Indonesia and the Philippines are important from a geopolitical and security perspective.

The study by Gilbert (2003), shows that economic gains to the United States are indeed greatest under a U.S.-Thailand FTA. The welfare gains are attributable to substantial terms of trade gains. US welfare gains under a U.S.-Indonesia FTA are negative because of sizable negative terms of trade effects. These negative terms of trade effects arise because average levels of protection against U.S. exports to Indonesia (and Singapore) are substantially less than against US exports to the other three ASEAN countries. The economic incentive for the United States to form a U.S.-Indonesia FTA is therefore weaker than for FTAs with other ASEAN countries.

On the other hand, the economic gains from FTA with US are largest for Indonesia (\$1.3 billion in 1997 prices) amongst ASEAN-4. This due to improvement of allocative efficiency as well as positive terms of trade effects arising from preference margins in the

US market. The preference margin, however, will be eroded when the US pursues FTAs simultaneously with other countries.

From the Indonesian perspective, it is quite obvious that the major benefit from the FTA with the United States is the improvement of allocative efficiency as it helps lock in major domestic economic policy reforms that go with the FTA (Soesastro, 2003). However, forming a FTA with the United States is not an easy proposition for Indonesia. As the Report of the National Commission has indicated, “Indonesian side favors expanding trade but is concerned about the political costs of market-opening commitments.” (USINDO, 2003). The Report also suggested that immediate hurdle for Indonesia to overcome is on the issue of IPR protection. This was also explicitly stated in the Report by the U.S.-ASEAN Business Council. The Council also proposed that the two sides to revive the bilateral energy dialogue that was suspended during the economic crisis. The importance to the U.S. business is that their involvement in the energy sector in Indonesia is particularly concerned with contract sanctity.

FTA is as much about investment expansion as it is about trade expansion. The U.S. is a major source of FDI for Indonesia. Since the crisis, followed by political transitions, Indonesia’s investment climate has become less attractive as the economic recovery remains sluggish and the policy and legal environment continued to deteriorate. U.S. investors have made it investment protection is a key issue for them. Japanese investors have focused more on investment incentives as well as on the tax administration and customs (Maidir and Atje, 2004). “Reliability” is important for all investors as production activities in Indonesia are becoming an integral part of the regional production networks.

U.S. investments in Indonesia have been rather broad based. They are significant in oil and gas and mining, and have been involved in a wide range of manufacturing activities as well as services. They are also present in the plantation sector. Before the crisis, U.S. investments have increased their involvement in infrastructure development, particularly in the energy and power sector. Renegotiations of contracts due to the financial crisis have soured the relationship.

As can be seen from Table 3, FDI approvals have drastically declined since 1998. Outside of the oil and gas, and the financial sector, EU and East Asian investments have been much larger than those from the United States. Prospects for the revival of U.S. investments in Indonesia have not yet improved. A U.S.-Indonesia FTA must give particular attention to the revival of FDI from the U.S. into Indonesia.

Table 3 **FDI in Indonesia from the United States, European Union and East Asia (a)**
1997 – 2003 (million US\$)

	U.S.	EU	East Asia
1997	1,017.7	11,746.3	15, 148.7
1998	568.3	5,308.8	4,717.3
1999	136.7	731.8	6,487.6
2000	243.1	5,938.5	3,829.0
2001	72.7	922.9	12,205.1
2002	467.7	1,279.6	6,182.4
2003	173.4	1,263.1	2,943.0

(a) Approvals, excluding oil and gas, and the financial sector.
Source: BKPM, *Perkembangan Persetujuan Penanaman Modal* (various issues).

Main Elements of a U.S.-Indonesia FTA

Indonesia does not need to start from scratch in designing and formulating a FTA with the United States. It can draw on some of the elements in the U.S.-Singapore FTA (USSFTA). It is clear that adjustments will need to be made since the structure, nature and level of development of the two economies are significantly different. It is possible that Thailand, who is currently negotiating its FTA with the United States, has also made use of the USSFTA. Perhaps, the U.S.-Thailand FTA, when concluded, provides a better model for Indonesia than the USSFTA. Thailand and the United States will begin negotiations on 28 June 2004 in Hawaii. A U.S.-Thailand Business Coalition was formed in March 2004. It is made up of approximately 100 US companies interested in

supporting the negotiation, passage, and implementation of the US Thailand FTA. They have pledged to work for a “world-class” agreement. Thailand has recently finalized its FTA negotiations with Australia. The Australia-Thailand FTA is also a useful reference for Indonesia.

Table 4 U.S.-Singapore Free Trade Agreement

Chapter	Title
1	Establishment of Free Trade Area and Definitions
2	National Treatment and Market Access for Goods
3	Rules of Origin
4	Customs Administration
5	Textiles and Apparel
6	Technical Barriers to Trade
7	Safeguards
8	Cross-Border Trade in Services
9	Telecommunications
10	Financial Services
11	Temporary Entry of Business Persons
12	Anticompetitive Business Conduct, Designated Monopolies, and Government Enterprises
13	Government Procurement
14	Electronic Commerce
15	Investment
16	Intellectual Property Rights
17	Labor
18	Environment
19	Transparency
20	Administration and Dispute Settlement
21	General and Final Provisions

Source: www.ustr.gov/new/fta/Singapore/final.htm

Table 4 lists the elements of the USSFTA. The USSFTA is comprehensive in scope and covers aspects of trade in goods, services, investment, government procurement, protection of intellectual property, competition policy, and the relationship between trade and labor and environment.

The following is a brief discussion on aspects of the main elements that are of relevance to Indonesia in designing a FTA with the United States. This discussion is limited to general principles. In the manufacturing sector it is easy to identify the sensitive sectors. They are limited to foods, beverages and tobacco, chemical products, and the automotive sector. Peak tariffs are to be found in these sectors. In agriculture there are many sensitive sectors. While applied tariffs have also come down, the use of non-tariff measures are still rampant here. In services, many sectors are considered to be sensitive sectors. However, there have been significant developments in a number of these sectors, including financial services and telecommunications, largely because of increased involvement by foreign investors through acquisitions. The approach taken by this study is not to emphasize on the sensitive sectors so that the FTA would not be used to legitimize the protection of certain sectors. Capacity building and facilitation should be emphasized, in particular in regard to the services sectors.

The principle of *National Treatment* (Chapter 2) prevents discrimination against foreign products once they have entered the domestic market. Excise duties and value-added tax must apply equally to imported and domestic products. A thorough investigation needs to be made to see whether Indonesia has made some violation of this principle.

Rules of Origin (Chapter 3): Indonesia does not have the capacity to deal with complicated methods. It should be kept as simple as possible and as liberal as possible. Transparency is most important. The USSFTA use a product-specific approach based on a change in tariff classification. The USSFTA tends to be more liberal than, for instance the Japan-Singapore Economic Partnership Agreement (JSEPA). USSFTA mostly requires a lesser degree of change at the 6-digit or sub-heading level. The JSEPA requires a change at the 4-digit or heading level.

The Integrated Sourcing Initiative (ISI) perhaps will not be applied to Indonesia. It has been said that this Initiative was originally proposed as a way of showing appreciation to Indonesia for its support of the US' efforts against terrorism. An ISI product is originating from Singapore as long as it is imported into the US from Singapore. In other

words, it does not matter where the ISI product is manufactured provided there is a Singapore consignee involved. The ISI list contains 266 electronic (products covered under the WTO Information Technology Agreement) and medical/precision instruments. However, these products already enter the US and Singapore duty-free. Thus the ISI will not have much of a liberalizing effect on bilateral trade. It will only benefit companies that procure such products regionally or globally through Singapore. These companies can declare the procured ISI products as originating in Singapore under the rules of the USSFTA when importing into the US. They can enjoy the waiver of the Merchandise Processing Fee (MPF) that is imposed by the US on all imports. The possibility of any dutiable products making it to the ISI list in the foreseeable future is rather remote.

On *Customs Administration* (Chapter 4), the USSFTA is most comprehensive in terms of customs cooperation. This is an area in which Indonesia needs a great deal of capacity building, facilitation and cooperation. The USSFTA applies the provisions of the WTO Agreement on Customs Valuation. Under the article on Review and Appeal, it provides access to businesses to a review and appeal mechanism that is applicable to all determinations relating to customs matters. Administrative rulings must be made public. The USSFTA has an expansive section on customs cooperation.

Textiles and Apparel (Chapter 5) is an industry that is regarded as sensitive by the United States. This is also an important sector for Indonesia and is a major export item from Indonesia to the United States. This will be one of the most important elements of the FTA. The enforcement and cooperation regime instituted in the textiles and apparel chapter in the USSFTA is much more aggressive than that provided for under the general customs administration chapter. The US is concerned about Singapore's status as a transshipment hub. Therefore, Singapore must track the movement of all textile trade, including activities within the free trade zone, and is obliged to turn over all information obtained to the US. This is an extremely heavy-handed treatment of an FTA partner. Singapore must also facilitate the site visits by US "jump" teams.

Technical Barriers to Trade (Chapter 6) is an important area to be included in the FTA as they create serious distortions in the domestic economy. Indonesia has instituted a number of licensing requirements, such as in sugar trade, that does not serve the country well. As the FTA should be seen as a means to lock-in domestic economic reforms, it should seriously address various technical barriers to trade.

Safeguards (Chapter 7): the USSFTA does not impose any additional obligations or rights with regard to *global safeguard measures*. The Agreement specifically permits either party to exclude the other party from such measures. On *bilateral safeguard measures*, the USSFTA allows one FTA partner to suspend preferential import duty reductions or increase import duties for goods from the other FTA partner during the 10-year transition period following the effective date of the USSFTA. The parties can impose a bilateral safeguard measure only after an investigation conducted according to the WTO Safeguards Agreement provisions, namely that there must be increased imports, a finding of serious injury, and a causal link between the injury and the imports. Safeguards will be an important element in a U.S.-Indonesia FTA. It is seen as an insurance and provides some level of comfort to pursue further liberalization.

Cross-border Services (Chapter 8): the USSFTA contains obligations and disciplines provided for under the GATS, but it makes significant improvements as compared to the transparency requirements in the GATS.

Singapore will provide substantial access for all types of services, subject to a few exceptions. US services suppliers are granted non-discrimination and national treatment. Singapore's services market access commitments include: financial services (banking and insurance); construction and engineering; computer and related services; telecommunications services; tourism; professional services (architects, accountants, lawyers); express delivery; and energy services. In many of these areas, Singapore agreed to bind its market access commitments at levels that provide substantially better access than that which it currently offers other WTO members (GATS plus). The USSFTA uses a "negative list" approach.

The USSFTA provides for bilateral negotiations on mutual recognition of qualifications, certification and licensing requirements. For instance, Singapore commits to recognize law degrees from specific US law schools for admission to the Singapore Bar. In the field of education services, Singapore guarantees unrestricted access for US suppliers to provide primary education services to non-Singapore citizens. Singapore's commitments in secondary education are rather limited. On higher education, Singapore only limits US education service suppliers in relation to the training of doctors in Singapore. Indonesia has yet to liberalize its education system. It lags behind its neighbors, Malaysia and Thailand, in this regard. There are increased pressures from within the country to liberalize this field.

Telecommunications (Chapter 9) and *Financial Services* (Chapter 10) are likely to be included in the Agreement as these two sectors are of great interest to the United States. Within these sectors there are many areas of activities that Indonesia is prepared to open up. However, Indonesia must have a clearer picture as to how it wants to develop the telecommunications industry in Indonesia. It also needs to have a firm plan to realize the country's financial architecture that has been drafted recently. Telecommunications market opening measures include reasonable and nondiscriminatory access to networks, transparent rule making by an independent regulator, and adherence to the principles of deregulation and operator choice of technology. But the USSFTA recognizes the U.S. and Singapore's respective rights to regulate these sectors.

Temporary Entry of Business Persons (Chapter 11) is not as sensitive an issue for Indonesia as it appears. Its inclusion in the Agreement will be seen as favorable to Indonesia.

A provision on *Competition Policy*, as in Chapter 12 (Anticompetitive Business Conduct, Designated Monopolies, and Government Enterprises), is an element that is now common to most FTAs. Indonesia has a competition law, but it continues to seal off its state enterprises. This is an area ripe for reform, but the government lacks determination to

implement reforms of its state enterprises. The Agreement provides protection for U.S. firms relating to sales to and purchases from Government Linked Companies (GLCs). It also ensures that GLCs do not discriminate against US goods, services and investments, and do not engage in anti-competitive practices. Singapore will enact laws that will proscribe anticompetitive business conduct and establish an authority to enforce such laws.

Government Procurement (Chapter 13): Indonesia is unlikely to agree to an inclusion of this provision. It is also not a signatory of the WTO Government Procurement Agreement (GPA). Under the USSFTA, Singapore has agreed not to exercise any governmental control or influence over the procurement decisions of its GLCs. Singapore is one of the 27 GPA countries. The WTO GPA open government contracts to foreign bidders on a non-discriminatory basis when the value of a government contract exceeds a designated threshold. The USSFTA reduced each country's GPA thresholds for federal/national government procurement by over two-thirds.

Electronic Commerce (Chapter 14) is a new area for Indonesia. There are no strong feelings in the country as to whether to include or exclude this subject in a FTA. The USSFTA commits to the non-discriminatory and duty-free treatment of all digital goods, whether they are classified as goods or services. It establishes (for the first time) explicit guarantee that the principle of non-discrimination applies to digital products delivered electronically. It also creates the first binding prohibition on customs duties being levied on digital products delivered electronically.

Investment (Chapter 15) will be a key element in a U.S.-Indonesia FTA. Indonesia's investment regime is already quite open, but the problem is the overall investment climate which suffers from legal uncertainty, inconsistent policies in general, discretionary policies of local governments, as well as irrational labor policies. The draft law on investment provides for national treatment (NT), but the law has been pending agreement by the Parliament for many years.

On investors' protection, the USSFTA ensures a secure and predictable legal framework. The investment provisions draw from US legal principles and practices, including due process and transparency. The investor rights are backed by effective and impartial procedures for dispute settlement. The USSFTA obliges Singapore and the US to accord NT, MFN and fair and equitable treatment. It does not make MFN exceptions for situations involving other FTAs. This implies that any deals Singapore offer on investment issues in future FTAs may be extended to the US. This holds for the US as well.

Intellectual Property Rights (Chapter 16) is an area that is of great importance to the United States. Indonesia must strengthen its legal system to make any commitment on IPR protection credible. This could be a sticking point in the negotiations. Protection of IPR builds upon the TRIPS Agreement, and provides strong protection for new and emerging technologies and reflects standards of protection similar to those in US laws.

The USSFTA vastly expands protections for and enforcements of IP rights, including protections for patents, trademarks, copyrights and digital copyrights, and trade secrets. It represents the highest standards of protection and enforcement for intellectual property achieved to date anywhere in the world in any bilateral or multilateral agreements, treaty or convention. It more closely reflects the status quo of IP protection and enforcement in the US than in Singapore.

The Agreement stipulates the following:

1. Full national treatment (NT) and non-discrimination obligations that are as broad as possible, apply to all types of IP, and permit no exceptions.
2. The parties agreed to accede to a number of international treaties, agreements and conventions that establish IP protection and enforcement standards.
3. Increased copyright protection.
4. Enhanced trademark protection.
5. Greater patent protection.
6. Other Internet- related provisions.

7. Restrictions on use of compulsory licensing that are stricter than those in the WTO TRIPS Agreement.
8. Singapore agreed to apply its IP laws to transshipments through its territory.
9. Strengthened enforcement of IP rights.

Labor (Chapter 17) and *Environment* (Chapter 18) will be areas of controversy in the negotiations between Indonesia and the United States. The labor chapter and environment chapter of the USSFTA include commitments by the FTA partners regarding effective enforcement of their respective labor and environmental laws, high levels of worker rights and environmental protections, and a pledge not to weaken existing labor and environmental laws to attract investment or encourage trade. The USSFTA is the first trade agreement subject to review under the terms of the Trade Promotion Act (TPA), whereby the US Congress is mandated to evaluate all aspects of a trade agreement, including provisions on labor and environment standards.

Transparency (Chapter 19) should be promoted. The Agreement includes provisions to ensure regulatory transparency. This is an effective deterrent to combat corrupt business practices. This is in Indonesia's own interest.

Dispute Resolution (Chapter 20): the USSFTA allows for some involvement by the private sector. Developing such a dispute resolution system will also be in Indonesia's own interest.

As can be seen from Table 5, essentially the coverage of the Australia-Thailand FTA is similar to the USSFTA (see Table 4). The USSFTA has a separate chapter on Textiles and Apparel as well as Telecommunications and Financial Services. In addition, it also has provisions on Labor and Environment, which may have to be included in any FTA with the United States. On the other hand, the Australia-Thailand FTA has provisions on anti-dumping and subsidies and countervailing duties that are included in the first chapter on Trade in Goods (see Annex).

Table 5 Australia-Thailand Free Trade Agreement (a)

Chapters:	Trade in Goods
	Customs Procedures
	Rules of Origin
	Safeguards
	Sanitary and Phytosanitary Measures and Food Standards
	Industrial Technical Barriers to Trade
	Trade in Services
	Investment
	Movement of Natural Persons
	Electronic Commerce
	Competition Policy
	Intellectual Property
	Transparent Administration of Laws and Regulations
	Government Procurement
	General Exceptions
	Institutional Provisions
	Consultations and Dispute Settlement.

(a) Final text, subject to approval by Governments; published on 12 May 2004.

Detailed contents are in the Annex to this paper.

Source: www.dfat.gov.au/trade/negotiations/aust-thai/index.html

In contrast, the USSFTA has avoided inclusion of anti dumping measures because any suggested changes in the US anti-dumping law would be politically controversial, particularly for frequent users of the law, such as the steel industry. The USSFTA contains no specific provision for dealing with subsidies and CVD, probably for the same reasons for not including provisions for AD investigations.

Indonesia will certainly be interested to include a clause on anti dumping. As DeRosa (2003) has shown Indonesia has been affected most by recent US administered protection activities, with 13 anti-dumping investigations and 4 countervailing investigations initiated (between January 1995 and June 2002) against US imports from Indonesia, and with duties being applied in 50 percent of the cases for which investigations were started (7 out of 13 and 2 out of 4, respectively). Indonesia will have to see whether Thailand can have an anti dumping clause included in its FTA with the United States. If it does not, it

is unlikely that Indonesia will be successful. In that case it should not even attempt to do so and should direct its energies to other areas of great concern.

Concluding Notes

The USTR cannot negotiate many FTAs at the same time. At any one time it may be able to negotiate two FTAs at the most. The USSFTA takes two years to conclude. It is not clear whether the U.S.-Thailand FTA can be concluded within a shorter time because both parties have a good basis from which to start, the USSFTA for the United States and the Australia-Thailand FTA for Thailand. The Australia-Thailand FTA is the first comprehensive agreement for Thailand. In previous agreements, Thailand had carved out agriculture. Some expect that negotiations between Thailand and the United States may take a longer time because of agriculture.

In view of this, it is unlikely that a U.S.-Indonesia FTA will be negotiated even beginning in 2005. This means that Indonesia has more time to prepare for the negotiations. In view of the fact that Indonesian MFN applied tariffs are already low, it cannot give much concessions from the reduction of tariffs. Thailand has much higher average tariffs than Indonesia. It is in the other areas, such as investment, services, IPR protection, and transparency that Indonesia will have to make concessions. These areas involve a lot of regulations. Indonesia needs to begin to develop a vision for each of these areas.

In addition, Indonesia also needs to develop chief trade negotiators, supported by a trade negotiations office that cuts across agencies.

These are the two main requirements for successful preparations to negotiate a FTA with the United States or any other partner.

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Annex

Australia-Thailand Free Trade Agreement

(Final, Subject to Approval by Governments)

Trade in Goods

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National Treatment

Elimination of Customs Duties

Accelerated Tariff Elimination

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Agricultural Export Subsidies

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Minimum Data Requirements – Certificate of Origin

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Control, Inspection and Approval: Priority Products

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