7

Services Trade

In 2004 US-Indonesian two-way services trade amounted to $1.5 billion (table 7.1), the largest components of which were travel ($335 million) and business, professional, and technical services ($299 million), composed of management, consulting and public relations, and operational leasing (table 7.2).

Many services, such as retailing, are end products. Other services are production inputs.[1] One example is efficient financial services. Another is time-sensitive supply chain management, covering transportation and communication. Best practice providers can reduce costs dramatically for these and other services, but laggard countries are becoming economically remote because of inefficient service sectors.[2] Indonesian exports often experience this problem, as many of their exports are both time sensitive and finance intensive. For Indonesia, the benefits of a US-Indonesia FTA lie in promoting a more efficient services sector,[3] which in turn can improve the country's competitiveness by reducing home barriers to exports.

1. Additionally, expanding the services sector can lead to increased merchandise production and trade. For civil aviation services, for example, fleet expansion or renewal could stimulate US exports and imports with Indonesia.

2. Hildegunn Kyvik Nordas, Enrico Pinali, and Massimo Geloso Grosso (2006) and Joseph Francois and Miriam Manchin (2006) estimate the impact of transport, communication, and logistic services on national exports. Post–September 11, the United States imposed heightened security regulations that have challenged international distribution networks.

3. The Coalition of Service Industries (CSI 2006) presents—perhaps a bit too cheerfully—the case for liberalizing services. A key gain lies in improving quality and efficiency among domestic service providers as a result of increased competition.

Table 7.1 Cross-border services trade between the United States and Indonesia, 2002–04 (millions of US dollars)

	US exports			US imports		
Service category	**2002**	**2003**	**2004**	**2002**	**2003**	**2004**
Business, professional, and technical[b]	207	327	236	51	73	63
Travel	178	169	191	151	111	144
Passenger fares	116	110	131	0	0	0
Other transportation	76	77	85	31	57	58
Royalties, license fees[a]	30	35	38	3	1	1
Royalties, license fees[b]	41	38	38	1	(*)	(*)
Insurance	11	8	11	12	1	4
Telecommunications	9	17	11	21	28	25
Financial services	70	71	55	7	8	15
Other private services	241	232	224	6	6	(D)
Total private services	1,089	1,192	1,126	286	288	323

(D) = not disclosed
(*) = less than $500,000

a. Transactions between affiliated firms.
b. Transactions between unaffiliated firms.

Source: US BEA (2006).

This chapter is divided into four sections. The first two analyze barriers to trade in the United States and Indonesia in the financial services, telecommunications, professional services, and maritime sectors. The third reviews services trade negotiations in selected US bilateral FTAs. The last section outlines our recommendations to further liberalize services trade in the context of a prospective US-Indonesia FTA.

US Barriers to Trade in Services

The United States is the premier producer and exporter of services. Its service sector constitutes some 64 percent of its GDP and some 30 percent of total US exports (USTR 2005a). The main service exports are business, professional, and technical services, travel services, royalties and license fees, and financial services. The United States has the largest insurance market in the world, and its telecommunication market is highly competitive, with mobile, fixed line, and cable, as well as voice over Internet protocol (VOIP) services.

Although barriers to foreign entry prevail in several US service sectors, the US Trade Representative (USTR) has affirmed US intentions to reduce

Table 7.2 US-Indonesia unaffiliated trade in business, professional, and technical services, by industry, 2002–04
(millions of US dollars)

Industry	US exports			US imports		
	2002	2003	2004	2002	2003	2004
Advertising	1	2	2	1	1	2
Computer/information	7	19	20	1	1	(*)
Research, development, and testing	2	(*)	5	5	(D)	7
Management, consulting, and public relations	22	50	30	8	(D)	14
Legal services	3	1	7	8	3	2
Construction, architecture, and engineering	77	63	27	1	1	2
Industrial engineering	4	(D)	9	(*)	(*)	0
Installation, maintenance, and repair	15	20	19	2	5	10
Operational leasing	55	119	85	(*)	(*)	(*)
Other	21	(D)	34	26	23	26
Total business, professional, and technical services (unaffiliated)[a]	207	327	236	51	73	63

(D) = not disclosed
(*) = less than $500,000

a. Data for these services, when furnished between affiliated firms, are not reported.

Note: Unaffiliated trade represents transactions between independent companies.

Source: US BEA (2006).

barriers, notably in finance, telecommunications, transportation, and professional services. Yet some US sectors remain off-limits, including government monopolies, such as the US Postal Service and the Bureau of Engraving; areas of keen regulatory interest, such as consumer safety and healthcare; programs restricted to US citizens and minority set-aside requirements, such as Overseas Private Investment Corporation (OPIC) guarantees, US Trade and Development Agency financing, and certain public contracts; municipal water supply and distribution; and state and local education.

Financial Services

Two-way financial services trade between Indonesia and the United States accounts for approximately 6 percent of all services trade, amounting to $85 million in 2004. This level could be many times larger if Indonesia liberalizes its market for financial services, such as banking, mortgage markets, insurance, mutual funds, and other products.

Banking

The Findlay-Warren restrictiveness index[4] indicates that barriers to banking services are substantially higher in Indonesia than they are in the United States (table 7.3). This difference arises from disparities in ongoing operations—mostly limits on licensing and restrictions on establishing a firm, due mainly to visa and work permit requirements for professional personnel. For the most part, US legislation permits the cross-border supply of banking services, so foreign banks without a commercial presence in the United States may deal directly with US customers. More serious issues arise when a foreign bank wants to establish a US commercial presence.

As a consequence of the US dual banking system—both federal and state governments can charter and supervise banks—foreign banks can establish a commercial presence either by opening a federal- or state-licensed branch, agency, or representative office, or by creating or acquiring a national or state bank as a corporate subsidiary. However, there are state-level market access limitations on foreign banks establishing branches, agencies, or representative offices. Approximately half of the states limit for-

4. The Findlay-Warren trade restrictiveness indices were created in 2000 and have not been updated. Given the move towards liberalization over the last six years, it is likely that current measures of restrictiveness in Indonesian services markets would be lower—that is, less restrictive—than are the 2000 values. See Measures in Restrictions on Trade in Services Database, 2000, ed. Christopher Findlay and Tony Warren, www.pc.gov.au (accessed on August 4, 2006).

Table 7.3 Restrictiveness index for foreign banking firms, 2000

Country	Foreign restrictiveness index
Indonesia	0.55
United States	0.06
Current US partners	
Australia	0.12
Canada	0.07
Chile	0.40
Mexico	0.17
Singapore	0.38
Prospective US partners	
Malaysia	0.65
New Zealand	0.06
Philippines	0.53
South Africa	0.19
South Korea	0.43
Thailand	0.39

Notes: The index is based on restrictions on the establishment of new operations (e.g., licensing requirements for new firms, restrictions on direct investment in existing firms, restrictions on the permanent movement of employees) and restrictions on ongoing operations (e.g., limits on lines of business, the pricing of services, and the temporary movement of employees). The index attempts to measure all restrictions that hinder foreign firms from entering and operating in an economy. 0 = least restrictive; 1 = most restrictive.

Source: Christopher Findlay and Tony Warren, Measures of Restrictions on Trade in Services Database, www.pc.gov.au.

eign firms initially entering or expanding into their markets by acquiring or establishing a state-chartered commercial bank (WTO 2006b).[5]

State restrictions lose much of their punch, however, because all states permit a foreign person to enter the US market by establishing or acquiring a nationally—that is, federally—chartered bank subsidiary. But foreign-owned banks, unlike domestic banks, are required to establish an insured banking subsidiary to accept or maintain domestic retail deposits of less

5. Most of the states that restrict foreign banks are of limited commercial interest. Despite these restrictions, there is very significant overall participation of foreign banks through state-chartered affiliates (WTO 2006b).

than $100,000.[6] Apart from this requirement, the United States has a general policy, at the federal level, of granting national treatment to US branches, agencies, securities affiliates, and other operations of foreign banks. The USTR (2005b) indicates that the United States is willing to revise the remaining handful of federal provisions that discriminate against foreign-owned banks.

Insurance

The United States has the largest insurance market in the world, but the US retail insurance market is highly segmented because regulations are made at the state level. Each insurance company must be licensed under the laws of each state where it intends to offer insurance (WTO 2006b). Hence, each company must deal with solvency, licensing, and operating requirements on a state-by-state basis. In addition, unlike banking, there is no such thing as a federally licensed or regulated insurance company. Such market segmentation may impede foreign firms because it entails higher compliance costs. A foreign insurer hoping to offer nationwide services would have to fulfill the licensing requirements of all 50 states. However, although a license is required in each state where an insurer does business, primary responsibility for company oversight remains with the state regulator where the insurer is domiciled; in practice, once an insurer establishes operations in its state of domicile, other states rely on that state regulator for primary oversight responsibilities, facilitating licensing in other states (WTO 2006b).

The European Commission (2004) notes that foreign insurance companies face discrimination on two main fronts. The first involves the absence of so-called port-of-entry legislation in many states. If a foreign insurance company wants to underwrite risks in a state that does not offer a port of entry, it must first seek a license in another state that does offer entry before seeking a license in the targeted state. Second, some states require their insurers to buy reinsurance from state-licensed companies before allowing reinsurance premiums to leave the state.

Most states do not allow insurance companies unlicensed in the state to transact business there. Nevertheless, certain prominent insurers are exempt from licensing requirements and allowed to operate on a cross-border basis.[7] These prominent insurers, such as Lloyd's, are part of the $9 billion US surplus lines market, but they face constraints as well. To participate in surplus lines business, foreign insurers and reinsurers have to be white-

6. There is a grandfather exception for foreign-bank branches that were engaged in insured deposit-taking activities as of December 19, 1991 (WTO 2006b).

7. Allowing insurers to operate across borders means that various types of insurance related to maritime shipping, commercial aviation, space launchings, and other hard-to-place risks are exempt from licensing requirements.

listed by the National Association of Insurance Commissioners (NAIC). In addition—and this is minor—they must name a US attorney and hold a local trust fund in a US bank of up to $60 million. Some foreign companies are effectively regulated in their home country, but that carries little weight in the NAIC's determination (European Commission 2004).

Pursuant to the Gramm-Leach-Bliley (GLB) Act, and to streamline the licensing of insurance agents and brokers, a majority of states have implemented a reciprocal licensing system. As of August 2004, all states except New Mexico had passed the Producer Licensing Model Act (PLMA) or other licensing laws to satisfy the reciprocity licensing mandates of the GLB Act. Also, the NAIC had certified 42 states as meeting the requirements for producer licensing reciprocity under the GLB Act. Pursuant to the Declaration of Reciprocity and the PLMA, a system of reciprocal licensing is being implemented whereby a resident producer may obtain a nonresident license through a uniform process. The NAIC has also implemented the Uniform Treatment Project, through which participating states agree to license nonresident firms, provided they are in good standing in their resident states, without imposing restrictions or qualifications above those required of resident firms.[8] Finally, the insurers' organization has been involved in other uniformity initiatives.[9]

The US government levies a federal excise tax on all insurance premiums ceded abroad for companies that are not incorporated in either the United States or a country with which the United States has signed a double taxation treaty.[10] The European Union has requested the United States to eliminate this discriminatory tax. Most states also require US citizenship and in-state residency for key personnel in insurance companies. Some require that a majority of directors, lawyers, and brokers be US citizens or permanent US residents, exempting Mexico and Canada. Local brokers must be used in all states where a risk has been underwritten. An FTA could modify some of these restrictions.

Telecommunications Services

The restrictiveness index for telecommunications services (table 7.4) suggests that the United States has a more open market for foreign firms than

8. The NAIC developed a uniform application for individual nonresident license and a uniform certificate of authority application, currently accepted in all states, allowing foreign and domestic insurers to file copies of the same application for admission in all states.

9. These include a system for electronic rate and form filing; the Coordinated Advertising, Rate, and Form Review Authority; and the Interstate Insurance Product Regulation Compact.

10. The tax rates are 1 percent for reinsurance and life insurance and 4 percent for nonlife insurance.

Table 7.4 Restrictiveness index for telecommunications services

Country	Domestic index	Foreign index
Indonesia	0.26	0.67
United States	0.03	0.03
Current US partners		
Australia	0.02	0.04
Canada	0.13	0.44
Chile	0.08	0.09
Mexico	0.21	0.53
Singapore	0.19	0.44
Prospective US partners		
Malaysia	0.22	0.58
New Zealand	0.03	0.03
Philippines	0.13	0.45
South Africa	0.26	0.59
South Korea	0.26	0.68
Thailand	0.27	0.79

Notes: The index is based on restrictions on the establishment of new operations (e.g., licensing requirements for new firms, restrictions on direct investment in existing firms, restrictions on the permanent movement of employees) and restrictions on ongoing operations (e.g., limits on lines of business, the pricing of services, and the temporary movement of employees). The domestic index attempts to measure all restrictions that hinder domestic firms from entering and operating in the domestic economy, while the foreign index captures the restrictions that foreign firms face in the domestic economy. 0 = least restrictive; 1 = most restrictive.

Source: Christopher Findlay and Tony Warren, Measures of Restrictions on Trade in Services Database, www.pc.gov.au.

do its current and prospective FTA partners. The US telecommunication market is the largest in the world and highly competitive, with mobile, fixed line, cable, and VOIP all fighting for market share. Table 7.1 indicates that, based on current settlement rates,[11] the United States is a net importer of telecommunications services from Indonesia. To a large extent, this reflects higher settlement rates in Indonesia than in the United States. Given the volume of present and prospective traffic, conditions of access to the telecommunications sector, including settlement rates, will probably be an important issue in FTA talks between Indonesia and the United States.

The Federal Communication Commission (FCC), in cooperation with the USTR, began to liberalize internationally in 1996. One element of the US strategy was the General Agreement on Trade in Services (GATS) Basic

11. Settlement rates are charges that local carriers impose for calls or data originating in a foreign country.

Telecommunications Agreement, which entered into force in February 1998. That agreement committed the 69 signatory countries, including Indonesia, to significantly liberalize market access for foreign carriers. Reflecting this obligation, in December 2004 the FCC adopted new regulations that expand the extent to which incumbent firms must make elements of their network available to other carriers, including foreign carriers (WTO 2006b). Nevertheless, US market access restrictions remain a matter of contention. The initial US offer schedule in the GATS talks in the Doha Round refers only to liberalizing common carrier networks and excludes cable networks. The revised May 2005 USTR offer, however, contemplates foreign ownership of cable television networks and direct broadcast by non-US satellite companies to American viewers.[12] The USTR is also willing to push for expanded ability by foreign companies to provide information services directly to consumers.

Professional Services

In 2004 US professional services accounted for 11 percent of US GDP and approximately 5 percent of US exports of goods and services. US exports of professional services are geographically diversified, with 25 percent of revenues originating from Asia and 16 percent from Latin America. The origin of imports, however, is highly concentrated, with Organization for Economic Cooperation and Development (OECD) countries being the main providers (WTO 2004b).

The Findlay-Warren restrictiveness index for professional services (table 7.5) indicates that trade barriers to accounting, architectural, engineering, and legal services are higher in Indonesia than they are in the United States, although the index values are similar, excepting architecture. Table 7.2 shows that in 2004 the United States was a net exporter of all professional services to Indonesia, excepting the research, development, and testing. US exports amounted to $236 million and were highly diversified; US imports of professional services from Indonesia were relatively small ($63 million), centered on management, consulting, and public relations.

An important feature of service delivery to foreign markets is the so-called fly in–fly out (FIFO) mode, by which lawyers, accountants, engineers, and other professionals work with clients abroad predominantly through short-term visits.[13] This type of work raises distinctive issues, such as the unauthorized performance of professional duties or malpractice that

12. "US Submits Revised Services Offer to the WTO," USTR press release, May 31, 2005, Washington.

13. This probably results in understated services exports in official statistics. The US Bureau of Economic Analysis 2004 figure for exporting legal services probably misses many payments foreign clients made for FIFO services.

Table 7.5 Restrictiveness index for foreign professional services firms

Country	Engineering	Accountancy	Architecture	Legal
Indonesia	0.30	0.24	0.56	0.57
United States	0.23	0.19	0.33	0.48
Current US partners				
Australia	0.15	0.08	0.41	0.42
Canada	0.33	0.16	0.42	0.52
Chile	0.14	0.24	0.35	n.a.
Mexico	0.31	0.33	0.36	0.49
Singapore	0.08	0.11	0.41	0.42
Prospective US partners				
Malaysia	0.33	0.26	0.51	0.54
New Zealand	0.34	0.19	0.39	0.47
Philippines	0.33	0.15	0.63	0.54
South Africa	0.11	0.10	0.44	n.a.
South Korea	0.19	0.12	0.48	0.44
Thailand	0.12	0.11	0.49	0.44

n.a. = not available

Notes: The index is based on restrictions on the establishment of new operations (e.g., licensing requirements for new firms, restrictions on direct investment in existing firms, restrictions on the permanent movement of employees) and restrictions on ongoing operations (e.g., limits on lines of business, the pricing of services, and the temporary movement of employees). The index attempts to measure all restrictions that hinder foreign firms from entering and operating in an economy. 0 = least restrictive; 1 = most restrictive.

Source: Christopher Findlay and Tony Warren, Measures of Restrictions on Trade in Services Database, www.pc.gov.au.

harms the client or the public at large. How can clients and the public be protected internationally from unauthorized or incompetent lawyers and other professionals?[14] The scope of two-way trade in professional services can be substantially increased by resolving these issues.

The European Commission (2004) notes that, since the implementation of the GATS schedules, access terms for foreign suppliers of professional services to the US market have improved. Gary Freeman, Luis Plascencia, and Mark Setzler (2003) report that citizenship requirements for such occupations have sometimes been dropped altogether, and that requirements still in the statutes are often not enforced.[15] However, differing regulatory

14. Rules of professional conduct require that a lawyer fully understand the factual basis for his advice and the legal principles to be applied. Bearing these rules in mind, the American Bar Association's Commission on Multi-Jurisdictional Practice is concerned with the unauthorized practice of law (WTO 2004a).

15. These changes are attributed to federal court decisions, advisory opinions of state attorneys general, and state legislative and administrative actions.

and licensing requirements from state to state still restrain foreign access. As the European Commission notes, "the application of Buy America and positive discrimination provisions, as well as burdensome visa procedures for registration and for obtaining work permits, make it difficult for foreign suppliers of professional services to enter the US market" (European Commission 2004, 73).

Legal

In 2004 recorded US exports of legal services to Indonesia amounted to $7 million and US imports to $2 million. These figures seem very small and may be understated. As for US barriers to foreign lawyers, US courts have held that the US Constitution prohibits nationality requirements for a license to practice law.[16] However, other barriers restrict foreign firms and persons from practicing law in the United States: Because the states rather than the federal government largely regulate the practice of law, most barriers are found in state regulatory requirements. In 2000, the United States committed to liberalize state-level citizenship and residency requirements for licensing,[17] scope of practice, association of foreign-qualified lawyers with local lawyers (only possible in 24 states), and association of foreign-partner law firms with local law firms (WTO 2004a). As of 2003, 9 jurisdictions require in-state offices for licensing and 16 require in-state or US residency for practitioners (WTO 2004a). The European Union has requested the United States to drop the state residency requirements for commercial companies and natural persons (GATS modes 3 and 4) in Michigan, Texas, and Washington for the specialty of giving advice on the law of foreign jurisdiction for which the service supplier is already a qualified lawyer (GATS 2002).

The US GATS schedule specifies that a natural person, as opposed to a company, must supply legal services. This makes barriers to international labor mobility important—and the United States is not disposed to grant additional work visas, a federal matter, in the context of trade negotiations (WTO 2004a). However, as mentioned, the United States is willing to address barriers created by state requirements for residency, minimum

16. In *Raffaelli v. Committee of Bar Examiners,* 7 Cal. 3d 28841 (1972), the California Supreme Court held that the citizenship requirement for attorneys was unconstitutional. The US Supreme Court issued a similar finding in Application of *Griffiths,* 413 U.S. 717 (1973), holding that "Connecticut's exclusion of aliens from the practice of law violates the Equal Protection Clause of the Fourteenth Amendment."

17. US willingness to liberalize citizenship and residency requirements does not, however, imply greater US willingness to extend work visas (e.g., H1-B visas) to foreign lawyers. It only means that, once legally admitted to the United States, foreign-born lawyers should not be denied the right to practice because they are not US citizens or because they have not resided in a certain state for a period of years.

age, diploma or title, professional examinations, and registration (WTO 2001, 2004a).

Accounting and Auditing

Foreign accountants who wish to practice in the United States are required to pass the Certified Public Accountant uniform examination, comply with state laws, which differ across states, and meet state board educational or continuing professional education requirements. The European Union has challenged residency and citizenship requirements and the obligation to create an in-state office in several US states (GATS 2002) and may also challenge the requirement that accounting firms operating in the United States abide by US accounting standards as opposed to the international standards used in Europe (European Commission 2004). The Securities and Exchange Commission has rejected several requests to allow the domestic use of international accounting standards. The European Union argues that this regulatory trade barrier must be resolved (GATS 2002).

Finally, the Sarbanes-Oxley Act could have a substantial negative impact on US-listed Indonesian companies and Indonesian auditors. Essentially, foreign firms that list their shares on US security markets need to comply with US governance and auditing standards, as well as standards in their home country. Moreover, by auditing the accounts of foreign firms that list their shares on US security markets, the law obliges all accounting firms that do business in the United States to register with the Public Company Accounting Oversight Board. This requirement conveys an objectionable extraterritorial flavor to some foreign firms (WTO 2004a). A US-Indonesia FTA could address this registration requirement.

Engineering

Like other services, engineering services face market segmentation owing to differing state regulations, and several states have citizenship and in-state residency requirements. For the same reason that citizenship requirements have been held unconstitutional for practicing law, they are equally suspect in providing engineering and other professional services. The European Union has requested that the United States abolish statutory citizenship requirements in the District of Columbia, as well as in-state residency requirements in Idaho, Iowa, Kansas, Maine, Mississippi, Nevada, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, and West Virginia (GATS 2002).

Maritime Services

The restrictiveness index for maritime services (table 7.6) shows that the United States has a less open market for foreign firms than does Indonesia,

Table 7.6 Restrictiveness index for foreign maritime services firms

Country	Foreign restrictiveness index
Indonesia	0.56
United States	0.60
Current US partners	
Australia	0.42
Canada	0.32
Chile	0.50
Mexico	0.48
Singapore	0.21
Prospective US partners	
Malaysia	0.52
New Zealand	0.35
Philippines	0.64
South Africa	n.a.
South Korea	0.58
Thailand	0.60

n.a. = not available

Notes: The index is based on restrictions on the establishment of new operations (e.g., licensing requirements for new firms, restrictions on direct investment in existing firms, restrictions on the permanent movement of employees) and restrictions on ongoing operations (e.g., limits on lines of business, the pricing of services, and the temporary movement of employees). The index attempts to measure all restrictions that hinder foreign firms from entering and operating in an economy. 0 = least restrictive; 1 = most restrictive.

Source: Christopher Findlay and Tony Warren, Measures of Restrictions on Trade in Services Database, www.pc.gov.au.

or any of its current and prospective FTA partners except the Philippines. This sector comprises 10 percent of cross-border services trade between the United States and Indonesia, amounting to $143 million in 2004. Indonesia is among the 20 leading developing-country exporters of maritime services in the world, and its exports to the United States in 2004 ($58 million) made up 18 percent of its total services trade with the United States.

The Federal Maritime Commission (FMC), an independent agency, regulates ocean-borne transport to correct or balance unfair or discriminatory foreign practices that adversely affect US shipping or US carriers in international commerce. The FMC's mandate also includes oversight of collective—that is, cartel—agreements among shipping lines, which are exempt from US antitrust laws (WTO 2006b).

The United States did not table an offer in the WTO negotiations on maritime transport services, which were suspended with no progress in June 1996. Nor has the United States tabled an offer regarding maritime transport services in its initial offer on services in the Doha development agenda (WTO 2006b). US unwillingness to negotiate reflects very strong political support for the Jones Act of 1920, which reserves cargo service between two points in the United States, known as cabotage trade, for ships that are registered and built in the United States, owned by a US corporation, and manned by a crew comprised of at least 75 percent US citizens. Domestic maritime passenger services are subject to similar cabotage requirements. By contrast, the US international maritime transport market is generally open to foreign competition. Although some cargo preferences are written into law, most international maritime transport takes place in foreign vessels (WTO 2006b). The Shipping Act of 1984, as amended by the Ocean Shipping Reform Act of 1998, seeks to enhance competition in the international shipping sector by allowing shipping lines to enter into individual long-term service contracts with importers and exporters, without restriction by organized carrier groups (WTO 2004a).[18] This legislation represents a break from the cartel arrangements that have long characterized international shipping.

As a general rule, the United States follows a nondiscriminatory policy with respect to its ports and harbors and does not grant preferential treatment to the vessels of particular countries.[19] However, in the wake of September 11, 2001 attacks, increasingly stringent security requirements are imposed on all flagged vessels, their crew, and their cargo. The United States maintains a most favored nation (MFN) exemption restricting longshore work by crews of vessels owned and flagged in countries that similarly restrict US crews on US-flagged vessels.[20] The MFN exemption mirrors the Immigration and Nationality Act of 1952, as amended, which prohibits foreign crew members from performing longshore work in the United States but provides a reciprocity exemption (WTO 2006b).

Post–September 11, the United States imposed heightened security regulations that have entailed additional costs for international distribution networks, vessels, crew, and cargo. A US-Indonesia FTA would allow both countries to address supply chain procedures, ensuring security while reducing the frequency of screening both in US and Indonesian ports. As a first step, the parties should address obstacles that prevent Indonesian

18. The FMC reviews the rates of foreign government–owned carriers to ensure they are not below a just and reasonable level (WTO 2004a).

19. However, vessels from Cambodia, Cuba, Iran, Iraq, Libya, North Korea, and Syria may not enter US ports on national security grounds (WTO 2006b).

20. For more information see, for example, WTO document number S/C/W/71 (1998).

ports from joining the Container Security Initiative (CSI), the Business Anti-Smuggling Coalition (BASC), and the Carrier Initiative Program (CIP), all of which US authorities designed to combat terrorism and smuggling.[21] A more ambitious long-term objective—possibly to be addressed by the joint committee of the US-Indonesia FTA—is to bring bilateral trade under the coverage of the Customs-Trade Partnership Against Terrorism (C-TPAT) program.

Indonesian Barriers to Trade in Services

To embark on a path of sustainable development, Indonesia should develop a stronger and more market-oriented services sector. Services accounted for an estimated 38 percent of Indonesia's GDP in 2004 (EIU 2006a). As in many developing countries, the Indonesian services sector ranges from highly efficient to highly inefficient. It includes enclaves that are well integrated into the world economy, such as certain financial and consulting firms, as well as activities that offer a sure ticket to sustained poverty.

In WTO negotiations, Indonesia undertook many commitments to liberalize certain services, particularly finance and telecommunications. Subsequent policy reforms sponsored by the International Monetary Fund (IMF) have augmented the WTO commitments (WTO 2003). However, the Indonesian government continues to be an important player in the services sector. About 56 percent of Indonesian SOEs supply services and account for about 80 percent of SOE assets. The government is active in finance, telecommunications, transport services, logistics, and trade (see table 6.7 in chapter 6), and government regulation bans or strongly regulates foreign investment in other services, namely trading and information—chiefly audiovisual and printing—telecommunications, air transport, shipping and seaports, education services, and utilities (water and electricity).

The Yudhoyono government recognizes that retrenching government ownership, control, and regulation is a healthy long-term strategy for Indonesia. The private response so far has been selective, for reasons identified in chapter 6. Indonesia lags behind global and regional standards in basic infrastructure, such as electricity, water, roads, civil air transport, and

21. CSI entails a security regime to identify and inspect containers that pose a potential risk for terrorism at foreign ports before they are placed on vessels destined for the United States. The US Customs and Border Protection (CBP) agency has already stationed US officers in more than 40 foreign ports, including Singapore and Port Klang and Tanjung Pelepas in Malaysia. Under the CSI program, CBP provides anti–drug smuggling training to air, sea, and land commercial transport companies. BASC is a voluntary program with no government-imposed mandates, though corporate participants are expected to follow certain standards designed to deter contraband smugglers and terrorists. For more information, see www.cbp.gov.

telecommunications. These sectors call for significant capital and greater competition. A US-Indonesia FTA could contribute to both, reinvigorating trust between foreign investors, regulators, and SOEs.[22] US FTAs typically have ambitious liberalization targets for service sectors, but the US approach offers room for phased liberalizations and keeping some sectors off limits. The following section reviews sectors that are likely to capture negotiators' attention, as well as areas in which liberalization may be especially difficult.

Financial Services

Indonesian barriers to its domestic financial services sector will probably lead the US services agenda in FTA talks.

Banking

Banks dominate the Indonesian financial sector. Within banking, public-sector banks as a group top their private-sector counterparts in both assets and branches per bank (IMF 2005, Pangestu and Habir 2002). Deregulation in the 1980s and 1990s allowed private banks to emerge (McLeod 2002).[23] Foreign interests benefited from financial deregulation, as they were allowed 100 percent foreign ownership of Indonesian banks, expanded establishment rights, easier portfolio management requirements, and greater room to lend to domestic banks (Pangestu and Habir 2002). Indonesia, however, still has a modest ratio of bank credit to private-sector activity, which means that many domestic firms, particularly those that cannot tap international markets directly, must finance new investment from accumulated profits.

22. This chapter reviews a selection of service sectors that are typically addressed in US FTAs. Some service sectors not covered in this chapter, such as electricity services and civil air transportation, attracted the interest of US investors in the early 1990s, but some of these investments ended in disarray (McLeod 2002). PWC (2004) reviews the current state of Indonesia's electricity market following the Asian crisis and predicts that competition for power generation will only occur in certain regions by 2007, while electricity distribution might be liberalized by 2008.

23. Public-sector banks, including both state-owned banks and provincial regional development banks, account for roughly 40 percent of financial-sector assets. Private domestic banks follow with 36 percent, and foreign banks control about 11 percent of financial-sector assets either directly or through joint ventures. Nonbank financial institutions—finance companies, mutual funds, pension funds, and insurance companies—currently conduct very limited intermediation (IMF 2005). Note, however, that in the early 1990s private banks overtook public banks in loans, deposits, and assets (Pangestu and Habir 2002), but they suffered a tremendous blow during the Asian crisis. Of the top 10 banks, 2 were closed, 5 were taken over, and 2 were recapitalized.

Currently, foreign banks cater to multinationals and the largest domestic firms.[24] However, vast untapped opportunities for modern banking furnish an incentive to enlarge foreign bank operations. A US-Indonesia FTA could contribute to this process by securing the property rights of investors, protecting them from arbitrary court decisions, and addressing management requirements and other irritants.[25] Dealing with these concerns, however, may not entice meaningful foreign entry if the domestic financial system remains weak.[26] Moody's financial strength index ranks Indonesia among the least attractive financial systems in East and South Asia, and foreign banks worry about structural problems in the Indonesian banking sector.

To address these deficiencies, the Indonesian central bank has laid out a vision for the Indonesian banking sector intended to create a sound banking system.[27] Elements include consolidating minor banks, strengthening bank regulation and supervision, and replacing implicit guarantees with an explicit financial safety net. However, the government's reform agenda lacks clear guidelines for privatization in the banking sector, which should be a foundation stone to reform. Past mismanagement of publicly owned banks led to huge nonperforming loans that endangered Indonesia's entire economic structure during the Asian crisis.[28]

The goal today is to prevent a repetition of past mismanagement of public banks, even though privatizing major state banks stirs nationalist sentiments and fierce opposition from the political establishment (EIU 2006a). The sale of minority stakes in private banks held by Perusahaan Pengelola Aset (PPA), the state asset management company, looks certain.

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24. Mari Pangestu and Mangii Habir (2002) present a sobering account of the possible systemic consequences of increased entry by foreign banks. Increased entry could accentuate the risk management deficiencies of domestic banks if the domestic banks attempt to make up lost ground by entering new, risky, and unregulated markets. In prior episodes, foreign banks' transfer of technology, know-how, and technical assistance fell short of expectations. However, foreign banks were not a major cause of financial collapse during the Asian crisis. Poor corporate governance, corruption, politically directed lending, unhedged dollar and yen borrowing, and implicit guarantees of rescue were far more salient causes.

25. The USTR (2006a) complains about Indonesia's minimum paid-in-capital requirements.

26. In 2002 about 40 foreign banks owned 11 percent of Indonesian banking assets and had 2 branches per bank on average. Pangestu and Habir (2002) note that foreign banks did not take advantage of the opportunity created by loosening branch establishment limitations.

27. See IMF (2005) and Bank of Indonesia, "The Indonesian Banking Architecture," www.bi.go.id (accessed on December 13, 2006). Many political hurdles must be surmounted before a technocratic agenda, such as the one laid out by the central bank, can become a reality.

28. Pangestu and Habir (2002) show that the losses of all seven state-owned banks were so large that they would have been closed if they were treated as were private banks. Rescuing state-owned banks cost $36 billion, about 66 percent of the total bill for recapitalizing the financial system.

In mid-April 2006 the government approved the sale of its remaining shares in Bank Internasional Indonesia and Bank Permata, a 5.5 and 26.2 percent shareholding, respectively.

Insurance

All insurance companies must be licensed and meet certain prudential requirements. In April 2000 the Indonesian government improved prudential supervision and introduced new regulations requiring insurance firms to phase in solvency requirements over five years based on risk-based capital and also requiring minimum capital levels for new companies. The government also introduced more stringent financial disclosure requirements for insurers (WTO 2003).

Only a locally incorporated insurer can supply insurance products unless the products are unavailable in Indonesia—a provision similar to the surplus lines rules of US states. But there are no restrictions on obtaining reinsurance overseas, except that the reinsurer must have a minimum BBB rating. Wholly foreign-owned companies in Indonesia may purchase any form of insurance from overseas; however, branches of foreign insurance companies are not allowed to operate in Indonesia. Foreign insurers, including reinsurance companies, can operate in Indonesia only as a joint venture with a local firm or a shareholder of a listed company. The maximum foreign stake in a joint venture is 80 percent. However, foreign ownership above 80 percent is possible if a joint venture requires more capital than the local partner can provide (WTO 2003). Moreover, there is no limit on the foreign shareholding of an Indonesian company listed on the Jakarta stock exchange.

Telecommunications

Indonesia's Telecommunications Law 36, which came into force in 2000, has guided reforms designed to end local monopolies and open basic telecommunications services to majority foreign ownership.[29] Telecommunications Law 36 lays out goals that exceed many of the commitments that Indonesia agreed to under the WTO Basic Telecommunications Agreement and the WTO Pro-Competition Annex in 1997 (USTR 2006a).[30]

Indonesia has partially privatized its telecommunications companies. Public offerings opened room for Indonesian foreign residents, including

29. Implementing this law led to a breach of public-private contracts with many foreign enterprises (including US firms) that had been issued in the first round of reforms in the telecommunications sector (Lee and Findlay 2005).

30. WTO commitments may eventually compel Indonesia to introduce competition in fixed-line local, long-distance, and international services.

US citizens, to acquire significant stakes in PT Telkom and PT Indosat, Indonesia's two fixed-line companies. The government retains majority ownership of PT Telkom (51 percent), but in December 2002 it sold a 42 percent stake in PT Indosat to Singapore Technologies Telemedia, thus reducing its stake to 15 percent.[31] However, the government retains a veto over appointing and removing top managers and directors and over amending the articles of association.[32] The government enjoys similar powers in PT Telkom.

PT Telkom and PT Indosat currently share a duopoly over fixed-line local, long-distance, and international services. Both companies have extended their operations into the mobile service market: Telkom owns a majority of Telkmsel, and Indosat fully owns Satelindo and IM3 (Lee and Findlay 2005).[33] However, in the mobile market they face competition from several private companies owned by domestic and Asian-based conglomerates. According to the USTR (2006a, 326), "there is very little that would impede a foreign investor from coming into the Indonesian value-added telecommunications market."[34]

Telecommunications Law 36 removed previous requirements that prospective foreign investors partner or share revenue with an SOE. However, the requirement that a foreign satellite operator must have an Indonesian partner remains a significant trade barrier (USTR 2006a). Despite its many reforms, the Indonesian government has yet to submit a revised telecommunications offer in Doha negotiations.

Professional Services

Indonesia's professional services commitments do not in general cover cross-border supply, purchase from a foreign supplier at its location abroad, or the presence of natural persons. Supply of professional services via the commercial presence of a foreign provider in Indonesia tends to be limited to joint ventures involving a representative Indonesian office or partner.

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31. Telecommunications Law 36 had established a maximum limit of 35 percent for foreign investment in telecommunications services companies, but this was ignored in the Singapore Technologies Telemedia acquisition of 42 percent of Indosat.

32. In early 2006 Vice President Kalla expressed a desire to increase public ownership in Indosat, but his views did not enjoy consensus within the government.

33. Since 2002 PT Telkom has focused its investment in the value-added cellular market and added very few fixed lines to remote areas. Since May 2004 PT Indosat has installed new long distance networks and agreed on interconnection protocols with PT Telkom (METI 2006).

34. The USTR (2006a) asserts that Indonesian joint venture requirements are onerous for foreign satellite operators.

Legal

A few local law firms currently dominate the legal market, and foreign law firms cannot operate directly in Indonesia. All lawyers must hold Indonesian citizenship and a degree from an Indonesian legal facility or other recognized institution to practice law in Indonesia. Foreign lawyers can only work in Indonesia as "legal consultants" and must first obtain the approval of the Ministry of Justice and Human Rights (USTR 2006a). As a practical matter, a foreign law firm seeking to enter the market must establish a relationship with a local firm.

Accounting and Auditing

Foreign accounting firms must operate through technical assistance arrangements with local firms. Moreover, foreign firms cannot practice under the names of international firms, although terms such as "in association with" are permissible. Licensed accountants must hold Indonesian citizenship (USTR 2006a). Foreign accountants may act only as consultants and cannot sign audit reports.

Engineering

Foreign construction firms are only permitted to be subcontractors or advisors to local firms if the government determines that a local firm cannot do the work. For government-financed projects, foreign companies must form joint ventures with local firms (USTR 2006a). Foreign consultants working under government contract are subject to government billing rates.

Maritime Services

Similar to the Jones Act in the United States, in Indonesia foreign investment in dedicated interisland shipping services is prohibited. Cabotage restrictions also apply to individual cargos, although the government may relax them on some routes, allowing foreign ships to carry certain commodities if there is a lack of Indonesian shipping capacity.

Some enacted measures allow greater foreign participation in maritime services outside the cabotage trade (WTO 2003). There are no entry barriers for foreign vessels to Indonesian ports that are open for international trade, provided the vessels meet international safety, operation, and crew standards[35]—and in fact, foreign ships dominate international shipping to and from Indonesia. However, foreign shipping companies oper-

35. Moreover, in a joint venture with Indonesian partners, foreign firms can hold up to 95 percent of the equity in an Indonesian ocean freight service company, exceeding the 51 percent minimum commitment in the WTO.

ating international services in Indonesian ports must appoint an Indonesian shipping company as an agent (Government Regulation No. 82/1999).

Indonesia does not participate in any international shipping cartels (WTO 2003). Port services, such as pilotage, towing, tug assistance, anchorage and wharf access, and emergency repair facilities are provided on reasonable and nondiscriminatory terms.

Express Delivery Services

Indonesia has had an express delivery market since the 1970s, but the business has flourished in recent years and increasing numbers of express service firms have been formed. Reports suggest that Indonesia can still reap significant gains, perhaps some of the largest among South and East Asian countries, by liberalizing trade in air express services (CSI 2006). The Ministry of Transportation oversees the express delivery industry. DHL, owned entirely by Deutsche Post World Net, began its Indonesian operations in 1973, and in 1981 established cooperation with PT Birotika Semesta, a local firm. Under the name of DHL Express, the firm controls 50 percent of the market for international express delivery to and from Indonesia.

Indonesia could do much to improve customs clearance procedures. One immediate priority is to permit the preclearance of imports. Over the longer term, procedures should be put in place to speed clearance, eliminating the need for original paperwork and allowing duties and taxes to be paid after clearance.

Because no regulations govern package retrieval from Indonesian customs authorities, customs does not return shipments associated with fraudulent credit card transactions to the shipper unless duties and taxes have been paid. Express delivery firms seeking full custody over their consignments argue that such cases should be deemed free transshipments and returned upon request (US-ASEAN Business Council 2005).

Services Trade in Selected US FTAs

Both the US-Singapore and US-Australia FTAs allow insights into US expectations of service-sector liberalization in a US-Indonesia FTA. From a political economy perspective, congressional ratification of an FTA may depend on the lobbying support of the US services industry.[36]

36. Barriers in services are sometimes quite resistant to liberalization efforts because progress requires concerted action by both federal and subfederal governments. Noting this reality, USTR Susan Schwab has requested decisive support from the services industry to keep the US liberalization agenda on track. For more information, see "Schwab Calls on Services Industry to Increase Trade Lobbying Efforts," *Inside US Trade* 24, no. 40, October 6, 2006.

The US services industry has rallied behind all recent FTAs—particularly US-Singapore—because they offered an opportunity to push the envelope of liberalization much further than anything WTO negotiations envisaged. However, Indonesia may not be willing to accept the high degree of services liberalization in recent US FTAs.

Excepting the US-Jordan FTA, all US FTAs have been negotiated on a negative-list basis, meaning that all service sectors are completely open, across all modes of supply, unless a partner government has introduced a specific reservation. This modality generally leads to a higher degree of openness than does the positive-list approach, by which governments schedule areas and measures for liberalization, leaving the rest of the trade environment undisturbed.[37]

Transparency in Service Regulation

Ensuring transparency in the domestic regulation of services is relatively less contentious than is outright liberalization. Service chapters in previous US agreements have included strong language to ensure minimum standards for the conduct of government regulation. Several provisions are now standard fare: mechanisms for responding to inquiries; prior notification of proposed regulations with an opportunity to comment; a requirement that governments respond to comments in writing; and nondisclosure of confidential information. Additional service chapters establish criteria to guarantee that measures relating to qualification requirements, technical standards, and licensing procedures do not constitute an unnecessary barrier to trade in services. One important criterion is that regulation should achieve its objective in the least burdensome manner possible. Such transparency measures leave ample scope for policymakers, ensuring a basic level of nondiscrimination between domestic and foreign service providers.[38]

Bearing this record in mind, negotiators of a US-Indonesia FTA should adopt a flexible approach that accounts for the features of specific sectors as well as general principles.

Financial Services

In financial services, the US-Australia FTA guarantees that Australia will extend national treatment and MFN status to private-sector management

37. The Coalition of Service Industries (CSI) strongly supports the negative-list approach for services negotiations, specifically for those with ASEAN countries such as Singapore and Malaysia.

38. The CSI strongly supports including standard-setting transparency principles in an FTA.

of its civil service pension funds. It allows US asset management firms to sell portfolio management services to Australian mutual funds and improves the transparency of financial services regulations (USTR 2004b). Australia also agreed to lock in existing practices regarding its review of acquisitions in the banking and insurance sectors. A side letter on financial services commits Australia to pursue its Foreign Investment Review Board's current restrained approach.[39]

In insurance, the FTA covers life, nonlife, reinsurance, and intermediation (brokerage) for marine, aviation, and transport (MAT) services that are auxiliary to insurance but not covered by GATS. National treatment and right of establishment are core principles. The FTA also ensures two-way access for key cross-border insurance products. Under the agreement, US life insurers may expand their branches in Australia, a practice that was previously prohibited.

The US-Singapore chapter on financial services contains core obligations regarding nondiscrimination, MFN treatment, and additional market access obligations and guarantees several aspects of access in the banking sector. Singapore must remove its ban on new licenses for full-service banks within 18 months and within three years for wholesale banks. US banks must have access to Singapore's local automatic teller machine (ATM) network within two and a half years for locally incorporated Singaporean banks, and within four years for all other banks. Qualified US banks can open up to 30 branches and service locations; before the FTA, they could open only up to 15. US firms can offer asset and portfolio management and securities services in Singapore by establishing or acquiring local firms. Finally, US firms can offer pension services under Singapore's privatized social security system, with more liberal requirements regarding the number of portfolio managers who must reside in Singapore.

In insurance, all US and Singapore suppliers are assured fair and nondiscriminatory treatment and market access. Singapore has generally been recognized for its open insurance market. However, the FTA ensures further liberalization in the sector. It guarantees US firms access to customers in Singapore through subsidiary or branch offices located there. This feature covers life and nonlife insurance, reinsurance, insurance intermediation, and insurance auxiliary services. The FTA also allows US insurance companies to sell MAT insurance, intermediation of reinsurance and MAT insurance, and insurance auxiliary services to customers in Singapore from offices in the United States. US firms can continue to sell reinsurance services to Singapore customers in the same manner. Finally, the FTA includes an innovative provision that allows licensed US insurers to provide new insurance products to their business customers in Singapore

39. The side letter encourages a process of government-to-government consultation and periodic revisions of the investment screening mechanism (USITC 2004b).

without prior regulatory approval. The United States did take a reservation for one government program: as the USTR reports, "The Overseas Private Investment Corporation insurance and loan guarantees are not available to certain aliens, foreign enterprises or foreign-controlled domestic enterprises." (USTR 2003c, annex 8A).

In securities, the FTA guarantees market access, national treatment, and MFN treatment, opening Singapore's market to US investment firms. US investment firms that establish mutual funds in Singapore can use personnel based in the United States to manage the securities held in the fund portfolios. Singapore also commits to easing the local staffing rules for US asset management and insurance companies that offer market access for their investment products to the Central Provident Fund, Singapore's mandatory national savings scheme (USITC 2003).

Telecommunications

In telecommunications, the United States International Trade Commission (USITC 2004b) describes several important WTO-plus obligations for major suppliers covered in the US-Australia FTA. The obligations deal with resale, provisioning of leased circuits, and location of telecom facilities. The agreement guarantees the independence of regulatory bodies, ensuring that a regulatory agency cannot have a financial interest in any supplier of public telecommunications services. It also commits Australian regulatory bodies to consult with interested parties before issuing regulations, seek public remarks on prospective rules, and publish all relevant regulations. Improved transparency is intended to ensure nondiscriminatory access for US firms to public telephone networks that major carriers operate. As with the Singapore FTA, however, the category of major carriers excludes mobile service providers, which means that cost-based interconnection rates are not the norm,[40] and Australian mobile carriers have recently demanded higher termination rates (USITC 2004b).

The US-Singapore FTA addresses interconnection, resale of services, regulatory procedures, and nondiscriminatory access to the market. It ensures that all US telecommunication companies have market access to all of Singapore's telecommunications sectors and vice versa.[41] US companies can access the market in different ways: They can acquire or build local facilities, link their US network with a network in Singapore, or lease lines from Singaporean firms. Singapore's telecom regulatory authorities com-

40. However, mobile service providers are required to comply with the country's WTO commitments.

41. By contrast, under the WTO, Singapore has committed to granting market access to only three foreign telecom providers in selected telecom markets.

mit to open and transparent administrative procedures (USITC 2003). However, the United States took a reservation to protect its restrictions on ownership of US radio licenses, and Singapore took a similar reservation (USTR 2003c, annexes 8A and 8B).

Professional Services

The US-Australia FTA creates a working group that encourages the relevant bodies to harmonize their criteria for licensing and certifying professional service suppliers and recognizing professional credentials (USTR 2004a). However, the agreement does not directly alter state regulations of professional services in either Australia or the United States. Nor does it contain commitments for the temporary entry of businesspersons. The annexes in the FTA limit its professional services commitments by reiterating that US and Australian obligations need not exceed those previously accepted under the market access provisions of GATS Article XVI (USTR 2004a).[42]

By contrast, the US-Singapore FTA significantly liberalized professional services. Table 7.7 provides a general layout of the service sector provisions. The agreement guarantees improved access to Singapore's market for US providers of professional services and eases entry procedures for legal, architectural, engineering, and other professions. Singapore reduced the fraction of directors of engineering and architectural firms that must be professionally accredited in Singapore from two-thirds to more than half. The FTA also eliminates local ownership requirements for US land-surveying firms, eases restrictions on US law firms that form joint law practices in Singapore, and recognizes degrees earned from certain US law schools so that their graduates can be admitted to Singapore's bar (USTR 2003c). However, the FTA included reservations regarding the residency requirements of architects, the registration and residency requirements for auditing services, and the national treatment requirements for engineering services.[43]

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42. The so-called ratchet mechanism built into the US-Australia FTA requires the United States to multilateralize any new services and investment concessions to existing bilateral partners, but it does not bind the new bilateral partners to do the same. The mechanism does not apply to nonpartners or concessions outside of services and investment (Dee 2004).

43. The reservation with respect to architects and accountants restricts the temporary entry of professionals. The reservation with respect to engineers requires 51 percent local ownership of engineering corporations and, in the case of engineering partnerships, full local control of assets and profits. The USTR (2003c, 10) argues that these reservations "severely constrain US firms trying to open a Singaporean operation for single projects and requires them to give technical, managerial and financial control to outsiders in order to establish a long term presence."

Table 7.7 Selected provisions relating to services in the US-Singapore free trade agreement

Item	Provision
Scope of measures	Measures by central, regional, or local government affecting cross-border trade in services (negative list).
Schedules	Annex 8A (measures) and 8B (sectors) list scheduled exceptions to national treatment and most favored nation treatment, market access, local presence, performance requirements, or senior management and boards of directors.
Market access	Applies to all sectors unless otherwise specified in the agreement. Removes limitations on the number of services providers, the value of services transactions, the quantity of services output, the number of persons that may be employed in a particular sector, and measures that restrict or require specific types of legal entity or joint venture.
Most favored nation treatment	Unconditional MFN treatment in like circumstances.
National treatment	National treatment unless otherwise specified in Annexes 8A and 8B.
Local presence	A party shall not require a service supplier of the other party to establish or maintain a representative office or any form of enterprise or to be resident in its territory as a condition for the cross-border supply of a service.
Domestic regulations	Measures relating to qualification and licence requirements should be based on objective and transparent criteria, not more burdensome than necessary to ensure the quality of the service, and should not themselves restrict the provision of the service.
Transparency measures	Mandates publication of laws, regulations, procedures, and administrative rulings affecting trade in services or the reason for failure to comply with these mandates.
Entry of business persons	Secures temporary access for business visitors and investors for up to 90 days. Also grants, not subject to labor market tests, 5,400 US work visas for different categories of Singaporean professionals. This concession was reciprocated by Singapore.
Full set of provisions on services	Chapter 8—Trade in Services Chapter 9—Telecommunications Chapter 10—Financial Services Chapter 11—Temporary Entry of Business Persons Annexes to chapters 8, 10, and 11.

Sources: USTR (2003b, 2003c); Singapore Ministry of Trade and Industry (2003).

Express Delivery Services

In the US-Australia FTA, the agreement recognizes express delivery services as a unique service sector and makes important commitments to maintain market access. It also contains provisions to facilitate customs clearance, which is critical to express carriers' efficient operation.

Although Singapore took a reservation regarding its postal services, the FTA guarantees further liberalization of Singapore's express delivery services by giving market access to US service suppliers and improving customs administration[44]—areas of keen interest to US providers such as UPS and FedEx. Both firms have expressed concern about recent proposals to limit foreign involvement in the express delivery industry in Indonesia.[45]

Rules of Origin for Trade in Services

Rules of origin (ROOs) are central to negotiations of trade in goods, but the issue of ROOs for trade in services is only beginning to receive attention in bilateral and regional trade agreements (RTAs).[46] It was recognized early in the negotiation of merchandise trade agreements that without ROOs, an RTA would de facto reduce the external tariffs of each partner to the lowest MFN rate in the whole RTA area. Exporters from the rest of the world would have an incentive to transship their goods to the RTA member with the lowest MFN tariff, and from there reach the markets of the other RTA members.

In the case of goods, to limit such trade deflection, ROOs define the minimum level of transformation for products imported in one RTA member to be eligible for export to another RTA member at the preferential tariff. This device enables each RTA partner to apply a different MFN tariff rate on imports from the rest of the world.

ROOs for services, however, aim to identify the national origin of a service supplier rather than the geographical origin of the service itself. Liberal rules of origin permit service providers from nonmember countries to benefit from improved market access created by the RTA. This is not equivalent to MFN treatment because service providers based in nonmember states must still establish a legal presence in at least one RTA member. However, if entry conditions in at least one member country are relaxed, then liberal ROOs imply broad market access within the RTA territory for

44. The agreement requires Singapore to prohibit its postal authority from subsidizing its express letter services so that the authority has an unfair commercial advantage in express delivery services.

45. Personal communication with Selina Jackson, United Parcel Service (UPS), April 2006.

46. This section heavily draws from Fink and Nikomborirak (2006).

service providers from the rest of the world. Conversely, under restrictive ROOs, only a subset of service providers benefit from RTA liberalization. This potential difference in treatment of nonmember service providers has economic and bargaining implications.

From an ex post economic standpoint, liberal ROOs are preferable because they increase efficiency by reducing discrimination among competing service providers. Liberal rules can also help attract FDI from outside the RTA territory, both from nonmember service suppliers and from users who depend heavily on external service providers. However, from an ex ante economic standpoint, the prospect of liberal ROOs might prompt negotiators to pull back their offers for fear of free riding by nonmember service providers. This consideration suggests adopting more restrictive ROOs, but such restrictions inevitably undercut the potential gains from complete free trade in services. Tension thus arises between the negotiating benefits of restrictive rules and the toll they take once the negotiating package is signed.

ROOs can be phrased in different ways, both for service companies and for individuals who are service suppliers. Possible requirements for companies include:

- ***Incorporation.*** A service supplier must be incorporated under the laws of the exporting FTA member.
- ***Substantive business operations.*** A service supplier must show that it is more than a shell, by one or more indicators: possessing a service license in an RTA member, paying profit taxes in an RTA member, owning or renting premises meeting a minimum sales requirement, or doing business for a minimum number of years.
- ***Domestic ownership and control.*** A service supplier firm must be owned or controlled by persons within the exporting RTA member.
- ***Domestic employment.*** A minimum share of the firm's employees must be RTA nationals or local residents.

Possible requirements for individual service suppliers include:

- ***Nationality.*** The individual service supplier must be a citizen or legal resident of an RTA member country.
- ***Center of economic interest.*** The individual's center of economic interest must be located in an RTA member country. The center of economic interest could be defined by a minimum number of years of residency, paying local income taxes, or owning or renting a dwelling.

The most restrictive ROOs, such as those in the Thailand-Australia FTA, define the eligibility of a service supplier in terms of the nationality of the individuals or controlling persons. However, the overwhelming

majority of service agreements involving countries in the Association of Southeast Asian Nations (ASEAN) only require substantial business operations in the territory of a member. RTAs in the ASEAN region usually do not define the terms "substantial business operations" in detail, nor the expression "owned and controlled." Implementation is left to the parties and, so far, disputes have not arisen.

The ROOs for services trade in each bilateral or regional free trade agreement are likely to reflect the particular interests and bargaining powers of the countries involved. The United States already has a strong service sector and welcomes foreign service providers as new investors, and thus prefers more liberal rules. With a less competitive service sector and protections designed to nourish its infant service industries, Indonesia may prefer more restrictive ROOs.

Recommendations

The US-Singapore FTA can be the model for a US-Indonesia FTA. In the former FTA, reciprocal provisions cover a wide range of service activities. All limitations on the number of service providers, the value of service transactions, the quantity of services output, and the number of persons that may be employed per sector were removed.

ROOs in a US-Indonesia FTA should not be more strict than those adopted in the US-Singapore FTA. Both countries should abolish citizenship and residency requirements for senior professionals, managers, and directors, except for a very short (negative) list of reserved activities. As in the Australia FTA, the US-Indonesia FTA should establish a professional services working group to review professional diplomas and credentials and recommend the mutual recognition of degrees and standards that the working group determines are essentially equivalent. The working group should have an adequate budget to engage experts to assist in making these determinations.

Indonesian firms might have limited interest in enhanced access to the US telecommunications and information services market, but nevertheless, the United States should use the FTA to advance its liberalizing agenda. In particular, the United States should permit ownership of cable networks, direct satellite broadcast, provision of satellite services, and provision of information services by bona fide Indonesian firms.

For US business firms, market access improvements for US services providers would rank among the most important gains from a US-Indonesia FTA. For Indonesia, increased liberalization could enhance efficiency and lower costs in key sectors such as transportation, telecommunications, financial services, and business and professional services. The exchange of services between Indonesia and the United States—especially combined with liberalization in other areas—holds much potential to improve the economic health of both countries.