
Introduction

US-Indonesia relations have been cordial for most, but not all, of Indonesia's history. The United States supported Indonesia when it declared independence from the Netherlands in 1945. In the first half of the Cold War, under the presidency of General Sukarno, Indonesia maintained an independent foreign policy and became a core member of the Non-Aligned Movement along with India and Egypt.¹ In 1967, after three years of carnage directed against Indonesian communists and the ethnic Chinese community, a military faction led by General Haji Mohammad Suharto gained control of the government and installed General Suharto as president.

Washington supported President Suharto for most of his regime, primarily because Indonesia became a strategic anticommunist ally under Suharto's rule. Indonesia received considerable sums of US foreign aid and military assistance, and US firms obtained favorable conditions for investing in Indonesia. Perhaps the high point of US-Indonesia economic cooperation was the Bogor Declaration of 1994, in which US President Bill Clinton, Suharto, and other leaders in the Asia Pacific Economic Cooperation (APEC) forum committed to Asia-Pacific free trade by 2010 for developed members and by 2020 for developing members. However, after 1995, when the independence movement gathered steam in East Timor—now known as the Democratic Republic of Timor-Leste—and the corrupt dealings of Suharto's children became evident, Washington distanced itself from the Indonesian government. The United States

1. Like many Javanese Indonesians, General Sukarno used only one name.

supported an International Monetary Fund (IMF) program that contributed to the collapse of the Suharto government in 1998. Washington's relations with subsequent presidents Jusuf Habibie and Abdurrahman Wahid were lukewarm, but after the terrorist attacks of September 11, 2001, and the Bali bombings, strategic considerations related to international terrorism strengthened ties between Washington and Jakarta. Bilateral cooperation improved with President Megawati Sukarnoputri, and relations are genuinely cordial with President Susilo Bambang Yudhoyono.

The Washington-Jakarta alliance has historically emphasized common enemies: communism in the past, al Qaeda and religious extremism in the present. In the context of warmer relations in the face of a shared threat, a free trade agreement (FTA) could round out the relationship by promoting economic reform within Indonesia. The present study analyzes the economic merits of a free trade initiative. However, economic policy is never divorced from history and politics. Consequently, we start with an overview of the broader political and historical context (see box 1.1) in which an FTA will have to take place.

US-Indonesia Relations

US leaders will only entertain an FTA proposal with Indonesia if it fits within the larger policy framework of US diplomacy toward Southeast Asia and the Muslim world. As mentioned, the United States supported Indonesia's independence after World War II, encouraging the Netherlands to grant independence. Despite Indonesia's nonaligned status, celebrated at the famous Bandung Conference of 1955, it was a reliable anticommunist bulwark from the mid-1960s until the end of the Cold War.² US-Indonesia relations suffered briefly in the late 1950s when the United States intervened in Indonesia's domestic strife, and during the post-Suharto transition to democracy. Cooperative relations prevail today, although there is no formal security treaty between the two countries.

In 1967 Indonesian foreign policy under the New Order government of President Suharto moved away from the loudly anti-Western stance that characterized the last years of the Sukarno era. Under Suharto, Indonesia maintained close relations with the donor community, particularly the United States, Western Europe, Australia, and Japan. Over four decades the US Agency for International Development (USAID) and its predecessors provided substantial development assistance to Indonesia. The current USAID budget is around \$130 million per year, distributed between

2. This section draws heavily from the Economist Intelligence Unit (EIU 2006a), US Department of State (2006a), United States Trade Representative (USTR 2006c), and National Commission on US-Indonesian Relations (2003).

Box 1.1 Timeline of political events

1945: Japan permits independence leader Sukarno to return from internal exile and declare independence from Dutch rule.

1949: The Netherlands recognizes Indonesian independence after four years of guerrilla warfare.

1950s: The Molucca Islands declare independence from Indonesia and fight an unsuccessful separatist war.

1962: The Netherlands agrees to transfer West Papua to Indonesia after an interim UN administration. The new province becomes part of Indonesia in 1969, renamed Irian Jaya.

1965: In the aftermath of a failed coup, hundreds of thousands of suspected communists and ethnic Chinese (seen as a communist fifth column) are killed. Violence spreads and also exacerbates local rivalries.

1966: President Sukarno hands over emergency powers to General Haji Mohammad Suharto. Shortly after he becomes president in March 1967, Suharto reorients the nation's foreign policy towards the West and courts both foreign assistance and foreign investment.

1973: The first oil shock generates a windfall of resources for the Indonesian government. Some of these resources help support government objectives of attaining self-sufficiency in rice and strengthen the country's heavy industries.

1975: Portugal grants East Timor independence. A year later Indonesia invades East Timor and incorporates it as a province, without objection from the United States or other Western powers.

1976: The Free Aceh Movement (GAM) demands the independence of Aceh province. Jakarta responds by sending troops to the region. Several GAM leaders go into exile, and fighting does not end the conflict over autonomy.

1979: The second oil shock leads to another surge of revenue for Indonesia.

1980: Group Petition of Fifty (Petisi 50) leads demands for greater political freedoms.

1980–84: Transmigration policy moves half a million poor families, typically Javanese, to peripheral regions such as Papua, Kalimantan, Sumatra, and Sulawesi. Local populations, particularly independence movements, resent their arrival.

1989–91: End of the Cold War. With fear of communist takeover eradicated, foreign leaders and media examine and question Suharto's human rights and corruption records, including the role of his children in key Indonesian conglomerates. As democracy gains a foothold in developing and transition countries, Indonesia's political regime looks detached from global political trends.

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Box 1.1 Timeline of political events *(continued)*

1993: Megawati Sukarnoputri becomes an increasingly popular leader of Partai Demokrasi Indonesia (PDI [Indonesian Democratic Party]), the official opposition party in Congress.

1996: In July police and the army conduct a raid on PDI headquarters, killing several party officers and arresting more than 200 party members.

1997: Indonesia is hit by the Asian financial crisis and the rupiah plummets in value from about 3,000 rupiah per dollar in 1997 to 10,000 rupiah per dollar in 1998.

1998: In the wake of economic chaos and tough reform measures, protests and rioting topple Suharto. His deputy, Jusuf Habibie, becomes president. Later a corruption case is opened against Suharto, but the case ultimately collapses.

1999: Ethnic violence breaks out in the Molucca Islands. Jusuf Habibie permits free elections in Indonesia and allows the East Timorese population to vote for independence in a UN-sponsored referendum. Soon after the referendum, anti-independence militias initiate systematic violence and East Timor comes under UN administration. Abdurrahman Wahid is elected president.

2000: Financial scandals afflict the Wahid administration. Irian Jaya separatists become more vocal, demanding their own referendum.

2001: Ethnic violence erupts in Kalimantan as indigenous Dayaks force out Madurese transmigrants. Mass political demonstrations by Wahid's supporters clash with opponents in the streets of Jakarta. The International Monetary Fund stops further loans, citing lack of progress in tackling corruption.

In July Parliament dismisses President Wahid over allegations of corruption and incompetence. Vice President Megawati Sukarnoputri, the daughter of the first Indonesian leader, Sukarno, replaces Wahid.

2002: In January Indonesia inaugurates its human rights court, expected to test government willingness to hold the military accountable for atrocities in East Timor. Irian Jaya province is granted greater autonomy by Jakarta and allowed to adopt the locally preferred name of Papua.

In May East Timor emerges from UN administration as an independent state.

In July Hutomo "Tommy" Mandala Putra, son of Suharto, is sentenced to 15 years in jail for ordering the killing of Supreme Court Judge Syafuddin Kartasasmita.

In August constitutional reform is adopted as a step toward democracy, enabling voters to directly elect a president and vice president.

In October terrorist attacks in Bali kill 202 people, most of them Australian tourists. In August 2003 three Bali bombing suspects are found guilty of the attacks and sentenced to death. A fourth suspect is given life imprisonment.

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Box 1.1 *(continued)*

Cleric Abu Bakar Ba'asyir is arrested shortly after the bombings. He is accused of plotting to overthrow the government as the alleged spiritual leader of Jemaah Islamiah (JI), the group thought to be behind the Bali bombing. Abu Bakar Ba'asyir is cleared of treason but jailed for subversion and immigration offenses. The subversion charge is later overturned. Ba'asyir is released from prison in 2006.

In December the Indonesian government signs a peace agreement in Geneva with the separatist GAM. The accord aims to end 26 years of violence and provides for autonomy and free elections in the oil-rich province of Aceh; in return GAM must disarm. However, in May 2003 peace talks break down and the government mounts military offensive against GAM rebels. Martial law is imposed.

2003: In August a car bomb explodes in Jakarta, killing 14 people.

2004: In April the Golkar Party of former President Suharto wins the greatest share of votes in the parliamentary and local elections. Megawati Sukarnoputri's PDI-P party comes in second.

In July, in the first direct presidential elections in Indonesia's history, the contest after the first round narrows to Susilo Bambang Yudhoyono (SBY) and incumbent Megawati Sukarnoputri.

In September a car bomb outside the Australian embassy in Jakarta kills 9 and injures more than 180. Yudhoyono wins the second round of presidential elections.

In December more than 220,000 people are dead or missing in Indonesia after a powerful undersea earthquake off Sumatra generates massive tidal waves. The tsunami has its most devastating effect in Aceh province. The world community responds with massive emergency and reconstruction aid.

2005: In March a powerful earthquake off Sumatra kills at least 1,000 people, many of them on the island of Nias. The quake triggers tsunami alerts around the Indian Ocean.

In August government and GAM separatists sign a new peace deal providing for rebel disarmament and the withdrawal of government soldiers. Rebels begin handing in weapons in September, and the government completes its troop pullout in December.

In October three suicide attacks on the resort island of Bali kill 23 people.

2006: In January East Timor accuses Indonesia of widespread atrocities during its 24-year occupation, holding it responsible for the deaths of more than 100,000 people.

In February and March deadly protests at PT Freeport, a local subsidiary of a major US-owned gold and copper mine in the Papua province, follow attempts to remove illegal prospectors from the site.

In May a powerful earthquake hits Yogyakarta, with a death toll of about 6,000 lives. Property damages are also substantial, as the epicenter is located in a densely populated area.

basic education, democratic governance, health, water, food, the environment, and reconstruction after the tsunami in 2004.

A cornerstone of Indonesia's foreign policy is its leadership in the Association of Southeast Asian Nations (ASEAN). Indonesia was a founding member in 1967, together with Thailand, Malaysia, Singapore, and the Philippines.³ Initially created to alleviate tensions between its members and counter the threat of communist insurgency through shared economic, social, and cultural goals, ASEAN developed an external security dimension after Vietnam invaded Cambodia in 1979. This dimension expanded when the ASEAN Regional Forum was established in 1994; it now comprises 22 countries, including the United States.

Through the Declaration of Singapore in 1992, ASEAN members committed to establishing the ASEAN Free Trade Area (AFTA) by 2008. AFTA became fully operational for original signatory countries ahead of schedule, in 2003. Countries that joined subsequently—Vietnam, Laos, Myanmar (Burma), and Cambodia—were granted a longer transition period until 2010. Aside from creating a regional market, ASEAN's agenda includes external trade negotiations with China, Japan, and Korea, the countries referenced by "ASEAN plus 3," plus India, Australia, and New Zealand.

In October 2002 President George W. Bush announced the Enterprise for ASEAN Initiative (EAI), a major new effort to strengthen US trade and investment relations with ASEAN, both regionally and bilaterally.⁴ Under the EAI, the United States offers the prospect of bilateral FTAs with ASEAN countries that are committed to the economic reforms and openness that underpin the US approach toward FTAs. Potential FTA partners must be World Trade Organization (WTO) members—a criterion that currently excludes Laos and Vietnam⁵—and as a first step, they must negotiate a trade and investment framework agreement (TIFA) with the United States.⁶ Since the launch of the EAI, the United States concluded an FTA

3. Since then, Brunei, Vietnam, Laos, Myanmar (Burma), and Cambodia also have joined ASEAN.

4. The ASEAN group as a whole is the fifth largest US trading partner, with over \$136 billion in two-way goods trade in 2004 (USTR 2006c).

5. Laos and Vietnam are in the process of joining the WTO. For obvious political reasons, even though Burma is a WTO member, there is no prospect of a US-Myanmar (Burma) FTA as long as the military regime remains in power.

6. TIFA agreements create a formal consultative mechanism to address bilateral trade and investment issues and may lead to sector-specific, trade-enhancing agreements. Since 1996, Indonesia and the United States have used this framework. Bilateral investment treaties (BITs) are another means to foster bilateral economic relations and in some instances have preceded FTA negotiations (e.g., Bahrain, Jordan, Honduras, and El Salvador). However, many developing-country US FTA partners did not negotiate BITs before engaging the United States in FTA talks (e.g., Colombia, Mexico, Costa Rica, and Guatemala). For these countries, the FTA investment provisions afford a similar level of assurance to foreign investors as does a BIT.

with Singapore in 2003 and began FTA negotiations with Thailand in 2004 and Malaysia in 2005. The United States has concluded TIFAs with Indonesia (in 1996) and several other ASEAN countries.⁷

After Suharto resigned in 1998, Indonesia's four successive presidents—Jusuf Habibie, Abdurrahman Wahid, Megawati Sukarnoputri, and Susilo Bambang Yudhoyono—have maintained the broad outlines of Suharto's moderate foreign policy. However, from time to time, particularly when the threat of shared enemies has receded, human rights concerns have created friction between Indonesia and the United States. After a 1991 incident in East Timor in which police killed demonstrators, in 1992 Congress cut off military training assistance, in the form of International Military Education and Training (IMET) grants, to Indonesia. IMET funds were partially restored in 1995, but East Timor's separation from Indonesia, following the August 1999 referendum and widespread ethnic violence, severely strained Indonesia's relations with the United States and the international community. As the Western press and most UN members strongly sympathized with East Timor, the United States again suspended its military assistance programs. Later, in the fall of 2002, the United States urged the Indonesian government to bring to justice the perpetrators of the August 2002 ambush and murder of two US teachers near Timika in Papua province (formerly Irian Jaya). In 2005 Secretary of State Condoleezza Rice declared that Indonesian cooperation in the investigation had met the conditions set by Congress, and the flow of IMET funds resumed. Eight suspects were arrested in January 2006 and are now awaiting trial.

In November 2005 the State Department exercised a national-security waiver provision contained in the 2005 Foreign Operations Appropriations Act to lift legislative restrictions on foreign military financing (FMF) and normalize military relations. This allowed the United States to provide greater support for Indonesian efforts to reform the military, both to respond to national and regional disasters and to promote regional stability.

Since September 11, 2001, the war on terrorism has driven US strategic calculations in its relationship with Indonesia. Combat in Iraq fueled large anti-American demonstrations in Jakarta and other Indonesian cities as well as official and private criticism, but the government took strong measures to prevent violence. President Megawati criticized the absence of UN support for the initial invasion but stressed that the war was not an attack on Islam.

Until the Bali bombings in October 2002, Washington was frustrated by Jakarta's limited commitment to counterterrorist efforts in Southeast

7. The United States has concluded TIFAs with Brunei, Cambodia, Malaysia, Philippines, Singapore, and Thailand.

Asia and many Indonesians' reluctance to recognize that terrorism was a serious internal problem.⁸ The police investigation that followed the first Bali bombings, however, is clear evidence of a change in attitude toward terrorism as a domestic problem in Indonesia. The investigation led to the arrest of more than 90 suspected Indonesian terrorists by mid-September 2003. US-Indonesia counterterrorism cooperation has improved steadily since the end of 2002, as subsequent terrorist attacks—in Jakarta in August 2003 and September 2004 and a second attack in Bali in October 2005—underlined the serious and immediate nature of the terrorist threat. The United States has welcomed Indonesia's contributions to regional security, especially its leading role in restoring democracy in Cambodia and mediating territorial claims in the South China Sea.

Recently, President Yudhoyono has sought a higher international profile to match Indonesia's size and credentials. In March 2006 he traveled to Burma to discuss democratic reform, and in April and May 2006 he visited several Middle Eastern capitals and delivered a major speech in Saudi Arabia, calling on the Islamic world to fight extremism.⁹

The FTA Case

Geographical distance and significant economic and political differences might seem to weigh against a US-Indonesia FTA. Indonesia and the United States do not share a common border or even the same continent. The United States is among the foremost advocates of market capitalism; Indonesia only began economic liberalization in the mid-1980s, and the government still plays a major role in the economy (see tables 1.1, 1.2, and 1.3 for comparative economic, development, and trade indicators). Political institutions in the two countries have had hugely different origins and evolutions. In the closing months of the WTO Doha Development Round, it might not seem sensible to drain diplomatic and legislative energy from the overarching goal of global trade liberalization.¹⁰ And generally, bilateral deals might stimulate latent protectionist tendencies by focusing

8. Initially after the first Bali bombings, many Indonesians believed that their countrymen were incapable of such an atrocity. Some blamed the Central Intelligence Agency (CIA), seeing a conspiracy to draw Indonesia into the war against international terrorism.

9. See US-ASEAN Business Council Indonesia update, "Yudhoyono Calls on Islamic Countries to Fight Ignorance in Speech in Riyadh," May 3, 2005. Available at www.us-asean.org (accessed on July 5, 2006).

10. US trade promotion authority (TPA), as written, expires on June 30, 2007. Therefore, the Doha Development Round should conclude by spring 2007, to be ratified by Congress under the existing TPA legislation. The two alternatives are a failed Doha Round or an extension of the TPA.

Table 1.1 Comparative indicators for the United States and Indonesia

| Indicator | Indonesia | United States |
|---|-----------|---------------|
| GDP (billions of dollars) ^a | 270 | 11,734 |
| GDP per capita (dollars) ^b | 3,600 | 39,959 |
| Exports (billions of dollars) | 84 | 808 |
| Imports (billions of dollars) | 62 | 1,473 |
| Inward FDI stocks (billions of dollars) | 11 | 1,474 |
| Outward FDI stocks (billions of dollars) | 7 | 2,018 |
| Population (millions) | 245 | 296 |
| Labor force (percent, by sector) | | |
| Agriculture | 46 | 1 |
| Manufacturing | 12 | 22 |
| Services | 48 | 77 |
| Literacy ^c | 87 | 97 |
| Male | 93 | 97 |
| Female | 83 | 97 |
| Life expectancy at birth (years, males) | 65 years | 75 years |
| Life expectancy at birth (years, females) | 68 years | 80 years |
| Religious groups (percent of population) | | |
| Christian | 8 | 78 |
| Jewish | n.a. | 1 |
| Muslim | 88 | 1 |
| Other | 4 | 20 |

n.a. = not available

a. At market exchange rate.

b. At purchasing power parity.

c. Literacy indicates whether the person can read and write by age 15.

Note: The figures generally refer to 2004 or 2005.

Sources: EIU (2006a); UNCTAD (2005b); CIA (2006a, 2006b).

public and regulatory attention on areas and issues that were not yet in the spotlight.¹¹

Looking at the differences between Indonesia and the United States, commentators in both countries could argue that a bilateral FTA makes no sense. Others could question the timing: Why not wait until after the Doha Round concludes and Southeast Asia gets a better sense of its economic and political direction? Still others could respond that each skeptical question can be turned into an argument for a bilateral FTA. This study will be of most interest to those in the second and third camps, who do not dismiss

11. This argument is used to explain some US business groups' limited enthusiasm for US bilateral trade initiatives: They fear that negotiations could "awaken the sleeping dog" of protectionist instincts. The counterargument, of course, is that bilateral commitments provide a better buffer against actual protectionist measures.

Table 1.2 Indonesian trade in goods, 2005

| Country/region | Value (billions of dollars) | Share (percent) |
|-----------------------|---------------------------------------|---------------------------|
| Major export markets | | |
| Japan | 18 | 28 |
| ASEAN | 15 | 23 |
| Singapore | 8 | 12 |
| Malaysia | 3 | 5 |
| Thailand | 2 | 3 |
| Philippines | 1 | 2 |
| European Union (25) | 10 | 16 |
| United States | 10 | 15 |
| China | 7 | 10 |
| Australia | 2 | 3 |
| <i>Total</i> | 65 | 100 |
| Major import sources | | |
| ASEAN | 17 | 39 |
| Singapore | 9 | 22 |
| Thailand | 3 | 8 |
| Malaysia | 2 | 5 |
| Japan | 7 | 16 |
| China | 6 | 14 |
| European Union (25) | 6 | 14 |
| United States | 4 | 9 |
| Australia | 3 | 6 |
| <i>Total</i> | 43 | 100 |

ASEAN = Association of Southeast Asian Nations

Source: UN Comtrade database, 2006.

the possibility or desirability of a US-Indonesia FTA. Before launching into the chapters, issue by issue, it is worth seeing how the broader skeptical questions might be answered.

Are the Geographic and Political Distances Too Great?

Given the certain economic hurdles over agriculture, textiles, and services, can support for an FTA gain traction if the partners are not steadfast allies and are separated by thousands of miles? Before the mid-1990s, FTAs and customs unions were primarily pacts between countries that were already close political allies or in the process of becoming so: the European Common Market and then the European Union, ASEAN, the Australia–New Zealand

Table 1.3 US trade in goods, 2005

| Country/region | Value (billions of dollars) | Share (percent) |
|-----------------------|---------------------------------------|---------------------------|
| Major export markets | | |
| Canada | 183 | 23 |
| European Union (25) | 167 | 21 |
| Mexico | 102 | 13 |
| Japan | 51 | 6 |
| China | 39 | 5 |
| Korea | 26 | 3 |
| Taiwan | 21 | 3 |
| Singapore | 19 | 2 |
| Australia | 15 | 2 |
| Indonesia | 3 | 0 |
| <i>Total</i> | 804 | 100 |
| Major import sources | | |
| European Union (25) | 307 | 18 |
| Canada | 288 | 17 |
| China | 243 | 15 |
| Mexico | 169 | 10 |
| Japan | 138 | 8 |
| Korea | 43 | 3 |
| Taiwan | 35 | 2 |
| Malaysia | 34 | 2 |
| Venezuela | 33 | 2 |
| Indonesia | 12 | 1 |
| <i>Total</i> | 1,662 | 100 |

Source: USITC Interactive Tariff and Trade Dataweb, 2006, dataweb.usitc.gov (accessed on July 10, 2006).

Closer Economic Relations pact, the North American Free Trade Agreement (NAFTA), and the Southern Cone Common Market (Mercosur).

Experience up to the mid-1990s led many commentators to forecast a three-bloc world of contiguous customs unions and FTAs organized around the European Union, the United States, and Asian powers—China, Japan, or both. FTAs came to be seen as building blocks for the economic and political integration that characterizes modern geographically contiguous nations, and it was suggested that the economic blocs might fortify political alliances while erecting walls that would divide the global economy.

Simply put, this forecast proved wrong, though FTAs have flourished. According to the WTO (2005), some 176 new trade agreements have been

notified since the WTO's birth in January 1995, and their total number may soon exceed 300. Many of the post-1995 FTAs are between countries that are distant from each other and draw no inspiration from existing or anticipated political integration processes. The United States has FTAs with Chile, Australia, and Singapore; the European Union has FTAs with Mexico and Chile; and Japan has FTAs with Mexico and Singapore. China's menu of prospective FTA partners also includes distant partners (Hufbauer and Wong 2004). Today, FTA partners are often separated by thousands of miles and distinct cultures and do not speak a common language.¹² The United States has adopted a strategy of competitive liberalization based in part on concluding bilateral and regional FTAs with a large number of partners, many of them outside the Western Hemisphere. In addition to forming a few tightly knit geographic units centered on a major power, FTAs are also creating criss-cross networks spanning the globe, where there is no clear separation between "hubs" and "spokes."¹³

As pointed out earlier, the United States and Indonesia concluded a TIFA in 1996, and the Bush administration has used the agreement to encourage Indonesia to liberalize its economy. In 2005 the Yudhoyono administration began to review Indonesia's trade policy regime with a view to improving the nation's trade and investment climate. Senior US and Indonesian trade officials met several times in 2005 to discuss outstanding issues, both in APEC and the WTO, and consider steps to allow for a possible future bilateral FTA (USTR 2006c). In the context of the Bush administration's EAI, bilateral FTAs ratified with Australia and Singapore, Indonesia's immediate neighbors, and the administration's emphasis on stronger ties with moderate Muslim states, a US-Indonesia FTA fits well into the US strategic vision.

Post-September 11 considerations will be important factors in deciding whether to explore the prospect of US-Indonesia FTA negotiations. The Bush administration and many public leaders place a very high priority on better US relations with Muslim countries. The administration believes that prosperous market-oriented economies governed by democratic principles are far less likely to breed terrorists and threaten world peace, a vision that stands at the apex of its policy. Accordingly, the administration favors new FTAs with countries in the Middle East and Asia. Morocco was first on the list, followed by Bahrain, Oman, and the United Arab Emirates. Egypt, Pakistan, Malaysia, and Indonesia are all prospects. The United States val-

12. US FTAs with Jordan, Morocco, Bahrain, Oman, Chile, Peru, and Colombia all illustrate this point.

13. The United States, to take a leading example, is the core of a Western Hemisphere group that includes Canada, Mexico, Central America, and the Andean Region. However, the United States, Canada, Mexico, and Chile all have extensive FTA networks outside the Western Hemisphere.

ues the prospective FTAs for their ability both to promote broad economic reform and avert the so-called clash of civilizations that Samuel Huntington predicted would dominate global politics in the 21st century.¹⁴ From this point of view, Indonesia is an excellent candidate for an FTA with the United States. As the world's largest Muslim country and a secular state, Indonesia along with Turkey distinguishes itself as a moderate voice in the Organization of the Islamic Conference and other settings.

A US-Indonesia FTA would also be important in the context of increasing Chinese influence in Southeast Asia. The ability of the United States to remain committed to the region beyond the war against terror will influence how regional states react to the rise of China. If Southeast Asian states see the United States as unwilling or unable to help with their economic and security concerns, they may be drawn increasingly to China, especially in the economic dimension.¹⁵ On the other hand, it is also possible that as China's influence grows, Southeast Asian states may seek to balance that influence in new ways; if they perceive the United States to be a reluctant partner, they may then look to India, Australia, Japan, or to new ASEAN-based initiatives, possibly led by Indonesia (CRS 2006).

Are There Economic Benefits to a US-Indonesia FTA?

An FTA between Indonesia and the United States is fundamentally about large political gains for the United States and potentially large economic gains for Indonesia.¹⁶ However, while the political payoff is crucial, it would be wrong to focus the FTA analysis on politics alone. Even if FTA signatories are mainly interested in political benefits, they must appraise the pact's economic merits. The political costs of trade liberalization must be weighed against the gains from creating trade, promoting investment, improving productivity, and, most important, fostering reform.

14. In a 1993 *Foreign Affairs* article outlining his thesis of the clash of civilizations, Huntington argued that the primary axis of conflict in the 21st century will be along cultural and religious lines. The fault lines between civilizations, he wrote, will be the battle lines for the future. He later developed the case in a book (see Huntington 1993; 1996).

15. Conversely, a US-Indonesia FTA could give China an additional incentive to pursue commercial integration with ASEAN, but this would simply accelerate current Chinese policy. A US-Indonesia FTA would likely have similar effects on Japan-ASEAN and EU-ASEAN relations.

16. See Gresser (2003) for the case that freer trade can support the US war against terror. Byman (2006) argues that closer diplomatic ties with Indonesia, Pakistan, and India should become top US priorities in the fight against al Qaeda. Conversely, in the current political climate in Indonesia, closer ties between Indonesia and the United States could become a liability for President Yudhoyono. Between 1999 and 2006, the percentage of Indonesians with favorable opinions of the United States declined from 75 percent to 36 percent. See Pew Research Center, "America's Image Slips, But Allies Share US Concern on Iran, Hamas," press release, June 13, 2006. Available at pewglobal.org (accessed on December 1, 2006).

For Indonesia, an agreement could spur measures to liberalize the domestic economy and integrate into world markets.¹⁷ For the United States, which has historically based its relationship with Indonesia on geostrategic considerations, an FTA would add a complementary economic dimension. As described in the chapters that follow, both countries retain significant trade barriers, and Indonesia has important investment barriers. Commerce in agriculture, some manufactures, many services, and government procurement is often conducted on terms far from the ideals of transparency and free trade.

Econometric models suggest that reducing barriers will substantially augment commerce between the United States and Indonesia. To preview the econometric research presented in chapter 8, our gravity model suggests that eliminating all bilateral barriers between Indonesia and the United States could expand overall Indonesia-US merchandise trade by about 40 percent. Companion estimates using computable general equilibrium (CGE) analysis suggest that a US-Indonesia FTA could improve economic performance in Indonesia, resulting in annual gains of around 0.6 percent of GDP.

Is the Timing Wrong?

Perhaps the strongest argument against a US-Indonesia FTA is the matter of timing. Why distract attention from the final push to complete the Doha Development Round? For both countries, the political and economic payoffs from a successful WTO negotiation far exceed whatever achievements can be realized on a bilateral basis. As a related point, the US battle over the Central American Free Trade Agreement–Dominican Republic (CAFTA-DR) was prolonged and bruising; the House of Representatives only narrowly approved CAFTA-DR by a vote of 217 to 215 on June 28, 2005. The US-Oman FTA was similarly caught up in labor issues and was approved only by a modest 221 to 205.¹⁸ After these legislative battles, there is a certain amount of “trade fatigue” among US business and legislative proponents over the prospect of new FTAs. Votes will be scheduled in early 2007 for the agreements with Panama, Peru, and Colombia. A case can

17. See Ferrantino (2006) for the argument that FTAs between large countries and developing countries can be policy anchors for smaller countries to commit credibly to policy reforms that they might not otherwise undertake.

18. By contrast, fewer than 100 legislators in the House of Representatives opposed the US-Bahrain FTA in late 2005. A collateral issue in the Oman debate was concern that the FTA might limit US ability to block investment from Oman that threatened national security. That investment debate echoed the Dubai Ports World case, in which Congress effectively blocked an acquisition of US port facilities in March 2006.

be made that, after these votes, American trade stalwarts will need time to rest up before the big battle—either congressional ratification of the WTO Doha Development Round package or extension of the TPA, set to expire on June 30, 2007.

The timing arguments might be persuasive if the US-Indonesia FTA and the WTO Doha Round were competing for political attention in Congress at roughly the same time. However, if exploratory talks lead to a decision to move forward with FTA negotiations, the central focus in 2007 will be hard bargaining, not ratification, either by Congress or the Indonesian Parliament. Ratification debates are not likely before 2009. By that time, the US president will need new trade negotiating authority from Congress, and the Doha Round will be either an accomplishment of the past or an aspiration of the more distant future.

Moreover, leaving the ratification process aside, the US-Indonesia FTA could liberalize bilateral trade in goods and services to a far greater extent than even the best conceivable outcome from the Doha Round, which collapsed in late July 2006. The possibility remains that talks will be revived, but if they are, limited progress seems to be the outside prospect for reducing barriers to agricultural markets. WTO service negotiations are lagging badly, and only modest new commitments are on the horizon. The tariff-cutting formulas to improve nonagricultural market access (NAMA) may reduce applied rates in industrial countries and eliminate “water” from the tariff schedules of developing countries, but the foreseeable outcome will not lead to zero tariffs on manufactured goods.¹⁹ By contrast, in all of these areas and others, such as government procurement, investment, and sanitary and phytosanitary barriers, the US-Indonesia FTA should go far beyond what can be achieved in the WTO. In fact, US-Indonesia FTA liberalization should start where the Doha Round ends, even under the most optimistic WTO scenario.

Will the Agreement Comport with GATT Article 24?

The United States has entered into numerous FTAs. As mentioned above, apart from NAFTA, the United States has FTAs with Israel, Jordan, Chile, Singapore, Australia, Morocco, CAFTA-DR, Bahrain, Oman, Peru, and Colombia. Several others are in various stages of discussion and negotiation (see table 1A.1).

19. See “Ministers Likely to Fail on AG, NAMA, Terms in June if Wide Gap Persists,” *Inside US Trade*, June 16, 2006. Water in the tariff refers to the difference between the maximum tariff rates bound—that is, legally committed—in the WTO and the tariff rates actually applied. Many developing countries, including Indonesia, have average differences of 10 to 30 percentage points between their bound and applied rates, allowing them to raise applied rates very substantially without breaching a legal commitment.

As a founding member of ASEAN, Indonesia, along with other ASEAN members, has committed to regional free trade under the auspices of AFTA, which became operational among the original ASEAN members—Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand—in January 2003. The other ASEAN members—Vietnam, Laos, Myanmar (Burma), and Cambodia—were given longer periods of adjustment and will fully remove barriers in 2010.

Indonesia also participates actively in ASEAN’s external trade relations, the main efforts of which are to establish an East Asia Free Trade Area (EAFTA), sometimes called ASEAN plus 3—a regional free trade area embracing ASEAN bilateral agreements with China, Korea, and Japan.²⁰ Potential partnerships with India, Australia, and New Zealand are also under way. As an APEC member and the host of the landmark 1994 meeting in Bogor, Indonesia, like all APEC developing members, agreed to implement free trade throughout the Asia-Pacific region by 2020.²¹

So far, none of the US or Indonesian free trade pacts has been found to violate the Generalized Agreement on Tariffs and Trade (GATT) Article 24, even though some of them cover much less than “substantially all trade,” the GATT/WTO standard. The simple reason that they have not been found wanting is that GATT/WTO reviews of Article 24 compatibility either say nothing or convey only bland misgivings (Schott 2004). Only one WTO review group, for the Czech-Slovak pact, reached an affirmative consensus and found no violation of WTO standards (Sutherland et al. 2004).²² But US FTAs come fairly close to the Article 24 ideal anyway, eliminating barriers on substantially all merchandise trade among partners. Their major shortcoming is inadequate coverage of agricultural barriers, as in the Canada-US FTA signed in 1989, or very long phaseouts and even exclusions for sensitive agricultural products, a conspicuous fault of the US-Australia FTA at US insistence. However, US FTAs also liberalize services and investment, areas that the GATT/WTO system barely touches.

20. While EAFTA is a key objective, the ASEAN plus 3 agenda also includes cooperation on economic and social development and political and security relations. Progress in trade negotiations to date has been delivered partly through bilateral negotiations. In December 2003 China and ASEAN signed an FTA including “early harvest” tariff cuts with individual tariff schedules for ASEAN members. Japan has initiated bilateral negotiations with ASEAN members individually. In May 2006 Korea and ASEAN signed an Agreement on Trade in Goods, which will liberalize trade on 90 percent of products by 2010.

21. APEC members are Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, South Korea, the Philippines, Russia, Singapore, Taiwan, Thailand, the United States, and Vietnam.

22. Even when an FTA is fully consistent with Article 24, one or both parties may still owe compensation to other WTO members for trade diversion. Usually such claims are settled in the context of larger trade negotiations, such as the Tokyo Round, the Uruguay Round, or the Doha Round.

Under GATT's enabling clause,²³ exceptions from most favored nation (MFN) treatment are allowed through either differential and more favorable treatment of a developing country by a developed country or regional or global arrangements among developing countries such as AFTA. This clause could permit the United States to stop far short of liberalizing substantially all imports from Indonesia without the FTA running afoul of Article 24. However, the United States is not disposed to rely on the enabling clause in its FTA pacts with developing countries.

If Indonesia and the United States negotiate an FTA, in our view it should come close to the Article 24 ideal. Long phaseouts and special safeguards may be necessary on both sides for sensitive agricultural products and a few manufactured items. Otherwise, the coverage should be comprehensive and the elimination of barriers should be rapid.

Indonesia's Place in the Queue

Three factors have emerged as key conditions for US acceptance of FTA partners: the democratic nature of the country in question, its commitment to a market-oriented economy, and the potential for deeper bilateral relations to foster US foreign policy goals.²⁴ As mentioned, the United States is currently engaged in free trade talks with many potential partners, mostly developing countries, although three of the potential candidates—New Zealand, South Korea, and Switzerland—belong to the Organization for Economic Cooperation and Development (OECD). Given the relatively long list of potential FTA partners, the US Trade Representative, Ambassador Susan Schwab, will inevitably establish priorities. As with her predecessors, Schwab's priorities will depend on a variety of considerations, such as political alliances, prospective economic payoffs, ease of negotiation, and quality of results. Most of these considerations cannot be quantified, but available data can shed light on the strength of trade and investment ties between the United States and a prospective partner, the height of protective barriers, and the degree of social similarity, measured by corruption, economic freedom, and labor and environmental standards.

We now turn to the array of quantitative and qualitative indicators that enable us to compare Indonesia and other present and prospective US FTA partners. Quantitative indicators consist of inward and outward foreign direct investment (FDI) stocks, two-way US merchandise trade, two-way US services trade, and the average MFN tariff rates for agricultural and

23. GATT Decision of November 28, 1979 on Differential and More Favorable Treatment; see GATT (1980).

24. The democratic precondition clearly puts Thailand in an unfavorable position among the candidates for an FTA with the United States after Thailand's military coup in September 2006.

nonagricultural products. Qualitative indicators include a corruption index, two economic freedom indexes, and indexes for labor and environmental standards.

Based on these indicators, tables 1A.1 through 1A.7 compare Indonesia with current and potential US FTA partners. Current FTA partners include Israel (1986), Canada (1989), Mexico (1993), Jordan (2001), Chile (2003), Singapore (2004), Australia (2004), Morocco (2004), CAFTA-DR (2005), Bahrain (2005), and Oman (2006). Prospective US FTA partners are divided into three different groups: partners for which an FTA has been negotiated but not yet ratified, that is, Colombia and Peru; partners in the process of negotiation, that is, Ecuador, Malaysia, Panama, South Korea, the Southern African Customs Union (SACU), Thailand, and the United Arab Emirates; and partners under consideration, that is, Bangladesh, Bolivia, the Caribbean Community (Caricom), Egypt, New Zealand, Pakistan, Philippines, Qatar, Switzerland, Taiwan, and possibly Indonesia.

Quantitative Indicators

Table 1A.1 shows that Indonesia's two-way FDI stocks with the United States rank 11th out of the 31 current and prospective US FTA partners. If an FTA with Indonesia is concluded, US multinational enterprises (MNEs) as well as MNEs in Europe and Asia may take a more favorable view toward expanding their stakes in Indonesia.

Table 1A.2 depicts US two-way merchandise trade with its current and potential FTA partners. When two countries have an important base of merchandise trade, not only do business firms have a tangible reason to support an FTA but also the prospects are much better for a substantial dollar increase in bilateral commerce.²⁵ Indonesia ranks 14th among 31 current and prospective US partners, with a total of about \$15.1 billion in two-way merchandise trade in 2005. This figure is obviously far behind two-way trade with NAFTA partners Mexico and Canada, which totaled almost \$800 billion of two-way trade with the United States in 2005, but it easily exceeds the two-way trade with current Muslim partners Jordan, Morocco, Bahrain, and Oman. US-Indonesia trade flows exceed US merchandise trade with Colombia and Peru and are comparable in magnitude to US merchandise trade with the Philippines.

Table 1A.3 presents US two-way trade in services with its current and potential FTA partners. The logic of this indicator parallels merchandise trade. Data on services trade do not exist for many countries and are missing for several current and prospective FTA partners, but tentative conclusions can be drawn from the available figures. Indonesia ranks 14th in two-way

25. This point is underscored by US business groups' preference for FTAs with large countries, such as Brazil and Indonesia, rather than with small ones, such as Bahrain and Oman.

trade in services, with around \$1.4 billion annually. These flows are comparable in magnitude to US services trade with Chile and another prospective partner, Malaysia.

Table 1A.4 presents recent MFN tariff rates for current and prospective FTA partners. The MFN figures are averages for applied tariff rates for agricultural and nonagricultural products, respectively. The indicator suggests whether commercial negotiations will be more or less difficult in the sense that they may require larger or smaller tariff cuts to create free trade. An FTA, by definition, aims to eliminate tariffs and quotas, a goal that is easier to reach if the partner country already has low applied MFN tariff rates. Indonesia's intermediate average MFN applied rate for nonagricultural products, 6.7 percent, ranks it 14th out of 31 current and prospective partners. For agricultural products, Indonesia has a relatively low applied average MFN rate of 8.2 percent, a figure which ranks 9th. However, Indonesia's bound tariff rates substantially exceed its applied rates, which could pose a problem (see table 1A.4). High bound rates favor domestic firms in that Indonesia can raise its applied tariffs on a particular product without having to compensate foreign suppliers. In an FTA, this buffer would disappear, but it would be replaced in some instances by special safeguard provisions.

The United States has concluded FTAs with countries that had both high and low applied MFN tariffs. Canada, Singapore, Australia, and Chile had relatively low applied MFN tariff rates on both agricultural and nonagricultural products.²⁶ Mexico, Jordan, Morocco, and Israel had much higher applied MFN rates. From this spectrum, one might conclude that the United States can negotiate with partners that have a wide range of MFN barriers, provided that countries with relatively high barriers are prepared to make asymmetric cuts.

Qualitative Indicators

Table 1A.5 compares levels of corruption among current and prospective FTA partners. The logic of this indicator is twofold. First, less corruption probably means less political influence by vested interests, which inevitably seek to preserve the economic rents generated by trade and investment barriers. Second, less corruption definitely means a more desirable environment for foreign firms to expand their trade and investment contacts within the partner country.

Corruption could be a stumbling block to a successful agreement and subsequent implementation. With levels of corruption exceeded only by Bangladesh and Pakistan, Indonesia ranks 28th out of the 30 prospective

26. The figures in table 1A.4 refer to the situation in 2004. When the FTAs were negotiated, all of the partners had comparatively low average MFN tariffs.

partners for which corruption information is available. Apart from Morocco, Mexico, and Jordan, existing US FTA partners have low levels of corruption. Several prospective partners have somewhat higher levels.

Table 1A.5 also presents two indexes of economic freedom as assessed by the Heritage Foundation and the World Economic Forum.²⁷ The indexes cover trade policies, fiscal burdens, government interventions in the economy, monetary policies, capital flows and foreign direct investment, wages and prices, banking and finance conditions, property rights, and overt and informal market regulations. They suggest that Indonesia's business environment is relatively unattractive compared with other current or prospective partners, ranking 25th out of 29 countries.²⁸ Indonesia's current score places it in the "mostly unfree" category from an economic standpoint, though the Heritage Foundation notes the initiatives that President Yudhoyono has undertaken to fight corruption and deregulate the economy.

Table 1A.6 presents the Environmental Sustainability Index (ESI) for current and prospective partners. The ESI reflects water and air pollution, protected areas, and environmental regulations and enforcement. Indonesia is at an intermediate point on the scale, at an advantageous position compared with several other prospective partners, such as Pakistan, Bangladesh, Taiwan, and Philippines. However, a trade agreement between the United States and Indonesia could raise environmental concerns in Congress. With the possibility of criticism akin to what Central America faced over CAFTA-DR, Indonesia must commit strongly to improving enforcement of its environmental laws.

Table 1A.7 compares labor standards for current and prospective partners. Our labor standards index is based on five indicators: the right of association—that is, the right to form unions—bargain, and strike; forced labor; child labor; working conditions; and the number of international labor treaties that have been ratified. The labor index for each country reflects whether labor standards are high, medium/high, medium, medium/low, or low in each of the five categories. The index indicates that labor affairs are another troublesome area for Indonesia; to answer critics, Indonesia must make credible assurances to adhere to core labor standards.

While Indonesia's relatively weak performance on some of the indicators positions the country less favorably in the US FTA queue, Indonesia has made significant headway in the quality of governance over the last six years. President Yudhoyono has committed his government to significant economic reform, which future rankings should reflect. An FTA with the United States could help anchor existing commitments and hasten the reform process. The experience of current US FTA partners provides tentative support for this argument. As table 1.4 shows, in two of the five

27. See Heritage Foundation (2005) and WEF (2006).

28. The rank is an average of the two indexes.

Table 1.4 Corruption and economic freedom of US FTA partners, before and after the FTA

| Current partner ^c | Corruption ^a | | | Economic freedom ^b | | |
|------------------------------|-------------------------|-----|---------------------|-------------------------------|-----|-------------|
| | Before FTA | Now | Change | Before FTA | Now | Change |
| Australia | 8.8 | 8.8 | No change | 1.8 | 1.8 | No change |
| Chile | 7.4 | 7.3 | Small deterioration | 2.1 | 1.9 | Improvement |
| Jordan | 4.9 | 5.7 | Improvement | 2.8 | 2.8 | No change |
| Mexico ^d | 3.2 | 3.5 | Improvement | 3.1 | 2.8 | Improvement |
| Singapore | 9.4 | 9.4 | No change | 1.6 | 1.6 | Improvement |

a. Countries with high scores are the most transparent (i.e., high score is better).

b. Countries with high scores are the most corrupt (i.e., low score is better).

c. Bahrain, Canada, Israel, and Morocco are not considered because information for before the FTA is missing or because the FTA has not been implemented for long enough.

d. 1995 is considered as pre-NAFTA for Mexico, because there is no available data for years prior to 1995.

Sources: Heritage Foundation (2005); Transparency International (2005).

countries for which information is available on corruption levels before and after the creation of the FTA (Mexico and Jordan), corruption declined substantially. In one case (Chile), corruption marginally increased from a low level, and in two cases (Singapore and Australia) it remained unaltered at very low levels.²⁹ Similar patterns emerge in the Heritage Foundation's index of economic freedom. Three countries (Singapore, Chile, and Mexico) saw some improvement in their levels of economic freedom, while two others (Australia and Jordan) maintained their scores.

An FTA could also put economic relations between Indonesia and the United States on a better footing, with a robust economic dimension to complement geostrategic relations. The US FTA with Jordan provides evidence that FTAs can work. In 1999 US imports from Jordan amounted to a paltry \$31 million, US apparel imports from Jordan were negligible at \$2 million, and the United States had a trade surplus of \$239 million. In 2005 US imports from Jordan were almost \$1.3 billion, of which \$1.1 billion was clothing. US exports to Jordan also increased significantly, from \$270 million in 1999 to \$607 million in 2005. The remarkable increase in Jordanian exports, which come mainly from qualifying industrial zones (QIZs), demonstrates how rapidly a country can take advantage of trade preferences (Galal and Lawrence 2005).

US officials in the past have argued that countries with weaker initial conditions, such as Jordan, Egypt, and Morocco, should undertake further

29. Chile ranks 21st out of 158 countries, with the same corruption score as Japan. Singapore has the second-lowest score.

reforms before beginning FTA negotiations. A similar argument surrounds Indonesia today, but that leaves open the question of how much reform is enough before the parties hold exploratory talks. Indonesia has much to reform, but the same can be said of other countries that are already US FTA partners. An excessively high hurdle will diminish the key benefits of an agreement to anchor and propel reforms.

Negotiating Difficulties

If Indonesia and the United States decide to explore an FTA, their preliminary survey will uncover difficult problems. Indonesia has relatively low average tariffs and a fairly open investment regime by regional standards, but important barriers remain in place. Peak tariffs and import licenses protect sensitive commodities. Regulatory impediments and weak intellectual property rights (IPRs) limit foreign investment and hamper service providers. The United States has its own peak tariffs on sensitive products and has lately shown an allergy to foreign investment that raises national security concerns.

Figure 1.1 takes a snapshot of issues that might be resolved with relative ease and issues for which greater difficulties might be encountered. The vertical axis ranks subjects by increasing difficulty for Indonesia and the horizontal axis ranks subjects by increasing difficulty for the United States. The easier issues, in our view, are those grouped in the northwest quadrant of the table. Moving from northwest to southeast indicates areas of greater and greater difficulty. Sensitive commodities for Indonesia include fruits, meats, alcoholic beverages, rice, textiles, and automotive components; many of these are attractive markets for US exporters. Indonesia will insist on market access for processed agricultural products, such as cocoa, fish, and tobacco, and for labor-intensive clothing and footwear. All of these are sensitive issues for the United States. Better protection of IPRs will be crucial for the United States, but certain IPR aspects are extremely touchy in Indonesia. Indonesia will seek much better access for individual professionals (mode 4 in the Generalized Agreement on Trade in Services), but this has become a very sensitive issue for the United States.

Plan of the Report

Two-way trade in agricultural goods and mineral resources represents almost 30 percent of bilateral merchandise trade between Indonesia and the United States. Chapter 2 of the report is devoted to these products, reflecting their commercial importance and strategic sensitivities. Chapter 3 turns to commerce in manufactured goods, which dominate both Indonesian and US merchandise trade accounts. While the Indonesian and US MFN tariff rates on manufactured imports are low, protection is very high for key sectors,

Figure 1.1 Areas of increasing difficulty in US-Indonesia FTA negotiations

| | | United States | | |
|------------------|----------------------------|---|---|---|
| | | Less difficult | Difficult/sensitive | Very difficult |
| Indonesia | Less difficult | Raw hides, skins; cotton; ^a ceramics; machinery; pulp and paper; electrical equipment; chemicals; minerals and fuels; ^b optical instruments, musical instruments | | Peanuts |
| | Difficult/sensitive | Vegetable oils; ^c bovine meat; ^d plywoods; lubricants | Agriculture (fruits) and fishery products (tuna); processed foods; textiles, clothing; footwear; steel plates and steel products | Rubber footwear, travel goods; tobacco |
| | Very difficult | Restrictions on professional services (accountants, lawyers); performance requirements (local partners); retail distribution; halal products; entertainment Regime for protecting intellectual property rights | Restrictions on foreign participation in government procurement and broadcast media Sanitary and phytosanitary for agricultural and fishery products | Remaining restrictions in services, investment, and government procurement (Buy America act, etc.); Mode 4 in professional services (US visa issue) Rules of origin for textile and clothing imports Intramartime transport; rice and sugar |

a. Indonesia is not likely to export cotton to the US market.

b. Barriers are likely in investment and services related to energy exploration.

c. Vegetable oils could become an issue if the United States restricts the use of trans fatty acids in foods and restaurants.

d. Halal issues.

e. Partly because of halal issues and partly because of protection for domestic farmers.

Note: The issues for each country are defensive in nature.

such as clothing and footwear in the United States and motor vehicles in Indonesia. Our recommendations point to quick tariff elimination for lower rates and more gradual phaseouts for higher barriers.

Chapter 4 examines how labor and environmental issues might be addressed in a US-Indonesia FTA. We review how prior agreements treat these issues, recapping the arguments raised and the terms agreed to during congressional ratification of CAFTA-DR. The arguments are sure to be replayed if a US-Indonesia FTA is submitted for ratification. Chapter 5 reviews government procurement, an area that has proven highly resistant to liberalization in the WTO and a subject that evokes political sensitivities in both countries. In prior FTAs, the United States has selectively opened up its market on a reciprocal basis. We recommend that Indonesia join the WTO's Government Procurement Agreement (GPA) and that Indonesia and the United States extend each other the best government procurement terms offered to any other country, through either the GPA or bilateral FTAs (an unconditional MFN approach).

Chapter 6 takes up investment links between Indonesia and the United States and IPR issues. For Indonesia, the significance of an FTA lies in attracting substantially more inward long-term FDI. The chapter traces changes in Indonesia's investment regime and identifies major obstacles to the foreign business community. It also sketches the principal provisions of prior US investment agreements and recommends key provisions for the US-Indonesia FTA. IPRs are a contentious issue in all US FTAs with developing countries. Chapter 6 highlights issues that are crucial for the United States but touchy for Indonesia.

Chapter 7 discusses trade in services, analyzing barriers to trade in the United States and Indonesia in the financial services, telecommunications, professional services, and maritime sectors. It also reviews services trade negotiations in selected US bilateral FTAs and recommends sharp liberalization of Indonesian barriers.

Chapter 8 provides econometric estimates, drawn from two different econometric models, of potential two-way trade expansion. The estimates are based on a gravity model and a CGE model. The models attempt to forecast the effect of a bilateral FTA on the volume of trade created, the volume of trade diverted, and economic gains for the two partners.

Chapter 9 concludes with a review of the main points and recommendations of the previous chapters. This report is essentially an economic analysis; while we recognize that ultimately, geostrategic forces will determine the course and outcome of FTA talks between Indonesia and the United States, we argue that exploratory FTA talks could improve the level of trust between the United States and Indonesia generally and highlight opportunities for US firms doing business in Indonesia. Eventually, the growth payoff from an FTA could lift many Indonesians out of poverty. For these reasons, the multiple obstacles to an FTA discussed in the following pages are worth overcoming.

Appendix 1A

Table 1A.1 Foreign direct investment stocks, 2004
(billions of US dollars)

| Partner | Rank ^a | From United States | To United States | Two-way FDI |
|----------------------------|-------------------|-----------------------|------------------|----------------|
| Current | | | | |
| Australia ^b | 3 | 48.9 | 28.1 | 76.9 |
| Bahrain ^c | 29 | 0.2 | 0.1 | 0.3 |
| Canada | 1 | 216.6 | 133.8 | 350.3 |
| Chile | 12 | 10.2 | 0.0 | 10.2 |
| Israel | 10 | 6.8 | 4.1 | 10.9 |
| Jordan | 27 | 0.5 | 0.0 | 0.5 |
| Mexico | 4 | 66.6 | 7.9 | 74.4 |
| Morocco | 30 | 0.3 | 0.0 | 0.3 |
| Singapore | 5 | 56.9 | 1.8 | 58.7 |
| To be ratified | | | | |
| CAFTA | 20 | 4.0 | 0.0 | 3.9 |
| Colombia | 22 | 3.0 | 0.0 | 3.0 |
| Dominican Republic | 24 | 1.0 | 0.0 | 1.0 |
| Oman | 28 | 0.4 | 0.0 | 0.4 |
| Peru | 21 | 3.9 | -0.1 | 3.8 |
| Under negotiation | | | | |
| Ecuador | 26 | 0.8 | 0.0 | 0.8 |
| Panama | 8 | 5.9 | 10.7 | 16.6 |
| SACU-5 | 16 | 5.0 | 0.4 | 5.4 |
| Thailand | 14 | 7.7 | 0.2 | 7.9 |
| United Arab Emirates | 23 | 2.4 | 0.0 | 2.4 |
| Under consideration | | | | |
| Bangladesh | 31 | 0.3 | 0.0 | 0.3 |
| Bolivia | 32 | 0.2 | 0.0 | 0.2 |
| Caricom | 6 | 17.8 | 22.0 | 39.8 |
| Egypt | 19 | 4.2 | -0.1 | 4.2 |
| Indonesia ^c | 11 | 10.5 | 0.1 | 10.6 |
| Malaysia | 13 | 8.7 | 0.3 | 9.0 |
| New Zealand | 17 | 4.5 | 0.8 | 5.3 |
| Pakistan | 25 | 1.0 | 0.0 | 1.0 |
| Philippines | 15 | 6.3 | 0.0 | 6.4 |
| Qatar | 18 | 4.4 | 0.0 | 4.4 |
| South Korea | 7 | 17.3 | 4.2 | 21.5 |
| Switzerland | 2 | 100.7 | 122.9 | 223.7 |
| Taiwan ^b | 9 | 12.1 | 3.2 | 15.4 |

CAFTA = Central American Free Trade Agreement; Caricom = Caribbean Community; SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)

a. Based on two-way FDI.

b. 2003 data for FDI from the United States.

c. 2001 data for FDI from the United States.

Note: FDI stock computed as direct investment position on a historical-cost basis.

Source: US Bureau of Economic Analysis (2006).

Table 1A.2 US merchandise trade, 2005 (billions of dollars)

| Partner | Rank^a | US exports | US imports | Two-way trade |
|----------------------------|-------------------------|-------------------|-------------------|----------------------|
| Current | | | | |
| Australia | 11 | 15.8 | 7.3 | 23.1 |
| Bahrain | 31 | 0.4 | 0.4 | 0.8 |
| Canada | 1 | 221.4 | 287.9 | 509.3 |
| Chile | 16 | 5.2 | 6.7 | 11.9 |
| Israel | 9 | 9.7 | 16.9 | 26.6 |
| Jordan | 27 | 0.6 | 1.3 | 1.9 |
| Mexico | 2 | 120.0 | 170.2 | 290.2 |
| Morocco | 30 | 0.5 | 0.4 | 1.0 |
| Singapore | 6 | 20.6 | 15.1 | 35.8 |
| To be ratified | | | | |
| CAFTA | 7 | 16.8 | 18.1 | 34.9 |
| Colombia | 15 | 5.4 | 8.8 | 14.3 |
| Dominican Republic | 19 | 4.7 | 4.6 | 9.3 |
| Oman | 29 | 0.6 | 0.6 | 1.1 |
| Peru | 21 | 2.3 | 5.1 | 7.4 |
| Under negotiation | | | | |
| Ecuador | 20 | 2.0 | 5.8 | 7.7 |
| Panama | 26 | 2.2 | 0.3 | 2.5 |
| SACU-5 | 17 | 4.1 | 6.8 | 10.8 |
| Thailand | 8 | 7.2 | 19.9 | 27.1 |
| United Arab Emirates | 18 | 8.5 | 1.5 | 9.9 |
| Under consideration | | | | |
| Bangladesh | 25 | 0.3 | 2.7 | 3.0 |
| Bolivia | 32 | 0.2 | 0.3 | 0.5 |
| Caricom | 12 | 7.2 | 9.9 | 17.1 |
| Egypt | 23 | 3.2 | 2.1 | 5.3 |
| Indonesia | 14 | 3.0 | 12.0 | 15.1 |
| Malaysia | 5 | 10.5 | 33.7 | 44.2 |
| New Zealand | 22 | 2.6 | 3.2 | 5.8 |
| Pakistan | 24 | 1.2 | 3.3 | 4.5 |
| Philippines | 13 | 6.9 | 9.2 | 16.1 |
| Qatar | 28 | 1.0 | 0.4 | 1.4 |
| South Korea | 3 | 27.7 | 43.8 | 71.4 |
| Switzerland | 10 | 10.7 | 13.0 | 23.7 |
| Taiwan | 4 | 22.0 | 34.8 | 56.9 |

a. Ranking based on two-way trade.

Source: US Department of Commerce, TradeStats Express, 2006.

Table 1A.3 US trade in services, 2004 (billions of dollars)

| Partner | Rank ^a | US exports | US imports | Two-way trade |
|----------------------|-------------------|------------|------------|---------------|
| Current partner | | | | |
| Australia | 4 | 6.9 | 3.9 | 10.7 |
| Bahrain | n.a. | n.a. | n.a. | n.a. |
| Canada | 1 | 30.0 | 20.0 | 50.0 |
| Chile | 11 | 1.1 | 0.7 | 1.8 |
| Israel | 7 | 2.6 | 2.2 | 4.8 |
| Jordan | n.a. | n.a. | n.a. | n.a. |
| Mexico | 2 | 18.0 | 13.5 | 31.4 |
| Morocco | n.a. | n.a. | n.a. | n.a. |
| Singapore | 6 | 5.6 | 2.7 | 8.3 |
| To be ratified | | | | |
| CAFTA | n.a. | n.a. | n.a. | n.a. |
| Colombia | n.a. | n.a. | n.a. | n.a. |
| Dominican Republic | n.a. | n.a. | n.a. | n.a. |
| Oman | n.a. | n.a. | n.a. | n.a. |
| Peru | n.a. | n.a. | n.a. | n.a. |
| Under negotiation | | | | |
| Ecuador | n.a. | n.a. | n.a. | n.a. |
| Panama | n.a. | n.a. | n.a. | n.a. |
| SACU-5 ^b | 10 | 1.3 | 1.1 | 2.4 |
| Thailand | 12 | 1.1 | 0.7 | 1.8 |
| United Arab Emirates | n.a. | n.a. | n.a. | n.a. |
| Under consideration | | | | |
| Bangladesh | n.a. | n.a. | n.a. | n.a. |
| Bolivia | n.a. | n.a. | n.a. | n.a. |
| Caricom | n.a. | n.a. | | n.a. |
| Egypt | n.a. | n.a. | n.a. | n.a. |
| Indonesia | 14 | 1.1 | 0.3 | 1.4 |
| Malaysia | 13 | 1.2 | 0.6 | 1.8 |
| New Zealand | 9 | 1.1 | 1.3 | 2.5 |
| Pakistan | n.a. | n.a. | n.a. | n.a. |
| Philippines | 8 | 1.5 | 1.7 | 3.3 |
| Qatar | na | n.a. | n.a. | n.a. |
| South Korea | 3 | 9.1 | 4.8 | 13.9 |
| Switzerland | 5 | 8.7 | 8.3 | 8.8 |
| Taiwan | n.a. | n.a. | n.a. | n.a. |

n.a. = not available

a. Based on two-way trade; rank positions exclude countries for which information is not available.

b. Using data for South Africa.

Source: US Bureau of Economic Analysis (2006).

Table 1A.4 Simple average MFN tariff rates, 2003–04 (ad valorem)

| Partner | Agricultural | | | Nonagricultural | | |
|--------------------------|--------------|---------|------|-----------------|---------|------|
| | Bound | Applied | Rank | Bound | Applied | Rank |
| Current | | | | | | |
| Australia | 3.2 | 1.1 | 2 | 11.0 | 4.6 | 8 |
| Bahrain | 37.5 | 9.0 | 9 | 35.1 | 7.6 | 17 |
| Canada | 3.5 | 3.1 | 5 | 5.3 | 4.2 | 6 |
| Chile | 26.0 | 6.0 | 7 | 25.0 | 5.9 | 13 |
| Israel | 73.0 | 15.9 | 19 | 9.2 | 4.0 | 4 |
| Jordan | 23.7 | 19.8 | 23 | 19.8 | 12.1 | 24 |
| Mexico | 35.1 | 24.5 | 27 | 34.9 | 17.1 | 28 |
| Morocco | 54.5 | 48.6 | 30 | 39.2 | 27.5 | 31 |
| Singapore | 9.5 | 0.0 | 1 | 6.3 | 0.0 | 1 |
| To be ratified | | | | | | |
| CAFTA ^a | 42.3 | 10.5 | 14 | 38.2 | 5.7 | 11 |
| Colombia | 91.9 | 14.9 | 15 | 35.4 | 11.9 | 23 |
| Dominican Republic | 39.6 | 13.0 | 16 | 34.2 | 7.8 | 18 |
| Oman ^b | 28.0 | 10.2 | 13 | 11.6 | 5.0 | 9 |
| Peru | 30.8 | 17.2 | 21 | 30.0 | 13.1 | 25 |
| Under negotiation | | | | | | |
| Ecuador | 25.5 | 14.7 | 17 | 21.1 | 11.5 | 22 |
| Panama | 27.7 | 14.8 | 18 | 22.9 | 7.4 | 16 |
| SACU-5 ^c | 39.2 | 9.1 | 10 | 15.8 | 5.3 | 10 |
| Thailand | 35.5 | 29.0 | 28 | 24.2 | 14.2 | 26 |
| United Arab Emirates | 25.4 | n.a. | n.a. | 13.1 | n.a. | n.a. |
| Under consideration | | | | | | |
| Bangladesh | 188.5 | 21.7 | 25 | 35.7 | 19.2 | 29 |
| Bolivia | 40.0 | 10.0 | 12 | 40.0 | 9.3 | 20 |
| Caricom ^d | 98.0 | 18.4 | 22 | 51.2 | 11.1 | 21 |
| Egypt | 95.3 | 22.8 | 26 | 28.3 | 19.4 | 30 |
| Indonesia | 47.0 | 8.2 | 8 | 35.6 | 6.7 | 14 |
| Malaysia | 12.2 | 2.1 | 4 | 14.9 | 8.1 | 19 |
| New Zealand | 5.7 | 1.7 | 3 | 11.0 | 3.5 | 4 |
| Pakistan | 97.1 | 20.4 | 24 | 35.3 | 16.6 | 27 |
| Philippines | 34.7 | 8.0 | 7 | 61.8 | 4.3 | 7 |
| Qatar | 25.7 | 4.9 | 6 | 14.5 | 4.1 | 5 |
| South Korea | 52.9 | 52.1 | 31 | 10.2 | 7.0 | 15 |
| Switzerland ^e | n.a. | 36.2 | 29 | n.a. | 2.3 | 2 |
| Taiwan | 15.3 | 16.3 | 20 | 4.8 | 5.5 | 12 |
| US comparison | 6.9 | 9.8 | 11 | 3.2 | 3.3 | 3 |

n.a. = not available

a. Simple average of observations for Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

b. Data for 2001.

c. Using South Africa's average bound tariff. Tariff binding figures are based on simple averages of national averages reported by the World Trade Organization (WTO) and exclude Lesotho.

d. Simple averages of observations reported by the WTO for each Caricom member.

e. Using ad valorem equivalent (AVE) for specific tariffs.

Source: WTO (2004a).

Table 1A.5 Corruption and economic freedom

| Partner | Corruption | | Economic freedom | | |
|----------------------|--------------------------|------|-----------------------------|---|--------------|
| | Index, 2005 ^a | Rank | Heritage, 2005 ^b | World Economic Forum, 2005 ^c | Average rank |
| Current | | | | | |
| Australia | 8.8 | 4 | 4.2 | 5.2 | 5 |
| Bahrain | 5.8 | 10 | 3.9 | 4.5 | 9 |
| Canada | 8.5 | 5 | 4.1 | 5.1 | 6 |
| Chile | 7.4 | 6 | 4.2 | 4.9 | 7 |
| Israel | 6.4 | 7 | 3.6 | 4.8 | 11 |
| Jordan | 5.3 | 12 | 3.2 | 4.3 | 14 |
| Mexico | 3.6 | 20 | 3.1 | 3.9 | 17 |
| Morocco | 3.2 | 23 | 2.8 | 3.5 | 23 |
| Singapore | 9.3 | 2 | 4.4 | 5.5 | 1 |
| To be ratified | | | | | |
| CAFTA | 3.2 | 23 | n.a. | n.a. | n.a. |
| Colombia | 3.8 | 19 | 2.8 | 3.8 | 20 |
| Dominican Republic | 2.9 | 26 | 2.5 | 3.1 | 26 |
| Oman | 6.1 | 8 | 3.2 | n.a. | n.a. |
| Peru | 3.5 | 22 | 3.2 | 3.7 | 19 |
| Under negotiations | | | | | |
| Ecuador | 2.4 | 28 | 2.5 | 3.0 | 28 |
| Panama | 3.7 | 18 | 3.3 | 3.6 | 18 |
| SACU-5 ^d | 4.9 | 15 | 3.2 | 4.3 | 15 |
| Thailand | 3.6 | 20 | 3.0 | 4.5 | 16 |
| United Arab Emirates | 6.1 | 8 | 3.3 | 5.0 | 12 |
| Under consideration | | | | | |
| Bangladesh | 1.5 | 32 | 2.0 | 2.9 | 29 |
| Bolivia | 2.2 | 29 | 3.3 | 3.1 | 21 |
| Caricom | 4.0 | 17 | n.a. | n.a. | n.a. |
| Egypt | 3.2 | 23 | 2.6 | 4.0 | 22 |
| Indonesia | 2.0 | 31 | 2.5 | 3.5 | 25 |
| Malaysia | 5.0 | 14 | 3.0 | 4.9 | 13 |
| New Zealand | 9.6 | 1 | 4.3 | 5.1 | 4 |
| Pakistan | 2.1 | 30 | 2.3 | 3.3 | 27 |
| Philippines | 2.6 | 27 | 2.7 | 3.5 | 24 |
| Qatar | 5.2 | 13 | 2.9 | n.a. | n.a. |
| South Korea | 4.5 | 16 | 3.4 | 5.1 | 10 |
| Switzerland | 9.1 | 3 | 4.1 | 5.5 | 3 |
| Taiwan | 5.6 | 11 | 3.7 | 5.6 | 8 |
| US comparison | 7.5 | 6 | 4.1 | 5.8 | 2 |

n.a. = not available

a. Countries with high score are the most transparent (i.e., high score is better).

b. Heritage index scores were rescaled so that 5 = economically free and 1 = economically unfree.

c. High score = economically more free.

d. Using data for South Africa.

Sources: Transparency International (2005); Heritage Foundation (2005); and WEF (2006).

Table 1A.6 Environmental standards

| Partner | ESI rank 2005 ^a | ESI ^b | CO ₂ emissions damage ^c | Protected areas ^d | Environmental compliance ^e | Treaty ^f |
|----------------------|----------------------------|------------------|---|------------------------------|---------------------------------------|---------------------|
| Current | | | | | | |
| Australia | 3 | 61.0 | Medium | Medium | Medium | High |
| Bahrain | n.a. | n.a. | Low | Low | n.a. | Low |
| Canada | 1 | 64.4 | High | Low | High | High |
| Chile | 10 | 53.6 | Medium | Medium | Medium/high | High |
| Israel | 12 | 50.9 | High | Medium | Medium | Medium |
| Jordan | 18 | 47.8 | Low | Medium | Medium/high | Medium |
| Mexico | 19 | 46.2 | High | Low | Medium | Medium/high |
| Morocco | 20 | 44.8 | Medium | Low | Medium/low | High |
| Singapore | 13 | 50.0 | Medium | Low | High | Low |
| To be ratified | | | | | | |
| CAFTA | 15 | 49.0 | High | Medium | Low | Medium |
| Colombia | 7 | 58.9 | High | High | Medium | Medium/high |
| Dominican Republic | 25 | 43.7 | Medium | High | Med/low | Medium |
| Oman | 17 | 47.9 | Medium | Medium | Medium/low | Medium/low |
| Peru | 5 | 60.4 | High | Medium | Low | Medium/high |
| Under negotiation | | | | | | |
| Ecuador | 12 | 52.4 | Low | High | Low | Medium/high |
| Panama | 8 | 57.7 | Medium | High | Medium/low | Medium/high |
| SACU-5 | 11 | 52.9 | Medium | Medium | Medium | Medium/low |
| Thailand | 14 | 49.7 | Low | Medium | Medium | Medium |
| United Arab Emirates | 21 | 44.6 | Low | Low | n.a. | Medium/low |

| Under consideration | | | | | | | | | | |
|---------------------|------|------|--------|--------|-------------|-------------|-------------|--|--|--|
| Bangladesh | 23 | 44.1 | High | Low | Low | Low | Medium/low | | | |
| Bolivia | 6 | 59.5 | Low | Medium | Low | Low | Medium | | | |
| Caricom | 27 | 41.0 | Medium | Low | Medium | Medium | High | | | |
| Egypt | 24 | 44.0 | Low | Medium | Low | Medium/low | Medium | | | |
| Indonesia | 16 | 48.8 | Medium | Low | High | Medium/high | Medium | | | |
| Malaysia | 9 | 54.0 | Low | High | Medium | High | Medium/high | | | |
| New Zealand | 4 | 60.9 | High | Low | Low | Low | Medium | | | |
| Pakistan | 28 | 39.9 | Low | Medium | Low | Low | Low | | | |
| Philippines | 22 | 44.3 | Medium | Low | Low | Low | Medium/High | | | |
| Qatar | n.a. | n.a. | Low | Low | n.a. | n.a. | Low | | | |
| South Korea | 26 | 43.0 | Medium | Low | High | Medium/high | High | | | |
| Switzerland | 2 | 63.7 | High | Low | Low | High | High | | | |
| Taiwan | 29 | 32.7 | Medium | Low | Medium/high | Medium/high | Low | | | |
| US comparison | 11 | 52.9 | High | High | High | Medium | High | | | |

ESI = Environmental Sustainability Index

n.a. = not available

a. Low rank = poor environmental standards. Higher score indicates higher environmental standards.

b. Countries high on the ESI have high environmental standards.

c. High = CO₂ damage < 0.5 percent, medium = CO₂ damage > 0.5 percent and < 1 percent, low = CO₂ damage > 1 percent.

d. Ratio of protected area to total area: High = ratio > 0.2, medium = ratio > 0.1 and < 0.2, low = ratio < 0.1.

e. High = compliance score > 5.8, medium/high = compliance < 5.8 and > 4.6, medium = compliance < 4.6 and > 4.0, medium/low = compliance > 3.6 and < 4.0, low = compliance < 3.6.

f. High = 120+ treaties, medium/high = 80 to 120, medium = 60 to 80, medium/low = 50 to 60, low = less than 50.

Sources: 2005 Environmental Sustainability Index of the Environmental Performance Measurement Project (Yale University, Columbia University, and the World Economic Forum); Environmental Treaties and Resource Indicators (ENTRI) for Treaties Participation, <http://sedac.ciesin.columbia.edu/entri>; WEF (2006); World Bank, *World Development Indicators*, 2005; United Nations, *Environmental Statistics for Protected Areas*, 2002.

Table 1A.7 Labor standards

| Partner | Rank, 2004 | Index^a | Right of association | Forced labor | Child labor | Working conditions | Conventions ratified^b |
|----------------------|-------------------|--------------------------|-----------------------------|---------------------|--------------------|---------------------------|---|
| Current | | | | | | | |
| Australia | 2 | 4.8 | High | High | High | Medium/high | High |
| Bahrain | 19 | 2.6 | Medium | Medium | Medium | Medium | Low |
| Canada | 4 | 4.4 | High | Medium/high | High | High | Medium |
| Chile | 4 | 4.4 | Med/high | High | Medium/high | Medium/high | High |
| Israel | 6 | 4.0 | Medium | High | High | Medium | Medium/high |
| Jordan | 13 | 3.0 | Medium | Medium | Medium/high | Medium/low | Medium |
| Mexico | 8 | 3.6 | High | Medium | Medium | Medium | High |
| Morocco | 19 | 2.6 | Medium/low | Medium | Medium | Low | Medium/high |
| Singapore | 7 | 3.8 | Medium | High | Medium/high | Medium/high | Medium |
| To be ratified | | | | | | | |
| CAFTA | 8 | 3.6 | Medium | Medium/high | Medium/high | Medium | Medium/high |
| Colombia | 13 | 3.0 | Medium/low | Medium/high | Medium/low | Medium/low | High |
| Dominican Republic | 24 | 2.0 | Medium/low | Medium | Low | Low | Medium |
| Oman | 22 | 2.2 | Medium | Medium | High | Medium | Low |
| Peru | 13 | 3.0 | Medium | Medium | Medium/low | Medium/low | High |
| Under negotiation | | | | | | | |
| Ecuador | 16 | 2.8 | Medium/low | Medium | Medium/low | Medium/low | High |
| Panama | 12 | 3.2 | Medium | Medium | Medium/low | Medium | High |
| SACU-5 | 27 | 1.8 | Low | Medium | Low | Low | Medium |
| Thailand | 30 | 1.4 | Medium/low | Low | Low | Medium/low | Low |
| United Arab Emirates | 22 | 2.2 | Medium | Medium | Medium/high | Medium | Low |

| | | | | | | | | | | | | | |
|---------------------|----|-----|-------------|------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Under consideration | | | | | | | | | | | | | |
| Bangladesh | 30 | 1.4 | Medium/low | Low | Low | Low | Low | Low | Low | Low | Medium | Medium/high | Medium |
| Bolivia | 24 | 2.0 | Medium/low | Low | Low | Medium/low | Medium/high | Medium/low | Medium/high | Medium/low | Medium/high | Medium | Medium/high |
| Caricom | 8 | 3.6 | Medium/high | High | Medium/high | Medium/high | Medium/high | Medium/high | Medium/high | Medium/high | Medium/high | Medium | High |
| Egypt | 16 | 2.8 | Medium/low | Medium | Medium | Medium/low | Low | Medium | Medium | Medium | High | Low | Low |
| Indonesia | 24 | 2.0 | Medium | Medium/low | Medium/low | Medium/low | Low | Medium | Medium | Medium | Medium | Medium | Medium |
| Malaysia | 19 | 2.6 | Medium/low | Medium/low | Medium/low | Medium/low | High | High | High | High | High | High | High |
| New Zealand | 2 | 4.8 | Medium/high | High | High | High | Low | Low | Low | Low | Medium/low | Medium/low | Medium |
| Pakistan | 30 | 1.4 | Medium/low | Low | Low | Low | Low | Low | Low | Low | Medium/low | Medium/low | Medium |
| Philippines | 29 | 1.6 | Medium | Medium | Medium | Medium | Low | Low | Low | Low | Medium | Medium | Medium |
| Qatar | 27 | 1.8 | Low | Low | Low | Medium/low | Medium/high | Medium/high | Medium/high | Medium/high | Low | Low | Low |
| South Korea | 11 | 3.4 | Medium | Medium | Medium | Medium/high | Medium/high | Medium/high | Medium/high | Medium | Medium | Medium | Medium |
| Switzerland | 1 | 5.0 | High | High | High | High | High | High | High | High | High | High | High |
| Taiwan | 16 | 2.8 | Medium/low | Medium | Medium | Medium/high | Medium/high | Medium/high | Medium/high | Medium/low | Medium/low | Medium | Medium |
| US comparison | 5 | 4.2 | High | High | High | High | High | High | High | High | High | High | Low |

Note: Methodology for labor indicators:

1. Collective bargaining, right of association, and labor strikes

Low: Collective bargaining, strikes, and right of association are all prohibited.

Medium/low: Some prohibited or government approval needed.

Medium: Not prohibited and no authorization requirements, but rights are not enforced or widespread antiunion discrimination.

Medium/high: Not prohibited and labor rights are enforced most of the time.

High: All allowed and labor rights enforced.

(table continues next page)

Table 1A.7 Labor standards (continued)

| |
|---|
| <p>2. Forced labor</p> <p><i>Low:</i> Pervasive forced labor.</p> <p><i>Medium/low:</i> Law prohibits forced labor but certain foreigners and local groups are consistently subject to forced labor.</p> <p><i>Medium:</i> Forced labor is prohibited but some cases are reported.</p> <p><i>Medium/high:</i> Rare cases of forced labor reported.</p> <p><i>High:</i> No cases of forced labor are reported.</p> |
| <p>3. Child labor</p> <p><i>Low:</i> Pervasive (child labor exceeds 8 percent of the age group).</p> <p><i>Medium/low:</i> Prohibited, but in different sectors of the economy child labor represents 2 percent to 8 percent of the age group.</p> <p><i>Medium:</i> Prohibited, but some cases are reported in the informal sector (child labor 0 percent to 2 percent of the age group).</p> <p><i>Medium/high:</i> Prohibited, but rare cases of child labor are reported.</p> <p><i>High:</i> No child labor reported.</p> |
| <p>4. Working conditions</p> <p><i>Low:</i> Working standards not enforced, substandard living conditions, lack of protections, abuse, and labor law violations.</p> <p><i>Medium/low:</i> Labor laws exist but not well enforced regarding protection, safety and health standards, and working hours.</p> <p><i>Medium:</i> Working conditions acceptable, usually with acceptable safety and health standards, and premium for longer hours.</p> <p><i>Medium/high:</i> Most working conditions are satisfied.</p> <p><i>High:</i> All working conditions are satisfied.</p> <p>a. Low rank = low labor standards. Higher score indicates better labor standards.</p> <p>b. International Labour Organization (ILO) conventions ratified: high = ratified conventions > 50, medium high = ratified conventions > 40 and < 50, medium = ratified conventions > 20 and < 40, low = ratified conventions < 20.</p> |

Sources: Based on WTO and US Department of State (Bureau of Democracy, Human Rights, and Labor) country reports; World Bank, *World Development Indicators*; and ILO databases.