Coalition of Services Industries (CSI) Submission:
Comments for the Initiation of Country Practice Review of Indonesia
Docket Number USTR-2018-0007

Overview

The Coalition of Services Industries (CSI) appreciates the opportunity to submit comments identifying trade-distorting investment practices and barriers to trade in services to the Office of the United States Trade Representative to assist in the preparation of the country practice review of Indonesia and the Generalized System of Preferences (GSP) criteria.

CSI, established in 1982, is the leading industry association devoted exclusively to helping America's services businesses, which are increasingly digitally enabled services, and workers compete in world markets. CSI member companies represent a broad spectrum of the U.S. services sector including distribution services, express delivery, financial services, media and entertainment, telecommunications, information and communication technology services, and professional services. These services are a critical enabler for U.S. economic growth.

With services accounting for over 75 percent of the American workforce and nearly 80 percent of U.S. gross domestic product (GDP), services, including digitally enabled services, are a part of and enable every single sector, from manufacturing to agriculture.[1] Nearly 10 million U.S. services sector jobs are directly supported by U.S. services trade and investment.[2] These services allow all businesses to be more productive, reach more customers in more foreign markets, and ultimately, support a better livelihood through higher wages and greater opportunities.

The growth of services trade has been facilitated by the emergence of the internet, the rise of digital technologies, and the proliferation of cross-border data flows. Digital tools and the free flow of data have enabled businesses of all sizes and in all sectors to operate globally in an efficient and secure manner. This means companies can not only easily integrate staff around the world, maintain their customer networks, but also can, through digital marketplaces, tap into foreign markets and receive payment from customers. Having grown by 45 times since 2005, and will have grown by another nine times by 2020, data flows now hold more economic value than the global goods trade.[3] Data flows are building blocks for current and future technological advances, such as cloud computing, the Internet of Things, and Artificial Intelligence, all of which are and will be critical to the future of services trade.[4]

Services, especially digital services, are also a major democratizing force in global trade. Online marketplaces give small businesses access to customers around the world, and software and other cloud technologies make them more efficient. By allowing companies of all sizes to participate in trade, services are making trade more inclusive, which is key to responding to the growing challenges to globalization and trade. Further, services will support further progress in this area: a recent study by the Boston Consulting Group found that if more small and medium-sized enterprises in the United States used the full range of available digital tools, these businesses could hire 2.1 million employees and inject $357 billion into the economy.[5]

While the United States is the world's leading exporter of services, its position, however, is not guaranteed. Significant barriers remain for U.S. services firms operating around the world. These barriers include forced data localization, equity cap limitations, mandatory cessions and preferences given to domestic "champions," all of which is currently faced by U.S. services providers operating in Indonesia. Further, because of the important role that data plays in a modern, competitive economy, restrictions on data flows, information and communications technologies (ICT), and related services also obstruct U.S. services firms from effectively accessing foreign markets. These policies impede the ability of all U.S. services firms to supply cross-border services and make investments. The inability to operate cross-border, the loss of efficiency, and increase in costs, ultimately reduce U.S. competitiveness.

Looking ahead, addressing these services and investment barriers within Indonesia and more broadly are necessary to advance the U.S. economy. Eliminating such barriers could increase U.S. services exports by as much as $1.4 trillion and support as many as 3 million new jobs in the United States.[6] Current and prospective trade and investment agreements, to which the United States is and/or could be party to, represent a significant opportunity to further boost U.S. services trade and investment worldwide. By facilitating stronger services trade and investment flows with other countries, these agreements can, in turn, support more jobs and contribute to increased growth. As a result of the non-discriminatory treatment and transparency provided under such agreements, U.S. services firms, both large and small, have greater access to overseas markets and are able to compete on a level playing field. Further, these agreements promote U.S. competitiveness by encouraging the participation of services firms in global value chains (GVCs). Additionally, the World Trade Organization (WTO) has been and continues to the foundation of multilateral trade rules, which are central to transparent, fruitful trading relationships and the continued growth of services trade. CSI members are longstanding supporters of the WTO, including the General Agreement on Trade in Services (GATS), which created rules and a minimum level of market access that has been the starting point for deepening trade relations bilaterally and through broader trade agreements. The WTO also established a set of principles that created an environment of nondiscriminatory treatment for both services and goods trade, such as the most favored nation and national treatment guidelines, which provide for equal treatment for all participants, foreign or domestic.

Pursuant to the Federal Register Notice, CSI providing a summary of the current trade and investment environment faced by U.S. services providers in Indonesia. We present services trade and investment data, outlining the benefits that this trade has generated for U.S. services firms and the overall U.S. economy, while also highlighting the trade and investment currently faced when operating in the Indonesia market.

Indonesia

In services, the United States has maintained a services trade surplus with Indonesia since 1999 (first data available). In 2016 (latest data available), U.S. services exports to Indonesia were $2.361 billion, while U.S. imports were $908 million, resulting in a $1.453 billion trade surplus in services, lower than the 2015 surplus of $1.7 billion.[7]

Looking at specific sectors, U.S. services have seen strong performances in transport, financial services, licensing and intellectual property fees, telecommunications, and business. A few years ago, the United States exported no financial services to Indonesia; now the U.S. exports approximately $280 million.

The growth is even more stark with business services, which includes accounting, architectural services, consulting, and other professional services. In 2016, the U.S. exported $529 million worth of business services, making it one of the largest type of U.S. service export in Indonesia, followed by intellectual property fees, which amounted to $269 million. Services exports in the telecommunications and computer sectors, maintenance sector, and transport sector were also strong as of 2016.[8] U.S. trade in ICT and potentially ICT-enabled services is also significant, amounting to $141 million in exports in 2016.

As a result of the WTO GATS, Indonesia:

- Increased market access in cross-border supply, specifically in business services and tourism.
- Opened consumption abroad and, in most sectors, there are few restrictions.
- Substantially increased commercial presence, even though there are a few limitations on foreign investment ownership, especially in telecom.
- Lifted temporary entry barriers.

Despite this promising picture, impediments to services trade exist. Most notably, the ongoing and problematic Regulation 82 Year 2012included data server localization requirements and data flow prohibitions. In addition, the banking regulator has sought to impose its own data server localization requirements. The current amendment to Regulation 82 calls for data to be classified into three classifications, strategic, high-risk, and low-risk. Under this approach, the assumption are companies operating commercially would not be required to store or process data in Indonesia as they generally fall into the "high-risk" category. Unfortunately, these improvements have not been finalized and more troubling is the fact that Ministry of Communication and Informatic may be considering permitting individual ministries or regulators to adopt their own requirements re-opening the door to data localization requirements in specific sectors. Data localization requirements do not make data more secure or safer and, in fact, expose companies to greater cyber security risks by undermining the protections offered under their global platforms. Further, the Ministry of Communication and Information Technology (MCIT) is considering two other implementing regulations to Regulation 82, including (1) information security management; and (2) software used in electronic systems. If implemented, these regulations would require the disclosure of software source code by electronic system providers responsible for managing or operating computer systems used in connection with public services, further undermining the security and intellectual property rights of global companies operating in Indonesia.[9]

Other impediments in Indonesia include:

- **Media:** Indonesia maintains extensive foreign investment restrictions in the media sector, including a 20% cap on foreign ownership of broadcast TV stations. Indonesian law technically imposes a 60-percent local content requirement in films, though it has not been enforced in practice. It is considering regulations that would restate the quota and, to achieve that quota, "also provides authority to implement unspecified import restrictions, prohibitions against the dubbing of foreign films, and prohibitions against foreign companies distributing or exhibiting films."[10] Indonesia's proposals for online video services (permanent establishment, local payment processors, localize data) would all limit market access for U.S. online video service providers.
- **Online Retail:** Foreign ownership restrictions generally prevent U.S. firms from participating in online retail in Indonesia. In some limited circumstances, foreign-owned enterprises may partner with an Indonesian firm to resell a small range of enumerated products, which does not include food, apparel, or housewares.
- **Electronic Payment Services:** Over the past several years, Indonesia has adopted a series of measures that prohibit cross-border electronic payment systems and require payment processing to take place locally. These measures, including Bank Indonesia (BI) Circular 17/52/2015, BI Regulation 18/40/2016, and Financial Services Authority (OJK) Regulation no. 38/2016, present substantial challenges to the continuation of U.S. electronic payment companies' business in Indonesia. Moreover, the recently passed National Payment Gateway regulation (BI Regulation 19/8/2017 and BI implementing guidelines 19/10/2017), which caps foreign ownership at 20 percent, will make it economically infeasible for U.S. payments companies to compete with local companies for domestic business, and would effectively require U.S. companies to relinquish control over ownership, pricing, branding, and rules to local entities.

- **Express Delivery:** The postal law of 2009 restricts courier services to JVs with a maximum of 49 percent foreign ownership and further prevents foreign express delivery firms from conducting the last-mile delivery unless they outsource to a third party. “Postal services” include the transport and delivery of written and/or electronic communication services, packages services, logistics services, financial transactions services and postal agency services. Under Indonesia’s foreign ownership regulations, a Foreign Investment Company (Perusahaan Penanaman Modal Asing or “PMA Company”), in which a foreigner can legally hold shares and engaging in domestic postal services activities/ courier services, has a 49 percent Foreign Ownership Restriction. This requires “Indonesian parties” (i.e., Indonesian nationals or Indonesian, non-PMA Companies wholly owned by Indonesian nationals) to own not less than 51 percent of the issued shares of a PMA Company providing domestic courier services/postal services without regard to the voting and dividend rights attached to the issued shares held by the Indonesian parties.”
- **Insurance:** Indonesia has recently imposed many new trade restrictive measures on foreign insurers and reinsurers, including 100 percent mandatory cessions to the domestic reinsurers, the implementation of forced localization of data processing in October 2017, and the recent announcement that foreign insurers who have received regulatory approval to own more than 80 percent equity will in the course of their future expansion have to reduce their ownership stakes to 80 percent.
- **Legal Services:** Only Indonesian citizens may be licensed as lawyers in Indonesia.[11]
- **Transport:** The foreign ownership limit for freight forwarding is 67 percent, while express delivery is restricted to 49 percent.
- **Regulation of “Over-the-Top” Providers:** There is increasing interest by foreign governments in subjecting U.S. online services and applications to heavy-handed regulations that impede their cross-border delivery. These measures – often called “Over-the-Top” or “OTT” regulations in foreign markets – take different forms globally. However, it is increasingly common for regulators to seek to impose regulations on online services and applications that only serve to impede development of the digital economy. Some of these objectionable proposals include local presence, and local data storage and/or data retention requirements. Governments should reduce or streamline regulations, where appropriate, on OTT services in order to stimulate competition and greater investment in broadband infrastructure while enabling innovative new services to reach consumers. Additionally, governments should reduce or streamline regulations, where appropriate, on traditional services providers as markets become more competitive due to the introduction of new digital services and other technological changes. In many cases, the rationale behind these legacy regulations has become obsolete due to technologically-driven changes to the marketplace.
- **Digital tax**: We are concerned by attempts by Indonesia to introduce new taxes on the digital sector. Any new taxation measures should be broad-based and not discriminate against a particular mode of delivery or a particular type of business model. Increasing the cost of providing digital goods and services to Indonesians will hurt the local economy. Any new international tax measures should be agreed at the international level and not implemented unilaterally.
- **Customs Duty Moratorium**: We are very concerned by the introduction of Regulation 17, providing for a new Chapter 99 to the Indonesian tariff system assigning HS numbers

to digital goods and services, although charging zero duties. Creating a framework for future charge of duties on digital goods and services would set a dangerous precedent. Revenue raised via such a measure would be in contravention of the WTO moratorium on customs duties on electronic transmissions and would be a significant impediment to U.S. services exports to Indonesia.

These impediments, including the potential for data localization requirements and restrictions on cross-border data flows, are inconsistent with Indonesia's commitments to abide by the criteria set out under the GSP. CSI encourages the Administration, in consultation with stakeholders, to set out a strategy and framework for negotiations, coupled with specific deadlines for achieving results, that would demand action from Indonesia on these significant barriers faced by U.S. services providers operating in country. CSI and its members stand ready to work with the Administration in crafting a comprehensive and transparent approach to secure commitments from Indonesia to liberalize its services markets and refrain from potential protectionist measures on the transfer and storage of data.

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[1] Coalition of Services Industries (CSI) Testimony to the U.S. International Trade Commission (ITC), "Global Digital Trade I: Market Opportunities and Key Foreign Trade Restrictions," April 2017.

[2] Coalition of Services Industries (CSI) Testimony to the U.S. International Trade Commission (ITC), "Global Digital Trade I: Market Opportunities and Key Foreign Trade Restrictions," April 2017.

[3] James Manyika, Susan Lund, Jacques Bughin, Jonathan Woetzel, Kalin Stamenov, and Dhruv Dhingra, "Digital globalization: The new era of global flows," McKinsey Global Institute, February 2016, http://www.mckinsey.com/business-functions/digital-mckinsey/our-insights/digital-globalization-the-new-era-of-global-flows.

[4] Klaus Schwab, "The Fourth Industrial Revolution: what it means, how to respond," *World Economic Forum*, January 14, 2016, https://www.weforum.org/agenda/2016/01/the-fourth-industrial-revolution-what-it-means-and-how-to-respond/.

[5] David C. Michael, Neeraj Aggarwal, Derek Kennedy, John Wenstrup, Michael Rüßmann, Ruba Borno, Julia Chen, and Julio Bezerra, "Lessons on Technology and Growth from Small-Business Leaders; Ahead of the Curve," Boston Consulting Group, October 5, 2013, https://www.bcgperspectives.com/content/articles/technology_software_globalization_ahead_curve_lessons_technology_growth_s mall_business_leaders/.

[6] J. Bradford Jensen, Global Trade in Services: Fear, Facts, and Offshoring, Peterson Institute for International Economics: September 2011.

[7] Bureau of Economic Analysis, "Table 2.3. U.S. Trade in Services, by Country or Affiliation and by Type of Service," Indonesia, December 19, 2016, https://www.bea.gov/itable/.

[8] Bureau of Economic Analysis, "Table 2.3. U.S. Trade in Services, by Country or Affiliation and by Type of Service," Indonesia, December 19, 2016, https://www.bea.gov/itable/.

[9] Business Software Alliance (BSA), "Special 301 Submission," February 8, 2018, http://www.bsa.org/~/media/Files/Policy/Trade/BSA2018Special301.pdf/

[10] Executive Office of the President, Office of the U.S. Trade Representative, "2017 National Trade Estimate," Indonesia, March 2017, https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2017/2017-national-trade-estimate, 227.

[11] Executive Office of the President, Office of the U.S. Trade Representative, "2017 National Trade Estimate," Indonesia, March 2017, https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2017/2017-national-trade-estimate, 229.