

## Toward a US-Indonesia Free Trade Agreement

Policy Analyses in International Economics 83

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A US-Indonesia free trade agreement (FTA) could anchor and reinforce the reform process already under way in Indonesia and create better jobs, raise living standards, and help stymie Islamic radicalism. It would be another building block in US commercial strategy toward Southeast Asia.

Indonesia occupies an intermediate position among current and prospective US FTA partners in terms of the intensity of bilateral trade and investment relations. Such a position favors a US-Indonesia FTA because, when two countries have important commercial and investment links, not only do business firms have a tangible reason to support the FTA but also the prospects are much better for a substantial increase in bilateral trade and investment.

Both countries retain significant trade barriers, and Indonesia has important investment barriers. An FTA could substantially expand commerce between the United States and Indonesia, stimulate investment in Indonesia, and deliver economic benefits to the Indonesian people. Gravity model analysis suggests that eliminating all bilateral barriers between Indonesia and the United States could expand overall US-Indonesia merchandise trade by about 40 percent. A computable general equilibrium analysis suggests that a US-Indonesia FTA could improve economic performance in Indonesia, resulting in annual gains of around 0.6 percent of GDP.

The authors recognize that strategic and political considerations will ultimately determine the course and outcome of FTA talks between Indonesia and the United States. They therefore recommend that the two countries consider a stepping-stone approach, which might enable the countries to resolve issues one at a time, building trust as they go along, rather than confronting all questions in a single big package. The stepping-stone approach would entail ministerial dialogues to address specific issues under the existing trade and investment framework agreement:

- **Customs facilitation.** Improved customs facilitation is crucial for enhanced Indonesian access to the US market, and vice versa. For this to happen, US security concerns must be answered.

- **Behind-the-border protection.** Regulations on product labeling, sanitary and phytosanitary standards, technical standards, and professional accreditation increase the cost of market access for US and Indonesian suppliers alike. Working committees could gradually reach agreement on common standards or mutual recognition of different standards.
- **Intellectual property rights (IPR).** Indonesia should work closely with the United States to enforce its own IPR laws and to resolve the sensitive issues surrounding pharmaceutical and educational materials. Indonesia will need to cut the supply chains that feed counterfeit products to the market. Compulsory licensing and parallel imports should be confined to specific products, and the list of eligible items should become progressively shorter over time. The United States should extend technical assistance to improve Indonesia's patent and copyright offices.
- **Bilateral investment treaty (BIT).** The United States will view Indonesia's willingness to sign a BIT as a litmus test for the nation's ability to negotiate an FTA. A BIT will commit Indonesia to ensure minimal business conditions at both the central and provincial levels, requiring a political agreement between central ministries and provincial governors.

For both parties, a US-Indonesia FTA is worth pursuing for political as well as economic reasons. If a full-blown FTA is not possible in the near future, a sequential approach could still pay off in creating opportunities for American businesses. Even incremental gains in freer trade in goods and services, coupled with a larger inflow of direct investment, can boost Indonesian economic growth and lift millions out of poverty. But the benefits of a full FTA would be greater still, anchoring labor, environmental, and anticorruption policy reforms in Indonesia and fostering closer relations between the United States and a country that is a moderate voice in the Islamic world.

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