CHAPTER I

INTRODUCTION

1.1. Background

To illustrate globalization as two sides of the same coin would be at one side it is the result of major changes in the global economic, social, cultural, and political interconnectedness; but on the other side it plays a significant role driving the growth of the same aspects it derived from. Martin Wolf defined globalization narrowly to an economic framework as the integration of the world via a market-driven global economy founded on lower transportation and communication costs and an increased reliance on market forces[1]. Gaston and Khalid further characterized globalization with the growth of the international trade of goods and services, the growth in foreign direct investment as well as the political and social linkages that accompany growing economic integration[2].

Globalization induces interdependence between states and a variety of transnational actors[3] to continually invest in each other in order to develop and attain economic growth and sustainability, and dramatically reduced foreign direct

[1] Wolf, Martin. *Why globalization works*. Yale University Press, 2004.

[2] Noel Gaston and Ahmed M Khalid, *Globalization And Economic Integration: Winners And Losers In The Asia-Pacific*, 1st ed. Cheltenham: Edward Elgar Publishing, 2010, page 3.

[3] Keohane and Nye defined transnational relations as the "regular interactions across national boundaries when at least one actor is a non-state agent…". Noting the concept defined, it encompasses any relations as long as human agency is involved however it differs the phenomena of cross-border capital flows, international trade, media, international migration, cross-border tourism, the diffusion of values and norms, transnational social movements, NGOs, and MNCs. Thomas Risse, "Transnational Actors and World Politics", in *Corporate Ethics And Corporate Governance*, Walther Zimmerli, Klaus Richter and Markus Holzinger ed., Berlin: Springer, 2007, page 427.

investment (FDI) restriction[4]. Brewer stated that the internalization or eclectic theory of FDI includes the important insight that government policies create market imperfections, which make it an economically rational strategic alternative for firms[5]. Foreign investment can be further understood with it involving the transfer of tangible or intangible assets from one country to another for the purpose of their use in the host country to produce wealth under the total or partial control of the owner of the assets[6]. FDI, in accordance to the International Monetary Fund (IMF)[7] and the Organization for Economic Cooperation and Development (OECD)[8] definition, reflects the aim of obtaining a lasting interest by a resident entity in an enterprise that is resident in another economy[9]. Global FDI growth rose 36% in 2015, reaching the highest point after the 2007- 2008 global crisis[10], however it declines in 2016 by 10 to 15 percent[11]. The

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[4] Douglas H. Brooks, Emma Xiaoqin Fan and L. R. Sumulong, "Foreign Direct Investment: Trends, Trims, And WTO Negotiations", *Asian Development Review* 20, no. 1 (2003): 1-33.

[5] Brewer, Thomas L. "Government Policies, Market Imperfections, and Foreign Direct Investment." *Journal of International Business Studies* 24, no. 1 (1993): 101-20. http://www.jstor.org/stable/154973.

[6] To compare, the United Nations Conference on Trade and Development (UNCTAD) defined foreign investment as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in a given economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate) (See United Nations Conference on Trade and Development. M. Sornarajah, *The International Law on Foreign Investment*, 3rd ed. Cambridge: Cambridge University Press, 2010, page 8.

[7] The International Monetary Fund (IMF) is an organization of 189 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduction of poverty. “About the IMF”, Accessed October 10, 2017. http://www.imf.org/en/About.

[8] The Organization for Economic Cooperation and Development (OECD) is an inter-governmental economic organization with 35 member countries, founded in 1961 with goals to stimulate economic progress and world trade. It is a forum of countries describing themselves as committed to democracy and the market economy, providing a platform to compare policy experiences, seeking answers to common problems, identify good practices and coordinate domestic and international policies of its members. Accessed October 10, 2017. http://www.oecd.org/about/

[9] Maitena Duce, *Definitions of Foreign Direct Investment (FDI): A Methodological Note*, 2017, accessed January 4, 2017, https://www.bis.org/publ/cgfs22bde3.pdf.

[10] United Nations Conference on Trade and Development, *FDI Recovery Is Unexpectedly Strong, But Lacks Productive Impact*, ebook, 1st ed. (United Nations Conference on Trade and Development, 2016), accessed November 29, 2016, http://unctad.org/en/PublicationsLibrary/webdiaeia2016d1_en.pdf.

[11] United Nations Conference on Trade and Development, *Global Investment Prospects Assessment 2016–2018* (United Nations Conference on Trade and Development, 2016), accessed November 29, 2016, http://unctad.org/en/PublicationsLibrary/webdiaeia2016d3_en.pdf.

United Nations Conference on Trade and Development (UNCTAD) projected that FDI would be picking up in 2017 up to 2018, but still be lower than the pre-crisis peak[12]. The decline reflects the fragility of the global economy, persistent weakness of aggregate demand, effective policy measures to curb tax inversion deals and a slump in multinational enterprises (MNE) profits[13].

The FDI dynamic involves the transfer of various elements, namely as such financial capital, technology, skilled labor, and a vast variety more from one home country to one host country recipient of the investment. In result, the process of foreign investment increases the costs and benefits for the both home and host countries[14]. First, the primary benefits to the host countries are namely capital inflow in helping to improve its balance of payments; technology spillover which would benefit domestic firms and industries; advanced management know-how to be highly valued; and indirect benefits from jobs created when local suppliers increase hiring and when investors spend money locally. However the cost to host countries would be loss of sovereignty; adverse effects on competition; and capital outflow. Second, the benefits to the home countries are repatriated earnings from profits of FDI; increased exports of goods and services; and learning from operations abroad. Its costs are subjected primarily to capital outflow and job loss[15].

Considering the flow of foreign investment in the last 10 to 15 years, the development of the international law which regulates the issue of foreign investment

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[12] United Nations Conference on Trade and Development, *Global FDI To Fall 10-15% In 2016, Road To Recovery Looks Bumpy* (United Nations Conference on Trade and Development, 2016), accessed November 29, 2016, http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1346.

[13] See *Global Investment Prospects Assessment 2016–2018,* page 3.

[14] Irena Pekarskiene and Rozita Susniene, "Features of Foreign Direct Investment in the Context of Globalization", *Procedia - Social and Behavioral Sciences* 213 (2015), page 208.

[15] Mike W Peng, *Global Business*, 3rd ed. United States: South-Western College Publishing, 2013, pp. 175–78.

could be deemed as rather slow[16]. There are various reasons relating to the slow development of international investment law, naming a few to be lack of effort of the international community to come up with rules and policies in this regards, as well as there is no specific international body to formulate international investment regime[17]. Basically, there are in principle four main scope of international law which regulates international investment. First would be international law which regulates the protection of investors and their possessions[18]. Second would be international law which regulates bilateral investment relations and transactions, namely bilateral investment treaties. While the first one majorly covers the relations between state and private parties ("state-to-private"), the second covers the relations between states ("state-to-state"). Third, international law which regulates the efforts of regional foreign investments deriving from the unsatisfied reaction towards international law which covers investors and their possessions. Included in this is the principle of payment of compensation when nationalization of foreign investment occurs. Lastly, the development of international law governing trade-related investment measures (TRIMs) in the framework of the World Trade Organization (WTO)[19]. The Agreement of Establishing the WTO has been ratified by Law Number 7 Year 1994 Concerning the Ratification of the Agreement Establishing the World Trade Organization[20].

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[16] Huala Adolf, *Perjanjian Penanaman Modal Dalam Hukum Perdagangan Internasional (WTO)*, 2nd ed. Bandung: Keni Media, 2011, page 2.
[17] Sornarajah, *op. cit.*, pp. 15-16.
[18] Sergio Puig, "The Merging of International Trade and Investment Law", *Berkeley Journal of International Law* 33, no. 1 (2015), page 13.
[19] Huala Adolf, *op. cit*., pp. 2-3.
[20] Law Number 7 Year 1994 concerning the Ratification of the Agreement Establishing the World Trade Organization.

The arguments for a binding, multilateral legal instrument on FDI mainly covers the issue that multilateral investment agreement is an important development tool because it will attract FDI that will in turn improve competitiveness, transfer of technology and knowledge; it will introduce transparency, predictability, and legal security in the FDI process; and that national legislation would be able to provide legal protection for FDI and is not an alternative to a multilateral agreement.

The Agreement on Trade-Related Investment Measures (TRIMs) are a set of rules that apply to domestic regulations of which a country applies to foreign investors, mostly in regards to industrial policy[21]. It was negotiated during the many rounds of GATT and then was concluded in 1994 and came into force the following year. It is one of the four major principal legal agreements of the entire WTO Agreement[22].

The Uruguay Round Multilateral Trade Negotiations[23] addressed TRIMs and integrated the host government relations with multinationals to the WTO agenda. It has been recognized that TRIMs can be used by host state in bargaining with MNEs. FDI would only occur when MNEs see that there are profits gained and from the perspective of the host state, they would want to ensure that it also have benefits from the investment. The negotiations for multilateral investment regulations continued with In 1955, the GATT Contracting Parties adopted a resolution on International Investment for Economic Development in which they, *inter alia*, urged countries to

[21] World Trade Organization. “Investment Information”. *Website*. Retrieved from https://www.wto.org/english/tratop_e/invest_e/invest_info_e.htm, accessed on October 10, 2017.
[22] *Ibid*.
[23] The Uruguay Round was the 8th round of multilateral trade negotiations conducted within the framework of the General Agreement on Tariffs and Trade (GATT) in Punta del Este, Uruguay. It spanned from 1986 to 1994 with 123 contracting parties and culminated with the creation of the WTO with GATT as its integral part of the WTO Agreements. Retrieved from https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact5_e.htm, accessed October 10, 2017.

conclude bilateral agreements to provide protection and security for foreign investment[24].

The TRIMs sees that a number of investment measures might be affecting trade, in terms of restriction and/or distortion. It stipulates that WTO members may not apply any measure that discriminates against foreign products or that leads to quantitative restrictions, both of which violate basic WTO principles. There is a list of things of which are prohibited within the stipulation of the TRIMs, one of which is local content requirement.

The Agreement was first negotiated in 1948 in Havana, Cuba which concluded with the Havana Charter, establishing the International Trade Organization (ITO), however it was never ratified but rather its provisions were taken into as the GATT. In 1955, the 23 GATT contracting states adopted a resolution on International Investment for Economic Development urging, *inter alia*, countries to conclude bilateral agreements to provide protection and security for foreign investment[25].

Following so, the Uruguay Round negotiations on trade-related investment measures begins with disagreements between the participating states in regards to the entirety of coverage and nature of new investment policies many from developed countries who were proposing prohibitions measures as such to local content requirements, inconsistent to the Article 3 of the GATT[26].

Bearing in mind, the term "*trade-related investment* measure" though limited only to measures related to trade in goods only, the term itself is not defined in the

[24] World Trade Organization. "Investment Information". *Website*. Retrieved from https://www.wto.org/english/tratop_e/invest_e/invest_info_e.htm, accessed on October 10, 2017.
[25] *Ibid*.
[26] *Ibid*.

agreement. The Agreement, which is limited only to investment measures related to trade in goods only, then was concluded with the objective, as stated in its preamble, as follows:

> "the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particularly developing country members, while ensuring free competition".[27]

The Agreement does, however, includes an annex an Illustrative List of measures that some are inconsistent to GATT III:4 or Article XI:1 of GATT 1994. The disciplines of the TRIMs primarily focusing toward trade in goods meaning it focuses on investment measures that infringe GATT Articles III (national treatment of imported products) and XI (prohibition of quantitative restrictions on imports or exports)[28], whether it is domestic or foreign investors in the imposition of the requirement would be irrelevant under the TRIMs Agreement. The annexed Illustrative List contains the measures which are inconsistent with paragraph 4 of Article III and paragraph 1 of Article XI. The List covers firstly mandatory under domestic law or under administrative rulings, and secondly compliance to TRIMs which is necessary to gain advantages. Paragraph 1 of the List is identified as inconsistent with Article III:4 and it concerns the purchase or use of products by an enterprise, while the Paragraph 2 is identified inconsistent with Article XI:1 of GATT 1994 concerning the importation or exportation of products by an enterprise.

In terms of economic developments, FDI is becoming an increasingly important source of external capital for developing countries. FDI flows keeps track of the value

[27] Preamble of the Agreement on Trade-Related Investment Measures.

[28] Van den Bossche, Peter, and Werner Zdouc. The Law and Policy of the World Trade Organization. Cambridge University Press, 2013, pp. 30-31.

of cross-border transactions related to direct investment during a given period of time, usually a quarter or a year. It consists of *first,* inward financial flows which consist of equity transactions, reinvestment of earnings, and intercompany debt transactions; and *second*, outward flows which are the transactions that increase the investment that investors in the reporting economy have in enterprises in a foreign economy[29]. In the last decade, as shown in the figures below, it can be seen that the FDI flow is fluctuated, reaching its peak in 2007 with 2.7 million US Dollars and decreasing from then noting the global financial crisis that follows[30] resulting in record drop in 2009 at 1.09 million US Dollars. It can be a significant source of capital inflows and investment, even for the poorest of nations. Thus most, if not all, countries would attempt to seek attraction of investing countries and will be concerned about relations with MNEs.

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[29] Organization for Economic Cooperation and Development. "FDI Flow". *Website*. Retrieved from https://data.oecd.org/fdi/fdi-flows.htm, accessed on October 10, 2017.

[30] The financial crisis of 2007-2008 was considered to have been the worst financial crisis since the Great Depression of the 1930s. It began with a crisis in the subprime mortgage market in the United States and developed into an international banking crisis with the collapse of the Lehman Brothers. Great bail-outs of financial institutions and economic measures were employed to prevent a further collapse of the world financial system. Williams, Mark. Uncontrolled Risk: Lessons of Lehman Brothers and How Systemic Risk Can Still Bring Down the World Financial System. McGraw Hill Professional, 2010, page 213.

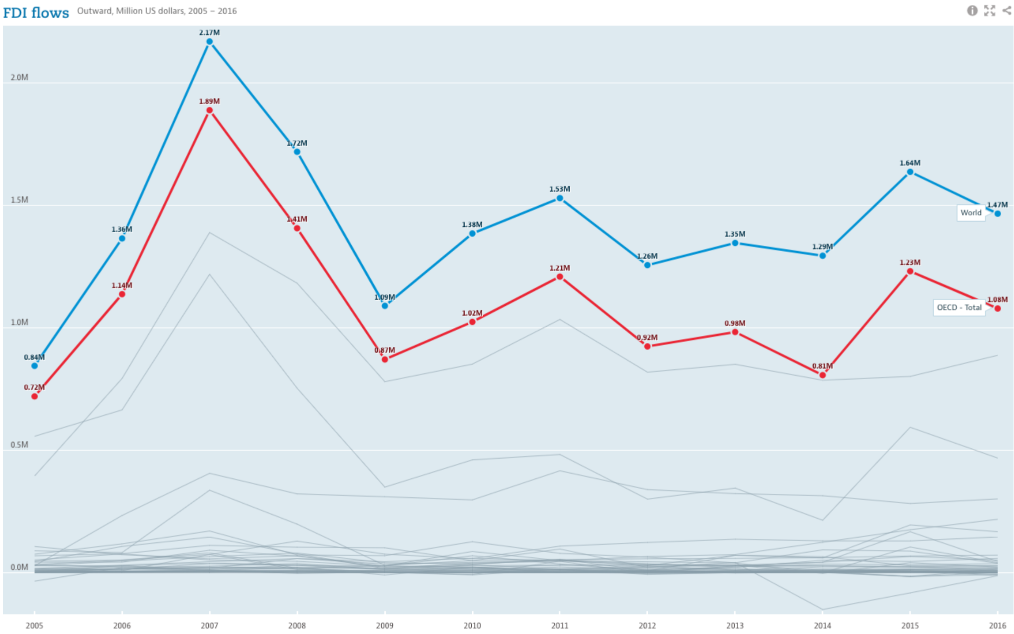

Figure 1.1.1 Global FDI Outward Flows in Million U.S. Dollars, 2005-2016[31]

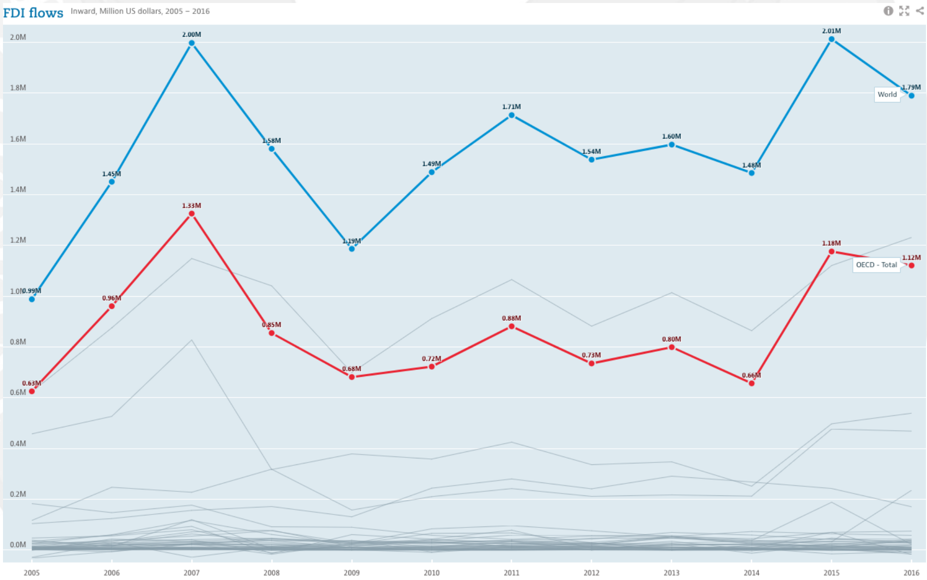

Figure 1.1.2 Global FDI Inward Flows in Million U.S. Dollars, 2005-201632

The TRIMs refer to the restrictions attached by host states to the activities of MNEs that have invested in them. It is trade-related because of the activities of the

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[31] Organization for Economic Cooperation and Development. "FDI Flow". *Website*. Retrieved from https://data.oecd.org/fdi/fdi-flows.htm, accessed on October 10, 2017.

[32] *Ibid*.

MNE impact on trade flows, in one or more of essential ways. The MNE may be potentially able to export, and the TRIMs may relate to export requirements. Or alternatively, the MNE may be producing import-competing goods and the TRIMs may restrict said competition. Lastly, the MNE may import inputs available locally, and the TRIMs may require some minimum of local content purchased from the host state's producers.

In the underlying context, FDI establishes a relationship between the MNE and host state, and both parties to the relationship will wish to maximize their gains from the investment[33]. Nevertheless, the significance of FDI does not diminish the role of productive investment from the domestic economy. In one hand, private domestic investment can be deemed as more of a permanent, reliable link to improve productivity, investment in public sector is also considered an even more importance in infrastructure, research and development and training[34]. Gonzales in his work stated that welfare gain from foreign investment in the small economy is independent of the pattern of trade though its size depends on labor market and trade distortion and the pattern of trade[35].

The geographic pattern of FDI outflows has not changed much with Europe and North America continued to be the largest sources of FDI, contributing with staggering 75 percent. However, it should be noted that in Asia and the Pacific in sum of FDI outflows, it dropped significantly beginning in 1998. In the matter of FDI inflows,

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[33] Kurtz Jürgen, "A General Investment Agreement in the WTO? Lessons from Chapter 11 Of NAFTA And The OECD Multilateral Agreement On Investment", *University of Pennsylvania Journal of International Economic Law* 23, no. 4 (2002).

[34] Eatzaz Ahmad and Anis Hamdani, "The Role of Foreign Direct Investment In Economic Growth", *Pakistan Economic and Social Review* (2003): 29-43.

[35] Jorge G. Gonzales, "Effects of Direct Foreign Investment In The Presence Of Sector-Specific Unemployment", *International Economic Journal* 2, no. 2 (1988): 15-27.

Europe and North America also remain as the biggest recipients of shares of world FDI inflows. In the same decade, in Asia and the Pacific started to increasingly larger share in the beginning of the 1990s[36]. Indonesia, which was one of the top 10 FDI destinations in the early 1990s, has been dropped from the list and replaced by India in the late 1990s and the decade follows.

Rank	Host Economy	1991-1993	Rank	Host Economy	1998-2000
1	China, People's Rep. of	14,346	1	China, People's Rep. of	41,614
2	Malaysia	4,729	2	Hong Kong, China	33,768
3	Singapore	3,926	3	Korea, Rep. of	8,009
4	Hong Kong, China	2,082	4	Singapore	7,866
5	Thailand	1,978	5	Thailand	3,839
6	Indonesia	1,754	6	Malaysia	3,466
7	Taipei,China	1,022	7	Taipei,China	2,692
8	Korea, Rep. of	832	8	India	2,373
9	Philippines	670	9	Viet Nam	1,491
10	Viet Nam	539	10	Philippines	1,190
	Total	31,877		Total	106,309
	(Percent of World Total)	17.3		(Percent of World Total)	9.7

Figure 1.1.3 Top 10 FDI Destination in Developing Asia (annual average in $ million)37

As mentioned earlier, FDI greatly contribute to the movement financial capital, technology, skilled labor, and a vast variety more from one home country to one host country recipient of the investment that may or may not be available locally. The debate on whether the ways in which FDI is beneficial or harmful to the host state mainly depends on the context in which the investment takes place and in which the resulting economic activity operates. Most states offer incentives in hopes of gaining attraction of investing states, which vary from tax concessions, tax holidays, tax credits, accelerated depreciation on plants and machinery, and export subsidies and import entitlements. However, at the same time, most states also put on regulation and

[36] Douglas H. Brooks, Emma Xiaoqin Fan and L. R. Sumulong, "Foreign Direct Investment: Trends, TRIMs, and WTO Negotiations", *Asian Development Review* 20, no. 1 (2003): 1-33.
[37] *Ibid.*

limitation to the economic activities of foreign firms operating within their borders, with example regulations being limitations on foreign equity ownership, local content requirements, local employment requirements, and minimum export requirements.

Indonesia has long since undergone comprehensive trade liberalization measures beginning with unilateral efforts to deregulate its trade and investment regime as a response to adverse external developments, such as drop of oil prices. This deregulation measures opened the path to active participation in the formation of the ASEAN Free Trade Area (AFTA)[38], positive attitude towards joining the Trans-Pacific Partnership (TPP), and ultimately to fulfil its multilateral commitments under the Uruguay Round Agreement[39]. As part of its commitments, Indonesia has been reducing border tariffs, opening its markets, and reducing taxes and subsidies, most of them the agricultural sector. One of this commitment to the Uruguay Round Agreement would be its commitment to remove local content regulations under the TRIMs, with the local content requirement for motor vehicles and agricultural products being notified in 1995 and removed by the end of 2000. However, the Government of Indonesia did took a step back in its commitment through the passage of a national car policy in 1996 which reinstated the local content elements requirement which violate the GATT's most-favored nations and national treatment regulations[40].

The Government of Indonesia regulates foreign investment with its Law Number 25 of 2007 concerning Investment (the "Investment Law") where over the past

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[38] The ASEAN Free Trade Area (AFTA) is a trade bloc agreement by the Association of Southeast Asian Nations supporting local manufacturing in all ASEAN countries. It was signed on January 28th, 1992 in Singapore. Retrieved from http://asean.org/asean-economic-community/asean-free-trade-area-afta-council/, accessed on October 10, 2017.

[39] Tubagus Feridhanusetyawan and Mari Pangestu, "Indonesian Trade Liberalisation: Estimating the Gains", *Bulletin of Indonesian Economic Studies* 39, no. 1 (2003): 51-74.

[40] *Ibid.*

four decades, the government's behavior towards investment has shifted from an antagonistic policy towards a more actively encouraging in terms of its policy and regulations[41]. Its history of reformation begun following the 1945 independence from the Netherlands, where the first administration nationalized most, if not all, former Dutch manufacturing enterprises. It follows a weak property rights and socialistic perspective that kept foreign investment at a trickle throughout the 1950s and 1960s. The first reform was in 1967 during Soeharto's *New Order* administration where many of the previously stated nationalized assets were returned and the enactment of Foreign Investment Law Number 1 in 1967 where it established a licensing procedure for foreign operations that remains the basis of the current policy.

Following the collapse of oil prices in the middle of 1980s, the Government of Indonesia began to seek outside investment more actively with new policy also granting exemptions to investment in capital-intensive, technology-intensive, and export-oriented sectors. These exemptions generally allowed a lower minimum initial Indonesian equity stake, a lower long-term equity target, and a longer period to achieve said target. Finally, in 1994 the Government of Indonesia lifted almost the entire equity restriction on foreign investment where MNEs in most sectors were allowed to establish and maintain indefinite operations with 100 percent of equity.

Recently, Indonesian policymakers have looked increasingly to foreign investment to provide the capital and technological inputs needed to strengthen

[41] Garrick Blalock and Paul J. Gertler, *Firm Capabilities and Technology Adoption: Evidence from Foreign Direct Investment in Indonesia.*, 2004.

Indonesia's manufacturing capabilities, to modernize its infrastructure, and to provide jobs to the millions of individuals of productive age entering the work force[42].

Harris and Robinson stated that "if foreign ownership *per se* is not associated with a productivity advantage, then it is difficult to see how FDI can have a positive impact on overall (…) productivity and thus growth in the host country"[43]. Indonesia's industrial achievements is a relatively recent phenomenon and there have been distinguished inflows of FDIs in the last twenty years. In terms of GDP, FDIs inflows has been rising constantly and significantly ranging from the mid-1980s to the time of the Asian financial crisis. However, when the Government of Indonesia began to reduce trade barriers and deregulation of industry, it received a vast uplift in inflows that geared toward efficiency and internationally competitive activities, mostly in the manufacturing sector[44].

Douglas McWilliams, chief economist at the Institute of Chartered Accountants in England and Wales (ICAEW), stated that Indonesia had recorded the highest FDI growth with 36.8 percent between 2000 and 2013 in comparison to fellow ASEAN member-states[45]. The Investment Coordination Board (*Badan Koordinasi Penanaman Modal* or BKPM) provides the data concerning investment in Indonesia. The state

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[42] Robert N. Hornick and Mark A. Nelson, "Foreign Investment In Indonesia", *Fordham International Law Journal* 11 (1987), page 724.

[43] Selma Kurtishi-Kastrati, "The Effects of Foreign Direct Investments For Host Country's Economy", *European Journal of Interdisciplinary Studies* 5, no. 1 (2013), page 26.

[44] Jens Matthias Arnold and Beata S. Javorcik, "Gifted Kids or Pushy Parents? Foreign Direct Investment and Plant Productivity in Indonesia", *Journal of International Economics* 79, no. 1 (2009): 42-53.

[45] Grace D. Amianti, "Indonesia To Benefit from Foreign Investment, Trade", *The Jakarta Post*, 2014. Retrieved from http://www.thejakartapost.com/news/2014/12/18/indonesia-benefit-foreign-investment- trade.html, accessed January 10, 2017.

achieved Rp 342.7 trillion (US$ 26.57 billion) between January and September of 2014, increasing by 16.8 percent from the previous year[46].

The Ministry of Finance had stated its commitment to prepare the country's business sector, with focus on services and manufacturing sectors[47]. The Government of Indonesia is also prepared to intensify development, trade, and investment cooperation with potential markets as also committed by the state's Ministry of Foreign Affairs[48][49].

In 2017, the Government of Indonesia presented a set of new export regulations which covers, in general, first the exports of certain amounts of mineral concentrates may continue for a further five years, with permission for exports monitored at least every six months and tied closely to the progress of physical construction of domestic processing and refining facilities. Second, the Contract of Work (COW) holders who produce mineral ores are forced to convert their Contracts of Work into IUPKs (licenses) or else they will be prohibited from exporting mineral concentrates. Last, every producing mine in Indonesia (whether under a Contract of Work or IUP) must become at least 51% Indonesian owned - the exceptions which previously allowed foreign control of underground mines and mines with processing and refining facilities have been scrapped[50]. The regulations issued were Government Regulation Number 1

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[46] *Ibid*.

[47] Ben Otto and I Made Sentana, "Indonesia Makes Attracting Foreign Investment a Priority", *The Wall Street Journal*, last modified 2015, accessed January 10, 2017, http://www.wsj.com/articles/indonesia-makes-attracting-foreign-investment-a- priority-1440676597.

[48] "Foreign Policy Outlook 2017: Focus On Borders, Counter-Terrorism, Palestine", *The Jakarta Globe*, last modified 2016, accessed January 13, 2017. http://www.jakartaglobe.beritasatu.com/news/foreign-policy-outlook-2017-focus- borders-counter-terrorism-palestine/.

[49] Blalock, Garrick, and Paul J. Gertler, *op. cit*.

[50] Retrieved from http://www.bakermckenzie.com/en/insight/publications/2017/01/new-export-regulations/, accessed on October 11, 2017.

of 2017 on the Fourth Amendment to Government Regulation Number 23 of 2010 on the Activities of Mineral and Coal Mining (GR1/2017); Regulation of the Minister of Energy and Mineral Resources Number 5 of 2017 on Increasing Added Value Through Domestic Processing and Refining of Minerals (PERMEN5/2017); and Regulation of the Minister of Energy and Mineral Resources Number 6 of 2017 on Procedures and Requirements to Obtain Recommendations for Export Sale of Minerals Resulting from Processing and Refining (PERMEN6/2017)[51].

As of June 2017, Indonesia currently ranks 72 out of 190 countries in ease of doing business in a list[52] compiled by the World Bank. The list comprises of the values of points as follows[53]:

1. Starting a business;
2. Dealing with construction permits;
3. Getting electricity;
4. Registering property;
5. Getting credit;
6. Protecting minority investors;
7. Paying taxes;
8. Trading across borders;
9. Enforcing contracts;
10. Resolving insolvency.

[51] *Ibid*.
[52] The ease of doing business index is an index created by researchers at the World Bank Group. Higher rankings (a low numerical value) indicate better and in general simpler regulations for business and stronger protections of property rights. It has been proven that economic growth impact of improving these regulations is strong. Djankov, Simeon, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer. "The regulation of entry." The Quarterly Journal of economics 117, no. 1 (2002): 1-37.
[53] Retrieved from http://www.doingbusiness.org/rankings, accessed on October 14, 2017.

Economy	Ease of Doing Business	Filtered Rank	Starting a Business	Dealing with Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Minority Investors	Paying Taxes	Trading across Borders	Enforcing Contracts	Resolving Insolvency
Singapore	**2**	1	2	5	4	2	8	1	2	2	1	3
Malaysia	**24**	4	12	3	3	4	2	2	9	6	6	6
Thailand	**26**	5	5	9	5	12	11	4	8	4	5	2
Brunei Darussalam	**56**	6	7	10	6	19	1	7	15	22	7	9
Vietnam	**68**	8	13	6	10	9	5	10	11	9	8	15
Indonesia	**72**	9	17	18	8	14	12	8	19	16	18	4
Philippines	**113**	16	24	17	7	15	21	20	16	12	19	8
Cambodia	**135**	19	25	25	20	17	4	15	23	14	22	10
Lao PDR	**141**	20	22	8	23	10	14	21	25	17	13	25
Myanmar	**171**	24	20	13	24	18	25	25	21	25	24	20

Figure 1.1.4 World Bank Rankings of ASEAN Countries' Ease of Doing Business (per June 2017)54

Formerly, mining companies in production were required to limit foreign ownership to 49%, except where such companies were carrying out underground mining activities, in which case foreign owners were entitled to hold up to 70% of the shares of such company (for companies carrying out smelting activities, the applicable foreign ownership limitation was 60%).

The new divestment requirements will ultimately cause all foreign investors to lose the majority stake in the mines they have invested in—regardless of whether they are carrying out underground mining or smelting activities.

Consequently, the divestment has now reverted to an earlier scheme, and is the same for all IUP, IUPK, COW and Coal Contract of Work (CCOW) holders. The amount of shareholding required to be held by Indonesian participants is as follows[55]:

- in the sixth year of production, 20%

[54] *Ibid*.
[55] H. Salim H. S. *Hukum Pertambangan di Indonesia.* Jakarta: PT RajaGrafindo Persada. 2014, pp. 135-137.

- in the seventh year of production, 30%
- in the eight year of production, 37%
- in the ninth year of production, 44%
- in the tenth year of production, 51%

The time that production is measured from is the issuance of the IUP / IUPK rather than actual production (meaning that construction time is counted). Consequently, shares to be divested must be offered within 90 days after five years from the grant of the IUP/IUPK (the precise timing for Contract of Work holders is unclear).

The shares to be divested must still be offered in this order: (1) to the Central Government; (2) to Provincial / Regional Governments; (3) to State-owned Companies and Regional-owned Companies and only then to (4) private entities. However, there are no longer express response times required for when the shares are offered, meaning that each participant at each step of the process could delay matters (and potentially dilute shareholder value pending any such transfer). IPOed shares of a mining company held by foreign investors will no longer be deemed to be held by domestic participants.

Provisions which formerly stated that divestment does not apply to holders of an IUP specially for Processing and Refining have been deleted. However, the revised article refers to the timing from the "mining production stage", which suggests that there may not be a direct intention to impose a divestment regime on owners of processing and refining facilities; however, it does leave the question open.

There is some grey area in interpretation as to whether this new divestment regime applies immediately to COW and CCOW holders (who have been in production for more than five years) or whether they may have up to a further five years to comply.

The price to be paid for the shares to be divested has not been specified in Government Regulation Number 1 Year 2017 concerning the Fourth Amendment to Government Regulation Number 23 Year 2010 concerning Implementation of Mineral and Coal Mining Activities (hereinafter "GR 1/2017"), meaning that the current ministerial regulations still apply (meaning that only sunk costs, not fair market value, is payable where the divestment shares are taken up directly by the Government (as opposed to Government-owned companies/national companies)).

These new divestment requirements can be seen as a hardening of the Government's stance on foreign investment in the mining sector. The previous understanding that underground mining projects (due to their technical complexity and the high level of investment needed) could have foreign control has been removed. If the Government (Central, Provincial or Regional) or State-owned or Regional-owned Companies exercise their preferential right to take up the shares to be divested (rather than private Indonesian entities), the result may be a largely national/nationalized Indonesian mining industry.

PT. Freeport Indonesia (hereinafter "PFI") is a company affiliated from the Arizona-based mining company Freeport-McMoRan Copper & Gold Inc.[56]. It mines, process and explores the iron, gold, and silver core, and later markets their concentrates globally. The company operates in the highlands of Tembagapura, in the District of Mimika, Papua. Its exploration in Indonesia first begun in 1936 when Jean Jacques Dozy discovered the Ertsberg reserve in the current-site of PT. Freeport Indonesia's mining activities and samples were brought back to the Dutch, of which they were the

[56] Accessed on October 15, 2017. https://ptfi.co.id/en/about

main mining company in East Indonesia. Forwarding 5 decades, in 1960 an expedition team of the Freeport Sulphur Company 'rediscovered' the *Erstberg* reserve – deemed '*the mountain of ore*'. In 1967, Freeport managed to obtain the Freeport's First Contract of Work (*Kontrak Karya Pertama Freeport (KK-I))* which lasts from 1973 to 1991 and totaled an exploitation of 258 thousand tons[57]. In 1991, the company obtained its Second Contract of Work (*Kontra Karya Kedua Freeport (KK-II))* which would expire in 2021 and currently totaled an exploitation of 3.992 thousand tons[58].

With the establishment of GR 1/2017, the contract of work is converted into a special mining business license with the gradual divestment of up to 51 percent. In January 2017, the company ceased its export of concentrates and by February of that year, they wanted to will sue the Indonesian government to international arbitration. PT Freeport Indonesia's parent company, which owns the Grasberg gold and copper mine, is reluctant to follow the government's request to change the status of the contract of work into a special mining business license (IUPK)[59].

However, from the Indonesian perspective, it is claimed that Freeport has on its own committed a number of violations, namely did not release shares to the national as agreed in the contract by 51 percent, to date the shares owned by the Government of Indonesia only 9.36 percent, establishing a smelter facility whereas on its COW was only to establish ore factory, and violations to Law Number 4 Year 2009 concerning Minerals and Coal[60].

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[57] Retrieved from https://bisnis.tempo.co/read/848981/kronologi-kontrak-dan-eksploitasi-tambang-freeport-di-papua, accessed on October 15, 2017.
[58] *Ibid*.
[59] *Ibid*.
[60] Retrieved from http://bisnis.liputan6.com/read/2865384/ini-pelanggaran-yang-dilakukan-freeport-indonesia, accessed on October 15, 2017.

In this connection, it remains to be seen what scope there will be for on Government of Indonesia private investment to support some of these government or state-owned company equity participations.

Taking into consideration the aforementioned explanation, this author would like to present this research titled "**Analysis of Investment Policy in Indonesia in Compliance to International Investment Regulations**".

1.1. Research Questions

Based on the aforementioned elaboration, this author infers two formulation of issues, which are:

1. How would Indonesian investment policy should be best designed to comply to the TRIMS Agreement?
2. How much reservation should the Indonesian investment policy be regulated in favor to national interests?

1.2. Research Purpose

Based on the formulation of issues, the following are the purposes of this thesis:

1. To examine and understand the how the Indonesian investment policy would be best design to comply to the TRIMs Agreement.
2. To analyze the reservations, the Indonesian investment policy should be regulated in favor to national interests.

1.3. Research Benefits

In addition to the aforementioned purposes, this thesis also has a number of benefits in the theoretical and practical benefits, such as:

1. Theoretical Benefits
    1. To analyze the role and implications of the TRIMs in Indonesia's trade regulation measures; and
    2. To examine the regulations and benefits of good investment policy in Indonesia in favor to its national interests.

2. Practical Benefits
    1. To provide references for further researches in relations to investment policies, TRIMs, and its implications and benefits; and
    2. To apply legal theory into practice, more specifically in the field of investment policies, TRIMs, and its implications and benefits to the Government of Indonesia.

1.4. Framework of Writing

Based on the background explained, the following are the framework of writing of this thesis. First to start with CHAPER I which will cover the background explanation of the issue of this thesis as well as its coherent issues which are applicable for research, categorized, and studies. In this chapter also stated the formulation of issues, purposes and benefits of the thesis, as well as its framework of writing.

Secondly, CHAPTER II would cover the explanation of the theories, concepts, and regulation studied in this thesis. These framework of theories were quoted and analyzed from a collection literature and legal sources as well as experts to conceptualize this thesis and also would include a framework of relevant references to support the issue at hand.

Third, CHAPTER III would cover the preference of this author’s in regards to the system and methodology of research used in this thesis.

Fourth, CHAPTER IV would contain the culmination of the examination and analysis of research questions using the aforementioned relevant framework of theories.

Lastly, CHAPTER V would summarize the research in a conclusion reached from the research as well as the author’s relevant recommendation to the issues at hand.

In addition, this thesis would contain a bibliography which states the information of legal sources, literatures, and further references used in this thesis. Also, appendices of relevant complementary documents that concluded the research.