

## CHAPTER I

### INTRODUCTION

#### A. Context of Study

Nowadays era as what so called globalization, creates a big impact to society including international community.<sup>1</sup> The information flow from one state to another state through technology as the most perceivable impact<sup>2</sup> causes a borderless state.<sup>3</sup> This condition increases the chance of investment, especially Foreign Direct Investment [hereinafter FDI] in overseas where almost all of states open the chances for foreign investors to invest in the host countries.<sup>4</sup>

It is undeniable that investment has strong implication to economic stability in a state.<sup>5</sup> Some countries such as South Korea, Malaysia, Thailand, and China have shown that foreign investment is profitable,<sup>6</sup> mostly in economic development and growth.<sup>7</sup> In Indonesia, the example can be seen from the impact of FDI practice to economic condition in New Era. At that

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<sup>1</sup> Eddy Lee and Marco Vivarelli. *The Social Impact of Globalization in the Developing Countries*. Discussion Paper No. 1925, IZA January 2006, Germany, p.1 – 3.

<sup>2</sup> Sentosa Sembiring, *Hukum Investasi*. Cetakan Kedua, 2010, Nuansa Aulia, Bandung, p. 1.

<sup>3</sup> *Ibid.*

<sup>4</sup> *Ibid.*, p.2.

<sup>5</sup> Abdul Khaliq and Ilan Novy, *Foreign Direct Investment and Economic Growth: Empirical Evidence from Sectoral Data in Indonesia*, March 2007, p.1.

<sup>6</sup> Indonesian Bank Seminar, December 19, 2007 as quoted by Tulus Tambunan, *Daya Saing Indonesia dalam Menarik Investasi Asing*, Pusat Studi dan UKM, Uninvestias Trisakti & Kadin Indonesia, p.1.

<sup>7</sup> *Ibid.*

time, economic growth increased up to an average of 7% per year in 1980s where previously has been collapsed in Old Era.<sup>8</sup>

Dorodjatun Kuntjoro-Jakti stated that the rise of economic in many state, results “interdependency”, eventually creates the higher standard of economic disclosure in the world, it is not only the increase of flow of goods which visible but also the increase of flow of services, money, and capital. In its turn, the investment flow in the world follows the development of this disclosure, and the increase of investment flow triggers the trade flow in the world.<sup>9</sup>

Trade and investment are both separated and close business activities. Both go hand in hand, either in substitutes or complements.<sup>10</sup> In the practice, compared to multilateral agreement on trade, agreement on investment is extremely rare.<sup>11</sup> However, it does not necessarily mean there is none. In international level, investment agreement started with *Multilateral Agreement on Investment*<sup>12</sup> as the efforts taken by international community in reacting the development of investment within the society.

Further in 1994, the *Uruguay round* agreement was concluded<sup>13</sup> and produced a well-rounded Agreement on Trade-Related Investment Measures

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<sup>8</sup> *Ibid.*

<sup>9</sup> Yanto Bashri (ed). “*Mau Ke Mana Pembangunan Ekonomi Indonesia. Prisma Pemikiran Prof. Dr. Dorodjatun Kuntjoro-Jakti.*”, 2003, Predna Media, Jakarta, p.12 – 13.

<sup>10</sup> Mitsuo Mitsushita, Thomas J. Schoenbaum, & Petros C. Mavroidis. *The World Trade Organization: Law Practice, and Policy*, 2006, Oxford Univesrity Press, Great Britain, p.831.

<sup>11</sup> *Ibid.*

<sup>12</sup> Mitsuo Mitsushita, ... p.833; Asaf Razin, Social benefits and losses from FDI, pp. 310 ff. in Takatoshi Ito and Anne Krueger (eds.), *Regional and Global Capital Flows*, 2001, The University of Chicago Press.

<sup>13</sup> See Part II Trade-Related Investment Measures Chapter 8 p.1. [TRIMs]

[hereinafter TRIMs].<sup>14</sup> This agreement, is the only World Trade Organization [hereinafter WTO] agreement which deals directly with investment. In the regional level, there are several regulation show the common practice of investment such as North American Free Trade Agreement [hereinafter NAFTA] 1994<sup>15</sup>, ASEAN Comprehensive Investment Agreement 2009<sup>16</sup>, ASEAN Australia New Zealand Agreement, Japan-Mexico Free Trade Agreement, IISD Model IIAs, Energy Charter Treaty.

Instead of Multilateral Investment Agreements [hereinafter MAIs], the most common agreement, Bilateral Investment Treaties [hereinafter BITs] also exists.<sup>17</sup> These are primary agreements which carry out investment liberalization bilaterally between states.<sup>18</sup> BITs have been practiced by many states with various models, such as US, Norway, Indian, German, and Canadian Model BIT.

Those various investment treaties provide varied application of scopes, systems and principles. One of the most common issues is about national treatment principle. Most International Investment Agreements [hereinafter IIAs] regulate about national treatment, but there is no absolute standard on how national treatment should apply. Even one main legal basis of national treatment, TRIMs as refer to General Agreement on Tariffs and Trade 1994

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<sup>14</sup> It is an Annex 1A to the General Agreement on Tariffs and Trade 1994 [GATT 1994].

<sup>15</sup> Enter into force on January 1<sup>st</sup>, 1994.

<sup>16</sup> Open for signature in February 26<sup>th</sup>, 2009.

<sup>17</sup> Sacerdotti, Giorgio, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, 1997, RECUIL DE COURT, p.269.

<sup>18</sup> Mitsuo Mitsushita, ... p.832.

[hereinafter GATT 1994] only provides the application scope of national treatment.

Article 2 section 1 of TRIMs stated “Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIMs that is inconsistent with the provisions of Article III or Article XI of GATT 1994.” This article prohibits WTO Members from applying any investment measures that inconsistent with national treatment (Article III GATT) and Quantitative Restrictions (Article XI GATT).<sup>19</sup> In Annex to TRIMs even provides An Illustrative List of measures that inconsistent with the stated principles.

Article III:1 GATT provides the scope application of national treatment as follows: (1) internal taxes and charges; (2) laws, regulations and requirements affecting the sale, transportation, distribution or use of products; and (3) internal quantitative regulations requiring the mixture, processing or use of products in specified proportions.<sup>20</sup>

In terms of trading activity, article III GATT 1994 provides any possible measures that discrimination may take place so as to afford protection to domestic “production”.<sup>21</sup> The problem occurs to the question on whether or not “production” in trading activity shall be deemed the same as “investment” or “investor” in investing activity. None of IIAs affords clear and absolute standard measure, even GATT—in terms of investment. This causes impact to an open interpretation of national treatment, which create vague legal test of

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<sup>19</sup> *Ibid*, p.839.

<sup>20</sup> *Ibid*, p. 235; Appellate Body Report, *Japan – Alcoholic Beverages*, para. 96.

<sup>21</sup> *See* Article III:1 GATT 1994.

national treatment to apply. Any party may interpret the principle based on its own interest.

The problem may occur in Indonesia. As a Member State to WTO, Indonesia shall subject to the rules under TRIMs and GATT. The rights and obligations under TRIMs and GATT have manifested in the Investment Law 2007.<sup>22</sup> Particularly the obligation of national treatment principle provided in article 3(1) letter d where Indonesia shall provide investment measures base on equal treatment and non-discrimination of country of origin.<sup>23</sup>

Article 4 section (2) of Investment Law in Indonesia states, In making the basic policy set forth in paragraph (1) above, the Government shall provide the same treatment to any domestic and foreign investors, by continuously considering the national interest ....” Its elucidation explains that equal treatment means that the Government shall refrain from giving different treatment to any investors that have made investment in Indonesia, unless specified by the rules of law.

Instead of those national regulations, there are also IIAs, BITs and FIPAs provides national treatment clause that bind to Indonesia. The clauses oblige Indonesia to *inter alia*, provide treatment to aliens no less favourable than treatment accorded, in like circumstances, to its nationals.

Presumably, the interest of aliens and nationals are being contested. Indonesia in one side has obligation to grant national treatment, while on the other side has obligation to protect national interest. The binding nature of

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<sup>22</sup> As WTO Member Indonesia has ratified the GATT 1994 by enacting the Act Number 25 Year 2007 about Investment on April 20, 2007 [Investment Act 2007].

<sup>23</sup> See article 3(1) letter d, article 4 section (2) and the elucidation p.11.

national treatment creates dilemma to Indonesia on whether Indonesia shall choose to grant the national treatment or prevail the national interest protection.

Indeed, FDI has a multiplier effect in Indonesia as a developing country such as to provide employment in Indonesia, create demand for local product as a raw materials, add the foreign exchange, and transfer of technology or transfer of know-how.<sup>24</sup> Once Indonesia enter into FDI, national treatment shall apply. However, the protection of national interest might be abandoned.

In one side, both national treatment and national interest are important, on the other side, they are opposing one another. This factual circumstances generate question on whether national treatment is significant to apply in Indonesia.

Therefore, in this thesis, the writer discusses on two problems: on how to apply national treatment principle in investment and on how is the significance of national treatment principle in investment activity in Indonesia.

## **B. Problem Statement.**

Based on the context of study above, there are two major problems of discussion:

1. How is the application of national treatment principle in investment?
2. How is the significance of national treatment principle in investment activity in Indonesia?

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<sup>24</sup> Hendrik Budi Untung, *Hukum Investasi.*, 2010, Sinar Grafika, Jakarta, p.41 – 42.

### C. Research Objectives.

Based on the context of study and problem statements above, therefore the purposes of this research are:

1. To understand the application of national treatment in investment.
2. To know the significance of national treatment principle in investment activity in Indonesia.

### D. Theoretical Review.

In Indonesian terms, Investment Act 2007 uses the term of *capital investment*<sup>25</sup> as a formal judicial term, but in common language people use the term *investment*.<sup>26</sup> According Ida Bagus Rahmadi Supancana, the terms of investment and capital investment are both known in business field or in legislation.<sup>27</sup> The term of investment is more popular in business while capital investment is used mostly in legislation. Basically, both terms have similar meaning as both refer to investment in the form of Foreign Direct Investment (FDI) and Foreign Indirect Investment (FII).<sup>28</sup>

Based on article 1 of Investment Act 2007, Investment shall be any kinds of investing activity by both domestic and foreign investors for running business within the territory of the Republic of Indonesia.

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<sup>25</sup> In Indonesian term, capital investment is defined as “*penanaman modal*”.

<sup>26</sup> Sentosa Sembiring ...p.33; Abdurachman. *Ensiklopedia Ekonomi Keuangan Perdagangan*. Cetakan Ke-enam. 1991, Radnya Paramita, Jakarta, p.340; Winardi. *Kamus Ekonomi (Inggris-Indonesia)*. Cetakan Ke-delapan, 1982, Alumni, Bandung, p.190; A.F. Elly Erawaty and J.S. Badudu. *Kamus Hukum Ekonomi Indonesia Inggris*. Edisi Pendahuluan, 1996, ELIPS, Jakarta, p.69; Departemen Pendidikan dan Kebudayaan RI. *Kamus Besar Bahasa Indonesia (KBBI)*. Edisi Ke-empat, 1995, Balai Pustaka, Jakarta, p.386.

<sup>27</sup> Ida Bagus Rahmadi Supancana, *Kerangka Hukum Kebijakan Investasi Langsung di Indonesia*, Ghalia Indonesia, Jakarta, p.1.

<sup>28</sup> FII is in the form of sale and purchase of portfolio shares, and conducted through Capital Market.

According to Law Dictionary,<sup>29</sup> “investment is the commitment of money or capital to purchase financial instruments or other assets in order to gain profitable returns in the form of interest, income (dividend), or appreciation of the value of the instrument. It is related to saving or deferring consumption.” In Glossary of Accounting, Finance, and Economic Terms, the investment is defined as “Expenditure used to purchase goods or services that could produce a return to the investor.”<sup>30</sup>

From several definition above, there is no different understanding in using the terms of investment and capital investment. In English common language, the proper term used is ‘investment’.<sup>31</sup> The key point of investment is that there is activity conducted by individual or legal entity to invest some or whole of the income for certain business activity aimed to earn the profit, interest and/or dividend.

Individual or legal entity who invest or conducting investment shall be investor. Article 1 number 4 Investment Act 2007 defines investor as any individual or corporation that makes investment in form of either domestic or foreign investors.

Investment Act 2007 distinguishes the domestic investor as any individual of Indonesian citizen, Indonesian corporation, the state of the Republic of Indonesia, or any region making investment within the territory of

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<sup>29</sup> See The Law Dictionary: *Featuring Black's Law Dictionary Free Online Legal Dictionary 2nd Ed.*

<sup>30</sup> See Glossary of Accounting, Finance, and Economic Terms, p.28, as cited in <http://www.alpineguild.com/> on Monday, December 12, 2015.

<sup>31</sup> See article 1 of the Trade-Related Investment Measures Agreement [TRIMs] states, “This Agreement applied to investment measures related to trade in goods only.” The terms ‘investment’ is being used rather capital investment.



the Republic of Indonesia.<sup>32</sup> Whereas the foreign investor is any individual of foreign citizen, foreign corporation, or foreign state making investment within the territory of the Republic of Indonesia.”<sup>33</sup> The key difference of both domestic and foreign investor is the nationality of investor.

In terms of BITs, two major actors are investor and the state as the host country. Generally, both parties enter into agreement for certain purpose which outlined in a promise of the parties’ and gained for mutual exchange.

In relation to investment, under TRIMs article 2 section (1) states clearly that WTO Member shall not apply any trade-related investment measures that inconsistent with article III of GATT 1994. From this article, it is to be noted that investment activity shall bound to national treatment principle as such.

Under GATT 1994, precisely article III, national treatment is the fundamental principle which imposes obligation of like treatment and non-discrimination between domestic and imported product.<sup>34</sup> In correlation to the trade activity, the key point is that no law, regulation, or taxation pattern may adversely modify the conditions of competition between “like imported” and domestic products in the domestic market.<sup>35</sup>

According to UNCTAD, the national treatment standard is one of the main general standards which used to secure a certain level of treatment for

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<sup>32</sup> Investment Act 2007, article 1 number 5.

<sup>33</sup> *Ibid*, article 1 number 6.

<sup>34</sup> Mistuo Mitsushita...p.234.

<sup>35</sup> *Ibid*; *Italian Discrimination against Imported Agricultural machinery*, 23 October 1958, GATT B.I.S.D. (7<sup>th</sup> Supp.), p.60, para. 12 (1959) (invalidating Italian law providing low-interest loans to purchasers of Italian-made tractors).

FDI in the host countries.<sup>36</sup> National treatment seeks to grant foreign investors treatment comparable to domestic investors operating in the host state.<sup>37</sup> Rudolf Dolzer mentioned, “The clauses state that the foreign investor is accorded treatment no less favourable than that which the host state accords to its own investors.”<sup>38</sup>

Foreign and domestic investors should subject to the same competitive conditions on the host state markets. There shall no government measure that should unduly favour domestic investors.<sup>39</sup> The national treatment standard in trade and investment, in some particular cases has no equivalency.

The activities of foreign investors in the host states cover a wide array of operations, including international trade in products, trade in components, know-how and technology, local production and distribution, the raising of finance capital and the provision of services, and the range of transactions involved in the creation and administration of a business enterprise. Therefore, in relation to the application of national treatment principle in economic transaction, investment agreements may be wider than trade agreements.<sup>40</sup>

In Indonesia the application of national treatment principle is granted under article 3 section (1) letter d of Investment Act 2007. The principle of equitable and nondiscriminatory treatment against country of the origin is the

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<sup>36</sup> Including fair and equitable treatment (UNCTAD, 1999a) and MFN treatment (UNCTAD, 1999b).

<sup>37</sup> UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT. *NATIONAL TREATMENT*. (UNCTAD/ITE/IIT/11). Vol. IV. (New York and Geneva, 1999), p.3. [UNCTAD, National Treatment].

<sup>38</sup> Rudolf Dozer, *National Treatment: New Developments*. Making the Most of International Investment Agreements: A Common Agenda, 2005, Symposium co-organized by ICSID, OECD AND UNCTAD, Paris, p.1.

<sup>39</sup> UNCTAD, National Treatment, p.8.

<sup>40</sup> *Ibid.*

principle of indiscriminative service treatment based on the rules of law between domestic and foreign investors, as well as among foreign investors.

Under article 4 section (2) letter (a) of the same regulation also mentioned that the government should “provide the same treatment to any domestic and foreign investors, by continuously considering the national interest. It means the government shall refrain from giving different treatment to any investors that have made investment in Indonesia, unless otherwise specified by the rules of law.”<sup>41</sup>

Article 3 and 5 of the template draft of Development and Protection of Investment 2014, assert substantial ground for national treatment principle. There are several conditions set forth in article 5, that State Party to the Agreement shall ensure the absence of denial of justice; make a content review of the treatment standard; and provide adequate police protection as appropriate under its domestic laws and regulation.

#### **E. Research Method.**

The type of this research is the normative legal research. This study conceptualizes law as the legal norms that include existing positive law. Statute and case approach are chosen; therefore any related laws, regulations and cases are analyzed and synchronized each other by the method of qualitative data (deductive-syllogism). The result of this research is in descriptive explanation of the research object.

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<sup>41</sup> Investment Act 2007, elucidation p.11.

The primary legal materials are any binding legal materials that relate to the object of research, *inter alia*, the Act Number 25 Year 2007 on Investment Law Government Regulation Number 39 Year 2014 on the List of Open and Close Business Fields by the Requirements in the Investment, Trade-Related Investment Measures (TRIMs) General Agreement on Trade and Tariffs (GATT) 1994, ASEAN Comprehensive Investment Agreement 2009, North American Free Trade Agreement (NAFTA) 1994, Energy Charter Treaty, Awards of ICSID Arbitral Tribunal. The secondary legal materials are, *inter alia*, UNCTAD Reports, WTO Working Groups Journal, OECD Journals and Reports, Canadian BIT and FIPA Model, US BIT Model, Norway BIT Model, related books, papers, journals, research reports related to the object of research.

The data collecting method is in library research method. The phases in library studies are: (1) records all of the important data from related books, articles, journals, official-related websites, and biographies; (2) reviews and compiles the materials based on its priority and relevance; (3) reads and notes all of the related-materials; and the last (4) writes down the materials into this writings.

After receiving all related data and documents, the writer: (1) compares one sources to the other sources (i.e. the formulation of clause in one agreement to the other one; the decision of certain case to other case); (2) analyzes and discuss the data; and (4) concludes the result of research.

## **F. Systematical of Writing**

In this thesis, the writer divides the chapter into four chapters: Chapter I Introduction; Chapter II General Overview of Investment Law; Chapter III the Legal Test of National Treatment Principle and its Significance within Indonesia Investment Activity; and Chapter IV Conclusion and Recommendation.

In the Chapter I, the writer explains the context of study, problem statements, research objectives, theoretical review, research method and systematical of writing. In this research, there are two research problems: how to apply national treatment in investment activity and how is the significance of national treatment in investment activity in Indonesia? To answer the problems, the writer analyzes Awards of ICSID Arbitral Tribunal, IIAs and BITs Model, and also Indonesian FIPA Model, based on the theoretical review of International and Indonesian Investment Law sourced from TRIMs, GATT, Investment Act 2007, and other related laws, regulations, books, journals, and research reports.

Chapter II is about general overview of investment. This chapter is divided into two subchapter: International Investment Law and Indonesian Investment Law. Both subchapters explain the history of investment, basic understanding of FDI and investors, sources of law, applicable principles, and dispute settlements within the framework of international in general and Indonesia in particular.

Discussion in chapter III is divided into two subchapters: the application of national treatment in investing activity and the significance of national treatment in investment activity in Indonesia. The first subchapter answer the first problem statement by comparing the national treatment clauses in IIAs, BITs, FIPAs and its interpretation in the Awards of ICSID Arbitral Tribunal. In order to answer the second subchapter, the writer provides factual grounds on the implication of national treatment in Indonesia and some urgency doctrines of the principle in question.

As the last chapter, chapter IV explains the summary results of the discussion as the answers of two problem statements in this thesis. The first answer explains the application of national treatment by providing the legal tests. The second answer explains the significance of national treatment to apply in Indonesia. At the end, the writer adds two recommendations to the reader in handling both problems.