

CHAPTER III

THE APPLICATION OF NATIONAL TREATMENT PRINCIPLE AND ITS SIGNIFICANCE WITHIN INDONESIAN INVESTMENT ACTIVITY

A. The Application of National Treatment Principle

The application of national treatment requires the legal test as one of the elements to apply national treatment. Some specific conditions is also needed to be consider in applying the principle. As a consequence, both legal test and specific conditions may affect one another.

1. The legal test to apply National Treatment.

Most IIAs and BITs provide national treatment clause differently. This various languages creates a pattern that establishes two main important legal tests. The first legal test is the factual condition such as the comparable circumstances of aliens and nationals, and also the specific activities to which national treatment apply. The second legal test is the standard treatment granted by the host state to the investors and their investments.

Unfortunately, there is no instrument explaining the interpretation of both legal tests above. The comparable circumstances require the element of “likeliness” of circumstances between aliens and the nationals. Whilst, the standard of treatment might be varied depend on the IIAs and BITs clauses. In the practice, the standard has strong relation to the “favourableness” of treatment accorded to aliens compared to nationals.

a. Comparable Factual Conditions to which national treatment applies

In some IIAs and BITs practice, the definition of national treatment specifies the factual situations in which the standard applies. There are two complementary or alternative conditions that indicating to which national treatment applies.

1) "like circumstances", "like situations", or "similar situations"

In European states practices, national treatment clause applies when "like situations"¹³⁹ or "similar situations" exist. In U.S. Treaties, the clause alters from "in like situations" to "in like circumstances".¹⁴⁰

In OECD National Treatment Instrument, the Code of Liberalisation¹⁴¹ formulates the term "in like situations" as states "countries commit themselves to treating foreign-controlled enterprises operating on their territories no less favourable than domestic enterprises **in like situations.**"

The "like circumstances" is more common as it could be found in many BITs and IIAs, such as in NAFTA article 1102 (1) and (2):

¹³⁹ UNCTAD, National Treatment, p.1.

¹⁴⁰ *Ibid.*

¹⁴¹ UNCTAD, *International Investment Instruments: A Compendium*, Sales Nos. E.96.II.A.9, 10, 11, vol. II, 1996, United Nations publications, New York and Geneva, [UNCTAD, 1996, Vol.II], p.184.

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, **in like circumstances**, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, **in like circumstances**, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

Similar term is also used in Canada-Chile Free Trade Agreement, in its article G-02:

1. Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, **in like circumstances**, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of the other Party treatment no less favourable than that it accords, **in like circumstances**, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

This approach is also found in 2012 US Model BIT.¹⁴²

Another different formulation of factual comparison is the term “in similar circumstances” in the World Bank Guidelines on the Treatment of FDI. None of the articles in the Guidelines using the “national treatment” term but “fair and equitable treatment” might be found. The article III.3 (a) mentions

“[...] With respect to the protection and security of their person, [...] such treatment will, subject to the requirement of fair and equitable treatment mentioned above, be as favorable as that accorded by the State to national investors in similar circumstances. [...]”

¹⁴² US Model BIT, article 3.

Alternatively, the clause may refer to the term “similar enterprise”, “similar investment” or even to investor with similar (economic activities).¹⁴³

However, the application of the provision may be a difficult task, where neither the treaty nor the annexes determine what constitutes “similar” or “like” circumstances, activities, or enterprises.¹⁴⁴ What constitutes “similar” or “like” circumstances is a matter that needs to be determined in the light of the facts of the case and practice.¹⁴⁵

Indian Model BIT even mention in the elucidation of article 4, in respect of the national treatment:

The requirement of “like circumstances” recognizes that States may have various legitimate reasons for distinguishing between investments including, but not limited to, (a) the goods or services consumed or produced by the Investment; (b) the actual and potential impact of the Investment on third persons, the local community, or the environment, (c) whether the Investment is public, private, or state-owned or controlled, and (d) the practical challenges of regulating the Investment. The factors and determinations used by the Host State to distinguish between Investors and Investments are to be **given substantial deference by any tribunal** constituted under Article 14.5 or Article 15.2.

The tribunal in the case of *S.D. Myers Inc. v Government of Canada* concluded that, in assessing the “like circumstances”, the “likeness” must be the first and foremost inquiry into the competitive relationship between foreign investors and domestic investors. The tribunal while applying the standard of national

¹⁴³ Rudolf Dolzer and Magrete Stevens, *Bilateral Investment Treaties*, 1995, Kluwer Law International, the Netherlands.

¹⁴⁴ Andrew Newcombe...p. 143.

¹⁴⁵ UNCTAD, National Treatment, p.16.

treatment shall question a relation between ‘competition’ and ‘likeness’ of both investors in question.

Similar test is also applied in the case of *Pope & Talbot Inc. v Canada*,¹⁴⁶ the tribunal interpreted article 1102 NAFTA in respect to the basis for comparison:¹⁴⁷

In evaluating the implications of the legal context the Tribunal believes that as a first step, the treatment accorded a foreign owned investment protected by Article 1102 (2) **should be compared with that accorded domestic investments in the same business or economic sector**. However, that first step is not the last one. Differences in treatment will presumptively violate article 1102 (2) unless they have a reasonable nexus to rational government policies that (1) **do not distinguish, on their face or de facto**, between foreign-owned and domestic companies, and (2) **do not otherwise unduly undermine** the investment liberalizing objectives of NAFTA.

The tribunal in *Marvin Feldman v. Mexico* and *ADF Group Inc. v USA* also apply the similar test of “likeness” in relation to competition. The latter award in the case *Occidental v Ecuador* started to take a different approach in applying national treatment standard. The tribunal agreed with claimant’s arguments that the treatment should be compared to the actors in other economic sectors,¹⁴⁸ and expressly rejected the GATT analysis which would restrict the comparison to “directly competitive or substitutable products.”¹⁴⁹

¹⁴⁶ *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2 of 10 April 2001. [Pope v Canada Award].

¹⁴⁷ *Ibid*, para.78.

¹⁴⁸ *Ibid*, paras.173 – 176.

¹⁴⁹ This case summary was prepared in the course of research for S Ripinsky with K Williams, *Damages in International Investment Law* (BIICL, 2008) Case summary *Occidental Exploration and Production Company v The Republic of Ecuador*, p.4

Similarly in *Methanex v USA*, the award insist on the weight to identical comparators. The tribunal accepted domestic methanol industry as the identical comparator to the claimant. However as the Californian ban had the same effect on these domestic actors as the foreign methanol industry (Methanex), thus the tribunal concluded that there was no breach of the national treatment obligation.

In *Cargil Inc. v. Mexico*, as referred to *Pope & Talbot*, *Methanex*, and *GAMI v. Mexico*, the tribunal rejects the assessment of “like circumstances” to the “like products.” The Award in *Cargil Inc. v. Mexico*, para 194 states:

It thus follows that, although as Claimant suggests "like goods" or "like products" can be an important component of "like circumstances", the fact that an investor is producing a good that is "like" a domestically produced good does not necessarily mean that the investor is in "like circumstances" with the domestic producer of that good. Thus, the fact that a WTO panel in *Mexico-Tax on Soft Drinks* concluded that cane sugar and HFCS are "directly competitive or substitutable" products is relevant but not determinative of whether the producers of these products are in "like circumstances" for the purposes of Article 1102.

The “like circumstances” element is determined by reference to the rationale for the measure that was being challenged. The awards in *Cargil Inc. v. Mexico*, *Pope & Talbot*, *Methanex*, and *GAMI v. Mexico* conclude that a determination of “like circumstances” had to consider the surrounding facts and that

“an important element of the surrounding facts will be the character of the measure under challenge.”¹⁵⁰

2) Specified Economic Activities

National treatment clause may also apply in the case where the IIAs or BITs specify the economic activities or industries. This approach affects to the narrowing scope of national treatment in the areas of which expressly mentioned in the agreement. National treatment applies only to those sectors in which the commitment have been made among the parties.

Functional delineation of national treatment can also arise as a result of the specialized nature of an agreement, such as: the GATS which limits the functional scope to services; Energy Charter Treaty in relation to energy industries; TRIPs Agreement in relation to intellectual property rights; and TRIMs Agreement in relation to investment measures.

Energy Charter Treaty approach has an opened but indicative list of activities to which the national treatment standard applies. As provided in article 10 (7):

Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and **their related activities including management, maintenance, use, enjoyment or disposal**, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their **related activities including management, maintenance, use, enjoyment or disposal**, whichever is the most favourable.

¹⁵⁰ Pope v Canada Award ... para.205.

This formulation makes it clear that it encompasses all types of activities associated with the operation of an energy investment.

NAFTA article 1102 (1) also provides specified list as being subject to national treatment, “[...] the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments [...]”¹⁵¹ Similarly MAI draft uses the formulation “establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition of investments.”¹⁵²

The World Bank Guidelines on the Treatment of FDI, article III.3 (a) mentions “

With respect to the protection and security of their person, **property rights and interests, and to the granting of permits, import and export licenses and the authorization to employ, and the issuance of the necessary entry and stay visas to their foreign personnel, and other legal matters relevant to the treatment of foreign investors** as described in Section 1 above, such treatment will, subject to the requirement of fair and equitable treatment mentioned above, be as favorable as that accorded by the State to national investors in similar circumstances. In all cases, full protection and security will be accorded to the investor's rights regarding ownership, control and substantial benefits over his property, including intellectual property.

The Framework Agreement on the ASEAN Investment Area, article 7 (1) (b) asserts that national treatment is accorded immediately to ASEAN investors and their investments in respect

¹⁵¹ UNCTAD, *International Investment Instruments: A Compendium*, Sales Nos. E.96.II.A.9, 10, 11, vol. III, 1996, United Nations publications, New York and Geneva, [UNCTAD, 1996, Vol.III], p.74.

¹⁵² OECD, 1998, p.13.

of all industries and measures affecting investment, “including but not limited to the admission, establishment, acquisition, expansion, management, operation and disposition of investments”¹⁵³

The listing of specific activities aim to provide guidance as to which types of activities the parties intended to cover national treatment, and which are not. Subsequently, the parties avoid an opened national treatment clause which may result an unintended interpretations of National Treatment clause.¹⁵⁴

b. National Treatment Standard

Once, the factual circumstances have found, the next question to answer is the standard of treatment. The determination of standard shall reliant on the treatment offered by a host country and not on some *a priori* absolute principles.¹⁵⁵

Under international customary law, there are at least two main different frameworks of national treatment standard. The first is known as the “Calvo doctrines” supported by mostly Latin American countries. In this framework, foreign investors and their investments are entitled only to the “same treatment” accorded to nationals of the host country under the national laws of the host country.

In contrast to the latter framework, the doctrine of State responsibility supported by mostly developed countries asserts that customary international law establishes a minimum standard of

¹⁵³ ASEAN Investment Treaty entered into force in 1998.

¹⁵⁴ UNCTAD, National Treatment, p.32.

¹⁵⁵ *Ibid*, p.6.

treatment to which foreign investors and their investments are entitled, allowing for treatment more favourable than accorded to the nationals. This doctrine falls under the discussion of international minimum standard principle.

In the reality, there are two major ways to define the standard of treatment: strict standard and “more favourable treatment” standard. Most IIAs use the language of: the “same” or “as favourable as” treatment, and the “no less favourable” clause.

1) “Same” or “as favourable as”

The treatment offered to foreign investors and their investments shall be the same as that accorded to the nationals of the host state. The treatment is no better than that received by national investors. This might close the chance for the foreign investor to claim preferential treatment, and possible for national investors to challenge such preferential treatment. This formulation might have the effect of extending protection to national investors.

This approach had been used in the World Bank Guidelines on the Treatment of FDI, stated “as favourable as that accorded by the State to national investors in similar circumstances.”¹⁵⁶

The Decision 291 of the Commission of the Cartagena Agreement (ANCOM) (1991) article 2 provides slightly different formulation of clause “Foreign investors shall have the same rights

¹⁵⁶ UNCTAD, *International Investment Instruments: A Compendium*, Sales Nos. E.96.II.A.9, 10, 11, vol. II, 1996, United Nations publications, New York and Geneva, [UNCTAD, 1996, Vol.I], p.250.

and obligations as national investors, except as otherwise provided in the legislation of each member country.”¹⁵⁷ Moreover decision 24, which preceded Decision 291, was blunter: “Member countries may not accord to foreign investors’ treatment more favourable than to national investors.”

The Community Investment Code of the Economic Community of the Great Lakes Countries, article 9 uses reference to “same conditions as enterprises of the host country.”¹⁵⁸

2) **“no less favourable” standard.**

Another common formulation in some IIAs are the “no less favourable” standard. This formulation offers treatment which will usually result in treatment as favourable as that received by national investors of a host country.¹⁵⁹ State may provide treatments that more favourable for foreign compared to nationals, as fall under the international minimum standard.

The use of “no less favourable” standard could be found in NAFTA, article 1102; Energy Charter Treaty, article 10 (7); Canada-Chile Free Trade Agreement, article G-02; CARICOM Agreement for the Establishment of a Regime for CARICOM Enterprises, article 12 (4) (a), (b), (c), (g); GATS, article XVII.1; TRIPs Agreement, article 3(1); and so on.¹⁶⁰

¹⁵⁷ UNCTAD, 1996, vol. II, p. 450.

¹⁵⁸ UNCTAD, 1996, vol. II, p. 255.

¹⁵⁹ UNCTAD, National Treatment, p. 37.

¹⁶⁰ *Ibid*, p.39 – 40.

According to Committee's reports on national treatment, the "no less favourable" standard has several implications. This clause may allow the preferential treatment of foreign investors where national treatment falls below such international minimum standards. The minimum standard entitled to foreign investors and their investments are recognized by states member of OECD as the substantive test of national treatment.

OECD Declaration on International Investment and Multinational Enterprises of 1976¹⁶¹ provides that, "[...] member countries should, [...] accord [...] "Foreign-Controlled Enterprises treatment under their laws, regulations and administrative practices, *consistent with international law* and no less favourable than accorded in like situations to domestic enterprises."

2. Affecting Conditions of National Treatment Application

In applying national treatment, the state shall consider another affecting conditions to the application of the principle, such as the phases of investment to which national treatment apply, the exceptions, and also *de facto* and *de jure* treatment.

a. The extent of coverage of national treatment.

Some IIAs and BITs may grant national treatment in the "post entry" stage or in an extended stage to the "pre and post entry".

¹⁶¹ UNCTAD, 1996, vol. II, p. 184.

1.) Post Entry Stage.

IIAs and BITs asserting the post-entry model clause restrict the operation of the treaty from other contracting parties admitted in accordance with the laws and regulations of the host contracting party.¹⁶² This model is followed with a provision that accords national treatment to investments after the admittance.¹⁶³

The national treatment of post-entry stage model is accorded to aliens only after the entry or establishment of the investments. Under the OECD regime, matters of entry and establishment are the concern of the OECD Code of Liberalisation of Capital Movements.¹⁶⁴

The National Treatment Decision in the OECD Declaration on the International Investment and Multinational Enterprises of 1976 makes a clear provision in paragraph II (4) that “this Declaration does not deal with the right of Member countries to regulate the entry of foreign investments foreign investment of the foreign investment or the conditions of establishments of foreign enterprises.”¹⁶⁵

¹⁶² UNCTAD. (1999c). *Admission and Establishment. UNCTAD Series on Issues in International Investment Agreements*, Sales No. E.99.II.D.10, United Nations publication, New York and Geneva [UNCTAD, 1999c] p.17 – 20.

¹⁶³ UNCTAD, National Treatment, p.19.

¹⁶⁴ UNCTAD, 1999c, p. 24.

¹⁶⁵ UNCTAD, 1996, vol. II, p. 184.

2.) Pre and Post Entry Stage.

The pre and post entry stage model has been practiced by United States Friendship Commerce and Navigation [FCN] Treaties, and some United States BITs, and Canadian BITs.¹⁶⁶ The clause makes entry to the host State subject to the national treatment standard in addition to post-entry treatment.

A significant example of pre and post entry model is the NAFTA. Article 1102 of the NAFTA grants national treatment to investors and the investments of another contracting party with respect to “the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”

Another agreements assert similar approach such as: the Asia Pacific Economic Cooperation (APEC) Non-Binding Investment Principles; the 1994 Treaty on Free Trade between Columbia, Mexico and Venezuela; and the Framework Agreement on the ASEAN Investment Area. Those examples include the entry of foreign investment and conditions of establishment of the foreign enterprises as a phase where national treatment shall be accorded.

b. Exceptions of national treatment.

Exceptions of national treatment reflect the needs of each contracting parties in terms of protecting essential interest. Practices

¹⁶⁶ UNCTAD, 1996, vol. III, p. 197.

show that there are several relative model of exceptions to national treatment. There are at least three main exceptions: general exceptions; subject-specific exceptions; industry-specific exceptions; and development-based exceptions.

1) General exceptions

General exceptions are mostly based on public health, public order and morals, and national security. This clause is found in OECD National Treatment instrument as it permits the distinctions of treatment for foreign investors and their investments in accordance with the need to maintain “public order, the protection of essential interests and the fulfilment of commitments to maintain international peace and security.” This clause is opened for interpretation as it left to the member of countries.¹⁶⁷

Article XX of GATT provides measures list that national treatment might not apply. The measures are, but not limited to, “necessary to protect public morals; necessary to protect human, animal or plants life or health; relating to the importations of exportations of gold and silver; necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement,” and so on.

Finland Model BIT provides an example of a general exception clause for actions taken for the protection of essential

¹⁶⁷ OECD, 1998, p.16.

security interests “in time of war or armed conflict, or other emergency in international relations” as well as the maintenance of public order.¹⁶⁸

A Canadian Model BIT provides a modified clause from GATT provision as, “reasonable measures for prudential reasons”, measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange policies, actions “necessary for the protection of essential security interests” or “in pursuance of the United Nations Charter for the maintenance of international peace and security.” Furthermore, paragraph 6 of the same article also provides that the agreement “shall not apply to investments in cultural industries”.

2) Subject-specific exceptions.

The exclusion from national treatment related to subject-specific are¹⁶⁹ taxation,¹⁷⁰ and intellectual property rights guaranteed under IPR Conventions,¹⁷¹ prudential measures in financial services,¹⁷² temporary macroeconomics safeguards,¹⁷³

¹⁶⁸ OECD Directorate Finance, *International Investment Perspectives*, 2006 Edition, p. 168.

¹⁶⁹ UNCTAD, National Treatment, p.45.

¹⁷⁰ BIT between the Republic of Korea and Mongolia article 7 (b); the draft MAI, article

VIII.

¹⁷¹ US Model BIT, article, II (2) (b).

¹⁷² BITs signed by Canada; the draft MAI.

¹⁷³ *Ibid.*

incentives,¹⁷⁴ public procurements,¹⁷⁵ special formalities in connection with establishment,¹⁷⁶ and cultural industries exception.¹⁷⁷

3) Industry-specific exceptions

Here, a host country may reserve right to treat domestic and foreign investors and their investment in different manner on the ground of national economic and social policy reasons. This has been practiced by United States FCN Treaties, as followed by *inter alia* US BITs, NAFTA, and Canada-Chile Free Trade Agreement.

Under NAFTA Annex II for instance, each contracting party is allowed to make reservations with respect to specific industries in which the party may adopt more restrictive measures. Exceptions have been made that preserve existing federal measures listed in Annex I to the Agreement. These include, *inter alia*, Mexico's primary energy sector and railroads, United States airlines and radio communications and Canada's cultural industries.¹⁷⁸

¹⁷⁴ BIT between Jamaica and the United Kingdom, article 3; NAFTA, article 1108.7 (a).

¹⁷⁵ NAFTA, article 1108.(b).

¹⁷⁶ NAFTA; United States BITs.

¹⁷⁷ NAFTA, annex 2106.

¹⁷⁸ UNCTAD, National Treatment, p.46.

4) Development-based exceptions.

In respect of the application of national treatment, developing countries felt that, if the national treatment standard were applied without qualifications, it may be damage their development efforts in view of the unequal competitive position of domestic enterprises as compared to many Trans National Corporations.

Developing countries insist on the need to allow for preferential treatment to domestic enterprises in respect of their development needs. In the last 1990, draft of the United Nations of Conduct on Transnational Corporations contain the provision as follows:

“50. Subject to national requirements for maintaining public order and protecting national security and consistent with national constitutions and basic laws, and without prejudice to measures specified in legislation relating to the declared development objectives of the developing countries, entities of transnational corporations should be entitled to treatment no less favourable than that accorded to domestic enterprises in similar circumstances”

Another significant examples of development-based clause exceptions are the Protocol 2 of the Indonesia-Switzerland BIT, Italy-Morocco BIT, and Germany BIT Model.¹⁷⁹

c. De Facto and De Jure Treatment

Basically, national treatment concerns more on the laws and regulations of host countries, which specifically address the treatment

¹⁷⁹ *Ibd*, p.49 – 50.

of foreign investors. Foreign investors may find disadvantageous situations as a result of regulations or practices that have detrimental effect on their ability to operate, precisely due to their being of “foreign.”¹⁸⁰

Any other foreseeable laws and regulations or the factual treatment which discriminate the nature of foreign investors as “aliens” may arise lose and injuries to them.

Therefore, *de facto* and *de jure* treatment to foreign investors and their investment as favourable as nationals in like circumstances shall be taken into account. GATS article XVII in paragraphs 2 and 3 provide virtuous model of clause deals with *de facto* as well as *de jure* treatment.¹⁸¹

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service providers.
3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.”

B. The Significance of National Treatment Principle in Indonesia

The significance of national treatment principle is related to the urgency of FDI in Indonesia. The needs of FDI and national treatment has a strong relationship to the interest of the parties: investor and the host state.

¹⁸⁰ *Ibid*, p.40.

¹⁸¹ UNCTAD, 1996, vol. I, p.302.

Furthermore, national treatment application may rise further implication to Indonesia as a host state.

1. The urgency of FDI

The practice of FDI has grown in many developed and developing countries. Most states are affected by FDI development in a good manner, such as in Indonesia.

a. FDI improvement in developing countries.

In 2014, global FDI inflows fell by 16 per cent to \$1.23 trillion, mostly due to the fragility of the global economy, policy uncertainty for investors and elevated geopolitical risks. In regard to the inward FDI flows to developing countries, the inflows reached their highest level at \$681 billion. As a consequence, China became the world's largest recipient of FDI.¹⁸²

Despite the fact that the FDI inflows had declined in 2014, FDI flows in its long-term practices indicate a rapid growth since early 1980s, faster than trade flows. Such an example in 1998, FDI inflows increased to around \$430 – 440 billion. Furthermore, FDI has proved to be resilient during financial crises. This condition happened in East Asia countries, where such investment was remarkably stable during the global financial crises of 1997 – 1998.¹⁸³

¹⁸² UNCTAD, *World Investment Report 2015: Reforming International Investment Governance*, 2015, United Nations Publication, New York and Geneva. [2015 World Investment Report].

¹⁸³ <http://www.imf.org/external/pubs/ft/fandd/2001/06/loungani.htm> accessed on 10 February 2016.

FDI inflows to developing countries increased by 2 percent from previous year in 2014. From top 10 FDI recipients, 5 (five) of them are the developing countries. Flows in developing Asian Countries increases while flows to Latin America and the Caribbean weakened, and those to Africa remained flat.

The developing countries lead the fluctuation not only inward FDI flows but also the outward FDI flows. In 2014, TNCs from developing countries invested \$486 billion abroad, 23 percent increase from 2013. The World Investment Report 2015 shows that, for the first time TNCs from developing Asia became the world's largest investing group as almost one third from the total. These are nine from 20 countries, Hong Kong (China), China, the Russian Federation, Singapore, the Republic of Korea, Malaysia, Kuwait, Chile and Taiwan Province of China.

For most developing countries, FDI is important as a source of private external finance. More significant benefit are also the transferring production technology, skills, innovative capacity, organizational and managerial practices between locations, and also accessing international marketing networks.

Feldstein¹⁸⁴ asserts that international capital flows generate several other advantages: by allowing the investor to diversify their lending and investment, international capital flows will reduce their

¹⁸⁴ Martin Feldstein, "Aspects of Global Economic Integration: Outlook for the Future," NBER Working Paper No. 7899, 2000, National Bureau of Economic Research, Cambridge, Massachusetts

risk; its global integration contribute to the spread of the best practices in corporate governance, accounting rules, and legal tradition; lastly, its global mobility limits the ability of governments to pursue bad policies.¹⁸⁵

Furthermore, Razin and Sadka¹⁸⁶ note that there are other forms of advantage to host countries from FDI. First, the transfer of technology, especially in the form of varieties of capital inputs. Secondly, host countries may gain employee training in the course operating the new business, which contributes to human capital development in the host countries. As last but not least, profits generated by FDI contribute to corporate tax revenues in the host country. To wrap up, FDI is important in the contribution to investment and growth in host countries, either in economy, socio-culture, or even politic fields.

b. The importance of FDI in Indonesia.

During 2010 – 2015 in Indonesia, FDI averaged IDR 58909.09 billion, in the highest number of IDR 92200 billion in the second quarter of 2015 and the lowest number of IDR 35400 billion in the first quarter of 2010.¹⁸⁷ FDI is amounted to \$ 29.28 billion in 2015 from \$ 28.5 billion in 2014, increase 19.2 than in previous year. In the last

¹⁸⁵ Assaf Razin and Efraim Sadka, forthcoming, *Labor, Capital and Finance: International Flows*, 2000, Cambridge University Press, New York and Cambridge, England..

¹⁸⁶ *Ibid.*

¹⁸⁷ <http://www.tradingeconomics.com/indonesia/foreign-direct-investment> accessed on 10 February 2016.

three months of 2015, FDI in the country increase 26 percent, following an 18 percent increase in the previous year.¹⁸⁸

According to UNCTAD 2014 World Investment Report, Indonesia is one of the three most attractive destinations for multinational companies for 2014 – 2016, ahead of India and Brazil. In terms of FDI inflows, Indonesia ranks 5th among East Asian countries after China, Hong Kong, Singapore, and India.¹⁸⁹

However, business environment in Indonesia can be challenging as ranked 114 out of 189 countries in the Ease of Doing Business 2015 by the World Bank. Moreover, some firm publications in regard to investment activities in Indonesia provide several forms of challenge as well as the obstacles of doing investment.¹⁹⁰

Despite the fact that strengthening political and economic stability has declined some investment risk, some obstacles remain such as the rising of credit, the poor investment climate, excessive and unpredictable regulation, and the poor quality of infrastructure, the control of the terrorism risk and a high level of corruption.¹⁹¹

This condition shall not be abandoned without any possible solution in facing the obstacles. In order to generate advantages of FDI

¹⁸⁸ <http://www.indonesia-investments.com/news/todays-headlines/q3-2015-foreign-direct-investment-in-indonesia-grows-18.1-in-rupiah-terms/item6068> accessed on 10 February 2016.

¹⁸⁹ 2015 World Investment Report.

¹⁹⁰ <http://export.gov/indonesia/doingbusinessinindonesia/index.asp> and <https://en.santandertrade.com/establish-overseas/indonesia/foreign-investment#finding> accessed on 10 February 2016.

¹⁹¹ <https://en.santandertrade.com/establish-overseas/indonesia/foreign-investment#finding> accessed on 09 Februari 2016; 2015 World Investment Reports.

within developing countries, Indonesia as a host country shall take any manner to attract FDI. Liberalization of the national policies to establish hospitable regulatory framework for FDI can be done by relaxing rules regarding market entry and foreign ownership, improving the standards of treatment accorded to foreign investor and investment, and also improving the functioning of markets.¹⁹²

Moreover, Indonesia and other ASEAN countries have committed for entering into ASEAN Economic Community.¹⁹³ There are at least four main frameworks of work plans to create integrated ASEAN economy: (i) establish single market and production base (free flows of goods, services, investments, capital and skilled-labour; (ii) establish regional competition policies, IPRs action plan, infrastructure development, ICT, energy cooperation, taxation and development of small enterprises; (iii) establish region of equitable economic development through promotion of small enterprises and Initiative for ASEAN Integration (IAI) programs; (iv) establish global economy integration.¹⁹⁴

The unrestricted of flows in ASEAN will rise to many challenge faced by Indonesia, as the competition is getting higher among ASEAN countries. The single market plan in five sectors possibly enhance economic condition in Indonesia, or in contrast

¹⁹² <http://www.imf.org/external/pubs/ft/fandd/1999/03/mallampa.htm> accessed on February 2016.

¹⁹³ ASEAN ECONOMIC COMMUNITY Blueprint, 2008.

¹⁹⁴ *Ibid.*

deterioration.¹⁹⁵ Indonesia not only has a power to attack, but also can be the target of attack, depends on the economic strategy. Furthermore, its ability to compete with other countries such as Singapore, Malaysia, Thailand, and Vietnam are questionable.¹⁹⁶

2. The magnitude of National Treatment in FDI

The fact that FDI is important in Indonesia, as a host state Indonesia shall provide offers to foreign investors. The most important offer is related to their protection.

a. The attraction of foreign investor to FDI.

Indonesia needs investment. Either in the FDI inflows or outflows Indonesia shall take part, in order to show the existence within international society. But not least to that, state economic growth shall be taken into consideration in taking part to investment activities. As it has been discussed in the “*sub-chapter 1*” that most developing countries generate advantages from FDI flows. The development is not limited only for the economic fields, but spread up to social, culture, and politics.

In regards to needs of investment, a host state shall be ready to offer possible benefit for the foreign investor as a reciprocity between both investor and the host state. The offer could be in the form of regulatory framework, where the host state shall provide guarantee to

¹⁹⁵ Mukti Fajar MD, *Strategi Kebijakan Perlindungan Investor Lokal dalam Arus Bebas ASEAN Economic Community*. Fakultas Hukum Universitas Muhammadiyah Yogyakarta.

¹⁹⁶ http://www.depkop.go.id/index.php?option=com_phocadownload&view=category&id=4:undang-undang&Itemid=93 accessed on 09 February 2016.

the easiness of establish investment, and also to the treatment in pre, during, or post establishment.

One most common offer is the non-discrimination clause provided in their BITs or IIAs. Article 2.1. TRIMs and article III GATT are binding to Indonesia and thus rise obligation to grant non-discriminatory manner, such as Most Favoured Nation or national treatment. Non-discrimination clause has pursued the magnitude of customary, since it applies in many IIAs and BITs.

In order to create attraction and trust among foreign investor, Indonesia shall therefore afford non-discriminatory manner in the relation to investment activity. Parties to IIAs, BITs, and FIPAs should make sure that there will be no overlapping regulations which come up to the loss or injury of foreign investor.

b. Foreign Investment Protection.

In the reality, state enters into treaties to offer foreign investment protection against any possible risk in the host state. The risks can arise in many ways including expropriation, conversion and transfer of assets, non-compliance with permits, or other forms of unfair, inequitable, discriminatory or arbitrary treatment.¹⁹⁷

Investment protection law is dominated by bilateral treaties, there also multilateral treaties, mostly of a regional character. For example 1994 Energy Charter Treaty provides protection for

¹⁹⁷ <http://www.rh-arbitration.com/arbitration-and-investment-law/investment-protection-and-bilateral-investment-treaties/> accessed on 10 February 2016.

investments in the energy sector, 1992 North American Free Trade Agreement (NAFTA) demonstrates both promises and possible pitfalls of investor-state arbitration, the 2004 Dominican Republic-Central America-United States Free Trade Agreements reflects the experience in NAFTA.

This Investment protection law has been the major issue since 1930s, although not in the specified manner. In the historical background, two main issues raised in regard to the state practice and case law on the treatment of aliens (foreign investment): the failure to protect aliens¹⁹⁸ and denial of justice to aliens.¹⁹⁹ The first generation of treatment background is to include as part of the elaboration of the law of State responsibility, as drafted by International Law Institute,²⁰⁰ Harvard Law School,²⁰¹ and public codification effort at the 1930 Hague Conference.²⁰²

¹⁹⁸ E Brusa, 'La responsabilité des Etats à raison des dommages soufferts par des étrangers en cas d'émeute ou de guerre civile' (1898) 17 *Annuaire de l'Institut de droit international*, p.96;

¹⁹⁹ AV Freeman, *The International Responsibility of States for Denial of Justice*, 1938, Longmans, Green and Co., London.

²⁰⁰ Resolution of the Institute of International Law on the International Responsibility of States for Damage Done in Their Territory to the Person or Property of Foreigner (1928) 22 *American Journal of International Law Special Supplement* 330.

²⁰¹ J Crawford and T Grant, 'Responsibility of States for Injuries to Foreigners' in J Grant and J Baker (eds), 2007, *Harvard Research in International Law: Contemporary Analysis and Appraisal*, New York, W&S Hein and Co.

²⁰² Bases of Discussion Drawn up in 1929 by the Preparatory Committee of the Conference for the Codification of International Law, League of Nations publication, V. *Legal, 1929.V.3* (document C.75.M.69.1929.V); Text of Articles Adopted in First Reading by the Third Committee of the Conference for the Codification of International Law (The Hague, 1930) League of Nations

In 1960s and 1970s, UNGA Resolution 1803 (XVII) on Permanent Sovereignty over Natural Resources in 1962 accepted the international obligation to compensate for expropriation and the binding nature of contracts.²⁰³ Further, another relevant documents argued for the protection of foreign investments by international law such as OECD, the 1967 Draft Convention on the Protection of Foreign Property formulated recognisably modern form such as fair and equitable treatment (FET) observance undertakings, indirect expropriation and investor-state dispute settlement.²⁰⁴ The 1976 Declaration on International Investment and Multinational enterprises even suggested in specified clause that national treatment should be applied to foreign investors.

Investment protection clause mostly found in IIAs or BITs are in certain standards such as FET, full protection and security, protection against arbitrary and discriminatory treatment, national treatment and most-favoured nation treatment.²⁰⁵ These standard are regarded as being closely interrelated. In *Plama v. Bulgaria*, despite the fact that FET was seen as an predominant standard to determine the

publication, *V. Legal, 1930.V.17* (document C.351(c).M.145(c).929.V); C Bories, 'The Hague Conference of 1930' in Crawford (n 9) p. 65-66.

²⁰³ UN Doc. A/5217 of 14 December 1962.

²⁰⁴ OECD 1967 Draft Conventoin on the Protection of Foreign Property, adopted 12 October 1967 (1968) 7 International Legal Materials 117 and (1963) 2 International Legal Materials 241.

²⁰⁵ Christoph Schreuer, *Investment International Protection*, para. 48.

other standards, the tribunal concluded that the better view is to see the standards as analytically distinct.²⁰⁶

In regards to national treatment, as it embodied in most BITs and multilateral treaties, it essentially provides the foreign investor and its investment are to be treated no less favourably than a national of the host state. A better treatment of the foreign investor remains possible and will even be required if the international standards are higher than the ones applying to nationals.²⁰⁷

National treatment clause protects foreign investors from certain measures taken by host States to protect nationals in order to give them a competitive advantage over their foreign investors. This standard covers regulatory measures that are expressly discriminatory in nature as well as measures that are indirectly discriminatory or discriminatory in their effect.²⁰⁸

Relevant example can be perceived in the practice in Australia. Guide list of standard of protection afforded by Australia's BITs and FTAs provide illustration of national treatment prohibits a special tax on foreign companies as come up to a discriminatory measure.²⁰⁹

Beyond that, investment protection also manifested in the Foreign Investment Promotion and Protection Agreement (FIPA) Negotiations. For example in Canada – China FIPA Negotiations,

²⁰⁶ *Lama v. Bulgaria Award of 27 August 2008, paras. 161–163, 183–184.*

²⁰⁷ *Op-cit*, para. 67.

²⁰⁸ Clayton Utz, *Guide to Protecting Foreign Investment*, 2014, p. 17.

²⁰⁹ *Ibid.*

Canada has secured a high-standard agreement with comprehensive scope and coverage and substantive obligations pertaining to national treatment in post establishment period.²¹⁰

In regard to the FIPA Negotiations, 2004 Canadian FIPA would be the best model to compare. National treatment clause provides the treatment accorded to foreign investor and its investment shall accorded no less favourable than that accords, in like circumstances, to nationals and its investment in the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.²¹¹

Unlike Indonesian FIPA, where the national treatment clause applied in so called “post entry phase” as the draft provides that:

Without prejudice to its domestic laws and regulations, the Host State shall accords to each investor and to its covered investments, after the entry of the Covered Investment into the Host State, treatment no less favourable than the treatment it accords in like circumstances to the Host State’s local investors and to their investments with respect to the operation, management, maintenance, use, enjoyment and sale or disposal of their investments in the Host State’s Territory.

Both FIPA grants the protection of foreign investors and its investments, but only the matter of different phase of applicability.

3. Implication and Foreseeable Response

The application of national treatment is not without implication. Indonesia as a host state is obliged to protect the foreign investors and their investments under national treatment clause. On the other side,

²¹⁰ <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-chine.aspx?lang=eng> accessed on 19 February 2016.

²¹¹ Canadian FIPA Model, article 3.

Indonesia as a sovereign state has an obligation to protect their national interest. Both national treatment and national interest are being contested, but Indonesia shall be able to maintain them hand in hand.

a. Challenges to protect national interest.

Most scholar during Renaissance era believed that a state's political behavior should be subject to concerns of national interest. National interest is a combination of individual interests, collective interests, and universal interest. A country is formed by a group of individual; each citizen's interest is a part of the national interest. For instance, when the overseas enterprise of a certain country's citizen loses money in competition, this is in fact an economic loss for the whole country.

Collective interest may include an entire social class or only the people of a certain district. If this kind of interest is harmed by a foreign power, it would harm the national interest.²¹² The universal interest are the most important element of national interest. The universal or combined interests have broad content, such as territorial security, international status, the success in the international economy, a good ecological environment, political stability, and cultural influence.

States is obliged to uphold and pursue short-term interest, middle-term interest, and long-term interest. The short term interests is

²¹² Scott Burchill, *The National Interest in International Relations Theory*, 2005, Palgrave Macmillan, New York, p.13.

temporal and the most unstable one. They depend on the change in the international environment. Examples include striving for commercial loans, adjusting tariffs and lobbying for a price change in a particular commodity.

Middle-term interests are the national interest over a fixed period of time that usually last a few years or several decades. Examples include importing certain types of advanced military or scientific technology and striving for a certain kind of economy aid. At last, long-term interest are relatively stable. They are pursued by state over a long period of time such as the ecological balance, military nuclear force and industrial modernization.

In order to achieve the above-mentioned interest, Indonesia has an obligation to protect the national interests. However, the protection might find a dilemma when it has been contested to the international obligation. In respect to this thesis, Indonesia is bound to national treatment principle as an international obligation. The protection over national interest may be harmed by a foreign protection.

The history of China show the implication of international obligation over the national interest:²¹³

In the 1980s, China was debating whether or not to enter GATT. One of the major concerns was how to protect the domestic automobile industry. If, for example, the domestic Tianjin's Xiali Car Corporation could not compete with the Japanese Nissan car imports because of a combination of price and quality, it would lose market share. Further, its inventory would grow and its capital would not circulate. Thus, the Tianjin Xiali Car Corporation would be responsible for a national economic loss. On the surface it would appear as though only the interests of the employee's of the enterprise

²¹³ *Ibis*, p.18.

would be harmed and not other economic interests. Moreover, consumers might even gain from this kind of competition because they could buy high quality import cars at a lower price. In fact, the economic problems of this factory would not only reduce the income and benefits of its employees, it would also affect the normal development of China's domestic automobile industry by hindering its modernization and expansion. It would also make it more difficult to catch up with developed countries. Therefore, damage to this enterprise from international competition would be damage to China's overall national interest.

b. National Treatment and National Interest shall go hand in hand.

National treatment and national interest are both important for the development of the state. It is undeniable that Indonesia needs FDI. In response to that, Indonesia as a host state grants the national treatment to attract FDI and protect foreign investors and the investments. On the other side, Indonesia as a sovereign state has obligation to protect its own national interest in order to pursue individual, collective and universal goal of the state.

As a consequence of the above-fact, both national treatment and national interest might be overlapping one another. But they might also support one another, such as the foreign protection by national treatment contributes to national interest. Here, Indonesia should be able to maintain both hand in hand. The foreseeable actions could be in the form of: taking careful attention in BITs, FIPAs, or any IIAs drafting and establishing the proper and clear laws and regulations.

As a sovereign state, Indonesia has the same rights and obligations as another state. Theoretically, in entering into agreement Indonesia has the same bargaining position. Thus, in respect of freedom of contract, Indonesia may propose for mutually interest in

the IIAs drafting. Based on reciprocity principle, contracting parties may gain reasonable mutual exchange. The clauses in IIAs shall equally share the benefit of both contracting parties. In the context of FDI, the benefit might be achieved by the foreign investors and Indonesia as a host state.

A specific example might be seen from the arrangement of national treatment clause. The clause of national treatment may arise legal consequences to Indonesia. Unfortunately, there is no clear and absolute standard of national treatment interpretation. Therefore, Indonesia should pay full attention in setting up the clause.

Another foreseeable step is the establishment of a proper and clear laws. Indonesia as a host state should be able to make a strong regulation and policy related to FDI. The arrangement of the laws, regulations, and policies should consider on the national interest. Indonesia shall not easily open the percentage of foreign capital ownership, but Indonesia should also consider the needs of national interest protections.