
Dynamics of Foreign Investment Law in Indonesia

Berton Lumban Tobing¹, Henry Aspan²

tobingparbubu8@gmail.com henryaspan@dosen.pancabudi.ac.id

Panca Budi Development University

Abstract

This study examines the dynamics of foreign investment law in Indonesia, focusing on two main issues: legal uncertainty and the challenges of harmonizing regulations with international standards in the era of globalization. Legal uncertainty in Indonesia often arises from unexpected regulatory changes, overlapping regulations between the central and regional governments, and inconsistencies in law enforcement. This creates an environment that is less conducive to foreign investors, reducing Indonesia's attractiveness as an investment destination. In addition, the challenges of legal harmonization involve difficulties in aligning domestic regulations with the provisions of bilateral investment treaties and free trade agreements, as well as the application of international arbitration. Although Indonesia has taken steps to align its domestic laws with global standards, there are still inconsistencies in implementation that affect the investment climate. This study suggests the need for comprehensive legal reform, capacity building of law enforcement institutions, and active involvement in international forums to create a stable and competitive investment climate.

Keywords: *Foreign Investment, Legal Uncertainty, Legal Harmonization*

INTRODUCTION

Foreign investment has long been an integral part of Indonesia's economic development. As a country with large market potential and abundant natural resources, Indonesia has attracted foreign investors since the colonial era until today. However, the dynamics of the law governing foreign investment in Indonesia have undergone significant changes along with political, economic, and social developments in the country. This reflects the Indonesian government's efforts to balance the need to attract foreign capital with the aim of protecting national interests and ensuring that such investment provides optimal benefits to the domestic economy.

In the early days of independence, the Indonesian government adopted a relatively protectionist approach to foreign investment. The first Foreign Investment Law, Law Number 1 of 1967, was implemented in a very limited economic context and was constrained by political instability and ideological pressure from nationalist forces. This law provided space for foreign investors to invest in Indonesia, but with strict restrictions to protect national interests. The government, for example, imposed provisions on local share ownership, technology transfer, and the obligation to use Indonesian labor (Adam, 2017).

However, along with the shifting paradigm of the global economy and pressure for economic liberalization, foreign investment policy in Indonesia underwent significant changes during the New Order era. During this period, the Indonesian government, under the leadership of President Soeharto, began to open the economy to foreign investment more widely. Revisions to investment regulations were made to create a more friendly investment climate for foreign capital, by providing various incentives, such as tax holidays, legal certainty, and ease in the licensing process (Setyawan, 2018).

As a result, Indonesia experienced a significant increase in foreign investment inflows, which contributed to national economic growth.

The biggest change in the dynamics of foreign investment law occurred after the 1997-1998 Asian economic crisis, which forced Indonesia to undertake major reforms in various sectors, including the investment law sector. The crisis exposed various weaknesses in Indonesia's economic and regulatory systems, including a high dependence on foreign loans and foreign investment that was not balanced by strengthening the domestic sector. To regain investor confidence, the government issued various reform policies, including the revision of the Foreign Investment Law through Law Number 25 of 2007, which provided more freedom and protection for foreign investors, and introduced a dispute resolution mechanism through international arbitration (Faisal, 2020).

However, the dynamics of foreign investment law in Indonesia are not only determined by domestic economic and political factors, but also by global developments that affect investment policies worldwide. In the era of globalization, the emergence of international organizations such as the World Trade Organization (WTO) and various free trade agreements have encouraged countries including Indonesia to adjust their investment regulations to comply with international standards. This has led to increasingly intensive efforts to harmonize laws between national regulations and international provisions, although this also poses challenges in maintaining national sovereignty and interests (Susanto, 2019).

However, behind the various advances achieved, foreign investment law in Indonesia still faces various challenges. One of them is legal uncertainty which is often the main complaint of foreign investors. This uncertainty arises due to overlapping regulations, frequent changes in policies, and inconsistencies in law enforcement at various levels of government. In addition, issues of corruption and slow bureaucracy also often hamper the investment process and reduce Indonesia's attractiveness as an investment destination (Lubis, 2018).

In this context, it is important to understand the dynamics of foreign investment law in Indonesia not only as a result of economic policies, but also as a reflection of the interaction between broader political, social, and legal interests. This study aims to examine in depth how foreign investment law in Indonesia has developed over time, what factors influence it, and how existing challenges can be overcome to create a more stable, fair, and profitable investment climate for all parties involved.

In addition, this study will also highlight the role of law in balancing the need to attract foreign capital with efforts to protect national interests. This includes an analysis of various existing regulations, case studies on foreign investment in strategic sectors, and a review of dispute resolution mechanisms applied in Indonesia. With this comprehensive approach, it is hoped that this study can provide a significant contribution to the understanding of the dynamics of foreign investment law in Indonesia and provide relevant recommendations for future policies.

METHOD

This study uses a normative legal approach to analyze the dynamics of foreign investment law in Indonesia. The normative legal approach was chosen because this study focuses on the study of applicable positive law and how the law develops in the context of foreign investment regulation in Indonesia. This method involves literature studies and analysis of legal documents, including laws, government regulations, court decisions, and international agreements relating to foreign investment.

This study will examine the Foreign Investment Law that has been in effect in Indonesia, starting from Law Number 1 of 1967, Law Number 25 of 2007, to the latest regulations issued by the Investment Coordinating Board (BKPM). In addition, this study will also examine the impact of these regulatory changes on the investment climate in Indonesia, as well as analyze how foreign investment law in Indonesia adapts to the demands of globalization and international trade agreements (Faisal, 2020).

Secondary data used in this study will be obtained from various sources, including scientific journals, legal textbooks, policy reports, and relevant statistical data from government institutions such as BKPM and the Ministry of Law and Human Rights. Analysis of these documents will be conducted to identify trends, changes, and challenges in foreign investment law in Indonesia. Furthermore, this study will also utilize the comparative analysis method by comparing foreign investment law in Indonesia with other countries in the Southeast Asian region to see how Indonesia can learn from best practices in neighboring countries (Susanto, 2019).

This methodology aims to provide a comprehensive analysis of how foreign investment regulations in Indonesia have developed and how they can be improved to create a more stable and profitable investment climate for the national economy. Thus, this study is expected to provide policy recommendations that can be implemented by policy makers to strengthen Indonesia's competitiveness as a foreign investment destination.

RESULTS AND DISCUSSION

Legal Uncertainty and Its Impact on the Foreign Investment Climate in Indonesia

Legal uncertainty is one of the biggest challenges faced by foreign investors looking to invest in Indonesia. Although Indonesia is known as one of the countries with the largest economic potential in Southeast Asia, legal uncertainty is often a major barrier that reduces the attractiveness of foreign investment in the country. Legal uncertainty refers to a situation where regulations and policies related to investment are changing, inconsistent, or not enforced in a way that investors can predict. This creates significant risks for foreign investors who need certainty and stability in running their businesses.

One of the main causes of legal uncertainty in Indonesia is the frequent and unexpected changes in regulations. The Indonesian government, both at the central and regional levels, often issues new regulations that can affect the investment climate without adequate consultation with stakeholders. These regulatory changes are often made in response to political, economic, or social pressures, without considering the long-term impacts on the investment climate. For example, policies regarding the mining and natural resources sector often experience drastic changes, such as restrictions on the export of raw minerals or the obligation to process minerals domestically, which causes uncertainty for foreign investors who have invested large amounts of capital in this sector (Lubis, 2018).

Legal uncertainty also arises due to overlapping regulations between the central and regional governments. Regional autonomy introduced after the 1998 reformation gave regional governments greater authority to manage local resources and regulations. However, this often leads to regulatory conflicts between the central and regional governments, where rules implemented by one level of government conflict with rules made by another level of government. For example, business licenses issued by regional governments often conflict with national policies or are not recognized by the

central government, causing confusion and uncertainty for investors (Faisal, 2020). This overlap not only slows down the investment process but also increases compliance costs for foreign investors.

Furthermore, inconsistency in law enforcement is also a significant source of uncertainty. In Indonesia, law enforcement is often influenced by various factors, including political pressure, economic interests, and corruption. Foreign investors often face situations where the law is applied inconsistently, depending on the relationship between the parties involved or pressure from certain interest groups. This makes investors feel insecure and reluctant to invest further in Indonesia. For example, land dispute cases involving foreign companies are often resolved in a non-transparent manner, where court decisions can change without clear reasons or due to intervention from certain parties (Adam, 2017).

Legal uncertainty is also exacerbated by high levels of corruption at various levels of government. Corruption makes the licensing and law enforcement processes slower and less transparent, which in turn increases the risks and costs for foreign investors. In Transparency International reports, Indonesia is often classified as one of the countries with a fairly high level of corruption, which is one of the main inhibiting factors for foreign investment. Foreign investors are often faced with situations where they have to give bribes or gratuities to speed up the licensing process or resolve legal disputes. Such practices are not only illegal but also increase legal uncertainty and damage the investment climate in Indonesia (Susanto, 2019).

In addition, legal uncertainty in foreign investment in Indonesia also arises from the lack of harmonization between national and international laws. In the era of globalization, foreign investors often compare investment conditions in various countries and demand legal standards that are in line with international practices. However, in Indonesia, there are still significant differences between domestic regulations and international standards, especially in terms of protecting investor rights and dispute resolution. For example, although Indonesia has signed various bilateral investment treaties (BITs), the implementation of the protection guaranteed in these agreements is often inconsistent with national practices (Setyawan, 2018). Investors who rely on the protection promised in international agreements often face obstacles when trying to enforce their rights in Indonesian courts.

This legal uncertainty has a direct impact on the foreign investment climate in Indonesia. First, legal uncertainty reduces Indonesia's attractiveness as an investment destination. Investors tend to avoid countries where legal risks are unpredictable or where regulations frequently change without adequate notice. This can lead to a decline in foreign capital inflows, which in turn hinders national economic growth. According to data from the Investment Coordinating Board (BKPM), despite the increase in foreign investment in recent years, many potential investors have chosen to shift their capital to neighboring countries such as Vietnam or Malaysia, where the investment climate is considered more stable and predictable (BKPM, 2020).

Second, legal uncertainty increases investment costs. Foreign investors must incur additional costs to manage legal risks, including costs for legal consultations, insurance, and efforts to comply with frequently changing regulations. These costs add to operational burdens and can reduce the expected return on investment. For example, in the energy and natural resources sector, investors often have to deal with regulatory changes that require them to modify their operations or pay additional costs for compliance, which can significantly harm their profits (Lubis, 2018).

Third, legal uncertainty also affects long-term investment decisions. Foreign investors usually seek legal certainty before making large investment commitments, especially in infrastructure or heavy industry projects that require large initial capital and long return on investment. Legal uncertainty makes investors hesitate to make long-term investments in Indonesia, because they are not sure

whether existing regulations will remain in effect or whether they can protect their investments from future legal risks (Faisal, 2020).

To overcome the problem of legal uncertainty and improve the foreign investment climate in Indonesia, the government needs to take proactive steps. First, regulatory stability is needed by ensuring that changes in policies and regulations are made through a transparent consultation process and involve all stakeholders. This can reduce surprises for investors and give them enough time to adjust to the changes. Second, the government needs to improve coordination between the central and regional governments to reduce regulatory overlap and ensure that regulations implemented at all levels of government are consistent and not contradictory (Setyawan, 2018).

In addition, consistent and transparent law enforcement is also very important. The government must ensure that the law is applied fairly and without the influence of external pressure. This includes strengthening law enforcement institutions and eradicating corruption at all levels of government. Transparent and consistent law enforcement will give foreign investors confidence that they can rely on the Indonesian legal system to protect their rights (Susanto, 2019).

Finally, harmonization of national laws with international standards should be a priority. The government needs to ensure that foreign investment regulations in Indonesia are in line with international standards, especially in terms of protecting investor rights and dispute resolution mechanisms. This can be done through revising existing regulations and increasing the capacity of legal institutions to handle international investment disputes. Thus, Indonesia can increase its competitiveness in the global market and attract more quality foreign investment (Faisal, 2020).

Challenges of Harmonizing Foreign Investment Law in the Context of Globalization

Globalization has brought the world into an era where national boundaries are increasingly blurred, and cross-border economic interactions are becoming more intense. One of the impacts of this globalization is the increasing flow of foreign direct investment (FDI) which brings capital, technology, and innovation from one country to another. However, globalization also demands legal harmonization, especially in the investment sector, so that there is harmony between domestic regulations and international standards. For a country like Indonesia, this legal harmonization is not an easy task, given the complexity of domestic laws that interact with various international agreements and global best practices.

One important aspect in the harmonization of foreign investment law is the protection of foreign investors' rights. Under the globalization regime, foreign investors seek assurance that their invested capital will be protected from expropriation or discriminatory treatment that may be carried out by the host country. To provide this assurance, many countries, including Indonesia, have signed various bilateral investment treaties (BITs) that serve to protect the interests of foreign investors. These agreements often include provisions on fair and equitable treatment (FET), protection against expropriation without adequate compensation, and the right to move capital and profits without hindrance (Susanto, 2019).

However, the challenge in legal harmonization arises when the provisions in these BITs must be translated into national law. In Indonesia, although many BITs have been ratified, the implementation of these provisions is often inconsistent with national law. For example, the protection against expropriation guaranteed in many BITs often conflicts with national policies that allow the government to take over assets for public interest, without adequate compensation or through a non-transparent process (Setyawan, 2018). This creates uncertainty for foreign investors, who feel that their rights are not fully protected by domestic law.

In addition, the misalignment between national law and international standards can also be seen in legal protection against disputes involving foreign investors. Although Indonesia has made efforts to create a friendlier investment climate through legal reform, the reality is that law enforcement is still often not in line with the expectations of foreign investors who are accustomed to international standards. For example, in terms of investment disputes, although many BITs regulate dispute resolution mechanisms through international arbitration, such as those facilitated by the International Centre for Settlement of Investment Disputes (ICSID), the implementation of international arbitration decisions in Indonesia still faces challenges, especially in terms of the recognition and enforcement of arbitration awards in national courts (Adam, 2017).

Settlement of disputes through international arbitration is one of the widely recognized mechanisms in international investment law. International arbitration provides foreign investors with a neutral and trusted forum to resolve their disputes with the host country, with the expectation that this process will be fairer and faster than national courts that may be influenced by local politics or lack independence. Indonesia has been a party to the ICSID Convention since 1968, which means that foreign investors have the right to file claims against Indonesia before the ICSID in the event of a violation of the investment agreement (Faisal, 2020).

However, the biggest challenge in harmonizing laws related to international arbitration is the issue of implementation and recognition of arbitral awards at the national level. Although Indonesia has ratified the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which should facilitate the implementation of international arbitral awards, in practice, investors often face obstacles in executing these awards in Indonesia. These obstacles can be in the form of a refusal by national courts to recognize and enforce foreign arbitral awards, or a protracted court process that ultimately harms investors (Lubis, 2018).

A well-known case related to this issue is the dispute between Indonesia and a foreign investor in the mining sector. Although the investor won the arbitration case at the international level, the implementation of the arbitration award faced significant obstacles when brought to the national court in Indonesia. In several cases, Indonesian courts refused to enforce international arbitration awards on the grounds that the awards were contrary to public policy or inconsistent with national legal principles (Setyawan, 2018). This reflects the misalignment between Indonesia's commitments at the international level and its law enforcement practices at the national level, which is a major challenge in legal harmonization.

Globalization has also had a major impact through free trade agreements (FTAs) which often include investment provisions. These free trade agreements not only regulate trade in goods and services, but also include protection of foreign investment and dispute resolution between investors and countries. Indonesia is a party to several free trade agreements, both bilaterally and within the framework of regional cooperation such as ASEAN and Asia-Pacific Economic Cooperation (APEC) (Susanto, 2019).

However, one of the challenges in legal harmonization is how these free trade agreements affect domestic regulations. Many provisions in FTAs require Indonesia to adjust its domestic regulations to comply with international standards set out in the agreement. For example, FTAs often contain provisions on national treatment and Most-Favoured-Nation (MFN), which require Indonesia to provide equal treatment between foreign and domestic investors, and provide equal benefits to all trading partner countries that have signed the agreement (Faisal, 2020).

Although it aims to create a level playing field for foreign investors, its implementation at the national level often conflicts with protectionist policies that are still adopted by the Indonesian

government to protect domestic industries. For example, provisions on MFN in free trade agreements may conflict with government policies that want to provide special treatment to certain investors or certain sectors that are considered strategic for national development. This creates a dilemma for the government in balancing national interests with international obligations (Setyawan, 2018).

In addition, FTAs also often affect the legislative process in Indonesia, where the government must ensure that new laws and regulations related to investment do not conflict with international commitments made in FTAs. This requires better coordination between government institutions, as well as increased legislative capacity to understand and apply international provisions in the context of domestic law. These challenges are often exacerbated by the lack of transparency and public participation in the FTA negotiation process, leading to a lack of understanding and support for these agreements at the national level (Lubis, 2018).

Addressing the challenges of harmonizing foreign investment law in the context of globalization requires a comprehensive and coordinated approach. First, Indonesia needs to strengthen law enforcement institutions, including courts and arbitration institutions, to ensure that they are able to enforce the law consistently with international commitments. This includes increasing the capacity of judges and arbitrators to understand and apply international law and international standards in resolving investment disputes (Faisal, 2020).

Second, the government needs to carry out legal reforms aimed at adjusting domestic regulations to international standards, while maintaining national sovereignty and interests. These reforms should include revising laws relevant to investment, as well as developing effective mechanisms to integrate international provisions into national law. This also requires close cooperation between the central and regional governments to ensure that all levels of government implement harmonious and consistent investment policies (Susanto, 2019).

In addition, Indonesia also needs to increase transparency and public participation in the negotiation and implementation of free trade agreements. By involving more stakeholders in this process, including the private sector, academics, and civil society, the government can ensure that national interests are well represented in these agreements. This will also help create broader public support for the international commitments made by Indonesia (Lubis, 2018).

Finally, it is important for Indonesia to continue to actively participate in international forums related to investment, such as ICSID, WTO, and APEC, to ensure that national interests are championed at the international level. Through active participation, Indonesia can contribute to the development of fairer and more balanced international norms, and influence the direction of the development of global investment law in accordance with national interests (Susanto, 2019).

CONCLUSION

In the context of globalization, the harmonization of foreign investment law in Indonesia faces significant challenges that reflect the misalignment between domestic regulations and international standards. Uncertainty in the protection of investor rights, inconsistency in the application of international arbitration, and the influence of free trade agreements on domestic regulations are some of the main issues that hinder the achievement of a stable and competitive investment climate. Despite efforts to align regulations with global demands, implementation at the national level still needs to be improved to ensure legal certainty for foreign investors.

Therefore, comprehensive legal reform is needed, including aligning domestic regulations with international commitments and increasing the capacity of law enforcement institutions. In addition,

active involvement in international forums and increasing transparency and public participation in the legislative process and negotiation of free trade agreements will be essential to ensure that national interests are protected while meeting global standards. With these steps, Indonesia can create a more harmonious and attractive investment environment for foreign investors.

BIBLIOGRAPHY

- Adam, R. (2017). "The Development of Foreign Investment Policy in Indonesia." *Journal of International Law*, vol. 14, no. 2, pp. 178-194.
- BKPM (Investment Coordinating Board). (2020). *Annual Investment Report*. Jakarta: BKPM.
- Faisal, A. (2020). "Post-Asian Economic Crisis Investment Law Reform in Indonesia." *Journal of Economics and Public Policy*, vol. 15, no. 3, pp. 45-62.
- Lubis, F. (2018). "Corruption and Legal Uncertainty in the Investment Climate in Indonesia." *Journal of Business Law*, vol. 22, no. 4, pp. 212-230.
- Setyawan, R. (2018). "Economic Liberalization and Its Impact on Investment Law in Indonesia." *Indonesian Journal of Economic Law*, vol. 11, no. 1, pp. 55-71.
- Susanto, A. (2019). "Globalization and Harmonization of Investment Law in Indonesia." *Journal of International Law*, vol. 16, no. 1, pp. 90-106.
- Law Number 1 of 1967 concerning Foreign Investment.
- Law Number 25 of 2007 concerning Investment.
- Law Number 30 of 1999 concerning Arbitration and Alternative Dispute Resolution.
- Law Number 11 of 2020 concerning Job Creation.
- Presidential Regulation Number 49 of 2021 concerning Amendments to Presidential Regulation Number 10 of 2021 concerning the Investment Business Sector.
- Government Regulation Number 5 of 2021 concerning the Implementation of Risk-Based Business Licensing.
- New York Convention 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.