

Implication of Bilateral Investment Treaties on Sustainable Development: Indonesia Mining

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Keywords: bilateral investment treaty, protection to foreign investors, international investment law, mining, sustainable development.

Abstract: This paper examines the role of political factors play in the investment location decisions of multinational enterprises. It has been found that foreign direct investors shy away from countries with excessive government spending, especially when this spending is directed towards the military. They also seem to have a slight preference for leftist executives and be negatively predisposed toward situations in which the ruling party has held power for prolonged periods of time. “Ceteris paribus”, more foreign direct investment (FDI) flows to countries that have presidential systems which mostly developing countries, established political parties and where the party of the executive controls all houses with law-making powers. The foreign investors who mostly liberal-minded are spoiled with the political economy system of developing countries which rather can be manipulated to fulfill their desire of protection and full access of the desired resources. However, after World War II, the political constellation has changed dramatically that caused an emergence of rising-new countries and forceful demand of developing countries to obtain equity in free market economy system through a modern mechanism known as bilateral investment treaty (BIT). A continuous changing dynamics in global political economy leads the mankind to the era where the scarcity of natural resources almost become a realization. One way to sort of postpone the scarcity is by implementing so called sustainable development in business activities especially in mining investment sector. This research aims finding BIT advantages on Indonesia’s mining to implement sustainable objectives.

1 INTRODUCTION

The international economic relation has always been an endless intriguing topic to discuss in any platform. Unbelievable dynamic changes makes international economic relation unpredictable. This particular circumstance has affected the international relations by creating new trends in economy sector. One of the new trends is known as “investment” which has already conducted since before the World War II occurred. Notwithstanding the adequately long period of time of existence, there is still no common legal definition of the term “investment” due to the variety meaning in accordance to the object and purposes of different investment instruments which contain it (OECD I 2008). However, Trygve referred to two classical notions of investment which; first, is the transfer of a certain amount of wealth from one ownership, or employment, to another that may cause single individuals or firms to carry out such “spot investment” operations in a closed economy environment; and second, investment is derived from

the idea of capital as a revolving stock. That means a part of gross current output must be “invested” each year in order to keep the stock of capital constant (Trygve Haavelmo 1960). As a consequence of those notions that are still inclusive, practically speaking, investments may be done in domestic or foreign territory. Sornarajah confirms the first notions of the term of investments by explaining so called foreign investment which involves the transfer of tangible or intangible assets for one country to another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets. In practice, the said investment can be done by transfer of physical property that is bought or constructed such as equipments or plantations, which later known as direct investment. Another form of transfer of assets, known as indirect investment, normally be represented by a movement of money for the purpose of buying shares in a company formed or functioning (M. Sornarajah 2010).

The emergence of investment activities was as the result of major changes in the international political

constellation caused by the World War II. Establishment of new emerging countries that resulted in changes in the mindset of countries in the world in conducting international relations from previously dominated by the developed countries to coordination between countries with upholding their sovereignty. The post-war circumstance caused the developing countries in need to attract foreign capital as their wish to foster their emerging equity markets (Sir Kenneth Berrill 1990; M. Sornarajah 2010). A desire to lower countries' trade-barriers as a way to encourage international economic development was generally proposed by both developed and developing countries, although there is no doubt that this system was proposed by developed countries who carry out the "liberalism" perspective; this system later be known as liberalization. In spite of the system is preferred by both developed and developing countries in various point of views, financial crises have occurred over the years, and the world has become rather more non-resistant to them with the growth of financial market liberalization since 1970s (T. Chon 2012). Nevertheless, the establishment of two international economic organizations (i.e. International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD) or World Bank) resulted from Bretton Woods Conference in July 1944 and the General Agreement on Tariffs and Trade (GATT) which led to the Marrakesh Declaration in 1994 constituted the Agreement on Establishing the World Trade Organization (WTO Agreement) brought a "fresh air" to the global economy.

Throughout historical timeline, from the mercantilist period before the World War II to the WTO mechanism, there has been changing trends in global economy, for instance, the existence of cross-border investment agreements such as Bilateral Investment Treaty (BIT) and International Investment Agreement (IIA) in general. Based on the data compiled by United Nations Conference on Trade and Development (UNCTAD), Indonesia had signed throughout its history approximately 71 BITs and only 28 of them has been terminated.

This change in trend may be due to the substantial role of the international agreements as the guideline for countries, especially by developing countries, on conducting international relations. It may also be due to the increasing number of world population which leads to a situation where the consumption of natural resources, notably minerals and gas, also increases to meet the needs and demands of the population itself. A balance between business which in this case is represented by investment, with the environmental

protection and preservation has become a crucial issue for mankind from generation to generation.

This paper is intended to examine the political factors that embodied in investment activities of multinational enterprises while also ensuring the sustainability of environment by bridging between investment law and environment. The authors argue that by having a decisive guideline such as BIT can ensure the energy sustainability of a country, especially Indonesia, while also conducting promising business activities to enhance its development.

2 METHOD

This research has adopted doctrinal, historical, and analytical research methods to study the political and legal concepts, laws and regulations, international or municipal, applied to investor-state disputes and arbitrations, also interconnection between investment or business activities in general and sustainable development so as to address to the issues raised in this research. Such a method declares, explains and highlights the active laws and global political economy relations in any given field. A library based research is rated by the authors as the most convenient methods used in this research. It is also referred to as "arm-chair" based research. Hence all the tools of library research have been used as sources of data collection to carry out this research including published official reports; special volumes of journals; articles and books; working papers; legislations and any other relevant information from online databases.

3 RESULTS

BIT offers various advantages for developing countries especially Indonesia despite some of its characteristics that still need further development. As a results of structural economic change, BIT can attract foreign investment because indirectly it create a suitable investment climate and provide legal certainty and adequate protection for investors. In addition, the basic principles in free-trade mechanism can also be applied into the agreement which makes BIT even more appealing to the developing countries come under Indonesia.

Continuous sustainability of minerals and coal can be accomplished if the clause in the BIT does not pose a problem. So far the clauses in BITs have been

detrimental to Indonesia. Implementation of mineral and coal mining business activities is aimed at implementing policies in prioritizing the use of minerals and/or coal for the benefit of the country.

4 DISCUSSION

Interlacing the previous argument in the introductory section and in order to be able to understand the rationale of this research, it is necessary to know the correlation between investment law and environment. It is noticed that investment law and environment have some sort of a “gap” between those two fields. Martijn Scheltema acknowledged that there are various possible approaches to bridge this “gap”. One would be modifying the content of investment treaties from an approach that only aims to protect the financial interests of investors towards an approach that also secures public interests including environmental concerns. Environmental issues are treated quite differently in the context of investment law. Although most countries agree that investment laws should leave room for national policymakers to regulate environmental issues, there is still no global understanding about what we should do to align investment protection with maintaining a healthy environment on a global scale. Scheltema points out that there is a real challenge to implement environmental issues into investment treaties in a proper manner. The second approach would be amending the procedures in investment law disputes. For instance, arbitrators should be chosen from different legal backgrounds than today, e.g. they should also have experience in dealing with environmental law issues (Rosalien Diepeveen and Yulia Levashova and Tineke Lambooy 2014).

Natural resources, besides as a part of environment, are the basic capital of a country's development. Among countries in the world, natural resources may be relatively more prevalent for developing countries due to the modest size of the modern sector of economy makes agriculture and natural resource-based economic activities play a big role in its development (Thorvaldur Gylfason and Gylfi Zoega 2001). However, a serious and long-term issue so-called climate change, awaits countries all around the globe that may cause global challenge in social and economic development, especially developing countries, which are expected to experience larger percentage losses of gross domestic product (GDP) than developed countries (OECD 2009; IPCC 2007). Besides, natural resources have high economic value. High economic value is

obtained which caused by natural resources as the main factor for human needs. Such factor could lead to an injustice of resource distribution. A term known as environmental justice is noteworthy and should be addressed in this discussion, for which it refers to the equitable distribution of environments among peoples in terms of access to and use of specific natural resources in defined geographical areas, and the impacts of particular social practices and environmental hazards on specific populations (as defined on the basis of class, occupation, gender, age, tribe, caste and ethnicity) (Rob White 2013). If the said matter is put aside or at least not being a common concern in business activities, what was put forward by Garrett Hardin with the Tragedy of Common which is a theory when natural resources are increasingly limited in number but on the other hand each individual has a rationality to incentive utilize which then leads to decreasing availability of resources and adversely affecting all circles or classes might come into a realization (Ahmad Redi, 2017). For the completion of the tragedy of common, the emergence of property rights over natural resources occurs. Distribution of ownership classification by Neil Mayer among others:

1. Private Individual;
2. Public Individual;
3. Public Group;
4. Private Group.

Emily E. Harwell and Owen J. Lynch's Spectrum of Property Rights schemes are divided into four:

1. State ownership;
2. Private control or ownership;
3. Individual mastery;
4. Mastery of community groups (Emily E. Harwell and Owen J. Lynch, 2002).

The distribution of ownership mentioned above affects the distribution of benefits of natural resources. Natural resource exploitation must be balanced that takes into account all natural resource owners.

Among all kinds of natural resources that lay on or beneath the surface of the earth, due to their effortless utilization and solid trading power, minerals and coals have an important role in meeting the many needs of human life despite their non-renewable nature. This is shown by and consumption throughout the year of 2007 to 2016. Started at the number of 258,190,629 barrel of oil equivalent (BOE) for supply in the year 2007, Indonesia has managed to maintain the number of supply between 250,000,000 to 290,000,000 BOE from 2007 to 2010 although there was sort of declining number of coal supply in 2008 that reached 224,587,657 BOE. Then,

since the year of 2011 until the most recent data collected of the year of 2016, Indonesia's coal supply has not reached the number below 300,000,000 BOE and nearly made its way to the number of 400,000,000 BOE, approximately 380,310,000 BOE. Surprisingly, in the range of 9 years, in spite of following the increasing dynamics of coal supply, Indonesia has managed keeping its consumption below 150,000,000 BOE. Moreover, from 2013 to 2016, Indonesia has never reached the number above 71,000,000 BOE on coal consumption while its supply was beyond 300,000,000 BOE (MoEMR 2017).

The description above shows that the presence of the state as the manifestation of people's sovereignty is crucial to ensure the balance of the usage of natural resources which is the right of the people of the state. Therefore, management of natural resources must be controlled by the states to provide added value for their economy in order to achieve national prosperity and prosperity of the people fairly. Mining business activities have an important role in providing real activities in the national economic growth and sustainable regional development. In other words, substantially minerals and coal are under the control of the state. The concept of state control of natural resources in Indonesia is regulated under Article 33 paragraph (2) and (3) of the 1945 Constitution of the Republic of Indonesia in essence, referring to the guidelines and legal basis in the management of resources owned by Indonesia. Basically, the concept of state control belongs to the ideology of socialism. The term "controlled by the state" is included in the explanation of the 1945 Constitution of the State of the Republic of Indonesia namely "the important branches of production and which control the life of many, must be controlled by the state and used the greatest prosperity of the people". The prosperity of the people is part of socialism which is also mentioned in the fifth of "Pancasila" (Indonesian ground norms) which comprised in the preamble of the 1945 Constitution of the Republic of Indonesia that stated in translation:

"Social justice for all the people of Indonesia".

The motive underlying the conception of the Article 33 of the 1945 Constitution of the Republic of Indonesia basically makes the natural resources in Indonesia as national property which the people of Indonesia have an exclusive rights over it.

As two kinds of natural resources, minerals and coal were originally public property but changed at the time of legal subjects. It metamorphs from public-group becomes public-individual property. For example, sand can initially be utilized freely by a

community and is not restricted by anyone and/or required some expenses to utilize it. But in present circumstance if it will be attempted by the party (individuals or private) who wish to commercialize it, whosoever must submit a request for permission to the government as a representative of the state (Ahmad Redi, 2017). The division of the above rights in practice can be a boomerang weapon or even a conflict. The conflict is intended to seize the right to the minerals and coal between the existing community and the companies that will cultivate the minerals and coal.

Mining disputes involve almost all aspects, among others; investment, forestry, industry, labor, the environment and indigenous peoples. The forms of mining disputes may include government disputes with business entities, disputes between state institutions, disputes between government and state governments and disputes between business entities and mining communities (Ahmad Redi, 2017).

In recent years, Indonesia continues to be one of notable role-players in the global mining industry with definite rise of mining production such as copper, tin, gold, coal, and nikel. As early the Government of Indonesia (GOI) started its "liberalization" program by enacting its Investment Law No. 1 (Abdul Khaliq and Ilan Noy 2007). However, in green-field project there has been limited investment in mining. In addition, natural resource investment, including mining, tend to require high capital costs up front for instance to build a mine, oil pipeline or agro-processing facility for agriculture-based enterprises (Lorenzo Cotula 2016). Likewise, on 24 April 2014, the Government of Indonesia has made the long awaited modifications on so-called "The Negative List" effective under the Presidential Regulation No. 39 of 2014 which did not provide any real liberalization but a tightening of foreign investment restrictions in some key sectors (KPMG 2015). The implementation of this regulation has had an adverse effect on investment activities in Indonesia especially in the mining sector. As survey conducted by PwC, Indonesia decreased by 31% from US \$ 7.4 billion in 2014 to US \$ 5.2 billion in 2015 (Table 1) based on data obtained from Ministry of Energy and Mineral Resources Republic of Indonesia shown in Table 2 (PwC 2017).

Table 1: PwC Survey on Indonesia's Mining Investment

Survey Results	2015 US\$ millions	2014 US\$ millions	Year-on-year movement
Greenfields exploration spending	29	36	-20%
Other exploration and feasibility	58	75	-22%
Total exploration	87	110	-22%
Development	126	198	-36%
Fixed assets	1,701	2,109	-19%
Total investment	1,913	2,418	-21%

Table 2: Ministry of Energy and Mineral Resources Data

Government Data	2015 US\$ millions	2014 US\$ millions	Year-on-year movement
Total investment	5,152	7,430	-31%

(source: Ministry of Energy and Mineral Resources)

In spite of the declining growth of mining investment in Indonesia in 2014-2015, international surveys on mining companies continues to rank Indonesia highly in terms of mining prospectivity, but poorly in terms of its mineral policies and investment climate (PwC 2017). The necessity of mining law framework and regulatory to encourage new investment by providing the investors the certainty needed to commit the investment activities in Indonesia and also reinforce Indonesia position as the main role in the mining sector. Beside PwC, OECD as one of the leading international organization in global economic development suggests that policy reform is essential to make investment of a country more attractive destinations for potential investors. Improving the enabling environment for investment, including in specific sectors such as infrastructure, agriculture or clean energy and promoting responsible investment and responsible business conduct in home and host countries are two significant roles of OECD in terms of encouraging reform and promoting international good practice in all parts of the world (OECD 2015).

Nevertheless, such policy reform is not something that can be done overnight which the changes is radical or fundamental and comprehensive for some countries, it will take an adequately long period of time to satisfy the potential investors with the certainty they need. Yet there have been various attempt to create a multilateral framework of investment. Combined with the regulation of cross-border trade, in 1994, WTO has produced several agreements covering important aspects related to investments in General Agreement on Tariffs and Service (GATS) and Trade-Related Investment Measures (TRIMs). Unfortunately, the arrangement by the WTO is more focused on market access rather than investment protection. As a consequence, the issue is taken up by the OECD which has held several international conferences related to the making of multilateral agreements on investment. However, the fact had shown that there were some countries, developing countries in particular, to participate into such agreements and in result is a network of over 2,750 bilateral and regional agreements, which UNCTAD describes as "a universe in constant expansion and change, formed by variable constellations that are linked by overlapping membership and complex interactions (IISD 2012).

BIT similar as contract or policy to countries specifically between investors. To date, there are divergence BITs template between one with another. For instance, what is mentioned and set forth in the 2012 investment treaty model by the United States are different with other countries. While the Indonesian government is still compiling the model of the BIT. Globally, it creates problem about legal certainty. However, be found minimum standard of forming the BIT which consists of:

1. Definition
2. Scope and Coverage
3. National Treatment
4. "Most-Favoured Nation" Treatment
5. Expropriation and Compensation
6. Investment and Environment
7. Consultation and Education
8. Arbitration
9. Dispute Settlement

Despite the divergence exists, the very basic principles of free trade mechanism may apply to investment law. Trade without discrimination is one of these basic principles, guaranteed through the operation of various clauses included in the multilateral agreements on any trade means. The non-discrimination principles embedded in the WTO Agreement are first, "most-favored nation treatment" which oblige the Contracting Parties of WTO

Agreement to grant to the products of other contracting parties treatment no less favorable than that accorded to products of any other country; second, “national treatment” condemns discrimination between foreign and national goods or services and service suppliers or between foreign and national holders of intellectual property rights; and third, “transparency principles” are set out in the WTO Agreement and its Annexes, with the objective of guaranteeing the fullest transparency possible in the trade policies of its Members in goods, services and the protection of intellectual property rights (Eun Sup Lee 2012).

A discussion on the doctrine of sustainable development which derives from a discipline in economics has been evolving since early 1800s initiated by the work of English political economist Thomas Malthus. Since the days of Malthus, economists tend to neglect the dilemma of resources depletion and only focus on the efficiency usage of resources because they have been reluctant in developing economic models that adequately account the rareness of resources and pollution. Moreover, it was only rarely that the economists worried that some resources may be in short supply and these resources may become exhausted and constrain the very growth for which they are developed if they are used indiscriminately (A. D. Basiago 1999). Sustainable development refers to the development that meets the needs of the present without compromising the ability of future generations to meet their own needs (WCED 1987). With the definition on sustainable development given, mankind are demanded to be able to account or even predict the state of nature in the future while increasing their economic growth. Hence, a question arises whether sustainable development can be in line with economic growth. To answer that, it should be noted that the principle of sustainable development is essentially a balance between economic, equity, ecology which can be ensured by renewing the global economic models. Van der Heijden suggests to fulfil the need of new global economic models by applying so called the “green incentives” i.e. greening the tax system; removing environmentally harmful subsidies, such as subsidies for fossil fuels; making pollution more costly by pricing externalities; valuing natural assets and ecosystem services; encouraging green innovation and devising effective regulations (Rosalien Diepeveen and Yulia Levashova and Tineke Lambooy 2014).

Although Heijden has given some options regarding reformation of the economic models, the issue of sustainable development can not only be

solved by just using one way and in a short period of time. It requires structural economic change and can only be brought about by investment, and in those countries with low levels of domestic savings that investment must come from abroad. One of many steps commonly taken by governments in the pursuit of investment is to carry out cross-border cooperation is, traditionally done by concluding agreements such as BITs or IIAs (IISD 2004). Indonesia has reformed its mining law sufficiently comprehensive. In respect of natural resources sustainability, Indonesia’s Regulation of the Government of Substitutes of the Law No. 37 of 1960 and Law No. 11 of 1967 have never alluded to the term “sustainable”. It is illustrated by the underlying considerations of the drafting of the regulation which at that time, the main of concerns is to accelerate the national economic growth alone regardless the sustainability of the natural resources required for it. 40 years later, the characteristics of regulations of Indonesian Government began to indicate a significant change in which one of them is Law No. 4 of 2009. The main objective of the management of mineral and coal business activities as stated in Law No. 4 of 2009 on Mineral and Coal Mining as follows:

1. Ensure the benefits of mineral mining and coal in a sustainable and environmentally sound manner;
2. Increase the income of local, regional and state communities and create jobs for the greatest prosperity of the people;
3. To ensure legal certainty in the conduct of mining business activities;

The aforementioned objectives, containing various elements of interest that is economic, social and environmental. It has to do with the nature of minerals and coal as a non-renewable natural resource, the concept of sustainable development seeks to collaborate on the concept of mining management with economic, social and environmental aspects.

Most Favored Nation (MFN) as international business law principle can be inhibit to Indonesia’s sustainability. The principle of MFN emphasize equal treatment all members countries of WTO. With difference quality and ability in one and another can create barriers to developing and undeveloped countries. Based on Regulation Of The President Of The Republic Of Indonesia Number 44 of 2016 About List Of Closed Business Fields and Open Business Fields With Requirements In The Field Of Investment, Mining investment classified as Open Business Fields. In the case of an individual foreign legal entity engaging in investment in Indonesia, shall

pay attention to the provisions of Article 112 of the Mining Law. In accordance with the mandate of Article 112 Paragraph (2) of the Mining Law, the Government Regulation no. 23 of 2010 concerning the Implementation of Mineral and Coal Mining Business Activities. Implementation of mineral and coal mining business activities is aimed at implementing policies in prioritizing the use of minerals and / or coal for the benefit of the country. Thus, in the preparation of bit models, Indonesia needs to

pay attention to domestic interests especially for the implementation of sustainable mining business that consider to the economic, social and environmental aspects.

5 CONCLUSION

Emerging new trends of investment and environment makes BIT become more “mature” than it used to. Providing promising advantages and legal certainty makes BIT as a mechanism for developing countries to seek an equity in free market access and trade regardless the power of their partner.

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