DIVESTMENT POLICY ON MINING SECTORS : THE CHALLENGE AND THE IMPLICATION FOR FOREIGN DIRECT INVESTMENT IN INDONESIA

Dr. Mas Rahmah, S.H., M.H., LL.M
Prof. Dr. Muchammad Zaidun, S.H., M.Si
Faculty of Law- Airlangga University-Indonesia
rahmah_arifin@yahoo.com

ABSTRACT

In 2012, Indonesia government issued the new divestment regulation that limits foreign ownership in mining sectors, by requiring a mandatory divestment of at least 51% of shares after 10 years of production and obligating all foreign mining firms to have an Indonesian majority shareholders by 2022. This paper aims at exploring the challenges in implementing the divestment policy at doctrinal, normative and practical level. At doctrinal level, the challenges relates to the conflict between the policy and "right of property". At normative level, the existing problems are:(a) no detail regulations of divestment requirements;(b) no penalties for non compliance with the requirements;(c) no transitional provision providing "retrospective effect;(d) legal inconsistency with Indonesian obligations on Bilateral Investment Treaties (BITs) preventing the investment insecurity. At practical level, the policy seems difficult to be implemented regarding to:(a) the ability of Indonesian parties to purchase the shares, then to involve and manage mining companies professionally;(b) uncertain divestment mechanism such as slow progress of bureaucratic process, selling price of divested shares, continuity of the divestment obligation if there is no purchaser, etc. This paper argues that uncertain divestment policy will potentially deter the longterm investment and attractiveness of investing in Indonesia's mining sectors, influenting foreign direct investment (FDI) rate. This paper then proposes that divestment policy should balance the national interest and the interest of promoting investment by:(a) clearly regulating the term and method of divestment;(b) providing adequate incentives to investment returns prior to divestment deadlines;(c) providing transparent guidance; and (d) communicating the need of FDI to maximize the industry contribution to Indonesia development goals.

Key words : divesment, mining, foreign direct investment, Indonesia.

1. INTRODUCTION

On 21 February 2012, Indonesia amended divestment policy by issuing Government Regulation No. 24/2012[1] (amendment to Government Regulation Number 23/2010[2] on the Implementation of Mineral and Coal Mining Activities) to increase the share of Indonesian firms in foreign mining companies. While the previous regulation (GR 23/2010) required foreign enterprises to divest 20% within 5 years, the latest regulation (GR24/2012) requires a further progressive divestment of 51% of their assets to locals by the 10th years of production. Under this new regulation, foreign mining firms have to ensure that 20% of their shares will be

[1] Hereinafter GR 24/2012
[2] Hereinafter GR 23/2010

Indonesian-owned after 6 years of production and this proportion would rise to 30% after 7 years, 37% after 8, 44% after 9, and 51% by 10 years. From the nationalist perspective, the policy is an effective mean to increase the participation of Indonesian companies in mining sector. However, the policy may raise the foreign companies resistance and counteraction such as complain about 10 years is insufficient for making an adequate return on their investment, that the divestment regulation is unclear and uncertain, thus foreign companies face difficulties with the divestment process and pricing mechanism.

This paper aims at exploring the challenges in implementing the divestment policy at doctrinal, normative and practical level. At doctrinal level, the challenges relates to the the conflict between the divestment policy and the right of property. At normative level, the details of divestment requirements left to future government regulations have not been yet formulated. This policy does not provide the penalties for non compliance with the divestment requirement and transitional provision consisting "retrospective effect" to existing companies formed on the earlier requirements or regulations. In addition, the policy also creates a potential inconsistency with Indonesian obligations on BITs avoiding the investment insecurity and expropriation. At practical level, the ability of Indonesia parties to buy the divested equity, then to involve and manage the mining company professionally will be the major practical problems. Furthermore, the policy seems difficult to be implemented regarding to the uncertain divestment mechanism such as potential slow progress of the bureaucratic process, uncertainty of selling price of divested equity and compensation, or the possibility of foreign shareholders to accept divestment if there is no Indonesian buyer, problems on whether the policy will apply to publicly listed companies or to joint venture arrangements, etc. This uncertain divestment policy will potentially affect to the longterm foreign mining investment in the Indonesia, then subsequently discourages the the attactiveness of investing in Indonesia and reduces the rate of FDI since mining sectors still contributes a significant portion of Indonesia's FDI. This paper recomandates that divestment policy should balance the interest of nationalistic concern and the concern of promoting investment in mining area by clearly regulating the term and method of divestment; providing transparent guidance to reduce uncertainty in projecting future returns for mining corporations and to avoid disputes from divesting process; providing adequate incentives to investment returns generated prior to divestment deadlines; and communicating that the foreign investment in mining sector is still required and welcomed to maximize the industry contribution to Indonesia development goals.

2. DIVESTMENT POLICY

2.1. Concept of Divestment

Divestment is defined as a sell-off of units in foreign locations, or conversely units owned by foreign firms.[3] In Indonesian divestment regulation perspective, divestment means a number of foreign shares that is subject to offer for sale to Indonesian participants (Article 1.8 of GR 23/2010). In Indonesian regulation view, it is mandatory (forced) divestment since it requires all foreign mining firms a phased divestment of at least 51% of equity after 10 years of commercial production, meaning that all mining firms is required to have an Indonesian majority shareholder by 2022. According to Kobrin, forced divestment is defined, first, ownership of assets-where that ownership entails foreign direct investment, in the sense of

[3] Gabriel R.G. Benito (2003), "Divestment Seen through the Lens of International Business Strategy", *Paper* presented at International Conference on Divestment: Corporate Strategies, The Regions and Policy Responses, Lisbon, p. 2

cross border transfer of equity accompanied by some degree of managerial control-is required.[4] Second, the divestment must be involuntary since the transfer of ownership takes place only because of (generally public) coercion.[5] Third, divestment focuses on deprivation of ownership and not deprivation of the benefits of ownership.[6]

Forced divestment is designed for a compulsory and systematic transfer of ownership.[7] Forced divestment requires foreign companies to sell either the majority or totality of ownership to local participants within a stipulated period by divesting a certain proportion of equity (usually 51%) under the same terms and conditions (percentage of equity divested, the time period allowed, manner of sale and selection of buyers).[8] Glenn E. Hachadorian notes that a host countries must attempt to exert increased control over foreign investors through a range of policies which vary in terms of both intent and effect, thus, it becomes difficult to determine exactly forced divestment actually takes place.[9]

Forced divestments of foreign property which were classified into the four categories: (a) formal expropriation, (b) intervention, (c) forced sale and (d) contract renegotiation.[10] Unlike formal expropriation which took place in accordance with the local law, intervention is an extra-legal forced transfer of ownership.While contract renegotiation is a revision of contractual agreements involving coercive power of the government, which resulted in an efective transfer of ownership.[11] Indonesia divestment policy can be constituted as a forced sale of foreign shares to Indonesian articipants.

2.2. The Divestment Rationales and Benefits

For developing countries, it is inevitable to stimulate its own development by attracting foreign investors.[12] However, at the same time, the concessions and authorizations granted to multinational corporations often hand over control over some of the most important resources of the state.[13] Thus, for a state to retain an effective exploitation and development of its natural resources and national policies, it is necessary for them to enjoy the freedom to regulate FDI, and then ultimately to also have the right in limited circumstances to apply divestment policy with various rationales.

According to John T. Lindquist, the rationales of divestment policy can be divided into economic and non economic rationales. Based on economic rationales, divestment is seen as a solution for economic cost derived from FDI becoming a retarding influence, less essential as the capacity of local economy, inhibiting the development of local enterprises and local savings.[14] The value of FDI for host country declines because after the initial contribution of management, marketing, capital and enterpreneurship made by foreign enterprises, technology becomes commonspread and knowledge diffused, FDI becomes less important. Divestment is a

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[4] J. S. Kobrin, S. J. (1980), "Foreign Enterprise and Forced Divestment in LDCs", *International Organization*, 3 4(l), p. 65-88.
[5] *Id*
[6] *Id*
[7] John T. Lindquist (1972) , The Merits of Forced Divestment: The Experience of the Andean Group, *Discussion Paper No. 31,* Research Program in Economic Development, Woodrow Wilson School, Princeton University, p.1
[8] *Id*, p.2
[9]Glenn E. Hachadorian (1987), "Hierarchical Determination of the Risk of Forced Divestment to Foreign Owned Enterprises In LDC?", *Mathematical Modelling*, Volume 8, p. 163.
[10] Sergei Gurievy, Anton Kolotilin, Konstantin Sonin (2008), " Determinants of Expropriation in the Oil Sector: A Theory and Evidence from Panel Data", *Working Paper No 115 CEFIR / NES Working Paper series*, p.10
[11] *Id.*
[12] S. A. Riesenfeld (1995), "Foreign Investments" in R. Bernhardt ed.*, Encyclopedia of Public International Law,* Amsterdam, Vol II, p. 436.
[13] M. Sornarajah (2004), *The International Law of Foreign Investment*, 2nd ed., Cambridge, p. 40.
[14] *Id*, p.5

remedy and possible means of alleviating the economic problems created by FDI since control of foreign firms passes to national hands.[15] Nationals are believed to be more responsive to government economic policies and controls. Constantine Vaitsos affirms that national control can be essential in reducing the economic cost of FDI since the loss of control has overwhelmingly important economic repercussions, not for the "psychological insecurity" of "national ideology and fears of foreign domination' reason only.[16]

Based on non economic rationales, the desire of host countries to gain control over foreign enterprises for nationalistic reasons is sufficient justification for a divestment policy. Nationalists argue that FDI is a threat to national sovereignty/independency and to the achievement of national goals in accelating economic development. Nationalists see that the massive presence of FDI can weaken national solidarity, impairing government's ability to ask sacrifices from the public.[17] Nationalists often view that FDI affects to dependency of host countries, indicating the direct and indirect loss of host countries ability to influence and control the vital decisions influencing their economic and future development.[18]

When FDI percieved as hindering Indonesian government's legitimate prerogative to implement policies in economy, politic and social in the best national interest, dependency of Indonesia becomes a critical problems. To reduce the dependency, obtaining greater control over foreign enterprises by having majority ownership can be achieved by applying divestment policy. Therefore, divestment policy will be an effective means for controling over the mining resource, obtaining greater national control over Indonesian economy, lessening of external dependence, obtaining an equitable distribution among countries of new investment projects, strengthtening the bargaining position in regard to foreign investments, and avoiding excessive competition for new FDI.

The Indonesian divestment regulation's preamble explicitly states that one of divestment rationales is to increase more Indonesians to participate in mining sector. This rationale aims at lessening Indonesian dependence on foreign investors and achieving a greater level of autonomy, especially in mining sector since divestment policy aims at limitting foreign ownership by requiring a phased divestment of at least 51% of equity after 10 years of commercial production. The greater autonomy in mining corporations will also contribute to a more equitable distribution of income and welfare within society. A greater level of autonomy, a lessening dependence on the advanced nations, or a more equitable distribution of income and welfare or prosperity within society will be the most important national goals.[19] Article 33(3) of Indonesian Constitution (UUD 1945) stipulates that state has obligation to create and ensure social welfare and prosperity as national goals by dominating, controlling and governing the national resources (the land, the waters and the natural resources). This provision ascertains the right of state to control over the natural resources, including mining resources as the implementation of the sovereign right of each nation to control its economy and resources.

According to Article 33(2) Indonesian Constitution, the national goals can also be achieved by setting the sectors of production which are important for the country and affect to the life of the people shall be under the power or control of the state. The Preamble of Indonesian Mineral and Coal Act (UU 4/2009) asserts that Indonesian mining resources as

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[15] *Id,* p.3

[16] Contantine Vaitsons (1970), "Transfer of Resources and Preservation of Monopoly rents", Harvard Universtiy, Centre for International Affairs, Development Advisory Services, p. A.6

[17] Carlos F. Diaz-Alejandro (1970), "Direct Foreign Investment in Latin America", New Haven, Yale University, Economic Growth Centre, p. 344.

[18] Ronald Muller (1970), The political Economy of Foreign Direct Investment: An appraisal for Latin American Policy Making, p.10.

[19] Supra note 7, p.11

nonrenewable natural resources granted by God Almighty, have important roles in meeting the life of many people and in bringing continuously real added value to the national economic growth and development. Therefore, the management and control over the mining resources by the state will contribute national economic growth and development.The divestment policy is one means to control over the mining resourses, therefore a foreign-owned mining company is required to assign majority control of the company, not later than 10 years after commercial production.

2.3. Divestment Process

Article 97(1) GR 23/2010 regulates that Mining Permit holders (IUP)[20] and Special Mining Permit holders (IUPK)[21] with foreign capital[22] must upon 5 years of production divest 20% of their shares to Indonesian participants.Then, this provision is amended by GR 24/2012, stipulating that foreign companies must sell down stake in mines and increase domestic ownership to at least 51 percent by the 10th year of a mine's production. It means that GR 24/2012 escalates the portion of 20% divested equity into 51%.

Similar to the previous GR 23/2010, GR 24/2012 provides that divested equity shall be offered directly to targetted Indonesian participants. According to these provisions, the foreign mining companies cannot simply select the buyers to which it would like to divest. The buyer must be Indonesian and provisions set forth a priority of Indonesian parties to whom the shares must be offered:(a) the Central Government;(b) Provincial or Regional Government;(c)State/Region-owned Enterprises; and (d) National privately-owned companies. According to Article 97(3) GR 23/2010 and GR 24/2012, when government lacks interest in the purchase of shares as intended, the shares shall be offered to the provincial governments or the district/city governments. If the provincial/regional governments disregard the offer, the shares shall be offered to State/Region-Owned Enterprises through a bidding process.[23] According to Article 97(5) GR 23/2010 and GR 24/2012, when State/Region-Owned Entities lack intention to purchase, the shares shall be offered to national private entities through a bidding process. It means that if there is none is willing to purchase the shares offered after the expiry of a divestment period, the targetted parties will shift (e.g.from the Central Government to Provincial or Municipal Governments, so on). A share offer shall be made no later than 90 working days of the 5th year of the issuance of a mining-stage Production Operation permit.[24] During each of these stages, those involved are given 60 days from the date of the offer to declare an interest. If there is no declaration of interest of the targetted parties, the shares must then be offered to national-private business entities, which are then given 30 days from the date of the offer to express an interest.[25]Payment by and delivery of divested shares to Indonesian

[20] According to Article 1(1) UU 4/2009, "Mining Permit," hereinafter called an "IUP," means a permit to conduct mining business. While "Special Mining Permit," hereinafter called an "IUPK," means a permit to conduct mining business in a special mining permit area (Article 1(11) UU 4/2009).

[21] "Special Mining Permit," hereinafter called an "IUPK," means a permit to conduct mining business in a special mining permit area (Article 1(11) UU 4/2009).

[22] According to elucidation of Article 97(1) 23/2010, foreign capital means capital that is owned by a foreign state, an individual of foreign nationality, a foreign entity, a foreign legal entity, and/or an Indonesian legal entity whose entire capital is foreign-owned. The definition of foreign capital can be also found in Indonesian Investment Act (UU 25/2007) : foreign Capital means capital that is owned by a foreign state, a foreign national, a foreign business entity, a foreign legal entity, and/or an Indonesian legal entity, of which the capital is in part or in whole is owned by a foreign part.

[23] Article 97(4) GR 23/2010 jo. GR 24/2012.

[24] Article 97 (6) GR 23/2010 jo. GR 24/2012.

[25] These requirements can be seen on Article 97(7)(8)(9) of GR 24/2012.

participants must be completed within 90 working days of the date of the expression of willingness to purchase or the date of the awarding of preferred bidder status.

The divestment policy aims at improving national participation in mining sectors, therefore the minimum Indonesian ownership requirement can only be satisfied if the shares are held by the above mentioned Indonesian entities. If those entities express no interest in the shares, the entire process will have to be repeated the following year in order to meet the requirement.[26] In addition, to keep the Indonesian participation, after successful divestment, if the capital of a company is increased, ownership of its capital by Indonesian shareholders may not be diluted to less than the minimum divestment percentage. According to Article 98 GR 23/2010 and GR 24/2012, if there is an increase in capital of the company, the shares of Indonesian participants shall not be diluted to less than 20%.

3. CHALLENGES FOR APPLYING DIVESTMENT

3.1. Doctrinal Level

The one of most challenging difficulties in implementing divestment is the conflict between the divestment policy and the "right to property". Right to property[27] is one of the freedoms and fundamental right of humanbeings. However, indeed right to property barely an absolute right, a government can take over private property for the public interest with compensation accompanied.

Most often the state will argue that divestment policy is merely its sovereign right to regulate foreign investment for national interest. Under international law, sovereignty of a nation over its territory grants a nation with various types of rights. The United Nations General Assembly resolutions from 626 (VII) of 21 December 1 952 through 1 803 (XVII) of 14 December 1962, 2158 (XXI) of 25 November 1966 to resolution 3201 (SVI) of 1 May 1974 recognize the principle of "*permanent sovereignty over natural resources*". "*Permanent sovereignty over national resources*" emerged as one of the main principles of international law, determines the right of states to freely use their natural resources and that they must utilize such resources in order to be in a better position to further the realization of their plans of economic development in accordance with their national interests.[28] In relation to investment, N.J. Schrijver has summed up the significant implications arising from the principle of "*permanent sovereignty over national resources*": (a)to possess use and dispose of its natural resources to;(b) regulate the admission of foreign capital and to exercise authority over the activities of foreign investors;(c) control the out flow of capital;(d) nationalize or expropriate property both of nationals and foreigners.[29] United Nations Charter of Economic Rights and Duties of States General Assembly resolution 3281 of 12 December 1974 also deals with the states' right to nationalize or expropriate foreign investments.

Exercizing such sovereign rights, Indonesia can regulate foreign capital, exercise authority over the activities of foreign investors, even expropriate or transfer ownership of foreign property in the scheme of divestment. However, serious predicament may arise for

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[26] Article 97 (11) GR 23/2010 jo. GR 24/2012.

[27] Property under International Law has been defined very broadly covering both tangible and intangible property. Thus, by referring to property, all proprietary of an individual as well as firms, is meant. Hence, property includes besides physical property, economic interests associated with the business, contracts or other forms of economic relationships. See Apurba Khatiwada (2008) , "*Indirect Expropriation of Foreign Investment", Working Paper,* p.8.

[28] Faisal O. Al-Rfouh, Hasan A. Johar (2006), "The National Sovereign Rights And International Law", *Journal of Middle Eastern Geopolitics*, Vol. 4, No. 4, p.93.

[29] Nice J. Schrijver (1998), "Permanent Sovereignty over Natural Resources versus the common Heritage of Mankind" in P.D. Waart, Paul Peters and Erik Denters (eds.) *International Law and Development,* Dordrecht, Maritinus Njihoff, p.90.

determining the extent and nature of the Indonesian regulation on divesment, whether that regulation is truly justified or it has over stepped. Opponent may argue that divestment can be a direct attack on one of the fundamental freedoms of human beings, that of right to property. Indeed right to property barely is an absolute right and divestment can be constituted as 'taking of property' including not only an outright taking of property but also any such unreasonable interference, use, enjoyment, or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference.[30] Divestment presents an example of specialized circumstances which a state measure can impact upon an investor's rights on property. Divestment regulation shows the implication of regulatory change on property rights since it limits and interferes the property ownership of foreign investors, causing significant degree of deprivation of fundamental rights of ownership. Foreign investors can also argue that their property security and its legitimate and reasonable expectations from their property are injured by the government's act amounting to divestment.

3.2. Normative Level

The most challenge of divestment at normative level is that the details of divestment requirements left to future government regulation has not been yet formulated. Also, the divestment policy also not provide the penalties for non compliance with the divestment requirement and transitional provision giving a "retrospective effect" to existing foreign companies formed on the earlier requirements/regulations. The uncertain issue is whether GR 24/2012 will be retroactively applied to foreign investors that formed Indonesian companies, obtained mining license (IUPs) and have made substantial investments, in reliance on the earlier requirement. GR 24/2012 itself does not expressly address this point, therefore the rejection of existing companies formed on the earlier requirements/regulations to divestment policy remains unsolved. Divestment policy is difficult to be implemented because foreign companies will stick out to their contract of work or mining business licenses and clauses in their contract of work, and mining licenses that may not obligate divestment, rather than conform to divestment regulations.

The other normative problems is that GR 24/2012 amounts to appropriation without appropriate compensation in violation of Article 7 of the Indonesian Investment Act (UU 25/2007) if the purchase price is not at fair market value. Article 7 of Indonesian Investment Act stipulates that:(1) government shall take no measures of nationalization or expropriation against the proprietory rights of investors, unless provided by law;(2) where the government takes measures of nationalization or expropriation against the proprietory rights as intended by section (1), then the Government shall pay compensation the amount of which shall be established by market value. Further, since divestment policy is required for foreign investors only, divestment may an event of a violation of the Article 3(1)d[31], 4(2)a[32] and 6[33] of

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[30] Supra Note 26, p. 8.

[31] According to Elucidation of Article 3(1), "Principle of equitable and non discriminatory treatment against country of origin" is the principle of a non discriminatory treatment between domestic investors and foreign investors, or between investors of one foreign country and investors of another foreign country based on provisions of laws and regulations.

[32] Article 4(2)a regulates that Government shall accord equitable treatment to domestic investors and foreign investors with due regard to the national interest. According to elucidation of Article 4(2) a : "Equitable treatment" is that the Government does not discriminate treatment against investors having invested in Indonesia, unless provided otherwise by provisions of laws and regulations.

[33] Article 6 stipulates that Government shall accord equitable treatment to all investors of any countries that carry out investment activities in Indonesia in accordance with provisions of laws and regulations.

Indonesian Investment Act that requires foreign companies to be treated equally with Indonesian companies based on *non discrimination principle*.[34]

In addition, the policy also creates a potential inconsistency with Indonesian obligations on BITs avoiding the investment. Indonesia has ratified approximately 43 BITs under which foreign parties receive certain protections/security in respect of investments made in Indonesia. The extended divestment requirements under GR 24/2012 is arguably inconsistent with Indonesia's international BITs obligations. Divestment policy will be difficult to be implemented because it will destroy the principle of "pacta sunt servanda" (or "promises shall be kept") after ratifying BITs that consists of "full protection and security"[35] and "fair and equitable treatment"[36] for foreign investment.

3.3. Practical Level

The policy seems difficult to be implemented regarding to the ability of Indonesia parties to buy the divested equity, then to involve and manage the mining company professionally. Furthermore, the mechanisms for divestment process become major practical problems such as potential slow progress of the bureaucratic process, uncertainty of selling price of divested equity and compensation, the possibility of foreign shareholders to accept divestment if there is no Indonesian buyer, problems on whether the policy will apply to publicly listed companies or to joint venture arrangements, the problem on foreign investors sentiment and resistance, etc.

Details of the procedure for divesting foreign shares and the pricing mechanism remain unclear. GR 23/2010 and GR 24/2012 are silent on whether a foreign investor can privately negotiate a transfer of shares to an Indonesian private company or individual without first offering the shares following the above divestment process.There are many other practical issues raised by GR 24/2012 for which there are no clear answers:

a. If a foreign-owned mining company has an Indonesian shareholder with a guaranteed right of first refusal to buy the foreigner's shares, will that pre-existing right be honored or will it give way to GR 24/2012?.
b. What rules will apply if the foreign shareholder of an Indonesian mining company chooses to divest all or part of the 51% prior to the GR 24/2012's timeline? Is it free to select a divestment candidate in that case and avoid GR 24's divestment requirements? Can the foreign shareholder accelerate the divestment if it considers that will result in a preferred co-shareholder?.
c. Will the Government be flexible on the 90-day period? Can the foreign investor roll the offer over to the next year if there are no confirmed takers within 90 days? There has been recent experience with a contract of work having a similar divestment requirement in

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[34] Non Discrimination consists of Most Favoured Nation (MFN) and National Treatment (NT) principles. In the context of investment, MFN means a houst country treats investors from one foreign country no less favourably than investors from different foreign countries. Whereas, NT requires foreign investor and their property are entitled only to the same treatment accorde to national of the host countries under national laws. NT principle seeks to ensure a degree of competitive equality betwwn national and foreign investor, while MFN establishes equality of competitive opportunity bewen investors from different foreign countries. See UNCTAD, "Most Favoured Nation Treatment*" in UNCTAD Series on Issues in International Investment Agreement,* United Nation, New York, 1999, p.1.

[35] Full protection and security suggests that the host State is under an obligation to take active measures to protect the investment from adverse effects and guarantee legal security enabling the investor to pursue its rights effectively. See Christoph Schreuer (2010), "Full Protection and Security", *Journal of International Dispute Settlement*, Vol 1, Issue 2, p. 1.

[36] Fair and equitable treatment seems to be concerned mainly with the obligation not to denay justice in criminal, civil or administrative adjudictory proceedings in accordance with the principle of due process embodied in principal systems in use worldwide. See Surya P Subedi (2012), *International Investment Law,* Second Edition, Hart Publishing, North America, p. 66.

which the 90-day period proved impractical and the parties' negotiations continued substantially beyond that period.

d. Will a local business entity be allowed to finance a government purchase with a pledge of the shares purchased, such that a share foreclosure would allow the local entity to become the shareholder without complying with the tender process?.
e. If there is no purchaser for the first offer, is the five-year divestment period pushed forward, so that the first offer need only be re-offered the next year, or must the first and second years offers be aggregated in the second year?.
f. Is the purchase price freely negotiable or will the Government impose an appraisal procedure and will the foreign investor be compelled to accept the appraisal? Can the foreign investor impose a minimum purchase price in the tender process or must it accept the highest price offered even if it doesn't represent fair value?.

4. IMPLICATION DIVESTMENT FOR FDI

The beneficial effects of FDI on efficiency and growth are generally recognised, and there is a wide consensus that divestment policy should aim at reducing or eliminating hindrances to national growth and FDI integration. However, nationalist has seen FDI as a drawback to achieve national goals and threat national sovereignty because of foreign enterprises domination in national economy, causing the dependency of host countries to the foreign investors. The cost of FDI is the dependency of host countries that can be characterized as direct and indirect loss of the ability by the nationals to influence and control the vital decisions affecting to their economy and future development. Obtaining the greater control over the foreign corporations in important industries through the majority of share ownership will reduce the dependency.

Divestment has formula that host countries allow foreign investors to enter investment and maintain their complete ownership for certain periods, and at stipulated period they must transfer the majority or complete ownership to nationals in host countries. This formula is seen as means of gaining participation in foreign firms which are unwilling to enter joint ventures or remain dominate their ownership. Divestment is a remedy and possible means of alleviating the economic and polical problems created by foreign investment since control of foreign firms passes to local hands.[37]

However, it has become a clear that the controversy over the divestment policy toward FDI. Divestment policy is seen by foreign investors as a potential dangerous precedent for their investment projects. The main problem with the divestment policy is that it will significantly reduce the Indonesian mining sector's desirability to foreign investors. According to Pritchard, investors perform decision-making process to invest in host countries based on three stages:(a) evaluation over the commercial prospects and potential project value;(b) risk assessment;(c) the potential rewards greater than the risks.[38] When the potential rewards greater than the risk, in some event investors may continue if the host country has:(a) good reputation;(b) good economic policies;(c) sustained economic growth.[39] The investors will pull back at making investment when the host country does not provide sufficient legal security and stability. From investors perspective, divestment can be seen as the threat for their investment stability.

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[37] Supra Note 7, p.3

[38] Sergei Gurievy, Anton Kolotilin, Konstantin Sonin (2008), " Determinants of Expropriation in the Oil Sector: A Theory and Evidence from Panel Data", Working Paper No 115 CEFIR / NES Working Paper series, p.25

[39] *Id*

From opponent view, the host countries will likely commit economic suicide when applying divestment policy since divestment will result in a loss of future flow of FDI and rate of economic development. The national investment of scare resources to purchase divested share is wasteful from the point of view of development. The utilization of scarce national resources/capital to purchase equity in foreign enterprises is unwise due to the need to increase the capital formation in Indonesia.

Divestment can lead to an estatization of the private sector, weakening private enterprises system. If state purchases the foreign equity and acquires majority control in foreign mining enterprises, private groups will lose the potential economic rewards to be received from the purchase and their investment. Also, divestment rise to losses of output and national income, for instance in Mexico in 1938 and in Iran in 1951, divestment not only resulted in a decline in growth rates, but were also followed by a decline in output and wages in the industry.

FDI will be reduced as a result of divestment policy and the investment postponement falls most heavily, actual and potential ventures are being delayed. The divestment policy will be to deter rather than to attract inflow foreign resources and transfer of technology, affecting to the balance of payment and resulting in a wasteful utilization of local capital. Instead of contributing positive objectives, divestment will impede rather than promote progress toward developments, national participation and regional integration.

When GR 24/2012 announced, the share price of foreign investors in Indonesia which listed in Australia and Canada stock exchange plummeted, mostly are companies in the exploration stage. The market reaction showed that this regulation is ambiguous in nature toward the investors. The government promotes investment in Indonesia, including foreign investors, however at the same time makes the potential foreign investor to reconsider its decision. The government reiterates that the spirit of GR 24/2012 not to expropriate foreign shares in the mining industry, but to share the opportunity for Indonesian to gain maximum benefit from the non-renewable resources.

The impact of GR 24 may not be affected immediately. It applies to IUP holders that are in production. The Government of Indonesia moved from a contract of work regime to a licensing regime when it adopted the Mining Law in 2009 and thus far there are few new IUP holders in production. Further, the contracts of work in effect at that time continue until they expire, at which time they must be converted to IUPs. There have been many generations of contracts of work and they include divestment requirements or not. The particular divestment obligation will continue to apply until the contract expires and a mining license is issued in its place. If a divestment requirement in a contract of work is less than that required by GR 24, the foreign shareholder can anticipate that it will be required to comply with GR 24, and since 10 years commercial production will have then elapsed, it is likely that the greater divestment requirement will be imposed immediately. It is also important that though the Mining Law provides that existing contracts of work will not be affected by the new licensing regime, the Indonesian Government has attempted to convince companies to surrender their contracts for mining licenses and some have done so. One could expect that contract of work companies would now be more reluctant to make this switch if the divestment requirements in their contracts of work are less stringent than those in GR 24.

5. SOLUTIONS

5.1. Balancing National Interest and Investment Concern

Although local partners would benefit from the divestment but they will hurt investment by hitting foreign miners who had already spent potentially hundreds of millions of dollars on exploration. Divestment regulation should balance not only the interest of nationalistic concern, but also the concern of promoting investment in mining area by communicating that the FDI in mining sector is still required and welcomed to maximize the industry contribution to Indonesia development goals. Government needs to be careful on the divestment provision, because this may alert the foreign investors who wish to invest in the mining sector in Indonesia.The divestment provision to foreign investors will be a major issue for foreign investors in particular, because this provision can be deemed tantamount to expropriation towards the foreign assets. Government has to take steps to ensure that the interest of foreign investors will not adversely affected, the government must formulate the model to determine prices that fair/equitable to cover the investment made by foreign investors. The government basically wants to protect the natural resource when deciding divestment, however this must be done without impeding economic growth from the flows of FDI.

Nationalists in developing countries argues that their national resources and major industries should no be controlled by foreigners and the matters of national importance should not depend on decision made aboad by foreign companies. There is reexamination of the role of FDI and a search for new solutions to the ecomonc and political problems engendered by foreign investment.[40] Divestment policies aims at insuring local participation in the equity of foreign companies, even to transfer the foreign asset ownership to the local control. The desire for increasing national control in foreign companies has been incorporated into "mandatory or forced divestment"[41] requiring foreign companies to sell the majority of ownership to locals within stipulated period.

The efective form of divestment is mandatory since in nature foreign companies are the economic institutions aiming at profit maximization, thus they tend to maintain their 100% control of their firms for their operation. As economic entity, foreign companies use the resources efficiently and engage in business activities designed to increase profits".[42] The very basis of a firm's responsibility is economic nature, so its primary obligation is to operate at a profit way and to legitimately pursue growth.[43] According to Milton Friedman, the responsibility of corporations is to increase and maximize profits.[44] Friedman declared that companies only have economic responsibility and focus on profit as economic gain has positive outcome on development as a whole.[45] Joel Lexchin suggests that corporate activity in developing countries is motivated by business interest[46] and for most corporations,

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[40] Supra note 7, p.1.

[41] *Ibid.*

[42] Michael Hopkins (2003), *The Planetary Bargain : Corporate Social Responsibility Matters*, Earthscan Publications Ltd, p.13.

[43] T.S. Pinkston, Carroll AB (1996), " A Retrospective Examination of CSR Orientations: Have They Changed?", *Journal of Business Ethics*, Vol. 15, p.205.

[44] Viktor J. Vanberg (2011), "Corporate Social Responsibility in a Market Economy: The Perspective of Constitutional Economics," in Lorenzo Sacconi, et all (ed), *Corporate Social Responsibility and Corporate Governance, The Contribution of Economic Theory and Related Disciplines,* Palgrave Macmillan, p. 131.

[45] Karin Czubala (2008), "Is Access to Medicines A Corporate Social Responsibility", *Tesis*, p. 26

[46] Lisa Forman, Jillian C. Kohler (2010), 'Introduction: Access to Medicines as a Human Right – What Does it Mean for Pharmaceutical Industry Responsibilities?'., in Lisa Forman and Jillian Clare Kohler, (eds)., *Access to Medicines as a Human Right: Implications for Pharmaceutical Industry Responsibility,* University of Toronto Press, p.12.

commercial interest and profit comes first.[47] Corporations fullfill its responsibility if they engage in its core business activity as profitably as possible in lawful way.[48] For this reason, foreign companies seem not serious to change their behaviour to reduce their control and domination in host countries by selling their equity, therefore the efective form of divestment is mandatory.

5.2. Providing Detailed Regulation and Guidance

The details of divestment requirements shall be formulated to address some problem at normative level. It must respect the *right of property* and comply with *non discrimination*, *full protection and security* and *fair and equitable treatment* principles by providing appropriate divestment requirement measures and model. The detail divestment measures must also provide the penalties for non compliance with the divestment requirement and transitional provision giving a "retrospective effect" to existing foreign companies formed on the earlier regulation/contract or obtained mining license (IUPs) and have made substantial investments, in reliance on the earlier requirements.

The detailed guidance to implement GR 24/2012-consisting of clear procedure and the divestment mechanism-will probably address some relevant issues at practical level. The detailed regulation may also highlight some guidances such as:

a. Clear and fit mechanisms for divestment process to relieve slow progress of the bureaucratic process and other practical problems.
b. Divestment process only applies to companies which do not already have a 20% Indonesian shareholder at 5 years after production, and divested shares must be voting shares.
c. Shares offered in a public offering do not constitute divestment and the fact that a company has gone public and obtained a listing does not appear to exempt it from the divestment requirement; foreigners holding shares in the public float are not subject to the divestment requirement.
d. Government sets an offering selling price based on investment less depreciation/amortization.
e. If government does not elect to buy the shares, they are then offered by auction to eligible Indonesians; the auction process is run by a committee of government representatives.
f. The detailed provisions regarding the auction and payment process.
g. The detailed provisions regarding incentives to investment returns generated prior to divestment deadlines.

6. CONCLUSION

Foreign investors looking to invest in a state, definitely consider political risks in the host state especially in the form of potential divestment policy. Thus, it is natural for a state, particularly developing country that wants to attract foreign capital and technology investment and does not want to be perceived internationally as posing threat of divestment. However, it does not mean foreign investment should be left unregulated and

[47] Matthew Lee, Jillian Kohler (2010), "Benchmarking and Transparency: Incentives for the Pharmaceutical Industry : Corporate Social Responsibility", *Journal of Business Ethics*, Vol. 95, p. 65.
[48] Mag Christina Keinert (2008), *Corporate Social Responsibility as an International Strategy*, Physica-Verlag Heidelberg, p. 59.

states be deprived of their quintessential sovereign interests in then investment made in its territory and the overall impact on the economic development.

Although divestment is important step to control over mining resources and increase national participation, divestment is seen as the threat for investment stability, thus, it will affect to FDI rate, the investment postponement, and delay actual and potential investment ventures. Divestment will deter rather than to attract inflow foreign resources/capital and transfer of technology, will impede rather than promote progress toward investment and economic developments.Therefore, some challenges can arise for applying divestment at doctrinal, normative and practical level. Some challenges can be answered by balancing interest and providing regulation of the term and method of divestment, providing transparent guidance, providing adequate incentives to investment returns generated prior to divestment deadlines.

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