

## Local Content Provision in National and International Law Investment Rules

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### ABSTRACT

Investment is one of the efforts to increase national development which in accordance with *Pancasila* and *Undang-Undang Dasar Negara Republik Indonesia 1945* (the 1945 Constitution of the Republic of Indonesia). The national interest in investment implements the performance requirement, especially related to the local content, but in international agreement often prohibits the local content rules, for example the Trans-Pacific Partnership (TPP) Agreement and the World Trade Organization (WTO). The purpose of the study was to construct the substance of local content regulation in the agreement of TPP, WTO, and positive Indonesian law. The researcher also conducted the visibility assessment towards Indonesia's desire to join the TPP Agreement. The method of the study used the law and regulation approach that applicable nationally and internationally. The method of analysis integrated the 1945 Constitution, international agreement, court decision and other material relating to the local content. This study resulted in the finding that Indonesia still applied the local content rules in law and regulation, but the WTO and TPP Agreement local content rules was prohibited. In the WTO there was still opportunity for developing countries to apply local content with the certain requirement. Local content rules of developing country in the WTO could still be applied, but with the certain requirement. One of them was giving notification and transparency on the regulation and policy from member countries as stated in the TRIMs regulation.

**Keywords:** *Rule of Law, Investment, Provision, Local Content, National, International.*

### INTRODUCTION

Investment activity is part of national development. National development must refer to the ideological foundation of *Pancasila* and the constitutional foundation, namely *UUD Negara Republik Indonesia 1945* (the 1945 Constitution of the Republic of Indonesia) (Jened, 2016:78). *Pancasila* as an ideological foundation as stated in the Opening of the 1945 Constitution of the Republic of Indonesia is a recht idea in fostering the Indonesian economy, particularly in investment activity. The constitutional foundation of the 1945 Constitution of the Republic of Indonesia is a grund norm or basic norm from the sources of law and regulation. This meant that all the law and regulations which applicable in Indonesia should not contradict with the basic norm of the 1945 Constitution of the Republic of Indonesia (Jened, 2016:78).

The economic system of *Pancasila* or economic democracy is a basic concept of the national economic system that is explicitly stated in Article 33 paragraph (4) of the 1945 Constitution of the Republic of Indonesia. Economic democracy which regulated in the 1945 Constitution of the Republic of Indonesia is a joint effort which aimed to the prosperity of the Indonesian people and not the prosperity for certain people or groups. The existence of investment is a support, so that the prosperity of Indonesian people is fulfilled. Investment activity is not only intended to process the sources of wealth and potential which is owned by Indonesia, but it must also be ensured that investment activity is implemented by maintaining and securing economic wealth and preventing groups to control over vital elements of the national economy with its purpose not for the interest of the Indonesian people welfare. The Indonesian nation is more active in actualizing economic independence by mobilizing strategic sectors of the domestic economy (Abrianto *et al.*, no date).

The existence of rules regarding investment is closely related to the state sovereignty. The country has the right to regulate the entry of foreign investment to maintain national interest in its territory. A country also has the right to determine, regulate and impose any actions, people, the object within its territorial (Zaidun, 2005:107). This shows that it needs the balance of arrangement which accommodate the national interest and the

application of foreign investment policy. The Indonesian government is promoting the increase in consumption and the use of domestic products. It is intended to prosper the community by exploring the potentials of the local community itself.

According to (Krivonos and Kuhn, 2019) the debate regarding the openness of trade with foreign countries triggers the occurrence of greater competition. Openness in the trading system will affect the domestic sales (Le, Pieri and Zaninotto, 2019:479). Market competition has been effective in increasing the average productivity of company and reducing the discrepancy in efficiency among the types of ownership (Umrani et al., 2019).

In general, to protect national interest, a country provides requirements to the investor before investing in their country. There are two form of requirements, namely entry requirement and operational requirement or performance requirement (Zaidun, 2005:13). In the first stage, the entry requirement of the investment agency from the host country carry out the examination to the foreign investment proposal in accordance with the country's development goals and provide benefit to the host country (Zaidun, 2005:12).

The host country government considers that the foreign investment proposal meets the requirement, then the second requirement will be applied, namely the operational requirement or performance requirement (Zaidun, 2005:13). One of the requirements which applied by the government at this stage is the requirement using the local content. The application of local content requirement in the country is different. In Indonesia, one of the local content arrangements is the Regulation of the Minister of Industry Number 65 of 2016 concerning Provision and Procedure for Calculating Domestic Component Level Values for Cellular Phone Product, Handheld Computer and Tablet Computer that require local content in the form of Domestic Content Level (Haseeb et al., 2020).

Local content is one of the requirements undertaken y a country to maximize the role of foreign investment in increasing the economic development in the host country (Nwapi, 2015:187). Local content which applied by one country to another country is different. In general, local content requirement is carried out to utilize the indigenous companies in the procurement of goods and services, local labor, and the use of local raw materials by foreign investor (Nwapi, 2015:188).

The policy of local content is also to ensure that not only the capability of the host country can be accepted to international standards, but also to utilize the sources of local wealth and raw material that can be used in investment sector (Arthur and Arthur, 2014). The existence of local content can also protect local goods and can improve the domestic industry. This is certainly in accordance with Indonesia's constitutional foundation, which is, primarily Article 33 of the 1945 Constitution of the Republic of Indonesia.

The article philosophically aims to secure Indonesia's economic wealth, which is for social welfare and to prevent certain groups from controlling vital economic elements in Indonesia (Jened, 2016). Although Indonesia applies protection towards local content, it is not used as an excuse to close off foreign investment to invest in Indonesia.

Based on the background above, the formulation of the problem in this study is firstly, how to regulate local content in international law, in this case the Trans-Pacific Partnership Agreement (TPP) and the World Trade Organization (WTO) regime. Second, whether the regulation of local content in National Law is compatible with the regulation of local content in international law. The purpose of the study is to construct the substance of local content regulation in the TPP agreement, WTO, and positive Indonesian law. Analyzing the compatibility of local content rules in Indonesia with local content rules in the TPP agreement. Finally, conducting a visionary assessment to the Indonesia's desire to join the TPP in terms of local content regulation aspects.

## METHOD

Type of normative juridical writing was a problem approach which was carried out by analyzing the law and regulation and other regulations that applicable both national and international regulations. The problem approach was carried out through statute approach and conceptual approach. The statute approach can be used to make comprehensive research. The statute approach was carried out by examining all the laws and regulations relating to local content in Indonesia and the TPP agreement (Marzuki, 2011). The conceptual approach can be carried out by reviewing local content in national law and regulation and the TPP Agreement. This approach also referred to the view of legal scholar and legal doctrines (Marzuki, 2011).

Sources of legal material consisted of primary and secondary. Primary legal material sources from the law and regulation as follow, the 1945 Constitution of the Republic of Indonesia, Law Number 25 of 2007 concerning Investment, Law Number 25 of 2004 concerning the National Development Planning System, Law Number 17 of 2007 concerning National Long-Term Development Plan 2005-2025, Regulation of the Industry Minister of the Republic of Indonesia Number 16/M-Ind/Per /2/2011 concerning Provision and Procedure for Regulating Domestic Component Levels.

Regulation of the Industry Minister of the Republic of Indonesia Number 65/M-IND/PER/7/2016 concerning Provision and Procedure of the Calculation of Domestic Component Level Values for Cellular Phone Product, Handheld Computer and Tablet Computer, Regulation of the Energy and Mineral Resources Minister of the Republic of Indonesia Number 15 of 2013 concerning the Use of Domestic Product in Upstream Oil and Gas Business Activities, Presidential Regulation Number 4 of 2015 concerning the Procurement of Government Goods/ Services, Trans-Pacific Partnership Agreement; The General Agreement on Tariffs and Trade (GATT), Trade Related Investment Measures (TRIMs).

Sources of secondary legal material was obtained from literature, papers, journals, e-journals, legal dictionaries, internet, magazines, newspapers, news, and other materials related to this study. The next step was to choose the source of legal material that can be used in study, then, classified the source of legal material based on the problem being studied. Furthermore, after classifying the two primary and secondary legal sources, the researcher connected the two in order to obtain a comprehensive and systematic explanation.

The data analysis method used the deductive method. In this case the material of analysis was the National Law and regulation of the Republic of Indonesia, International Agreement, International Convention, Court Decision both nationally and internationally, and other material related to study.

## RESULT AND DISCUSSION

### *Local Content Provision in the Trans-Pacific Partnership Agreement (TPP) and World Trade Organization (WTO)*

Local content was one of the requirements which applied by the host country to investor who would invest their capital in their country. Local content rules differ from one country to another. Local content was the part of the performance requirement. Performance requirement was "stimulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations to the host country" (Unctad, 2002). The definition explained that performance requirement was the host country policy which applied restrictions and conditions that must be met by investor when they were going to invest in their country. The Government of the Republic of Indonesia could be the ontological basis of law and policy related to investment law (Pawestri *et al.*, no date). One of performance requirement form was the regulation of local content.

The application of local content was intended to reduce the discrepancy which faced by domestic company with foreign company. Local content also aimed to increase the national participation in relation to certain sector in economic activity. Increase the national technology development. Create jobs to increase people's income. Promote cross-sectoral relation, and reduce dependency on one sector by increasing the value creation capacity from certain sector. This was carried out in order to the domestic company could compete regionally and internationally (Husnasari, 2018).

The TPP agreement was an international trade agreement that assigned new standard in world trade. The TPP agreement was also expected to answer future challenges to support the economies of its members. There were several key features in the TPP Agreement, including (1) Comprehensive market access, TPP agreements eliminated or reduced tariff and non-tariff barriers in all goods. This was to create opportunity and benefit for companies, workers and consumers.

(2) Regional Approach to Commitment, as a facilitator in developing production and production chain and facilitating cross-border integration also opening local market. (3) Addressing New Trade Challenges, encouraging innovation, productivity and competitiveness by responding the new issues that discussed the development of the digital economy and the role of State-Owned Enterprise. (4) Inclusive trade, including the new issue, which ensured all the levels of the economy and business obtained the benefit from trade. This agreement was used to increase trade capacity thus all parties could take the advantage and benefit. (5) Platform

for Regional Integration, as a platform for regional economic integration and designed to engage economies throughout the Asia-Pacific region.

On October 5, 2015 the ministers from Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam announced the result of negotiation to form agreement which supported economic growth, sustained and created jobs. They supported innovation, productivity and competitiveness to raise the living standard, reduced poverty, and supported the transparency. Good governance could improve the labor and environmental protection.

In the TPP Agreement, local content was included in the article of performance requirement. Performance requirement regulated the local content and local technology requirement. Local content in the TPP agreement was regulated implicitly in the Investment Chapter, Article 9.10 Performance Requirement, while the local content character was the same as the domestic content which regulated in Article 9.10 paragraph 1 letter b and c of the TPP agreement which prohibited the member country to determine the level of local content percentage or prioritize domestic production goods. It aimed to promote competitive neutrality in investor competition in member countries or state parties.

Local content regulation in this TPP Agreement influenced and given rise to legal consequences in the country's economic policy, therefore to implement it, it required various considerations. International economic law has encountered many obstacles, especially in trade and investment law. International trade law with the WTO as universal institution which seemed centralized could not be applied in other countries, because each country had the different rights and obligations (de Chazournes *et al.*, 2019:401).

Another example was if Country X as a host country which was a TPP member was not permitted to implement the policy which required that investor in certain businesses, for example in the car assembly business, had to use 75% (seventy-five percent) of the material of the car, it was the spare parts which produced in his country. If the regulation had existed before country X became a TPP member country, then, after the ratification of the TPP agreement, country X had to make adjustment to the regulation that required the local content in the car business.

The World Trade Organization (WTO) was an international organization that dealt with the problem of world trade which was officially established on January 1, 1995 by the Marrakesh Establishing of the World Trade Organization (hereinafter referred to as the WTO Agreement). The provisions of the WTO encouraged the creation of national regulation harmonization that referred to international standards or rules, thus with the harmonization, it could minimize the misuse of national regulation for the purpose of protection for the host country (Van den Bossche *et al.*, 2010:82).

From the explanation above, it could be interpreted that since Indonesia ratified the WTO agreement by issuing Law Number 7 of 1994, Indonesian law and regulation must be in line with the provision that found in Trade Related Investment Measures (TRIMs) which was the part of the WTO agreement. When considering the world economy that continued to develop, then, the country had an important role to bind to the international trade agreement.

The developing country tended to see that the provision of TRIMs only as a means for developed country to take an important role in investment policy, but kept in mind that developing country also needed to develop the potential for their resources. In this case an adjustment to investment law was needed, but it should continue to prioritize the interest of national stability. According to (Le, Pieri and Zaninotto, 2019:479) the legalization of GATT into the WTO affected the distribution of the benefit of problem solving between developed country and developing country.

### ***Compatibility of Local Content Rules in National Law with International Law***

Indonesia's investment policy also applied the local content as part of effort to drive the national economy. The regulation could be seen from various law and regulations including Law Number 25 of 2007 concerning Investment; Regulation of the Industry Minister of the Republic of Indonesia Number 16/M-Ind/Per/2/2011 concerning Provision and Procedure for Regulating Domestic Component Levels; Regulation of the Industry Minister of the Republic of Indonesia Number 65/M-IND/PER/7/2016 concerning Provision and Procedure for the Calculation of Domestic Component Level Value for Cellular Phone Product, Handheld Computer, and Tablet Computer; and Regulation of the Energy and Mineral Resources Minister of the Republic of Indonesia

Number: 15 of 2013 concerning the Use of Domestic Products in Upstream Oil and Gas Business Activities. This chapter would be elaborated regarding the local content regulation in these regulations.

Local content was not explicitly regulated in Law Number 25 of 2007 concerning Investment (hereinafter referred to as UUPM). In UUPM, the government would provide facilities to the investor if they carried out the certain requirement. Based on the Article 18 paragraph (2) of UUPM, the facility referred to the facility which provided to investor who was expanding their business or making new investment. This was explained further in Article 18 paragraph (3) letter j of the UUPM, namely, "Investment that obtain facilities as referred to in paragraph (2) is those that at least meet one of the following criteria: (j) industry which use capital goods or machines or equipment that produced domestically."

Government policy as host state in implementing local content was only an appeal or encouragement, it was not an obligation or absolute prerequisite which must be met by investor if they were going to invest in Indonesia. The encouragement was such as providing facilities that would provide benefit for the investor in conducting business activities. For example, if a company used goods which produced domestically, then, while running its business activities, the company was entitled to various facilities guaranteed by the government. One of them was the imposition of value addition tax on import of capital goods or machines for production purpose that could not be produced domestically. It was a win-win solution provided by the government as an effort to attract investment, mobilization effort and protected the domestic business actors.

Ratification of Law Number 7 of 1994 resulted in the Indonesian government must comply the WTO rules. Indonesian law and regulation must also be in line with the TRIMs agreement, one of which was related to local content requirement. The consequence for Indonesia to ratify the WTO was not easy. This was because the Indonesian business world was directly confronted with the business world of developed countries without direct protection from the government.

The TPP agreement was one of the international agreements that promoted liberalization in international trade. This was proven by the member countries being prohibited for applying local content requirement because it could hamper the investor for investing in the host country. Unlike Indonesia which still encouraged investor to use local products. This was reflected in the law and regulation in Indonesia that still applied the Domestic Component Level rules in certain sectors. The example of the application of Domestic Component Level on 4G smartphones intended in developing domestic industry. The changes in the Domestic Component Level rules previously was only 20% (twenty percent) for hardware.

As the impact of the ease of importing foreign products which entered Indonesia, the domestic business actor must be able to compete with these foreign products. This competition encouraged domestic business actor to improve the quality of local products. In terms of product quality, business actor or investor must consider the price offered. The good quality product must be supported with competitive prices.

The Indonesian government must be able to negotiate to maintain national interest, kept in mind that in the TPP Agreement, the rules regarding accession for new country was inflexible. The Indonesian government would experience challenges in maintaining national interest because of the strict control of member countries. Member countries had the full control over countries that wanted to accede to the TPP agreement. Member countries had the veto power which could be used at any time to disagree towards the new country with national regulation that was not in accordance with what has been promised in the TPP. Indonesian government would have little discretion to maintain the local content rules that is currently still needed to grow the domestic economy.

## CONCLUSION

Indonesia still applied local content rules as stated in the National Law and regulation intended to encourage the domestic products, thus it was able to compete with foreign products. The TPP agreement prohibited the local content. If Indonesia acceded to the TPP Agreement, it would be difficult to maintain national interest, one of which was by applying local content. The TPP agreement made it difficult for Indonesia to maintain national interest by protecting the local product to develop the domestic economy. Based on WTO rules, developing countries can still apply local content with certain requirement. One of them was by giving notification and transparency to the regulation and policy from the member country as stated in the TRIMs regulation.

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