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Protection of foreign investors in investment law: A comparative study between Indonesia and Japan

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Abstract
This paper aims to investigate the protection of foreign investors in Indonesia and Japan's investment Law. This study applies the normative legal research method with a qualitative approach to examine Indonesia and Japanese investment law. After reviewing relevant literature, this study found that Indonesia and Japan have developed economic agreement partnerships to safeguard investor rights. Indonesia also has a regulated mechanism to resolve the dispute between investors and host countries. Both countries provide incentives to encourage investment for economic growth and development. Nonetheless, Indonesia has six forbidden sectors for foreign investors, while Japan does not. Japan only has restricted sectors, namely mining, domestic shipping, broadcasting, radio, telecommunication, consigned freight forwarding, and aviation.

Keywords: foreign investors, Indonesia, Japan, investment law

Introduction

Foreign direct investment is a principal means of financing the 2030 Agenda for Sustainable Development that can contribute through expanding access to markets, bringing in foreign exchange, contributing to skills development/ human capital growth, technology transfer, and increasing competition in local markets (ESCAP, 2019) [18]. Foreign direct investment may promote economic growth significantly in the process of development. (Ekanayake & Ledgerwoord, 2010) [17]. Before investing their capital, investors tend to do a feasibility study. The feasibility study is a complex investment elaborate detailing and comprehensively examining the possibility of realization of a particular investment project and justification of the rationality of the investment law (Budimir, 2016) [12]. The problem for investors is if the losses experienced are not due to mismanaging the company but no legal protection, both for the capital they have invested and for the goods to be produced (Sembiring, 2010) [43]. Hence, studying investment law is quite interesting due to the accelerating pace of Indonesia's national development and open access to global markets.

Indonesia's Membership in the World Trade Organization (WTO) has led to the renewal of the Indonesian Investment Law by issuing Law Number 25 of 2007 concerning Investment as a form of commitment to economic liberalization and eliminating discrimination between domestic capital and foreign capital (Rohendi, 2014) [39]. During the Jokowi regime, the government felt that the latest regulation regarding investment was insufficient to increase the investment level in Indonesia, which required amendment. Hence, the government formulated the Omnibus Law on Job Creation and approved it by the House of Representatives in October 2020 (Rosana, 2020) [40]. The promulgation of this new regulation hoped can provide legal certainty to attract foreign capital. In addition, economic opportunity and political stability are also very decisive in bringing in foreign capital to a country (Suparji, 2008) [45]. Based on research, the economic growth of 116 countries between 1965 and 1986 proves that political instability harms economic development (Barro & Lee, 1994) [5]. Another study from 1996 and 1998 in 89 countries also examine the negative relationship between corruption and foreign investor due to moral obligations and operational inefficiencies (Habib & Zurawicki, 2002) [22].

The Indonesian Investment Coordinating Board noted that investment realization for the whole of 2021 was approximately IDR 901.02 trillion or US$ 6.273 million, with foreign investment contributing 50,3% (Maesaroh, 2022) [30]. After the weakening of the national economy due to restrictions on community activities during the COVID-19 pandemic, the export value of the manufacturing industry reached USD 160 billion or contributed 76.51% of total national exports in 2021 (Media Indonesia, 2021) [31]. Based on data from the Investment Coordinating Board, Japan is the second-highest project, with 3,623 units, and the fifth-ranked investor in Indonesia is almost USD 2.3 billion or equivalent to IDR 33 trillion (Wijayanti, 2022) [49]. Hence, it is crucial to study the protection of foreign investors in investment in Indonesia and compare the investment laws between Indonesia and Japan. This study will address the following question. First, How is the protection of foreign investors in investment law in Indonesia, especially Japanese investor? Second, How does the foreign investment law compare in Indonesia and Japan? This paper intends to find similarities and differences between both countries' investment laws and Indonesia's protection of foreign investors in investment law.

This paper will organize into five sections. After the introduction, section two will explain the theoretical concept. Then, the method in section three. Section four will examine the result and discussion of this study consisting of the protection of foreign investors in Indonesian investment law and a brief comparison of investment law in Indonesia and Japan. The last section will conclude this study and explain the limitation that requires further research.

Theoretical Review

The theoretical framework used to analyze the data in this study is the theory of the legal system by Lawrence M. Friedman and the role of law in economic development, according to J. D. Nyhart. Lawrence M. Friedman further explained the legal system always contains three elements, namely structure, substance, and legal culture (Friedman, 1998) [21]. First, the structural including the number and type of courts, presence or absence of a constitution, presence or absence of federalism or pluralism, division of powers between judges, legislators, governors, kings, juries, administrative officers; modes of procedure in various institutions (Friedman, 1969) [20]. Friedman's description above shows that the structure as part of the legal system includes the institutions created by the legal system, including the judiciary, legislative, and executive. The legal structure component is the institutional representative that plays a role in implementing the law and making laws. The structure in its implementation is a uniformity related to one with others in a legal system.

The substantive output side of the legal system consists of the rules, doctrines, statutes, and decrees used by the rulers and the ruled, and other rules and decisions which govern, whatever their formal status (Friedman, 1969) [20]. Thus, the legal substance as an aspect of the law is the applicable regulation, norms, and behavior reflection of the people in the system. Last, legal culture consists of values and attitudes that bind the rule together and determine the place of the legal system in the culture of the society as a whole (Friedman, 1969) [20]. Hence, legal culture includes views, attitudes, or values that affect the establishment of the legal system. People's perspectives and attitudes towards legal culture vary due to influential of sub-cultures such as ethnicity, gender, education, descent, belief (religion), and the environment. Society's values, expectations, and orientation tend to influence the formulation of investment regulation. Therefore, investment law implementation not only depends on the substance but also on legal apparatus performance due to cultures such as law enforcement, whether corruption, collusion, or nepotism. For instance, permit executor interests and position affect the investment licensing process.

Despite Friedman's theory, this study also uses J. D. Nyhart's theory. According to Nyhart, basic jurisprudential concepts that consider legal influence in economic development consist of predictability, procedural capability, and legitimacy (Nyhart, 1964) [35]. First, predictability to create law certainty through sets of rules for guiding economic relationships among people to facilitate economic activity. Hence, the investor can predict the consequences of actions and will have confidence in assessing how others will act. Second, procedural capability to accomplish stability in investment law includes individuals, groups, and the public interest related to the challenges that may face in host countries. Last, the law must be able to create justice for society and prevent unfair and discriminatory practices. Aspects of justice such as due process, equality of treatment, and government standards of behavior are necessary to maintain market mechanisms and prevent the negative impact of excessive bureaucratic actions to avoid loss of government legitimacy.

The legal theories above show the existence of phenomena that influence each other between law, economics, and politics. These phenomena flourish when liberalism ideology idea to reduce state intervention in the marketplace has encouraged economic growth in western countries (Harrison & Boyd, 2018) [23] (Badie, Berg-Scholler, & Morlino, 2011) [4]. Douglas, an economic historian who won the Noble Prize, also conceptualizes law as an institution embedded in society, closely related to political and economic processes (Faundez, 2016) [19]. Therefore, Legal certainty in law enforcement is necessary to guarantee foreign investment. Foreign investors are attracted to a legal system's predictability, stability, and efficiency. An inefficient legal system will add to the transaction costs of obtaining a cheap mechanism for enforcing rights and obligations law. Therefore, the host country should provide adequate courts, bureaucracy, and human resources to ensure excellent public service.

Method

This study used a normative legal research method with a qualitative approach. In normative legal research, the object is the law that formulates an argument, theory, or new concept as a prescription for solving the problem, called Dogmatic Jurisprudence (Christiani, 2016) [15]. This legal proposition contains stipulations regarding the rights and obligations of certain legal subjects (Irianto & Sidharta, 2009) [25]. Foreign investment is beyond national boundaries issues. Hence, this study uses a comparative law method by comparing investment laws for foreign investment in Indonesia and Japan. This study also will analyze foreign investor protection in Indonesia investment Law, specifically Japanese investors.

This study collects secondary data from primary, secondary, and tertiary legal material such as regulations, research, legal community report, books, encyclopedia, and dictionaries. Qualitative data will be analyzed using a deductive approach. Deductive reasoning works from the more general to the more specific that informally called a "top-down" approach which logically follows by conclusion from premises (Burney & Saleem, 2008) [13]. Hence, this study aims to provide systematic descriptions with logical opinions and analyze the data to answer problems and conclude.

Result and Discussion

Protection of Foreign Investor in Indonesia Investment Law

According to research conducted by ADB, the investment climate and productivity in Indonesia has substantial issues (ADB, 2005) [1]. First, foreign investors feel more business barriers than domestic companies. Second, legal uncertainty still stands out because still often involved in corruption. Third, the establishment and closing of businesses in Indonesia are most expensive and delayed compared to other ASEAN countries. Therefore, the Indonesian government formulates Indonesian Law No. 25 of 2007 about capital investment to create a conducive climate. This law unifies regulations to provide legal certainty to foreign and domestic investors. In other words, there is no longer any difference in provisions between foreign investment and domestic investment (Sembiring, 2010) [43]. Then, the Indonesian government amended many regulations with the Indonesian Law on Job Creation No. 11 of 2020, which may worsen the investment climate, and slows down development and people's welfare in Indonesia. Several derivative regulations from this Law, namely Government Regulation concerning Tax Treatment of Transactions Involving Investment Management Institutions and Entities Owned No. 49 of 2021, and Presidential Regulation concerning Investment Business Sector No. 09 of 2021.

Legal protection for foreign investors here will be devoted to foreign investors from Japan. Although history records the grim story of Japanese colonialism in Indonesia, the two countries have developed friendly relations based on cooperative and exchange relations in various fields such as politics, economy, and culture. Indonesia and Japan are complementary and has mutual need. On the one hand, Indonesia needs capital or investment, technology, and products technology, while on the other hand, Japan needs natural resources, labor, and the Indonesian market. Japan-Indonesia relations after the Second World War began with the realization of the War Reimbursement agreement of US$223 million in goods and services over 12 years starting in 1958, plus US$400 million in loans for 20 years promulgated on March 27, 1958 (Rusman, 2010) [41]. Because goods and services must produce by Japan, Japanese companies compete for contracts in diverse ways by lobbying the Indonesian government and involving Japanese politicians to get the contract.

Bilateral economic and trade relations between Indonesia and Japan started with the Treaty of Amity and Commerce, signed in Tokyo on July 1, 1961 (ILM, 1963) [24]. Japan has been one of the largest investors since 1967, with the cumulative value of investment until the end of 2000 being 15.5% of the total foreign investment in Indonesia, which has a direct impact on economic growth and development (DIRJEN Kerjasama ASEAN, 2001) [16]. Then, Japan's total investment in 2017 was approximately USD 17 billion, with the main sectors being the automotive, electronics, food, and beverage industries and almost 100 companies from Nagoya city (Admin, 2017) [2]. Realization of investment from Japan occupies the second position in Indonesia, worth US$ 22,537.7 million during the 2015-2019 period with 33,318 Indonesian workers (BKPM, 2020) [7]. Despite the pandemic COVID-19, 70% of Japanese companies are invested in Indonesia, of which 95% are Indonesian workers (Barus, 2020) [6].

The investment climate in Indonesia is getting better, in line with data from the world bank that Indonesia is ranked 2nd as an investment-worthy country. Indonesia has proven to withstand the shocks of the financial crisis from the outside (Saputra, 2018) [42]. The increase in investment grade has also made Indonesia the target of the world's big investors, as evidenced by a 90.67% increase in investment in 2019-2021 (Muhammad, 2022) [33]. Based on the survey conducted by Japan External Trade Organization, almost 1740 Japanese companies in Indonesia plan to expand in the next one to two years (JETRO, 2021) [28] (KSP, 2021) [29]. Major Japanese automotive companies are also committed to developing their investment in Indonesia. Honda Motor Company. Ltd. committed to investing IDR 5.2 trillion, Suzuki Motor Corporation is planning to invest IDR 1.2 trillion, Toyota Motor Corporation around IDR 28 Trillion, and Mitsubishi Motors Corporation submitted an investment plan of IDR 11.2 trillion (Redaksi, 2021) [38]. This predicate absolutely must be maintained and improved to be even better. The factor of legal certainty becomes important in investment because foreign investors are willing to invest if they get legal protection in investing their capital.

Bilateral treaty institutions had known since the decade of the 1970s within the framework of the International Guarantee Agreement (Situmorang, 2011) [44]. Additionally, the investment agreement applies only to investors and host countries that qualify for coverage under the relevant provisions, so they may benefit from the protection and are eligible to take a claim to dispute settlement (OECD, 2008) [36]. The bilateral Investment Treaty (BIT) signed by the two countries guarantees investment in both countries, especially in business certainty, security guarantees, and foreign investment disputes settlement. Among 73 countries that signed BIT with Indonesia, only 26 remain in force, such as the Republic of Korea and the United Kingdom (UNCTAD, n.d.). Indonesia is also a member of some investment agreements to ensure foreign investors' rights in the absence of regular BIT in force, such as the ASEAN Comprehensive Investment Agreement and the Agreement between Japan and the Republic of Indonesia for an Economic Partnership (ASEAN, 2007) [3] (Japan, 2008) [26]. Based on the Agreement between Japan and the Republic of Indonesia for an Economic Partnership articles 2 and 3, both countries shall respect sovereignty rights and jurisdiction, which may not affect obligations under international law. Then, Article 69 states that an investment dispute shall, as far as possible, be settled amicably through consultation or negotiation between an investor and a disputing party, but not prevent seeking an administrative or judicial settlement. Nonetheless, when the investment dispute cannot solve through consultation or negotiation within five months, the investor may submit the investment dispute to one of the following international conciliations or arbitrations. Firstly, conciliation or arbitration under the ICSID

convention that is in force between the Parties. Second, conciliation or arbitration under the Additional Facility Rules of the ICSID, if ICSID is not in force between the Parties. Third, arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law, adopted by the United Nations Commission on International Trade Law on April 28, 1976. Last, if agreed with the disputing Party, any arbitration under other arbitration rules.

After the Job Creation Law, the Investment Law remains an investment reference in whole sectors of Indonesian territory. However, any laws and regulations relating to investment that apply after the promulgation of the Job Creation Law must comply with the provisions of the Job Creation Law.

For instance, revocation of the obligation of the central government to determine business fields for large businesses with requirements must cooperate with micro, small, and medium enterprises, and cooperatives. This regulation does not yet formulate foreign investors' protection. Hence, this study will analyze Indonesian Law on Investment No. 25 of 2007, which regulates legal protection for all foreign investors, as stated in article 32. First, when an investment dispute between the government with investors, the parties first resolve the dispute through deliberation and consensus. Second, if the previous conflict does not resolve, the settlement can be done through arbitration or alternative dispute resolution or court following the provisions of the legislation. Third, when the government conflicts with domestic investors, the parties can resolve the dispute through arbitration based on both parties' agreements. Then, if still not agreed upon, the conflict will solve in court. Last, when disputing between the government with foreign investors, both parties must agree to resolve the dispute through international arbitration. However, it does not regulate how to resolve cases between domestic and foreign investors that generally it has been determined, in a partnership contract, whether jurisdiction or law.

Indonesia ratified the International Center for Settlement of Investment Disputes (ICSID) convention with Law Number 5 of 1968 concerning the Settlement of Disputes between States and Foreign Citizens Regarding Investment. Indonesia's becoming a member of ICSID to convince the international if there is a dispute with the Government of Indonesia regarding investment does not have to resolve in Indonesia court, which foreign investors can judge to be subjective (Sembiring, 2010) [43]. Based on article 25, paragraph 1, whole Indonesian disputes shall have an agreement from disputing parties in writing that they agree to resolve disputes through the ICSID. Furthermore, Indonesia Presidential Decree Number 34 of 1981 concerning the Ratification of the Convention on The Recognition and Enforcement of Arbitral Awards, became a member of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, this participation does not make Indonesia immediately implement foreign arbitration decisions. The New York Convention states that a participating country may refuse the implementation of foreign arbitration if the main agreement containing the settlement of the arbitration dispute is contrary to its national law or the country's public policy (Suparji, 2008) [45].

Based on Article 66 of Law Number 30 of 1999 concerning Arbitration and Alternative Dispute Resolution, states International Arbitration Awards are only recognized and can be enforced in the jurisdiction of the Republic of Indonesia if they meet the following requirements. First, The International Arbitration Award had determined by an arbitrator or arbitration tribunal in a country bound by a bilateral or multilateral agreement with Indonesia. Second, International Arbitration Award is limited to decisions that, according to legal provisions, Indonesia includes in the scope of trade law. Third, International Arbitration Awards can only be enforced in Indonesia, limited to decisions that do not conflict with public structure. In addition, after obtaining the exequatur from the Chairman of District Court Central Jakarta. Last, An International Arbitration Award involving the Republic of Indonesia as a party to the dispute can only implement after obtaining an exequatur from the Supreme Court of the Republic of Indonesia, which delegate to the Central Jakarta District Court.

Comparative Foreign Investment Law between Indonesia and Japan

The primary law that governs foreign investments in Japan is the Foreign Exchange and Foreign Trade Act [FEFTA], supplemented by various orders issued by the Cabinet (Ministry of Finance Japan, n.d.). The Ministry of Finance (MOF) published the final version of the implementing ordinances on 30 April 2020. The new Foreign Investment regulations enter into force on 8 May 2020 and apply to investments that close or complete on or after 7 June 2020 (Chance, 2020) [14]. The Ministry of Finance and the Ministry of Economy, Trade, and Industry are the primary Japanese authorities responsible for administering the FEFTA. The Minister of Finance is responsible for approving all capital transactions and foreign direct investments, excluding trade (Yamada & Nakajima, 2021) [50]. Then, the Minister of Economy, Trade, and Industry is responsible for authorizing the whole transaction related to trade, such as settlements of trade payments and compensation. Meanwhile, the Bank of Japan has jurisdiction over certain administrative matters, such as all reports and notifications to the ministries must be submitted through the Bank of Japan (Nishi, Shikakura, Nagae, & Ishii, 2021) [34].

The purpose of the FEFTA is to enable the proper development of foreign transactions and the maintenance of peace and security in Japan and the international community by implementing the minimum necessary management and coordination for foreign transactions (Yamada & Nakajima, 2021) [50]. A foreign investor that invests needs to submit a prior notification before investing and report after investing in Japan through Bank Japan unless specific exceptions apply. After that, the Bank of Japan will notify the responsible ministry that foreign investors intend to make the acquisition. Based on FEFTA Regulation, there are no sectors that have expressly forbidden in which foreign investment. While restricted sectors consist of broadcasting, radio, telecommunications (Ministry of Internal Affairs), aviation, consigned freight forwarding, domestic shipping

(Ministry of Land, Infrastructure, Transport, and Tourism), and mining (Ministry of Economy, Trade, and Industry). Individual laws enforce uniform foreign capital regulation that does not depend on screening by the authorities. For instance, the Aviation Act and the Nippon Telegraph and Telephone Corporation Act stipulate that if the voting rights of foreigners of the target company are one-third or more, the shareholder may refuse to transfer the name. Acquisition of 1 percent or more of the shares in a Japanese listed company became subject to the filing requirements. The foreign investor may utilize the passive investment exemption to avoid the filing requirement if fulfilling the relevant conditions (Nishi, Shikakura, Nagae, & Ishii, 2021) [34].

There are some tax incentives on both the national and local levels available to foreign investors and all companies in Japan (Tago, Mutou, & Godo, 2019) [46]. These incentives include Tax incentives for comprehensive special zones, tax incentives for strengthening local business, wage and productivity improvement, and local tax incentives. In addition to tax incentives, the Japanese government has to reduce from March 2020 and April 2022 the cost to businesses of complying with administrative procedures by 25% (PwC, 2022). The Constitution of Japan provides that the right to hold property is inviolable that must conform to the public welfare. Japan has 36 Bilateral Investment Treaties and currently 31 in force, with the majority of the partners located outside of the Asia Pacific region (UNCTAD, n.d.). Japan also has 22 Treaties with Investment Provision, and 20 remain in force and primarily from Asia Pacific Region. The EPAs generally provide for most-favored-nation treatment and national treatment, meaning that the treatment of investors from the EPA countries will be no less favorable than Japan's local investors. Japan also signed ASEAN-JAPAN EPA in 2008 and the Regional Comprehensive Economic Partnership with ASEAN, Australia, China, Japan, the Republic of Korea, and New Zealand in November 2020 and force in January 2022. The economic partnership agreement has not overlapped with others, including the Indonesia Japan agreement in 2007.

Before the amendment to the Investment Law in Indonesia, twenty business fields were closed to investment in the Negative Investment List. After the Job Creation Law, the closed business fields were reduced to 6 (six) business fields, namely as follows: (a) class I narcotics cultivation and industry, (b) all forms of gambling and casino activities, (c) species catching fish listed of the Convention on International Trade in Endangered Species of Wild Fauna and Flora, (d) the use or extraction of coral and the utilization or extraction of coral from nature used for building materials/lime/calcium, aquarium, and souvenirs /jewelry, as well as live or dead coral (recent death coral) from nature, (e) chemical weapons manufacturing industry; and (f) industrial chemical industry and industrial ozone-depleting substances. Further provisions regarding investment requirements regulate in a presidential regulation.

The Job Creation Law no longer lists the types of investment incentives and will be subject to the laws and regulations in the field of taxation. Further arrangements regarding investment incentives regulate in Presidential Regulation Number 10 of 2021 concerning the Investment Business Sector. Incentives provide for investors who invest in business fields included in the list of priority business fields. Article 4 of this regulation regulates incentives consisting of (a) fiscal incentives in the form of tax allowances, tax holidays, investment allowances, and customs incentives, and (b) non-fiscal incentives in the form of ease of business licensing, provision of supporting infrastructure, the guarantee of energy availability, a guarantee of available raw materials, immigration, employment, and other facilities following the provisions of the legislation. The Job Creation Law significantly increases business opportunities for the investor compared to Investment Law. In addition, there is an expansion of opportunities for investors to get investment incentives. Thus, the change aims to improve the ease of doing business for investors in Indonesia.

Conclusion

This study explains the protection of foreign investors in Indonesia and Japanese investment law. After researching legal material and literature review, this study found that Indonesian investment Law No. 25 of 2007 has regulated protection for the whole foreigner regardless of nationality and mechanism to solve the dispute. Then, amended by Job Creation Law No. 11 of 2020, Government Regulation concerning Tax Treatment of Transactions Involving Investment Management Institutions and Entities Owned No. 49 of 2021, and Presidential Regulation concerning Investment Business Sector No. 09 of 2021 to realize the conducive investment in Indonesia. Indonesia and Japan also have treaties with investment provisions to protect Japanese investors through Economic Agreement Partnership, both bilateral and multilateral in ASEAN, that remains in force. Last, the Indonesian and the Japanese Investment Laws aim to develop their respective national interests and promote foreign investment in their respective countries by providing incentives and discretion. While the difference was the forbidden sector for foreign investors, Indonesia has six sectors while Japan does not. Japan only has restricted sectors, namely mining, domestic shipping, broadcasting, radio, telecommunication, consigned freight forwarding, and aviation. Due to the time limit, this study does not analyze the whole investment law, such as the procedure to get an investment permit, so more studies may consider this aspect to improve international climate investment.

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