



## OPTIMIZATION OF BILATERAL INVESTMENT TREATY TO ENCOURAGE THE DEVELOPMENT OF MICRO SMALL AND MEDIUM ENTERPRISES IN INDONESIA AS HOST STATE IN INTERNATIONAL INVESTMENT ACTIVITIES

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### ABSTRACT

International investment can accelerate economic growth and accelerate development in Indonesia. The Bilateral Investment Treaty (BIT) is an international agreement between two countries on provisions for international investment. The BITs are intended to promote the development of micro, small and medium enterprises in the country. Again, Small and medium-sized enterprises (SMEs) in Indonesia need support in promotion and legal protection to develop and become more optimal, as SMEs are the backbone of the Indonesian economy and part of the implementation of the Pancasila economic system. SMEs development provisions can be addressed in international agreement such as BIT or Free Trade Agreements (FTA) to provide a forum for broader sectors that include SMEs. Therefore, to develop SMEs in Indonesia through international investment practices, it is necessary that related parties, i.e., the government to take measures for optimizing the development of SMEs in Indonesia and obtain comprehensive international investment support to strengthen through International Investment Agreements (IIA) and be competitive in the global market through strengthening and broadening the scope of SMEs in IIA.

**Keywords:** bilateral investment treaty; international investment; micro, small and medium enterprises.

### I. INTRODUCTION

International investment can increase the wheels of economic growth and accelerate development.<sup>1</sup> This is because the economy is the backbone of people's welfare. Some of the benefits that can be obtained from investment include job creation, poverty rate reduction, improvement in living standards, increase in Gross Domestic Product (GDP), and others.<sup>2</sup> International investment practices that constitute the movement of capital between countries are one of the main categories of international economic relations transactions.<sup>3</sup> *Bilateral Investment Treaty* (BIT) is an international agreement between two countries regarding provisions for international investment. BIT regulates reciprocal agreements related to the promotion of activities and protection of international investments. The purpose of the BIT is expected to reduce non-economic risks and open broad investment opportunities by establishing legally enforceable international investment treatment standards.<sup>4</sup> Seeing this, BIT should be one of the instruments that can encourage positive economic development both for business actors who become investors and for business actors in the countries where they invest.

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<sup>1</sup> OK Isnainul (et.al), "Peranan Investasi Asing Dalam Percepatan Pertumbuhan Ekonomi di Indonesia", *Jatiswara*, No. 3 (2020): 242, <https://doi.org/10.59581/jrp-widyakarya.v1i2>

<sup>2</sup> Herman Kambono and Elyzabet Indrawati Marpaung, "Pengaruh Investasi Asing dan Investasi Dalam Negeri terhadap Pertumbuhan Ekonomi Indonesia", *Jurnal Akuntansi*, No. 1 (2020): 139.

<sup>3</sup> Huala Adolf, *Hukum Ekonomi Internasional* (Bandung: CV. Keni Media, 2015), 5.

<sup>4</sup> Yacob Rihwanto, "Bilateral Investment Treaties dan Penyelesaian Arbitrase Internasional (Studi Kasus Pencabutan Izin Kuasa Pertambangan Churchill Mining)", *Lex Renaissance*, No 1 (2016):112.

Economic growth is synonymous with *multinational companies* (MNCs). However, there are other aspects of economic development in Indonesia, including through small and medium-sized enterprises (SMEs). SMEs are businesses owned by individuals or business entities that meet the criteria as businesses.<sup>5</sup> SMEs are believed to have high economic resilience, enabling them to support the financial system and economic stability.<sup>6</sup> This is because the number of SMEs accounts for almost 99% of all business units and the contribution of SMEs to GDP also reaches 60.5% and the employment intake in is 96.9% of total national employment.<sup>7</sup> In addition, according to the Ministry of Cooperatives and Small and Medium Enterprises (KUKM), in 2022, the total number of SMEs in Indonesia will exceed 8.71 million business units in 2022 it could be stated that the number of SMEs businesses in Indonesia dominates more than large business fields or Multinational Company (MNC). SMEs often have obstacles faced, one of which is an inadequate investment climate, lack of capital in running a business, lack of education in obtaining permits, marketing products, and how to run an effective business, as well as technology and human resources that are not of high quality.<sup>8</sup> Seeing this, steps are needed so that the development of SMEs in Indonesia gets optimal results. To be able to optimize SMEs in Indonesia, of course, there is a need for promotional assistance and protection for SMEs business actors to be able to continue to develop the potential of SMEs in Indonesia.

At the international level, SMEs are responsible for most businesses around the world and contribute significantly to job creation and global economic development. It turns out that SMEs account for around 90% of companies and more than 50% of jobs worldwide Formal SMEs contribute up to 40% of national income (GDP) in developing countries. These numbers are much higher when informal SMEs are included.<sup>9</sup> Formal SMEs are businesses that have a business license, while informal SMEs are businesses that do not have a business license, such as street vendors.<sup>10</sup> The World Bank estimates that SMEs could take on 600 million jobs by 2030 to accommodate a growing global workforce, making SME development a high priority for many governments around the world.<sup>11</sup>

In the process of development, SMEs face challenges in the quality of goods that have not met standards, while the large number of SMEs actors requires a focus on development from the government. This is reflected in Article 96 of Law Number 6 of 2023 concerning the Stipulation of Government Regulations in Lieu of Law Number 2 of 2022 concerning Job Creation into Law (Job Creation Law), which requires the Central and Regional Governments to provide legal assistance and assistance for SMEs actors. In addition, some SMEs can get development assistance through international investment in the context of the national economy. Other countries have encouraged SME growth through international agreements, such as the Canada-European Union Comprehensive Economic and Trade Agreement (CETA), The EU-Japan Economic Partnership Agreement (EPA), and the UK-Australia Free Trade Agreement, which have special provisions to encourage the development

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<sup>5</sup> Vivi Kumalasari Subroto, "Pengertian Dan Kriteria UMKM Menurut Undang-Undang", Last modified May 1, 2023, <https://komputerisasi-akuntansi-d4.stekom.ac.id/informasi/baca/Pengertian-dan-Kriteria-UMKM-Menurut-Undang-Undang/80de71af402e6d711782f27fa3083d30a2d80103>

<sup>6</sup> Bank Indonesia, "Pengembangan UMKM", Last Modified January 10, 2023, <https://www.bi.go.id/id/fungsit-utama/stabilitas-sistem-keuangan/pengembangan-umkm/default.aspx#:~:text=UMKM%20memiliki%20peran%20penting%20bagi,stabilitas%20sistem%20keuangan%20dan%20perekonomian>

<sup>7</sup> *Ibid.*

<sup>8</sup> Fahimul Amri, "PERMASALAHAN UMKM: STRATEGI DAN KEBIJAKAN", *Prosiding Pluralisme Dalam Ekonomi dan Pendidikan*, Last Modified January 12, 2023, <http://ekp.fe.um.ac.id/wp-content/uploads/2017/06/30.-Fahimul-Amri.pdf>

<sup>9</sup> *Ibid.*

<sup>10</sup> Muhammad Rokib, "Perbedaan UMKM Formal dan Non Formal", Last Modified Junly 10, 2023, <https://pontianak.tribunnews.com/2020/12/14/berikut-perbedaan-umkm-formal-dan-non-formal>

<sup>11</sup> *Ibid.*

of SMEs. However, based on information from *The United Nations Conference on Trade and Development* (UNCTAD), Indonesia has 74 BITs. However, until now, it still needs to pay attention to the interests of SMEs as part of economic development. The issue is whether the BIT only focuses on protecting foreign investor protection. Still, it does not pay attention to the interests of host state actors.<sup>12</sup> After analyzing there are several clauses in the BIT that can provide development to SMEs, this is certainly an important concern so that the BIT model, especially in Indonesia, to develop SMEs in Indonesia.

## II. RESEARCH METHODS

This research uses a normative juridical approach method to analyse the main material using library materials or secondary data. In addition, this study also analyses other countries investment agreements with BITs in Indonesia through comparative legal studies. Data was collected through literature studies, virtual studies, and interviews with resource persons from the Ministry of Foreign Affairs and the Ministry of Investment

## III. DISCUSSION AND RESULTS

In the era of economic globalization, BIT is a key component in facilitating cross-border investment. The agreement aims to provide legal protection for foreign investors in the host state and encourage international investment flows. For Indonesia, BIT provides benefits for more value for home states to invest in the long term and protect the investment interests and investors of Indonesia in the territory of partner countries.<sup>13</sup> Until now, Indonesia has made a total of 74 BITs, namely, 29 BITs that are valid (in force), 14 BITs signed (signed not in force), 31 BITs that are no longer valid (terminated).<sup>14</sup>

BIT has the potential to encourage international investment, so the Indonesian government has carried out various strategies and efforts to make investors feel safe and secure while investing in Indonesia. For Indonesia, the existence of BIT is useful in increasing value in the eyes of investors from partner countries to invest in the long term and protecting the interests of investment and investors from Indonesia in the territory of partner countries.<sup>15</sup>

BIT has been regulated directly or indirectly through laws and regulations in Indonesia.<sup>16</sup>

- a. Article 11 of the 1945 Constitution states that the President with the approval of the House of Representatives declares war, makes peace and treaties with other countries.
- b. Law Number 37 of 1999 concerning Foreign Relations which reinforces the importance of foreign relations in the form of international agreements.
- c. Law Number 24 of 2000 concerning International Treaties and the ratification mechanism of international treaties.
- d. Law on Amendments to Law Number 12 of 2011 concerning the Establishment of Laws and Regulations
- e. Law Number 7 of 2014 concerning Trade regulates international agreements, especially in trade.

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<sup>12</sup>Indonesia for Global Justice, "*Lembar Fakta| Review Bilateral Investment Treaty di Indonesia*", Last Modified January 11, 2023, <https://igj.or.id/wp-content/uploads/2017/05/FACT-SHEET-Indonesia-BITS-Bahasa.pdf>

<sup>13</sup>Laura Natalia Sembiring, "Urgensi Perjanjian Investasi Bilateral Antara Indonesia dan Negara Lain Dengan Klausula Penyelesaian Sengketa Investor-State Dispute Settlement", *DHARMASISYA*, No 4 (2021):945

<sup>14</sup>UNCTAD, *loc.cit.*

<sup>15</sup>Laura Natalia Sembiring, *Op.Cit.*,1945

<sup>16</sup>*Ibid.*,1946.

BIT already has a predetermined structure or commonly referred to as the standard of treatment. The structure in the BIT is an essential legal framework in governing the relationship between host state and home state. With its well-organized and well-defined structure, BITs form a solid foundation for providing legal protection, facilitating cross-border investment, and striking a balance between economic interests and public policy. There are various forms of standards of care in a BIT, including a standards of care article, but which sets out several different standards of care.<sup>17</sup> The standards of treatment in a BIT include National Treatment, Most-Favoured-Nation (MFN), A Fair And Equitable Standard Of Treatment, An International Minimum Standard Of Treatment, and Full Protection And Security.<sup>18</sup>

National treatment is the principle under which the host state provides treatment that is as favorable and at least as beneficial to foreign investors as the treatment granted to domestic investors.<sup>19</sup> This principle aims to create a level of competitive equity between domestic and foreign investors.<sup>20</sup> One form of national treatment is the equal treatment of imported and locally produced goods, and the same applies to domestic and foreign services as well as patents, local and foreign trademarks, and copyrights.<sup>21</sup>

Most Favored Nation (MFN) is the principle that the host state should grant investors from another country the same treatment as its fellow investors from other foreign countries.<sup>22</sup> This potentially applies to any type of investment activity, such as trading, holding, using, selling or liquidating an investment.<sup>23</sup> In general, using the MFN principle, every time a country reduces trade barriers or opens markets, it must do the same with the same goods or services of all its trading partners, regardless of whether the country is poor, rich, weak or strong.<sup>24</sup> The principles of MFN and National Treatment have a connection, and these two principles can be summarized under the principle of non-discrimination, since both principles fundamentally prevent discrimination between partner countries in investment activities.<sup>25</sup>

A fair and equitable level of treatment may mean that the beneficiaries, i.e. the host state and the home state, are entitled to justice and equality and that the beneficiaries are guaranteed treatment in accordance with minimum international standards for foreign investors.<sup>26</sup> In practice, there are still uncertainties that can influence the policy decisions of host states that are willing to accept the treaty clause on a fair and equitable level of treatment, but the country is not willing to offer minimum international standards.<sup>27</sup> This may be particularly the case if the host state believes that foreign investors deserve better treatment than local investors based on minimum international standards.<sup>28</sup>

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<sup>17</sup> M. Sornarajah, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT*, United Kingdom: Cambridge University Press, 2010, 201.

<sup>18</sup> *Ibid.*

<sup>19</sup> UNCTAD, “*NATIONAL TREATMENT*”, Last Modified August 26, 2023, <https://unctad.org/system/files/official-document/psiteiidt11v4.en.pdf>.

<sup>20</sup> *Ibid.*

<sup>21</sup> WTO, “*Principles of the trading system*”, Last Modified August 26, 2023, [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact2\\_e.htm#:~:text=without%20discrimination%20%E2%80%94%20a%20country%20should,giving%20them%20%E2%80%9Cnational%20treatment%E2%80%9D\)%3B>](https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm#:~:text=without%20discrimination%20%E2%80%94%20a%20country%20should,giving%20them%20%E2%80%9Cnational%20treatment%E2%80%9D)%3B>)

<sup>22</sup> UNCTAD, “*MOST-FAVORED-NATION TREATMENT*”, Last Modified August 26, 2023, <https://unctad.org/system/files/official-document/psiteiidt10v3.en.pdf>.

<sup>23</sup> *Ibid.*

<sup>24</sup> WTO, *Loc.Cit.*

<sup>25</sup> *Ibid.*

<sup>26</sup> UNCTAD, “*FAIR AND EQUITABLE TREATMENT*”, Last Modified August 26, 2023, <https://unctad.org/system/files/official-document/psiteiidt11v3.en.pdf>.

<sup>27</sup> *Ibid.*

<sup>28</sup> *Ibid.*

Full Protection And Security is based on a guarantee of physical security for investors and the investment.<sup>29</sup> The host state is obliged to provide a legal framework that allows investors to take effective measures to protect their investments, i.e. H. to protect against coercive interventions by private individuals such as employees, business partners or demonstrators.<sup>30</sup> Total Protection and Security is also directed against coercive interventions by state institutions such as the police and the Bundeswehr.<sup>31</sup> In some agreements, one of the North American Free Trade Agreements (NAFTA) limits the meaning of full protection and security to the minimum international standards required by customary international law.<sup>32</sup> However, when there are no explicit restrictions on minimum international standards, these conventional standards are treated as autonomous and additional to customary international law.<sup>33</sup>

Based on the explanation above about the standard principles contained in the International Investment Agreement (IIA), one of which is BIT, each of these principles aims to protect investors. However, based on these principles, BIT Indonesia, with partner countries, does not have direct provisions to regulate the development of SMEs. But the provisions could be added indirectly in some clause. If you look at the BIT Indonesia – Singapore (2018) Article 11, there is one provision that discusses the Right to Regulate, which contains:

1. The Parties reaffirm their right to regulate within their respective territories to achieve legitimate policy objectives, such as the protection of public health, social services, public education, safety, environment, or public morals, social or consumer protection, privacy and data protection, and the promotion and protection of cultural diversity.
2. For greater certainty, the mere fact that a Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectations of profits, does not amount to a breach of an obligation under this Agreement.

One definition of a right to regulate in this context is that it consists of a legal right that specifically permits the host state to regulate to the exclusion of international commitments that have been made through investment treaties without giving rise to an obligation to provide compensation.<sup>34</sup> There are two angles, firstly that the right is a legitimate right, which means there is no obligation to compensate foreign investors. Secondly, if viewed from a human rights point of view, it is described as an assertion of sovereign rights for states to choose political, social, and economic priorities by applying laws and administrative practices without violating international regulations that protect international investment.<sup>35</sup> In the scope of international investment, will be closely related to the rules and principles of the World Trade Organization Agreement (WTO Agreement) with one of its annexes such as the Agreement on Trade-Related Investment Measures (TRIMs Agreement).

The TRIMs, one of the WTO's annexes, expressly state their aim is to encourage the gradual development of world trade liberalization.<sup>36</sup> It aims to facilitate the growth of cross-border investment worldwide, focusing on enhancing the economic growth of all parties, especially traders and investors

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<sup>29</sup> Christoph Schreuer, "Full Protection and Security", *Journal of International Dispute Settlement*, No. 2 (2010):368

<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*, 369.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*

<sup>34</sup> Ted Gleason dan Catharine Titi, "The Right to Regulate", Last Modified August 26,2023, <https://www.jus.uio.no/pluricourts/english/projects/leginvest/academic-forum/papers/the-right-to-regulate..pdf>

<sup>35</sup> *Ibid.*

<sup>36</sup> Ni Ketut Supasti Dharmawan, et.al, "Penjabaran Standar Internasional Trims dan Oecd dalam Ketentuan Hukum Penanaman Modal Indonesia", *Jurnal Magister Hukum Udayana*, No. 3 (2015):555.

from developing countries.<sup>37</sup> In addition, this agreement still upholds the principle of free competition in trade based on the principles stipulated in the WTO-TRIMs Agreement.<sup>38</sup> TRIMs only regulates 3 of the 5 principles in the WTO, namely National Treatment, Quantitative Restriction, and Transparency.<sup>39</sup> Therefore, at least at the domestic level, a member state must describe these international provisions as a form of compliance with international obligations.<sup>40</sup>

The principles of National Treatment and Quantitative Restrictions are contained in Article 2 of TRIMs as follows:

1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM inconsistent with Article III or Article XI of GATT 1994.
2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement.

Based on the provisions of Article 2 of the TRIMs as mentioned above, about the provisions of Article III and Article XI of GATT 1994 concerning National Principles, in essence it can be stated that in investment activities there should be no discrimination in the treatment of imported goods products from other member States. In other words, it prohibits treating trade products from WTO member countries as inferior to domestic products. Through the provisions of Article 2 TRIMs, it is expressly seen as the embodiment of the Non-Discrimination Principles. Jurgen Kurtz, in his previous studies, suggested that the regulation of National Treatment Principles exists in the regulatory parts of the WTO, including in GATT and GATs. Based on Article III, GATT stipulates the obligation of WTO Member States to carry out obligations related to the National Treatment Principle, namely equal treatment for imported products. In other words (no less favorable than that accorded to like products of national origin in respect of all laws).

In investment law in Indonesia, the National Treatment Principle is constructed through the provisions of Article 3, Article 4, and Article 6 of Law No. 25 of 2007 concerning Capital Investment. Based on the provisions of Article 3 of Law No. 25 of 2007 concerning Capital Investment, one of the principles underlying investment activities in Indonesia is the principle of equal treatment and does not distinguish national origin. Through the provisions of Article 4 (2) letter a. Law No. 25 Of 2007 Concerning Capital Investment, it can be understood that the Indonesian government gives equal treatment to domestic nodal investors and foreign investors through the basic investment policy in Indonesia. However, the provisions of this article also emphasize equal treatment while considering the national interest. Furthermore, the elaboration of the Non-Discrimination Principle can be observed from the provisions of Article 6 (1) of UU. No. 25 of 2007 specifies that the government provides equal treatment to all investors from any country carrying out investment activities in Indonesia following legal and regulatory provisions.

The elaboration of the principle of Non-Discrimination in Law No. 25 Of 2007 Concerning Capital Investment in Indonesia does not seem entirely consistent with the TRIMs. For example, as stated in Article 4 (2) letters. a. Law No. 25 Of 2007 Concerning Capital Investment is regulated on equal treatment but still considers the national interest. The reality of norming such legal substance does not imply that Indonesia, as one of the member states, has not complied or does not comply with WTO

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<sup>37</sup> *Ibid.*

<sup>38</sup> Ni Ketut Supasti Dharmawan, *Loc.Cit.*, 554.

<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.*

obligations because the provisions of WTO law, including the TRIMs Agreement, are given space or regulate exceptions, namely special needs for developing country members.

The principle of Transparency contained in Article 6 TRIMs exists in its elaboration in Indonesian investment law, namely through Article 3 of the Law No. 25 Of 2007 Concerning Capital Investment. H Salim and Budi Sutrisno stated that 10 principles underlie investment activities or investment in Indonesia, one of This is the principle of openness, which guarantees the public's right to truthful, honest, and non-discriminatory information about investment activities. The principle of transparency in TRIMs originates in Article X of the GATT 1947, which relates to the publication and administration of trade regulations.

The Right to Regulate is closely linked to a country's various public interest objectives, such as environment, employment, public health, human rights, climate change, protection of public order, important security interests, and cultural diversity.<sup>41</sup> Based on the understanding and scope of the Right to Regulate that Indonesia as a host state can form laws and regulations that cover national interests but are not allowed to profit in violation of international investment provisions. This is supported by the Charter of Economic Rights and Duties of States mentioned in the Chapter Economic Rights and duties of States, Article 2 Section 2, that every state has the right to:

- a. To regulate and exercise authority over foreign investment within its national jurisdiction under its laws and regulations and in conformity with national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment.
- b. To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, cooperate with other States to exercise the right outlined in this subparagraph.

The article explains that one of the rights of a State is to regulate and exercise authority over international investments in its national territory in accordance with its laws and regulations and in accordance with its national objectives and interests. In addition, on the basis of permanent sovereignty over natural resources, it establishes that the right of peoples and nations to permanent sovereignty over their wealth and natural resources must be exercised in the interests of their national development and the well-being of the population of the state concerned.<sup>42</sup> The declaration states that states and people have the right to permanent sovereignty over natural wealth and resources, which must be exercised in the interests of national development and the well-being of the people of the country concerned. Both statements support the concept of the right to regulate, which states that the state has the right to regulate based on the country's national interests.

One of the interests of the Indonesian state in the economic sector is the development of SMEs. According to the Decision No. 21-22 / PUU-V / 2007 of the Constitutional Court (MK) regarding the consideration of Law No. 25 of 2007 on Capital Investment in contradiction to the Constitution of the Republic of Indonesia in 1945, which is based on the Investment Law in Article 12 paragraph (5) one of the open business areas based on criteria of national interest, including the development of micro, small, medium and cooperative enterprises. SMEs are an important pillar of the economy in Indonesia. This is according to data from the Ministry of Cooperatives, Small and Medium Enterprises (KUKM)

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<sup>41</sup>Ted Gleason dan Catharine Titi, *Loc.Cit.*

<sup>42</sup>United Nation, "General Assembly resolution 1803 (XVII) of 14 December 1962, "Permanent sovereignty over natural resources"", Last Modified September 30,2023, <https://www.ohchr.org/en/instruments-mechanisms/instruments/general-assembly-resolution-1803-xvii-14-december-1962-permanent>.

for 2022, according to which the number of SMESs is 64.2 million, or 99.99% of the number of enterprises. Actors in Indonesia, and SMEs have a labor force of 117 million workers, or 97% of the business world's labor force.<sup>43</sup> SMEs also make a major contribution to the national economy through the 61st Gross Domestic Product (GDP).1%, the remaining 38.9% are accounted for by large companies, which make up only 5,550 or 0.01% of economic actors.<sup>44</sup> In developing a business, of course, it does not escape from various obstacles. In SMEs, there are several obstacles that often occur, internally:<sup>45</sup>

- a. Quality human resources
- b. Investment climate and business climate are less conducive
- c. Lack of guidance and coaching from related parties
- d. Low technology
- e. Less capital resources
- f. Traditional management
- g. Inadequate infrastructure
- h. The difficulty of obtaining raw materials
- i. Difficulty in obtaining a business license or legal entity
- j. The difficulty of marketing the resulting product.

Based on the KUKM, the contribution of SMEs exports in 2023 will penetrate 14.5% or equivalent to 9.3 million SMEs players.<sup>46</sup> Meanwhile, 85.5% or 54.9 million other SMEs players have not carried out export activities (Go Export).<sup>47</sup> However, there are still 12% or 18.1 million SMEs players who have not received assistance on the procedures for exporting products produced by SMEs players. Because of this, SMEs have great potential to get international investment assistance, especially the President of the Republic of Indonesia, Joko Widodo, also supports international and domestic investment assistance through partnerships to SMEs to grow competitively and contribute to equitable economic growth.<sup>48</sup>

If it is related to the Right to Regulate where the state can regulate regulations regarding SMEs as one of the national interests, this is stated in the Decree of the People's Consultative Assembly (TAP MPR) of the Republic of Indonesia Number XVI / MPR / 1998 concerning Political Economy that the involvement of SMEs and cooperative development is necessary for economic democracy regarding investment policies based on people's economy. Economic development is also listed in Article 33 of the 1945 Constitution paragraphs (1) and (4) as the foundation of the Pancasila economic system also known as Economic Democracy where:

- (1) The economy is structured as a joint enterprise based on the principle of kinship.

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<sup>43</sup>Kementerian Koordinator Bidang Perekonomian Republik Indonesia, “*Perkembangan UMKM sebagai Critical Engine Perekonomian Nasional Terus Mendapatkan Dukungan Pemerintah*”, Last Modified January 12, 2023, <https://www.ekon.go.id/publikasi/detail/4593/perkembangan-umkm-sebagai-critical-engine-perekonomian-nasional-terus-mendapatkan-dukungan-pemerintah>,

<sup>44</sup>*Ibid.*

<sup>45</sup>Fahimul Amri, *Loc. Cit.*

<sup>46</sup>Septia Rianthie, “*Baru 14,5 Persen UMKM Sukses Tembus Pasar Ekspor, Apa Sebabnya?*”, Last Modified June 22, 2023, [https://bisnis.tempo.co/read/1735100/baru-145-persen-umkm-sukses-tembus-pasar-ekspor-apa-sebabnya?page\\_num=2](https://bisnis.tempo.co/read/1735100/baru-145-persen-umkm-sukses-tembus-pasar-ekspor-apa-sebabnya?page_num=2)

<sup>47</sup>*Ibid.*

<sup>48</sup>Kementerian Komunikasi dan Informatika RI, “*Tingkatkan Daya Saing UMKM Melalui Kemitraan dengan Usaha-Usaha Besar*”, Last Modified June 22, 2023, <https://www.kominfo.go.id/content/detail/32139/tingkatkan-daya-saing-umkm-melalui-kemitraan-dengan-usaha-usaha-besar/0/berita>

- (4) The national economy is organized based on economic democracy with the principles of togetherness, equitable efficiency, sustainability, environmental insight, independence, and by maintaining a balance of progress and national economic unity.

The development of SMEs through positive law in Indonesia is also enshrined in Article 3 of Law No. 20 of 2008 on Micro, Small and Medium Enterprises (SMEs Law), which states that micro, small and medium enterprises the Aim to grow and develop businesses to build an economy based on a fair economic democracy. Based on Article 4 of Law No. 25 of 2007 on Investment, it is stated that there are several principles for strengthening SMEs, including the growth of independence, unity and entrepreneurship of SMEs and business development based on the regional Potential and market orientation in accordance with SMEs competence and to increase the competitiveness of SMEs. In addition, it is also stated in Article 3 of Law Number 6 of 2023 concerning the Stipulation of Government Regulations in Lieu of Law Number 2 of 2022 concerning Job Creation into Law (Job Creation Law) that the Job Creation Law is formed to:

- a. create and increase employment by providing convenience, and empowerment to cooperatives and as well as national industry and trade as an effort to be able to absorb the widest possible Indonesian workforce while still paying attention to balance and progress in national economic unity; protection SMEs Interregional
- b. ensure that every citizen obtains employment, as well as fair and decent remuneration and treatment in employment relations;
- c. adjust various aspects of regulations related to alignments, strengthening, and protection for cooperatives and national industries; and SMEs
- d. adjust various regulatory aspects related to improving the investment ecosystem, facilitating, and accelerating national strategic projects oriented to national interests based on national science and technology based on the direction of Pancasila ideology.

There are several policies in empowering SMEs through investment into Indonesia. The policy direction of SMEs empowerment is carried out based on two strategies, namely:<sup>49</sup>

1. The upgrade strategy is to encourage enterprises of a certain size to become larger enterprises, micro enterprises to small enterprises, then medium enterprises, and finally large enterprises.
2. Strategic alliance strategy, namely a partnership strategy in the form of relationships (cooperation) between two or more economic actors, based on equality, openness, and mutual benefit (provision of benefits), to strengthen relationships between economic actors in different companies. Scale. Alliances are built to enable small-scale entrepreneurs to enter the market and build productive collaborative networks on a larger scale. The alliance is based on commercial considerations and mutually beneficial cooperation. Such an alliance pattern will create commercial links between SMEs, cooperatives, and large companies.

SMEs can be divided into 4 groups, namely Micro Enterprises, Small Enterprises, Medium Enterprises, and Large Enterprises. There are different definitions of Micro Enterprises with Small Enterprises, Medium Enterprises, and Large Enterprises. Micro enterprises are defined as productive businesses while in other groups they are defined as creative economy businesses. The term for adding "economy" to other groups is Indicates that the activities carried out have been well regulated by

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<sup>49</sup>Mas Rahmah, *Hukum Investasi*, (Jakarta Timur: Kencana, 2020), 72.

business actors.<sup>50</sup> In other words, the business world run by these business actors has good corporate governance when compared to micro enterprises.<sup>51</sup>

To be able to distinguish groups from SMEs forms can be seen through the criteria of working capital (establishment or registration of business activities) or annual sales results. The criteria for SMEs groups based on working capital and annual sales results are listed in Article 35 paragraphs (3) and (5) of Government Regulation (PP) Number 7 of 2021 concerning the Convenience, Protection, and Empowerment of Cooperatives and Micro, Small and Medium Enterprises, namely:

- a. Micro Enterprises have a working capital of up to a maximum of Rp1,000,000,000.00 (one billion rupiah) excluding land and buildings for business premises. Have annual sales up to a maximum of Rp2,000,000,000.00 (two billion rupiah);
- b. Small Business has a working capital of more than Rp1.000.000.000,00 (one billion rupiah) up to a maximum of Rp5.000.000.000,00 (five billion rupiah) excluding land and buildings for business premises. Have annual sales of more than Rp2,000,000,000.00 (two billion rupiah) up to a maximum of Rp15,000,000,000.00 (fifteen billion rupiah); and
- c. Medium Enterprises have a working capital of more than IDR 5,000,000,000.00 (five billion rupiah) up to a maximum of IDR 10,000,000,000.00 (ten billion rupiah) excluding land and buildings for business premises. Have annual sales of more than Rp15,000,000,000.00 (fifteen billion rupiah) up to a maximum of Rp50,000,000,000.00 (fifty billion rupiah).

SMEs play an important role in the Indonesian economy, particularly contributing significantly to the formation of gross domestic product (GDP) and employment. In addition, SMEs are believed to have strong economic resilience, allowing them to serve as a buffer for the financial system and economic stability.<sup>52</sup> According to Article 3 of the SMEs Law, SMEs strive for the growth and development of their enterprises to build a national economy based on fair economic democracy. Article 5 of the SMEs Law also mentions the objectives of empowering SMEs, including:

- a. Realizing a balanced, developing, and equitable national economic structure;
- b. grow and develop the ability of Micro, Small and Medium Enterprises to become resilient and independent businesses; and
- c. increase the role of Micro, Small and Medium Enterprises in regional development, job creation, income equality, economic growth, and alleviation of people from poverty.

When carrying out their business activities, SMEs economic actors must be aware that SMEs are a forum designed in this way and therefore there are principles underlying SMEs. Article 2 of the SMEs Law states that the principles of SMEs consist of:

- a. Family;
- b. economic democracy;
- c. Togetherness;
- d. equitable efficiency;
- e. Sustainable;
- f. environmentally sound;
- g. Independence;
- h. balance of progress; And
- i. National Economic Unity

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<sup>50</sup>Lathifah Hanim dan MS. Noorman, *UMKM (Usaha Mikro, Kecil, & Menengah) & BENTUK-BENTUK USAHA*, UNISSULA PRESS: Semarang, 2018, 12.

<sup>51</sup>*Ibid.*

<sup>52</sup>Bank Indonesia, *Loc. Cit.*

### **The urgency of containing provisions on Micro, Small and Medium Enterprises (SMEs) in the Bilateral Investment Treaty (BIT) between Indonesia and other countries in order to optimize the development of SMEs in Indonesia**

SMEs as a part, the most important part as well, of the global economic development shows that the government around the world must encourage to make a cooperation between countries through international agreements so that SMEs can compete globally. International agreements can be made by two countries (bilateral) or more than one country (multilateral/regional), BIT and Free Trade Agreement (FTA) is an example of an international agreement made by two countries, in addition to ASEAN Comprehensive Investment Agreement (ACIA) which is an agreement between several countries that are ASEAN member states so that the agreement is one example of a regional international agreement.<sup>53</sup>

International investment assistance is one way to shape the development of SMEs. International investment is a way to connect forces between countries in order to make maximum growth.<sup>54</sup> The role of international investment can also be seen based on the basic theories of foreign investment, namely classical theory, dependence theory, and middle path theory.<sup>55</sup> Classical theory explains that international investment is entirely beneficial to the host state, while dependence theory explains that international investment does not provide benefits to economic development because it is considered to make developing countries dependent on developed economies.<sup>56</sup> Mediating the two theories is the middle path theory which explains that international investment provides benefits and risks that need to be watched out for, where this theory is an influence on international investment policies and arrangements in Indonesia.<sup>57</sup>

Cooperation between countries to carry out international investment practices, one of which can be through international agreements. International treaties are the backbone of international investment law.<sup>58</sup> International investment law is a part of international law regarding the licensing of entry and treatment of foreign investments, while international investment treaties regulate the rights and obligations between states and foreign investors towards the territory of the country to which it is given its capital.<sup>59</sup> In an international agreement that becomes the parties or can be referred to as a contracting party, namely the home state and host state.<sup>60</sup> There are several subjects of BIT, the first is investors. Investors consist of legal subjects in the form of individuals / humans (natural person) and legal entities (legal person), currently foreign investment is mostly carried out and dominated by multinational companies (MNCs).<sup>61</sup> MNC is considered a very important actor because it can influence economic power, it can be seen that MNC has the power to form international investment law for the benefit and has an independent influence on the formation of legal rules which later become principles of international law.<sup>62</sup> MNCs are considered to have the power to ensure the protection of their global investments by encouraging international institutions such as the International Monetary Fund (IMF)

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<sup>53</sup> Muhammad Iqbal Hasan, *Hukum Investasi Internasional Teori dan Implementasi*, (Jakarta: Rafika, 2021), 57.

<sup>54</sup> Muhammad Iqbal Hasan, *Op.Cit.*,10.

<sup>55</sup> *Ibid.*, 11.

<sup>56</sup> *Ibid.*

<sup>57</sup> Rahmi Jened, *Teori Investasi Kebijakan Hukum Investasi Langsung*, (Jakarta: PT Fajar Interpratama Mandiri, 2016), 107.

<sup>58</sup> Muhammad Iqbal Hasan, *Op.Cit.*, 55.

<sup>59</sup> *Ibid.*

<sup>60</sup> Mas Rahmah, *Op.Cit.*,33

<sup>61</sup> Mas Rahmah, *Op.Cit.*,34

<sup>62</sup> *Ibid.*, 35.

and the World Bank to withdraw aid, loans, or other facilities to countries that violate their investment protection.<sup>63</sup>

Second, there are state companies or commonly referred to as State-Owned Enterprises (SOEs).<sup>64</sup> Through state enterprises, the government is oriented to provide services to the community which are grouped into several characteristics, including:

- a. Public goods
- b. Basic essentials industry
- c. Financial services
- d. Social services

From these four criteria, state companies can be categorized as public utility/services enterprises and commercial enterprises.<sup>65</sup>

There are several factors that need to be considered in analyzing the urgency of containing provisions regarding SMEs in BIT between Indonesia and other countries to optimize the development of SMEs in Indonesia. If you look at the strength, SMEs are the backbone of the Indonesian economy where SMEs make a significant contribution to economic growth. SMEs have the potential for greater and more diverse growth in various sectors. It can be seen through regulations in Indonesia that the Government in Indonesia has taken several policies to support and promote SMEs. There are wider opportunities in employment, this is because SMEs create local jobs that are important for community empowerment.

The weakness that can be seen is the limited access to capital and costs to SMEs business actors, this leads to the quality of their products. There are still some SMEs that need to improve the quality of their products and services to compete in the international market. In addition, the limitations of SMEs actors to be able to negotiate directly in making international investment agreements.

Some opportunities in placing clauses for the development of SMEs include wider SMEs market access abroad, if SMEs are covered in BIT, SMEs in Indonesia can more easily expand their market wings to the international arena. This certainly can attract the attention of foreign investors, BIT as an international agreement could provide views to investors to provide international investment to SMEs in Indonesia. BIT is certainly a door to cooperate with SMEs in partner countries, it is undeniable that SMEs are also one of the things that are of concern in the international economic realm. With the presence of cooperation between countries through BIT, it can provide opportunities for SMEs to take advantage of technology transfer from foreign investors to increase innovation.

On the other hand, there are several threats to watch out for. Political and legal uncertainty in partner countries can be an obstacle, with policy changes or legal uncertainty potentially affecting SMEs investment. In the international market, Indonesian SMEs will face stiff competition from global competitors. Foreign currency fluctuations can also affect the profits of SMEs operating abroad, and the global economic crisis can reduce demand for SMEs products and services.

There are several forms of international agreements, one of which is BIT. BIT is an agreement between two countries that protects investments made by investors from one country in the territory of another country.<sup>66</sup> Based on The Vienna Convention on the Law of Treaties (VCLT 1969) or the Vienna

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<sup>63</sup> *Ibid.*

<sup>64</sup> *Ibid.*

<sup>65</sup> *Ibid.*,36.

<sup>66</sup> Helena Sprenger dan Bouke Boersma, "The Importance of Bilateral Investment Treaties (BITs) When Investing in Emerging Markets", 2014, Business Law Today, Last Modified August 27, 2023, [https://www.houthoff.com/-/media/houthoff/publications/bboersma/investment\\_treaties.pdf](https://www.houthoff.com/-/media/houthoff/publications/bboersma/investment_treaties.pdf)

Convention 1969 which defines international agreements in Article 2 paragraph 1 as "Whether contained in a single document, two or more related instruments, or under any other specific designation, the term "treaty" refers to an international agreement reached between nations in writing and controlled by international law". Regardless of whether it is contained in a single document, in two or more related instruments or under another specific name, the term "treaty" can be interpreted as referring to an international agreement concluded in writing between States and governed by international law agreement refers. In general, the objectives of the BIT are expressed in the introductory or opening words, which refer to the desire to improve economic cooperation between the countries involved, as well as the recognition of the fact that the promotion of and the protection of Investments will strengthen this cooperation. economic protection.<sup>67</sup>

BITs provide protection against international investments from expropriation without compensation and against any mistreatment and to provide legal remedies.<sup>68</sup> The protection and guarantees provided by BIT against non-commercial risks have acted as incentives for potential foreign investors and as useful guarantees for countries that have cooperated as BIT partner countries.<sup>69</sup> Partner countries, seeking protection and guarantees under international law as an aspect of promoting foreign investment have been designed to establish standards of protection.<sup>70</sup> Therefore, BIT can be referred to as an agreement that only has elements of protection or protection because it only provides legal protection as collateral for foreign investors.<sup>71</sup>

BIT, as an international investment treaty, can have an impact on the rise or fall of capital flows provided by partner countries. If you look at the development of International Investment through BIT, it can be seen through BIT Indonesia – Singapore in 2018. During the Covid-19 virus pandemic around the world, all kinds of activities are restricted and have a significant impact on the social life of the global community. This is certainly an obstacle to economic growth in every country, economic recovery will depend on handling the global pandemic that has occurred. In an effort to overcome this situation, Indonesia and Singapore are working together to leverage the long-standing cooperation of SIJORI (Singapore-Johor-Riau) to improve mutual prosperity and prevent rapid economic expansion amid the pandemic.<sup>72</sup> Both countries have adopted BIT by utilizing the SIJORI concept.<sup>73</sup> Because both were severely affected by the Covid-19 pandemic, they again used a cooperative approach in the development of SIJORI. In 2020 the GDP of both experienced a decline, they needed available resources to recover their economies. therefore m<sup>74</sup> Singapore is also the largest investor in Indonesia. Based on the Ministry of Foreign Affairs that Singapore's investment in Indonesia reached a value of US\$ 9.8 billion in 2020, which is a significant increase from US\$ 6.5 billion in 2019.<sup>75</sup>

It can also be seen through the Indonesia-Korea BIT in 1991, there was a notification in 2014, The Indonesian government announced that it would end all signed BITs.<sup>76</sup> If the Indonesian government decides not to proceed with the BIT, there will be no more protection for foreign investors,

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<sup>67</sup> *Ibid.*

<sup>68</sup> Surya P Subedi, *International Investment Law Reconciling Policy and Principle*, (North America: OXFORD AND PORTLAND, 2008), 84

<sup>69</sup> *Ibid.*

<sup>70</sup> *Ibid.*

<sup>71</sup> Muhammad Iqbal Hasan, *Op.Cit.*,58.

<sup>72</sup> Humphrey Wangke, "Ratifikasi Perjanjian BIT Indonesia-Singapura", Last Modified August 9,2023, [http://berkas.dpr.go.id/puslit/files/isu\\_sepekan/Isu%20Sepekan---II-P3DI-Maret-2021-170.pdf](http://berkas.dpr.go.id/puslit/files/isu_sepekan/Isu%20Sepekan---II-P3DI-Maret-2021-170.pdf)

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*

<sup>75</sup> *Ibid.*

<sup>76</sup> Gabriella Hardori, "Implementasi Bilateral Investment Treaty antara Indonesia dan Korea Selatan Periode 2014-2018", (*MJIR*) *MOESTOPO JOURNAL INTERNATIONAL RELATIONS*, No 2 (2021):120.

and it could harm them. This news then developed among investors from abroad, including those from South Korea. In 2014, the amount of investment from South Korea entering Indonesia experienced a considerable decrease compared to the previous year. In 2013, foreign investment from South Korea flowing into Indonesia reached US\$ 2.2 billion, but in 2014 that number dropped dramatically to half, namely US\$ 1.1 billion.<sup>77</sup>

Thus, cooperation between countries through BITs has significant implications for international investment flows. Government policies in maintaining or terminating such agreements may affect the attractiveness of foreign investment in the country and may form a more stable investment climate or vice versa. Therefore, the policies taken by the government in managing BIT are crucial in influencing foreign investment flows and their impact on economic development and state welfare.

Some countries have included protection clauses for SMEs in their model BITs, including investor-state dispute settlement (ISDS) mechanisms. For example, Canada's BIT (2021) or FIPA, allows for the acceleration of legal proceedings for claims under CAD\$10 million, with an emphasis on supporting underrepresented groups such as SMEs, women, and indigenous peoples.<sup>78</sup> FIPA also accommodates the use of a single arbitrator for SME cases or claims with low compensation.<sup>79</sup> Similarly, the Belgium-Luxembourg Economic Union BIT (2019) and the Netherlands model BIT (2019) both offer options for single-member tribunals and emphasize low procedural costs, particularly for SMEs.<sup>80</sup> While Indonesia's model BITs have not explicitly provided specific protections for SMEs, many developed countries have integrated SME protections in their bilateral investment treaties, recognizing the role of SMEs in economic growth and sustainable development. ISDS clauses provide convenience for SMEs in resolving disputes, reducing costs and time with the flexibility of arbitration processes and external funding.<sup>81</sup> This shows that BITs provide a foundation for the protection and development of SMEs, promoting investment and attracting FDI, particularly in countries with less credible reputations.<sup>82</sup> This shows that BIT can serve as a guide for the development and promotion of SMEs as they provide legal protection and certainty in foreign markets, although their effectiveness depends on host country provisions and implementation.<sup>83</sup>

#### IV. CONCLUSION

BIT Indonesia and partner countries regulate the provisions for SMEs development indirectly. It can be seen through BIT Indonesia-Singapore in Article 11 concerning Right to Regulate. The Right to Regulate provision provides an opportunity for the state to make a rule to support the national interest if it does not violate the regulations in TRIMs as a reference in international investment law, in this case SMEs are one of the national interests. There are several provisions through positive law in Indonesia to support the development of SMEs. This shows that Right to Regulate can be an indirect means to develop SMEs through BIT Indonesia with partner countries. BIT can be referred to as an agreement that discusses the liberation of capital flows, this can be seen from the influence of BIT on foreign capital flows into Indonesia. BIT has an element of Protection which is in line with SMEs in Indonesia

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<sup>77</sup> *Ibid.*

<sup>78</sup> Katia Fach Gómez dan Catharine Titib, "Facilitating Access to Investor-State Dispute Settlement for Small and Medium-Sized Enterprises: Tracing the Path Forward", *EUROPEAN BUSINESS LAW REVIEW*, No 7 (2023), 32.

<sup>79</sup> *Ibid.*

<sup>80</sup> *Ibid.*

<sup>81</sup> Alexander Gebert, 'Legal Protection for Small and Medium-Sized Enterprises through Investor-State Dispute Settlement: Status Quo, Impediments, and Potential Solutions', *Small and Medium-Sized Enterprises in International Economic Law*, (Oxford: Oxford University Press, 2017).

<sup>82</sup> Axel Berger, et.al., "More Stringent BITs, Less Ambiguous Effects on FDI? Not a Bit!", *World Trade Organization*, 2010, 2

<sup>83</sup> *Ibid.*

requiring assistance in terms of promotion and legal protection to continue to develop and become more optimal because SMEs are the backbone of the economy in Indonesia, as well as part of the implementation of the Pancasila Economic System. Thus, the placement of SME provisions in BITs is an urgent matter. Although Indonesia's BIT model does not yet have an explicit clause for SMEs, a comparison with developed countries shows that the inclusion of MSME protection in investment treaties can be a progressive step. These protections not only create a more inclusive investment environment but can also provide positive incentives for the optimal development of Indonesian MSMEs to engage in international investment practices.

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