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LOCAL CONTENT REGULATIONS IN INFRASTRUCTURE DEVELOPMENT AND THE NATIONAL TREATMENT PRINCIPLE

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ABSTRACT

The local content requirement is a policy aimed at promoting domestic industries and reducing dependence on imported products. However, its application, particularly in the procurement of goods for solar power plants, raises concerns about potential violations of the national treatment principle found in international agreements such as GATT 1994 and the Agreement on TRIMs. This study seeks to explore the implementation of local content requirements in infrastructure project procurement in relation to the national treatment principle and the government's efforts to enforce these regulations. The research employs a normative juridical approach, drawing on literature sources and analyzing the issue based on legal principles. The study is descriptive-analytical in nature, utilizing secondary data gathered from primary, secondary, and tertiary legal materials through literature review and analyzed using qualitative juridical methods. The findings indicate that the application of local content requirements in the procurement of infrastructure projects for solar power plants in Indonesia is not fully aligned with the national treatment principle. The government has made efforts to enforce local content requirements without breaching international law by implementing incentives and providing exceptions for imported goods under certain conditions.

Keywords: investment; local content requirements; non-discrimination principles.

I. INTRODUCTION

Indonesia is an archipelagic country with the fourth-largest population in the world, totaling 281 million people. The growing population is accompanied by an increasing demand for electricity to support productivity. In 2023, the per capita electricity consumption in Indonesia was 1,285 kWh. The government has set a target for 2024, aiming to reach 1,408 kWh per capita. Numerous coal-fired power plant (CFPP) projects have been undertaken to meet the rising electricity needs. One of the largest CFPP projects is the Jawa 7 CFPP in Serang, Banten, with a capacity of 2 x 1000 megawatts.

As a country that has signed and ratified the Paris Agreement to The United Nations Framework Convention on Climate Change and is committed to achieving carbon neutrality by 2060, Indonesia must seek alternative ways to meet its increasing electricity demand each year. Observing other developing countries with faster carbon neutrality goals, these nations have accelerated the development and use of renewable energy power plants. According to the Minister of Energy and Mineral Resources Regulation No. 50 of 2017 concerning the Utilization of Renewable Energy Sources for Electricity Supply, Article 1, paragraph (2), renewable energy is defined as energy sources derived from sustainable energy resources if properly managed, including geothermal, wind, bioenergy, sunlight, water flow and waterfalls, as well as oceanic movements and temperature differences.

Indonesia has the potential to utilize Solar Power Plants with a capacity of 4.80 kWh/m² per day. The main obstacle in the development and utilization of Solar Power Plants is the unfamiliarity with the technology, which drives up the cost of solar module and cell components. Foreign investment can be one of the ways to encourage the development and utilization of Solar Power Plants. Clear

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regulations are a key aspect in attracting foreign investment to Indonesia.[1] The development of solar power plants is regulated by the Ministry of Energy and Mineral Resources in collaboration with the Ministry of Industry. The Ministry of Industry oversees the use of domestic products in the construction of power plants in Indonesia. The use of domestic products is mandated for every infrastructure project in Indonesia according to Presidential Regulation No. 12 of 2021 on Government Procurement of Goods/Services.

The utilization of domestic products in the development of solar power infrastructure is comprehensively governed by the Minister of Industry Regulation Number 34 of 2024 concerning the Procedures for Calculating the Local Content Value of Solar Module Products. This regulation outlines specific requirements and standards that mandate the inclusion of locally manufactured components in the construction and operation of solar energy facilities. The primary objective of such regulations is to bolster the domestic manufacturing sector, promote local industries, create employment opportunities, and enhance the nation's self-sufficiency in renewable energy production. However, despite these noble intentions, the enforcement of strict local content requirements has raised significant concerns regarding their compatibility with international trade agreements.

Notably, these domestic content regulations appear to conflict with provisions stipulated in the Agreement on Trade-Related Investment Measures (TRIMs Agreement). The TRIMs Agreement, particularly in its annex, explicitly prohibits the imposition of requirements that compel investors to use domestic products as a condition for investment approval or operation. Such measures are deemed trade-distorting as they can create unfair advantages for local producers and hinder the free flow of goods and services across international borders. Consequently, Indonesia's adherence to stringent local content mandates may be considered inconsistent with Article 2, subsection 1 of the TRIMs Agreement. Furthermore, these regulations may violate the principle of national treatment outlined in Article III of the General Agreement on Tariffs and Trade (GATT) 1994, which obligates member countries to treat imported goods no less favorably than domestically produced goods in terms of internal taxation and regulation.

The implications of enforcing local content requirements have been exemplified in previous international disputes. For instance, India faced a formal complaint from the United States concerning its domestic content requirements for solar power infrastructure projects. In this case, India's regulations mandated that foreign investors incorporate specific domestically produced components, such as solar modules and cells, as a prerequisite for participating in the country's solar energy development initiatives. The United States argued that such requirements discriminated against foreign products and investors, thereby violating India's obligations under various World Trade Organization (WTO) agreements. The dispute underscored the tension between national policies aimed at promoting domestic industries and the commitments made under international trade frameworks to ensure non-discriminatory and fair-trade practices.

Similarly, the WTO case DS412, titled "Canada-Certain Measures Affecting the Renewable Energy Generation Sector," illustrates the complexities associated with domestic content regulations. In this dispute, Japan challenged Canada's policies in the province of Ontario, where the government provided financial incentives to investors who utilized locally manufactured products in renewable energy projects, particularly in wind and solar power generation. Japan contended that these incentives, tied explicitly to the use of domestic goods, contravened Canada's obligations under WTO agreements

[1] Agung Sudjati Winata, "Perlindungan Investor Asing dalam Kegiatan Penanaman Modal Asing dan Implikasinya Terhadap Negara", *Ajudikasi: Jurnal Ilmu Hukum* Vol 2. No 2, 2018: 131.

by discriminating against foreign products and distorting trade. The WTO ruling in this case emphasized that while governments may pursue environmental and economic development objectives, such measures must comply with international trade rules and should not unfairly disadvantage foreign competitors.

Indonesia's current approach, which includes offering various forms of financial incentives contingent upon the use of domestic products, mirrors the policies that have been subject to dispute in the aforementioned cases. Under the Agreement on Subsidies and Countervailing Measures (SCM Agreement), subsidies that are contingent upon the use of domestic over imported goods are explicitly prohibited, as they can distort international trade and negatively impact foreign producers. Therefore, Indonesia's incentive schemes linked to local content requirements could potentially expose the country to similar challenges and disputes within the WTO framework.

Given these precedents and the potential for international legal challenges, it is imperative for Indonesia to conduct a thorough and comprehensive analysis of its local content regulations in the context of its international trade obligations. Such an assessment should consider the balance between promoting domestic industrial growth and adhering to the principles and rules established by international trade agreements. Policymakers must explore alternative strategies that support local industries without violating trade commitments, such as investing in capacity building, enhancing competitiveness through quality improvements, and fostering innovation within the domestic sector.

Moreover, the complete elimination of local content regulations could have adverse effects on domestic industries, exposing them to intense competition from foreign producers and potentially leading to job losses and economic downturns in certain sectors. Therefore, Indonesia should aim to develop a nuanced policy framework that supports domestic economic objectives while maintaining compliance with international trade laws. This could involve engaging in negotiations within the WTO to seek permissible flexibilities, participating in international cooperation initiatives to develop sustainable and fair trade practices, and implementing supportive measures that enhance the global competitiveness of domestic industries without resorting to trade-distorting requirements. In conclusion, while local content regulations serve important national interests by supporting domestic industries and promoting economic development, they must be carefully crafted and implemented in a manner that respects and aligns with international trade obligations. Through diligent analysis, strategic policymaking, and proactive engagement in the international trade community, Indonesia can strive to achieve its developmental goals while upholding the principles of fair and equitable trade.

II. RESEARCH METHOD

The research method employed in this study is the normative juridical method, which relies on library sources and involves analyzing theoretical aspects based on legal principles. This research will conduct a literature review, supported by theories from academics relevant to the topic, to formulate the effectiveness of local content regulations. Additionally, the author will use a case approach by analyzing decisions in WTO cases to assess the success of domestic product usage regulations. This will be complemented by examining the principles of foreign investment law and applicable international law, as well as relevant international investment agreements. This method is utilized to explore existing concepts and theories to develop a clear understanding of their application in practice and legal decisions. The author will collect data from literature studies, obtaining secondary data in the form of legal theories concerning the principle of national treatment sourced from books, journals, and articles.

III. DISCUSSION

1. Regulation on the Development of Solar Power Plant Infrastructure.

The development of solar power plants in Indonesia is a critical component of the government's commitment to ensuring equitable social welfare and promoting sustainable energy sources.[2] Solar power, as a form of renewable energy, is central to the nation's strategy to diversify its energy mix, reduce reliance on fossil fuels, and meet its international commitments to combat climate change. The government's role in this development is not just limited to policy-making but extends to the actual procurement and construction of solar power plants, which is regulated by a series of complex legal frameworks aimed at ensuring the successful implementation of these projects.

Central to this regulatory framework is the Presidential Regulation of the Republic of Indonesia Number 16 of 2018 on Government Procurement of Goods/Services, which was later amended by Presidential Regulation Number 12 of 2021. These regulations lay the groundwork for how government procurement processes should be conducted, with a specific focus on transparency, efficiency, and the promotion of domestic products. Article 66 of Presidential Regulation Number 16 of 2018 explicitly mandates that all ministries, agencies, and regional governments prioritize the use of domestic products in the construction of infrastructure projects, including those related to electricity generation. This regulation underscores the government's intention to bolster local industries and ensure that the benefits of large-scale infrastructure projects, like solar power plants, are felt within the national economy.

Further reinforcing this requirement, the Minister of Energy and Mineral Resources Regulation Number 11 of 2024 stipulates that domestic products must be used in the development of electricity infrastructure. This regulation applies not only to projects undertaken by government agencies but also to those executed by state-owned enterprises, regional-owned enterprises, and even private entities involved in public-private partnerships or projects utilizing state-controlled resources. The broad applicability of this regulation reflects the government's commitment to maximizing the involvement of local industries in the nation's push towards renewable energy.

To operationalize these local content requirements, the Minister of Industry Regulation Number 34 of 2024 provides detailed guidelines on how the local content value of solar module products should be calculated. According to this regulation, solar module components must consist of 91% local content in materials, 5% in labor, and 4% in indirect factory costs. This stringent requirement is designed to ensure that the majority of the economic activity generated by the construction and operation of solar power plants stays within Indonesia, thereby fostering the growth of local industries and reducing dependency on imported goods.

However, the high local content requirement presents significant challenges for businesses, especially those involved in the procurement process for renewable energy projects. According to PT PLN Director Regulation Number 18 of 2023, which governs the strategic procurement policy for goods and services, the process for procuring electricity generation facilities is complex and multi-staged. It begins with the initiation of the power plant project and a feasibility study to determine its viability. Once a project is deemed feasible, the procurement process moves forward with the preparation of detailed procurement documents, including work plans and cost estimates, which are reviewed by the relevant officials. Prospective participants are then invited to submit bids, which are thoroughly evaluated through a process of due diligence, clarification, negotiation, and ultimately, the selection of a winner.

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[2] Musa Darwin Pane, "Aspek Hukum Pengadaan Barang Dan Jasa Pemerintah Suatu Tinjauan Yuridis Peraturan Pengadaan Barang Dan Jasa Pemerintah", *Jurnal Media hukum*, Vol 24 No.2, 2017:148.

The selected bidder is awarded the project, leading to the signing of a power purchase agreement (PPA). These agreements, governed by Minister of Energy and Mineral Resources Regulation Number 10 of 2017, are crucial in defining the terms of the project, including the duration of the contract, which can last up to 30 years depending on the type of power plant. Initially, these agreements followed a build-own-operate-transfer (BOOT) model, but Minister of Energy and Mineral Resources Regulation Number 4 of 2020, which amended Regulation Number 50 of 2017, introduced a build-own-operate (BOO) model. This shift in the collaboration scheme reflects the evolving nature of renewable energy projects in Indonesia, aiming to create more flexible and sustainable partnerships between the government and private sector.

Despite these regulatory efforts, the requirement to use domestic products, particularly for solar power plants, poses several significant obstacles for both domestic and international businesses.[3] Under Presidential Regulation Number 16 of 2018, businesses that incorporate higher levels of local content in their goods and services are granted price preferences, which effectively lower their bid prices in government procurement processes. While this provides a competitive advantage to those who can meet the local content requirements, it also places a heavy burden on businesses that struggle to source high-quality local components at competitive prices.

One of the primary challenges lies in the availability and quality of domestically produced goods.[4] For instance, although Indonesia has made strides in developing its solar energy sector, the country currently has only one factory that manufactures solar modules, while the remaining 21 factories are assembly plants that rely heavily on imported solar cells.[5] This limited domestic production capacity means that businesses often face difficulties in sourcing the required components locally, which can lead to delays in the construction and operation of solar power plants. Furthermore, domestically produced solar modules are significantly more expensive—by approximately 30%-45%—than their imported counterparts. This price disparity not only increases the overall cost of renewable energy projects but also makes it challenging for businesses to comply with the local content requirements without compromising their financial viability.

These challenges are particularly pronounced for foreign investors, who may be deterred from participating in Indonesia's renewable energy sector due to the high costs, limited availability of local components, and the complexities associated with meeting the stringent local content requirements. International financial institutions and businesses, which are often key players in funding and implementing large-scale renewable energy projects, may find Indonesia's regulatory environment less attractive compared to other markets with more favorable investment conditions. This could result in a reduction of much-needed foreign investment in the sector, potentially slowing down the country's progress towards its renewable energy targets.

The combination of these factors high costs, limited local production capacity, and stringent regulatory requirements creates a challenging investment landscape for renewable energy projects in Indonesia. For domestic businesses, the financial and operational burdens associated with meeting the local content requirements can be substantial. Many companies may find themselves caught between the need to comply with government regulations and the practical realities of operating in a market where local inputs are either too expensive or insufficiently available.

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[3] Muhamad suhud and Aloysius Damar Pranadi. *Power Purcchase Agreements in Indonesia: Solar Photovaltaic Hyrbid Systems.* (Jakarta:Mentari, 2022) 59.
[4] *Ibid*., p. 59.
[5] Hilma Meilani, *Permasalahan Dalam Pengembangan PLTS.* Isu Sepekan Bidang Ekuimbang, Komisi VII. (Jakarta: Pusat Analisis Keparlemenan Badan Keahlian Setjen DPR RI, 2024) 1.

Moreover, the potential penalties for failing to meet the required local content levels add another layer of risk for businesses involved in these projects. The verification process for local content value, conducted by independent agencies licensed to provide electricity support services, ensures that companies adhere to the stipulated requirements. However, if a business is found to have fallen short of the required local content, it may face sanctions, which could include fines or other penalties that further erode the financial viability of the project.

The broader implications of these challenges extend beyond individual businesses to the overall progress of Indonesia's renewable energy sector. If the current regulatory framework continues to deter foreign investment and strain domestic businesses, there is a risk that the country's ambitious renewable energy targets may not be met. This could have significant consequences for Indonesia's efforts to reduce greenhouse gas emissions, diversify its energy mix, and fulfill its international commitments to combat climate change.

To address these challenges, there may be a need for policy adjustments that strike a balance between supporting local industries and attracting the necessary investments to advance Indonesia's renewable energy infrastructure. One possible approach could involve revising the local content requirements to make them more flexible, allowing for a gradual increase in the use of domestic products as local industries develop and production capacities improve. Additionally, the government could consider providing targeted support to domestic manufacturers to help them scale up production and reduce costs, thereby making locally produced components more competitive in the global market.

Another potential solution could involve enhancing the incentives offered to businesses that meet local content requirements, such as providing additional tax breaks, subsidies, or other forms of financial support to offset the higher costs associated with using domestic products. These incentives could help to alleviate some of the financial pressures on businesses and make it more economically viable for them to comply with the regulations.

In conclusion, while the development of solar power plants is a critical component of Indonesia's energy strategy, the current regulatory framework, particularly the stringent local content requirements, presents significant challenges for businesses and investors. To ensure the successful implementation of renewable energy projects and achieve the country's sustainable development goals, it is essential for the government to strike a balance between promoting local industries and creating an attractive investment environment for both domestic and international players. By making strategic adjustments to the existing policies, Indonesia can continue to advance its renewable energy sector while fostering economic growth and ensuring a more sustainable and equitable future.

2. Cases Related to Local Content Requirements and the National Treatment Principle

2.1. DS456 India-Certain Measures Relating to Solar Cells and Solar Modules

In 2014, the United States requested consultations with India concerning the domestic content requirements imposed under the Jawaharlal Nehru National Solar Mission (National Solar Mission).[6] These requirements mandated that solar cells and modules used in projects funded by the National Solar Mission must be domestically produced. This regulation was specifically targeted at entities entering into power purchase agreements with government authorities overseeing the National Solar Mission. The mission aimed to promote sustainable development and address critical energy security challenges faced by India. India argued that the domestic content requirements were a necessary response to its energy deficit and reliance on

[6] World Trade Organization, India-Certain Measures Relating to Solar Cells and Solar Modules. Case No. WT/DS456/R. 2016.

fossil fuels and imported energy resources, which it sought to mitigate through promoting domestic production.

The United States contended that these domestic content requirements disadvantaged foreign solar cells and modules, providing undue preference to domestic products. This, according to the U.S., constituted a violation of Article III:4 of the General Agreement on Tariffs and Trade (GATT) 1994 and Article 2.1 of the Agreement on Trade-Related Investment Measures (TRIMs). Article III:4 of the GATT 1994, titled "National Treatment on Internal Taxation and Regulation," stipulates: "The products of the territory of any Member imported into the territory of any other Member shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations, and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use." Article 2 of the TRIMs Agreement, titled "National Treatment and Quantitative Restrictions," specifies:

1. "Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of 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."

Paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement further elucidates that "TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require: (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production."

India argued that its domestic content requirements for the procurement of solar cells and modules were justified under the derogation provided in Article III:8(a) of the GATT 1994. This article allows for certain exceptions for government procurement measures. However, the WTO panel held that a violation of the national treatment obligation under Article III:4 of the GATT 1994 must be assessed by examining whether: 1) the imported and domestic products in question are "like products"; 2) the measure in question is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of these products; and 3) the imported products receive less favorable treatment compared to like domestic products. The term "like products" generally refers to products with similar physical characteristics, end uses, and those considered substitutable for each other.[7] The panel concluded that the sole distinguishing factor between the products in question was their origin. Moreover, Solar Power Developers were legally bound by power purchase agreements that mandated the use of domestically produced solar cells and modules, thereby impacting their internal sale, purchase, or use in India.

[7] Darminto Hartono Paulus, Fx Djoko Priyono, Adinda Kartika Putri, "Konsep Like Product Dalam Penyelesaian Sengketa Oleh Panel World Trade Organization (WTO)." *Diponegoro Law Review, vol*. 5, no. 2, 2016.

The panel found that the less favorable treatment of Solar Power Developers using imported solar cells and modules, which excluded them from participating in the National Solar Mission and from entering into power purchase agreements without committing to use domestic products, was in violation of Article III:4 of the GATT 1994. The panel reasoned that this less favorable treatment altered competitive conditions in the market, disadvantaging imported products, and thus required an effective equality of opportunities for imported products to compete with like domestic products under the principle of national treatment.

India further contended that the domestic content requirements were exempt under Article III:8(a) of the GATT 1994, which pertains to government procurement measures. This provision permits differential treatment of domestic products if they are purchased for governmental purposes and not intended for commercial resale or use in the production of goods for commercial sale. However, the WTO panel determined that India's measures could not be viewed in isolation but had to be evaluated in the context of their requirement for certain components of power generation facilities to use domestic products. The panel noted that the National Solar Mission was indeed a government procurement project, as it was implemented by state-owned enterprises in India, which could be classified as government entities responsible for executing the project. Furthermore, the panel observed that commercial transactions were involved, with solar power being sold from Solar Power Developers to government agencies, which then distributed it to electricity companies and ultimately to consumers.

In conclusion, the panel determined that the discriminatory treatment of imported solar cells and modules through the domestic content requirements did not fall within the exceptions provided by Article III:8(a) of the GATT 1994. The WTO panel concluded that India's domestic content requirements were inconsistent with Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994 and did not qualify for the derogation under Article III:8(a) of the GATT 1994. Furthermore, these domestic content requirements undermined or reduced the benefits that the United States should have received under the TRIMs Agreement and the GATT 1994, thus violating the principles of fair trade and non-discrimination enshrined in these agreements.

2.2 DS412 Canada-Certain Measures Affecting the Renewable Energy Generation Sector

Canada, through the Government of Ontario, implemented a Feed-in Tariff (FIT) program related to wind and solar power generation.[8] Japan, as the party initiating consultations with Canada through the Dispute Settlement Body, requested that the WTO Panel determine whether the FIT program, within the scope of wind and solar power projects, constituted a prohibited subsidy. Japan argued that the program required the use of domestic goods over imported goods, thereby violating Articles 3.2(b) and 3.2 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Furthermore, Japan contended that the domestic content requirement under the FIT program disadvantaged renewable energy products from Japan compared to those from Ontario, in breach of Article III:4 of the GATT 1994. Japan also claimed that the FIT program, as applied to wind and solar power projects, constituted a trade-related investment measure that was inconsistent with Article III:4 of the GATT 1994, thereby violating Article 2.1 of the TRIMs Agreement.

[8] World Trade Organization. "DS412: Canada Certain Measures Affecting the Renewable Energy Generation Sector." WT/DS412/R 2012.

The WTO Panel sided with Japan, agreeing that the domestic content requirement under the FIT program disadvantaged Japanese renewable energy products relative to similar products originating from Ontario. The rules within the FIT program were deemed requirements because suppliers of goods had to comply with them to benefit from the program. The domestic content requirement influenced the sale, purchase, and/or internal use of renewable energy products by incentivizing suppliers to favor domestic products. This requirement created a less favorable condition for imported renewable energy products compared to similar domestic products, altering the competitive landscape to the detriment of imported goods.

Japan argued that the FIT program constituted a trade-related investment measure because the domestic content requirement encouraged investment in the production of renewable energy equipment and components in Ontario. By definition, this favored the use of domestic products over imports, thus falling under the category of "trade-related" measures. The WTO Panel concurred that the domestic content requirement was inconsistent with Article 2.1 of the TRIMs Agreement. The FIT program, with its domestic content requirement, was classified as a trade-related investment measure within the scope of Paragraph 1(a) of the Illustrative List under the TRIMs Agreement. The obligation to use renewable energy products sourced from Ontario constituted a minimum domestic content requirement, and compliance with this requirement was necessary to participate in the FIT program, which was seen as a means to gain an advantage. The Panel concluded that Canada had violated its obligations under Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994.

However, the WTO Panel determined that the FIT program did not violate Articles 3.1(b) and 3.2 of the SCM Agreement. The FIT program was deemed a financial contribution in the form of government procurement of goods under Article 1.1(a) of the SCM Agreement, and there was no evidence that the FIT program provided a benefit to renewable energy product suppliers. Article 3.1(b) of the SCM Agreement prohibits subsidies contingent, either entirely or as one of several conditions, on the use of domestic over imported goods.

Canada appealed the WTO Panel's conclusion, arguing that the domestic content requirement constituted a derogation under Article III:8(a) of the GATT 1994. The Panel found that the FIT program, implemented through government procurement, retained a commercial intent. The Appellate Body concluded that the domestic content requirement under the FIT program did not qualify as a law, regulation, or requirement governing the procurement of electricity by governmental agencies, and therefore, the derogation under Article III:8 of the GATT 1994 did not apply in this case.

3. Application of the National Treatment Principle in Local Content Regulations

Local content requirements represent a critical aspect of performance requirements that are often employed by countries, particularly developing nations, as a means to leverage foreign direct investment (FDI) for broader economic and industrial development.[9] Despite their utility as a policy tool, Local content requirements are prohibited under the TRIMs Agreement due to their potential to distort trade and create barriers to international competition. Performance requirements, in general, are conditions that host countries impose on foreign investors, requiring them to meet specific objectives

[9] Wenny Setiawati, "Regulating Local content requirements in indonesia: The risk hidden in the free trade agreement", *Asian Law Institute Conference,* 2016: 4

related to their operations within the country.[10] These objectives often aim to enhance the host country's economic benefits from FDI, such as boosting local employment, promoting the transfer of technology, or ensuring that a significant portion of the economic value generated by the investment remains within the country.[11]

According to the United Nations Conference on Trade and Development (UNCTAD), performance requirements serve as a mechanism for host countries to exert control over foreign investments and ensure that these investments contribute meaningfully to national development goals. Among the various forms of performance requirements, Local content requirements are particularly notable because they mandate that a certain percentage of inputs used in the production of goods or services be sourced domestically.[12] This requirement is intended to stimulate the growth of local industries, create jobs, and reduce reliance on imported goods, thereby fostering a more self-sufficient and resilient economy.

However, the implementation of Local content requirements is a double-edged sword. While they can drive local economic development and help nascent industries gain a foothold in the global market, they can also lead to inefficiencies, higher costs for businesses, and potential conflicts with international trade rules. Explicit Local content requirements are typically enshrined in laws or regulations, specifying the minimum proportion of goods and services that must be sourced locally. This can be measured either in quantitative terms, such as a specific percentage of local content, or in qualitative terms, such as requirements related to the technical specifications of goods.

Implicit Local content requirements, on the other hand, do not have a formal regulatory basis but are nonetheless enforced through other means, such as government procurement processes where political considerations may play a significant role. For instance, in government tenders, preference may be given to suppliers who use local inputs, even in the absence of a formal LCR. This indirect approach can still effectively prioritize domestic products over imports, influencing market dynamics and potentially leading to trade disputes.

In practice, Local content requirements can manifest in several forms within a host country. These include requirements for the purchase or use of domestically produced goods, mandates that a certain percentage of the value of goods or services be derived from local inputs, or conditions that must be met for foreign investments to proceed, such as the establishment of joint ventures with local firms or the transfer of specific technologies.[13] Each of these forms of Local content requirements can have significant implications for both domestic and international businesses.

From a trade perspective, Local content requirements are problematic because they inherently discriminate against imported goods. By mandating the use of local inputs, Local content requirements effectively limit the market access for foreign products, forcing businesses to either source locally, often at higher costs, or face penalties. This not only distorts competition but also restricts the ability of foreign firms to operate efficiently, potentially leading to higher prices for consumers and reduced product quality. Additionally, Local content requirements can stifle innovation by insulating domestic

[10] Nagesh Kumar, Performance Requirements as Tools of Development Policy: Lessons from Experiences of Developed and Developing Countries for the WTO Agenda on Trade and Investment, *Research and Information System for the Non-Aligned and Other Developing Countries* (RIS), 2003.
[11] United Nations Conference on Trade and Development, *Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries*, New York: United Nations, 2003.
[12] Davin Giovannus, "Pengaturan Tingkat Kadungan Dalam Negeri (TKDN) Atau Local Content Requirements di Indonesia", *Jurnal Paragdima Hukum*: Vol. 5 No. 1, 2020: 6
[13] Esty Hayu Dewanti, "Persyaratan Kandungan Lokal (Local Content Requirements) Di Indonesia Dan Kaiitannya Dengan Perjanjian Internasional Di Bidang Investasi", *Yuridika*: Vol.27, No.3, 2012: 207.

industries from global competition, reducing their incentive to improve and adapt to international standards.

Indonesia's approach to Local content requirements, particularly in the context of its Domestic Component Level regulations, exemplifies the tension between national economic policy and international trade obligations. The domestic component level regulations require that a certain percentage of goods and services used in specific sectors, such as renewable energy, be sourced domestically. For example, in the development of solar power plants, Indonesia mandates the use of domestic components to boost the local solar industry. While this policy aims to strengthen the domestic industry and reduce reliance on imported solar panels and components, it also raises concerns under international trade law.

The implementation of domestic component level in Indonesia, particularly in sectors like renewable energy, where global supply chains are critical, has sparked debates about its compliance with international agreements, particularly the TRIMs Agreement. The TRIMs Agreement prohibits measures that are inconsistent with the National Treatment principle of the GATT 1994, which requires that imported goods be treated no less favorably than domestically produced goods. The cases of DS456 (concerning Canada) and DS412 (concerning Ontario) serve as precedents where similar Local content requirements were found to violate international trade rules.

In Indonesia’s case, the imposition of Local content requirements in the solar power sector could be viewed as a violation of Article 2.1 of the TRIMs Agreement, which specifically prohibits measures that require the use of domestic products over imports. The purpose of such measures is often to protect and promote domestic industries, but in doing so, they restrict the market for foreign goods and create an uneven playing field. This restriction is particularly concerning in the context of global industries like renewable energy, where technology and components are often sourced from multiple countries to optimize efficiency and cost.

Moreover, Indonesia's policy also raises issues under the SCM Agreement. Article 1 of the SCM Agreement defines a subsidy as a financial contribution by a government that confers a benefit. This can include direct financial transfers, tax incentives, or the provision of goods and services. If such subsidies are contingent on the use of domestic over imported goods, as is the case with Local content requirements tied to fiscal incentives, they may be prohibited under Article 3.1 of the SCM Agreement. This article specifically outlaws subsidies that are contingent upon export performance or the use of domestic goods over imports.

Indonesia’s policy of providing fiscal incentives, such as tax breaks or import duty exemptions, to businesses that comply with domestic component level requirements, could therefore be considered a prohibited subsidy under the SCM Agreement. This is because these incentives effectively act as a financial reward for businesses that prioritize domestic inputs over foreign ones, distorting trade and disadvantaging foreign competitors. The impact of such measures can be significant, not only for foreign businesses but also for Indonesia’s trade relations, potentially leading to disputes at the WTO.

The Indonesian government has attempted to address some of these concerns by allowing certain flexibilities in the application of Local content requirements. For instance, the regulation under the Ministry of Energy and Mineral Resources allows for the procurement of imported goods if certain conditions are met, such as when the goods cannot be produced domestically, do not meet the required technical specifications, or when domestic production capacity is insufficient to meet demand. This flexibility is intended to balance the need to protect domestic industries with the practical realities of global trade, ensuring that Local content requirements do not unduly hinder the competitiveness of foreign products or violate international agreements.

Despite these efforts, the core issue remains that any form of LCR that disadvantages imported goods relative to domestic goods risks violating international trade rules. The challenge for countries like Indonesia is to find a way to promote domestic industries without running afoul of their international obligations. This requires careful policy design and a nuanced understanding of the global trade environment.

The provision of fiscal and non-fiscal incentives, as outlined in Presidential Regulation No. 112 of 2022, further complicates this issue. While these incentives are aimed at accelerating the development of renewable energy, including solar power, they must be structured in a way that does not discriminate against foreign products. For example, while the government may provide tax incentives or subsidies to encourage investment in domestic renewable energy projects, these incentives must be available on a non-discriminatory basis, regardless of whether the inputs used are sourced domestically or internationally.

Ultimately, the challenge for Indonesia and other countries that wish to implement Local content requirements is to do so in a way that complies with international trade rules while still achieving their domestic economic objectives. This requires a delicate balance between protecting and promoting domestic industries and maintaining an open and fair trading system. Failure to strike this balance could lead to trade disputes and potential sanctions, undermining the very industries that Local content requirements are intended to support.

In conclusion, while local content requirements can be a powerful tool for economic development, they must be carefully managed and aligned with international obligations to avoid negative repercussions. As Indonesia continues to develop its renewable energy sector, it will need to navigate these complex issues, ensuring that its policies support sustainable development without violating international trade agreements. This requires a strategic approach that leverages both domestic capabilities and global market opportunities, fostering a competitive and innovative industry that can thrive on the global stage.

IV. CONCLUSION

Reflecting on the cases decided by the WTO panel concerning local content requirement regulations, and based on the analysis presented, it is evident that Indonesia's local content requirement regulation for solar power plant infrastructure projects is inconsistent with Article 2.1 of the TRIMs Agreement and violates the national treatment principle under Article III:4 of the GATT 1994. This regulation has conferred significant advantages to domestic products over foreign ones with identical specifications and uses. Additionally, the provision of fiscal incentives also breaches the SCM Agreement by offering subsidies contingent on the use of domestic products.

To enable the continued enforcement of local content regulations while protecting domestic industries and products, the Indonesian government must prioritize transparency. This can be achieved through the clear dissemination of information related to these regulations, making it easily accessible to all stakeholders. Furthermore, notifications could serve as an additional strategy, where the government provides verifiable reports demonstrating that the protected industries are still in their developmental stages and not yet ready to compete internationally. If these reports are accepted by the WTO and its member countries, restrictions and import duties can be applied and maintained until the industry is capable of competing globally. In conclusion, while the goal of fostering domestic industries is important, it must be balanced with adherence to international trade obligations. By emphasizing transparency and providing thorough justifications for protective measures, Indonesia can support the

growth of its renewable energy sector while remaining compliant with WTO rules. This approach not only helps avoid trade disputes but also ensures that Indonesia contributes effectively to global efforts toward sustainable energy development.

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