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## BALANCING HOST STATE SOVEREIGNTY AND FOREIGN INVESTORS' RIGHTS THROUGH A MINING DIVESTMENT RULE

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### ABSTRACT

Share divestment in foreign mining has been a significant focus for the Indonesian Government as its purpose to reverted national sovereignty through the state-control over natural resources and attempt to gain direct access to profits of the multinational companies through an ownership stake. Under Law No. 4 of 2009 on Mineral and Coal Mining (Mining Law), all foreign companies in mining are required to divest 51 percent of their interest in stage to the national participant. The State has indeed the right to protect its economy as a manifestation of permanent sovereignty. In an age of globalization, however, it is also necessary to maintaining their external sovereignty rights, including the right to establish relationships outside. This research aims to examine the implementation of shares divestment scheme in Mining Law to host state sovereignty. The method used is normative legal research and specification of descriptive analysis. The finding shows that the intention of the divestment obligation challenging to attain due to the process of the implementation of the divestment obligation is not in line with the fundamental principles of investment law and the concept of international economic sovereignty of Indonesia. The main goal of which is to devise series of recommendations and whether the alternative solution based on the other countries' experience, which expected will be applied to reduce the risk for both host state and foreign investors in the mining sector.

**Keywords:** share divestment; mining law; sovereignty; foreign investment.

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## I INTRODUCTION

Nowdays almost all countries, especially developing countries, urgently need foreign capital to support the development of a nation. The Law No. 1 of 1967 on Foreign Investment Law and Law No. 11 of 1967 on The Basic Provisions of Mining have paved the way for the entry of foreign investment and milestones relationship between Indonesia's corporation with international mining companies forth in the Contract of Work (CoW) Generation I.<sup>2</sup>

As a private company, the primary purpose of the transnational company is to gain the maximum benefit. No wonder that in the contract of work, many aspects of the economy are missed, for example, fiscal leeway in the form of a tax holiday for the first three years after starting production, exemption of all sorts of taxes and royalties that are not following applicable legal provisions.<sup>3</sup>

The government now began to think to reorganize the mastery of it.<sup>4</sup> Through the divestment of shares, after five years of production, holders of IUP and IUPK in the context of foreign investment are required to divest their shares in stages to reach a minimum of 51 percent ownership in Indonesian participants.<sup>5</sup>

Principally, both national law and international law recognize that the State does have sovereignty in the economic field as the basis for being able to determine economic policies and manage its natural wealth. Problems began to emerge when there was a paradigm that the divestment of shares seemed to decline what Constitutional expectations made by the founding fathers.<sup>6</sup> First, this divestment obligation is considered risky because many parties deem this rule to be the result of a creeping nationalization feeling. Therefore, it can have an impact on the negative image of Indonesia's investment climate. As a comparison, this has happened in Algeria, a country that also has abundant natural resources but is not able to maximize it. Algeria's protectionist policies made the Algerian economy decreased dramatically due to investors' fear of doing business in Algeria.<sup>7</sup> However, foreign investment law should have a crucial role in the era of economic globalization. It should be able to reflect a favorable and conducive investment climate for foreign investment activities and have international competitiveness, which in turn will provide free movement for capital, technology, and labor can move quickly between the territorial sovereignty of the country.<sup>8</sup>

Furthermore, company owners will be more willing to take investment risks because, after five years of production, foreign investment companies are required to divest their

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<sup>2</sup> Muhammad Farid Idris, "Pembangunan Melalui Sektor Pertambangan di Indonesia: Sebuah Tinjauan Etis", *Journal of Science and Technology*, Vol. 3, Nomor 11, Tahun 2013.

shares. It means how bad the company's performance, loss, or a lot of debt, there must be someone who will bear the burden and save it.<sup>9</sup>

The next major issue is the absence of reference rules regarding the price of divestment shares, giving rise to a price paradigm that is considered extravagant and has the potential to harm the country. Domestic purchases on divestment shares will lead to an increase in foreign debt or divert a large amount of domestic investment from other sectors.<sup>10</sup> This is different from Australia or Canada that already has specific rules and institutions to assess the company's shares.

The problems mentioned, cause the goal of share divestment, one of which is to provide benefits and higher revenue is difficult to achieve. Indonesia, as if it does not have economic sovereignty over its natural resources, making it arduous to be able to develop a welfare state despite its abundant potential.

Based on the background above, it shows that the issue of divestment of shares becomes an essential study of national economic sovereignty. The authors limit this research to the legal review of the share divestment obligation in the mining sector and its implementation in Indonesia. Therefore, the formulation of legal issues that must be investigated is as follows: *First*, how is the implementation of the divestment provisions in foreign investment companies in the mineral and coal mining sector in relation to the economic sovereignty of states? *Second*, how to attain national economic sovereignty through divestment obligations?

## II DISCUSSION

### 1. General Brief of Economic Sovereignty

The state is the only legal subject that has sovereignty. Huala Adolf defines economic sovereignty as the highest power of a country to regulate economic policy within its territory

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<sup>3</sup> Felix Simon Sembiring, *Satu Dekade Nasionalisme Pertambangan, Mengungkap: Karut-marutnya Implementasi UU Minerba dan Divestasi Freeport yang Penuh Jebakan*, Jakarta: Penerbit Gatra Pustaka, 2019, p. 194.

<sup>4</sup> Lathono Sujantyon, "Inilah Review Memaksa Asing Berbagi", *Majalah Ekonomi dan Bisnis*, Edisi 19 – 25 Maret 2012, p. 9.

<sup>5</sup> Indonesia Government Regulation No. 1 of 2017, Article 97.

<sup>6</sup> Results of the Author's Interview with Bisman Bakhtiar, the Executive Director of the Center for the Study of Mining Energy Law, on July 25, 2019.

<sup>7</sup> Saru Arifin, "Implementasi Kedaulatan Permanen atas Sumber Daya Alam dalam Aturan Investasi Asing di Aljazair dan Indonesia", *Jurnal Hukum Ius Qui Iustum*, Vol. 15, Issue 3, September 2018, p. 483-484.

<sup>8</sup> *Ibid.*

<sup>9</sup> Taufan Adharsyah, "Psst, Ada Risiko di Balik Hilirisasi dan Investasi Minerba RI", <<https://www.cnbcindonesia.com/news/20190828140153-4-95364/psstada-risiko-di-balik-hilirisasi-dan-investasi-minerba-ri>>, [accessed on 5/01/2020]

<sup>10</sup> David Manley and Emanuel Bria, "Developing a Strong Mining Divestment Rule in Indonesia", *Paper Policy*, February 2017, p.16.

or international economic system.<sup>11</sup> The power includes conducting policies (*beleid*), and stewardship (*bestuursdaad*), arrangement (*regelendaad*), management (*beheersdaad*), and control (*toezichthoudensdaad*) in all-natural wealth in Indonesia.<sup>12</sup>

According to Bagir Manan, the right to control the State cannot be separated from the obligation of the State to prosper its people, including:

- a) All forms of utilization of the earth and water and the results obtained (natural resources), must significantly increase the prosperity and welfare of the people.
- b) Protect and guarantee all the rights of the people contained in or on the earth, water, and various natural resources that can be produced directly or can be enjoyed directly by the people.
- c) Prevent all actions that will cause people not to have a chance or will lose their rights to enjoy the natural wealth.<sup>13</sup>

Following the basic principles in international law, state sovereignty is an essential principle in investment arrangements.<sup>14</sup> The principle of state sovereignty provides the basis for the state as the creator of the law to justify that the state has the authority to supervise the entry and establishment of a foreign company and the whole process of direct foreign investment.<sup>15</sup>

Several international documents that recognize the country's sovereignty over its natural resources can be seen in the UN General Assembly Resolution, 21 December 1952, on the principle of economic self-determination, which affirms the right of each country to utilize its natural resources freely;<sup>16</sup> United Nations General Assembly Resolutions, 14 December 1962, 25 November 1966 and 17 December 1973, which expanded the scope of the principle of permanent sovereignty over natural resources on the seabed and underneath and in seawater that is still in the national jurisdiction of a country;<sup>17</sup> and also, the Charter of Economic Rights and Duties of State in 1974 reaffirmed the right of control of the state to monitor its natural resources to increase economic growth.<sup>18</sup>

In the context of international law, there are known permanent sovereignty over natural resources, where each country has three aspects of control over that sovereignty, namely

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<sup>11</sup> Huala Adolf, *Hukum Ekonomi Internasional: Suatu Pengantar*, Jakarta: Rajawali Press, 2005, p. 199.

<sup>12</sup> Decision of the Constitutional Court Number 001-021-022 / PUU-I / 2003 concerning Case of Judicial Review of Law Number 20 Year 2003 concerning Electricity to the 1945 Constitution of the Republic of Indonesia, December 21, 2004.

<sup>13</sup> Abrar Sableng, *Hukum Pertambangan*, UII Press, Yogyakarta: 2004, p. 17.

<sup>14</sup> Kusnowibowo, *Hukum Investasi Internasional*, Bandung: Pustaka Reka Cipta, 2019, p. 117.

<sup>15</sup> Salim HS, *Perkembangan Teori Dalam Ilmu Hukum*, Jakarta: Rajawali Pers, 2010, p. 131.

<sup>16</sup> JG. Starke, *Introduction to International Law*, 10th edition, London: Butterworth, 1989, p. 121.

<sup>17</sup> Huala Adolf, *Aspek-aspek Negara dalam Hukum Internasional*, Edisi Revisi, Jakarta: Raja Grafindo Persada, 2002, p. 53-54

<sup>18</sup> Parry and Grant, et al., *Encyclopedic Dictionary of International Law*, New York: Oceana Publication Inc., 1986. p. 290.

external sovereignty, internal sovereignty, and territorial sovereignty.<sup>19</sup> Internal sovereignty is the right or exclusive authority of a country to determine the form of its institutions, the way these institutions work, and the right to make the laws they want and actions to comply with them. The external sovereignty is the status and ability of the state to defend itself against attacks that come from outside and are capable of establishing international relations. According to the doctrine of relative sovereignty, all countries are in the same position according to international law. The territorial sovereignty is the full and exclusive power possessed by the state over individuals and objects in the territory<sup>20</sup>

## 2. Share Divestment in the Mining Sector

Share divestment according to Article 1 number (8) Government Regulation No. 23 of 2010 (GR 23/2010) regarding the Implementation of Mineral and Coal Mining Business Activities means the number of foreign shares that is subject to offer for sale to Indonesian participants.<sup>21</sup> In finance and economics, divestment or divestiture is the reduction of an asset or business through sale, liquidation, exchange, or any other means for financial or ethical reasons.<sup>22</sup> It is distinct from divestment in the legal framework which is an obligation, meaning that the disposal of the shares is done not due to business considerations, but rather to fulfill contractual obligations and legislation in force.

Regulations that specifically regulate divestment of shares of mining companies in Indonesia do not yet exist. Nevertheless, they are scattered in various laws and regulations, such as Article Article 112 of the Mining Law, which states that after 5 (five) years of production, the company holding an IUP and an IUPK whose shares are owned by foreigners is obligated to undertake a divestment of shares to the Government, the Regional Government, state-owned enterprises (SOEs), regional-owned enterprises (ROEs), or national private companies.<sup>23</sup>

Further provisions concerning the divestment of shares are regulated by Government Regulation No. 1 of 2017 on the Fourth Amendment of GR 23/2010 regarding the Implementation of Mineral and Coal Mining Business Activities (GR 1/2017). Through GR 1/2017, holders of IUP and IUPK from foreign investment, after five years of initial

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<sup>19</sup> Anshar, "Penguasaan Negara Atas Migas Sebagai Wujud Kedaulatan Atas Sumberdaya Alam Dalam Perspektif Hukum Internasional Kontemporer", *Jurnal IUS*, Vol. 5, Nomor 2, Agustus 2017, p. 176.

<sup>20</sup> *Ibid.*, p. 169.

<sup>21</sup> Indonesia Government Regulation No. 23 of 2017, Article 1 (8).

<sup>22</sup> Divesting, <<https://www.divestopedia.com/definition/919/divesting>>, [accessed on March 15, 2020]

<sup>23</sup> Mining Law, Article 112 (1).

production, must divest its share gradually. Therefore, that in the tenth year, Indonesian party has 51 percent share for the least,<sup>24</sup> with the minimum divestment as follows: 20 percent in the sixth year, 30 percent in the seventh year, 37 percent in the eighth year, 44 percent in the ninth year, 51 percent in the tenth year, of the total share.<sup>25</sup>

Moreover, detailed elaboration on the pricing mechanism for the divestment shares regulated by The Indonesian Ministry of Energy and Mineral Resources (MEMR) Regulation No. 9 of 2017 regarding Procedures for Divestment and Mechanisms for the Determination of the Price of Divested Shares for Mineral and Coal Mining Businesses, as amended by MEMR Regulation No. 43 of 2018 (MEMR 43/2018). It is stipulated that the divestment shares pricing shall be calculated based on fair market value, and not consider the mineral or coal reserves except those which may be mined within the period for IUP-OPs or IUPK-OPs.<sup>26</sup> To streamline the process of share divestment, Regulation 43/2018 provides that the central government, through the MEMR, may collaborate with regional governments (provincial and municipal governments), SOEs, and ROEs in purchasing the divestment shares at the first stage.<sup>27</sup>

### **3. Correlation between State Economic Sovereignty and The Implementation of The Provisions on Divestment of Shares in Foreign Investment Companies in the Mineral and Coal Mining Sector.**

The Government policy in enforcing the divestment is the implementation of the national resource existence. The fundamental concept of resource nationalism is the host state's right to be sovereign of its natural resources in their national territory.<sup>28</sup> Eve Warburton defines resource nationalism as the attempt to expand local ownership over resource sectors by transferring assets from foreign to domestic hands and industrializing and upgrade resource industries to compete with foreign countries in the global market.<sup>29</sup>

International legal instruments have recognized the existence of an absolute right of a state in controlling its natural resources which can be found in Article 2 number (1) Charter of Economic Rights and Duties of States (CERDS) that states:

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<sup>24</sup> Indonesia Government Regulation No. 1 of 2017, Article 97 (1).

<sup>25</sup> Indonesia Government Regulation No. 1 of 2017, Article 97 (2).

<sup>26</sup> Indonesian Ministry of Energy and Mineral Resources (MEMR) No. 43 of 2018, Article 14 (1) and (2).

<sup>27</sup> Indonesian Ministry of Energy and Mineral Resources (MEMR) No. 43 of 2018, Article 9 (1).

<sup>28</sup> John Kurtz and James van Zorge, 'The Myth of Indonesia's Resource Nationalism: Jakarta's New Mining and Oil Regulations Are Really about Rent Seeking and Corruption', *Wall Street Journal*, 1 October 2013.

<sup>29</sup> Eve Warbuton, "Our Resources, Our Rules: A Political Economy of Nationalism in Indonesia's Resource Sectors", The Australian National University, February 2018., p. 4.

*“Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal over all its wealth, natural resources, and economic activities.”*<sup>30</sup>

The permanent sovereignty of the state over these natural resources then gives rise to the right for each state to:

- a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment;<sup>31</sup>
- 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 in the exercise of the right outlined in this subparagraph;<sup>32</sup>
- c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case, where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought based on the sovereign equality of States and following the principle of free choice of means.<sup>33</sup>

The regulation of share divestment stipulates that the state began to demonstrate the existence of its internal sovereignty with the control of all-natural resources with the aim of people’s prosperity. Indra Yuspiar, Head of Sub Directorate Mineral Business Guidance of MEMR, said that the phrase of ‘exploitation’ in the Mining Law becomes vital inasmuch natural resources management without going through the exploitation (business) process makes it valueless.

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<sup>30</sup> Charter of Economic Rights and Duties of States (CERDS), Article 2 (1).

<sup>31</sup> Charter of Economic Rights and Duties of States (CERDS), Article 2 (2) a.

<sup>32</sup> Charter of Economic Rights and Duties of States (CERDS), Article 2 (2) b.

<sup>33</sup> Charter of Economic Rights and Duties of States (CERDS), Article 2 (2) c.

Similarly, the phrase 'prosperity of the people' in Article 33 of the 1945 Constitution has economic value. Economic level indicators are measured by increasing state revenues, and one way to improve them is by share ownership.<sup>34</sup> The assumption that Indonesian participants were able to run the mining business also motivated the government to impose a divestment regulation.

In practice, however, the implementation of the divestment obligation encountered impediments. One problem that is appearing is the issue of Indonesia's external sovereignty, which includes Indonesia's cooperative relations with foreign mining companies that invest their capital in Indonesia. Syahrir Abubakar, Executive Director of the Indonesian Mining Association, stated that the obligation to divest shares would disrupt the investment climate and prevent foreign mining companies from reinvesting in Indonesia.<sup>35</sup> It is because in the calculation of foreign investors if they are required to sell their shares from the sixth year to the tenth year in stages, the mining sector will become less profitable.<sup>36</sup>

Mining is a sector with high capital, high risk, and high technology. Therefore it requires quite a long time to make a profit. The economic value of the mining sector potentially lost because the investment cost allocated by foreign investors is enormous so that it can extend the estimated break-even point. Besides, each type of mining also has a different value. If the restrictions on foreign ownership are limited to commodities that have low economic value, it will be detrimental to foreign parties.

Many foreign investors perceive the 51 percent share divestment obligation to be categorized as indirect expropriation, making the mining sector less attractive. Foreign investors' fears are exacerbated by the legal uncertainty in the divestment process. The Fitch Solutions, a global financial institution, found that extreme attitude of resource nationalism has made Indonesia held a position far behind in the Asia Pacific Mining Competitiveness Index (20 out of 100) from other countries, such as China, Malaysia, Myanmar, Philippines, Laos, and Australia. The strict government regulation makes foreign companies such as Newmont Mining, Sumitomo Corporation, and BHP Billiton have to sell their mining operations in Indonesia to Indonesian participants.<sup>37</sup>

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<sup>34</sup> Results of the Author's Interview with Indra Yuspiar, Head of Sub Directorate Mineral Business Guidance of MEMR, on July 19 2019.

<sup>35</sup> Reza Thaher, "Indonesia Rule Change Rattles Foreign Mine Owners", <<https://www.reuters.com/article/us-indonesia-mining/indonesia-to-limit-foreign-ownership-in-mines-idUSTRE8260FP20120307>>, [accessed on 9/03/2020]

<sup>36</sup> Wayne Forest, "New Indonesia Mining Divestment Rules", <<https://aiccusa.org/new-indonesian-mining-divestment-rules>>, [accessed on 10/03/2020]

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

The principle of sovereignty over national natural resources is a fundamental principle in external sovereignty and investment law. From the point of view of foreign investors', the obligation to divest shares regulated in the Mining Law may not support the mandate of the Investment Law. In essence, the legal regulation on investment has the spirit to create a conducive investment climate as an effort to encourage national economic growth and a competitive economic system. Enormously benefit felt both financially and non-financially from the presence of this multinational mining company. For example, direct advantages in the form of taxes, royalties estimated at US \$ 19.5 billion, and indirect advantages through regional development, employment opportunities for residents, and technology transfer reached US \$ 41.5 billion from PT Freeport Indonesia.<sup>38</sup>

The divestment rule reflects that Indonesia still sees foreign capital as threatening national interests. In contrast, Article 7 paragraph (1) of the Investment Law provides a guarantee that the government will not take action on nationalization or expropriation of investor ownership rights unless specified in the law. The home country is also conscious that the risk of foreign investment in the form of nationalization or divestment could occur at any time through the host country's national legal system. It has created legal uncertainty for foreign investors.

Refers to the pull factors of foreign investment, the law also plays a substantial role that is seen by foreign investors when they decide to invest their capital in a country. It is related to the legal protection provided by the national government for foreign investors in conducting their business and whether or not there is discrimination against foreign investment. The decline in legal authority will significantly affect the attraction of foreign investors to invest their capital. In the age of globalization, a legal system that can create certainty, fairness, and efficiency is needed.

This divestment obligation regulation also less in harmony with the principles stipulated in international law, such as the principle of fair and equitable treatment, the principle of non-discrimination, the principle of the most favored nations, and the principle of national treatment. These principles mandate that the host state is prohibited from giving special treatment and distinguishes the treatment between foreign investors and domestic investors in the host country.<sup>39</sup>

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<sup>38</sup> PT Freeport Indonesia Financial Contribution, *Fact Sheet* 2019.

<sup>39</sup> Suparji, *Penanaman Modal Asing di Indonesia*, Jakarta: Universitas Al-Azhar, Indonesia, 2008, p. 211.

It should be recalled that state sovereignty includes two aspects, namely sovereignty in the internal and external sense.<sup>40</sup> According to the theory of relational sovereignty, state sovereignty under international law is a relational and open concept rather than “insular” and enclosed. Sovereignty in an external perspective has prioritized the ability to establish good relations outside, rather than the right to resist foreign influence.<sup>41</sup> Therefore, the implementation of the principle of permanent sovereignty over natural resources must consistently be able to adjust the current development and accept elements from outside that can facilitate the national development that is being done by this nation.

One of the evidence that divestment of shares hurts a country's external sovereignty is a protectionist policy towards investments made by the Algeria Government. The Algeria Investment Code of 1966 regulates “mandatory local participation rules normally providing that foreign investors could only operate as minority (49%) equity partners of local (national) shareholders”, which causes it became the hardest country to doing business.<sup>42</sup> The UN Conference on Trade and Development (UNCTAD) study in the World Investment Report 2017 stated that the economy in Algeria has decreased by 26 percent year-on-year.<sup>43</sup> Furthermore, the Government also needs to look in the case of nationalization in Venezuela. The rise of the divestment and nationalization carried out by Venezuela, made Venezuela's national economic position fall due to the distrust of foreign investors with the country.

The second obstacle in this divestment regulation is that there are no legal consequences if the foreign mining company does not have high economic value or has the potential to harm the country. Article 10A MEMR 43/2018, merely regulates during the implementation of the divestment procedure, the holders of IUP-OPs or IUPKOPs shall grant access to Indonesian Participants, to conduct due diligence.<sup>44</sup>

This provision can create uncertainty and potentially cause harm to both Indonesia and foreign investors. As foreign parties, they assume too risky for them due to the absence of rules regarding legal consequences for companies that do not pass the due diligence process. There is uncertainty whether they still obliged to be divested or not, and therefore, it makes foreign companies arduous to protect their assets in Indonesia. Besides, Indonesia will also be

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<sup>40</sup> Janet Morrison, *The Global Business Environment: Meeting the Challenges*, Third Edition, London: Palgrave Macmillan, p. 233.

<sup>41</sup> James J Sheehan, “The Problem of Sovereignty”, *The American History Review*, Volume III, No. 1 February 2006. Oxford: Oxford University Press, p. 43 – 46.

<sup>42</sup> Lamine Ghanmi, “Algeria Lags Behind Neighbours In Attracting Foreign Investment”, <<https://theArabweekly.com/algeria-lags-behind-neighbours-attracting-foreign-investment/>>, [accessed on 10/032020].

<sup>43</sup> UNCTAD, World Investment Report, 2017, p. 222.

<sup>44</sup> Indonesian Ministry of Energy and Mineral Resources (MEMR) No. 43 of 2018, Article 10A.

disadvantaged because of if the divestment offering to Indonesian Participants fails to be implemented, the divestment must be accumulated based on the obligation according to divestment procedure.<sup>45</sup> Indonesia seems "forced" to remain to buy companies that have lousy performance and prone to legal problems, especially if the party who buys are SOEs and ROEs, given that in all corporate action, there will be profits and losses.

The following problem is the implementation of share divestment, which did not produce maximum benefits for the public. Share ownership could admittedly provide an opportunity for Indonesian participants to get dividends. Yet, unfortunately, if the dividends received by Indonesian participating shareholders turn out to do not reflect the intended purposes of the divestment of shares. It is because of the Indonesian participants did not have enough capital to purchase shares and constrained external loans such as syndication.

For example, to purchase 24 percent of NNT shares, PT Multi Daerah Bersaing had to borrow USD 300 million from Credit Suisse in Singapore with pledge shares. The dividends obtained will be used to repay the loan so that the profits target is not reached. Furthermore, looking at the implementation of PT Freeport Indonesia's divestment shares, the cost offered by PT Freeport Indonesia is considered high-priced and severe for Indonesian participants to purchase. The debt also has made the Indonesian State trapped in a neo-liberal capitalist economic system, which relies on foreign debt lending schemes to finance development and encourage economic growth. There certainly also will be more risks to be borne in the eventuality.

Moreover, inconsistencies of practice with the regulation also frequently occurred. The divestment share value, which is offered by PT Freeport Indonesia, also contains the assumption about the investment, which may be invested by Freeport if the Government extends the operational license of Freeport until 2041. It violates MEMR 43/2018 that states divestment share pricing should be based on fair market value without considering the amount of the mineral or coal reserves at the time when the divestment is conducted.<sup>46</sup>

The State does have possession rights, but it does not mean they act as an entrepreneur or '*ordernemer*'.<sup>47</sup> In line with Sri Edi Swasono's opinion, the mastery of natural resources does not mean that the State is the owner of natural resources.<sup>48</sup> Due to the fact, the owner of all-natural resources is the people of Indonesia. Muhammad Alim, a former judge of

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<sup>45</sup> Indonesian Ministry of Energy and Mineral Resources (MEMR) No. 43 of 2018, Article 10 (1).

<sup>46</sup> Indonesian Ministry of Energy and Mineral Resources (MEMR) No. 43 of 2018, Article 14 (2).

<sup>47</sup> Mohammad Hatta, *Penjabaran Pasal 33 Undang-Undang Dasar 1945*, Jakarta: Mutiara, 1977, p. 28.

<sup>48</sup> *Ibid.*, p. 769-770.

Indonesia Constitutional Court, also conveyed the same thing that the form of state control is not only in the way of ownership, yet could be done in the way of policies, stewardship, arrangement, management, and also supervise. In essence, no matter what the form of mastery, it is solely an instrument. The most significant is the purpose of Article 33 paragraph (3) of the 1945 Constitution of the Republic of Indonesia, namely for the greatest prosperity of the people can be realized in the life of all Indonesian people.

Based on the explanation above, it appears that the regulations regarding divestment obligations are based on good intention, so that the results of mining exploration in Indonesia can be controlled by the Indonesian side itself and increase profits for the State. However, due to these problems, the intended benefits of the divestment rule may be challenging to attain.

#### **4. Maintaining the Balance of National Sovereignty and International Economic Relations Through Provisions on Divestment of Shares**

Permanent sovereignty over natural resources is a fundamental concept that cannot be separated from investment laws and the country's external sovereignty. Therefore, it is necessary to have a legal instrument that can accommodate these principles. It is not a simple problem; additionally, sometimes, the concerns of home and host states behind their national laws and policies could be different.

An An Chandrawulan quoted the opinion of Salomon and Mirsky, said the policy-makers have to confront at least the following three common problems when they are regulating foreign direct investment:

- a) How to attract foreign investment without incurring damaging drain on domestic foreign exchange savings and other resources;
- b) How to preserve the foreign investor's legal rights and give it adequate protection while, at the same time, keeping its domination and adverse effects to a minimum; and
- c) How to design their laws and tax systems in such a way as to simultaneously foster economic growth and attract foreign investment while concurrently raising enough revenue to meet the budgetary requirements of the government.<sup>49</sup>

Based on these three problems, it is necessary to create favorable legislation based on the principles of good making rules, which includes:

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<sup>49</sup> An An Chandrawulan, *Hukum Perusahaan Multinasional, Liberalisasi Hukum Perdagangan Internasional dan Hukum Penanaman Modal*, Bandung: Alumni, p. 71.

- a) clear purpose;
- b) made by a proper agency or official;
- c) match between the types, hierarchy, and the contents;
- d) can be implemented;
- e) versatility and result;
- f) precise formulation; and
- g) openness.<sup>50</sup>

One of the principles above, namely the "principle of can be implemented" which means that every making rules should take into account the effectiveness of such regulations in the community, both philosophical, sociological, and legal.<sup>51</sup> The Mining Law should also consider these three bases. Philosophically<sup>52</sup>, the divestment of shares is expected to fulfill the mandate of the 1945 Constitution, namely to reach justice for the people.

John Rawls, through his theory of justice, stresses that the program of justice enforcement with a democracy dimension should provide equal rights and opportunities for all citizens. It is also able to arrange social and economic inequalities; therefore, it could give a reciprocal relationship between those who benefit and those who are asked to sacrifice their life prospects.<sup>53</sup>

In terms of sociological,<sup>54</sup> the ownership of shares in a mining company makes Indonesia receive a percentage of dividends, which can be used to improve the welfare of the citizens.<sup>55</sup> Furthermore, legally,<sup>56</sup> the existence of this share divestment provision was formed to overcome the legal problems that exist, the majority of mining company ownership in Indonesia is owned by foreign companies that focus on maximizing revenue, while our natural resources are running low. With the divestment of shares, local partners as majority shareholders can control the course of the company by placing local people in the board of directors.<sup>57</sup>

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<sup>50</sup> *Law Number 12 of 2011 on Legislation Making*, Article 5.

<sup>51</sup> Elucidation of *Law Number 12 of 2011 on Legislation Making*, Article 5 letter e.

<sup>52</sup> The philosophical elements are interpreted as the reasons, which illustrate the formed regulations have considered outlook of life, awareness, and legal ideas, which encompass the inward atmosphere, and also, the philosophy of Indonesia people that originates from Pancasila and the Preamble to the 1945 Constitution.

<sup>53</sup> Ahmad Redi, "Divestasi Saham di Bidang Pertambangan Mineral dan Batubara Dalam Rangka Pelaksanaan Penanaman Modal Asing di Indonesia", Depok: Universitas Indonesia, 2012, p. 22.

<sup>54</sup> The sociological element means that regulations are formed to meet the needs of the community in various aspects.

<sup>55</sup> Purnama Trisnamansyah dan Yusuf Saepul Zamil, "Divestasi Saham Asing dalam Penambangan Bawah Tanah Dihubungkan dengan Kedaulatan Negara", *PADJADJARAN Jurnal Ilmu Hukum*, Vol. 3, Nomor 3, Tahun 2016, p. 622.

<sup>56</sup> The legal element illustrates that regulations are formed to overcome legal problems or fill the legal vacuum by considering existing rules, which will be changed, or which will be revoked to ensure legal certainty and a sense of community justice.

<sup>57</sup> Purnama Trisnamansyah dan Yusuf Saepul Zamil, *Op.cit.*, p. 619.

Based on some of the problems that have been explained above, it can be seen that the rules for divesting shares contained in the Mining Law have not been appropriately implemented due to the lack of legal certainty, which led to unfavorable results. In responding to those problems, the Government needs to endeavor for the best approach to be able to control all-natural resources, mainly mineral and coal, as mandated by the Constitution, the Investment Law, and also reflect the economic sovereignty as a whole as a sovereign state, by determining: firstly, by considering the abolition of the divestment rules and explore other approaches to a state-led mining sector, e.g., the extension of licenses in the form of 2 x 10 years (in accordance with CoW) with conditions which certainly benefit the Indonesian participants. Indonesia could also boost its revenue from mining outputs through increased royalties and tax rates that are regulated by government regulations. It will be more convenient compared to the divestment of shares that require a long process and consider the eagerness of foreign investors to invest in the future. Economic growth is particularly significant in developing economies. However, this should not make the Government ought to justify any means, including owe lots of loans, but the Government needs to build strong economic fundamentals. Economic development has to concentrate on economic equality; therefore, it would be more appropriate if the Government accelerated the smelters' construction so that the Indonesian people could manage the results of its purification.

The second alternative, the Government, can still impose divestment provisions with a few additional rules. For example, the companies ought to be clean and clear in all aspects and have the potential to benefit Indonesia, such as the potential for transfer of technology management, human resources, and potentially provide substantial multiplier effect. The Indonesia Government can also emulate the provisions of the share divestment in Bolivia, where the Bolivia Government also imposes regulations on raising tax significantly for foreign mining investors.

Regulations regarding legal consequences if the obligation to divest shares is not carried out also necessitate to be regulated. The regulation related to penalties can refer to Article 34 paragraph (1) of the Investment Law regarding administrative sanctions for foreign companies that fail to fulfill their obligation based on the law of the Republic of Indonesia, in the form of (a) written warning; (b) business restriction; (c) suspension of business and/or investment facility; or (d) revocation of business license and/or investment facility.

Third, by not changing the divestment provisions in the mining sector, there has to be arranged the technical guidelines regarding the precise mechanism for determining the

divestment share price and balance calculations. It is crucial to protect the interests of both parties and attract foreign investment. According to data from the Natural Governance Institute, the calculation of existing stock valuations will hamper foreign investment in Indonesia. Therefore, the Government of Indonesia may adopt international assessments. Some countries already have detailed rules related to the valuation of mining assets such as The Australian Institute of Mining and Metallurgy (VALMIN), the Canadian Institute of Mining, Metallurgy, and Petroleum (CIMVAL) and the South African Mining Association (SAMVAL).<sup>58</sup>

According to Widhayani Dian Pawestri et al., Indonesia may also follow the ICSID standard in resolving a dispute between *Rusoro v. Venezuela*. The arbitral tribunal decides to use a combination of three valuation methods, namely maximum market valuation, book valuation, and adjusted investment valuation in determining the actual value of investments made by Rusoro in Venezuela. By implementing one of the international rules or decisions, it is expected to reduce the potential for disputes between various related parties and reduce uncertainty in determining the divestment share price of the mining sector.<sup>59</sup>

The fourth thing the Indonesian Government could do is transfer shares, followed by the placement of Indonesians in the directors and commissioners positions. In essence, the State, as a subject of international law, should be able to balance the rights and obligations of each party without neglecting the State's control of natural resources themselves. The Government also necessitates looking at the advantages of the regulation; therefore, the rules can be executed accurately and provide maximum returns for the Indonesian people.

### III CONCLUSION

1. The regulation of share divestment obligations aims to gain control of natural resources and maximize profits challenging to attain due to the process of the implementation of these rules are not in line with the fundamental principles of investment law and the concept of international economic sovereignty of Indonesia. Legal uncertainty in the share divestment regulations potentially causes a reduction in the amount of foreign investment in the mining sector in the future and to make the divestment results less than the maximum and possibly detrimental to the State.

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<sup>58</sup> David Manley dan Emanuel Bria, *Op.cit.*, p. 16.

<sup>59</sup> Widhayani Dian Pawestri, "Rational Choice Theory in the Scheme of Mining Shares Divestment Based on National Interest Protection", *International Journal of Innovation, Creativity and Change*, Vol. 5, Issue 2, Special Edition, 2019, p. 386.

2. The appropriate way to balance Indonesia and foreign investors' interests and also, to reflect the economic sovereignty as a whole as a sovereign state by determining: firstly, by considering the abolition of the divestment rules and explore other approaches to a state-led mining sector. The second alternative, the Government, can still impose divestment provisions with a few additional rules. Then, stipulate technical guidelines regarding the determination of a balanced divestment share price for both parties. Furthermore, placing Indonesian citizens in the position of directors or commissioners to facilitate financial and operational control.

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