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What Gives with Indonesia's Bilateral Investment Treaties?

President Susilo Bambang Yudhoyono apparently feels BITs are economic dinosaurs. Is he right?

By AmCham Correspondent
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Indonesia's apparent plans to review dozens of existing treaties that govern bi-lateral foreign direct investment has stirred considerable debate, locally and globally, since it first came to light on March 26 in a Financial Times article.

The pacts, known as bi-lateral investment treaties (BITs), are common internationally and typically offer investors guarantees of fair and equitable treatment, protection from expropriation and free repatriation of profits. Many BITs also allow for investors to take disputes to binding international arbitration though the International Center for the Settlement of Investment Disputes (ICSID), an international organization under the World Bank Group that has more than 140 member states.

The issue came to light after the Netherlands sent an official notification that Indonesia opted not to extend a BIT that has been in force since April 6, 1994. The Dutch are not alone. According to some government sources, President Susilo Bambang Yudhoyono's administration is reviewing BITs with more than 60 countries.

Various observers have pointed to the recent case of United Kingdom-based Churchill Mining taking Indonesia to the ICSID tribunal, claiming that its coal assets in East Kalimantan were seized by the East Kutai district administration without proper compensation.

The contentious case involved a lawsuit for over $2 billion by Churchill. The ICSID said the revocation of Churchill's permit was illegal and in breach of a BIT between Indonesia and the UK.

Even though it was not final, the ruling was controversial in Indonesia, considering the huge amount of money at stake during a time of tight liquidity and pressures to increase spending on infrastructure development.

Indonesia's history with BITs

Some local law experts say the BIT reviews are in line with the Yudhoyono administration's desire to allow existing treaties to expire and to refrain from entering into any new treaties. The move is also in line with broader nationalist sentiment.

Hikmahanto Juwana, a professor of international law at the University of Indonesia, wrote an article in early April in the Jakarta Post outlining his support for the move and reviewing the history of Indonesia's BITs.

In his article Indonesia should withdraw from the ICSID! he traced the treaties to a time when Indonesia was in dire need of foreign capital, know-how and technology.

"In the 1960s, Indonesia followed many other developing countries in ratifying the Convention," Hikmahanto said, referring to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, which led to the establishment of the ICSID.

Indonesia, Hikmahanto wrote, became a member of the convention on Oct. 28, 1968, two years after the body came into being.

"The government realized that decisions to invest in Indonesia did not depend only on tax facilities, natural resources or cheap labor, but most importantly on the legal basis for investment protection," Hikmahanto said in his article, explaining the reasons why in the early days of the Soeharto administration, Indonesia decided to take part on the convention.

The ICSID on its website describes itself as an "autonomous international institution" with the primary purpose of providing "facilities for conciliation and arbitration of international investment disputes." The ICSID is seen as the leading international arbitration body devoted to investor-state dispute settlements.

Hikmahanto, who served as Senior Legal Adviser to Indonesia's Coordinating Minister for Economic Affairs from 1999-2001, and as a member of the board of commissioners at various private and state-owned companies, analyzed how the Indonesian legal system views the ICSID.

“Even though the ICSID is referred to as an arbitration apparatus, it is, however, distinct from commercial arbitration mechanisms such as the Indonesian National Arbitration Board [BANI], or the Singapore International Arbitration Center [SIAC],” he said.

“What differentiates the ICSID from both BANI and SIAC is that it purely oversees cases where a government is being sued.

“Under the Indonesian judicial system, the ICSID is similar to an administrative court, which oversees cases in which an individual or private entity is suing the government for its actions. However, unlike an administrative court, the ICSID can grant compensation to the investors as the plaintiff,” he added.

“As a member, Indonesia has the right to withdraw as stipulated under article 71 of the convention, which states: ‘Any contracting state may denounce this convention by written notice to the depository of this convention. The denunciation shall take effect six months after receipt of such notice,’” the professor wrote.

Irrelevant treaties

Ahmad Kurniadi, a deputy chairman of the Indonesian Investment Coordinating Board (BKPM), said a review of BITs occurred because many of them are no longer relevant.

“That’s why it needs to be fixed, adjusted with the conditions and the state’s interests,” he said, as quoted by local media reports at the end of March.

Hikmahanto outlined five arguments for Indonesia withdrawing from the ICSID, saying it is in line with the moratorium plan and will also show the world that the country is attractive to foreign investors even without BITs because of its lucrative market, huge population, young demographic and growing middle class.

Hikmahanto also argued that under the current system of regional autonomy, the central government can no longer exercise full control over regional administrations.

“It would, thus, not be fair for the central government to be brought to the ICSID due to local government actions. This is because under the convention, it is only the central government that can be sued by foreign investors, not the local government [regional administrations],” he said.

Unhappiness at the top

Yudhoyono was clearly unhappy with the Churchill case. “Imagine if hundreds of regents [district heads] did something like that, the implications [to the state] would be enormous,” the president said, as quoted on the official cabinet secretary website. He has since ordered

government officials to exert maximum efforts to win the international arbitration case against Churchill.

“I don’t want multinational companies using international institutions to push developing nations around,” Yudhoyono said.

Hendri Saparini, founder of the Center of Reform on Economics, a local think tank, also agreed with the government’s move, saying many BITs could “disadvantage” the country. Still, she questioned why the government only reacted when a big case hit the nation hard.

Better explanations needed

Uchok Sky Kadafi, a director at The Indonesian Forum for Budget Transparency (FITRA), said Yudhoyono still has to explain to the public his reasoning for the review.

“I have never read a reason for the review until now. Does the review consider the cost benefits, or economic calculations from the treaties? This has not been explained. A clear reference is needed,” said Uchok.

International law experts from Singapore wrote a reaction to the Financial Times article, which was published by The Jakarta Post on April 22. In their article, Indonesia Should Not Withdraw from the ICSID, Michael Ewing-Chow and Junianto James Losari from the Center for International Law at the National University of Singapore, took exception to the choice of words used by the Financial Times.

“The usage of the word ‘terminate’ does not adequately capture the nuanced process that Indonesia is going through to review its BITs by letting the old ones lapse so that new and better ones can be renegotiated.

“Most BITs actually have multiple fora for ISDS arbitration and ICSID is only one of them. Thus, before suggesting that Indonesia withdraw from ICSID, we should consider how the ICSID compares to the other fora for dispute resolution,” Ewing-Chow and Losari said.

Both experts cited the fact that the ICSID was the most often used investor-state dispute settlement body, having registered 433 cases. Other international arbitrators include the Stockholm Chamber of Commerce (SCC), the International Chamber of Commerce (ICC) and the Permanent Court of Arbitration (PCA).

They also cited that “many cases have also been submitted to ad-hoc international arbitration under the United Nations Commission on International Trade Law (UNCITRAL) Rules.

“The difference between ICSID arbitration and non-ICSID arbitration lies mainly with the rules governing the proceeding, the challenge of awards, as well as the enforcement of the awards. The ICSID Convention provides a self-contained system of arbitration, fully autonomous and

independent of any national legal system — including the legal system at the place and seat of arbitration," Ewing-Chow and Losari said.

The main argument, according to the two experts, is that "Being both a capital importing and exporting country, Indonesia also has an interest to protect its investors who invest abroad."

They also slammed Hikmahanto's argument that the central government should not be accountable for the actions of local governments under decentralization.

"It is a fundamental principle of international law that all states are responsible for the actions of their local governments, otherwise local governments [and states] would be free to breach their international obligations."

Furthermore, Indonesia also remains bound to the ASEAN Comprehensive Investment Agreement (ACIA) and other ASEAN investment agreements negotiated with Australia/New Zealand, China and Korea.

"These agreements all represent an attempt by the states to balance the interest of protecting investors while providing policy space for regulation in the public interest on issues such as health, the environment or to deal with financial crises."

The article also rebutted Hikmahanto's argument that the ICSID does not provide a level playing field for both domestic and foreign investors.

"This is true but this is not necessarily problematic. Foreign investors have many choices about where to invest. By providing an investor with a transnational system, ICSID reduces the concerns about the legal risks," Ewing-Chow and Losari said.

"All things considered, Indonesia should not withdraw from ICSID unless the alternatives to ICSID arbitration provide compelling advantages. We do not believe that they do," they said.