Lex Scientia Law Review

Volume 7 Number 1 May, 2023

Type: Research Article

Comparative Analysis of Indonesia's Minimum Capital Requirements for Foreign Direct Investment

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Abstract *This research seeks to examine the compatibility of the Indonesian minimum capital requirement for foreign direct investment companies (FDI) with the national treatment obligation under international investment agreements (IIAs). The requirement is compared with investment requirements under Australian and Austrian Law. This research combines*

the normative legal research method with law and economics by conducting cost and benefit analysis (CBA). The national treatment protects foreign investors from less favorable treatment against domestic investors. The minimum capital requirement is contrary to national treatment because it is only applicable to FDI companies. However, not every IIA involving Indonesia provide a national treatment clause. To determine violation, the two-tier test must be conducted by analyzing the scope of the obligation and applicable exception. Some IIAs provide exceptions where a state can give different treatment to foreign investors for the sake of public interest. Indonesia justifies this requirement because it gives several benefits namely preventing foreign investors from controlling vital sectors, protecting MSMEs from unfair competition, and ensuring liquidity. Nevertheless, the benefits cannot be achieved due to weak supervision. The requirement can be easily circumvented through nominee agreements. Based on CBA, the requirement creates more harm than good. It is promiscuously applied to all business fields and is more burdensome compared to investment requirements in Australia and Austria. The solution proposed is either improving supervision or adjusting the requirement to be more consistent with the national treatment. The government can also protect national interests by empowering MSMEs and using more relevant criteria.

Keywords National Treatment, Foreign Direct Investment (FDI), Minimum Capital Requirement

1. Introduction

Foreign Direct Investment (FDI) can contribute to states' economic development in two ways.[1] First, FDI plays pivotal role in funding entrepreneurship to capture market opportunity and realize

[1] Ole Kristian Fauchald, "International Investment Law in Support of the Right to Development," *Leiden Journal of International Law* 34, No. 1 (2021): 181–201. https://doi.org/10.1017/S09221565200065.

unexplored natural resource potential.[2] Second, investment stimulates employment and improve people's welfare.[3] In order to attract FDI, states engages in International Investment Agreements (IIAs) which establish protection for foreign investors.[4] In addition, states must adjust their investment-related domestic legislations to create a stable legal framework.[5] To create favourable investment climate, the Indonesian government started business licensing reforms in 2018 and enacted the Job Creation Law in 2020. However, there is still one requirement that can potentially hinder foreign investment in Indonesia.

Foreign investors in Indonesia can invest either indirectly (via the stock market in the form of portfolio investments) or directly.[6] Pursuant to Article 5 (2) of the Indonesian Company Law, FDI in Indonesia must be in the form of a Limited Liability Company (LLC) or corporation. Generally, the shareholders are given the freedom to determine the amount of the company's authorized capital. However, there is a special requirement applicable for FDI companies (Article 32 (2) of the Indonesia Company Law as amended by the Job Creation Law). Based on Article 189 (2) of Government Regulation No. 5/2021, the minimum investment amount for FDI company is 10 billion rupiah excluding land and buildings. This minimum investment

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[2] Leila Tussupova Kulanov, Arslan, Saltanat Tamenova, Kamilya Amenova, Alma Karshalova, "Investment Climate and Its Influence on the Development of Entrepreneurship: Practice of the Republic of Kazakhstan," *Entrepreneurship and Sustainability* 2, No. 8 (2020): 421-437. https://doi.org/10.9770/jesi.2020.8.2(25)

[3] Januari Nasya Ayu Taduri, "The Legal Certainty and Protection of Foreign Investment Againsts Investment Practices in Indonesia", *Lex Scientia Law Review* 5, No. 1 (2021): 119-138. https://doi.org/10.15294/lesrev.v5i1.46286

[4] Fauchald, p. 181

[5] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford: Oxford University Press, 2012), p. 196.

[6] Ahmad Shamsul Bin Abd. Aziz Hossain, Mohammad Belayet, Asmah Laili Bt Yeon, "Legal and Policy Regulations of Performance Requirements for Foreign Investors in Bangladesh," *Society & Sustainability* 2, No. 3 (2020): 53-69. https://doi.org/10.38157/society_sustainability.v2i3.205

requirement is applicable per business field and per location. Consequently, foreign investors are required to multiply the amount of investment in accordance with the number of fields or business locations. 25% of the authorized capital must be issued and fully paid up as stipulated in Article 33 (1) of the Indonesian Company Law.

The minimum capital requirement prevents some foreign investors from investing in Indonesia. In other words, Indonesia is only open to large-scale FDI. Consequently, some foreign investors choose to invest in other countries which adversely affects Indonesia's competitiveness. Another option for small-scale FDI is doing business in Indonesia through local (Indonesian national) representation or so-called nominee agreements. Nominee agreement is prohibited, but it commonly used in Indonesia to circumvent certain investment requirements.[7] Several studies such as Yuniarti and Zaidun[8] and Taduri[9] discuss Indonesia’s policies toward foreign investors but no analysis was specifically made related to minimum capital requirement.[10] Meanwhile, according to Putri, the minimum capital requirement imposed by Indonesia is meaningless due to weak supervision.[11] Previous research conducted by Cheng et.al. stated that China succeed in alluring more FDI and creating efficient

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[7] David Kairupan, “Regulation on Foreign Investment Restrictions And Nominee Practices in Indonesia” *Mimbar Hukum* 25, No. 2 (2013): 313-326. https://doi.org/10.22146/jmh.16087

[8] Yuniarti, Yuniarti, and Muchammad Zaidun. "The Foreign Direct Investment Policy Which Reflects the Proportional Protection." *Yuridika* 34.2 (2019): 387-410. https://doi.org/10.20473/ydk.v34i2.13233

[9] Taduri, “The Legal Certainty and Protection of Foreign Investment Againsts Investment Practices in Indonesia", 2021

[10] Zaidun and Yuniarti, “The Foreign Direct Investment Policy Which Reflects the Proportional Protection,” 2019.

[11] Luh Putu Yeyen Karista Putri, “Persyaratan Modal Minimum Bagi Pt Pma Di Indonesia: Perlukah?,” ” *Repertorium: Jurnal Ilmiah Hukum Kenotariatan* 11, No. 2 (2022): 172–85.

market competition by eliminating minimum capital requirements.[12] This result is corroborated by Barwick et.al. which asserted that entry deregulation contributes to overall productivity growth and attracts more FDI.[13]

This paper emphasizes comparative approach to analyse minimum capital requirements imposed by Indonesia with investment requirements imposed by Australia and Austria. Australia has been regarded as the country with the most business-friendly regulation.[14] Meanwhile, Austria is chosen considering its reputation as the most friendly host state, particularly with regard to the ease of doing business.[15] With a value of 0.106 according to the OECD's FDI index, Austria is below the OECD average (0.06) for FDI restrictiveness and even in last place within the EU, FDI restrictiveness (indicator).[16] The comparative analysis will generate different perspectives on maintaining national interest without sacrificing a friendly-investment climate. Moreover, the first section will discuss the conformity of this requirement with obligations under IIAs.

The second section will analyse the requirement from an economic perspective. FDI is a double-edged sword. It can contribute to economic growth, innovation, and technology but on the other

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12 Hua Cheng, and Ding, Siying and Liu, Yongzheng, "The Effectiveness of Entry Deregulation: Novel Evidence from Removing Minimum Capital Requirements", *SSRN* January 12, (2023). http://dx.doi.org/10.2139/ssrn.4182365

13 Panle Jia Barwick, et al, "Entry Deregulation, Market Turnover, and Efficiency: China's Business Registration Reform", *Market Turnover, and Efficiency: China's Business Registration Reform* (2022), 32.

14 World Bank <https://data.worldbank.org/indicator/IC.BUS.EASE.XQ?locations=AU>

15 Andreas Learch, "2021 Investment Climate Statements: Austria", *U.S Department of State,* available online at <https://www.state.gov/reports/2021-investment-climate-statements/austria/>

16 OECD, "Foreign Direct Investment (FDI) Restrictiveness (Indicator)", *OECD Library* (2023). https://doi.org/10.1787/9a523b18-en

hand, it has a negative impact on the pollution and environment.[17] FDI concessions which are not in line with the environmental balance will affect sustainable economic growth.[18] The cost and benefit analysis (CBA) is used to weight the benefit and cost (harm) generated from the minimum capital requirements.[19] Economic analysis will supplement the normative legal research because it complement normative (ideal) analysis with real life situation.[20] For instance, factors that affecting the implementation of regulation such as bureaucratic inefficiency and weak supervision.

The conclusions of this study will provide a final answer on whether or not the minimum capital requirement is necessary and useful. Furthermore, this paper also provides suggestions for policymakers and related stakeholders to pursue national interest without adversely affecting investment climate. Previous research conducted by Hossain et.al provide alternatives performance requirements related to entry regulation such as local content requirement, transfer of technology requirements, and export requirements.[21] This study will not address further concerning the compatibility of such performance requirements with IIAs and Indonesian law, and thus this topic need to be analysed in future research.

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[17] Wen Jun, et al. "Effect of FDI on pollution in China: New insights based on wavelet approach." *Sustainability* 10, No. 11 (2018): 3859. https://doi.org/10.3390/su10113859

[18] Assad Ullah, et al. "Modeling the relationship between military spending and stock market development (a) symmetrically in China: An empirical analysis via the NARDL approach." *Physica A: Statistical Mechanics and its Applications* 554 (2020): 124106. https://doi.org/10.1016/j.physa.2019.124106

[19] Maria GS Soetopo, "Integrating Law and Economics in Indonesia." *Law Review* 18, No. 3 (2019): 369-384. https://doi.org/doi:10.19166/lr.v18i3.1493.

[20] Clark Nardinelli, "Some pitfalls of practical benefit-cost analysis." *Journal of Benefit-Cost Analysis* 9, No. 3 (2018): 519-530. https://doi.org/doi:10.1017/bca.2018.18.

[21] Hossain, et.al., 2020, p. 67.

2. Method

This study uses multidisciplinary approach. Normative legal research method is used to analyse the conformity between minimum capital requirement in Indonesia with the IIAs. Normative legal research is conducted by examining current investment law of Indonesia, and IIAs.[22] The discussion will address whether or not such requirements violate national treatment obligation since it is only applicable for foreign investors. Meanwhile, economic analysis is conducted to analyse cost (harm) and benefit of such requirement. Besides evaluating the positive law, this study also seeks to address prescriptive question on how to improve Indonesian investment climate.[23] Comparative study related to investment entry requirements is conducted by analysing Australian and Austrian Law to explore alternative solution.

3. Result & Discussion

A. Does Minimum Capital Requirement Violate IIAs?

In order to answer this question, first, we must elucidate the definition of IIAs and what kind of obligations arise from IIAs. IIA is a treaty concluded by two or more states pertaining investment promotion. IIA which involving only two states is called a Bilateral Investment Treaty (BIT). Meanwhile, Treaty with Investment Provision (TIP) is an international agreement on trade concluded by two or more states which contain a special provision or chapter on investment. Dolzer suggested that IIAs gives better chance for host

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[22] Sanne Taekema, "Theoretical and Normative Frameworks for Legal Research: Putting Theory into Practice", *Law and Method,* February (2018): 1-17. https://doi.org/10.5553/REM/.000031.

[23] Taekema, p. 7.

state to attract FDI.[24] The scope of protection contained in IIAs varies depending on the agreement between the state parties.

In general, IIAs contain protection for foreign investors against nationalization (expropriation), arbitrary measures, and discriminatory treatment by the authorities of the country where the investment is made (host State).[25] State parties must fulfil obligations arising from IIAs. Inversely, foreign investors have right to rely on the protection provided under IIAs.[26] The minimum capital requirement which only applicable for FDI companies is clearly discriminative. There are two types of protection against discriminatory behaviour under IIAs, namely Most Favored Nation (MFN) and National Treatment. MFN provision requires host states to provide investors from a country treatment no less favourable than treatment given to investors from other countries while National Treatment protects foreign investors from discriminatory treatment compared to domestic investors.

The National Treatment

National Treatment is a concept adopted from international trade law, however the criteria in determining likeness in investment law is different.[27] In the context of the General Agreement on Tariff and Trade (GATT), there is a prohibition on applying internal taxes or regulations that are more detrimental than those applied to similar

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[24] Dolzer, p. 87.

[25] David Price, "Indonesia's Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment?." *Asian Journal of International Law* 7, No. 1 (2017): 124-151. https://doi.org/10.1017/S2044251315000247

[26] Dolzer, p. 87.

[27] Ion Gâlea, and Bogdan Biriş. "National treatment in international trade and investment law." *Acta Juridica Hungarica* 55, No. 2 (2014): 174-183. https://doi.org/. doi:10.1556/AJur.55.2014.2.7.

domestic products.[28] This provision is made to prevent protectionism and create equality in competitive markets.[29] Whereas in the context of investment, the scope of national treatment is wider because it encompasses international trade in goods, services, technology, and other economic activities.[30] Some developing countries limit the scope of national treatment protection.[31] The financial and technological inequality between foreign investors (particularly multinational enterprise) and domestic entrepreneurs is the main reason for the developing state government to provide special treatment to domestic entrepreneurs compared to foreign investors.[32]

Indonesian government explicitly acknowledges the MFN treatment protection under Article 6 (1) of the Investment Law but is silent regarding National Treatment. In practice, the Indonesian investment regulations obviously gives preferential treatment to Micro and Medium Enterprises (MSMEs).[33] Meanwhile the Australian and the Austrian investment law does not regulate explicitly about MFN and national treatment *per se*. However, there is a reference to comply with international obligation, including IIAs.

Until 2022, Indonesia has been involved in 74 BITs. Nevertheless, only 27 BITs are still valid. Indonesia is also involved in 22 TIPs of

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[28] Peter Van den Bossche, and Werner Zdouc. *The Law and Policy of the World Trade Organization: Text, Cases and Materials*. (Cambridge: Cambridge University Press, 2013), p. 344.

[29] WTO Appellate Body. Korea–Alcoholic Beverages, "Korea–Taxes on Alcoholic Beverages." *WTO Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R* 18 (1999).

[30] UNCTAD. *Fair, and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II*. (Geneva: United Nations, 2012).

[31] Salacuse, Jeswald W. "BIT by BIT: The growth of bilateral investment treaties and their impact on foreign investment in developing countries." *Globaization and International Investment*. (London: Routledge, 2017), pp. 25-45.

[32] Gâlea, and Biriş, 2014, p. 182.

[33] UNCTAD. "Investment Policy Hub: International Investment Agreements Navigator", *Online*, available at <https://investmentpolicy.unctad.org/international-investment-agreements>

which 18 of them are still valid.[34] Australia is involved in 24 BITs and 23 TIPs meanwhile Austria is involved in 69 BITs and 77 TIPs. Most of the agreements were signed before the new BITs generation.[35] Although there are some IIAs made using a new model, in general, the provisions of the protection of investors are the same.[36] Even Mahardika analysed that some IIAs involving Indonesia had exact same content.[37]

Sunset Clause

Indonesia's policy not to extend a number of IIAs does not necessarily free Indonesia from the obligation to provide national treatment protection.[38] Indonesia is still bound by several agreements governing national treatment obligation. Some of them such as Article 3 (1) Indonesia-Denmark BIT; Article 3 (1) Indonesia-Finland BIT; and Article 7 (4) Indonesia-Korea Comprehensive Economic Partnership Agreement (CEPA). Several IIAs have sunset clause and thus, Indonesia remains obliged to provide protection even though the agreement has ended.[39] For instance, Article 14 (3) Indonesia-Gemany BIT which stipulates that the protection of foreign investors remains valid for 20 years from the termination of the agreement. Some other BITs contain sunset clause which is valid for 10 years or 15 years since the end of the agreement. The agreement which containing a 10-year

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34 UNCTAD. "Investment Policy Hub: International Investment Agreements Navigator"

35 Price, "Indonesia's Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment?", p. 142.

36 Nur Gemilang Mahardhika, "An Epilogue to Bilateral Investment Treaties Regime and The Fate of Foreign Investments Protection in Indonesia." *Jurnal Hukum Ius Quia Iustum* 29, No. 1 (2022): 93-117. https://doi.org/10.20885/iustum.vol29.iss1.art5

37 Mahardhika, p. 102.

38 Mahardhika,, pp. 96–97.

39 Price, "Indonesia's Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment?", p. 141.

sunset clause included: Article 12 (4) Indonesia-Singapore BIT and Article 15 (4) Indonesia-Denmark BIT. While the agreement containing a sunset clause which is valid for 15 years, namely Article 16 (4) Indonesia-Finland BIT.[40]

The Two-Tier Test

To determine whether the minimum capital requirement of Rp. 10 billion for FDI violates international obligations, a case-by-case analysis must be conducted per each IIAs' provision. If the IIAs do not have national treatment obligation, then the minimum capital requirements do not violate international obligations. IIAs that do not regulate national treatment such as Indonesia-Iran BIT and Indonesia-Qatar BIT. For IIAs which indeed regulates National Treatment, two stages of analysis must be carried out. The first stage of analysis is to determine the scope of national treatment and the second stage to determine applicable exceptions.

National treatment protection usually applies after the business is established (post-entry) but there are also agreements that contain pre-entry provisions as well as post-entry national treatment.[41] Based on the formulation of articles in BITs or TIPs involving Indonesia, there are three types of national treatment obligation. *First*, articles that do not explicitly describe the scope of the protection of National Treatment. For example, Article 3 (1) Indonesia-Germany BIT and Article 3 (2) Indonesia-Russia BIT which only contains the obligation of National Treatment without elaborating the extent of protection.

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[40] Putri, Luh Putu Yeyen Karista. "Persyaratan Modal Minimum Bagi PT PMA Di Indonesia: Perlukah?." *Repertorium: Jurnal Ilmiah Hukum Kenotariatan* 11, No. 2 (2022): 172-185. http://dx.doi.org/10.28946/rpt.v11i2.2093

[41] Rudolf Dolzer and Christoph Schreuer, "Principles of International Investment Law, Second."

Second, articles that limit the obligations of National Treatment are only at the post-entry stage. For example, Article 4 (1) Indonesia-Singapore BIT and Article 3 (3) Indonesia-Saudi Arabia BIT which explicitly states the protection of National Treatment only applies at the post-entry stage (after investment established) including management, implementation, operation and sale or investment transfer. Whereas Article 3 (1) Indonesia-Denmark BIT and Indonesia-Finnish BIT expressly states that National Treatment is given after the investment admitted in the host-state. *Third*, the article contains pre-entry and post-entry obligations. For example, Article 7.4 Indonesia-Korea CEPA and Article 14.4 Indonesia-Australia CEPA, which applies not only at the post-entry stage but also at the pre-entry stage including in the establishment and acquisition.[42] The minimum capital requirement is one of pre-entry requirements. If the IIAs only regulates national treatment at the post-entry stage (second category), then the minimum capital requirements do not violate international obligations. If the IIAs fall under the first or third category, then the next analysis must be conducted to determine applicable exceptions.

Exceptions to the National Treatment

There are some exceptions that are frequently found in IIAs. *First*, the general exception that applies to all provisions as a whole, including the National Treatment obligation. Usually, this provision is made in a special article.[43] Article 39 Indonesia-Singapore BIT provides exception for the sake to protect morality, health, and public order. *Second*, exceptions to the obligations of national treatment in certain

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[42] Putri, 20202, p. 177.

[43] National Treatment: UNCTAD Series on Issue in International Investment Agreements United Nations Conference on Trade and Development. 44.

aspects, for example, taxation or intellectual property rights.[44] Article 3 (5) Indonesia-Saudi Arabia BIT and Article 7.2.4.C Indonesia-Korea CEPA regulates the exception of the obligations of National Treatment in terms of taxation. *Third*, exceptions to national treatment in certain sectors.[45] Annex 1 Indonesia-Singapore BIT contains an exception to National Treatment for the public health services, water supply, liquid waste management, and real estate. *Fourth*, exceptions based on consideration of the interests of developing countries. Protocol 2 Indonesia-Swiss BIT regulates the exception of National Treatment in the interests of Indonesia's national economic development.[46]

The second type of exception is irrelevant because none of IIAs which involving Indonesia regulates the exception of special subjects in the form of minimum capital requirements. The third type of exception is also irrelevant because the minimum capital requirements for FDI applies to all foreign investors in all sectors. If the IIAs does not provide exceptions, then Indonesia violate the National Treatment obligation because it is only applied only to foreign investors. On the other hand, there are no minimum capital provisions for company formed by Indonesian. The discriminatory treatment is very burdensome to foreign investors, furthermore, the minimum capital requirements do not include the value of land and buildings.

If the IIAs regulates exceptions (the first type or the fourth type), it is necessary to further analyse whether the minimum capital requirements are applied based on legitimate purpose, namely to maintain public order or support national economic development.

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[44] UNCTAD Series, p. 45.

[45] UNCTAD Series, p. 46; Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries," p. 668.

[46] United Nations Conference on Trade and Development, National Treatment: UNCTAD Series on Issue in International Investment Agreements, p. 49.

The exception to National Treatment obligation is provided to protect local entrepreneurs from unequal competitions with foreign corporations particularly in terms of financial, human resources, and technology.[47] In other words, Indonesia harnesses the requirement as a filter to obtain large-scale, long-term, and labour-intensive investment. Minimum capital requirements of 10 billion rupiah for FDI company per business sector per location will prevent small scale foreign investment from entering Indonesia so that it can protect domestic businesses from competitions.

On one hand, this requirement is considered to be contrary to the purpose of the Job Creation Law, namely creating a conducive investment climate. This requirement has an important role to maintain state control over important economic sectors and protection of MSMEs that are vulnerable to competition. From historical perspective, developed countries (when they were still capital-importing countries) were also implement certain policies to ensure that foreign investors do not control the vital economic sector of the country.[48] If the vital economic sector of a country is controlled by foreign investors, the country will become very dependent and lose control of its resources. China has proven that although it seems protective, policies to protect national interests are not the main barrier for foreign investors to invest.[49] Therefore, the state must adjust the policy towards foreign investment with the development status and domestic industry.[50] National treatment will only provide benefits that are greater than the negative effects if the domestic

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47 UNCTAD Series, 48; Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries," p. 668.

48 Ha-Joon Chang, "Regulation of Foreign Investment in Historical Perspective." *The European Journal of Development Research* 16, No. 3 (2004): 687-715.

49 Chang, 2004

50 Chang, 2004

industry has reached a certain level to be able to compete with big competitors.[51]

In addition to protecting MSMEs from competition, this requirement is also important to protect creditors or third parties who will be in contact with FDI companies. Capital can be used as collateral to determine company's credibility.[52] Shareholders are only liable to the extent of the capital invested in the companies. If there is no minimum capital requirement, there will be a risk that a company is not formed with adequate capital. In case of bankruptcy, creditors or employees cannot collect receivables in excess of the amount invested by investors. Furthermore, the bankruptcy asset often insufficient and unreliable.[53] A minimum capital requirement of 10 billion rupiah for FDI companies can minimize the risk of default that harms creditors or employees due to capital inadequacy. However, this reason cannot justify national treatment violation because the requirement is imposed only to FDI companies.

Comparative Analysis-by Country

The regulatory scheme established by the *Corporations Act 2001* (Cth), the *Foreign Acquisitions and Takeovers Act 1975* (Cth) and the *Register of Foreign Ownership of Water or Agricultural Land Act 2015* (Cth) comprises Australia's restrictions on FDI - however, there are no minimum capital requirements for investing in Australia.

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[51] Chang, 2004

[52] Xavier Nugraha, Krisna Murti, Saraswati Putri, "Third Parties' Legal Protection over Agreed Authorized Capital Amount by Founders in Limited Liability Companies," *Lentera Hukum* 6, No. 2 (2019): 173-188. https://doi.org/10.19184/ejlh.v6i1.9676

[53] Santoso Halim, "Insolvency Test as The Requirement for Bankruptcy Declaration to Maintain Investment Conduciveness in Indonesia." *Proceedings from the 1st International Conference on Law and Human Rights, ICLHR 2021, 14-15 April 2021, Jakarta, Indonesia*. 2021. https://doi.org/doi:10.4108/eai.14-4-2021.2312449.

Australia's approach to ameliorating the negative effects of FDI attempts to put the focus on the individuals controlling the investment activity by imposing residency or personal presence and moral fitness requirements on foreign directors. Also, inversely to the Indonesian scheme, certain kinds of investment over various monetary thresholds require approval by Australia's Foreign Investment Review Board (FIRB). The federal government also imposes targeted levies on foreign-owned vacant residential properties.

Meanwhile, new formations of limited liability companies in Austria require a minimum capital threshold, regardless of whether the founding party is a foreigner or not. The share capital, which must be raised by the shareholders at the time of formation, must amount to at least EUR 35,000, which equals approximately 563 million Rupiahs.[54] Half of this sum must be paid in cash at the time of formation.[55]

Alternatively, the capital contribution can be reduced by means of the so-called "foundation privilege": In this case, the nominal capital is EUR 35,000, but the shareholders' agreement can stipulate that the capital contributions are limited to EUR 10,000 (approximately Rp. 161 million). Of this amount, half must be paid in cash at the time of formation. The remaining capital must only be raised after 10 years.[56]

Austria's regulations on FDI, by contrast, do not know any additional minimum investment threshold. In Austria, FDI is mainly regulated by the Austrian Investment Control Act

[54] This and any further calculations are made based on the ECB's average exchange course for Q1 2022 of EUR 1 = IDR 16088.34.

[55] Section 6a and 6b "Act on Limited Liability Companies - 'GmbHG'; - Gesetz Vom 6. März 1906, Über Gesellschaften Mit Beschränkter Haftung (GmbH-Gesetz – GmbHG) StF: RGBl. Nr. 58/1906" (1906).

[56] Section 10b GmbHG.

(*Investitionskontrollgesetz* – "InvKG")[57], which is the successor to the Austrian Foreign Trade and Payments Act. However, the latter was considered too general and vague with regard to definitions important for the scope of application, such as those of transactions that may pose a threat to security and public order.[58] The InvKG which entered into force in 2020, follows and substantiates the Regulation (EU) 2019/452 establishing a framework for the verification of FDI in the Union ("EU-FDI-Screening-Regulation")[59].[60]

The InvKG applies to the acquisition of domestic companies by foreign legal entities or individuals. It is important to note that only investors from third countries (i.e. those who are not resident in the European Union, the European Economic Area or Switzerland) are considered "*foreign investors*".[61]

The definition of an acquisition is (a) the attainment of a certain minimum share of voting rights, (b) the acquisition of a controlling influence and (c) the acquisition of significant assets, whereby a controlling influence over these assets is acquired.[62]

However, transactions are only subject to FDI control if they involve a target company active in one of the sectors listed in the Annex to the InvKG. These are, on the one hand, "particularly sensitive sectors" (Annex Part 1) such as defence facilities, operators of critical energy or digital infrastructure or water supply.

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[57] "Austrian Investment Control Act Bundesgesetz Über Die Kontrolle von Ausländischen Direktinvestitionen (Investitionskontrollgesetz – InvKG) StF: BGBl. I Nr. 87/2020 (NR: GP XXVII RV 240 AB 276 S. 45. BR: AB 10376 S. 910.)" (2020).

[58] InvKG, 240 der Beilagen XXVII. GP - Regierungsvorlage – Erläuterungen.

[59] European Union. "European Union, Regulation (EU) 2019/452 Establishing a Framework for the Verification of FDI in the Union", (2019). http://data.europa.eu/eli/reg/2019/452/oj

[60] Christoph Ludwig, "Die Kontrolle ausländischer Direktinvestitionen"in *Series: Studien zum Internationalen Wirtschaftsrecht - Studies on International Economic Law* Vol. 39 (2023) https://doi.org/10.5771/9783748939948

[61] Section 1 No. 2 InvKG.

[62] cf. Section 2 para. 1 No. 3 InvKG.

Part 2 of the Annex also lists "Other areas in which security or public order, including crisis management and services of general interest within the meaning of Articles 52 and 65 TFEU, may be threatened" and includes other critical infrastructures such as traffic and transport, telecommunications and food.

The difference between Parts 1 and 2 of the Annex is that the sector-specific review in Part 1 already applies if 10% of the target company is to be acquired (or an increase to over 25% or 50% occurs). In other words: if the target company is engaged in the activities listed in Part 1, the scope of the InvKG is triggered more easily. In the case of the "other sectors" (i.e. Part 2 of the Annex), the InvKG applies if 25% or more of the target company is acquired (or increased to >50%).

In both cases (Part 1 and Part 2 of the Annex), however, a notification must also be made if a controlling influence over an Austrian company is acquired irrespective of the specific voting shares or through the acquisition of significant assets.[63]

As an additional criterion, the InvKG stipulates that EU and international law provisions must not conflict with an approval requirement.[64] The violation of a provision of EU law is unlikely, since the InvKG largely supplements the FDI Screening Regulation and only deviates slightly from it in the area of examination.[65]

From the international law perspective, Austria's obligations, for example, within the framework of the WTO (in particular GATS) may be relevant.[66]

However, Art XIV GATS provides that investment control licensing requirements may be justified under the general exception

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[63] *See* already above Section 2 para 1 no. 3 InvKG.

[64] Section 2 para 1 no 2 InvKG.

[65] Georg Adler, Célia Chausse, Volker Weiss, Cynthia Eva Zimmermann, *Handbuch Investitionskontrolle Handbuch* (Austria: MANZ, 2022).

[66] Adler, et.al., *Handbuch Investitionskontrolle* (Austria: Manz, 2022), Chapter 4, Para 4.211.," (2022).

and the security exception, according to which restrictive measures may be imposed for reasons of public order or security. The EU-FDI-Screening Regulation also stipulates that the implementation of the Regulation (which the InvKG is ultimately intended to be) should comply with the requirements for the imposition of restrictive measures on grounds of public policy and public security in the WTO Agreements, in particular Article XIV(a) and Article XIVbis.[67]

The InvKG makes an exception for small companies such as start-ups. FDI is not subject to approval if the target company is a microenterprise, including start-ups, with fewer than ten employees and annual sales or an annual balance sheet total of less than EUR 2 million.[68]

The benchmark for assessing whether a transaction subject to notification is to be approved is whether the FDI may lead to a threat to security or public order, including crisis management and public services within the meaning of Art 52 and Art 65 TFEU, whereby the effects on the respective affected sectors and industries are to be assessed.[69] In this evaluation, particular attention is to be paid to whether the acquirer (a) is controlled by the government or governmental institutions of the respective third country (b) is or was already involved in activities which have or had an effect on security or public order in another EU member state and (c) is or was involved in illegal or criminal activities.[70]

Whereas under Indonesian law the focus in FDI is therefore on the liquidity of the investors, Austria mainly examines whether investors pose a threat to public safety. In Austria, the liquidity of the investor, and thus whether a suitable liability fund is made available

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[67] Adler, et.al., 2022,. para 4.213-4.214.; cf also EU-FDI-Screening-Regulation, Rec 35

[68] Section 2 para 2 InvKG.

[69] Section 3 para 1 InvKG.

[70] Section 3 para 2 InvKG.

to the creditors, only arises from a corporate law perspective in the case of the establishment of new companies and here, equally, for nationals and foreigners.

B. Cost and Benefit Analysis

Reflecting on FDI in Indonesia in the last 10 years, there is an increasing trend in direct investment even though there was a decline in 2018. The Government Regulation No. 24/2018 concerning Electronically Integrated Business Licensing Services through Online Single Submission (OSS) provide ease of doing business, especially in terms of licensing. This regulation aims to improve the investment climate in Indonesia.

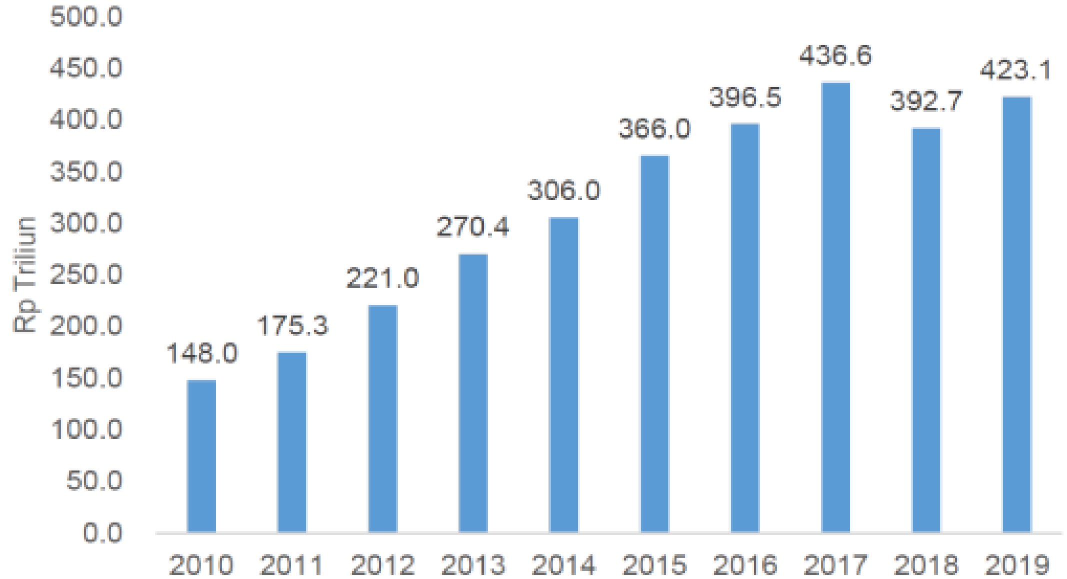

FIGURE 1. Development of FDI 2010-2019 in Indonesia
Source: Investment Coordinating Board, 2020

In the first quarter of 2021, housing, industrial and office areas became the largest sector among others, especially during the pandemic. The ease of licensing and Job Creation Law supports the acceleration of investment in Indonesia. On the other hand, there are

still problems and obstacles in investment. According to BKPM, the barriers are land acquisition, spatial planning, zoning regulation, sophisticated business licencing, and low quality of Indonesian Human Resources (HR).[71]

Other regulation that hinders FDI in Indonesia is the minimum capital requirement. According to Article 189 (2) of Government Regulation No. 5/2021, the total investment value for FDI companies must be greater than 10 billion rupiahs, excluding land and buildings per business field. The cost and benefit analysis (CBA) is used to weight the benefit and cost (harm) generated from the minimum capital requirements.[72] Economic analysis will supplement the normative legal research because it complements normative (ideal) analysis with real life situation.[73] The CBA is harnessed as a decisional tool to generate recommendation on how to improve the implementation of the regulation.

The Benefit

There are at least two reasons why the minimum capital requirement for FDI companies is still needed. *First*, to protect national interests so that vital economic sectors are not controlled by foreign investors and protect MSMEs from unfair competition with Transnational Corporations (TNCs). Robert Giplin explained that TNCs have changed the structure of the world, especially in terms of the economy, because giant companies have become one of the strategies to determine the main flow of world trade by investing only in capital-

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[71] Robby Alexander Sirait, et al. "Lookout Pendapatan Negara 2020 14/ARC. PKA/IV/2020." *Analisis Ringkas Cepat* (2020): 1-10.

[72] Soetopo, 2019, p. 375.

[73] Clark Nardinelli, "Some Pitfalls of Practical Benefit-Cost Analysis." *Journal of Benefit-Cost Analysis* 9, No. 3 (2018): 519-530. https://doi.org/10.1017/bca.2018.18

intensive sectors and technology. *Second*, these requirements are important to ensure the credibility of FDI companies and protect the interests of creditors or third parties from the risk of undercapitalized companies.[74] 408 These benefits will only be achieved if the minimum capital requirements for FDI companies can be implemented properly. However, in practice, weak supervision causes deviations.

There are several efforts made by Indonesia in regulating FDI. *First*, FDI must be in the form of companies (Article 5 (2) of Indonesian Company Law). *Second*, Indonesia limits the fields of business available to foreign investment. Restrictions on business fields for foreign investors are carried out in several ways, including listing business fields that are closed to foreign investors on the negative investment list, determining the maximum share ownership limit, requiring partnerships with MSMEs, limiting locations permitted for foreign investment, and requiring special permits.[75] *Third*, Indonesia sets a minimum total investment for FDI companies of 10 billion rupiah excluding land and buildings per business field per location. If FDI companies have branches in other locations or expand business activities, the total value of the investment must be increased by 10 billion rupiah per location and per business field. The total investment value is different from the companies paid-up capital. Although the minimum capital for FDI companies is 10 billion rupiah, at the time of establishment, shareholders of capital can deposit a minimum of 25% of the total investment value according to Article 33 (1) of Indonesian Company Law.

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[74] David Tan, "Scrutinizing Perseroan Perorangan: The Brainchild of Societas Unius Personae in the Realm of Indonesian Company Laws". *Lex Scientia Law Review* 6, No. 2 (2022): 391-442. https://doi.org/10.15294/lesrev.v6i2.56059.

[75] Wildatul Fitri Tatiara and Toshihiro Kudo, "The Impact of Negative Investment List (NIL) Introduction on Investment Decisions of Foreign and Domestic Investors in Indonesia," *The Journal of Indonesia Sustainable Development Planning* 2, No. 2 (2021): 160-175. https://doi.org/10.46456/jisdep.v2i2.151

The supervision of business fields restriction for foreign investors has been automatically integrated into the Online Single Submission (OSS) system. Risk-based OSS is implemented to create legal certainty, provide ease of doing business, and encourage investment. The online licensing system simplify the process and is very efficient. Business actors, both individuals and business entities can apply for permits from anywhere and anytime. Legal entities (including companies) do not need to enter data manually because OSS has been integrated with the system of the Directorate General of Legal Administration of the Ministry of Law and Human Rights.[76] Legal entities only need to enter the required details such as business field and business location. If the selected business field or location does not meet the specified requirements, the OSS system will automatically reject the application and the submission process cannot be proceeded. For example, the chosen business field is listed under negative investment list or exceeds the specified maximum share ownership requirements.[77] The automatic and integrated monitoring system in the OSS is very effective in preventing violations of regulations regarding restrictions on business fields for foreign investors.

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[76] *See* Desi Arianing Arrum, “Kepastian hukum dalam perizinan berusaha terintegrasi secara elektronik (Online Single Submission) di Indonesia”. *Thesis* (Surabaya: Universitas Airlangga, 2019); Ika Wulandari, and Martinus Budiantara. "Pembuatan Nomor Induk Berusaha (NIB) Melalui Online Single Submission." *Dinamisia: Jurnal Pengabdian Kepada Masyarakat* 6, No. 2 (2022): 386-394. https://doi.org/10.31849/dinamisia.v6i2.8205; Seto Sanjoyo, et al. "Perizinan Berusaha Melalui Online Single Submission Sebagai Ketaatan Hukum dalam Rangka Meningkatkan Investasi." *Borneo Law Review* 4, No. 1 (2020): 64-78. https://doi.org/10.35334/bolrev.v4i1.1397

[77] Arrum, 2019; Sanjoyo, et.al, 2020; Wulandari & Budiantara, 2022

Weak Supervision

The supervisory system of minimum capital requirement for FDI companies relies on the awareness of each shareholder and notary. Based on Article 7 (2) of the Company Law, a company must be established by a notarial deed. Usually, the proof of paid up capital of the companies is submitted by the shareholders to a notary. The notary inputs the company establishment data including the composition of capital into the AHU online system. The data recorded in the AHU database is automatically integrated with the OSS database, including data on authorized capital, issued capital, and paid-up capital.[78] The validity of the data completely depends on the honesty of the shareholders and notaries. So far, the capital data is conducted manually by a notary in the AHU system. Before uploading data, a notary must fill out a statement that guarantees the truth of the inputted data, the suitability of the data with laws and make a commitment to take responsibility in case of violation.[79] However, there is no obligation for a notary to upload proof of capital deposit or bank statement of companies. The OSS, AHU, and bank account of the company must be integrated to ensure compliance with the minimum capital requirement. Thus, supervision will be easier because companies that have not met the minimum capital requirements can be automatically excluded from business license application.

Many foreign investors fail to meet the minimum capital of 10 billion rupiahs excluding land and buildings. At the time of establishment, shareholders are only required to deposit a minimum of 25% of the authorized capital stated in the deed of establishment.

[78] *Online Single Submission Handbook*, p. 21.
[79] *Online Single Submission Handbook*, p. 25.

Furthermore, investment realization including additional capital deposit is inputted through the Investment Activity Report (LKPM). Business actors input their investment realization periodically every three months. However, no feedback or verification was carried out to check the validity of the submitted reports. LKPM does not guarantee that shareholders will meet the minimum total investment value requirement of Rp. 10 billion for FDI companies. Moreover, there is no time limit on when foreign investors must deposit capital of 10 billion Rupiah. In other words, the implementation of minimum capital requirements is not effective.[80]

The minimum amount of capital required for FDI companies applies to all business fields regardless of their respective characteristics. Some business fields do require large capital, such as the financial sector because it is related to customer trust. However, there are also some business fields that do not necessarily require large capital, such as laundry or bakery. There are also business fields where most of the investment is in the form of land or buildings such as villas. In Article 189 (2) of PP 5/2021, the calculation of the minimum capital for FDI companies does not include the value of land and buildings. This requirement will be burdensome for investors who invest most of their capital in land and buildings. Consequently, only large-scale foreign investors can meet this requirement.

Nominee Agreement

Foreign investors who fail to meet the minimum capital requirements have two options. First, investing in other countries with less restrictive requirement. This will adversely affect Indonesia's

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[80] Putri, "Persyaratan Modal Minimum Bagi Pt Pma Di Indonesia: Perlukah?", 2022.

competitiveness as a host state. Foreign investors who are keen to see market opportunities in Indonesia will seek ways to circumvent this requirement. The second option for foreign investors fail to meet the minimum capital requirements is by using a nominee agreement. The nominee agreement is made by the first party, namely the party whose name is listed as a shareholder in the deed of establishment of a company (legal/registered owner) and the second party, namely the party who actually owns the money/capital invested in a company (beneficial owner).[81]

Article 33 (1) The Investment Law contains a prohibition on making agreements or statements of ownership of shares of limited liability companies for and on behalf of other people. Then Article 33 (2) of the Investment Law also stipulates that the nominee agreement made is declared null and void. In other words, the nominee agreement has no legal consequences. As a consequence, the position of the parties who made the agreement returns to its original position where the party whose name is listed as a shareholder (legal/registered owner) is considered a normative as well as substantive (material) shareholder, while the actual owner of capital (beneficial owner) does not have rights to the shares. Shareholders whose names are registered (legal/registered owners) are required to return the money given by the real owners of capital as debt.[82] Although it is expressly prohibited, in practice many parties enter into nominee agreements to get around the regulations, one of which is the minimum capital requirement for FDI companies which is considered too large. The parties know that the agreement violates the law, but there is a need where the beneficial owner needs to borrow the name of an Indonesian citizen in order to get around the minimum capital requirements for FDI companies, and the legal/registered

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81 Kairupan, 2013.

82 Kairupan, 2013, p. 323.

owner whose name is borrowed usually benefits from the nominee agreement. in the form of money or other forms of compensation. In addition, the absence of an automatic and integrated monitoring system makes it difficult for law enforcement to detect let alone take action against parties who make nominee agreements. If supervision is enhanced and parties who are detected making nominee agreements are dealt with strictly, for example by being sanctioned, it will have a deterrence effect. Currently, supervision of nominee agreements is still very weak so the risk of nominee agreements being detected is very small or may not be detected at all. As a result, foreign investors can make nominee agreements without being detected. In other words, the benefits derived from the nominee agreement outweigh the risks such as sanctions that will be given due to the weak supervision and detection system. In addition to violating legal provisions, the use of a nominee agreement also poses risks to the parties. For example, when the registered owner abuses the trust given by the beneficial owner, causing material losses and being sued in court.[83]

The Cost or Harms

Foreign investors can easily circumvent minimum capital requirement by concluding nominee agreements. As a result, many companies that are actually owned by foreign investors compete freely with MSMEs without being subject to minimum capital requirement. This will certainly have a negative impact on the competitiveness of SMEs. According to OECD, there are only eight countries who still imposed discriminatory capital policy toward FDI companies. Indonesia sets the highest amount of minimum capital

83 Pengadilan Negeri Denpasar, "Putusan Pengadilan Negeri Denpasar Nomor 485/Pdt.G," 2016.

requirement in the world. The discriminatory capital policy hinders FDI penetration to Indonesia.[84]

In addition, deviations from the minimum capital requirement can also have a negative impact on the protection of creditors or third parties from the risk of default in the event of an undercapitalized company. The minimum capital requirement for FDI companies in its implementation is not right on target. Even though the capital has been paid up in accordance with the required amount, the shareholders can easily withdraw the nominal after the company's establishment process is completed. Weak supervision will cause injustice for FDI companies who are honest and have met the specified requirements. In addition, weak supervision is also detrimental to domestic investors who partner with foreign investors. Moreover, the classification of foreign investment is not determined based on majority share ownership. Based on Article 1 point 2 of the Investment Law, if there is an element of foreign investment, either wholly or partially, then the investment is classified as foreign investment. In other words, even though share ownership is foreign investment is very small, even only 1%, then the investment is classified as foreign investment and must be subject to a minimum capital requirement of Rp 10 billion. In this case, the minimum capital requirement does not contribute positively to the competitiveness of local entrepreneurs but actually hinders the ease of doing business, technology transfer and partnerships between foreign and local entrepreneurs.

The minimum capital requirement for FDI companies in practice does not contribute positively to the protection of national interests but instead has a negative impact on the ease of doing business. The Indonesian government can use other criteria that are more relevant

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[84] OECD. *Re-thinking Indonesia's FDI regime*, available online at <https://www.oecd-ilibrary.org/sites/70aed0d7-en/index.html?itemId=/content/component/70aed0d7-en>.

to protect national interest. For example, the government may require foreign investors to use environmentally friendly technology/energy.[85] Another alternative, for example, requires foreign investors to maximize the absorption of local workers or provide social contributions such as corporate social responsibility (CSR). Hossain et.al. provide alternatives performance requirements related to entry regulation such as local content requirement, transfer of technology requirements, and export requirements.[86]

4. Conclusion

This study concluded and highlighted that the minimum capital requirement for FDI companies in Indonesia violates the national treatment obligation as it discriminates against foreign investors. However, not all international investment agreements (IIAs) include a national treatment clause. To determine whether a violation has occurred, a two-tier test must be conducted, analyzing each provision of the IIA. The first test examines the scope of national treatment protection, whether it covers only post-entry or both pre and post-entry. The second test analyzes the applicable exceptions to the national treatment obligation. This study also confirmed that Indonesia justifies the minimum capital requirement for FDI companies by citing national interests, including protecting MSMEs from unfair competition with multinational corporations, preventing foreign investors from controlling vital economic sectors, and safeguarding creditors or third parties from liquidity risks associated with undercapitalization.

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[85] I. Gusti Ngurah Parikesit Widiatedja and I. Gusti Ngurah Wairocana, "The Lack of the Environmental Concern in Indonesia's Bilateral Investment Treaties," *Hasanuddin Law Review* 3, No. 3 (2017): 231-245. http://dx.doi.org/10.20956/halrev.v3i3.1202

[86] Hossain, p. 67.

However, according to cost-benefit analysis, the minimum capital requirement does more harm than good. Its benefits can only be realized through proper implementation, yet the requirement is easily circumvented through nominee agreements. The lack of supervision renders the requirement ineffective in achieving its goals and protecting MSMEs. Additionally, the requirement hinders FDI and negatively affects Indonesia's competitiveness. The minimum capital of 10 billion rupiahs is excessive, as it is applied per business sector, per location, and excludes the value of land and buildings. In contrast to Indonesia, Australia does not have a minimum capital requirement, while Austria has a requirement that is not excessive and is applied equally to domestic and foreign investors. To mitigate the negative effects of FDI, Australia focuses on FDI supervision, while Austria provides exceptions for MSMEs and certain sectors. In contrast, Indonesia applies the requirement indiscriminately to FDI in all sectors.

The proposed solutions involve ensuring proper implementation and modifying the requirement. Proper implementation requires improved supervision and compliance. The government can impose disincentives for investors who fail to meet the requirement, such as excluding them from online business permit applications. Furthermore, the minimum capital amount should be rationalized according to each business sector. The requirement should be applied equally to foreign and domestic investors, with exceptions for MSMEs. National interests can be pursued through more relevant criteria, such as requiring investors to use environmentally friendly technology/energy, maximizing local employment, and providing social contributions through corporate social responsibility (CSR).

5. Declaration of Conflicting Interests

The authors state that there is no conflict of interest in the publication of this article.

6. Funding Information

None

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How to cite (Chicago style)

Putri, Luh Putu Yeyen Karista, Miriam Imarhiagbe, I Made Mandira, Eric Gordon Withnall, and Putu Yasodhara Sthita Brahmani Duarsa. "Comparative Analysis of Indonesia's Minimum Capital Requirements for Foreign Direct Investment". *Lex Scientia Law Review* 7, No. 1 (2023): 179-214. https://doi.org/10.15294/lesrev.v7i1.64664.

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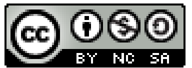

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History of Article

Submitted: January 7, 2023
Revised: May 28, 2023
Accepted: May 30, 2023
Available Online: May 30, 2023