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Reframing The Right to Regulate Clause in The Indonesia-China Investment Agreement

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Abstract: This analysis focusing on reframing the right to regulate clause as a legal mechanism for balancing Indonesia's regulatory autonomy with the protection of Chinese investors under the Indonesia-China investment framework. Although the 1994 Indonesia-China Bilateral Investment Treaty (BIT) was terminated in 2015, its survival clause continues to provide investment protection for a period of ten years. Using a normative legal approach, this analysis focusing on legitimate expectations; legal paradigm reorientation; and the application of principle non-discrimination. This analysis proving the reconstruction right to regulate clause in the BIT is a solution to end the conflict between investment protection and the domestic policy. The result of this analysis implying the shift of the clause from general to be more specific focusing on downstream policy as the new standard of the international investment focusing on Indonesia and China investment agreement.

Keywords: Right to Regulate; Industrial Downstream Regulations; Indonesia-China BIT; Investment Law

1. Introduction

Based on Law Number 3 of 2020 concerning Minerals and Coal (Minerba), the Indonesian government has ratified a ban on the export of raw ore as a form of downstream nickel industry policy and support for the construction of smelters in Indonesia (UNDANG-UNDANG REPUBLIK INDONESIA NOMOR 3 TAHUN 2020, 2020). This policy fundamentally became important for Indonesia as the strategy to have a massive economic growth focusing on nickel. However, based on Regulation of the Minister (Permen) of Energy and Mineral Resources (ESDM) Number 11 of 2019 concerning Management of Mineral and Coal Mining, has started some conflicts on foreign investment regulations and domestic policy. This also has become a problem for foreign investors, especially those from China who have invested in the smelter sector. Although the Indonesia-China Bilateral Investment Treaty (BIT) expired in 2015, the survival clause through the investment treatment clause still applies as the basis for the protection of foreign investors in Indonesia. This survival clause is the reason why, even though the Indonesia-China BIT was terminated in 2015, the investment relationship between the two countries continues. This clause emphasizes that investments made will continue to receive protection in accordance with the provisions of the 1994 Indonesia-China BIT for a certain period (10 years after 2015). This is clarified in the agreement document, "Agreement Between The Government of The Republic of Indonesia and The Government of The People's Republic of China on The Promotion and Protection of Investment" in Article XIII concerning ENTRY INTO FORCE, DURATION, AND TERMINATION, paragraph 2, which reads

"In respect of investment made prior to the date of termination of the present agreement, the provisions of Article I to XII shall continue to be effective for a further period of ten years from the date of termination of the present agreement." (Agreement

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Between the Government of the People's Republic of China and the Government of the Republic of Indonesia on the Promotion and Protection of Investments, 1994).

With this clause, the potential risk of lawsuits based on violations of foreign investor protection in the host country becomes possible. To address this, in 2020 the Indonesian government created a new BIT with several important additions, including limited Investor-State Dispute Settlement (ISDS); tighter investment restrictions; investor obligations; and, most importantly, the right to regulate clause. And in some conditions, international law does not preclude host states from taking over the foreign investment based on public purpose, and in a non-discriminatory ("Indirect Expropriation" and the "Right to Regulate" in International Investment Law, 2004).

The previous analysis emphasized that Indonesian BITs must achieve a balance between rights and obligations based on national interests (Dewi et al., 2024), while the second analysis explained that host state control often conflicts with the principle of Fair and Equitable Treatment (FET) (Azizah, 2025). The third analysis explains that regulations governing downstreaming are still considered inefficient and unharmonized (Putri, 2025). The first two analyses show a dilemma in achieving Indonesia's national interests, public interests, and domestic protection. And this become the gap analysis because the first two analysis only focusing on domestic situation and limited on economic sector as the reason of the analysis, and without give a concrete solution focusing on investment clause. From this point, clearly that international agreement (ex. BIT 1994) does not have a strong protection on regulations dynamic. And this analysis will use this gap by reconstruct the gap on investment clause as the solution. However, the third analysis further emphasizes why the right to regulate clause is necessary as a legal basis for downstream regulations, and this will become a strong fundamental for this analysis focusing on the right to regulate clause.

Given this situation, the problem addressed in this analysis is how the transformation of the right to regulate clause can implement downstream regulations without violating international investor protection in order to achieve public and national interests and strengthen Indonesia's legal position in the eyes of Chinese investors. The purpose of this analysis is to create legal certainty regarding Indonesia-China investment relations by encouraging the revision of Indonesia's international investment agreements.

2. Materials and Methods

This analysis uses normative legal analysis method that focuses on legal norms and principles closely related to international investment law. The approaches used in this analysis are the conceptual approach and the legislative approach. The conceptual approach is used to explain the right to regulate clause and the FET principle, while the legislative approach is used to explain downstream regulations in accordance with Law Number 3 of 2020 concerning Mineral and Coal; Regulation of the Minister (Permen) of Energy and Mineral Resources (ESDM) Number 11 of 2019 concerning Management of Mineral and Coal Mining; the 2024 Indonesia-China BIT; and the 1994 Indonesia-China BIT; Presidential Regulation No. 20 of 2018 concerning Foreign Workers (TKA); Law No. 6 of 1974 concerning Basic Provisions on Social Welfare; Law No. 25 of 2007 concerning Investment. Indonesia and China BIT 1994 have public goals that is not enough to explain the situation between Indonesia and China. Technically, this situation is become the law gap or *vague provisions*. Regulation of the Minister (Permen) of Energy and Mineral Resources (ESDM) Number 11 of 2019 that became the basic of the downstream policy explains that the host country (Indonesia) is have a strong right to apply the non-discrimination focus on the application of the downstream policy, and affecting the policy that Indonesia will not be label to indirect expropriation on Chinese Investment.

The technique for processing data in the form of laws and international agreements uses descriptive-analytical techniques with qualitative methods. With this method, it is

hoped that complete and efficient data can be obtained in the analysis of the right to regulate clause in legal protection in investment agreements with China through national downstream regulations.

3. Results and Discussion

3.1 Legitimate Expectations and Right to Regulate

In an international investment process, legitimate expectations are certainly important here. Simply put, legitimate expectations are investors' expectations regarding the stability and consistency of the rules and laws applicable in the host country. The question is whether the host country, through its policies, can avoid the risk of lawsuits for indications of violations of FET due to inconsistencies in the rules and laws that are enforced. This is what the Indonesian government faces through its industrial downstream regulations, which certainly affects the legitimate expectations of Chinese investors that the rules will not change until the agreement expires. This shows a contradiction between Indonesia's domestic interests and protection as the host country. I think it is okay to use German Law as the basic understanding to examine the concept of legitimate expectation, so according to Potestà in his understanding on, "Review Legitimate expectations in investment treaty law: Understanding The Roots and The Limits of a Controversial Concept," explain in German Law the protection of legitimate expectations has a strong connection to fundamental principle of "protection of trust" or Vertrauensschutz, and its scope is wide (Potestà, 2013). Trust, that he emphasized showing the trust of foreign investor is so important, and this becoming the fundamental of a country (or host country to be exact) on how they will react on this situation. This situation then becomes a strong basis for Chinese investors to file a lawsuit that the Indonesian government is indicated to have violated the FET principle. In her analysis, Azizah emphasizes that FET actually creates restrictions on state control (Azizah, 2025)and brings Indonesia into a situation of regulatory chill, which explains the government's hesitation to issue domestic policies that are indicated to violate the FET clause, and then the possibility of being sued in international courts. However, unlike Azizah, Dewi emphasizes the right to equality between foreign investors and the host country's national interests, and claims made by investors often burden the host country's economic capacity(Dewi et al., 2024). Of course, this contradiction will become a strong basis for encouraging Indonesia to act fairly towards foreign investors while implementing its domestic policies.

Seeing this situation, the Indonesian government is trying to reorient the legitimate expectations of Chinese investors to be in line with its downstream regulations. The role of international agreements is important here because in 2024 the Indonesian government issued a new BIT and explicitly included the right to regulate, or the right of the host country to issue certain regulations in accordance with national and public interests (one of which is support for the development of domestic smelters with the aim that the country not only sells raw materials but also finished and semi-finished goods). For example nickels can be process into stainless steel and battery for electric vehicles (EV) before export to another country (Sinaga, 2024). And from this the value significantly increased.

A contradiction arises when the downstream regulations process intersects with the environmental sector, which was initially emphasized as a public interest. Of course, this "disrupts" investors' legitimate expectations of the government when new environmental regulations are issued. The right to regulate is important in emphasizing that state sovereignty remains relevant and justified and cannot be used as a benchmark for whether this policy violates FET and the expectations of foreign investors who clearly have high ecological risks. Therefore, a check and balance mechanism is important in downstream regulations in Indonesia. This situation shows an antinomy between the function of downstream regulations and the purpose of the right to regulate. This policy

explains that there are three crucial things that form the basis for achieving Indonesia's public and national interests, including a ban on raw ore exports; requiring the construction of smelters in the host country for foreign investors; and providing tax incentives (tax holidays as a form of efficiency in investing in Indonesia). Then, related to the environment, this policy also goes hand in hand with several domestic environmental regulations, including Environmental Impact Analysis (AMDAL); emission and waste standards; and environmental approval as stated in the Job Creation Law. The right to regulate also has strict environmental standards, including a carbon tax plan for industries that produce high emissions; and a ban on Deep Sea Tailing Placement (DSTP) related to restrictions on the disposal of smelter waste into the sea.

Checks and balances play an important role in balancing these antinomies. Judicial oversight, which monitors the regulation of the right to regulate clause, focuses on important aspects such as social welfare, the environment, and others, or perhaps only focuses on political interests. The government is then required to understand and determine the stability of the downstream policy direction; transparency, at this stage, encourages discussion between the government and foreign investors so that it is not done unilaterally and does not affect legitimate expectations and gives investors the opportunity to make adjustments. This is reinforced by Regulation of the Minister (Permen) of Energy and Mineral Resources (ESDM) Number 11 of 2019 concerning the Second Amendment to Regulation of the Minister of Energy and Mineral Resources Number 25 of 2018 concerning Management of Mineral and Coal Mining (Minerba), in which the government provides a transition period of four months (September-December 2019) for foreign investors to adjust to the ban on exports of nickel ore with a grade below 1.7%; and proportionality, explaining the balance between the two interests with the aim of limiting arbitrary policies in the host country (PERATURAN MENTERI ENERGI DAN SUMBER DAYA MINERAL REPUBLIK INDONESIA NOMOR 11 TAHUN 2019, 2019). It must be clarified whether the right to regulate clearly controls the downstreaming process (minimizing negative impacts), then demands that the right to regulate clause has a clear purpose and does not intentionally harm foreign investors.

Both downstream regulations and the right to regulate have clear environmental standards, but in reality, these policies cause conflicts between economic and environmental interests. It should be noted that changes or new policies in the host country will indirectly affect the investment plans and profits of Chinese investors in Indonesia. However, on the other hand, the state also has the right to protect and fulfill its public and national interests through its policies based on the right to regulate. From this, we can see whether Chinese investors come to Indonesia solely based on legitimate expectations without any other considerations. This is certainly a special concern for the Indonesian government and a long-term assessment of investment relations with China. The legitimate expectations of Chinese investors certainly desire consistency in the rules in Indonesia until the agreement between the two parties is completed. However, it should also be noted that legitimate expectations must be considered reasonable. In the extractive sector, it is very clear that when foreign investors are proven to have caused environmental pollution, the host country has the right to regulate this without violating FET in any way. This was clarified by a firm statement from the Chairman of the National Economic Council, Luhut Binsar Pandjaitan, at the Critical Minerals Conference & EXPO on Thursday, June 5, 2025 (Dewi, 2025) that foreign investors who do not comply with environmental, social, and governance (ESG) aspects in the Indonesia Morowali Industrial Park (IMIP) area, Central Sulawesi, will have their agreements terminated. He added that if nickel downstreaming does not follow international standards, Indonesia and China will be blamed. Therefore, because this is an extractive sector, a clear legal basis and policy direction are needed, especially from the Indonesian government, in regulating investment flows in the country. Minister of Energy and Mineral Resources (ESDM) Bahlil Lahadalia also added that Indonesia's

nickel export value has increased significantly after the policy to stop nickel ore exports was implemented. Specifically, in 2017-2018, the value was US$3.3 billion, and it increased tenfold to US$35-40 billion in 2023-2024 (Uyun, 2025). This has strengthened the downstream regulations, one of which is to achieve Indonesia's economic interests.

3.2 Reorientation of the Legal Paradigm

The contradiction between legitimate expectations and the right to regulate has prompted the Indonesian government to reorient its legal paradigm. This was reinforced by the termination of the 1994 Indonesia-China BIT in 2015 (UNCTAD) and the formation of the 2024 BIT, which changed the focus of the Indonesian government from being investor-centric (Agreement Between the Government of the People's Republic of China and the Government of the Republic of Indonesia on the Promotion and Protection of Investments, 1994), which occurred because Indonesia at that time was trying to attract as many foreign investors as possible in order to boost Indonesia's development, especially its economy, to being development-centric, which tends to focus on national interests and domestic legal certainty. According to Dewi's analysis, the 1994 BIT tended to cause various problems based on instability rather than investor rights with the host country. She even emphasized that sometimes the claims made by investors actually burdened the economy of the host country (Dewi et al., 2024). Therefore, in 2024, a new BIT was issued containing five important points, including the right to regulate; limited ISDS; tighter investment; investor obligations; and transparency in the arbitration process.

As one of the largest investors in Indonesia, China has two main investment channels, namely BIT and the Belt and Road Initiative (BRI) related to technology transfer and infrastructure development in Indonesia (Leutert & Zachary, 2020). However, it should be noted that the characteristics of Chinese investment in Indonesia are often associated with Engineering-Procurement-Construction (EPC), which is closely related to labor, materials, and funding or capital from China itself. This then affects Indonesia's policy space because with new investment agreements from abroad, the Indonesian government may enter into a regulatory chill situation. Through Presidential Regulation Number 20 of 2018 concerning Foreign Workers (TKA), which regulates procedures and rules regarding work restrictions and training, the Indonesian government continues to protect Indonesian workers in anticipation of Chinese investors bringing large numbers of foreign workers to Indonesia (PERATURAN PRESIDEN NOMOR 20 TAHUN 2018, 2018). This regulation became effective on the management of foreign workers focusing Chinese workers in Chinese companies in Indonesia.

It should be noted that laws cannot be formulated as something rigid, especially in investment situations. On the one hand, this explains that investors must also be dynamic in understanding how standards in the host country (e.g., ESG) (Scott & Petrick, 2025) will always evolve over time, and this does not constitute a violation of the FET principle or other principles. This is also closely related to legitimate expectations and how Indonesia has also experienced a shift from static stability to dynamic stability as a form of adaptation and not a violation. This then redefines legitimate expectations. The understanding that Indonesia will continue to experience changes in the industrial sector certainly does not preclude the Indonesian government from making changes or issuing new policies in accordance with public and national interests. Legitimate expectations cannot be a standard for foreign investors to see how "stable" the regulations are in the host country, and become the basis for a lawsuit that there has been a violation of the investment treatment clause. However, legitimate expectations should instead be changed so that downstream regulations should be considered a new standard and ESG a prerequisite for investing in Indonesia. The right to regulate is important and must have a strong basis, otherwise it could sacrifice the public and national interests of

Indonesia. The right to regulate not only encourages foreign investors to implement downstream regulations but also "forces" foreign investors to comply with ESG as a form of compliance with the laws of the host country.

It should be noted that reorienting the legal paradigm does not always focus on newly enacted laws, but rather on changes in how the essence of the law is viewed. This explains Prof. Edward Omar's statement that law is an art of interpretation, whereby the law does not take sides and does not explain that right will prevail and wrong will lose, but rather depends on the perspective of the reader, which will produce diametrically different results. This forms the basis of this analysis to use Law Number 6 of 1974 concerning Basic Provisions on Social Welfare, which emphasizes that investment should not only focus on economic interests but also on the welfare of the people (public interest). Rdr. Hery Susanto, S.Pi., M.Si. as the member of Ombudsman RI explains if Indonesian natural resources can be handle effectively, it will positively affecting the economic growth and social welfare in Indonesia. Focusing on management, Indonesia will create a vast job vacancies (Ombudsman Republik Indonesia, 2025). This law is a strong reason for the Indonesian government's right to regulate and to continue to pay attention to social welfare in relation to investment with China. The law clearly prohibits the protection of foreign investors if the investment is indicated to or has already hindered the welfare of the people in the host country. Law Number 6 of 1974 Article 2 emphasizes that the state is obliged to regulate the downstream industrial sector so that there is no exploitation or pollution and its impact can damage the welfare of the people (UNDANG-UNDANG REPUBLIK INDONESIA NOMOR 6 TAHUN 1974, 1974). Then, the balance between economy and ecology (national interests and public interests) becomes important in the process of reorienting the legal paradigm. This law is a strong basis for stating that downstream regulations that have a negative impact on the environment are also considered to violate the principle of social welfare. Looking at the legal situation in Indonesia indirectly explains that the right to regulate clause is very important because by using this clause, the Indonesian government can use and issue new policies that not only focus on economic interests but also other aspects such as employment, the environment (ecology), and social welfare.

The increase in Chinese investment amid the strict regulations of Law Number 3 of 2020 proves that the reorientation of the legal paradigm through downstream regulations does not hinder capital inflows but rather directs investment to higher quality sectors. This synergy is reinforced by Law No. 6 of 1974, which views the utilization of low-grade nickel through China's HPAL (High Pressure Acid Leaching) technology as an effort to protect social welfare and public health from the impact of industrial waste. China GEM with Indonesian sovereign wealth fund Danantara develop a $1.42 billion high-pressure acid leaching (HPAL) smelter facility in Indonesia (TechNode Global, 2025). For 2025 investment, they both also invested 8. Billion US dollars in Indonesia (Sulaiman, 2025).

The fact that this technology is able to bridge economic needs (downstreaming) (Sinaga, 2024) and social responsibility (health) provides legitimacy for Indonesia to transform the right to regulate clause so that it remains in line with national social welfare objectives without damaging the international investment climate. The reorientation of Indonesia's legal paradigm is a solution in overcoming the tension between legitimate expectations and the right to regulate.

The reorientation of the legal paradigm ultimately explains that the law, which initially tended to be 'rigid' and focused only on one thing (investor protection) in order to attract many foreign investors to Indonesia, has now shifted its function to balance the rights of investors with public and national interests. What I want to emphasize in this section is that when a medium (country) undergoes change, the laws that form the basis of that medium must also be able to adapt. The question is, even when the law can and may undergo a reorientation process, should the legitimate expectations of investors also be able to understand this situation? of course, this argument is not baseless, but is

clearly regulated in the right to regulate clause, which clearly states that the state has absolute rights to the protection of its domestic laws.

It should be noted that the right to regulate clause used by the Indonesian government to achieve some of its interests is actually part of the international agreement itself. Therefore, based on Lex Specialis Derogat Legi Generali, which emphasizes that specific rules override general rules, the right to regulate clause is part of Lex Specialis itself. Thus, the right to regulate clause is not part of Indonesian domestic law but rather part of the international agreement. This shows a shift in meaning between traditional law and modern law. In the international investment agreement system, there is no absolute answer in determining between the right to regulate clause and investor protection; the focus is on finding a balance between the two.

3.3 Non-Discriminatory Treatment

The Indonesian government's downstream regulations must be based on the principle of non-discrimination. This means that there will be no distinction between investors on any basis. It should be emphasized that the Indonesian government needs to ensure that there are no indications of deliberately harming Chinese investors in particular. With clear equal treatment from the host country, if a lawsuit is filed due to indications of Indonesia's violation of the FET principle, the lawsuit will be weak in the eyes of international law. Mitchell, in his journal article entitled "Non-discrimination and The Role of Regulatory Purpose in International Trade and Investment Law," explains that this principle of non-discrimination provides protection for investors from the host country's tendency to prioritize domestic industries, and it must be clear that this is protection from the possibility of discrimination by the host country solely because of the status of foreign investors (Mitchell et al., 2016). Investor status here refers to the "special" relationship between Indonesia and certain countries that are considered to be able to provide special treatment in the investment process. Therefore, this non-discriminatory treatment is a requirement and limitation so that Indonesian rules and laws have clearer standards in the international community and are not abused.

As one of the largest countries investing in Indonesia, China naturally tends to monitor how the Indonesian government applies the principle of non-discrimination to China, other countries, and domestic investors. Based on Law Number 25 of 2007 concerning Investment, Article 3 paragraph 1 explains the principles of specific investment in point d, which states, "equal treatment and no discrimination based on country of origin" (UNDANG UNDANG REPUBLIK INDONESIA NOMOR 25 TAHUN 2007, 2007). This clearly emphasizes that discrimination between foreign investors (all countries) investing in Indonesia is clearly regulated in this law.

This principle is explained in two clauses, namely Most Favored Nation (MFN) and National Treatment (NT). MFN explains that the Indonesian government will not discriminate between investors (for example, different tax incentives), unless there is a special agreement between the two countries (exception clause) (*Exception Clause Clause Samples | Law Insider*, n.d.). Then NT emphasizes that there is no distinction between foreign investors and domestic investors without exception. These two clauses explain that there are two perspectives used as the basis for applying the principle of non-discrimination, namely between foreign investors themselves, and between foreign investors and domestic investors.

When linked to the downstream regulations, this actually causes a conflict of interest. The downstream regulations, and in particular the ban on nickel ore exports, indirectly discriminates against foreign investors engaged in raw materials. Therefore, the principle of non-discriminatory treatment requires a right to regulate clause from the Indonesian government to issue downstream regulations based on public interests (environment, health, and others) and not as a form of discrimination. This is also related

to the reorientation of the legal paradigm that this principle is not only a form of investor protection but also a balancing tool between protection and public interests.

4. Conclusions

The dynamics of Indonesia's investment relations with China in the smelter sector often emphasize sharp legal antinomies, namely between domestic law and the rigidity of international investor protection norms. Given this situation, there is an urgent need for the right to regulate clause to be internalized into the Indonesian legal paradigm. This emphasizes the balance between legitimate expectations and public interests. Then, calculated from the end of the Indonesia-China BIT with a 10 year investor protection period, which means in 2025 (10 years after 2015) (*Bilateral Investment Treaties (BITs)*, 1994), the Indonesian government is in a dilemma regarding the immediate formation of a new BIT under the right to regulate clause, particularly related to downstream regulations. While consistently adhering to the principle of non-discrimination, the Indonesian government is striving to create clear legal instruments to minimize any indications of violations in investment agreements while maintaining industrial policy sovereignty. The transformation of this clause is important to ensure the downstream regulations have strong legal legitimacy and proportional legal certainty for Chinese investors.

At the end, this analysis imply procedural reframing focusing on Indonesia as the host country that have a clear right to decide whether a domestic policy (ex. Regulation of the Minister (Permen) of Energy and Mineral Resources (ESDM) Number 11 of 2019) have a strong fundamental on economic security without any future intervention from arbitrate judges; interpretative reframing to decide judges must use standard of review as a form of respect to host country, and not just focusing on FET; the third one is substantive reframing to add downstream and national economic growth as the law object on BIT, and the act or decision of a host country will not label as intervention.

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