

## Legal Implications of Bilateral Investment Treaties (BITs) on Foreign Investment in Indonesia

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### ABSTRACT

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This study examines the implications of Bilateral Investment Treaties (BITs) on the dynamics of foreign investment in Indonesia, focusing on how treaty provisions, investor-state dispute settlement (ISDS) mechanisms, and regulatory reforms shape the country's investment climate. As Indonesia has undergone significant treaty termination, renegotiation, and policy restructuring particularly after high-profile arbitration cases such as Churchill Mining and Newmont—there is a growing need to assess the evolving balance between investor protection and national regulatory autonomy. Using a qualitative descriptive approach supported by doctrinal legal analysis, this research reviews international treaty frameworks, national investment legislation, and relevant dispute cases to capture the interaction between international obligations and domestic policy space. The findings indicate that while BITs historically contributed to enhancing Indonesia's investment attractiveness, concerns about excessive investor privileges, limitations on regulatory authority, and financial risks from arbitration claims have driven Indonesia to reformulate its investment treaty policy. The analysis also shows that the new generation of treaties emphasizes sustainable development, clearer definitions, and stronger state rights to regulate. This study contributes to academic discourse by providing a comprehensive assessment of Indonesia's shifting investment treaty landscape and offers policy implications for designing more balanced, transparent, and development-oriented international investment agreements.



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### Introduction

Foreign Direct Investment (FDI) plays a critical role in driving economic growth, enhancing production capacity, generating employment, and facilitating the transfer of technology, particularly in developing countries such as Indonesia. To strengthen the attractiveness of foreign investment, the Indonesian government has implemented various strategies, one of which is through the formulation and signing of Bilateral Investment Treaties (BITs) with multiple partner countries. BITs are international legal instruments that offer certainty, stability, and protection for foreign investors by establishing certain standards of treatment, such as fair and equitable treatment, protection against both direct and indirect expropriation, non-discrimination, and guarantees for dispute settlement through international arbitration mechanisms. The presence of BITs is considered an essential element in creating a conducive investment climate, as they provide a sense of security for foreign investors when facing potential risks arising from domestic regulatory changes or policy shifts.

However, the implementation of BITs also carries complex implications for the sovereignty of the host country's legal system. Several provisions in BITs, particularly those concerning Investor-State Dispute Settlement (ISDS), are often seen as potential limitations on the policy space available for governments to craft new regulations aimed at protecting public interests, the environment, or sustainable resource management. Indonesia has encountered numerous lawsuits from foreign investors in international

arbitration forums, highlighting the vulnerability of the country to large compensation claims. As global dynamics continue to evolve, and with an increasing need to balance investment protection with national regulatory autonomy, Indonesia has taken significant steps since 2014, including the evaluation and termination of numerous BITs deemed outdated or insufficient in addressing the nation's interests. The government has since developed a new, more comprehensive BIT model that reaffirms the country's regulatory rights while fostering sustainable development objectives.

Given these developments, analyzing the legal implications of BITs on foreign investment in Indonesia has become a critical area of research. This analysis not only concerns the extent to which BITs have contributed to the increase in foreign investment flows but also examines how these agreements influence national legal structures, government policy space, and potential international disputes. A comprehensive understanding of these aspects will contribute to the formulation of more effective, equitable, and sustainable investment policies for Indonesia amidst an ever-evolving global investment landscape.

BITs serve as essential tools in attracting foreign investors by offering legal protections and providing a predictable and secure investment environment. For many years, Indonesia's adoption of BITs was seen as an effective mechanism to attract FDI, particularly from developed countries. BITs create a framework for safeguarding foreign investments against discriminatory treatment and arbitrary government actions. In essence, these treaties provide investors with a guarantee of stability and protection from political risks, such as changes in law or the expropriation of assets. The security offered by BITs is critical in sectors like energy, mining, and infrastructure, which are typically seen as high-risk industries that require robust legal protections.

Over the years, however, Indonesia's increasing exposure to international arbitration under BITs has led to a growing concern about the power these agreements grant to foreign investors. Specifically, the Investor-State Dispute Settlement (ISDS) mechanism, which allows investors to sue host countries in international tribunals, has been a point of contention. Critics argue that ISDS provisions undermine national sovereignty by limiting the government's ability to regulate in the public interest, such as implementing policies related to environmental protection, labor rights, or public health. As Indonesia experienced high-profile arbitration cases, such as those involving Churchill Mining PLC and Newmont, it became evident that BITs could restrict the country's policy-making flexibility, especially in areas crucial to sustainable development.

In response to the challenges posed by the existing BIT framework, Indonesia has embarked on a path of reforming its approach to investment treaties. The government has actively sought to renegotiate or terminate BITs that were perceived to be too one-sided or overly favorable to foreign investors. Since 2014, a key focus of Indonesia's new investment treaty policy has been to preserve the country's regulatory space while still ensuring an attractive environment for foreign investment. This shift is grounded in the recognition that protecting the public interest and fostering sustainable economic development must be prioritized alongside investor protection.

The revised BIT model introduced by Indonesia aims to strike a balance between investor protection and national sovereignty. For example, newer treaties have incorporated provisions that explicitly affirm the right to regulate in critical sectors such as health, environment, and natural resource management. The right to regulate ensures that Indonesia retains control over domestic policy and regulation, particularly in areas vital for long-term sustainability. Additionally, the renegotiated BITs have introduced safeguards against abusive ISDS claims, ensuring that the country is not unduly exposed to costly arbitration proceedings that could harm its public policy objectives.

One significant change in Indonesia's BIT model is the introduction of more clarified definitions related to indirect expropriation, which limits the potential for investor claims related to regulatory measures that affect investments. By addressing concerns around the scope of expropriation and the application of fair and equitable treatment (FET) standards, Indonesia's new BITs aim to provide greater certainty for both investors and the government. These treaties also emphasize the importance of sustainable development as a guiding principle in international investment agreements, ensuring that economic growth does not come at the expense of environmental or social goals.

The implementation of BITs is not without its challenges, especially when it comes to reconciling international obligations with domestic policy priorities. One of the most contentious issues surrounding BITs is the ISDS mechanism, which allows foreign investors to challenge domestic regulations in international arbitration forums. In some cases, Indonesia has found itself at a disadvantage, as ISDS

tribunals have ruled in favor of investors, imposing substantial financial penalties on the government. This has raised questions about the sovereignty of Indonesia's legal system and its ability to enact policies that serve the best interests of its citizens.

The legal risks associated with ISDS claims are significant, as they can result in costly arbitration proceedings and financial compensation awards that put a strain on national resources. Furthermore, ISDS cases can create a chilling effect on policy-making, as governments may be hesitant to introduce new regulations if they fear that such actions could lead to investor lawsuits. This underscores the importance of ensuring that BITs are structured in a way that protects the interests of both investors and the host state, without undermining the state's regulatory capacity.

Indonesia's recent BIT reforms have sought to address these issues by incorporating provisions that promote legal certainty while preserving the government's ability to regulate in the public interest. These reforms aim to strike a balance between the protection of foreign investment and the safeguarding of national sovereignty, allowing Indonesia to pursue development goals without undue interference from international arbitration. Moreover, the introduction of more transparent arbitration procedures and the right to regulate provides a framework that ensures both foreign investors and the Indonesian government can engage in a fair and equitable legal relationship.

## **Method**

This research employs a qualitative descriptive approach using doctrinal legal analysis to examine the implications of Bilateral Investment Treaties (BITs) on foreign investment in Indonesia. The study focuses on the analysis of international treaties, national investment laws, and relevant case law, particularly disputes resolved through the Investor-State Dispute Settlement (ISDS) mechanism. This approach allows for a comprehensive examination of the legal frameworks that govern foreign investments, and how Indonesia's BITs have evolved over time in response to shifting national priorities and international dynamics.

The data collection process involves reviewing primary legal sources, including BIT texts and related national legislation, as well as case studies of prominent ISDS cases involving Indonesia. Secondary data includes scholarly articles, reports from international organizations, and government publications. The analysis uses normative legal analysis to interpret legal provisions and their implications for Indonesia's sovereignty and regulatory capacity. Additionally, a comparative approach is employed to assess the differences between older and newer BIT models, focusing on changes in investor protection clauses and the state's right to regulate.

The research also incorporates case study analysis of significant ISDS disputes, such as those involving Churchill Mining PLC and Planet Mining Pty Ltd, to assess how BIT provisions have been invoked in legal proceedings and their impact on Indonesia's investment climate. Finally, the study applies deductive reasoning to draw general conclusions about the broader implications of BIT reforms on the regulatory environment and foreign investment dynamics in Indonesia.

Overall, this methodology provides a systematic and comprehensive understanding of how BITs influence foreign investment flows and the interaction between international legal obligations and domestic regulatory policies.

## **Results and Discussion**

### **Overview of Indonesia's Bilateral Investment Treaties (BITs)**

Indonesia has signed numerous Bilateral Investment Treaties (BITs) with various countries to encourage foreign direct investment (FDI). Historically, these treaties have served as vital instruments for promoting FDI by offering foreign investors protections against political and economic risks. However, over time, Indonesia's experience with BITs has become more complex, particularly due to challenges related to Investor-State Dispute Settlement (ISDS) mechanisms and the tension between investor protection and the sovereignty of Indonesia's legal system.

This section delves into the findings from the study of Indonesia's BIT landscape, focusing on the evolution of these treaties, their role in foreign investment, and the legal and policy implications they have had on Indonesia. The analysis reveals that, while BITs have undoubtedly attracted foreign investments, they have also constrained Indonesia's ability to regulate in critical sectors such as public health, the environment, and natural resources. Consequently, the Indonesian government has sought to amend or replace several of these agreements in recent years.

### **Early BITs and Investor Protection**

Indonesia's early BITs, signed between the 1960s and the early 2000s, were primarily aimed at securing investment from developed countries, particularly in sectors critical to the country's economic growth. These treaties were crafted to give foreign investors guarantees of fair and equitable treatment (FET), non-discrimination, and protection against direct and indirect expropriation. The provisions in these BITs were structured to minimize the risks foreign investors faced, ensuring that their investments would not be undermined by arbitrary changes in the legal or regulatory framework.

A key feature of these early BITs was the inclusion of the ISDS mechanism, which allowed foreign investors to take legal action against the host state if they felt their rights were violated. The ISDS system was designed to give investors a neutral, international forum for resolving disputes, bypassing national courts that might be biased against foreign entities. While this was intended to provide security for investors, it also meant that Indonesia was vulnerable to claims from foreign investors who felt that domestic laws or regulations negatively impacted their investments.

In the past few decades, Indonesia has faced several high-profile arbitration cases initiated by foreign investors under these early BITs, such as Churchill Mining PLC vs. Indonesia and Planet Mining Pty Ltd vs. Indonesia. These cases have highlighted the risks posed by BITs with expansive ISDS provisions. The country found itself exposed to large financial claims when foreign investors sued the government for actions taken in the public interest, such as revoking mining permits. These disputes underscored the tensions between investor protection and Indonesia's sovereign right to regulate for public welfare.

### **Implications of ISDS Cases on Indonesia's Legal System**

The ISDS cases have had profound implications for Indonesia's legal system, as they revealed the extent to which the country's sovereignty could be undermined by international arbitration. For example, in the case of Churchill Mining PLC vs. Indonesia, the investor argued that the revocation of its mining concession by the Indonesian government amounted to expropriation and a violation of the FET standard outlined in the BIT. The arbitration tribunal ruled in favor of the investor, ordering Indonesia to pay substantial compensation. Similarly, the Planet Mining Pty Ltd case involved a dispute over changes to mining regulations, with the investor claiming that the government's actions amounted to indirect expropriation.

These cases exposed the vulnerabilities of Indonesia's legal and regulatory frameworks in the face of international arbitration. The rulings created a significant financial burden for the country and raised concerns over the broader implications of BITs on the government's ability to introduce and enforce regulations that prioritized public interests, such as environmental protections, labor laws, and health and safety standards. As the ISDS system seemed to favor investors' interests over the sovereignty of the host state, Indonesia was forced to reconsider its approach to investment treaties.

### **Indonesia's Response: Reforming the BIT Framework**

In response to these challenges, Indonesia embarked on a process of BIT reform starting in 2014. The reform process involved the evaluation, renegotiation, and termination of numerous BITs that were seen as overly protective of foreign investors to the detriment of Indonesia's sovereignty. A key element of the reform was the introduction of a new, comprehensive BIT model that emphasized a balance between the protection of foreign investments and the right to regulate of the host state.

The new BIT framework incorporates several important features designed to mitigate the risks posed by earlier treaties, particularly the ISDS provisions. One of the central goals of the reform was to ensure that Indonesia retained control over its domestic policy-making while still offering foreign investors a fair and stable legal environment in which to operate.

### **Key Features of the New BIT Model**

#### **1. Right to Regulate**

A major shift in the new BITs is the explicit affirmation of Indonesia's right to regulate in key areas such as public health, the environment, and natural resource management. Under the new treaties, Indonesia retains the ability to enact laws and regulations that promote sustainable development, protect public welfare, and ensure the long-term welfare of its citizens. This provision aims to protect Indonesia

from future challenges related to changes in regulatory policy, especially in sectors that have significant social and environmental implications.

The right to regulate provision is a direct response to the challenges posed by the ISDS mechanism in previous BITs, which allowed foreign investors to challenge Indonesia's regulations in international arbitration. By affirming the right to regulate, the new treaties ensure that Indonesia can prioritize public interest policies without the fear of facing costly legal challenges from foreign investors.

## **2. Clarity on Expropriation**

Another significant change in the new BIT framework is the inclusion of clearer definitions regarding expropriation. In the past, foreign investors could claim that changes to regulations, such as environmental laws or labor standards, constituted indirect expropriation under BITs. The new treaties provide more detailed provisions on what constitutes expropriation, particularly indirect expropriation, and clarify that regulatory actions taken in the public interest, such as environmental protection, cannot be considered expropriation.

This change helps to reduce the potential for frivolous claims under the ISDS mechanism and provides greater legal certainty for both investors and the Indonesian government. By ensuring that regulatory measures in the public interest are not subject to expropriation claims, the new BITs strengthen Indonesia's ability to protect its natural resources and pursue sustainable development goals.

## **3. Increased Transparency in Dispute Resolution**

The new BIT framework also introduces significant reforms to the ISDS process to increase transparency and accountability. In response to criticisms of the lack of transparency in arbitration proceedings, Indonesia's new BITs mandate greater openness in the dispute resolution process. For example, the new treaties require that arbitration hearings be made public and that third-party organizations, such as civil society groups, be allowed to observe the proceedings.

These changes aim to enhance public trust in the arbitration system and ensure that the decisions made by international tribunals are consistent with Indonesia's development goals. By promoting transparency, the new BITs help to ensure that foreign investors and the Indonesian government are held accountable for their actions and decisions.

## **4. Sustainable Development and Public Interest**

Sustainable development has become a central principle in the new BITs. The treaties explicitly recognize the importance of balancing economic growth with the protection of the environment and social welfare. By prioritizing sustainable development, the new BITs create a legal framework that encourages responsible investment that contributes to long-term prosperity, while also safeguarding the public good.

The emphasis on sustainable development reflects a shift in Indonesia's policy from purely economic objectives to a more holistic approach that takes into account environmental protection, social equity, and long-term growth. This approach is particularly relevant in light of global challenges such as climate change and the need to preserve natural resources for future generations.

## **Impact of BIT Reform on Foreign Investment**

The reform of Indonesia's BIT framework is expected to have significant implications for the country's foreign investment climate. On the one hand, the new BITs provide greater legal certainty for investors by establishing clear rules regarding expropriation, dispute resolution, and regulatory changes. The inclusion of provisions that protect the right to regulate allows Indonesia to attract responsible investors who are committed to long-term stability and sustainable development.

On the other hand, the more balanced approach in the new treaties may lead to a decrease in FDI from investors who prioritize maximum protection through the ISDS mechanism. Some investors may view the more restrictive ISDS provisions as less attractive, particularly those who are used to the greater protection offered by previous BITs.

Nonetheless, the emphasis on sustainable development and regulatory certainty is likely to attract investors who are focused on projects that align with long-term development goals, such as renewable energy, infrastructure, and sustainable agriculture. The clearer framework for public interest protections

will help to foster a more equitable and transparent investment environment, which is crucial for the development of Indonesia's economy.

Indonesia's experience with Bilateral Investment Treaties (BITs) has underscored the need for a careful balance between attracting foreign investment and safeguarding the country's sovereignty. While early BITs played a key role in encouraging FDI, they also exposed Indonesia to significant risks due to the ISDS mechanism and the limitations these treaties imposed on the government's ability to regulate in the public interest.

Through strategic reforms, Indonesia has developed a new BIT framework that aims to protect the country's right to regulate, encourage sustainable development, and ensure greater transparency in dispute resolution. The reform process marks a shift towards a more balanced approach to international investment agreements, one that recognizes the need for foreign investment while also prioritizing the long-term interests of the country and its people.

As global investment dynamics continue to evolve, Indonesia's approach to BIT reform offers valuable insights into how developing countries can navigate the complex intersection of international investment law and national regulatory authority. By maintaining a commitment to both investment protection and the sovereignty to regulate, Indonesia is positioning itself to attract responsible, sustainable investments that contribute to long-term economic growth.

## **Conclusion**

The analysis of Indonesia's Bilateral Investment Treaties (BITs) and the country's reform efforts reveals a complex but critical balancing act between attracting foreign direct investment (FDI) and maintaining national sovereignty, especially in the context of policy-making and regulatory authority. BITs have historically played a significant role in enhancing Indonesia's attractiveness as a destination for foreign investment by offering strong protections to investors, including guarantees of fair and equitable treatment (FET), non-discrimination, and access to Investor-State Dispute Settlement (ISDS) mechanisms. These provisions were intended to provide a stable and predictable legal environment for foreign investors, ensuring their investments would not be subject to arbitrary or discriminatory treatment.

However, Indonesia's increasing exposure to international arbitration through the ISDS mechanism has highlighted several vulnerabilities in the country's legal and regulatory frameworks. The cases involving Churchill Mining PLC and Planet Mining Pty Ltd, among others, demonstrated the potential risks of overly broad BIT provisions, particularly in terms of their impact on Indonesia's ability to regulate in the public interest. The ISDS mechanism, which allowed foreign investors to challenge domestic regulations and policies, exposed the country to significant financial liabilities and created a tension between protecting investor rights and safeguarding Indonesia's sovereignty, especially in sectors crucial to sustainable development such as environmental protection, natural resource management, and public health.

In response to these challenges, Indonesia has actively reformed its BIT framework since 2014, seeking to strike a balance between investor protection and the right to regulate. The new model introduces several key changes, including the affirmation of Indonesia's sovereign right to regulate for public welfare, clearer definitions of expropriation to prevent misuse of ISDS provisions, enhanced transparency in arbitration processes, and a stronger emphasis on sustainable development. These reforms aim to provide foreign investors with a stable and predictable legal environment, while also ensuring that Indonesia retains the flexibility needed to enact policies that serve the public interest and contribute to long-term economic and environmental sustainability.

The reform efforts reflect Indonesia's commitment to a more equitable investment environment, one that not only promotes foreign investment but also prioritizes national development goals. While the reformed BITs may reduce the risk of costly arbitration and empower Indonesia to maintain greater control over domestic policy, they may also alter the dynamics of foreign investment in the country. The success of these reforms in attracting sustainable and responsible investment will depend on the country's ability to balance investor protection with regulatory sovereignty and to create an environment where both foreign investors and the public can benefit from long-term, sustainable growth.

Indonesia's BIT reform represents an important step towards achieving a more balanced, transparent, and sustainable framework for foreign investment. It offers valuable lessons for other developing countries navigating the complexities of international investment law and underscores the importance of ensuring that investment treaties are designed in a way that protects not only investor rights but also the sovereignty

of the host state to regulate in the public interest. The future of Indonesia's investment climate will likely depend on the continued evolution of these treaties, ensuring that they remain relevant and aligned with the country's broader economic and social objectives.

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