Foreign Investment Legal Framework: Continuity & Changes

Prof. Erman Rajagukguk, S.H., LL.M, PhD *

*) Professor of Law, University of Indonesia

Over the last 39 years since the enactment of Act No. 1 of 1967 on Foreign Investment, legislation in the field of investment has undergone a number of changes. These changes have been induced by political factors, domestic economy and development in international economy, and are tending towards more liberal investment.
The following section attempts to explain the changes in regulation on investment in Indonesia which are related to ownership of national shares, the right of the minority shareholders, business opportunities for foreign investors, and licensing.

A. Joint Venture and Indonesianization of Equity

On January 15, 1974, coinciding with the arrival of Prime Minister Kakuei Tanaka, Jakarta was engulfed in demonstrations and riots. The riots caused burnings, especially on cars made in Japan. Many observers believe that the January 15, 1974 incident, which showed anti Japanese sentiment, pushed a change in the government's attitude to foreign investment. Only one week after the January 15 incident, the government announced a new policy on foreign investment, namely:

1. Foreign investment in Indonesia must be in the form of join venture with national capital.
2. National participation in old and new investment must be 51 % within a period of 10 years.
3. The foreign partner must fulfill the conditions for transfer of manpower to Indonesian employees.
4. The participation of Indonesian indigenous entrepreneurs in foreign investment and domestic investment must be bigger.

From the legal aspect, Act No. 1 of 1967 on Foreign Investment confers authority on the government to set up the period of commencement of transfer of shares to the national partner end how much national capital participation in the company. However, Act No. 1 of 1967 does not prohibit foreign investment made by a company whose entire shares are owned by foreigners. As a result of the resolution in the meeting of the Economic Stabilization Council on January 22, 1974 requiring foreign investment in the form of joint venture, this policy quietly amendment should have been made in the form of amendment to Act No. 1 of 1967, so that a regulation of a lower does not conflict with a Law as a result of this new policy.

On October 11, 1974, the Capital Investment Coordination Board (BKPM) issued a Circular Letter describing in a more detailed manner the policy, namely:

1. In the case of project taking a maximum period of 3 years in the project execution period, the increase of the national shares to become majority shares, shall be 51 % minimum, within a period of 10 years with effect from the date of the Business Permit of the Project issued by the technical department concerned.
2. In the case of projects taking more than 3 years in the project execution, the increase of national shares to become majority shares shall be 51 % minimum within a period of 10 years calculated from the middle date between the date of the Business Permit of the Project issued by the technical department concerned and the date of commencement of commercial production.
3. In the case of projects the Provisional Approval of which was issued prior to September 21, 1974, the increase of national shares to become majority shares shall be minimum 51 % within a period of 10 years, with effect from the date of ratification of the PT (Limited Liability Company) by the Department of Justice like what is applicable prior to the Presidential Instruction dated September 21, 1974.
4. In the case of projects the Provisional Approval of which had not been issued or had been issued after September 21, 1974, the provision of dictum 1 and dictum 2 above shall apply to the increase of national shares to become Majority, 51 % minimum.

Four months later, the Capital Investment Coordination Board (BKPM) issued another Circular Letter providing clarification on the earlier Circular Letter, namely:

1. The guidelines contained in Circular Letter No. B-1195/A/BKPM/X/1974 dated October 11, 1974 shall be applicable only to foreign investment the Provisional Approval/Approval in Principle of which from the BKPM was issued since September 21, 1974. Thus foreign investment:
   a. which has obtained the approval of the President prior to February 1974, either in the form of direct foreign investment or in the form of joint venture, prior to being burdened with the regulation on participation and increase of national shares reaching the majority status. In this case, the increase of national shares approved by the Government continues to be calculated as of date of ratification of the corporate body by the Department of Justice.
   b. what was approved by the President between February 1974 and September 21, 1974 was the increase of national shares reaching the majority level within of period of not later than 10 years still calculated since the date of ratification of the corporate body by the Department of Justice.
   c. a company the Provisional Approval of which from the BKPM was issued prior to September 21, 1974, the increase of national shares to become majority shares shall also be taken into account since the date of ratification of the corporate body by the Department of Justice.
2. As another alternative, it can also be designated that the date of commencement of the period of national share increase is the date of issuance of the Presidential Approval Letter.
3. In the case of foreign investment projects of a special nature viewed from the aspect of the business sector, the amount of investment, the level of technology applied, the absorption of manpower, the location, and soon, the Government may consider an amendment on the obligation to increase national shares participation to become majority shares within a period as described above.

In conclusion, the minimum condition for increase of national shares must be implemented by foreign investments in Indonesia. However, the Government appears not to be in a hurry to sell in fulfilling the obligation, and even opens again the possibilities for amendment to the policy itself on a project-to-project basis.

On July 1, 1981, six years later, the Capital Investment Coordination Board (BKPM) issued internal guidelines on the increase of national shares, linking it also to be the development of the Capital Market and Cooperative Societies. These new guidelines states amongst others:

1. Foreign Investment Companies, either those whose 100% shares are owned by foreigners or in the form of join venture company, having obtained the Presidential Approval prior to September 21, 1974:
   a. shall be obliged to fulfill the condition for increase of the national shares in accordance with the provisions laid down in Government Approval Letter as a continuation of the aforesaid Presidential Letter of Approval. The obligation for the increase of the national shares shall take effect since the time of commencement of commercial production, unless the Approval Letter from the Government determines otherwise.
   b. it is requested to make the best efforts so that by December 31, 1981 the position of ownership of national shares shall become a minimum of 30% of the number of shares paid-in and placed, unless the Letter of Approval from the government determines otherwise.
2. Foreign investment join-venture companies obtaining Presidential approval after September 21, 1974 are obliged to increase their national shares up to 51 % of the paid-in and placed shares in the fifth year through the tenth year since the commencement of the commercial production, unless the Government Approval Letter stipulates otherwise.
3. Foreign investment companies, whether those whose shares are 100% owned by foreigners or those in the form of join-ventures, which increase the share capital for the purpose of expansion, are obliged to sell 51 % of the additional share capital to the national participants starting in the fifth year through the tenth year since the commencement of commercial production of the expansion project, unless the Government approval serving as the basis stipulates otherwise.
4. Particularly in the forestry sector in accordance with Presidential Decree No. 20 of 1975, foreign investment companies holding Forest Concession (HPH) are obliged to transfer 51% of ownership to national companies not later than a period of 10 years since the issuance of the Forest Concession (HPH).
5. Unless stipulated otherwise, at least 20% of the shares of foreign investment companies must already constitute national participation since the incorporation of the companies. In case of expansion, the 20% shall be calculated from the share capital increase. Particularly in the case of plywood industry, the national participation stipulation is 51%.
6. Included in the definition of national participation is share capital participation in foreign investment companies by:
   a. National individual.
   b. National company.
   c. Cooperative Societies.
   d. Non-bank financial institution.
   e. BAPINDO.
   f. National individual or company through the capital market (through the go-public method).
7. For the purpose of giving a bigger role to the cooperative societies movement from time in the future, unless there is the right pf first refusal on the part of the existing national shareholders, it is recommended that for the purpose of increasing the national shares, the cooperative societies shall be given the widest possible opportunity.

In connection with cooperation with national capital, Act No. 1 of 1967 only lays down the general conditions regarding cooperation between foreign capital and national capital, by mentioning that in the business sectors that are open to foreign capital cooperation may be established between foreign capital and national capital. The Government further designates the business sectors, forms and methods of foreign expertise capital in the export sector and the sector of production of goods and services. This condition is interpreted not as a requirement for the existence of cooperation between foreign capital and national capital in the business sectors that are open to foreign investment. This interpretation is further strengthened with the issuance of Instruction of the Cabinet Presidium No. 36/U/IN/6/1967 on the provision of special incentives for foreign investment establishing cooperation in the form of joint enterprise. By providing incentives again, it can be said that the Government tries to encourage foreign investment to be made in the form of joint venture voluntarily. If foreign investment is made in the form of joint venture, the Government shall gain provide incentives, namely: a joint-venture company may be exempted from the obligation to invest a minimum of 2.5 million dollars to get corporate tax and dividend tax exemption.

Additional corporate tax and dividend tax exemption can even be granted during one year, on the condition that the amount of exemption of the two taxes shall not exceed five years.

As in other developing countries, the Indonesian Government appears to prefer investment through a joint-venture system that enables national capital to participate, and thus such condition expedites the implementation of transfer of knowledge and skill in conducting business, and at the same time also reducing the danger of foreign domination in economy and industry. However, the Government is prepared to compromise because to find a national partner having the ability to cooperate with a foreign entrepreneurs is not an easy thing. The government is aware that not all national entrepreneurs are able to take part in capital placement and almost always can only participate with relatively small capital I joint-venture company with foreigners. Even in the mining sector which requires a big investment, practically there is no local partner with the capability to take part in investing in this sector.

Indonesia introduced deregulatory measure in various fields particularly those related to foreign investment. One of the measures was the possibility for foreign investors to own all the shares of the company they established. The latest provision of 100% investment can be found in Government Regulation No. 20 of 1994. Actually this provision had already existed in 1967 through Act No. 1 1967 on Foreign Investment, but it was banned in 1974 after the Malari incident as described earlier. Government Regulation No. 177 of 1992 provides for the following:

1. Entrepot areas whose products are 100% for exports, the provision is 100% ownership for a period of the first five years of commercial production. In the sixth year, there shall be national share participation (equity) of 5% at the minimum for Indonesia.
2. From large investment with a paid capital of 50 million American dollars, the provision is the 100% ownership for a period of the first five years. In the sixth year thereafter, there shall be national capital participation of 5% and this shall increase to 20% in the twentieth year.

For certain services or labor-intensive industries, or 65% export products or semi-finished goods of other industries, investment is made in the form of joint ownership between foreign and national investors with the following stipulation:

1. For certain services, the composition of shareholding at the time of establishment shall be 80% (foreign) and 20% (Indonesia), and 49% and 51% in the twentieth year.
2. For the following cases:
   - labor-intensive industries
   - 65% export products
   - Production of raw materials
   - Semi-Finished goods of other industries

The shareholding composition at the time of establishment shall be 95% (foreign) and 5% (Indonesia). In ten years' time the composition shall be 51% and 49%, and in twenty years' time 51% and 49%. In October 1993 the Government issued Government Regulation No. 50 of 1993. This regulation seemed bolder than the previous regulation in July 1992 particularly concerning divestment, which was always disputed by foreign investors. Government Regulation No. 50 of 1993 stipulates the following:

1. In entrepot areas with products for export purposes, foreign investment of 100% is provided for. For cases where 25% of the products is for domestic market, the composition becomes 80% and 20% in twenty years of commercial production.
2. For large investment with a paid capital of 50 million American dollar in certain areas, foreign investment of 10% is also provided for. Ownership becomes 49% and 51% in twenty years after ten years of commercial production.
3. Provision for 100% foreign investment is also made companies that produce auxiliary materials, semi-finished goods or components for other industries with a minimum capital of 2 million American dollars, with divestment of 49% and 51% in twenty years after ten years of commercial production.

For certain services with a minimum capital of 250,000 American dollars, investment is made in the form of joint ownership with a ratio of 80% : 20% which in twenty years becomes 49% : 51%. For labor-intensives (minimum 50 workers, 65% for export, or production of basic materials or semi-finished goods) the original composition of 95% : 5% becomes 80% : 20% in ten years, then 51% : 49% in twenty years. For other lines of business with a minimum capital of 2 million dollars, the original composition of 80% : 20% becomes 49% : 51% in twenty years. The participation of national (equity) capital in foreign investment can be done through direct ownership or the capital market.

The latest development in provision on foreign capital particularly Foreign Investment of 100% Joint Venture in Indonesia is Government Regulation No. 20 of 1994. In this regulation business activities that are important for the States and concerned with public services, such as production/transmission/distribution of electricity, telecommunications, shipping, airlines, drinking water, railways, power plant and mass media can be done in the form of joint venture between foreign investors and Indonesian citizens or legal entities with a shareholders composition of at least 5% of the paid capital for the Indonesian partner, and further increase in shareholding can be decided on through consensus. Foreign investment of 100% is also provided for by this regulation for business activities other than those mentioned above with the stipulation that within 15 years of commercial production, the foreign investor must sell part of this shares to the Indonesian citizen or legal entities.

Participation of the national (equity) capital in foreign investment under this regulation can be done through direct ownership or the capital market. What is special about Government Regulation No. 20 compared with the previous provision is that a transfer of foreign shares to national shares does not change the status of a company. In addition, the amount of capital invested by a foreign investor is determined on the basis of the economic feasibility of the business activity concerned and the investor is free to decide on the amount of the invested capital. The company's business activity can be carried on in any location within the jurisdiction of the Republic of Indonesia except in entrepot or industrial areas.

B. Minority Shareholder Rights

One of the problems in joint-venture companies is the relationship between the majority shareholders and the minority shareholders.

Act No. 1 of 1995 concerning Limited Liability Company confers certain rights on the minority shareholders. These rights are delegated because if problems in the company are referred to only the resolution of the General Meeting of Shareholders (GMS), then the majority shareholders will simply approve the resolution of the Board of Directors, the Board of Commissioners and a GMS because such matter is favorable to them. Thus the wrong actions or policies of the Board of Directors, the Board of Commissioners, and even the majority shareholders that are unfavorable to the minority shareholders, insofar as the matter in question is favorable to the majority shareholders through the GSM the process can go on. The law does not allow such matter by delegating certain rights to the minority shareholders. The rights of the minority shareholders can be divided into two. First the rights clearly stated and the second, the action that must obtain the approval of the minority shareholders. The rights clearly stated, namely the right to file claims on the company (Article 52 (2), the right to request GSM (Article 60 (1), the right on behalf of the company to sue the board of directors and the board of minority shareholder in merger, acquisition and consolidation as mentioned in Articles 104 (2) , 105 (1), and the right of the minority shareholder to request a court to investigate the company (Article 110 (3a).

The minority shareholders may sue the company on behalf of itself. Likewise the shareholders on behalf of the company may sue the Board of Directors and the Board of Commissioners.

Article 54, paragraph 2, states that each shareholders shall be empowered to sue the company at a District Court, if the shareholders feels it has suffered a loss because of an action of the company considered to be unfair and without proper reason as a of the resolution of a GMS, the Board of Directors or the Board of Commissioners.

This Article 54, paragraph 2 may be troublesome for the company because one shareholders feels he/she has suffered a loss because of the resolution of a GSM, the Board of Directors or the Board of Commissioners. A minority shareholders on behalf of the company may also sue the Board of Directors and the Board of Commissioners. Article 85 (3) states that, on behalf of the company, a shareholders representing at least 1/10 (one tenth) of the total number of shares with legitimate voting right may file a lawsuit at a District Court against a member of the Board of Directors for a mistake or negligence resulting in a loss to the company.

Furthermore Article 98 (2) states that, on behalf the company, a shareholder representing at least 1/10 (one tenth) of the total number of shares with legitimate voting right may file a lawsuit at a District Court against the Board of Commissioners which on account of a mistake or negligence has caused a loss to the company.

In the United States or in the Common Law system, the right of the minority shareholders to sue on behalf of the company is referred to as derivative action. The consequence is that if this lawsuit wins, all of the cost of the case including the lawyer fee shall be borne by the company.

The minority shareholders representing 1/10 (one tenth) of the total number of shares with legitimate voting right, or a smaller number as designed in the Article of Association of the company concerned may also request an annual GSM and for the benefits of the company may request an extraordinary GSM.

The GSM in question may only discuss the problems related to the reason why the GSM is being requested.

Article 67 states that,

1. The Chief Justice whose jurisdiction covers the domicile of the company may grant permit to the applicant to:
   a. make the summons to the annual GSM himself, at the request of the shareholders if the Board of Directors or the Board of Commissioners fails to convene the annual GSM at the designated time; or
   b. make the summons to the other GSM himself, at the request of the shareholder as referred to in Article 66, paragraph (2), if the Board of Directors or the Board of Commissioners after a period of 30 (thirty) days with effect from the time of submission of the request has elapsed does not make the summons to the other GSM.
2. The Chief Justice of the District Court referred to in paragraph (1) may designate the format, contents, and period of summons to the GSM and appoint the Chairperson of the meeting without being bound to the provisions of this Law or the Article of Association.
3. In case the GSM is held as referred to in paragraph (1), the chief Justice of the District Court may instruct the Board of Directors and/or the Board of Commissioners to be present.
4. The ruling of the Chief Justice of the District Court on the issuance of the permit referred to in paragraph (1) shall constitute a ruling of the first and last level.

Each shareholder shall be empowered to request to the company that the shareholder's shares be purchased at a reasonable price, if the shareholder concerned does not accept the action of the company that is unfavorable to the shareholder or the company, in the form of:

a. amendment to the Article of Association;
b. sale, placing as collateral, exchange of most or all of the assets of the company; or
c. merger, consolidation, or acquisition.

Article 104, paragraph 1, further states that the legal action of merger, consolidation, and acquisition of the company must observe the interest of the minority shareholders.

Paragraph 2 states that merger, acquisition and consolidation of the company shall be without prejudice to the right of the minority shareholders to sell the shares at a fairs price.

Based on Article 110, paragraph 3a, a shareholder on behalf of itself or on behalf of the company if representing at least 1/10 (one tenth) of the total number of shares with legitimate voting right may request an investigating on the company to obtain data or information in case there is suspicion that:

a. the Company has committed an act against the law that is unfavorable to the shareholders or third parties; or
b. a member of the Board of Directors or the Board of Commissioners has committed an act against the law that is unfavorable to the company or the shareholders or third parties.

The investigation referred to in paragraph (1) shall be conducted by submitting an application in writing together with the relevant reasons to the District Court whose jurisdiction covers the domicile of the company. Article 86 (3) confers the right also on a minority shareholder to inspect the accounting records of the company. For this purpose, the shareholder concerned must submit an application in writing to the Board of Directors.

Dispute settlement through the District Court as required by Act No. 1 of 1995 on Limited Liability Companies restricted the freedom of the parties in dispute to settle their cases through arbitration. In 1982, in the case of Ahyu Forestry Company United v. Sutomo, 2924 K/SIP/1981, the Supreme Court decided that the District Court had no authority to deal with the case because both parties in the Joint Venture Agreement had chosen arbitration for settlement of their dispute. According to the

Supreme Court, a legitimate agreement is law to both parties. If this case had been filed after the enactment of Act No. 1 of 1995, the Supreme Court would have had a different view. Therefore, in drawing up a joint venture agreement, an arbitration clause should be clear because according to Act No. 1 of 1995, dispute between shareholders and the Board of Directors or Commissioners must be settled trough the District Court.

C. Business Opportunities for Foreign Investors

Article of Act No. 5 of 1967 on foreign Investment provides that the Government shall specify the kinds of business opportunities for foreign investors on a scale of priority and determines the requirements to be fulfilled by foreign investors in each business opportunities. In implementing this article, the Government has made an annual renewal on the list of business opportunities for foreign investors. It appears that the range of business opportunities is becoming more extensive.

Presidential Decree No. 6 of 1998 on the kind of business undertaking that are closed to foreign investors states two categories. First, undertakings absolutely closed for investment in the primary sector include the cultivation of ganja (marijuana) and suchlike, use and trade of sponge, contracts for forest clearance, and uranium mining. In the secondary sector, undertakings absolutely closed for investment are industries manufacturing Penta Chlorophenol. Dichloro Diphenyl Trichloro Ethane, Dieldrin, Chlordane, Pulp with Sulfite processing and Pulp with Chlor Alkali with Mercury processing, Chloro Fluoro Carbon, Cycmate and Saccharin, processing of Finished/Semi-Finished goods from Mangrove, alcoholic drinks, fireworks, explosive and components, arms and components, printing of postage stamps, seals, treasury bills, passport and post-paid items.

Undertaking closed in the tertiary sector are establishment of gambling places. The second category is concerned with undertakings that involve ownership by foreign citizens and/or foreign legal entities. In the primary sector: culture of freshwater fish and logging concession; in the tertiary sector: transportation by taxi and bus, shipping, private television and radio broadcasting, newspaper and magazine, film industry and cinemas, management of radio frequency spectrum, and satellite orbit, trading service except large-scale retail businesses (mall, supermarket, department store, shopping center), distributor/wholesaler, restaurant, quality certification, market research, and after-sales service, Medical service are also closed: clinic, maternity clinic, specialist clinic and dental clinic.

Any other undertaking that is not mentioned in the above list is open for domestic and foreign in investment.

D. Licensing

The procedure for investment has undergone a number of changes to ensure efficiency. On July 28, 1998 Presidential Decree No. 79 of 1993 concerning Investment Procedure. It is stipulated that a request for domestic investment that satisfies certain criteria can be directed to the Governor.

Later on Presidential Instruction No. 22 of 1998 was issued concerning the cancellation of the requirement of recommendation from a technical agency for approval of investment expect for mining, energy, oil palm plantation and fishery. In establishing this investment procedure, the Government has tried to simplify the bureaucratic process and ensure that the required licensing can be dealt with under the same roof.

THE NEW INVESTMENT BILL IN PARLIAMENT

Reform of the investment law in Indonesia at present carrying out in the Parliament. There is a desire to combine laws for foreign investment and domestic investment. In relation to GATT (General Agreement on Tariffs and Trade), there is still opportunity for Indonesia to change or add to the investment regulating that can cause trade distortion. In addition, the reform of the foreign investment law should not overlook the principles of investment agreed upon in APEC (Asia Pacific Economic Cooperation).

The APEC Non-Binding Investment Principles can be used us a guide to determine the transparency and of consistency of investment policy. Over the past few years, countries in the Asia-Pacific region have carried out significant liberalization. Amidst this severe economic difficulty, Indonesia needs to invite more foreign capitals to boost exports.

The new investment bill provides, among other things, the strengthening "national treatment" and "the most favored nations" principle under GATT, permits 100% foreign capital in certain industries, and requires joint venture companies for other industries, as stated under the "Negative List of Business Activities in Investment". The Government is working on the draft for Presidential Regulation on the new negative list of investment. The bill also provides a guideline for simplification investment procedure to ensure that the required licensing can be dealt with under the same roof in shorter time than before.

Any coalition of parties that forms a new government as a result of the general election cannot afford to put aside the need for political, economic, and legal reform that have been going on for years. Metaphorically speaking, let us suppose that economic growth is a building. This building should stand on a strong foundation, i.e. the law. This strong foundation can exist if the ground, i.e. the political situation, is stable. Foreign capitals will come if there are political stability, economic opportunities, and legal certainly. Legal reform to attract foreign investors is also concerned with reform of the all the component within the legal system as a whole, i.e. legislation in various fields, the government apparatus and legal culture of the Indonesian society.

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