

# Further Regulation of Equity Divestment in Coal and Mineral Mining Activities as A Manifestation of Economic Sovereignty as A Sovereign Nation

Ougy Dayyantara<sup>1</sup>, Rineke Sara<sup>2</sup>

{[ougy.dayyan@gmail.com](mailto:ougy.dayyan@gmail.com)<sup>1</sup>, [rineke\\_sara@borobudur.ac.id](mailto:rineke_sara@borobudur.ac.id)<sup>2</sup>}

Universitas Borobudur<sup>1,2</sup>

**Abstract.** The dominance and majority foreign ownership in coal and mineral mining activities have caused various issues, such as environmental damage, socio-economic conflicts, and threats to the national industry, even jeopardizing Indonesia's economic sovereignty by turning mining into a commodity that does not directly benefit the welfare of the people. The mining sector, which should contribute to the welfare of the people and support state revenue, has not provided its fullest contribution. The regulation of divestment obligations aims to control natural resources and maximize profits, but it faces several obstacles because its implementation fundamentally contradicts the basic principles of investment law and Indonesia's international economic sovereignty. Divestment rules may potentially reduce foreign investment in the mining sector in the future and make divestment results less than optimal, potentially harming the country. In order to safeguard national interests and foreign investors while reflecting overall economic sovereignty as a sovereign nation, divestment provisions can be supplemented with additional regulations such as differentiating divestment timeframes and percentages based on commodities and placing Indonesian citizens in strategic director or commissioner positions to facilitate financial and operational control.

**Keywords:** Equity Investment, Coal and Mineral Mining, Economic Sovereignty

## 1 Background

The primary goal of the divestment policy is based on the provisions of Article 33, Paragraph (3) of the 1945 Constitution, which states that the earth, water, and natural resources contained therein are controlled by the state and used for the greatest prosperity of the people. Article 33, Paragraph (3) of the 1945 Constitution serves as the basis for state control over natural resources. This article implies that:

1. The right to own natural resources comes from the people's power, known as the Nation's Right (Mineral Right). Hence, the utilization of natural resources must provide the greatest benefit for the people's prosperity.

2. The people delegate the authority right to the state as a national organizational entity. The state's control is seen as territorial with national characteristics, granting it the power to regulate, manage, and maintain its utilization and act domestically and internationally.
3. The government acts on behalf of the state to regulate and manage (mineral right).
4. The government, through its authority, issues various permits to business entities to conduct mining activities (economic right). In implementing these activities, the government continues to oversee and guide to ensure that mining activities achieve the greatest benefit for the people's prosperity.

The utilization, management, and exploitation can be delegated to private entities (legal entities or individuals) within mining areas under Mining Business Permits, Contracts of Work, or Coal Mining Concession Work Agreements (PKP2B). However, in reality, several foreign capital companies have dominated the mining sector in Indonesia. To reduce the dominance of foreign companies that potentially threaten national interests, a Share Divestment Policy has been issued. Share divestment is needed as a pro-national interest policy because the foreign dominance over strategic mining assets results in Indonesia's dependence on foreign parties, leading to the concentration of foreign power in the mining industry, including in the mineral and coal mining business activities. Share divestment is necessary because the mining sector is a highly strategic natural resource for Indonesia, not only as a domestic supplier and domestic industry but also as a main source of revenue and foreign exchange.[1] Share divestment is believed to be one of the strategies to reduce foreign private dominance in the mining sector.

According to Tras Palupi, there are two reasons why foreign legal entities divest their shares to the Indonesian government, Indonesian citizens, or Indonesian-controlled companies: Juridical and Non-Juridical reasons[2]. Juridical reasons are because the divestment is mandated by national laws and regulations. Non-Juridical reasons include increasing state revenue, enhancing regional income, improving community welfare, and reducing the role of foreign legal entities in managing and utilizing mining natural resources in Indonesia.

## **2 Library Review**

### **2.1 Regulation of Divestment Policy**

The obligation for divestment is explained in Article 112 of Law No. 3 of 2020, which essentially states that business entities holding IUP or IUPK in the Production Operation phase whose shares are foreign-owned must divest 51% (fifty-one percent) of their shares gradually to the central government, regional governments, state-owned enterprises (BUMN), regional-owned enterprises (BUMD), and/or national private enterprises.

Amount and Requirements for Divestment According to Article 147, Paragraph (2) of Government Regulation No. 96 of 2021, the obligation to divest shares for holders of IUP and IUPK in the Production Operation phase is detailed as follows:

- For open-pit mining activities not integrated with processing and/or refining facilities or development and/or utilization activities, the minimum shareholding of the central

government, regional governments, BUMN, BUMD, and/or national private enterprises is as follows:

- Tenth year: 5% (five percent);
- Eleventh year: 10% (ten percent);
- Twelfth year: 15% (fifteen percent);
- Thirteenth year: 20% (twenty percent);
- Fourteenth year: 30% (thirty percent);
- Fifteenth year: 51% (fifty-one percent) from the start of production.
- For open-pit mining activities integrated with processing and/or refining facilities or development and/or utilization activities, the minimum shareholding is:
  - Fifteenth year: 5% (five percent);
  - Sixteenth year: 10% (ten percent);
  - Seventeenth year: 15% (fifteen percent);
  - Eighteenth year: 20% (twenty percent);
  - Nineteenth year: 30% (thirty percent);
  - Twentieth year: 51% (fifty-one percent) from the start of production.
- For underground mining activities not integrated with processing and/or refining facilities or development and/or utilization activities, the minimum shareholding is:
  - Fifteenth year: 5% (five percent);
  - Sixteenth year: 10% (ten percent);
  - Seventeenth year: 15% (fifteen percent);
  - Eighteenth year: 20% (twenty percent);
  - Nineteenth year: 30% (thirty percent);
  - Twentieth year: 51% (fifty-one percent) from the start of production.
- For underground mining activities integrated with processing and/or refining facilities or development and/or utilization activities, the minimum shareholding is:
  - Twentieth year: 5% (five percent);
  - Twenty-first year: 10% (ten percent);
  - Twenty-second year: 15% (fifteen percent);
  - Twenty-third year: 20% (twenty percent);
  - Twenty-fourth year: 30% (thirty percent);
  - Twenty-fifth year: 51% (fifty-one percent) from the start of production.

In case of an increase in capital for holders of IUP and IUPK after the share divestment, the divested shares must not be diluted to less than the number of shares as per the divestment obligation outlined above.

### **3 Result and Discussion**

#### **3.1 Sovereignty over Natural Resources and the Implementation of Share Divestment Regulations in Foreign Investment Companies in the Mineral and Coal Sector**

The regulation on divestment is an implementation of the presence of national natural resources. The fundamental concept of nationalization of natural resources is that the country has sovereignty over the natural resources within its territorial boundaries[3]. Eve Warburton defines the nationalization of natural resources as an effort to expand local ownership of the resource sector by transferring assets from foreign hands to domestic ones, industrializing, and enhancing the resource industry to compete with foreign countries in the global market[4].

International law recognizes a country's full rights over its resources, as stated in Article 2 Number (91) of the Charter of Economic Rights and Duties of States (CERDS), which mentions: "Every state has and shall freely exercise full permanent sovereignty, including possession, use, and disposal over all its wealth, natural resources, and economic activities[5]."

Full sovereignty of the state over its resources grants the state the right to: a. Regulate and exercise authority over foreign investments within its national jurisdiction according to its laws and regulations, aligned with its national goals and priorities. No state can be forced to give special treatment to foreign investments[6]. b. Regulate and supervise the activities of transnational corporations within its national jurisdiction and take steps to ensure these activities comply with its laws, rules, and regulations, as well as its economic and social policies. Transnational corporations should not interfere in the internal affairs of the host country. Every state should, while upholding its sovereign rights, cooperate with other states in exercising the rights outlined in this subparagraph[7]. c. Nationalize, expropriate, or transfer ownership of foreign property, for which appropriate compensation should be paid by the state taking such action, considering relevant laws and regulations and all circumstances deemed relevant by the state. In any event, if a dispute arises regarding compensation, it shall be resolved according to the domestic law of the nationalizing state and by its courts, unless all concerned states freely and jointly agree to seek other peaceful means based on equal sovereignty of states and following the principle of free choice[8].

However, in practice, the implementation of divestment obligations faces challenges. One issue is Indonesia's external sovereignty, which involves cooperation with foreign mining companies investing in Indonesia. Syahrir Abubakar, Executive Director of the Indonesian Mining Association, stated that the obligation to divest shares would disrupt the investment climate and deter foreign mining companies from reinvesting in Indonesia[9].

Mining is a sector with high capital, high risk, and advanced technology, requiring a significant time to generate profits. The economic value of the mining sector may be lost due to the substantial investment costs allocated by foreign investors, thus prolonging the estimated break-even point. Additionally, each type of mine has different values.

Many foreign investors consider the obligation to divest 51 percent of shares as indirect expropriation, making the mining sector less attractive. Their concerns are exacerbated by legal uncertainties in the divestment process.

The principle of sovereignty over national natural resources is fundamental in external sovereignty and Investment Law. From the perspective of foreign investors, the obligation to divest shares is regulated by Law Number 3 of 2020, which does not accommodate the provisions of Law Number 25 of 2007. The investment legislation principally aims to create a conducive investment climate to boost national economic growth and a competitive economic system. The principle of sovereignty over national natural resources is a fundamental principle in external sovereignty law and investment.

The benefits of multinational mining companies are significant both financially and non-financially, such as taxes, royalties, indirect benefits through regional development, employment opportunities for residents, and technology transfer.

The divestment obligation rule also does not align with principles in international law, such as fair and equitable treatment, non-discrimination, most-favored-nation principle, and national treatment principle. These principles prohibit the host state from giving special treatment between foreign and domestic investors[10].

Another challenge of the divestment rule is the lack of legal consequences for foreign mining companies that do not have high economic value or potential to harm the state. Article 10A of the Minister of Energy and Mineral Resources Regulation Number 43 of 2018 only regulates the implementation of the divestment procedure, allowing IUP-OP or IUPK holders to access Indonesian participation for due diligence[11].

This regulation causes uncertainty and potential losses for both domestic and foreign investors. Foreign parties assume it is too risky as there are no rules regarding legal consequences for companies that fail the due diligence process. There is uncertainty whether they are still obliged to divest or not, making it difficult for foreign companies to protect their assets in Indonesia. Additionally, Indonesia may also feel disadvantaged as divestment offers to Indonesian participants fail to be implemented; divestment must be accumulated according to the divestment procedure[12]. Indonesia seems "forced" to buy companies with poor performance and legal vulnerabilities, especially if the buyer is a State-Owned Enterprise, where corporate actions will result in both profits and losses.

Other losses from the share divestment implementation, which do not generate maximum benefits for society, include share ownership creating opportunities for Indonesian participants to receive dividends. However, if the dividends received by Indonesian participant shareholders do not reflect the intended divestment goals, it is because Indonesian participants do not have sufficient capital to buy shares and are constrained by external loans such as syndications. The economic value of each mining business commodity has different payback periods. Therefore, it is unfair for business actors to be subject to the same rules for commodities with longer payback periods.

The state has ownership rights, but this does not mean the state acts as an entrepreneur[13]. In line with Sri Edi Swasono's opinion, the control of natural resources does not mean that the state is the owner of the natural resources[13]. In fact, the owner of all natural resources is the Indonesian people. Muhammad Alim, a former Constitutional Court judge, also stated that the form of government control is not only through ownership but can also be done through policy formulation, management, regulation, administration, and supervision. In this regard, any form of control is only an instrument. The most important thing is that the goal of Article 33 paragraph (3) of the 1945 Constitution is for the prosperity of the people, which can be seen in the lives of all Indonesian people.

Based on the above explanation, it is evident that the divestment obligation rule is based on a good objective, so the results of mining exploitation in Indonesia can be controlled by Indonesian parties and increase the country's profits. However, based on the issues outlined above, the benefits intended to be achieved by the divestment rule also become challenging to achieve.

### **3.2 Implementation of Share Divestment in the Mineral and Coal Mining Sector Has Not Reached Optimal Results**

Full sovereignty over natural resources is a fundamental concept inseparable from investment rules and external sovereignty of the state. Therefore, it is necessary to have legal instruments that can accommodate the alignment of these principles.

An An Chandrawulan, citing Salomon and Mirsky, notes that policymakers face at least three common problems when regulating foreign investment:

1. How to attract foreign investors without causing losses that drain domestic foreign exchange reserves and other resources.
2. How to maintain the legal rights of foreign investors and provide adequate protection while minimizing their dominance and adverse influence.
3. How to design their laws and tax systems to simultaneously encourage economic growth, attract foreign investment, and generate sufficient revenue to meet government budgetary requirements[14].

Based on these issues, it is crucial to create beneficial rules based on good regulatory principles, including: a. Clear objectives; b. Made by authorized bodies or officials; c. Matching type, hierarchy, and content; d. Implementable; e. Versatility and results; f. Proper formulation; and g. Transparency.

One of the principles mentioned above is the implementability principle, meaning every regulation must consider its effectiveness within the community, philosophically, sociologically, and legally[15]. Mining law must consider these three foundations.

Philosophically, share divestment is expected to fulfill the mandate of the 1945 Constitution for the prosperity of all Indonesian people. John Rawls, through his theory of justice, asserts that a democratic dimension of law enforcement justice programs must provide equal rights and opportunities for all citizens. It can also address social and economic inequalities, thus establishing a reciprocal relationship between those who benefit and those who are asked to sacrifice their assets.

Sociologically, share ownership in mining companies can enable Indonesia to receive a percentage of dividends, which can be used to improve the welfare of its people[16]. Additionally, legally, the existence of share divestment rules aims to resolve existing legal issues, as most mining companies in Indonesia are owned by foreign companies focused on increasing profits while Indonesian natural resources are depleting. With share divestment, local partners as major shareholders can control the company's operations by placing Indonesians on the Board of Directors[17].

Based on the problems explained above, it can be seen that the share divestment rule in the Mining Law has not shown results as initially intended. In response to this issue, the government needs to pursue the best approach to control all natural resources, especially minerals and coal, as mandated by the 1945 Constitution, the Investment Law, and reflecting overall economic sovereignty as a sovereign state, by determining:

First, stricter control over the implementation of divestment rules by imposing sanctions on companies that do not comply. If these companies' permits must be revoked due to non-compliance, it should be done swiftly so that natural resources are not "held hostage" for too long and can be managed by companies willing to comply with mining sub-sector rules properly.

Second, the government should impose additional rules for divestment. For example, further classification of divested share amounts based on commodities so that the divestment rules applied are closer to the payback period conditions of each company. This would make it fairer for each company in implementing the divestment rules.

Third, the Share Divestment Rules have reflected the principle.

## 4 Conclusion

The regulation of share divestment obligations aims to control natural resources and maximize benefits but faces several challenges. Fundamentally, the implementation of these rules does not align with the basic principles of investment law and Indonesia's international economic sovereignty. Share divestment regulations have the potential to reduce the amount of foreign investment in the mining sector in the future, resulting in less than optimal divestment outcomes and potentially harming the country.

To balance the interests of the state and foreign investors, and to reflect overall economic sovereignty as a sovereign state, the following measures can be taken:

1. Stricter control over the implementation of divestment rules, including imposing sanctions on companies that do not comply with divestment regulations.
2. The government should enforce divestment provisions with additional rules, such as differentiating the timing and percentage of divestment based on commodities.
3. Placing Indonesian nationals in director or commissioner positions to facilitate financial and operational control.

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