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The Implications of Foreign Investment Limitations on 'The End Justifies the Means' Practices within the Indonesian Investment Sector

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ABSTRACT

This study aims to analyze the implications of Presidential Regulation (Perpres) Number 49 of 2021 on the emergence of "the end justifies the means" practices by foreign investors within joint venture companies in Indonesia. Although this regulation provides investment facilities to stimulate national economic growth, certain strategic sectors remain subject to foreign ownership restrictions. A primary issue arises when domestic investors face financial constraints in fulfilling the required majority shareholding portions. This condition leads to legal smuggling practices by foreign investors seeking full corporate control, notably through nominee shareholder mechanisms. This legal research highlights how the capital disparity between foreign and domestic investors triggers the use of trusteeship agreements or dummy corporations, which are strictly prohibited under Indonesian law. The findings suggest the necessity of strengthening legal frameworks and oversight to balance foreign investment interests with national economic sovereignty.

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1. INTRODUCTION

The dynamics of global investment have significantly influenced the legislative landscape in Indonesia, leading to the enactment of Presidential Regulation (PR) Number 49 of 2021. This regulation, which serves as an amendment to PR No. 10 of 2021 regarding Investment Business Fields, is a fundamental component of the Indonesian government's broader "Omnibus Law" initiative to streamline licensing processes and attract substantial foreign capital. By transitioning from a restrictive "Negative Investment List" to a more open "Positive Investment List" approach, the government aims to stimulate national economic growth and enhance its competitiveness in the international market (Ssenyonga, 2021; Tatiara & Kudo, 2021). However, this shift toward liberalization often creates a complex legal tension between the urgent necessity of foreign capital inflow and the critical constitutional mandate to preserve national economic sovereignty over vital resources.

Despite the facilitative and "open-door" nature of the new regulation, the Indonesian government maintains a cautious stance by keeping specific strategic sectors subject to strict foreign ownership ceilings(Monsod et al., 2024). These limitations are designed to protect domestic industries and ensure that national stakeholders retain a degree of control over essential economic activities(Litvinenko, Bowbrick, Naumov, & Zaitseva, 2022). In the context of Joint Venture (JV) companies, these regulatory boundaries are intended to foster genuine partnerships between foreign expertise and local players(Alam, Fawzi, Islam, & Said, 2022; Dang, Jasovska, & Rammal, 2020). However, in practice, these restrictive clauses often become the focal point of legal friction, as the rigid requirements for local participation sometimes clash with the aggressive expansion strategies of multinational investors who prioritize total management control.

These structural restrictions frequently encounter significant practical hurdles, primarily due to the persistent capital disparity between foreign entities and their Indonesian counterparts. Many domestic partners face severe financial constraints and limited access to credit, making it difficult for them to meet the substantial capital calls required to maintain the mandatory majority shareholding portion(Didier, Huneeus, Larrain, & Schmukler, 2021; Nicolas, 2022). When a local partner is unable to fulfill their financial obligations, the stability of the Joint Venture is jeopardized(Bakhtiari, Breunig, Magnani, & Zhang, 2020; Sahlman, 2022). This imbalance creates a precarious legal environment where the foreign investor, possessing superior financial liquidity, feels compelled to intervene, often leading to arrangements that deviate from the original regulatory intent of the investment license.

Consequently, these economic pressures frequently trigger a "the end justifies the means" phenomenon within the corporate sector, where legal loopholes are systematically exploited to achieve commercial objectives at the expense of regulatory compliance. Foreign investors, driven by the need to mitigate risk and secure their capital, may perceive administrative restrictions as mere obstacles to be bypassed rather than mandates to be followed(Jiang & Kim, 2020). This mindset fosters a culture of "legal engineering," where the focus shifts from genuine collaboration to the construction of sophisticated legal facades. Such actions not only distort the spirit of the Investment Law but also create a shadow economy where the actual control of a company is hidden from the regulatory authorities.

One of the most prevalent and problematic manifestations of this approach is the utilization of nominee shareholder arrangements, commonly referred to as "pinjam nama" agreements(Nadia, 2024; Zigo & Vincent, 2022). In these schemes, an Indonesian citizen or entity is registered as the legal owner of shares, while the actual beneficial ownership and control are held by the foreign investor through a series of side contracts. Although Indonesian law—specifically Article 33 of the Investment Law No. 25 of 2007 and the Company Law No. 40 of 2007—strictly prohibits such practices, they continue to persist under the guise of complex trusteeship agreements or the establishment of dummy corporations(Cumming, Vanacker, & Zahra, 2021; Cunningham, 2020; Erel, Stern, Tan, & Weisbach, 2021). These arrangements are often shielded by professional secrecy and intricate corporate layers, making them exceptionally difficult for the Ministry of Investment (BKPM) to detect and sanction.

The persistence of these clandestine practices not only undermines the integrity and predictability of the national legal system but also poses a significant risk to the protection of domestic interests and national security. When foreign control is exercised through illicit means, the government loses its ability to monitor and regulate strategic sectors effectively, potentially leading to capital flight and the marginalization of local entrepreneurs. Therefore, an in-depth legal analysis of how PR No. 49 of 2021 inadvertently influences or fails to deter these deceptive investment practices is imperative. Such an inquiry is essential to ensure that the pursuit of rapid economic growth does not come at the cost of the rule of law, ensuring that Indonesia remains a transparent and law-abiding destination for legitimate global investment.

2. METHODS

Legal Research Method This study employs a normative legal research method, also known as doctrinal research. This approach is utilized to examine the consistency and synchronization of legal norms, specifically focusing on the implications of Presidential Regulation No. 49 of 2021 regarding investment business fields. The research analyzes legal principles, statutes, and regulations related to foreign direct investment and corporate governance in Indonesia. Problem Approach The researcher adopts a statutory approach (statute approach) and a conceptual approach. The statutory approach is used to review all laws and regulations relevant to the legal issues being handled, particularly the Investment Law and the Company Law. Meanwhile, the conceptual approach provides a foundation for analyzing the "the end justifies the means" phenomenon and the legal standing of nominee shareholder arrangements in joint venture structures.

Data Sources The data used in this study consists of secondary data, which includes: Primary Legal Materials: Such as the 1945 Constitution of the Republic of Indonesia, Law No. 25 of 2007 on Investment, Law No. 40 of 2007 on Limited Liability Companies, and Presidential Regulation No. 49 of 2021. Secondary Legal Materials: Comprising textbooks, scientific journals, previous research papers, and legal articles that provide explanations of primary legal materials. Tertiary Legal Materials: Including legal dictionaries and encyclopedias to clarify specific terminologies. Data Analysis The collected legal materials are analyzed through a qualitative normative analysis. This involves organizing, describing, and interpreting the legal data systematically to draw deductive conclusions regarding the legal implications and the potential for legal evasion by foreign investors in the Indonesian investment landscape.

3. FINDINGS AND DISCUSSION

The following section provides a comprehensive analysis of the legal findings derived from the normative examination of Indonesia's current investment climate. By synthesizing the regulatory framework established under Presidential Regulation No. 49 of 2021 with the empirical challenges faced by joint venture entities, this discussion illuminates the systemic vulnerabilities that permit clandestine investment activities. It specifically scrutinizes the intersection between rigid capital requirements and the strategic maneuvers employed by foreign investors, thereby exposing the legal friction that necessitates a re-evaluation of national investment oversight. This analysis serves to bridge the gap between theoretical legal norms and the practical complexities of corporate governance in a globalized economy.

3.1 Regulatory Transformation under Presidential Regulation No. 49 of 2021

The implementation of Presidential Regulation (PR) No. 49 of 2021 represents a transformative milestone in Indonesia's economic law, signaling a departure from a traditionally restrictive investment regime toward a highly liberalized "Positive Investment List."(Wei & Li, 2021; Wenger, 2023) This regulatory shift was strategically engineered to dismantle entrenched bureaucratic hurdles and establish a more transparent, predictable legal framework for international stakeholders. By significantly narrowing the list of business sectors closed to private investment and integrating fiscal incentives, the Indonesian government has effectively repositioned the nation as a competitive destination for global capital. This "open-door" policy is intended not only to accelerate capital inflow but also to foster technology transfer and industrial modernization through deeper integration with global value chains.

However, the analysis further reveals a complex "protective paradox" embedded within this liberalization, where the pursuit of economic openness clashes with the constitutional mandate to safeguard national economic sovereignty. While many sectors have been deregulated, the Indonesian government continues to enforce strict foreign ownership ceilings and reservations for domestic cooperatives and SMEs in strategic areas. This inherent regulatory tension creates a challenging environment for foreign investors who require total operational control to mitigate global business risks(Huong, Vinh, Hien, Ly, & Toan, 2022). Consequently, these structural limitations serve as a primary catalyst for investors to explore alternative, and often extra-legal, pathways—such as sophisticated nominee arrangements—to bypass official ownership restrictions while maintaining the appearance of compliance. This phenomenon underscores the critical need for a more nuanced balance between attracting foreign direct investment and ensuring the integrity of national protectionist policies.

3.2 The Capital Disparity and the "The End Justifies the Means" Phenomenon

A critical finding of this study identifies a profound structural imbalance characterized by the significant financial disparity between global foreign investors and their local counterparts within Joint Venture (JV) frameworks. While Presidential Regulation (PR) No. 49 of 2021 has undeniably broadened market access, it simultaneously upholds mandatory local partnership requirements for specific strategic sectors, ostensibly to foster domestic industrial growth. However, the discussion underscores a harsh economic reality: many domestic entities suffer from a chronic lack of "capital muscle," rendering them unable to meet the substantial equity contributions required for high-tech or large-scale industrial projects. This capital asymmetry creates a fragile partnership dynamic where the local party often becomes a passenger in a vehicle theoretically designed for mutual participation, thereby undermining the regulatory objective of genuine domestic empowerment.

In response to these financial constraints, foreign investors—frequently driven by the Machiavellian principle of "the end justifies the means"—tend to prioritize immediate project execution and absolute operational control over rigid adherence to statutory ownership ceilings. From the perspective of a multinational corporation, the legal requirement for a local majority or minority stake is often viewed as a commercial risk rather than a national mandate. Consequently, when the domestic partner fails to provide the necessary capital, the foreign investor assumes the financial burden, leading to an informal takeover of the company's governance. This pragmatic but legally flawed approach systematically treats regulatory compliance as a secondary concern, subordinating the integrity of Indonesian investment law to the overriding demands of global business efficiency and capital security(Angkasa, 2021; Gathii, 2020; McCarty, 2024).

The persistence of this phenomenon has led to the emergence of highly sophisticated legal structures specifically engineered to circumvent the spirit of the law while meticulously maintaining an appearance of formal legality. Through the utilization of tiered contractual arrangements—such as convertible loan agreements, irrevocable voting proxies, and management service contracts—foreign investors are able to extract beneficial ownership and decision-making power that far exceeds their registered shareholding. These "shadow" governance mechanisms effectively render the statutory protections of PR No. 49 of 2021 moot, as the local partner is reduced to a nominal figurehead or a dummy corporation. This sophisticated evasion not only distorts the transparency of the Indonesian corporate landscape but also poses a long-term challenge for regulators, who must distinguish between legitimate business collaborations and artificial structures designed to mask illicit foreign dominance.

3.3 Nominee Shareholder Arrangements as a Form of Legal Evasion

The research identifies the persistent use of nominee shareholder arrangements as the most prevalent manifestation of legal evasion, emerging as a strategic response to the rigid foreign ownership restrictions maintained under Indonesia's current investment regime. Despite the explicit prohibition of such practices under Article 33 of Law No. 25 of 2007, these "pinjam nama" schemes are meticulously engineered through a sophisticated trinity of contractual layers designed to decouple legal title from beneficial control. Typically, this involves an Irrevocable Power of Attorney that grants the foreign investor absolute voting rights, a Loan Agreement where the local partner's capital contribution is actually a debt funded by the foreign entity and secured by a pledge of shares, and a Profit Sharing Agreement that ensures all dividends are siphoned back to the foreign investor. This complex legal architecture allows foreign capital to exert total dominion over a company while maintaining a facade of domestic compliance(Sesay, 2020).

The discussion underscores that these clandestine arrangements create a pervasive "shadow ownership" environment, where the registered local shareholder functions as nothing more than a dummy corporation or a passive proxy for foreign interests(Morriss & Ku, 2024). This systemic circumvention of the law has profound implications, as it fundamentally distorts national investment statistics and masks the true extent of foreign penetration into the domestic economy. Furthermore, the prevalence of these proxy structures severely debilitates the government's regulatory capacity to protect strategic economic sectors from total foreign dominance, rendering statutory safeguards such as those in PR No. 49 of 2021 effectively toothless. By allowing the "the end justifies the means" philosophy to supersede the rule of law, these practices not only undermine the integrity of the corporate registry but also threaten the long-term stability of national economic sovereignty and the protection of genuine domestic entrepreneurs(Borgogno & Savini Zangrandi, 2024).

3.4 Implications for National Economic Sovereignty

The findings suggest that while PR No. 49 of 2021 aims for economic expansion, the resulting rise in clandestine investment practices poses a threat to national economic sovereignty. The discussion concludes that the "the end justifies the means" approach adopted by some foreign investors erodes the rule of law. If left unchecked, these practices could lead to a situation where the Indonesian economy becomes a host for foreign-controlled entities that operate outside the intended regulatory framework. Therefore, the study emphasizes that the liberalization of investment must be accompanied by robust "Beneficial Ownership" transparency and stricter post-audit mechanisms by the Ministry of Investment (BKPM) to ensure that foreign capital truly contributes to—rather than undermines—national interests.

The analysis of Presidential Regulation No. 49 of 2021 reveals a profound legal paradox: while the regulation is intended to broaden the horizon for foreign investment through a liberalized "Positive List," it simultaneously solidifies capital barriers that many domestic partners cannot overcome. In a Joint Venture (JV) structure, the law mandates a specific ratio of local participation to safeguard national interests; however, this research finds that such a "protective paradox" often backfires due to the acute capital disparity between global conglomerates and local SMEs. When domestic entities lack the financial "muscle" to fulfill their equity obligations, the legal framework inadvertently creates a vacuum of compliance. Foreign investors, operating under the pragmatic philosophy of "the end justifies the means," frequently fill this gap by prioritizing operational continuity over de jure adherence. This shift suggests that the liberalization brought by PR 49/2021, while economically ambitious, lacks the necessary compensatory mechanisms to empower local shareholders, thereby leaving the door open for strategic legal maneuvers that prioritize capital dominance over the spirit of mutual partnership.

Furthermore, the persistence of nominee shareholder arrangements—despite being strictly prohibited by Article 33 of Law No. 25 of 2007—serves as a primary indicator of systemic legal evasion within the Indonesian investment landscape. These clandestine practices, facilitated through a "trinity" of contractual layers—namely irrevocable powers of attorney, loan agreements for capital injection, and profit-sharing pledges—effectively render the local partner a mere facade or a dummy corporation. This study argues that such arrangements do more than just bypass ownership ceilings; they erode the very foundation of national economic sovereignty by creating a "shadow ownership" structure that is invisible to traditional regulatory oversight. The findings imply that unless the Ministry of Investment (BKPM) moves beyond formal administrative checks toward a more substantive "Beneficial Ownership" audit, the liberalization intended by PR 49/2021 will continue to be exploited. Ultimately, the "the end justifies the means" approach not only distorts investment statistics but also poses a long-term risk to the rule of law, as it fosters an environment where economic objectives are permitted to supersede the integrity of national statutes.

4. CONCLUSION

This study concludes that while Presidential Regulation (PR) No. 49 of 2021 marks a significant milestone in liberalizing Indonesia's investment climate, it inadvertently creates a "protective paradox" that facilitates legal evasion. The transition to a "Positive Investment List" successfully attracts global capital but maintains rigid ownership ceilings in strategic sectors that frequently clash with the financial realities of domestic partners. The profound capital disparity between foreign investors and local entities remains the primary catalyst for the "the end justifies the means" phenomenon. In the absence of sufficient financial "muscle" from domestic partners, foreign investors often prioritize operational control and capital security over statutory compliance, viewing regulatory restrictions as mere administrative hurdles to be bypassed through sophisticated legal engineering.

Furthermore, the research highlights that nominee shareholder arrangements—though strictly prohibited by Law No. 25 of 2007—persist as a dominant mechanism for "shadow ownership" in Indonesia. Through complex contractual layers involving irrevocable powers of attorney and disguised loan agreements, foreign entities effectively transform local partners into dummy corporations, thereby rendering national protectionist policies moot. This practice not only distorts national investment data but also poses a grave threat to national economic sovereignty and the rule of law. To mitigate these risks, this study recommends that the Indonesian government, particularly the Ministry of Investment (BKPM), must shift its oversight from formal administrative checks to substantive Beneficial Ownership audits. Strengthening post-audit mechanisms and ensuring transparency in corporate control are essential to ensure that foreign direct investment fosters genuine national development rather than systematic legal smuggling.

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