THE URGENCY FOR REGIONAL INTEGRATION IN ACCORDANCE TO INVESTMENT RISK MANAGEMENT

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Abstract

Investment is an activity which is needed by every country, especially in development country. However, the investment activity itself also brings in some risk which is called as investment risk. These investment risks usually recognized to be covered by an investment agency to protect the investor. Multilateral investment guarantee agency (MIGA) is usually used to maintained and cover the loose of investor. But, actually among the investment risks which are identified by MIGA will only responsible for the market risk, meanwhile the biggest lost for investor also came from political and financial risks which have to be recognized in advanced. This is where the export credit agency will take place. Nevertheless, there are still many loops to be identified to determine the characteristic of export credit agency itself. To deal with those kinds of risks, a regional integration is needed to avoid an overlapping regulation among ASEAN Economic Communiy. Thus, will lead to a common perception on how to treat those risks and who will be responsible to cover it.

Keywords *: Investment, regional integration, Investment risk, Export Credit Agency.*

I. INTRODUCTION

Foreign direct investment in Asian started to had its crisis in 1997 and started to raised afterwards. The raising progress in each country experienced different level of improvement from the condition before the crisis existed. China, Thailand and India are some example of the most fast revealing country and even get better than before the crisis, they become the most powerful country in foreign direct investment. The regulations governing foreign investment are commonly set out in "investment laws". The purpose of these laws is the creation of legal frame work that will attract and put to work foreign capital. The form that regulate foreign investment are varies from country to country, but the underlying purposes of the regulations are generally the same worldwide. These include (a) promoting local productivity and technological development, (b) encouraging local participation and (c) minimizing foreign competition in economic areas that already well served

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by local businesses.

The variety of investment laws are depends on a country's economic and political policy which is arranged by a certain legal product. The highest legal product arranged these policies are a constitution. Through its constitution, the economic policies set out in those countries could be known. Indonesian constitution declared its political view on economic sector. It is mention that the citizens of Indonesia held the highest sovereign of political and economical will. However, we can still find some contradiction in several regulations against thus principles. The other problems are to manage the environmental damage and people around the investment area who had been lost their rights because of the investment activity. Despite of that, Investment is a significant sector to increase a national income, which made it impossible to ignored or banned.

The concern in handling Investment demands a balance concern between public, state and foreign interest. Thus, the challenge's today are how to maintain the balance between public, state and foreign interest which could be derived from economical constitution as the basic principles for all economic sectors and to what extent it influence as a basic principle to economic activity especially investment law in host country's domestic law. Furthermore, the risk in investment activity is the main concern for investors to make a decision to do an investment in host country. However, transparency of law and regulations in host country become an important role to attract Investor interest.

If the economic policy, especially Investment and regulations concerning investment policy is stable, the national income through investment sector will be significantly improved. The labour and financial sector will also improve. Thus, reflected that one tools to improve the national development is by managing the Investment sector through its law.

These issues become crucial in ASEAN, regarding ASEAN Economic Community. Regionalism in ASEAN economic community is an urgent matter to formulized in order to materialized a stable investment policy order in the region. This paper selectively reviews the role of foreign direct investment (FDI) in the present state of economy, especially its risks and the urgency to regional integration. Multinational companies are normally the vehicles for FDI and are central to the current globalization process. The key analytical and policy question examined is whether regional integration is needed to overcome and minimize the investment risk.

II. FOREIGN DIRECT INVESTMENT

Investors underscore that motivation for investing in Emerging Market Countries (EMCs) and determinants of investment location differ among countries and across the economic sectors. They concur, however, that certain general factors consistently determine which countries attract the most foreign direct investment (FDI). Investors cite, in particular the following:

A. Market size and growth prospects of the host country play an important role in affecting investment location since FDI in EMCs is increasingly being undertaken to service domestic demand rather than to tap cheap labor.
B. Wage-adjusted productivity of labor, rather than the cost of local labor *per se*, will increasingly drive efficiency-seeking investments of "footloose" firms that use EMCs as export platforms.
C. The availability of infrastructure is critical. EMCs that are best prepared to address infrastructure bottlenecks will secure greater amounts of FDI.

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The transparency of law and regulations in host country become an important role to attract Investor interest. If the economic policy, especially Investment and regulations related with it stable, the national income through investment sector will be significantly improve. The labour and financial sector will also improve. Thus, reflected that one tools to improve the national development is by managing the Investment sector through its law. There is no specific investment law principles, but the principles in international trade law is implement in international investment law, because as long as the trade is moving then there is always investment activity, those principles are :

A. NON DISCRIMINATORY PRINCIPLE

This is one of the WTO principles related with the investment activity. This principle stated thet there is no discrimination allowed to be implemented in investment activity, in order to minimise the distortion the problems in foreign direct investment activity.

Non Discriminatory Principle is break into two further principles, they are: *The Most Favoured Nation (MFN) Treatment Principle* dan *National Treatment Principle.*

1. *The Most Favoured Nation (MFN) Treatment Principle*

This principle means that all host country have to implement the same treatment to the investor. The benefits from this is this principle implement generally to all country, without looking the further political relationship among the states.

However, there is an exception, for instance in regional integration practices in a region of countries. Indonesia have been implement this principle in Law number 25 in 2007 concerning Investment, especially in article 3.

2. National Treatment Principle.

Based on this principle investee are obliged to do the same treatment between foreign investor and domestic investor.

B. TRANSPARENCY PRINCIPLE

This principle is the development from *non discriminatory principle* substantion, which give the priority to the protection on foreign investor, especially from the very beginning step, which are the pre contract, contract and post contract. The government obligation is to show all the regulation involved in this activities. Those regulation concerning investment law in Indonesia include :

1. Law Number 25/2007 concerning Investment law
2. Law Number 40/2007 concerning Limited Liability Company
3. Law Number 32/2009 concerning Environment
4. Law Number 13/2003 concerning Employment

Indonesia Investment act this principle has been stated in article 3 about the basic fondation of Investment in Indonesia.

C. THE PRINCIPLE OF HUMAN RIGHT AND ENVIRONMENT

The Principle Of Human Right And Environment is the most controversial issues in investment activity. This principle were sued and asked by Non Governmental organisation and international society to the abusing human rights done by *non-states entities by having MNC's* *in their country.* adanya MNCs yang beroperasi di dalam negaranya.

International trade law regim initiate by the open market commitment of the respect to the human rights can be seen in GATT XX (a) which legalised trading activity to protect *human moral.* In Indonesian regulation, the 1945 constitution through article 28 have regulate more about the human rights in Indonesia.

Investment is a risky business and foreign investment particularly the same. It brings benefits not only for the investors, but also to host countries and home countries. As a result, investment protection becomes an essential issue. Thus, one of the principal purposes of the global investment protection regime is to reduce investor insecurity.[1] Setting an investment dispute resolution to settle an investment dispute is one of the existing investor protections. Furthermore, the attraction of the international arbitral award is the possibility of voluntary compliance, either to enforce the award or to abandonment of the dispute. Moreover, challenge of investment arbitration awards appears to be more prevalent than in commercial disputes.[2] In investment disputes, commonly the parties agree in advance to resolve their disputes using existing guidelines set up by several international arbitration organizations.[3] Each of them established set of arbitration rules and maintain a panel.

Based on the statute of International Court of Justice (ICJ) article 38, decisions of international courts and tribunals are a subsidiary source of international law. Therefore, they have to pay attention to all competing principles of international law and interest when making an award. Furthermore, international courts and tribunals also have a duty to uphold the fundamental principles of international law, such as the universal principles of human rights and the principle of sustainable development, fair and equal treatment, etc.[4] Investment tribunals also have to apply the same thing in resolving investment dispute to adhere

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[1] Christopher F. Dugan, Don Wallace Jr, Noah D. Rubins, Borzu Zabahi, *Investor-state Arbitration,*Oxford University Press. 2008.

[2] Ibid 182.

[3] Ray August, Don Mayer, Michael Bixby, *International business law : Text, cases and reading,* 6th eds Pearson. 2013

[4] Surya P. Subedi, *International Investment Law : Reconciling Policy and Principle. Hart* .2008

rule of law in investment dispute settlement. Further, once the proceedings are closed, the tribunal deliberates and issues an award. The finality of awards considers being one of primary advantages of arbitration. The losing party sometimes dissatisfied with the award, in this case they will try to adjust it. The challenges of investment arbitration award will be more common, which sometime because of political pressure from the government.

III. FACTS CONCERNING MULTINATIONALS AND FOREIGN DIRECT INVESTMENT

Substantial changes have occurred in the amounts and pattern of capital flows from industrial countries to emerging economies in the 1980s and the 1990s compared with the 1960s an 1970s. At the time, there has also been a sea change in developing countries perspectives on, and attitude towards, FDI. In the earlier periods developing countries were often hostile towards multinational investment and sought to control the activities of multinational companies through domestic and international regulations. During the last two decades, however, emerging countries have been falling over themselves to attract as much multinational investment as they can.

The following stylized facts concerning international capital flow to developing countries have been documented during the last two decades.

A. There has been an enormous increase in financial resources flows to developing countries during the last three decades as the world economy has liberalized and become financially more integrated
B. Net resources flows to developing countries recorded a quantum leap between 1990 and 1995, rising to nearly US$ 240 billion in the latter year. There was a further sharp increase in the next two years until the Asian Crisis. There have been reduced net resources flows since then.[5]
C. Foreign Direct Investment flows to developing countries are highly concentrated. Ten countries accounted for nearly three-quarters of

[5] Kern Alexander and Rahul Dumale*, Research handbook on international financial regulation*, Oxford University Press . 2012

the total foreign direct investment inflows in 2000.

This pattern of capital flows, including that Foreign Direct Investment, has important substantive implications for developing countries, this is due to the liberalization of trade and capital flows in the international economy.

IV. THE CURRENT INVESTMENT REGIME

The Hallmark of the WTO agreement in 1995 under the Uruguay Round has been that, apart from trade liberalization, they have also extended multilateral rules and disciplines to a number of domestic policy areas affecting national industrial development and the country's international competitiveness with regards to both goods and services. Such policy generally define as industrial policies and has been extensively used for decades, notably by fast growing countries. However, since 1995 under the Uruguay Round Agreements, the use of these policies has been greatly restricted, although developing and least developed countries have been given relatively more time to adjust to new regime. The relevant agreement include the following :

A. Agreement on subsidies and countervailing measures
B. Agreement on Trade Related Investment Measures (TRIMs)
C. Understanding the balance of payments
D. Agreement on Trade Related Aspects of Intellectual Property Rights
E. General Agreement on Trade in Services
F. Decision on Measures in Favour of Least Developed Countries
G. Subsidies and Countervailing Measures

Moreover, the current trading and investment regime for multinational corporations has significant drawbacks for developing countries in that it forecloses important industrial policy options which the highly successful East Asian Countries used during their success of industrial policies in this countries.

V. INVESTMENT RISK

Four large-scale that has been identified as the following risks as the principal hazards that affect the spatial and sectoral allocation of FDI: (1) economic risk, (2) legal risks, (3) political risks, and (4) infrastructure risks. Economic risks center around host-countries' economic performance, especially inflation; access to international credit; and participation in international agreements for resolving FDI disputes. Legal risks stem from vague legal environments in which FDI laws are erratically enforced and the limits to enforcement are not clearly defmed. Political risks are primarily the expropriation of assets and the reversal of government policies. Infrastructure risks result from incomplete and inferior transportation and communications networks.

In general, foreign investors reduce their exposure to risks by limiting the volume and direction of FDI. Typically, firms respond to risk by reducing their exposure through so-called "hedging strategies· and/ or "internalization strategies." In hedging strategies, firms minimize risk either by diversifying holdings across products and places or by apportioning investments in capacity across places. In internalization strategies, investors absorb would be foreign production into existing facilities in the face of exchange rate and price uncertainty. Thus, higher risks lead to lower foreign investment. For example, legal risks such as quantitative restrictions on foreign firms' investment produce a "suboptimal" pace of entry and investment. Legal risks stemming from vague tax schedules produce inefficient allocations of capital Political instability reduces both the volume and rate of investment, although to different degrees for different industries. Foreign investors are also sensitive to price and cost uncertainties, especially as a consequence of inflation and exchange rate fluctuations. Increases in a country's relative costs of production through inflation decrease the probability that investment will occur in that country. When facing these risks, firms will delay their investment decisions and wait for more favorable conditions.

VI. EXPORT CREDIT AGENCY

The risk for the investor inherent in major investment projects has lead to evolution of a market for investment insurance scheme. Private companies entered the investment insurance market on the assumption of higher efficiency and an acceptable margin of profit. In its original context and design, the private programmes emerged as extensions of traditional forms of marine insurance.

There are two kind of insurance in investment law, private insurers and public insurer. Private insurer does not practice cover the risk of currency devaluation or depreciation. An export credit agency or investment insurance agency is a private or quasi-governmental institution that acts as an intermediary between national governments and exporters to issue export financing. The financing can take the form of credit (financial support) or credit insurance and guarantees (pure cover) or both, depending on the mandate the ECA has been given by its government. ECAs can also offer credit or cover on their own account. This does not differ from normal banking activities. Some agencies are government-sponsored, others private, and others a combination of the two.

Export credit agencies (ECAs) provide three basic functions. First, they help exporters meet officially supported foreign credit competition. (When foreign governments subsidize their companies' exports by offering buyers below-market, fixed-rate financings, exporters often find it difficult to offer financing that matches those subsidized rates.) Secondly, ECAs provide financing to foreign buyers when private lenders cannot or will not finance those export sales, even with the risks removed. Third, and perhaps their most important function, ECAs assume risks beyond those that can be assumed by private lenders. ECAs do not compete with private financial institutions. To the contrary, they enhance the ability of their country's lenders to compete internationally. It should also be noted that they do not offer development assistance to other countries; other agencies typically fulfill this role.

Generally ECAs are accessed through a country's banking institutions, where the international divisions of larger financial institutions typically have a person or staff that specializes in their use. Essentially banks extend this type of export based on the support being provided to them by their governments. Increasingly, ECAs work directly with the exporters, consultants, attorneys, and advisors. This is particularly the case in the United States where financial intermediation tends to be more fragmented and no longer the exclusive role of banking institutions. For instance, the U.S. Ex-Im Bank permits companies to obtain preliminary financing commitments directly without any involvement of a financial institution. 5 ECAs address two fundamental risks involved in an export transaction. The first is political risks, which refers to those events that occur due to political actions taken by the government that impact payment by the buyer. These may include transfer risk (inability to exchange the local deposit to that of the ECA country), expropriation, war risks, cancellation of an existing import and export license, and/or political violence. The risks of countries are usually evaluated by OECD and classified into seven categories depending on their risk profile. Countries rated 1 have the lowest risk and those rated 7 have the highest risk. The second risk ECAs address is commercial, which refers to nonpayment as a result of bankruptcy, insolvency, protracted default, fluctuation in demand, unanticipated competition, shifts in tariffs, and/or failure to take up goods that have been shipped according to the supply contract and other factors not covered under political risks. ECAs currently finance or underwrite about US$430 billion of business activity abroad - about US$55 billion of which goes towards project finance in developing countries - and provide US$14 billion of insurance for new foreign direct investment, dwarfing all other official sources combined (such as the World Bank and Regional Development Banks, bilateral and multilateral aid, etc.). As a result of the claims against developing countries that have resulted from ECA transactions, ECAs hold over 25% of these developing countries' US$2.2 trillion debt. Both officially supported export credits and tied aid credit and grants are extended on terms controlled by governments. Therefore, there is a constant temptation to use these financial instruments to subsidize commercial exports in order to win a temporary advantage on an export market or to counterbalance such an action from another government (matching). However, the end result of such action is negative for importing countries (usually developing countries), who are rendered unable to choose the best combination of quality and price but consider financing first. It is also negative for tax payers, who foot the bill. It may only to the benefit of exporters whose government have the deepest pockets and the greatest willingness to subsidize, even though the macro-economic benefit of the subsidy is doubtful. In the past, there have been big, government-sheltered companies that were kept alive to a very large extent by export credits and tied aid credits

VII.REGIONALISM IN ASEAN INVESTMENT LAW

Regional and inter-regional investment treaty making involving more than two parties can take different forms – notably, negotiations within a regional grouping, negotiations between a regional bloc and a third country, or negotiations between like-minded countries. Some of the regional investment policy developments are described below.

On 22 November 2012, ASEAN officially launched negotiations with Australia, China, India, Japan, New Zealand and the Republic of Korea on a Regional Comprehensive Economic Partnership Agreement (RCEP). The RCEP seeks to create a liberal, facilitative and competitive investment environment in the region. Negotiations on investment under the RCEP will cover the four pillars of promotion, protection, facilitation and liberalization, based on its Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership. The RCEP agreement will be open for accession by any ASEAN FTA partner that did not participate in the RCEP negotiations and any other partner country after the conclusion of the RCEP negotiations. On 20 December 2012, ASEAN and India concluded negotiations on trade in services and on investment. The ASEAN–India Trade in Services and Investment Agreements were negotiated as two stand-alone treaties pursuant to the 2003 Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India. The agreements are expected to complement the already signed FTA in goods.

This regionalisation of investment law takes place intra-regionally either as part of an organisation's deeper economic integration agenda, such as ASEAN's Comprehensive Investment Agreement (ASEAN CIA) entered into force in 2013, or ad hoc, like the Trilateral China–Japan–South Korea Investment Treaty signed in 2012. Moreover, the trend towards regionalisation also encompasses inter-regional agreements connecting different parts of the globe as evidenced by the ongoing negotiations of a Transpacific Partnership (TPP), an African Tripartite Agreement or the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States.

The surge of regionalism raises new issues of treaty parallelism and overlap in investment treaty law. Of course, international investment agreements (IIAs) are no strangers to complexities, parallelism and overlap per se. As UNCTAD stated in its 2011 World Investment Report: '[w]ith thousands of treaties, many on-going negotiations and multiple dispute-settlement mechanisms, today's IIA regime has come close to a point where it is too big and complex to handle for governments and investors alike.' Indeed, treaty provisions on 'indirect investments' coupled with arbitral tribunals' expansive interpretation of concepts such as reflective shareholder losses already today make more than one BIT potentially relevant in an investment relationship. The parallel proceedings of the CME/Lauder dispute by one corporate entity (once via the Dutch company CME and once via its American shareholder Lauder) against the Czech Republic challenging an identical measure under two different BITs (Czechoslovakia–U.S. BIT and Czechoslovakia–Netherlands BIT) with two arbitral tribunals coming to opposite conclusions is a case in point. 8 Yet, while investment law is thus used to horizontal overlap of parallel BITs, regionalism has added a novel dimension to investment law: vertical overlap of BITs with regional investment agreements. Under this vertical overlap, an investor from country A investing in country B is protected by both a bilateral and a regional treaty signed between countries A and B. For example, a Thai investor in Indonesia can rely on, and may potentially launch an arbitration claim under, the Thailand–Indonesia BIT (1998) as well as the ASEAN CIA (2009) for investment protection.

While such vertical treaty overlaps are a relatively recent phenomenon in investment law, overlapping bilateral, regional and multilateral treaties have been commonplace in international trade law throughout its history. Since the inception of the GATT in 1947, multilateral liberalisation and regional economic integration have run side-by-side. In the last two decades, however, regionalisation has also picked up pace in trade law with the conclusion of an unprecedented number of free trade agreements (FTAs), more accurately known as preferential trade agreements (PTAs). Hence, in both trade and investment law we observe an increasing turn towards regionalism and a multiplication of vertical treaty overlaps.11 Indeed, it is often the very same agreements – PTAs with investment chapters also known as PTIAs (preferential trade and investment agreements) – that produces this overlap.

The regionalisation of investment law has given rise to widespread vertical overlap among investment treaty layers. Today, every fourth bilateral interstate relationship is covered by more than one investment treaty and on-going negotiations of large inter-regional investment treaties will further exacerbate this overlap. What makes this situation particularly challenging is that regionalism is not widely used to consolidate ensuing treaty overlap. Most countries opt for parallel treaty layers, with BITs and regional PTIAs existing side-by-side, rather than for de facto or de jure consolidation. Unconsolidated overlap can create a number of serious legal problems ranging from functional duplication or contradiction to parallel proceedings and normative conflicts. As a result, states must carefully design and manage the interaction of parallel layers of investment governance. The good news is that coordination tools exist to successfully tackle these challenges. Here, trade and investment law, both facing similar governance challenges arising from treaty overlap, can learn from each other. Investment law can benefit from the mechanism trade law uses to achieve functional coordination. Trade law can draw from investment law's experience in preventing parallel proceedings. In terms of conflicts of norms, both fields have developed distinct but equally effective strategies. The bad news is that managing treaty overlap requires considerable foresight and sophistication. Treaty interaction has to be anticipated and purposefully channelled by the 47 contracting states. Where states fail in this task, the consequences are dire. Some investors will be lost in the labyrinth of uncoordinated overlapping investment agreements. Others will take advantage of the system risking double jeopardy and an increased exposure of host states to investment claims. Finally, treaty innovation will be undermined as old treaties trump new ones in case of normative conflict. It is thus indispensable that states, if they opt for co-existing treaties, carefully coordinate between different treaty layers in terms of their function, jurisdiction and applicable law. Farming this task out to arbitral tribunals to be resolved in actual disputes on an ad hoc basis is undesirably and even irresponsible given the important underlying policy issues involved.

VIII. CONCLUSION

Investment law is an interesting issue, especially concerning investment risk. The risk in investment activity usually had been covered by an insurance agency. However, those risks will still be classified according to the causes of the risk. Those risks are (1) economic risk, (2) legal risks, (3) political risks, and (4) infrastructure risks. Political risk is the most complicated risk to be predicted, thus made this kind of risk became the most dilemmatic risk to be taken by the insurance agency. The urgency to regulate the risk from investment activity is very high, in order to maintain those risk. The risk of investment has not been regulated internationally, especially in ASEAN region. The urgency to regulate this problem is to avoid an overlapping in regulating the risk and to provide the umbrella clause to regulate it.

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