

## Policy Brief

# Compliance Analysis of Indonesia's Local Content Requirement Measures: International Trade and Investment Agreement Perspectives

Junianto James Losari

---

### Key Messages:

- Countries are increasingly adopting protectionist policies, and Indonesia has implemented local content requirements (LCRs) across key sectors to build domestic industries.
- Indonesia's LCRs, while intended to strengthen the economy, may conflict with international trade and investment obligations, potentially resulting in legal challenges.
- To balance industrial growth and foreign investment, Indonesia could modify its LCR policies, enhance the legal framework, and improve infrastructure to attract global investors.

*With the global economic landscape shifting from a relatively liberal to a more protectionist stance, local content requirements (LCRs) become more prevalent as a tool in industrial policy. During the last decade, Indonesia has adopted more LCR measures to build up strategic domestic industries to promote domestic value added. However, Indonesia has also made commitments in international trade and investment treaties which may be breached by these measures. Considering the importance of foreign direct investment for the growth of domestic industries, Indonesia should (i) review its LCR measures, (ii) assess the capacity of existing domestic industries to supply raw materials if the measures remain in effect, and (iii) prioritise improving the business environment.*

## 1. Background

Countries are shifting from a relatively liberal regime under the World Trade Organization (WTO) to a more protectionist regime, including the introduction of local content requirements (LCRs) (Limenta and Ing, 2022). Indonesia has adopted several LCR measures to build up and strengthen domestic industries that are considered strategic to promote domestic value added. The LCR measures are applied in many sectors, including mining, manufacturing, pharmaceuticals, telecommunications, and, lately, automobiles (specifically, electric vehicles) (Ing and Grossman, 2023). While the LCR policy can be traced to 1950 with the *Benteng* Program, it appears that the recently appointed President Prabowo Subianto will continue this policy that was reinvigorated in 2009 (Ing and Grossman, 2023).

Law No. 3 of 2014 on Industrial Affairs (Industrial Affairs Law) requires the use of domestic products in government, state-owned enterprises, and private enterprises' procurement where the funding of the relevant projects comes from central or regional government budgets, domestic or foreign loans, or grants. Price preferences and administrative flexibilities are given for the use of domestic products in government procurement (Limenta and Ing, 2022). Other sectoral laws and implementing regulations have broader scopes and require LCRs for commercial activities.

Indonesia also introduced the Programme to Increase the Use of Domestic Products (P3DN), which includes a local content certification scheme (TKDN certification) where the government provides free TKDN certification (Antara, 2021). In some sectors,

---

**Junianto James Losari**  
City University of Hongkong

a TKDN certificate is a condition to obtain licences (e.g. telecommunications) or incentives (e.g. pharmaceuticals).

This brief presents a comprehensive compliance analysis of Indonesia's LCR measures with Indonesia's international trade and investment obligations and suggests a few recommendations from a legal perspective.

## 2. Assessment from International Trade Law Perspective

Indonesia currently has 18 active trade agreements, including the WTO. An LCR may breach the national treatment obligation and restrictions on non-tariff barriers (including quantitative restrictions) and may amount to prohibited subsidies.

### *National Treatment and Trade-Related Investment Measures (TRIMs)*

The national treatment obligation can be found in the 1994 General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS), and such clauses are typically incorporated into Indonesia's free trade agreements (FTAs). This obligation essentially prohibits discrimination (less favourable treatment) against 'like' imported products or services. The less favourable treatment is assessed further 'by examining whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products' (WTO, 2000: para. 137). In addition, the Agreement on Trade-Related Investment Measures (TRIMs Agreement) prohibits the imposition of LCRs on investments. Box 1 illustrates a compliance analysis with these obligations.

#### **Box 1: Compliance Analysis of Indonesia's LCR Measure on Electricity Infrastructure Development – National Treatment and the TRIMs Obligations**

##### **LCR measure**

The measure sets a minimum threshold for using domestic goods and services in electricity infrastructure construction and development. The requirement applies to projects developed by a governmental agency, state-owned enterprise, or private enterprise using government budget, including onshore and offshore loans or grants.

##### **Compliance analysis**

The measure provides advantages to domestic goods and/or services, i.e. the developer will not

be subject to certain sanctions and will obtain certain rewards if using domestic goods and/or services. Paragraph 1(a) of the Illustrative List of the TRIMs Agreement provides a list of trade-related investment measures which are inconsistent with GATT Article III:4. These include measures which are mandatory or enforceable, or require compliance to obtain advantage, and require the purchase or use by an enterprise of domestic products. Since the measure is mandatory (i.e. sanctions), and compliance will provide advantages, the measure breaches the national treatment and TRIMs obligations.

##### **Potential derogation under GATT Article III:8(a)**

Three conditions must be fulfilled to derogate a national treatment breach on the basis of government procurement under GATT Article III:8(a) (WTO, 2013: paras. 5.63–5.74):

- the measure must be laws governing procurement;
- the procurement is done by a governmental agency; and
- the products must be procured for 'governmental purposes' and not intended for commercial sale or to be used to produce goods for commercial sale.

The LCR measure may fail to fulfil the last condition. The development of electricity infrastructure is arguably for public purposes, therefore constituting 'governmental purposes'. However, the produced electricity may be sold commercially. Accordingly, the measure breaches the national treatment and TRIMs obligations.

GATT = General Agreement on Tariffs and Trade, LCR = local content requirement, TRIMs = Trade-Related Investment Measures.

Source: Author.

### *Restriction on non-tariff barriers*

WTO agreements contain many rules regarding non-tariff barriers, including quantitative restrictions under GATT Article XI and market access restrictions under GATS Article XVI:2 (provided the relevant member made 'specific market access commitments' in its schedule) (WTO, 2005: para. 214).

Indonesia's LCR measures likely do not breach GATT Article XI as they do not restrict importation. For instance, in the telecommunications sector, the government sets minimum thresholds for domestic goods and services in consumer communication

devices and base stations, with non-compliance leading to non-issuance of distribution or sales certificates in Indonesia.

### ***Prohibited subsidies***

LCRs that are exempted under GATT Article III:8(a) may still breach Articles 3.1(a) or 3.1(b) of the WTO Agreement on Subsidies and Countervailing Measures if they are deemed prohibited subsidies. This may apply to Indonesia's LCR in the pharmaceutical sector, which offers price preference or tax incentives for producers of pharmaceutical products and medical devices (PPMDs) that use domestic raw materials or components.

## **3. Assessment from International Investment Law Perspective**

Indonesia has about 39 active international investment agreements (IIAs), which include its bilateral investment treaties, regional investment treaties, and investment chapters of its FTAs. Indonesia's LCR measures may breach the national treatment and performance requirement obligations in some of the IIAs.

### ***National treatment***

To prove a national treatment breach, foreign investors must demonstrate that domestic investors who are in 'like circumstances' are treated more favourably. LCR measures usually target raw or intermediate materials. For instance, Indonesia's LCR measure in the pharmaceutical sector incentivises domestic raw or intermediate materials use in the production of PPMDs without preventing foreign manufacturers of PPMDs or raw materials operating in Indonesia from accessing these incentives, provided they use domestically produced raw materials. Accordingly, the LCR measure itself may not breach Indonesia's national treatment obligation (see *Merrill & Ring Forestry LP vs Canada*, 2010).

### ***Performance requirements prohibition***

None of Indonesia's active (as of the time of writing) bilateral investment treaties contain a performance requirement provision. However, this provision is found in newer generation IIAs, e.g. the Association of Southeast Asian Nations (ASEAN) Comprehensive Investment Agreement (ACIA).

Similar to the TRIMs Agreement, Article 7 of the ACIA (as amended) prohibits LCRs in the form of domestic content thresholds or imposing the use of domestic goods. Imposing such requirements on foreign investors as a condition for receiving an advantage is also prohibited (Ing and Losari, 2022).

Indonesia's LCR measures in sectors like electricity infrastructure, upstream oil and gas, telecommunications, pharmaceuticals, and battery electric vehicles appear to breach this prohibition as they impose conditions for the operation of investments or a condition for the receipt of an advantage.

### ***Exceptions***

Certain exceptions are normally available to justify a breach of IIAs. The available exceptions may differ amongst the IIAs, but some exceptions which may be available include: (i) the 'advantage' is in the form of taxation measures and government subsidies or grants, (ii) the measure is included in Indonesia's schedule, (iii) the measure is for government procurement, (iv) general exceptions (similar to GATT Article XX), or (v) security exceptions (similar to GATT Article XXI).

## **4. Conclusions and Recommendations**

Some of Indonesia's LCR measures appear to breach its international trade, investment, or both obligations, potentially exposing the government to claims by other governments or investors. To minimise liability, the government should carefully design these measures.

Foreign direct investment is often vital for domestic industry growth. From a practical perspective, Indonesia should also assess the capacity of the existing domestic industry to supply raw materials if the LCR continues to be in place. Otherwise, the LCR measure would be counterproductive to the government's effort to build up the industry.

Instead of focusing on LCRs only, the government should continue improving the business environment by, amongst others, (i) improving the legal framework and legal enforcement to provide more certainty to businesses, and (ii) improving the hard infrastructure required by industries. With a better business environment, foreign investors may become more attracted to invest in Indonesia and contribute to the growth of domestic industry.

## References

- Antara (2021), 'Ministry to Push TKDN Certification for 1,250 Products in 2022', 28 December. <https://en.antaranews.com/news/206769/ministry-to-push-tkdn-certification-for-1250-products-in-2022>
- Ing, L.Y. and G. Grossman, eds. (2023), *Local Content Requirements: Promises and Pitfalls*, Routledge-ERIA Studies in Development Economics, Abingdon, Oxon: Routledge.
- Ing, L.Y. and J.J. Losari (2022), 'Local Content Requirements: Assessment from Investment Law', *ERIA Discussion Paper Series*, No. 416, Jakarta: Economic Research Institute for ASEAN and East Asia (ERIA).
- Limenta, M. and L.Y. Ing (2022), 'Indonesia's Local Content Requirements: Assessment with WTO Rules', *ERIA Discussion Paper Series*, No. 414, Jakarta: Economic Research Institute for ASEAN and East Asia (ERIA).
- WTO (2000), *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, Report of the Appellate Body, WT/DS161/AB/R, WT/DS169/AB/R, AB-2000-8. [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds161\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds161_e.htm)
- (2005), *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Report of the Appellate Body, WT/DS285/AB/R, AB-2005-1. [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds285\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm)
- (2013), *Canada – Certain Measures Affecting the Renewable Energy Generation Sector*, Report of the Appellate Body, WT/DS412/AB/R/ WT/DS426/AB/R, AB-2013-1. [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds412\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds412_e.htm)

©ERIA, 2025.

### DISCLAIMER:

The findings, interpretations, and conclusions expressed herein do not necessarily reflect the views and policies of the Economic Research Institute for ASEAN and East Asia, its Governing Board, Academic Advisory Council, or the Institutions and governments they represent. All rights reserved. Material in this publication may be freely quoted or reprinted with proper acknowledgement.



Sentral Senayan II, 5th, 6th, 15th floors  
Jalan Asia Afrika No. 8  
Senayan, Central Jakarta 10270, Indonesia  
Tel: (62-21) 57974460 Fax: (62-21) 57974463  
E-mail: [contactus@eria.org](mailto:contactus@eria.org)

