DOI: https://doi.org/10.54477/LH.25192353.2025.3.pp.50-59

LEGAL POLITICS OF INVESTMENT SCREENING IN INDONESIA'S FOREIGN INVESTMENT REFORM

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Abstract

This study aims to examine the significance and regulatory models of investment screening mechanisms in the context of Indonesia's legal and political framework for foreign investment. Employing a normative juridical method combined with a political-legal approach, this research critically analyzes the growing global trend of screening foreign direct investment (FDI) to safeguard national interests. The study finds that Indonesia has yet to establish a coherent legal basis for investment screening, despite increasing strategic and security risks associated with uncontrolled FDI inflows. The absence of a legal framework creates vulnerability in upholding national economic sovereignty and managing foreign capital with precautionary oversight. The research concludes that reforming Indonesia's investment policy is imperative, not only to ensure regulatory consistency but also to build a national mechanism capable of assessing the potential impacts of foreign investment on strategic sectors. Establishing such a screening regime would align Indonesia with global best practices while preserving its autonomy in economic governance.

Keywords: foreign investment; investment screening; legal reform; national interest.

1. Introduction

TIndonesia, as a developing country, continues to open its doors to foreign direct investment (FDI) as part of a broader strategy to stimulate national economic growth. FDI is often framed as a catalyst for industrial advancement, technology transfer, and job creation. Yet, alongside these potential benefits, there are growing concerns about foreign dominance in key strategic sectors, particularly given that Indonesia's investment oversight remains predominantly administrative and has yet to engage with more substantive dimensions. Several countries have institutionalized investment screening mechanisms to filter foreign investments that may pose risks to economic security—a regulatory approach that, to date, has not been fully integrated into the Indonesian legal system (Dimitropoulos, 2020) The absence of such mechanisms leaves a legal gap that could potentially neglect the protection of strategic national interests.

Global trends indicate that the legal architecture of investment regulation is gradually shifting from a classical liberal paradigm toward a more selective and responsive model that accounts for national security considerations. This transformation is evident in the increasing adoption of investment screening mechanisms across various jurisdictions, which recognize that foreign investment—particularly in strategic sectors—is not politically neutral. In the context of Southeast Asia, there exists a structural imbalance between the flow of capital and the institutional capacity of states to proactively safeguard national interests (Salacuse, 1984). At the same time, the development of regulatory frameworks that are more attuned to geopolitical risks and the long-term implications of foreign ownership has become a central theme in the discourse of international economic law (Salacuse, 1984). Despite the growing prominence of this discourse, Indonesia has yet to fully integrate itself into these evolving normative trajectories.

There is an apparent absence of a legal design capable of functioning as a systematic and measurable screening instrument for strategic investments. This gap indicates that Indonesia's foreign investment regulation continues to rely heavily on an administrative facilitation paradigm, rather than advancing toward a stage where law operates as a sovereign policy filter within the broader framework of economic governance.

The current regulatory framework in Indonesia reveals a conspicuous absence of legal mechanisms that could serve as systematic and calibrated instruments to screen strategic foreign investments. This institutional void suggests that the governance of foreign capital remains confined to an administrative facilitation model, falling short of positioning law as a sovereign tool for discerning and safeguarding long-term national interests within the architecture of economic policymaking.

This regulatory gap becomes increasingly salient amid escalating global economic tensions, where foreign investment is often deployed as a vehicle for exerting political and technological influence (Anthony, 2018). Consequently, Indonesia's current legal framework lacks the adaptive capacity to function as a safeguard for economic sovereignty in the face of such evolving geopolitical dynamics.

This article aims to articulate the urgency and policy direction of reforming foreign investment law in Indonesia by proposing a regulatory model for investment screening that balances economic openness with the protection of national interests. In doing so, the study seeks to offer a theoretical contribution to the development of investment law and serve as a policy input for lawmakers and regulatory authorities.

The approach employed in this article is normative juridical with a qualitative analytical method. It adopts a legal politics perspective by elaborating constitutional principles and regulatory frameworks governing investment, while also examining comparative international contexts to formulate a model of investment screening tailored to Indonesia's needs. The study relies on secondary data, comprising both primary and secondary legal materials, which are systematically examined using prescriptive-analytical techniques.

2. Materials and Methods

This study adopted a normative juridical method, complemented by a political-legal approach, in order to explore the regulatory and constitutional foundations of foreign investment in Indonesia and the absence of a coherent framework for investment screening. The normative juridical method was employed to analyse legal sources systematically, clarifying their doctrinal coherence and identifying regulatory gaps. By focusing on the interpretation of primary legislation and derivative regulations,

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this approach allowed the research to assess the extent to which Indonesia's investment law aligns with constitutional principles and broader international trends in investment governance.

The political-legal approach was used to situate these normative findings within the broader context of state policy and global regulatory developments. This perspective highlights the ways in which law interacts with political imperatives, particularly the tension between economic liberalisation and the protection of strategic national interests. By integrating this dimension, the study was able to examine not only the textual provisions of the law but also the political rationalities underpinning its formulation and application.

The materials analysed included primary legal sources, most notably Law No. 25 of 2007 on Investment, its derivative regulations, and constitutional provisions such as Article 33 of the 1945 Constitution. These were considered alongside regulatory practices such as the risk-based licensing mechanism and the investment priority list. Secondary legal materials comprised academic commentaries, journal articles, and international reports addressing investment screening and foreign direct investment governance. In addition, comparative references were drawn from the legal frameworks of the United States, the European Union, and Australia, each of which provides distinctive models for investment screening that balance openness to capital inflows with the safeguarding of national sovereignty.

The analytical process was qualitative in nature and followed a prescriptive-analytical technique. First, doctrinal analysis was undertaken to map the content and limitations of Indonesia's current investment regulation. Second, comparative analysis was conducted to identify best practices and adaptable principles from other jurisdictions. Finally, evaluative interpretation was applied to articulate a potential legal design for Indonesia, taking into account both normative principles and pragmatic policy considerations. This threefold process ensured that the research combined textual legal scrutiny with a critical appraisal of broader socio-political implications.

Through this methodology, the study was able to demonstrate that Indonesia's current approach remains predominantly administrative and facilitative, lacking the substantive evaluative capacity to filter foreign investments on grounds of strategic risk. By embedding the analysis within constitutional principles and international developments, the research offered both a theoretical contribution to legal scholarship and a practical framework for reforming investment law in Indonesia.

3. Result and Discussion

3.1 Investment screening as a legal-political instrument to uphold economic sovereignty and social justice

In Indonesia's constitutional conception, the state is not merely an administrative entity managing capital flows, but a custodian of public welfare and a protector of strategic resources that are intrinsically linked to the collective life of its people. This role is rooted in the principle of social justice as enshrined in Article 33 of the 1945 Constitution, which explicitly mandates that sectors vital to the state and essential to the livelihood of the people must be controlled by the state (Haris, 2024).

In this context, the investment screening mechanism must not be perceived merely as a technical procedure or an investment facilitation tool, but rather as a manifestation of the state's commitment to economic sovereignty and the protection of public interests. The state bears the responsibility to ensure that every incoming investment delivers not only financial gains but also respects the foundational values of the Constitution and does not disrupt the established social equilibrium (Anggara, 2024).

Investment screening is fundamentally not merely a technocratic matter of assessing capital feasibility; it touches on the deeper dimension of how economic power is distributed within society. In the absence of an adequate selection mechanism for foreign investment, the space for capital accumulation tends to be monopolized by powerful transnational economic entities, thereby narrowing the access of local economic actors to manage strategic resources.

This structural disparity gradually fosters a new form of oligarchy that not only disrupts domestic economic equilibrium but also undermines the state's authority in charting its development trajectory. Within the framework of distributive justice, investment screening functions as a state intervention to ensure that the economic benefits of investment are not concentrated in the hands of a few dominant actors, but are instead equitably distributed to communities directly affected by economic activities (Anthony, 2018). Absent such mechanisms, investment risks becoming a vehicle of social exclusion, marginalizing the rights of vulnerable groups over land, the environment, and their livelihoods (Cotula, 2012).

From the perspective of virtue ethics, the state is not merely a regulator enforcing the law in a mechanistic fashion, but a moral agent expected to embody the virtues of practical wisdom (phronesis), justice (dikaiosyne), and courage (andreia) in shaping public policies that affect the common good. Foreign investment entering the state's jurisdiction cannot be viewed as a value-neutral entity; rather, it constitutes a decision imbued with ethical dimensions, as it directly impacts the lives of citizens and the long-term direction of national development.

Within this framework, the state bears an active duty to discern and select forms of investment that align with the nation's collective values, while rejecting those that threaten to erode economic dignity or deepen structural dependency. The morality of such policy choices demands more than mere compliance with legal procedures; it requires accountability to future generations. A state that prioritizes nominal economic growth while neglecting normative dimensions ultimately risks forfeiting the ethical foundations upon which its legitimacy rests (Adger et al., 2017)

The concept of investment screening gains its moral relevance when approached from a communitarian perspective, wherein economic policy is inseparable from the state's obligation to safeguard the integrity of local communities and ensure the continuity of deeply rooted social values. Unfiltered foreign investment poses the risk of disrupting social structures, triggering forced displacement, and widening inequalities in the distribution of access to and benefits from development initiatives.

The state cannot solely rely on macroeconomic calculations, as development that neglects social dimensions tends to erode public trust and undermines national solidarity—the very foundation of democratic stability. Investment screening, therefore, represents a tangible expression of intergenerational responsibility: ensuring that today's economic decisions do not compromise the right to life and the sustainability of future communities.

Within this framework, the state's courage to reject forms of investment that threaten environmental sustainability, local wisdom, or the balance of social ecosystems constitutes a manifestation of the principle of collective protection grounded in relational justice (Trubek et al., 2013)

Indonesia's constitutional commitment, as articulated in Article 33 of the 1945 Constitution, positions the state not merely as a market regulator but as the mandated guardian of national prosperity, ensuring that strategic sectors are managed to the greatest benefit of the people. In this context, the investment screening mechanism becomes an inherent component of the state's responsibility to exercise oversight over incoming foreign capital that may influence the trajectory of national development.

In the absence of a structured and constitutionally grounded selection system, the state forfeits a vital mechanism to assess whether incoming investments align with the principles of economic sovereignty and social justice. The lack of substantive regulation for screening foreign investments not only creates a legal vacuum but also opens the

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door to deviations from the public interest first principle, which ought to be the primary orientation of national economic policy (Guzman, 1995). Furthermore, the gap between national economic law and constitutional commitments reflects an imbalance between liberalization and the protection of public interest, potentially weakening the state's position within the global legal order (Schneiderman, 2016)

As the currents of economic globalization continue to expand cross-border capital flows, developing countries like Indonesia face a structural dilemma: whether to open themselves to foreign investment to stimulate growth, or to safeguard sovereignty over strategic sectors that shape the nation's developmental trajectory. This tension cannot be reduced to a binary opposition between protectionism and liberalism; rather, it constitutes a reflective policy space that demands the state's courage to define the boundaries of sovereignty in a proportional and context-sensitive manner.

In an interdependent global economy, openness is indeed inevitable; however, without a substantive investment screening mechanism, the state remains vulnerable to losing its capacity to filter investments that may have long-term implications for national stability. This tension is reflected in the efforts of various countries to construct legal frameworks that enable a balanced evaluation of foreign investments—respecting the principle of non-discrimination while safeguarding national security and economic integrity (Rana Saad Shakar et al., 2025). Indonesia, in this regard, continues to face significant challenges in formulating legal instruments capable of bridging market demands with the principle of sovereignty, as overly administrative approaches often overlook the strategic dynamics inherent in foreign investment (Diamond & Liddle, 2011)

The investment screening mechanism can no longer be framed merely as an administrative tool for managing foreign capital flows; rather, it must be understood as a constitutional and moral articulation of the state's identity—asserting the boundary between openness and sovereignty. Amid a global landscape increasingly shaped by economic integration, the state's capacity to establish substantive criteria for investment is not a form of resistance to modernity, but an expression of courage in shaping a national development future grounded in social justice and collective dignity.

Within the logic of public law, the state is not merely required to respond to global realities, but also to project its foundational constitutional values into a regulatory structure that is both dynamic and responsive to risk. Thus, investment screening is, at its core, an existential affirmation of the state as a legal subject with a vision—rather than merely a passive executor of market-driven policy. This moment presents an opportunity for Indonesia not only to reassess its legal architecture but also to formulate a screening system that is relevant, adaptive, and contextually grounded—an agenda that will be further explored in the following subsection on the formulation and legal design of foreign investment screening.

3.2 Constructing a legal formulation for foreign investment screening in Indonesia

The legal formulation of foreign investment screening in Indonesia should not be perceived merely as a reactive measure to the dynamics of global capital flows, but rather as an effort to construct a normative system capable of wisely governing the intersection between economic interests and public sovereignty. To date, the legal approach has remained predominantly procedural-administrative in nature and has not substantially assessed the strategic risks embedded in incoming investments.

The reliance on risk-based licensing mechanisms—framed within the logic of bureaucratic efficiency—has, in practice, failed to provide adequate space for evaluating the potential economic, social, and political impacts of foreign investment in vital sectors. When regulations do not distinguish between speculative and productive investments, the state forfeits its ability to align investment flows with the trajectory of sustainable national development ("Balancing Risks," 2023). In this context, the legal framework cannot remain confined to merely prescribing entry procedures; it must evolve into a selective instrument capable of applying long-term risk-based considerations, including the authority to reject or defer investments that contradict constitutional values or threaten national interests (Trebilcock & Howse, 1998).

Indonesia's investment legal politics is situated within a tension between the aspiration to attract foreign capital through economic liberalization and the imperative to retain control over strategic sectors with long-term implications for national sovereignty. This friction arises from the fact that legislative direction is often driven by the pragmatic logic of short-term development, whereas the protection of strategic interests has yet to be adequately embedded in the prevailing normative framework.

As a result, regulatory development in Indonesia tends to be reactive and sectoral, lacking an institutional design capable of integrating a unified vision of sustainable national development. In policy practice, the implementation of the OSS system and the formulation of the investment priority list have indeed accelerated licensing procedures. However, these mechanisms fall short of addressing the evaluative dimensions of political, environmental, or social risks inherent in certain types of foreign investments (Chan & Meunier, 2022).

This creates a gap in the integration between technocratic instruments and the foundational values of the state that should serve as the basis for policymaking. A legal politics framework that fails to articulate a balance between liberalization and substantive control risks producing cosmetic regulations—superficial in nature and lacking genuine protection for the nation's vital assets.

One of the most frequently cited models in the formulation of national investment screening policies is the mechanism implemented by the United States through the Committee on Foreign Investment in the United States (CFIUS). This mechanism illustrates that investment screening is not merely a matter of administrative procedure, but rather a form of strategic state prudence in responding to the influx of foreign capital that may affect national security and control over critical technologies.

What distinguishes the CFIUS approach from other systems is its integration of intelligence analysis into the evaluation process, as well as the legal flexibility it affords the government to reject or unwind transactions based on threat parameters to critical infrastructure or domestic supply chains (Da Silva, 2025). This approach reflects a nuanced understanding that in the age of geoeconomics, foreign investment is no longer a politically neutral activity—it can function as a means of strategic penetration by other states into sensitive areas of national jurisdiction.

CFIUS does not operate merely as a technocratic body, but rather as a deliberative interagency forum that brings together elements of national security, defense, and finance. The incorporation of a "threat-based justification" principle in CFIUS policy frames investment screening not as a violation of economic openness, but as an exercise of sovereignty oriented toward risk prevention (Tinti, 2025). From this practice, Indonesia can learn that strengthening an investment screening system need not conflict with liberalization commitments, as long as it is grounded in legitimate strategic reasoning and firmly anchored in legal norms.

The European experience in developing an investment screening system under Regulation (EU) 2019/452 demonstrates that cross-national coordination need not be executed solely through a central authority, but can instead be structured via a dialogue mechanism among member states based on minimum standards for safeguarding national security and public order.

This framework underscores that openness to foreign investment must be balanced with the capacity to collectively evaluate risks inherent in cross-border transactions, particularly in the technology, energy, and digital infrastructure sectors. Unlike the centralized model exemplified by the United States' CFIUS, the European Union's approach places greater emphasis on the principles of subsidiarity and proportionality, allowing member states to retain policy autonomy insofar as it aligns

DOI: https://doi.org/10.54477/LH.25192353.2025.3.pp.50-59

with jointly agreed minimum standards (Wernicke, 2020).

This model demonstrates that investment screening can be established without sacrificing economic integration, as long as there is a legal architecture that ensures transparent participation among actors and an information-sharing framework that is institutionally accountable (Sattorova et al., 2020).For Indonesia, the key lesson from this practice is the importance of developing a screening system that is not only effective in selecting investments, but also capable of cultivating a culture of collective oversight involving multiple stakeholders, including sectoral regulatory bodies and civil society.

Australia's approach to foreign investment screening through the Foreign Investment Review Board (FIRB) offers a perspective that emphasizes conceptual flexibility in defining national interest. Unlike models that rely entirely on codified rules and rigid indicators, the FIRB system provides interpretive space for the government to evaluate investments contextually, taking into account dimensions such as economic security, impact on domestic employment, environmental sustainability, and the involvement of foreign governments in the proposed transactions.

This model enables the state to remain adaptive to global dynamics without losing control over its strategic resources (Dupont & Reckmeyer, 2012).One of the core strengths of this system lies in its capacity to articulate economic sovereignty through administrative practices that still uphold the principles of transparency and public accountability. Investment evaluations are not carried out by a single technical agency but instead occur through a consultative structure involving relevant ministries, intelligence agencies, and fiscal policy actors. The final decision rests with the Treasurer as the executive representative, but it is reached through a multi-layered deliberative process. In the context of Indonesia, the FIRB model is worth examining because it offers a synthesis between openness and protection, and it allows the state to define national interest through parameters that are not static but evolve in accordance with societal needs and geopolitical challenges (McCalman et al., 2024)

The absence of a risk-based investment screening mechanism and substantial parameters within Indonesia's legal framework creates a normative gap that severely undermines the state's capacity to proactively safeguard its economic sovereignty. Existing regulations, such as Law Number 25 of 2007 on Investment and its derivative provisions, remain largely entrenched in an administrative approach focused on ease of doing business. This orientation neglects the strategic dimension necessary for the state to conduct substantive evaluations of the motives and long-term consequences of foreign investment.

The absence of clear definitions for key concepts such as "strategic sectors," "national interest," or even "threats to economic security" renders Indonesia's investment selection process overly formalistic, failing to account for the multidimensional nature of contemporary global investment (Crystal, 2009). Regulatory fragmentation across sectors such as energy, technology, and natural resources further exacerbates the issue, as each domain operates under its own supervisory logic, lacking an integrated regulatory coordination mechanism.

As a result, the state lacks sufficiently robust legal instruments to reject investments that, in practice, harm local communities or create structural dependencies on external actors. Moreover, the absence of a comprehensive risk assessment mechanism hampers policymakers' ability to anticipate the potential for international arbitration when the state seeks to revoke permits or intervene on the grounds of protecting strategic interests (Adarkwah & Benito, 2023).

Building an effective investment screening system requires clarity on the substantive principles underpinning decision-making. Within the context of international economic law, the principle of nondiscrimination is often upheld to prevent differential treatment of foreign investors; however, within national legal frameworks, this principle must be balanced with the need to protect strategic sectors that have direct implications for national security and public welfare.

The principle of nondiscrimination should not be interpreted as an obligation to always accept investments, but rather as a commitment to approve or reject them based on objective, transparent, and legally accountable reasons (Mariotti, 2025). Furthermore, the principle of transparency must be upheld through the mandatory publication of evaluation criteria, public participation in policy assessments, and the accountability of screening institutions to prevent the mechanism from becoming a closed political tool.

Equally important, the national security review approach must be incorporated as part of a substantive legal framework, granting the state the authority to assess potential threats not only from military dimensions but also from digital economy, food security, and strategic technological infrastructure (Heidari, 2022). Finally, the public interest clause should be explicitly articulated to ensure that every screening decision consistently references constitutional values prioritizing the welfare of the broader population. By coherently integrating these four principles, the state can design an investment screening system that is not merely reactive to global pressures but proactively shapes a sovereign, just, and adaptive legal ecosystem.

The legal formulation of investment screening should not be positioned as an impediment to capital flows, but rather as an affirmative mechanism that ensures economic openness does not come at the expense of national sovereignty and social justice.

Amid the tension between liberalization and protection, risk-based screening offers a middle ground that enables the state to perform a reflective function regarding the direction of national development without disregarding commitments to international legal principles. A screening system designed with substantive indicators, cross-sectoral institutional involvement, and multidimensional security parameters provides the state with the legitimacy and capacity to exercise selective discretion grounded in solid legal foundations.

In a broader horizon, this also reflects a shift from a passive approach to investment toward a more active, responsive, and visionary regulatory model. Thus, investment screening is not merely an administrative control tool but a reflection of the state's courage to renegotiate its strategic position amid the uncertainties of the global landscape. This perspective lays the foundation for the subsequent discussion, which will highlight the challenges of implementation and institutional design of investment screening within Indonesia's national legal framework.

4. Conclusions

Strengthening the legal framework for foreign investment screening in Indonesia requires a shift from mere procedural facilitation to a normative formulation that integrates the principles of risk, sovereignty, and sustainability. In this context, the screening system cannot be designed as a passive administrative instrument but must become part of the state's legal strategy to safeguard the direction of national development, protect strategic sectors, and respond to evolving geopolitical dynamics. Lessons drawn from jurisdictions such as the United States (CFIUS), the European Union, and Australia demonstrate that successful screening lies not in a uniform model but in the clarity of principles, the accountable distribution of authority, and the flexibility to interpret national interests. Indonesia continues to face normative fragmentation and lacks legal parameters that enable substantive evaluation of the long-term impacts of foreign investment. Therefore, the urgent need is not merely to establish new norms but to transform the legal perspective itself—as a space for negotiating values between economic openness and the courage to determine the nation's future sovereignly.

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