The Inward Foreign Direct Investment (FDI) and decentralized governance system in Indonesia
Kuswanto, Kuswanto

IMPORTANT NOTE: You are advised to consult the publisher's version (publisher's PDF) if you wish to cite from it. Please check the document version below.

Document Version
Publisher's PDF, also known as Version of record

Publication date:
2019

Link to publication in University of Groningen/UMCG research database

Citation for published version (APA):

Copyright
Other than for strictly personal use, it is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), unless the work is under an open content license (like Creative Commons).

Take-down policy
If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

Downloaded from the University of Groningen/UMCG research database (Pure): http://www.rug.nl/research/portal. For technical reasons the number of authors shown on this cover page is limited to 10 maximum.

Download date: 28-09-2019
CHAPTER II. LITERATURE REVIEW AND RESEARCH DESIGN

This dissertation aims to analyze the ways in which Indonesia has managed inward FDI since the introduction of the decentralized governance system. Furthermore, it focuses on the ways in which investment policies are directed to achieve sustainable development, and the dynamic interactions between the national government, local governments, and MNCs in the process of managing inward FDI. In order to accomplish these objectives, a variety of literature and concepts have been assessed to develop a framework of analysis. In the beginning, we review the theory of Governance and the concepts of FDI and development. We also assess theory of International Business and Government Relationships in the international political economy, and a selection of international business literature.

2.1 GOVERNANCE

This dissertation examines the governance of inward FDI in Indonesia under the decentralized governance system. Understanding the concept of governance is necessary to fully determine the scope of the study. Currently, the governance is defined differently by many scholars across several academic disciplines. In sociology, Kooiman (2003) and Bevir (2010) define the governance as the system which influences social interactions between actors solving social problems. In political science, Bratton and van de Walle (1992) define the governance as dynamic interaction process between states and social actors to determine the rules of the political game. Frischtak (1994) defines governance as the capacity to determine good public policy that represents the public interest, through the aggregation of the many different interests of political actors. In economics, the concept of governance is understood as the formal and informal regulations used to govern the economic relationships between public and private parties (Williamson, 1979). In international relations, the United Nations (1995) defines the governance as the sum of the many ways that public and private individuals and institutions manage their common affairs. The governance consists of the formal and informal institutions which influence the interaction processes between actors with different interests.

Governance is defined, in this dissertation, as both an institution and an interactive process. Firstly, governance consists of the formal and informal regulations used to govern the social, political, and economic relationships between actors. Secondly, governance is perceived as the interactive process between social, political, and economic actors.
2.2 FOREIGN DIRECT INVESTMENT (FDI) AND DEVELOPMENT

The concept of foreign direct investment has several different meanings and measurements. In this dissertation, we select the definition developed by the Organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF). OECD (1996) defines FDI as an investment made by foreign enterprises in one economy to obtain a lasting interest in another country. In a more accurate definition, a direct investment enterprise is an enterprise with foreign equity of ten percent or more of an ordinary share of companies. Similarly, the IMF (2004 p.3) defines FDI as follows:

“[An] international investment that reflects the objective of a resident in one economy (the direct investor) obtaining a lasting interest in an enterprise resident in another economy (the direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise, and a significant degree of influence by the investor on the management of the enterprise. A direct investment relationship is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of an enterprise abroad.”

The above definitions have shown four essential characteristics of FDI. Firstly, FDI is conducted by companies in other countries. Secondly, investments involve a long-term relationship between the companies and the host countries, facilitated through an establishment of a physical entity such as factory, office, etc. Thirdly, investments implicate the control of foreign companies in the management of the firms in the host country. Fourthly, the international companies possess at least ten percent of the foreign equity of the newly created companies or partners companies in host countries.

There are two types of FDI, based on the flow of money. Inward FDI is the direct investment from abroad, which involving transfer of all liabilities and assets from the direct foreign investors to the resident's enterprises (World Bank, 2017). In contrast, the outward foreign FDI is the direct investments go abroad which involving transfer of all liabilities and assets from resident direct investors to the foreign enterprises (World Bank, 2017). Inward FDI has several forms; Markusen (1984) classifies three forms of FDI: horizontal FDI, vertical FDI, and conglomerate FDI. Horizontal FDI is a type of FDI that occurs when companies expand their target market and produce similar goods outside the country to reduce transportation costs and tariffs. Vertical FDI is a type of FDI that occurs when companies try to exploit raw materials that are not found in their home country, with the goal of reducing production costs. Conglomerate FDI involves both vertical and horizontal FDI occurring at the same time (Markusen, 1984).
In terms of mode of investment, Chaudhuri and Mukhopadhay (2014) classify three types of FDI: greenfield investment, merger and acquisition (M&A) investment, and joint venture. Greenfield investment is a form of FDI in which a foreign company begins a new venture and constructs new facilities in the foreign country; M&A investment is a form of FDI in which international companies merge with other domestic firms in the host country; joint venture investment is a mode of investment in which foreign enterprises develop a partnership with local enterprises in a particular business, and share profit, risk, and expertise (Chaudhuri and Mukhopadhyay, 2014)

Inward FDI provides significant contributions to the host country’s economic development, while at the same time it has adverse impacts on the country’s economic development. Considerable evidence shows that inward FDI can enhance the economic growth of a country (Borensztein et al., 1998, Blostroom and Kokko, 1998, Rodriguez and Clare, 1996). For instance, Chowdhury and Mavrotas (2006) found a positive relationship between inward FDI and economic growth in Chile, Malaysia, and Thailand. By using 24 developing countries as samples, Choe (2003) found that inward FDI can enhance economic growth in those host countries, and Faras and Ghali (2009) found a positive relationship between inward FDI and economic growth in Gulf countries. The contribution of inward FDI to the economic growth in a host country because of the technology and knowledge spillover from MNCs to domestic enterprises, the jobs created by MNCs, the tax paid by MNCs, and the supply and backward linkage between MNCs and domestic enterprises (Borensztein et al., 1998, De Mello, 1999). Furthermore, inward FDI improves productivity and competitiveness of domestic enterprises because it helps local enterprises to expand their access to international markets and to learn the technologies from foreign companies (Pavlinek, 2004).

Nevertheless, inward FDI also brings some negative consequences to the local economy. Shaikh (2010) found negative impacts of inward FDI on primary sectors of economic growth in 47 developing countries. Khalid and Noy (2007) have also found the adverse implications of inward FDI in the mining and quarrying sectors of economic growth in Indonesia. The negative impacts of inward FDI may be caused by the fact that inward FDI may result in the dependency of a country on foreign capital, the decay of local firms due to imbalanced competition, and external shift of control of the local economy (Pavlinek, 2004). Furthermore, inward FDI may create labor shedding, and the downsizing of production (Pavlinek, 2014).
Table 2.1 The Potential Effects of Inward FDI on Economic Development.

<table>
<thead>
<tr>
<th>Levels</th>
<th>Potential positive effects of inward FDI</th>
<th>Potential negative impacts of inward FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprises level</td>
<td>• Continued and expanded production&lt;br&gt;• Increased labor productivity&lt;br&gt;• Access to investment capital&lt;br&gt;• Access to the worldwide sale and distribution networks&lt;br&gt;• Improved competitiveness&lt;br&gt;• Increased R&amp;D</td>
<td>• Labor shedding&lt;br&gt;• Disinvestment and downsized production</td>
</tr>
<tr>
<td>Host country economy level</td>
<td>• Retainment of existing jobs and creation of new jobs&lt;br&gt;• Increased wages&lt;br&gt;• Economic Growth&lt;br&gt;• Increased tax base&lt;br&gt;• Increased exports&lt;br&gt;• Labor training&lt;br&gt;• Provision of social services to local communities&lt;br&gt;• Spillover of technology and wealth to the local and regional economy&lt;br&gt;• Increased opportunities for local companies to supply foreign-owned enterprises</td>
<td>• Local dependency on foreign capital&lt;br&gt;• External control of local economies&lt;br&gt;• Attracting skilled and semi-skilled workers from local businesses&lt;br&gt;• Suppression or destruction of local firms who are unable to compete with FIEs supported by generous government investment incentives and benefiting from transfer pricing&lt;br&gt;• Ensure the development of new indigenous enterprises</td>
</tr>
</tbody>
</table>

Source: Pavlinek (2004, p.48)

Note: The inward FDI has both positive and negative impacts on the economic development of the host country. On the one hand, inward FDI helps domestic enterprises to increase productivity, which helps to expand their markets internationally, increase their labor productivity, and enhancing their capacity to export. However, the inward FDI may also create labor shedding, and downsize production. On a national level, inward FDI may increase exports, raise taxes revenue, create jobs, increase wage standards, and generate technology spillovers. Inward FDI may also hurt local enterprises and increase local dependency on foreign capitals.
Several factors influence the levels of contribution that inward FDI has on the economic growth in a country. Boreinsztein et al. (1998), Bengoa and Robles (2003), and Li and Liu (2005) argue that the capacity of the human resources of the host country is a pivotal factor in the enhancement of the contribution of inward FDI to economic development. Li and Liu (2005) also emphasize that the technological gap is an influential factor in increasing the contribution of inward FDI towards the economic growth of the host country. Bengoa and Robles (2003), Alfaro et al. (2004), Durham (2004), and Hermes and Lensink (2000) found that a stable financial market system is essential for the enhancement of the contribution of inward FDI towards economic growth in a host country. Solomon (2011) found that in order to increase the contribution of inward FDI on economic growth in a host country, the country should provide a good political environment for foreign investors and conduct a good governance practice.

In addition to having significant contributions to economic growth, inward FDI also plays essential roles in social development. Inward FDI improves the welfare of local people via job creation, and the national increase of wage standards (Lipsey and Sjolhom, 2004 and Baghizarde, 2012). Baghizarde (2012) found significant evidence that inward FDI has enhanced the Human Development Index (HDI) in twelve of the Commonwealth of Independent States (CIS). OECD (2001) found evidence that inward FDI creates employment, increases the distribution of wealth within and across host country and helps its host country to alleviate poverty. Mabey and McNally (1999), Oman (1999), and Nordstrom and Vaughan (1999) show the positive impacts of inward FDI on the income-per-capita in host countries.

Nevertheless, significant evidence shows that inward FDI also has some negative social consequences. Galagher (2005) and Moran (2002) found that MNCs from countries that have low standards of labor rights tend to violate the labor rights of their host country. Zhang and Zhang (2003) and Wei et al. (2009) have found that inward FDI creates income inequality in China. It has also been found that inward FDI decreases income inequality in Mexico (Jensen and Guillermo, 2007) and the US (Chintrakan et al., 2012). Basu and Guariglia (2007) have shown significant evidence that inward FDI promotes economic inequality in 80 countries. Figini and Gorg (2011) and Hyungsung and Miguel (2017) have also found that inward FDI increases wage inequality in developing countries. Since inward FDI has both positive and negative impacts on the social development of its host country, the pro-market economic policy should be complemented with policies and interventions designed to expand the access of local people to income opportunities (OECD, 2001).
Inward FDI also has both positive and negative impacts on the environmental well-being of its host countries. It may improve the structural efficiencies of the environmental regulations in the host country government if multinational companies bring with them a benchmark for the improvement of the environmental regulatory framework (OECD, 2001). Furthermore, Galagher and Zarkhy (2007) have found that MNCs have fewer negative pollution impacts on a nation than its domestic companies (Galagher and Zarkhy, 2007). However, much evidence also shows that inward FDI mining sectors have deteriorated the quality of the environment in the areas of mining-related activities in many developing countries (OECD, 2001). Cole and Elliot (2005) argue that the presence of inward FDI in Japan and across South Asia increases the pollution in these areas. Cole et al. (2006) found that the least developed countries have the weakest environmental policies, which makes them vulnerable to become pollution havens for foreign enterprises.

Since inward FDI has both positive and negative impacts on sustainable development, many scholars have attempted to find the proper governance setting to minimize the risks of inward FDI and to maximize the benefits of inward FDI. OECD (2001) emphasizes the need for MNCs to conduct voluntary initiatives to pursue sustainable development by complying with ethical corporate governance principles, implementing codes of conduct in the management system, reporting environmental performance, and promoting corporate social responsibilities. Moran (2011) urges international organizations to pressure MNCs to conduct good corporate governance and comply with corporate social responsibilities. Furthermore, Moran (2011) also calls upon international organizations to assist developing countries in the processes of making contracts with MNCs in mining sectors, emphasizing the potential roles of global communities and international organizations to pressure MNCs to conduct sound corporate governance principles. The host country government, on the other hand, is responsible for establishing a proper governance setting. Many scholars refer to this as “good governance.” Hoen (2001) defines good governance as “a policy which defends the interests of the society at large and not necessarily particular interests of small groups.” To develop good governance OECD (2015) created the Investment Policy Framework (IPF), to assist host countries with the establishment of appropriate investment policies designed to attract inward FDI. While the IPF only focuses on strategies that attract inward FDI, the UNCTAD (2012) developed an investment policy framework for sustainable development (IPFSD) which also focuses on the regulation of inward FDI in host countries to achieve sustainable development from the investment.
2.3 INVESTMENT POLICY FRAMEWORK FOR SUSTAINABLE DEVELOPMENT (IPFSD)

In the IPFSD, UNCTAD (2012) asserts that one of the aims of investment policies should be achieving sustainable development. Sustainable developments can be defined as developments that meet not only the needs of people today but also the needs of future generations (WCED, 1987). The IPFSD provides some core principles and guidance to develop national investment policies and international investment agreements. In this dissertation, we focus only on the core principles and guidance proposed to establish national investment policies.

There are eleven core principles of investment policymaking, which should be followed by the host country’s government in the creation of investment policies (UNCTAD, 2012). First, the objective of the investment policies should be to promote inclusive growth and sustainable development. Second, investment policies should be grounded in the country’s overall development strategies. Third, investment policies should be developed with the involvement of all stakeholders, and the implementation must involve good public governance. Fourth, investment policies should be regularly reviewed in regards to their effectiveness and the relevance, in the face of dynamic change. Fifth, the investment policies should strike an agreeable commitment to respect the right of the states and investors. Sixth, each country has the sovereign right to establish entry and operational conditions of foreign investment to minimize the risks of investments. Seventh, the restrictions or conditions imposed upon MNCs when MNCs entry to a host country should be open, stable, and predictable. Eighth, the established investors should be protected and be treated equally with the domestic enterprises. Ninth, policies for investment promotion and incentives should be in alignment with sustainable development goals. Tenth, the investment policies should facilitate adoption and compliance with international practice of good corporate governance, and also with proper corporate social responsibility. Eleventh, the international community should cooperate in the addressing developmental challenges related to the investments such as inequality, environmental degradation, and human right violation (UNCTAD, 2012).

The eleven core principles outlined above should be incorporated into the national policies guidelines (UNCTAD, 2012). UNTAD (2012) assert that there are three policy actions to be taken by the host country’s governments, as stated below:

"At the strategic level, policymakers should ground investment policy in a broad roadmap for economic growth and sustainable development – such as those set out in
formal economic or industrial development strategies in many countries. At the normative level, through the set of rules and regulations, on investment in a range of policy areas, policymakers can promote and regulate investment that is geared toward sustainable development goals. At the administrative level, through appropriate implementation and institutional mechanisms, policymakers can ensure the continued relevance and effectiveness of investment policies (UNCTAD, 2012 p.15).

2.3.1 Grounding investment policy in development strategy.

Investment policies should be grounded in the host country's development strategies (UNCTAD, 2012). In line with that advice, the development planning document should be developed as a basis for developing investment policies. The development strategy should include investment priorities selected from sectors that will have the most significant contribution to national development. More specifically, the investment priorities are selected from investments which have a significant contribution to the host nation’s human resources capacity, technological spillover, infrastructure development, and enterprise development. Boreinsztein et al. (1998), Bengoa and Robles (2003) and Li and Liu (2005) emphasize the importance of human resources capacity to enhance contributions of inward FDI to the economy of the host country’s government. Another important principle is that the government should ensure that consistency of investment policies and other policy areas are geared towards their established development objectives.

2.3.2 Investment regulations and incentives

There are several guidelines to develop sound investment regulations and incentives. Fostering inclusive growth and sustainable development requires a balance of efforts to attract, and to regulate, inward FDI (UNCTAD, 2012). To attract inward FDI, the host country government should include policies to protect foreign investors from any expropriation, protectionism policies, discriminating behaviors. In addition, the host country government should secure foreign companies’ right to repatriate the profits. Furthermore, the government should not interfere with the operation of the foreign companies or impose any performance requirements and should provide a transparent, secure, and efficient land ownership registration system (UNCTAD, 2012). Similarly, OECD (2015) also suggests the host country government establish a transparent and predictable procedure of investments, avoid discriminatory treatment, protect the property rights of foreign enterprises, ensure the enforcement of contracts, and determine dispute settlements. Much evidence shows that
countries which are more open toward inward FDI have higher economic growth (OECD, 2001, Sachs and Warner, 1995, Ben David, Nordstrom and Winters, 1999).

OECD (2015) also suggests the host country government be less restrictive toward inward FDI. UNCTAD (2012), in contrast, indicates that the restrictions imposed upon MNCs are allowed but should first be deemed as justifiable to protect national interest and national security, to control natural resources, to develop a critical infrastructure, to preserve the environment, to accelerate national development, and they should be clear and get reviewed periodically.

In addition to being receptive to inward FDI, it is suggested that the host country’s government conduct investment promotion, and provide active incentives for foreign investors (UNCTAD, 2012 and OECD, 2015). Investment promotion should be connected with national investment policy objectives and be undertaken by a cross-ministerial body such as an investment promotion agency. (UNCTAD, 2012). The incentives should be given to the investments which stimulate the transfer of technology, enhance domestic workers’ skills, and support linkage with local enterprises without lowering environmental, labor, or other regulatory standards (UNCTAD, 2012).

Boreinsztein et al. (1998) and De Mello (1999) argue that the positive impacts of inward FDI on economic growth cannot be achieved automatically. UNCTAD (2012) suggest that the host country’s government should actively nurture and facilitate business linkage between foreign investors and domestic companies. These efforts can be made through direct intermediation between the national and international investors, by supporting national companies to upgrade their technology, by establishing national business norms and standards, and by providing incentives for foreign investors to assist in enhancing small and medium enterprises (SME) (UNCTAD, 2012).

2.3.3 Investment-related policies

UNCTAD (2012) suggest that the host country government develop a broad range of economic, social and environmental policies, in addition to investment policies such as trade policy, tax policy, competition policy, labor market regulations, land access regulations, corporate governance and social responsibility, environmental policy, and infrastructure policy. All of those policies must be combined with investment policies in order to achieve sustainable development (UNCTAD, 2012). For instance, the host country government should conduct a proper governance practice by adopting anti-corruption legislation, anti-monopoly policies, protection of property rights, and effective trade policies. The government also must
regulate the labor market, support job creation, and protect abusive labor practices by creating labor regulations that follow the international labor standard. Corporate governance practice is also encouraged, domestically, through the regulation of a company's corporate governance standards and environmental ordinances to regulate the company activities, which must adhere to international environmental standards (UNCTAD, 2012).

We have discussed the proper governance settings which are designed to ensure that inward FDI is beneficial for all people in host countries. One of the essential principles is that the host country government and foreign investors have an equal right (UNCTAD, 2012). We argue that by analyzing the dynamic relationship between the government and MNCs under the current decentralized system, we can further examine whether the states and investors interact in the process of managing inward FDI. Some relevant theories regarding the relationship between the host country government and MNCs are discussed in the following section.

2.4 THE NATIONAL GOVERNMENT – LOCAL GOVERNMENT - MNC RELATIONS: A MULTI-LEVEL GOVERNANCE APPROACH

As mentioned in the previous section, this dissertation examines the dynamic interaction between the national government, the local governments, and MNCs. Currently, the relationships between these actors have not been theorized by scholars. However, the relationships between the host country government and MNCs have been theorized by many scholars within the fields of international business and international political economy. In this dissertation, we combine the existing theories on the relationship between MNCs and host country government with Multilevel Governance Theory.

2.4.1 The actors involved in the process of managing inward FDI

Currently, worldwide, most countries in the world have implemented decentralization (Manor, 1999). This widespread decentralization has increased the roles of local governments in the governance process. Decentralization can be defined as a set of policies which transfer power, authority, and responsibilities within the government, and which also share authority and resources for shaping public policy within society (Cheema and Rondinelli, 2007). Furthermore, decentralization is classified into four types: first, political decentralization is the devolution of powers and authority to the local unit of government, power-sharing institutions, and institutionalization of procedures that allow freedom of association and participation of civil society organizations, both in public decision-making processes and in selecting political representatives. Second, fiscal decentralization is a mechanism for fiscal cooperation in
sharing public revenues among all levels of government; for budgetary delegation in public revenue raising and expenditure allocation, and for fiscal autonomy for the state, regional, or local governments. Third, administrative decentralization is the distribution of authority, responsibility, and financial resources from the central government to the local governments, semiautonomous public authorities, corporations, area-wide, regional, or functional authorities. Fourth, economic decentralization is a transfer of responsibility of functions such as liberalization, deregulation, privatization of state enterprises and public-private partnership from the public to private parties (Cheema and Rondinelli, 2007).

Due to the fact that so many countries have implemented decentralization, the current theory of the relationship between MNCs and the host country’s state government cannot explain the roles of the local governments in the interactions between state actors and international businesses, in regard to the processes of managing inward FDI. We consider Multilevel Governance Theory to be one of the important tools for the analysis of the interaction between the national government, the local government, and MNCs. Multilevel governance (MLG) is a structure of functions in which many actors negotiate at the international, national, and local levels of management (Blanche and Flinders 2004). While the MNCs and the host country government have previously been the two most dominant actors in the process of managing inward FDI, multilevel governance actors have become more involved in this process due to decentralization. On an international level, the MNCs are the most important actors involved in the process of managing inward FDI. Currently, global investment is not regulated by a multilateral agreement; instead, the interaction between MNCs and the host country government is governed by bilateral investment treaties between the host country government and the home country government. In the case of conflict, a supranational institution such as the World Bank establishes an investment settlement court as a neutral court to ensure fairness.

At a national level, the host country government is the most crucial actor in the process of managing inward FDI. The host country government establishes domestic regulations to determine the mechanisms of interactions between MNCs and host country government, in areas such as investment restrictions, procedures of investment, and requirements to be fulfilled by MNCs. Additional actors, such as non-governmental organizations and political parties, are essential in the process of managing inward FDI. However, their roles in the process are less significant than those of the national government.
Since the governance system in many countries has been recently decentralized, the actors at local levels have gained significant power in the process of managing inward FDI. District and provincial governments, which have recently gained considerable power in the management of regional economic development, are categorized as strategic actors in the process of managing inward FDI. Some non-governmental organizations and local communities, such as local business associations are impacted by inward FDI and these parties therefore actively participate in the process of managing inward FDI. Considering this situation, we identify the actors involved in the processes of managing inward FDI in Indonesia into six categories based on the roles and the power (see table 2.2). In the following section, we discuss the following actors and their interests in the process of managing inward FDI.

Table 2.2. Institutional actors in the governance process of FDI based on MLG

<table>
<thead>
<tr>
<th>Level</th>
<th>Strategic Actors</th>
<th>Additional Actors</th>
</tr>
</thead>
<tbody>
<tr>
<td>International</td>
<td>Multinational Companies</td>
<td>1. Home country government</td>
</tr>
<tr>
<td>Level</td>
<td></td>
<td>2. Supranational institution (WTO, WB, ASEAN)</td>
</tr>
<tr>
<td>National Level</td>
<td>National host country government</td>
<td>Nongovernmental actors, including business associations</td>
</tr>
<tr>
<td>Local Level</td>
<td>District and provincial government</td>
<td>Nongovernmental actors, including business associations</td>
</tr>
</tbody>
</table>

Source: created by Kuswanto, adopted from Blanche and Flinders, 2004

Note: The Multilevel Governance concept shows three levels of institutional actors in the process of managing inward FDI: the international level, national level, and local level. The interaction between these actors is governed through bilateral investment treaties (BIT) and domestic regulations related to FDI. There are three strategic actors: MNCs, host country (national) government, host country (district and provincial) government. There are three additional actors with different roles. The home country governments support MNCs by proposing the Bilateral Investment Treaties (BIT) to host country government. BIT is an investment treaty consists of norms to treat MNCs in a host country. Supranational institutions provide a neutral court to resolve any disputes between the host country government and MNCs, in accordance to the BIT.
A. Multinational Corporations (MNCs)

An MNC is a company that has its business in countries outside of its home country, with the ability to control the production of goods or services (Christos and Sugnen, 2000). The primary interest of MNCs in conducting investment activities is to obtain profits and efficiency. Dunning (1997, 1998a) lists three primary motivations of MNCs in performing foreign investment: seeking new markets, seeking resources unavailable in their home country government, and seeking efficiency. Since MNCs embrace new markets to gain more customers, MNCs consider market size, per capita income, market growth, market structure, and access to the global market in the location decision process. The MNCs also seek resources that are not available in their home countries, such as natural resources, raw material, low-cost labor, technological innovation, and infrastructure, to increase productivity and efficiency. The MNCs conduct foreign direct investment activities to lower production and transportation costs by considering the technology, labor, and infrastructure of a destination country. In addition to these economic factors, MNCs have recently begun to seek legitimacy from the local community as a critical motivation in conducting foreign direct investment (Eden et al., 2005).

B. Host country governments (national government)

The host country government is a government where the investment has been made. The primary interest of the host country government is the economic benefits reaped from the inward FDI such as the job creation, the technology, and knowledge spillover, and the balance of payment effects (Blosstroo and Koko, 1998, Clare, 1996). However, Eden et al. (2005) argue that every country has their specific objectives in term of inward FDI depends on the characteristic. For instance, the developed markets (US, UK, Western Europe) have the different purpose with the emerging markets (Brazil, India, South Korea) and the transition and developing countries.

C. Host country governments (local governments)

Recently, many countries have implemented decentralization as part of their government entity; as a result, local governments have become substantial players in the governance of FDI process. In a decentralized system, the local government can act as a representative of the local peoples’ interests alongside the national government. The primary function of the local government is to enhance regional economic development through productivity, knowledge spillover, and job creation, and to provide a link between MNCs and
domestic enterprises. In more democratic governance, the public policy developed by the
government must include citizens’ participation in the policy development process, so that the
next significant actors are local communities.

D. Home country governments

The country where MNCs originate from is referred to the home country government.
The home country benefits from job markets created by the MNC, and from profits generated
(Hill, 2005). However, the outward FDI made by MNCs may cause a decrease in production,
employment opportunities, and the home country’s economy, since economic activities have
shifted to the host country (Hill, 2015). The home country government can help their MNCs
by providing flagship cooperation, and negotiating with foreign governments and international
organizations to create favorable regulations (Bazuchi et al., 2013).

E. Supranational institutions

Another important actor involved in the process of managing inward FDI is the supranational
institution. There are specific supranational institutions related to trade and investments, such
as the international World Trade Organization (WTO) and regional organizations such as
Association of South East and Asia Nation (ASEAN) and ASEAN Free Trade Agreement
(AFTA and the Trans-Pacific Partnership (TPP). The WTO is a global international
organization that facilitates international trades, to help businesses to conduct their export and
import activities (WTO, 2016). Therefore, the WTO creates global norms and regulations
related the international trade, which have to be followed by its members. There are six
principles to be adhered by the organization such as non-discrimination trade principle, open,
predictable and transparent mechanism, more competitive markets, beneficial for less
developed countries, and protecting the environment. For countries in south-east Asia, the
ASEAN is a regional organization for countries in south-east Asia. The organization aims to
accelerate the economic growth, social progress, and cultural development, to promote
regional peace and stability, and to promote collaboration on economic, social culture and
scientific sectors (ASEAN, 2010).

F. National and local civil society

Other relevant actors in the managing process of inward FDI are the citizens and
communities which are represented by non-governmental organizations. The local community
may be defined as a group of people in a common place with shared values, beliefs, resources,
and some common identities (Beck, 1992). The local community is a part of civil society.
Civil societies are the sum of all aspects of society outside of the public and private sectors (Pharr, 2003). Civil society has been further defined as “an area of association and action independent of the state and the market in which citizens can organize to pursue purposes that are important to them, individually and collectively” (Brown et al., 2000 p. 275).

Civil society groups have different concerns in terms of inward FDI. For instance, non-governmental organizations concerned with the social, economic, and environmental aspects of development such as wage, ecological degradation, distribution of resources, and inequality. Another interest group which is concerned with the impacts of inward FDI on local business is the local business association. Local business associations are interested in benefiting from MNCs via linkage and market expansion.

2.4.2 The process of interactions between actors

Multilevel governance (MLG) Theory categorizes the modes of interaction between public and private actors into three different relationship patterns: the hierarchy, the network, and the market relationship (bargaining relationship) (Hooghe and Marks, 2001). Hooghe and Marks (2001) asserts that the hierarchical relationship is a relationship in which one actor is more dominant than the others and becomes a patron, leading the relationship to a client-patron relationship. The network relationship is a relationship which is developed based on mutual interests and trust among actors. The market relationship is a relationship based on a bargaining scenario among actors. In the process of managing inward FDI, public and private actors interact simultaneously.

The interaction between the multiple levels of institution actors above has not often been theorized in literature. In international business literature, the relationship between MNCs and the host country government is explained via bargaining relationship theories. The most prominent among these theorists is Raymond Vernon, who introduced the obsolescing bargaining model (OBM) (1971, 1977). According to the OBM, the nature of the relationship between the host country government and MNC is conflictual and is called the bargaining relationship. Due to the negative attitude of the government towards MNCs, there is always a bargaining process between the country and the MNC in the entry stages of FDI. In the beginning, the MNC possesses a higher bargaining power because the MNC offers economic benefits, abundant financial capitals, and superior technology needed by the host country government. Nevertheless, after the business is established the bargaining power of the MNC is obsolesced, and power shifts to the government’s side because the host country controls the assets possessed by the MNC (Vernon, 1978). This theory is cited by many scholars to explain

Nevertheless, over time, the OBM has been generally deemed irrelevant because, in more recent time, MNCs and host country government are interdependent due to globalization. Many scholars have criticized the OBM and proposed new models to theorize the relationship between MNCs and host country governments, which are grounded in institutional theory. For instance, Eden et al. (2005) propose the political bargaining model as an alternative to the OBM. According to this model, the nature of the relationship between MNCs and host country governments are cooperative instead of confrontational. Despite the collaborative relationship, bargaining between MNCs and host country government occurs, not only regarding the initial entry of the firm but also about a wide variety of government policies. The bargaining power of the parties is derived from the relative goals, stakes, resources, and constraints held by each party. Grosse (2005) proposes that domestic institutional factors are also critical in determining where the power of relationship lies. Dunning (1998b) also argues that in current economic globalization there is a mutual interdependence between MNCs and their host country government, which changes the attitude of government from confrontational to cooperative.

In the field of international political economy, some scholars claim that globalization has altered the relationship between MNCs and host country governments. Stopford and Strange (1991) illustrate the dynamic nature of the relationship between MNCs and host country governments by introducing the triangular diplomacy model. According to this model, the global political structure has changed the nature of the relationship between the MNCs and host country governments from a conflictual to a more cooperative one, due to the mutual interdependence of those actors. The placement of power within the relationship between the MNCs and the host country government is determined by its stake. There are three competitions which determine the stakes of each actor: the competition between MNCs, the competition between the government and the competition between MNCs and host country government.

Ramamurti (2001) proposes a new model to explain the relationship between MNCs and host country government by considering the roles of globalization and international investment agreements: the two-tier bargaining model. According to this model, the relationship between the host country government and the MNCs can be explained as follows. First, there is a shift in the government’s attitude toward MNCs, from one of conflict to one of
cooperation. Second, two bargaining processes occur. The first-tier bargaining process occurs between the host and home country governments, which results in a macro policy designed to provide a friendly environment for the MNCs. This bargaining can occur directly between the host and home country governments, or indirectly via supranational institutions. The second tier of negotiation occurs between the host country government and the MNCs, which aims to discuss some policy matters affects the operation of MNCs such as the investment requirements imposed upon MNCs, the use of local products, and the export targets. In contrast with the triangular diplomacy by Stopford and Strange (1991), this model views the roles of the home country governments as far more significant than the roles of the supranational institution. Although the bargaining theory has evolved over the time, the current context of decentralized governance has rarely been taken into consideration by scholars to theorize the relationship between MNCs and host country government. We propose a new framework, as follows (see figure 2.1).

Figure 2.1. The Triangular Governance Relationship in Managing Inward FDI
In the current globalized and decentralized era, three strategic institutional actors - the national government, local governments, and MNCs - have become involved in the process of managing inward FDI. The relationships between national government – local government – MNCs are governed by international and domestic regulations on foreign investment. Since there is no multilateral agreement related to the investment, the applicable international regulation on foreign investment recently is only the Bilateral Investment Treaties (BIT). BIT is the agreement between home country governments and host country governments related to the norms and rules which govern the processes of interaction between foreign investors and the host country government. Furthermore, the BIT provides a guarantee for the host country government to protect the property rights owned by MNCs (Guzman, 1998). The BIT also increases the attractiveness of a country for foreign investors, and as a result is considered to be the most crucial legal mechanism available to attract inward FDI (Elkins, Guzman and Simmons, 2004). The supranational institution provides a legal mechanism to resolve disputes between the host country government and MNCs via international courts, in the case of investment disputes.

The globalized regime has changed the relationship between MNCs and host country governments from adversarial to cooperative. The host country governments tend to be more open towards inward FDI due to the mutual interdependence between MNCs and the host country government; the host country government needs MNCs to accelerate economic development. On the other hand, MNCs need the host country government to pursue their financial objectives. In this relationship, the bargaining between MNCs and the host country government is not only related to the entry requirements, but also to domestic policies. Furthermore, the bargaining process is caused not by the negative attitude by host country government, but by transactional issues.

Under the decentralized system, the power and authorities of the public policy-making process are shared among institutions beyond single jurisdiction (Piationi, 2010). Furthermore, the national and local governments cannot be categorized as one entity, in which the different levels of government have different interests regarding FDI projects. Due to these changes under the decentralized system, MNCs need to bargain with multilevel government actors. Therefore, bargaining occurs not only between MNCs and the national government but also between MNCs and the local government. Decentralization encourages the local government to forge a more cooperative relationship with the MNCs. The bargaining process between the local government and MNCs is unavoidable, however, because political decentralization
encourages local leaders to consider the interests of the public in policy-making processes. In the bargaining process between MNC and local government, the power placement within the relationship is determined by the comparative goals, stakes, resources, and constraints owned by each party. Furthermore, the dynamic relationship processes between MNCs – national government – the local government will be explained in the following sections.

A. The relationships between the national and local government.

Under the decentralized system, the power and authority of the public policy-making process are shared among institutions beyond the single jurisdiction, and the non-state actors can participate in the policy-making processes (Piationi, 2010). That governance system has changed the relationship between the national and local governments from hierarchical to a collaborative relationship. Although the national and local governments have a different opinion regarding mechanism to screen inward FDI projects, the national and local governments have a similar vision of inward FDI, which is to enhance the contribution of inward FDI towards development. Due to that change, some problems may arise, in areas such as taxation, regulations, and poor coordination between the local and national governments. Therefore, proper coordination mechanisms are necessary.

The change of the relationship between the national government and local governments may follow two model of governance as follows: type I and type II of MLG. Type I of MLG is characterized by the fact that the decision-making power is shared with the lower unit of government with the limited number of jurisdictional levels. Each of the jurisdiction carries out multiple government affairs not the specific task, the jurisdictions are divided into different levels of governments, the authorities and the assignments owned by each level of jurisdiction do not overlap with other jurisdictions and the relationship between jurisdictional level is more formal and based on laws and constitutions (Hooghe and Marks, 2002). Type II of MLG is characterized by the fact that the jurisdictional levels are not limited, each the jurisdictional levels are assigned with the specific tasks, the assignments and authorities are overlapping, and the relationship between is less formal and more flexible (Hooghe and Marks, 2002).

Decentralization also influences the ways in which actors at the different levels of government interact to implement the national policies. There are three modes of governance in policy implementation exist: self-governing, co-governance and hierarchical governance (Kooiman, 2003). Self-governing is a mode of governance in which the local government is self-motivated, able to overcome issues autonomously. Co-governance is a mode of
governance in which all levels of government must work together to overcome a social problem. Hierarchical governance is a mode of governance in which the central government uses its authority to steer the lower levels of government. Under the decentralized system, the national government tends to shift from a hierarchical mode into a co-governance mode of interaction.

B. The relationship between the local governments and MNCs.

Decentralization influences the relationship between the local government and MNCs and encourages local governments to be open towards inward FDI. At the same time, political pressure from constituents urges local leaders to negotiate with potential MNCs as part of efforts to maximize the benefits of inward FDI. Eden et al. (2005) describe the nature of the relationship as a cooperative one, and negotiation between MNCs and local governments happens to ensure that the local people benefit from the investment project. In the negotiation process, interactions between the parties are shaped by the power relationship between local governments and MNCs (Dicken, 1994 and Yeung & Lie, 1999). The power of this relationship is determined by the comparative goals, stakes, resources, and constraints possessed by each party (Eden et al., 2005).

The goals of the local government are usually related to the economic benefits of inward FDI such as jobs, knowledge, and technology spillover (Eden et al., 2005). On the other hand, MNCs concerns are to embrace new markets, acquire raw materials, gain efficiency, acquire knowledge-technology, and to seek legitimacy by developing partnerships with local firms and local institutions (Eden et al., 2005). In addition to these goals, the power of the relationship between the local government and the MNC is also determined by the size of the stakes owned by each party (Eden et al., 2005). The more companies wanting to invest in a country, the higher that country’s bargaining power becomes (Eden et al., 2005).

Local governments hold strong bargaining power when they possess resources needed by MNC. On the other hand, MNCs will have strong bargaining power if MNCs own resources required by the government (Eden et al., 2005). MNCs possess essential resources such as money, networks, and advanced knowledge and management resources. On the other hand, the government owns resources such as raw materials, natural resources, inexpensive labor, access to local markets, highly skilled workers, and technology (Dunning, 1997).

Local governments are often constrained by unstable political situations, pressure from political parties or interest groups, pressure from international organizations, or economic constraints such as the balance of payment issues or financial crises (Eden et al.,
On the other hand, MNCs are constrained by international and national laws, and previous contract arrangements (Argyres and Liebesind, 1999).

C. Host country government – MNC relations.

The relationship between MNCs and host country government has recently become cooperative instead of conflictual, due to globalization (Ramamurti, 2001). The two tiers of bargaining models cause a shift in the relationship. The first-tier bargaining happens between the host country and home country government, focusing on macro policies designed to provide a friendly environment for the MNCs. Bargaining activities may be conducted directly between host and home country government, or indirectly via multilateral institutions. The direct bargaining activities result in international investment agreements, which are called Bilateral Investment Treaties (BITs). The indirect bargaining activities, conducted by multilateral institutions, are designed to set the guidelines, principles, and standards needed to govern the foreign investment. These guidelines, principals, and standards must then be followed by the host country governments. An example of indirect multilateral institution bargaining is when the IMF and the World Bank set requirements for developing countries to receive the loan to liberalize the market, to conduct privatization, to abolish the performance requirements for MNCs imposed by the host country government (Ramamurti, 2001).

The second tier of bargaining occurs between the host country government and the individual MNCs and focuses on the micro perspectives of projects such as requirements, use of local products, and export targets. In these bargaining processes, there is often a difference in goals between the government and the MNC. On the one hand, the government aims to benefit from the companies in areas such as job creation, knowledge, technology transfer, and financial capital owned by the corporations (Blostroom and Kokko, 1998 and Eden et al., 2005). On the other hand, the MNCs seek to acquire new markets, raw materials, improve their efficiency, and explore legitimacy by developing a partnership with local firms and institutions (Dunning, 1998 and Eden et al., 2005).

In the bargaining process, the bargaining power of each party depends on their possessions of resources. The MNC possesses advanced technology, better access to international market, knowledge and managerial expertise, and financial capacities (Grosse, 2005, Eden et al., 2005 and Ramamurti, 2001). On the other hand, the host country government possesses control over raw materials and natural resources, the domestic market, local labor, knowledge, and technology (Behrman and Grosse, 2005, Eden et al., 2005 and Dunning, 1998).
Some operational constraints affect the bargaining power owned by the host country government and the MNC. The MNC is constrained by international, national, and local regulations, and by existing contract commitments that have been made with the government (Argyes & Liebesind, 1999). On the other hand, the host country government is constrained by unstable political situations, pressures from interest groups, and economic crisis (Eden et al., 2005).

2.5 RESEARCH DESIGN AND METHODS

The objective of this research is to examine how Indonesia has managed inward FDI since the introduction of the decentralized system. More specifically, our dissertation focuses on the institutional policy framework and the dynamic relationship between the Indonesian government and MNCs, involving multi-level governance actors. Understanding this relationship is a challenging task which involves the understanding of peoples’ views, behaviors, and experiences. To pursue this objective, this dissertation employs a qualitative method. The qualitative method is a method to interpret the social phenomena about the people activities and behavior (Hennink et al., 2011). This method is selected because it helps us to understand the actors’ behaviors (Cresswell, 2003), is suitable for analyzing the work experiences of subjects, and in providing information to outsiders (Davies, 2007). Hennink et al. (2011) assert that the qualitative method is appropriate in the analysis of social interactions between actors, and the norms and values shared among them.

Qualitative research requires substantial data collection (Yin, 2011). Several methods of data collection this have been used in this study and will be outlined below.

2.5.1 Literature review, policy documentation, and content analysis

Literature review and policy documentation are crucial to the understanding of institutional design and legal framework regarding inward FDI in Indonesia. Relevant literature regarding governance, decentralization, FDI, multi-level governance, sustainable development, and international business and government relationship theory have been reviewed in the making of this study. Laws, policies, and regulations related to FDI, decentralization, the distribution of authorities between levels of government, trade policies, environmental policies, company policies, competition policies and other economic policies have been examined to more fully understand the Indonesian context. Regulations at the district, provincial, and central governments, along with speeches and meeting minutes have also been explored to fully understand the administrative processes of inward FDI. We have collected data from national and local newspapers which concern inward FDI, conflicts
between the government and MNCs, and important investment issues that have arisen from the press.

2.5.2 Case Studies

Our review of literature and policy documents lead to relevant case studies. A case study is a method used to investigate a phenomenon in depth, in which the boundaries of the phenomenon and its contexts are not yet clear (Yin, 1981).

We select two districts in Indonesia, Banyuwangi and Ogan Komering Ilir (OKI), as case studies to understand the dynamic relationships between the central government, local government, and MNCs in the processes of managing inward FDI in Indonesia. Moreover, we analyze the dynamic interactions between government actors at different levels of government and the dynamic interactions between the local government and MNCs. Indonesia consists of 34 provinces and 518 districts and municipalities; analyzing the processes of managing inward FDI in all of these areas goes beyond the scope of this study. Banyuwangi and OKI district have been selected due to their richness in natural resources, lack of adequate infrastructure, and economic dependency on agricultural sectors, all of which are representative characteristics of rural Indonesia (see table 2.3). These districts also represent the districts in the Java island (Banyuwangi), and outside of the Java islands (OKI). Therefore, we can generalize the findings of the case studies in Banyuwangi and OKI to other regions in Indonesia. Furthermore, these districts are two examples of districts which have successfully attracted inward FDI but represent the contrasting approaches in engaging with MNCs and the national government.

We conducted two field observations in the Banyuwangi and Ogan Komering Ilir districts. The first field observation took place from March 1st to May 14th, 2016 and the second observation took place from March 1st to May 25th, 2017. During our field research, we interviewed government officials from the central, provincial, and district governments, the MNC officials in Banyuwangi and Ogan Komering Ilir, and scholars and non-governmental actors in Jakarta (see interviewee lists in the appendix).
Table 2.3 Characteristics of Banyuwangi and OKI Districts

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Banyuwangi</th>
<th>Ogan Komering Ilir (OKI)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Location and size (km²)</strong></td>
<td>Banyuwangi is the largest district both in the in Eastern Java Province and on Java island with 5.8 thousand square kilometers in total</td>
<td>OKI is the most extensive district in the Southern Sumatera Province, with 19 thousand square kilometers in total</td>
</tr>
<tr>
<td><strong>Land topology</strong></td>
<td>Mountains, hills, forests, and cultivated land</td>
<td>Low-land plantations, forests, uncultivated land</td>
</tr>
<tr>
<td><strong>Distance from the capital city of the province</strong></td>
<td>291 kilometers from Surabaya (the capital city of Eastern Java)</td>
<td>121 kilometers from Palembang (the capital city of Southern Sumatera)</td>
</tr>
<tr>
<td><strong>Population</strong></td>
<td>1,614,482</td>
<td>787,515</td>
</tr>
<tr>
<td><strong>The important economic sectors</strong></td>
<td>Agricultural sector (35.5%) and service sector (24.8%)</td>
<td>Agricultural sector (44.6%), and service sector (17.4%)</td>
</tr>
<tr>
<td><strong>Economic conditions</strong></td>
<td>• economic growth 7.29% per annum</td>
<td>• economic growth 5.7% per annum</td>
</tr>
<tr>
<td></td>
<td>• inflation rate 5.2%</td>
<td>• inflation rate 5.3%</td>
</tr>
<tr>
<td></td>
<td>• unemployment rate 4.7%</td>
<td>• unemployment rate 7.04%</td>
</tr>
<tr>
<td></td>
<td>• poverty rate 9.57%</td>
<td>• poverty rate 15.47%</td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td>Belimbingsari airport, Ketapang port, Train stations</td>
<td>• Sungai Lumpur small port</td>
</tr>
</tbody>
</table>

Source: Table created by Kuswanto based on data BPS Banyuwangi (2015) and BPS OKI (2015)

Note: Banyuwangi and OKI have many similar characteristics, including rural location, lack of adequate infrastructure, richness in natural resources, and economic dependency on agricultural sectors.

We also have selected two case studies on the negotiation process between the government of Indonesia and Freeport Indonesia, Inc. and the government of Indonesia and Newmont Mining, Inc. These cases portray how the dynamic interaction in the negotiation processes between the government of Indonesia and MNCs which involving the home country government, the provincial government, the district government and local communities. In addition, the cases also show the interactions between actors from multiple levels of institutions: international, national, and local institutions; between state and private actors; and
between the private companies and the community. In addition, the cases illustrate the negotiation processes between the host country government and MNCs, involving multi-level government actors. These studies may be used to generalize the interactions between the national government and MNCs, within the current decentralization context. In table 2.4, we explain the design of this dissertation.

Table 2.4 The Research Methods Used in the Dissertation

<table>
<thead>
<tr>
<th>Empirical Chapters</th>
<th>Research Purposes</th>
<th>Research Methods</th>
<th>Data Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter III. Indonesian Investment Policy Review</td>
<td>To understand the investment policy reviews regarding the concept of sustainable development after the introduction of the decentralized system</td>
<td>Literature review, policy document analysis</td>
<td>Laws, government regulations, ministerial decree, ministerial regulations, local regulations, policy documents, and previous studies</td>
</tr>
</tbody>
</table>
| Chapter IV. The relationship between the national, provincial, and district governments in the process of managing inward FDI | 1. To understand the power arrangement in the process of managing inward FDI  
2. To understand the dynamic interactions between government actors at the different levels of government in the process of managing inward FDI and in the implementation of policies | Case studies of Banyuwangi and Ogan Komering Ilir district | • In-depth interviews with government actors at the national, provincial, and district levels of government  
• Laws, government regulations, ministerial decrees, ministerial regulations, local regulations, policy documents, and previous studies |
| Chapter V. The relationship between the local government and MNCs under the decentralized system | 1. To understand the nature of the relationship between the local governments and MNCs under the decentralized system  
2. To explore the bargaining position of local governments when having a negotiation with MNCs | Case studies of Banyuwangi and Ogan Komering Ilir district | • In-depth interviews with government actors at the national, provincial, and district levels of government, MNCs officials  
• Laws, government regulations, ministerial decrees, ministerial regulations, local regulations, policy documents, and previous studies |
Chapter VI. The relationship between the national government and MNCs under the decentralized system

1. To understand the nature of the relationship between the national government and MNCs
   Case studies regarding the negotiation process between the government and Freeport-McMoRan, Inc. and Newmont Nusa Tenggara, Inc.
   • Content analysis from reputable national newspapers
   • Laws, government regulations, ministerial decrees, ministerial regulations, local regulations, policy documents, and previous studies

2. To understand the ways in which the government resolves conflict with MNCs

Note: the dissertation consists of four empirical chapters. The first empirical chapter discusses investment policies in Indonesia. The second empirical chapter discusses the relationship between the national, provincial and district government in the process of managing inward FDI. The third empirical chapter examines the dynamic relationship between district government and MNCs in the process of managing inward FDI. The last chapter discusses the dynamic relationship between the national government and MNCs in the negotiation processes resolving disputes.

We begin our empirical analysis by reviewing Indonesian investment policies to understand if, in the post-decentralized governance system, the concept of sustainable development has been embodied in investment policies. In this analysis we review policy documents, using the Investment Policy Framework for Sustainable Development (IPFSD) as a primary tool of analysis. We choose the IPFSD because we have found that the IPFSD provides more comprehensive guidelines for managing inward FDI compared to other relevant works. It includes more guidelines not only for attracting inward FDI but also for steering inward FDI in a host country government. Using the IPFSD as a lens, we assess laws, regulations, ministerial decrees, local regulations, and previous studies conducted on the investment policies in Indonesia.

After examining investment policies, we observe the dynamic relationships between the national, provincial, and district governments to understand power arrangements and the coordination mechanisms at work in the implementation of policies to improve investment climates. We interview government officials from district, provincial and national government and analyze policy documents related to the management processes of inward FDI in the Banyuwangi and OKI districts.

In addition to analyzing the relationships between the different levels of government, we examine the dynamic relationship between local government and MNCs. This examination aims to understand the nature of the relationship between the local governments and MNCs, and to understand whether decentralization increases the bargaining position of local
governments with MNCs. To achieve that objective, we select case studies of Banyuwangi and OKI districts and interview government officials from their national, provincial, and district governments, as well as MNC officials in those districts.

Since the case studies of Banyuwangi and OKI district focus more on the relationship between local government and MNCs, we need to focus our attention on the relationships between the national government and MNCs. Therefore, we select two case studies that portray the negotiations between the Indonesian government and MNCs in Indonesia. This analysis is necessary for understanding the intersection of global and local regulations, the ways that the national government of Indonesia and MNCs resolve conflicts, and the roles of the local governments in their negotiation processes with MNCs. We select the cases of negotiations between the government of Indonesia and Freeport-MacMoRan, Inc., and between the government of Indonesia and Newmont Nusa Tenggara, Inc., both of which are large mining companies from the USA. We conduct a content analysis of articles from reputable national and local Indonesian newspapers, which cover information about the process of negotiations between the government of Indonesia and Freeport MacMoRan and between the government of Indonesia and Newmont Mining, Inc. To ensure the validity of these articles, we triangulate the information gathered from newspapers with interviews conducted with an official from the National Coordinating Board for Investment.

In the following chapter, we develop four empirical studies that illustrate the investment policies and dynamic relationship between actors in the process of managing inward FDI in Indonesia. We begin with the analysis of investment policies in Indonesia in conjunction with sustainable development.