The Inward Foreign Direct Investment (FDI) and decentralized governance system in Indonesia
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CHAPTER VII. GENERAL DISCUSSION AND CONCLUSIONS

7.1 INTRODUCTION

This chapter discusses some lessons drawn from the previous empirical chapters, final reflections of the overall studies, and the theoretical and social significance of the studies. The objective of the research is to provide an overview of the governance of FDI in Indonesia. We began the studies with an inquiry into the proper governance setting to achieve sustainable development from FDI. Then, we explored the dynamic relationship between the multi-level governance actors and the MNCs.

Studies to explain the dynamic relationship between the government MNCs highly focus on the roles of states and firms, and neglect the roles of subnational government despite the fact that the decentralized governance system has been implemented in most countries in the world. Examples of those studies are the obsolescing bargaining theory by Vernon (1971), the three-dimensional bargaining model by Behrman and Grosse (1990), triangular diplomacy by Stopford and Strange (1991), and the eclectic paradigm by Dunning (1998). Contributing to filling that gap, this dissertation also analyzes the roles of sub-national actors in the interaction.

Indonesia was chosen as an illustrative case study. Indonesia is an interesting country as it is an emerging economy that has successfully attracted FDI and is a country that has changed from a very centralized to a very decentralized model within a short period. Nevertheless, as explained in the introduction chapter, some decentralization problems remain unresolved, such as the lack of contribution of FDI to regional development, the unequal distribution of FDI among regions, the problem of coordination between government levels, and conflicts between government and MNCs.

Therefore, this dissertation has attempted to answer an overarching question: How has Indonesia managed inward FDI since the introduction of the decentralized system? Our research question embodies two sub-research questions as follows: 1) How do the investment policies in Indonesia embody the concept of sustainable development?; 2) What is the nature of the relationships between the central government – local government – MNCs under the decentralized system in Indonesia?

To answer these research questions, we developed four empirical chapters. The first empirical chapter reviewed the investment policy framework in Indonesia to provide a better understanding of the Indonesian context. The second empirical chapter analyzed the dynamic relationship between the national government, the provincial government and the district
government in the process of managing FDI. The third empirical chapter examined the
dynamic bargaining relationship between the local governments and MNCs under the
decentralized system. The last empirical chapter assessed the dynamic relationship between
the national government and MNCs. The findings of each empirical chapter are discussed in
the following sections.

7.2 GENERAL FINDINGS

7.2.1 The investment policies framework in Indonesia.

The first empirical chapter (Chapter III) attempted to answer the first sub-question:
*How do the investment policies in Indonesia embody the concept of sustainable development?*
To answer that question, we have analyzed the general investment plan and the national
development plan to understand the investment strategies in Indonesia. We have also assessed
relevant investment policies such as investment law, regulations on licensing procedure,
regulation on land registration system, regulation on investment promotion, regulation on
investment incentives, investment restrictions (the negative list of investments), trade policy,
property right policy, environmental regulations, market competition policy, corporate
 governance policy, labor and market regulation, and the regulation to create economic wealth.
As an instrument of analysis, we used the investment policy framework for sustainable
development (IPSFD) developed by UNCTAD (2012, 2015).

Our study concluded that the concept of sustainable development has been embodied
in the investment policies in Indonesia. In the General Investment Plan 2012-2025 and the
National Medium Term of Development Plan 2015-2019, sustainable development is
explicitly stated as the objective of all investment policies in Indonesia. Similarly, the Law 25
on Investment (2007) also states that the investment policies are directed to achieve
sustainable development. Other economy-related laws such as company law, mining law,
environmental law, industrial law, and SME law also state that sustainable development is an
objective.

Nevertheless, our analysis revealed that the strategies to achieve sustainable
development from investment remain unclear. We cannot find: any measurable actions to
generate linkage between foreign enterprises and domestic companies; any strategies to
stimulate and nurture local enterprises to be more competitive; strategies to support the
technology spillover; and strategies to overcome the gap of technical capacity between the
domestic and foreign enterprises. In the NMDP, the document asserts the strategies to support
the partnership between MNCs and SMEs in very normative ways, namely upgrading the
strategy and the partnership strategy with MNCs without clear actions to implement them. The absent of those strategies means it is difficult to use investment and development strategies as a cornerstone for other policies such as industrial policy, trade policy, labor policy and other economic policies.

Interestingly, our research found that the government of Indonesia has attempted to balance the efforts to attract and to steer inward FDI. From Law 25 on Investment (2007), we can see a strong commitment to improving the attractiveness of Indonesia for investors. The law shields the MNCs from expropriation, shows the commitment to provide generous incentives for foreign investment, and the commitment to liberalize the economy. Furthermore, several regulatory reforms to attract foreign investors were taken such as the introduction of laws on the protection of property rights and anti-monopoly laws, the promotion of open and liberal trade policies, and the revision of anti-corruption laws. In the more concrete actions, the government also simplified the licensing procedure through the one-stop services office (PTSP office), improved the land ownership registration system, provided massive generous incentives for FDI, and liberalized its economy.

At the same time, policies interventions were imposed to minimize the adverse impacts of FDI and to maximize the benefits of FDI in several ways. Firstly, in the economic development, the government uses the regulation on Negative List of Investment to screen inward FDI to Indonesia. This regulation determines how sectors open and close, based on restrictions for FDI. There are several restrictions applied to inward FDI such as foreign equity limitation, the joint venture requirement, divestment requirements and land ownership restrictions. Some laws to generate economic wealth from FDI were also enacted. For instance, the Law 3 on industry (2014) imposes a local content requirement for foreign companies in machinery, and the electronic and automotive industries. Law 4 on Mineral and Coal Mining (2009) requires all foreign companies in the mining sector to refine the mineral ore by establishing the smelter, to divest the stakes gradually up to 51% after ten years, and to prioritize domestic companies and local workers in operation. It also prohibits foreign companies from exporting unprocessed mineral.

Secondly, to enhance the contribution of FDI to social development, the labor laws were revised, and the company law was introduced. Law 13 on Workforce (2003) replaced Law 14 on Workforce (1969). Law 13 on Workforce (2013) mandates all companies to conduct training, transfer technology to domestic workers, pay decent wages, and respect ILO safety standards. It also allows the creation of labor unions as representative of workers.
and mandates the local government to determine wage standards based on the decent life index. Furthermore, Law 40 on the Company (2007) and Law 25 on Investment (2007) mandate all companies, include foreign companies, to conduct charitable activities in the surrounding neighborhood as part of corporate social responsibility.

Thirdly, as an effort to preserve the environment, Law 23 on the Environment (1997) was replaced by Law 32 on the Environment (2009). The new law requires all companies to conduct an environmental impact assessment as a part of the licensing procedure, requires environmental permits for every company before establishing manufacturing bases, requires an environmental audit before and after the operation of the business, and mandates all companies to compensate environmental damages by providing funds for environmental preservation.

Despite the fact that the concept of sustainable development has been adopted in the investment policies and other related policies, we found some weaknesses. Firstly, there is little coherence between investment policies, industrial policies, education policies, environmental policies and other policies. For example, the substances on the negative list of investment contradict with several laws including horticultural law, industrial law, and mineral and coal mining law. Secondly, the government of Indonesia has a serious problem in the implementation of the law. One example is that the state has enacted rules and regulations on the protection of property rights, but Indonesia remains under the priority watch list by the U.S. for weak property rights' protection. Another example is that despite the government enacting the competition policy, monopolies and oligopolies remain common practice due to the weak law enforcement. Thirdly, despite the fact that Indonesia is liberal in terms of FDI, the non-tariff barriers remain serious problems for foreign investors. Some regulation such as local content requirements, performance standard requirements and divestment requirements are considered as significant barriers for foreign investors, which are not justifiable.

7.2.2 The triangular governance relationships

The second important question to be answered by this dissertation is “What is the nature of the central – local- MNCs relationships under a decentralized system in Indonesia?” We have conducted three empirical studies to explore the relationships in addition to the first empirical chapter about the investment policy review.

Our research has revealed some interesting findings. Firstly, the research shows that decentralization has shaped the nature of the relationship between government actors and international business. In the previous model, the MNCs did not necessarily interact with the
sub-national institutions in the FDI process. However, due to decentralization, the MNCs have to interact with sub-national institutions. Furthermore, the government cannot be stated as unitary because of the diverse interests involved in the process of interaction. It means, in the current decentralized system, the MNCs have to deal with multi-level governance actors, so that the relationship becomes more complicated than before. There are several actors involved in the process which are categorized as the strategic actors and the relevant actors. The strategic actors are the actors who are the most involved in the process of managing inward FDI with adequate power to influence other actors. Three strategic actors in the FDI management are the national government, the local government, and MNCs. The relevant actors are the actors who have the impacts on the process but not directly. Some relevant actors involved are the home country government, supranational institutions, and some non-governmental actors.

Secondly, due to the economic globalization, the nature of the relationship between the government and MNCs is cooperative instead of conflictual. Nevertheless, decentralization and democratization have increased the tendencies of the conflicting interests between actors involved. These circumstances have led to further negotiation among actors. The object of the negotiation is not only related to the project itself but also to the policy context. The negotiation process involves not only the three strategic actors (national government, local government, MNCs) but also other relevant actors such as non-state actors. The negotiation process can happen before the entry process and even during the operation of the business.

Thirdly, the dialogue between the government and FDI has moved beyond the debate between the dependencies and non-dependencies argument, and has turned to the concept of sustainable development. Many policymakers are not only concerned with policies to attract inward FDI but also the policies to enhance the contribution of inward FDI to economic, social and environmental development. For the government, the democratic governance process pressures central and local leaders to conduct a bargaining relationship with potential investors to ensure the benefits of FDI. In fact, for the MNCs, legitimacy has become an important aspect of doing business recently. Therefore, it is now crucial for MNCs to accommodate the interests of the local community and local institutions to increase their legitimacy. Below are the details about conclusions that can be drawn the empirical studies.
The relationships between the national, provincial and district governments in the FDI management.

As part of the triangular governance relationship, in chapter IV, we have examined the intergovernmental relationships to answer the following sub-research question: **How do the national, provincial, and district/municipality government actors interact with each other in managing inward FDI in Indonesia?** Using the multi-level governance concepts, we analyzed the distribution of authority between the central, provincial and district governments and the mode of governance used by those parties to improve the investment climate.

The relationship between the different level of governments seems to be hierarchical, but in practice cooperation is crucial. Pursuant to the laws and regulation on decentralization and FDI management, our research revealed that central government is a dominant actor in administering the licensing process of inward FDI. However, we also found that the local governments (provincial and district governments) have significant roles in the whole administrative processes. The BKPM is the central government's agency to screen the FDI and to coordinate development of investment policies, investment promotion activities, investment information system development and investment monitoring activities. The BKPM issues the investment license (principle permit) and business license (operational permit) for foreign investment. As part of that process, the local governments issue specific permits such as location permits, environmental permits, land use permits, building permits, and disturbance permits for companies to obtain the business license. At the same time, the provincial/district government can enact local regulations on local taxes, local wage standards, environment standards, and land use planning/zoning standards. Our investigation suggests that in carrying out these functions, the central government must work together with the provincial and district administration, so that the multi-level government action is highly essential to the success of the project. This model follows the type I of multi-level governance.

Having investigated the efforts to improve investment climates, we found that the co-governance is more often used by the government since the mode is more effective than the hierarchical governance. For instance, in the process of harmonization of the policies at the different level of government, the central government used its coercive power to pressure the provincial and district/municipal government not to produce local regulations which contradict the national policies and are against the public interest. This method is ineffective because it is not followed by practical efforts to enhance the capacity of local governments’ officials. As a
result, it received both legal and political challenges from local government as the mode is not democratic.

On the other hand, the case studies of Banyuwangi and OKI have proven that the cooperation between different levels of government is crucial to improving the investment climates, primarily around the establishment of PTSP and infrastructure development. We found that the central and provincial government work together to oversee and to assist district governments in the process of establishing the PTSP offices. Also, the central government provides awards and grants instead of using coercive power. As a result, almost all regions have recently established PTSP offices.

In the infrastructure development, the collaboration between the central, provincial and district government is substantial. The financial and management support from the central government, the central-local government collaboration (co-management) and the public-private partnership are three examples of the co-governance model used in infrastructure development. Having learned from cooperation, we found that the keys to success in collaboration are the adequate capacity and strong commitment of both parties.

**Local Government and Multinational Corporations Bargaining Relationship**

The third empirical chapter (Chapter V) of the dissertation examined the second sub-research question: **What is the nature of the relationship between local governments and MNCs, with regards to inward FDI in the era of decentralized governance?** This chapter has analyzed the bargaining position of local government in front of MNCs and strategies to enhance its bargaining position. We have employed the idea of decentralization and the political bargaining model in the case studies of Banyuwangi and OKI districts.

The relationship between local governments and MNCs seems to be market-based or in the form of a bargaining relationship. Our research revealed the fact that the decentralized system has shaped the nature of the relationship between local government and MNCs. The relationship tends to be cooperative because local governments need MNCs to accelerate their regional economic development, and the MNCs need the support from local government to pursue their financial objectives. Nevertheless, the bargaining between local governments and MNCs is unavoidable. The political decentralization has encouraged local leaders to consider the interests of local citizens in the public policy process. Regarding the FDI, the decentralization encourages local leaders to negotiate with potential investors to make the FDI fit local needs. The negotiation aims to ensure that the potential of investors can accommodate the interests of the local community, represented by the district government. In the negotiation
process, the district government focuses on the economic aspects while the MNCs focus on the business objectives. However, many districts in Indonesia have problems related to the capacity of human resources.

The districts have different strategies in the interaction process. OKI district relies on the central and provincial government to negotiate the interests of local people with the MNCs. Banyuwangi conducts a direct negotiation with potential investors prior to the investment. The case studies show that the contrasting approaches have not resulted in the distinctive outcome in terms of the volume of FDI.

Different strategies are taken by the district government to increase the bargaining position of the local government. Many district governments focus on the improvement of investment climates through the simplification of investment procedures, the effective investment promotions, and the provision of adequate infrastructure. Nevertheless, innovation can take place such as institutionalizing local wisdom in the local regulations and providing incentives for investments which meet with criteria of investments determined by the local government. The strategies could be more effective if they are well-equipped with satisfactory human resource capacities of local officials during the implementation process.

The relationship between the government and multinational corporations (MNCs)

The fourth empirical chapter (Chapter VI) of the dissertation examined the relationship between the government and MNCs in Indonesia. It answered the sub-research question: **What is the nature of the relationship between the national government and MNCs in the era of decentralized governance?** We employed the two-tier bargaining model and used case studies on the negotiation processes with the government of Indonesia and two foreign companies in mining sectors: Freeport MacMoRan, Inc. and Newmont Nusa Tenggara, Inc. The investigation aimed to understand the actors involved, the negotiation processes, and the impact of the international investment treaties on the bargaining position of MNCs.

The relationships between the national government and MNCs are clearly bargaining relationships. Significant evidence shows that conflicts between the government and MNCs are taking place. In the current situation, conflicts arise due to protectionist policies imposed by the host country government. Protectionist policies have been introduced by many countries after the financial crisis of 2008 to enhance the contribution of FDI to economic development (Kettunen, 2016). The interventionist policy is unavoidable because it is believed to be a powerful tool to increase benefits from the FDI. Furthermore, the pressure from local communities is more prevalent under the democratization era, so that the interventionist policy
is a useful instrument to gain voters. Similarly, Indonesia enacted a protectionist policy in the mining sectors by requiring divestment for foreign companies, prohibiting export of unprocessed mineral and prioritizing domestic companies and local workers for foreign companies. In the beginning, MNCs respond to protectionist policies with the hard approach by filing lawsuits with international arbitration. However, later, MNCs chose the negotiation process to resolve the conflicts.

In the negotiation process, these cases also show the relevance of the two-tier bargaining models. There are two levels of bargaining between the host country and home country government, and between the host country government and MNCs. The bargaining between host country and home country government resulted in the principles, norms, and paradigms regarding the FDI management. The negotiation process between host country government and MNCs resulted in specific agreements on the operation of the businesses.

Our investigation revealed that the negotiation process involved multi-level governance actors and MNCs. Those actors are the home country government, the host country government, the MNCs, the provincial government, and the district government. The role of communities remain limited since the interest of local communities is considered to be represented by the district and provincial governments. In the negotiation processes, the home country government support the MNCs to develop norms, standards and favorable policies for the latter. On the other hand, the host country government focuses the attention on the economic and social benefits that can be received from FDI. Meanwhile, the MNCs are concerned about the business goals without losing legitimacy from local institutions. The provincial and district governments also focus on detailing potential economic and social benefits.

In the negotiation process, the bargaining power of the parties is derived from the resources and constraints owned by each side. The bargaining power possessed by the host country government is primarily derived from the existence of natural resources while the MNCs' power comes from their potential economic contribution to the country, and support from the home country government and the international investment regime. Moreover, in the negotiation processes, the government is constrained by the international agreements. On the other hand, the significant constraints retained by the MNC are the potential financial loss and the degradation of reputation from the dispute. Besides, the outcome of the bargaining depends on the capacity of parties involved in the process.
The cases show that MNCs are as equally powerful as the state. Using international investment agreements such as bilateral and multilateral investment agreement, the MNCs can be exempted from obligations determined by the local law. The MNCs often threaten the government to bring the dispute to international arbitration. The MNCs also use their home country government’s diplomatic power to pressure the host country government in the negotiation processes. On the other hand, the outcome of bargaining process is highly dependent on the capacity of state in the negotiation process and constraints owned by the government. The international agreement may decrease the bargaining power of the host country government in the negotiation process.

7.3 THEORETICAL CONTRIBUTION OF THE STUDY

We begin the dissertation with an overview of the theoretical gaps that are addressed by this study. This study mainly contributes to the international business and government relationship literature. The first contribution to the theory is coming from the additional actors involved in the bargaining relationship. While the traditional bargaining relationship models over-emphasize the roles of host country government and MNCs as strategic actors, this study also emphasizes the strategic roles of local governments. The state is not categorized as unitary because it consists of several local governments with different interests than the national government due to the decentralized system. Three case studies explored in this dissertation have shown the significant roles of local government in the relationship.

Second, the study confirms the theory which asserts that although the nature of the relationship between MNCs and host country governments are cooperative, the bargaining processes between MNCs and host country government are unavoidable. Moreover, the objects of the bargaining process between the host country government and MNCs are not only related to the entry requirements but also to the domestic policies. The MNCs have a strong interest to ensure domestic policies do not intrude upon their business in a country. The bargaining processes are unavoidable because, under the democratic governance system, the government must consider the interest of local communities and other non-state actors in the process of managing inward FDI. On the other hand, since legitimacy is important for MNCs in the current business world, MNCs tends to accommodate the interests of the host country government and local communities.

Thirdly, the study also confirms the relevance of the two-tier bargaining model in the current context. The cases of the negotiation process between the government and MNCs provide evidence that the bargaining process occurs in a two-tier process: between the host
and home country government, and the host country government with MNCs. The first-tier bargaining process focuses not only on the norms, standards, and guidelines to treat the MNCs but also the solution to a specific dispute involving MNCs. The second-tier bargaining process focuses on the operational level of the business. The cases also show that the first tier bargaining process can increase the bargaining power MNCs have with the host country government as suggested by the two-tier bargaining model. However, in addition to that model, the cases added another actor involved in the negotiation process, which is the local government. Now, the relationship is non-hierarchical and flexible, with the roles of non-state actors becoming more important.

This study also contributes to study on governance in general and study on multi-level governance (MLG) theory in particular. While the study of MLG was originally developed in the EU, this study shows an example of how the multi-level governance framework can be implemented in other countries to analyze the intergovernmental relations between central, provincial and district governments. Our study confirms that the relationship between the different levels of government, under the decentralized system, is more flexible and less hierarchical than it was in the past. Furthermore, in the process of managing inward FDI in Indonesia, there are some negotiation processes involving multi-level government and non-governmental actors including the multinational corporations (MNCs). Our findings also suggest that the role of the “supranational institution” in creating an international norm and regulations on inward FDI is less significant. For instance, the ASEAN cannot force the country members to comply with the obligations embedded in the investment agreements. Instead, the bilateral investment agreement has a stronger power to influence the host country government’s attitude toward FDI norms and regulations.

7.4 POLICY IMPLICATION AND RECOMMENDATIONS

The empirical chapters revealed several noteworthy findings which resulted in some policy implications. This section provides some practical recommendations for the government and the managers of MNCs.

Recommendations to the national government

Based on the findings of the research, we provide several policy recommendations. We classify the suggestions into two levels of policy recommendations: macro and micro levels. At the macro level, we recommend several improvements of laws and policies on investment,
and at the micro level, we advocate the national government to improve the relationship with local governments and MNCs to achieve better quality inward FDI.

At the macro level, this study suggests several recommendations. Firstly, we recommend the national government to improve the quality of the National General Investment Plan document. The National General Investment Plan is a planning document consisting of the objectives and strategies to direct investment policies in Indonesia. Our assessment has uncovered the fact that the National General Investment Plan document lacks information on the criteria used to determine the investment priorities and information on the strategies to achieve inclusive and sustainable investment. Therefore, we argue that the National General Investment Plan is not sufficient to be used as a cornerstone in developing other investment-related policies such as the industrial policy, trade policy and labor policy, as well as different economic policies. Two critical subjects are necessary to be considered in the improvements: the process of development and the substance of the policy. In terms of the process, the general investment plan should be developed involving all relevant stakeholders such as officials from all related ministries, local business associations, non-governmental organizations and MNCs. The involvement of those stakeholders will improve the quality of the planning document. Regarding the substance of the policy, we recommend some aspects should be added to the planning documents. The general investment plan document should explain the reasons for determining the investment sector priorities, the strategies with measurable actions to pursue the sustainable development, and the controlling mechanism. For example, related to the approach to nurture the domestic enterprises and to support the linkage between the foreign and domestic enterprises, measurable actions should be determined which are used to develop the industrial policies. Another example is the strategy to enhance the contribution of inward FDI through an increase of exports. Currently, there is no clear strategy on how the inward FDI can increase exports. In the general investment plan, the government can develop some actions to achieve the objectives through policy interventions such as providing incentives or imposing some requirements. In short, the general investment plan should become a cornerstone of any economic policies geared toward sustainable development.

Secondly, we recommend the government to revisit the current FDI restrictions carefully to increase the attractiveness of the country for FDI. Our research has discovered that despite the liberalization policies taken by the government, Indonesia remains restrictive compared to other OECD countries and ASEAN countries. We also found that the restrictions are applied in almost all economic sectors. We recommend the national government to relax the
restrictions in the manufacturing and service sectors. Much evidence shows that inward FDI in the manufacturing and service sectors can significantly contribute to economic growth in a country. A study by UNCTAD (2001) shows that restrictions in manufacturing sectors such as local content requirements, performance requirements and joint venture requirements do not succeed in increasing the contribution of FDI to economic development. Instead, the main contributor to success is the absorptive capacity. Therefore, the relaxation of the restrictions can be conducted simultaneously with efforts to increase the absorptive capacity. The absorptive capacity can be enhanced through increasing research and development, improving training for the workers, providing industrial cluster areas and strengthening property rights' protection. Nevertheless, we support the limitation imposed in the mining sectors, and we argue that the restriction are justifiable. We contend that the divestment requirements and the obligation to establish smelters for refinery processes can enhance the social contributions of inward FDI in the mining sectors. Indonesia should begin to develop the downstream mining industry to support the national economy.

Thirdly, we recommend that the national government scrutinize the existing Bilateral Investment Treaty (BIT) and improve the formulation of the contract of work with MNCs. Many policymakers believe that BIT can significantly increase the amount of inward FDI because it provides a commitment to protect foreign investors’ rights and offers a more transparent regulatory regime for foreign investors. However, on the other hand, the BITs can override national legislation and limit the policy spaces for the host country government to regulate the economic activities in the country (Singh and Ilge, 2016). The case studies on the negotiation between the government and MNCs indicates that International Investment Agreements (IIAs) have weakened the bargaining position of governments vis-à-vis the MNCs. The cases show that the MNCs often use the BIT to be discharged from the obligations determined by national legislation. Many BITs were made in the 1960s, which excessively protect the investors’ rights but fail to protect the government’s right to regulate. The new proposed model of BIT should balance the rights of states and companies. Furthermore, we also argue that the national government should improve the contract of work with MNCs in the mining sectors. The study found that the contract of work made in the 1960s gives little attention to some aspects such as human rights' protection, environmental protection, and local community rights. The negotiation should only involve the MNCs and the national government, without considering other actors’ interest such as local governments and the local community.
Lastly, we recommend that the national government harmonizes the national laws and regulations related to inward FDI. Our study revealed that Indonesia has conducted massive regulatory reforms to attract inward FDI and to pursue economic, social and environmental benefits from inward FDI. However, we also found that many of those laws and regulations are contradicting each other and are incoherent. For instance, the horticultural law and industrial laws contradict with the rule on the negative list of investments. Therefore, the harmonization of national laws and regulations is crucial to attracting inward FDI. Some conflicting national laws and regulations also lead to confusion in the implementation, especially when those regulations need to be implemented by the local governments. Different interpretation leads to the coordination failure. The significant conflicting laws and regulations are related to environmental protection. For instance, in some areas which are categorized as protected forests by the national government, the same government also grants mining licenses. The contradictions are not only happening between the national regulations and local regulations but also among the national regulations. This situation can significantly deteriorate the investment climate.

This study also delivers some policy recommendations at the micro level. The recommendations at the micro level focus on the aspects of the coordination mechanism to improve the relationship between the national government, local governments and MNCs. Firstly, we recommend that the national government improves the coordination mechanism among the different levels of government. Some important strategies can be made in improving the coordination mechanism. The national government can improve the coordination mechanism by strengthening the roles of provincial government as a coordinator for development in the districts. In doing that, the national government should delegate some authority to the provincial government. Another strategy is by providing financial incentives and disincentives for the provincial and district governments. Many district governments are constrained from developing the regions by a lack of financial and human resources. For the district government which is successful in attracting inward FDI and in improving the local economy, the national government can provide additional development grants. For the districts with low performance, the national government can reduce national grants and provide special assistance. The use of the informal association of local governments can also help the national government in improving the coordination mechanism.

Secondly, still related to the effort to improve the coordination mechanism, we recommend the national government to improve the quality of PTSP offices across the regions. Our research also indicates that the MNCs have to deal with multi-level governance
agencies in the licensing process. With the integrated electronic system of PTSP, the coordination mechanism between the different levels of government becomes more effective and efficient. The system increases the transparency and predictability in the licensing procedure, reduces rent-seeking behavior, and decreases business costs spent by companies in conducting business in Indonesia. Improving the quality of PTSP offices in all regions requires awareness from the district heads and the governor and the adequate capacity of local officials. The use of informal networks called PTSP Forums is an effective way to increase the awareness of the importance of PTSP. Furthermore, the national government can insert additional rewards such as the financial support. Sufficient assistance for the district government from the provincial and the national governments are required. The assistance can be in the form of financial assistance, training for local officials, or support with equipment. Delegating the authority to administer the licensing procedure to the provincial and district governments which possess an excellent PTSP office becomes another alternative incentive to be given. Additionally, some disincentives might be applied to the local governments which are unable to meet the minimum standard on the investment PTSP offices, such as a reduction of national grants.

Thirdly, we recommend that the BKPM office strengthens the roles of coordinating investment promotion and investment monitoring activities. Our research indicates that the district governments have financial restrictions but possess better understanding of the local potential for investments. Furthermore, good coordination between the local, provincial and national governments has proven to successfully help local governments achieve more inward FDI in Banyuwangi and OKI. In fact, the unequal distribution of inward FDI may also be caused by the insufficient investment in promotion to potential investments for the regions outside the Java and Bali regions. Due to those reasons, the role of BKPM will be more as a coordinator instead of implementer of the investment promotion. The role as coordinator means that the strategy adopted must follow the needs and interests of local governments. In the monitoring activities, our research found that the electronic monitoring system has improved the coordination mechanism between all levels of government. However, our research found that the compliance levels of companies remain low. We argue that the frequency of the reporting and the forms may influence the compliance levels. The quarterly reports are disproportionate for the MNCs. Therefore, we suggest improving the electronic system in term of the regularities from a quarterly basis to a semester basis, and with a simpler form of reports.
Fourthly, we recommend that the national government enhances the absorptive capacity and human resources in the regions. Absorptive capacity is ‘the ability of organizations or regions to identify, to assimilate and to exploit knowledge from the environment’ (Fu, 2008 p. 8). The action is necessary because this study has revealed that local government is constrained by a lack of sufficient human resources in the regions. Furthermore, some regions are unable to secure economic and social benefits from the inward FDI because of the inability to absorb the technology and knowledge spillover. To enhance the human resources and the absorptive capacity, the roles of universities are important. In fact, the educational services are not equally distributed across the regions, as universities do not exist in every region. The national government should accelerate the development of the universities in the regions outside the Java islands. Furthermore, the national government can stimulate the MNCs to conduct R&D and training activities. Simultaneously, the national government can support the local governments to carry out training activities and matchmaking between domestic and foreign enterprises.

Fifthly, we recommend the national government to accelerate the infrastructure development to attract highly intensive skill investments. Many studies have found that the highly intensive skill investments may make a better contribution to the economy in the regions compared to the highly intensive labor investment (Li and Liu, 2005). Nevertheless, the MNCs in those sectors are constrained by the inadequate infrastructure provided in many regions in Indonesia. Therefore, we argue that the infrastructure development is crucial to attracting the high quality of inward FDI. The acceleration of the infrastructure development will be more effective through the collaboration between three different levels of government, and public-private partnership. Since the local governments have financial constraints, the national government can increase financial support and provide some technical assistance in the implementation.

Sixthly, we suggest the national government improve public institutions to enforce the law. The research found that the enforcement of the law and regulations is one of the biggest challenges in Indonesia. For instance, although Indonesia has enacted some intellectual property right protections and has ratified some conventions on property rights, piracy remains unresolved. Indonesia was put on the Priority Watch List 2017 for the weak enforcement of regulations in terms of property rights' protection. Furthermore, corruption is a problematic issue in Indonesia. The improvement of the public institution can be made by increasing the transparency of public officials, enhancing the capacity of government officials and increasing the accountability of public institutions.
**Recommendation to the local governments**

Our study shows the important roles of local governments in the process of managing inward FDI in the regions. Our recommendation focuses on the roles to strengthen the coordination mechanism with the national government and the roles to find mutual benefits from the existence of MNCs. Firstly, we recommend the local government to continue improving local institutions and establishing an excellent PTSP office. The study shows that the good quality of an institution can increase the bargaining position of local governments in the negotiation process with MNCs. Furthermore, the good quality of institution can not only attract inward FDI but can also help nurture the domestic enterprises. Having learned from the cases in OKI and Banyuwangi, the establishment of PTSP offices can increase the investments to the regions. The integrated and online system of the PTSP office which connects with the national and provincial governments helps the MNCs to deal with multi-level governance actors more effectively. Furthermore, it reduces the business costs and complexity in dealing with bureaucracy, which otherwise discourage MNCs from investing in the regions. The improvement of the quality of PTSP office can be made gradually through the simplification of the procedure and the enhancement of the human resources.

Secondly, we also recommend the local governments to continue improving the infrastructure at local levels to attract inward FDI. The research found that the infrastructure is an important consideration for MNCs when looking to invest in a country. Our study indicates that local governments have financial constraints that prevent them from improving infrastructure. However, the cases of Banyuwangi and OKI show that those constraints can be overcome through cooperation with provincial and national governments, as well as the public-private partnership. As part of the efforts to improve the infrastructure, our study found that land acquisition is one of the biggest obstacles faced by MNCs in establishing a business in the regions. The conflicts with the local community are usually related to land acquisition and environmental problems. Therefore, we suggest local governments promote the development of eco-industrial parks. The development of such parks not only help MNCs in establishing businesses but also reduces environmental problems and conflicts with the local community.

Thirdly, we recommend the local governments to use innovative approaches in the investment promotion and to provide incentives for FDI. This study has found that the innovative approach in investment promotion can be more effective than traditional approaches such as promotional events. Banyuwangi set a good example on how the local
government can conduct an effective and efficient investment promotion by combining with the cultural events and international events conducted by private companies. The public-private partnership and the cooperation with the national and provincial governments in the investment promotion can reduce the costs but increase the effectiveness of the investment promotion.

Another important aspect of conducting an effective investment promotion is by gearing the investment promotion to the local investment priorities. The investment priorities are selected based on the comparative advantages of the region and the potential contributions to the local economy. Besides conducting effective investment promotion, the incentives should be provided to attract inward FDI. Instead of using that legislative power to levy local taxes to MNCs, we recommend local governments to provide incentives. The incentives can be given in either financial or non-financial forms. The incentives are important to attract inward FDI, because inward FDI will have multiplier effects to boost the regional economic development better than the tax paid by the MNCs.

Fourthly, inward FDI is not automatically beneficial for local economic development. An effective strategy needs to be implemented to make the inward FDI beneficial for local economic development. Having learned from the cases in Banyuwangi and OKI, we argue that direct negotiation with potential investors might help local governments to direct the inward FDI to benefit the local economy. However, before the negotiation is conducted, it is suggested that the local governments determine the investment priorities and that these investment criteria fits the local needs. In the negotiation process, the local government should consider the competition with other local governments, the resources and the constraints possessed by local governments and MNCs. Besides those factors, the capacity of local government officials in the negotiation process does matter. The understanding of the national and international business regulations and the company’s culture is important in the process of negotiation.

Fifthly, a strategy to support the linkage between MNCs and domestic enterprises need to be implemented. Having learned from the case of Banyuwangi, the district provides financial and non-financial incentives for MNCs which use local products and cooperate with domestic enterprises, especially SMEs. The district has also began the matchmaking process since the investment promotion. During the investment promotion, the district government has facilitated meetings between potential investor MNCs and local enterprises. After the business is established, the MNCs are required to train domestic managers and employees, so they learn the technology used by the MNCs.
Sixthly, we recommend local governments to enhance the capacity of local human resources and the absorptive capacity. Our research found that local governments have obstacles related to the capacity of human resources and absorptive capacity. Many strategies can be taken to enhance the capacity of local human resources. The efforts can be made by conducting more training to upgrade the skills of local workers or by establishing more universities in the regions. The establishment of good universities may attract highly talented people to the regions and may also increase the capacity of local workers. R&D is another tool to increase absorptive capacity. Local governments cannot carry out these strategies alone due to financial constraints, so they must stimulate the private sector or work together with the national government. In short, the enhancement of the capacity of human resources and the absorptive capacity can be done collaboratively with other stakeholders.

Seventhly, we recommend local governments to avoid making local regulations which contradict national laws and public interests. In the empirical chapters, the study revealed that many companies complaint about local regulations that increase business costs and discourage them from investing in the regions. Due to financial constraints, the district needs investors to improve people's welfare. Therefore, the introduction of local regulations which contradict with the public interest (usually economic development) is a disadvantage for the economic development in the region. To develop good local regulations, we recommend the district government to cooperate with legal experts in the process, to involve the community including business associations in the process, and to consider long-term economic objectives. One of the most important local regulations which can have an impact on the FDI is on the land use planning. Many districts do not have a definite land use plan. A land use plan can be used to protect the environment from the adverse impact of inward FDI. In the land use planning document, the local governments determine the use of pieces of land for the development. Through land use planning, the local government can determine what business activities are allowed, and what are not allowed.

Recommendations to the managers of MNCs

The study shows that decentralization has changed the nature of the relationship between the government and MNCs, involving multi-level governance actors. From the above discussion, it is clear that policymakers' concern has moved beyond the efforts to attract inward FDI to also include the concept of sustainable development. Recently, the economic benefit has not been the primary objective in the investment because the social and
environmental issues have gained much attention. Given that, we recommend the managers of MNCs to consider the following suggestions.

Firstly, the MNCs are suggested to fulfill their corporate social responsibility (CSR) obligations. CSR is “a concept whereby companies integrate the social and environmental concerns in their business operation and their business interactions with their stakeholders on the voluntary basis” (European Union Commission, 2002, p. 347). In broader terms, CSR means that the companies comply with the rules, regulations and ethical norms in conducting business by considering the social and environmental impacts of their business. There are ten fundamental principles related to the issues of human rights, labor standards, the environment and anti-corruption which companies should follow. The business should support and respect the protection of human rights and should ensure that the business does not become complicit in human rights violation. The companies should also respect freedom of association, eliminate all forms of force in the interaction process, avoid using child labor, and eliminate discrimination in employment and occupation. In term of environmental protection, the companies should support a precautionary approach to the environmental challenges, to promote greater environmental responsibility, and to use environmentally friendly technologies. In term of the anti-corruption principle, businesses should avoid any corrupt activities (Moran, 2011).

Besides holding those principles, we recommend that MNCs conduct CSR activities aimed at preserving the natural environment, improving the quality of life of people in the local community, improving the well-being of the company’s employee and any charitable social activities. Those activities are important to achieve sustainable development from the investment. The MNCs gain many benefits from the CSR activities. For instance, CSR activities can increase the legitimacy of the company and reduce the conflicts with the local community. Furthermore, CSR activities help MNCs to engage with their employees and customers to increase the value of the business. The CSR activities also help MNCs to develop a good reputation, which may improve the sustainability of the business.

Secondly, we suggest the managers of MNCs to adapt strategies for the global changes to be more supportive toward the development in a host country government. The economic crisis has changed the way many host countries regulate the international business. Many of those countries tend to be more protectionist toward inward FDI. Political pressure from constituents drives the changes in behavior. In response, we recommend the MNCs to change the strategies to be more accommodating toward the interest of local communities. MNCs
should be more sensitive to respond to social and environmental issues. At the same time, MNCs should follow the corporate governance principles in business operations.

7.5 FUTURE RESEARCH

This dissertation has provided a comprehensive analysis of the governance of inward FDI after the introduction of the decentralized governance system in Indonesia. This has been rarely found in studies on FDI in Indonesia. It covered the investment policies to achieve sustainable development objectives and the dynamic interaction between national government, local government and MNCs to enrich study on FDI and decentralization in Indonesia. Furthermore, this dissertation has opened up several interesting questions to be elaborated further. Firstly, it would be interesting to explore the role of the Association of Southeast Asian Nations (ASEAN) as a regional organization in influencing domestic regulations on FDI in its member countries. A study which includes the influence of ASEAN on the government's and companies' decision-making processes can be explored in the future.

Second, it would be interesting to explore the implementation of corporate social responsibility in the region. As much literature has suggested, one channel to enhance the contributions of inward FDI to social development is through Corporate Social Responsibility (CSR). Further research could address the roles of MNCs in supporting social development in host countries through CSR activities. In particular, research on CSR could help us understand the way MNCs directly interact with local communities.

To conclude, this dissertation has shown dynamic interactions between actors in the process of managing inward FDI after the introduction of the decentralized system in Indonesia. Studies on the dynamic interaction between actors in the process of managing inward FDI are limited. This dissertation has also provided a number of policy recommendations to increase the contributions of inward FDI for the development in Indonesia. For instance, it recommends the government to improve legislations, policies and regulations on investments at national levels. It also provides recommendations at the micro level to improve the coordination mechanism in the process of managing inward FDI under the multi-level governance system. The recommendations are given not only for the national government but also for the local government and MNCs. For the local governments, this dissertation has provided some benchmarks to be adopted in the process of managing inward FDI.