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Foreign Direct Investment, Inclusive Growth, and Institutions in Indonesia

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Foreign Direct Investment, Inclusive Growth, and Institutions in Indonesia

Colophon

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university of
 groningen

Foreign Direct Investment, Inclusive Growth, and Institutions in Indonesia

PhD thesis

to obtain the degree of PhD at the
University of Groningen
on the authority of the
Rector Magnificus Prof. E. Sterken
and in accordance with
the decision by the College of Deans.

This thesis will be defended in public on

Thursday 12 July 2018 at 12.45 hours

by

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born on 17 May 1981
in Jakarta, Indonesia

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Prof. H.W. Hoen

Prof. B. Hari Wibisono

Dedication

To my parents and family
(Thank you for your unconditional love)

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“On purpose or not...realized or not...each person life is very meaningful for other(s)...” (Unknown)

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LIST OF ACRONYMS

ADB	Asian Development Bank
AEC	ASEAN Economic Community
APINDO	Asosiasi Pengusaha Indonesia (Indonesian Entrepreneur Association)
ASEAN	Association Southeast Asian Nations
Bappenas	Badan Perencanaan Pembangunan Nasional (National Development Planning Ministry)
BKPM	Badan Koordinasi Penanaman Modal (Investment Coordinating Board)
BPS	Badan Pusat Statistik (National Statistic Agency)
Corp.	Corporation
CSM	Corporate Social Marketing
CSR	Corporate Social Responsibility
CV	Commanditaire Vennotschap
DPMPTSP	Dinas Penanaman Modal dan Pelayanan Satu Pintu (One-stop and investment services working unit)
EU	European Union
FDI	Foreign Direct Investment
GNP	Gross National Product
GRDP	Gross Regional Domestic Product
HDI	Human Development Index
HRD	Human Resource Department
ICDF	International Cooperation and Development Fund
IMF	International Monetary Funds
IPC-IG	International Policy Centre for Inclusive Growth
ITDC	Indonesia Tourism Development Corporation
K/L	Kementerian/Lembaga (Ministry/Non-Ministry)
KADIN	Kantor Dagang dan Industri Indonesia (Indonesian Chamber of Commerce and Industry)
KP3MN	Konsolidasi Perencanaan dan Pelaksanaan Penanaman Modal Nasional (Consolidation of National Capital Investment Planning)
KPPOD	Komite Pemantauan Pelaksanaan Otonomi Daerah (Regional Autonomy Watch)
LKPM	Laporan Kegiatan Penanaman Modal (Investment report)
LPD	Lembaga Perkreditan Desa (Village financial institution)
MLG	Multilevel Governance
MSME	Micro Small Medium Enterprise
Musrenbang	Musyawaharah Pembangunan (Development planning meeting)
NIE	New Institutional Economic
NIP	Ngoro Industrial Park
NIL	Negative Investment List
OECD	Organisation for Economic Co-operation and Development

PDKPM	Perangkat Daerah Kabupaten bidang Penanaman Modal (District government working unit for investment)
PDPPM	Perangkat Daerah Provinsi bidang Penanaman Modal (Provincial government working unit for investment)
PNPM	Program Nasional Pemberdayaan Masyarakat (National Program for Community Empowerment)
PTSP	Pelayanan Terpadu Satu Pintu (One-stop services)
Renstra	Rencana Strategis (Strategic plan)
RIF	Regional Investment Forum
RKP	Rencana Kerja Pemerintah (One-year government plan)
RKPD	Rencana Kerja Pemerintah Daerah (One-year regional government plan)
RPJMD	Rencana Pembangunan Jangka Menengah Daerah (Regional medium term development plan)
RPJMN	Rencana Pembangunan Jangka Menengah Nasional (National medium term development plan)
RPJP	Rencana Pembangunan Jangka Panjang (Long-term development plan)
RPJPD	Rencana Pembangunan Jangka Panjang Daerah (Regional long-term development plan)
RTRW	Rencana Tata Ruang Wilayah (Spatial plan)
RUPM	Rencana Umum Penanaman Modal (General investment plan)
SKPD	Satuan Kerja Perangkat Daerah (Regional working unit)
SUR	Seemingly Unrelated Regressions
THK	Tri Hita Karana
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nation Development Program
UNWTO	The World Tourism Organization
UPT	Unit Pelayanan Terpadu (Integrated service unit)
WB	World Bank
WDI	World Development Indicator

Chapter 1

Introduction

Chapter 1 – Introduction

1.1. Background

Most countries, especially developing countries like Indonesia, attempt to attract Foreign Direct Investment (FDI) since FDI plays a significant role in financing the gap between domestic savings and the required investments in the economy. The saving-investment gap of Indonesia was around 3.1 percent to Gross National Product (GNP) in 2014. Due to the importance of FDI, its flows to developing countries increased significantly between 2005 and 2016. According to the United Nations Conference on Trade and Development (UNCTAD), the inward of FDI flowing to developing countries increased significantly from USD 340 billion in 2005 to 646 billion in 2016. Moreover, mostly, the inward of FDI flew to developing countries in Asia, especially Southern Asia and South-Eastern Asia, during that period.

However, the impact of FDI on the host country is still debatable. On the one hand, the modernization theory suggests that FDI can contribute to the host countries through employment creation, technological transfer, and economic linkage (Borensztein et al., 1998; Bengoa and Sanchez-Robles, 2003; Durham, 2004; Li and Liu, 2005; Solomon, 2011). On the other hand, based on the dependency theory, economic liberalization, such as through FDI inflows, distorts the economies of host countries. FDI flows to host countries destruct local entrepreneurship, stifle technological innovation, crowd out domestic firms, and increase unemployment (Mihalache-O and Li, 2011; Amin, 1974; Alschuler, 1976; Bornschieer et al., 1978, and Frank, 1979). Unfortunately, the existing studies have focused only on the contribution of FDI to a narrow concept of economic growth. This concept of economic growth needs to be touched upon from a much broader perspective. Focusing only on economic growth in assessing the impact of FDI is indeed too narrow an approach.

Considering a broader perspective on economic growth is vital. Empirical evidence has shown that apparent positive economic growth is often not accompanied by less income inequality and thus lower poverty rates (World Bank, 2008; Kusumawati et al., 2015, Fosu, 2017). For instance, the more recent increase in economic growth in India was not accompanied by a decreasing mortality rate, nor by reduced income and gender inequality (UNDP, 2005). Similarly, during the current global financial crisis, Indonesia experienced a remarkable economic growth, but the country's income inequality was the worst of the last 50 years. The existence of poverty and inequality is an indication that economic growth has not been distributed evenly across social groups (OECD, 2014, p.8). Some research has suggested that rising poverty and inequality lead to economic and social illness, ranging from low consumption to social and political instability, as well as damage to the sustainability of economic growth and the future of

economic well-being (Dartanto, 2014; Kawachi, et al., 1997; Martinez, 1996; and Dabla-Norris, et al., 2015). Therefore, international organizations like the World Bank, the United Nation Development Programme (UNDP), and the Asian Development Bank (ADB) started focusing on a broader concept of economic growth in their programs, the so-called inclusive growth model. Inclusive growth is defined as growth which benefits all members of society on an equal basis regardless of their individual circumstances (Felipe, 2012; Ramos et al., 2013; ADB, 2008; and OECD, 2014). In addition, most studies measure inclusive growth as high economic growth, followed by less poverty and less inequality (Ramos et al., 2013; Bhalla, 2007; McKinley, 2010; ADB, 2013; Anand R et al., 2014).

The introduction of the inclusive growth concept has important consequences for assessing the quality of FDI. First, the contributions of FDI to host countries should be assessed by considering not only economic growth per se but also levels of poverty and inequality. Furthermore, however, despite the increasing popularity of the inclusive growth concept, both its definition and measurement are still under discussion. Second, a theory is needed which explains the links of FDI to inclusive growth. So far, there is no study which does this. Third, the role of institutions should be considered in studying the contributions of FDI to host countries. Based on the New Institutional Economics (NIE), institutions are a fundamental factor in promoting the development process of countries (North 1981; Rodrik, 2000; Acemoglu and Robinson, 2012). Acemoglu and Robinson (2012) have introduced the concept of inclusive institutions which mean the rules of the game that allow all members of society to participate in and benefit from development. Based on their studies, inclusive institutions are the reason behind the success of economic development. Dunning and Fortainer (2006) perceived the important role of institutions in supporting the positive impact of FDI on host countries.

Considering the consequences above, this dissertation aims to examine the effect of FDI on inclusive growth, taking into account the role of institutions in Indonesia. This is very relevant for Indonesia as a developing country which depends on FDI inflows on financing development and attempts to optimize the contributions of FDI to the domestic economy. In addition, since entering the decentralization era in 2001, to promote the contribution of FDI to domestic development strong coordination is needed between national and local governments (provincial and district governments). Therefore, the National Medium-Term Development Planning (RPJMN) 2014-2019 has explicitly stated that all investment, including FDI, should be directed toward promoting inclusive growth. The objective of the national government to promote FDI for inclusive growth should also be consistent with the priorities of provincial and district government-development plans.

1.2. Research Questions

Based on the background above, this dissertation aims to address two interrelated research questions. First, what is the contribution of Foreign Direct Investment (FDI) to inclusive growth in Indonesia? Second, to what extent do institutions play an important role in promoting FDI for inclusive growth in Indonesia?

For the first research question, follow three sub-research questions:

- 1.1. Theoretically, how and through which channels does FDI affect inclusive growth?
- 1.2. Based on existing studies, what is the inclusive growth concept and how it is measured?
- 1.3. Empirically, how does FDI affect inclusive growth through specified channels in three selected regions: Badung, Mojokerto, and Tangerang Districts?

Concerning the second research question, there are four sub-research questions:

- 2.1. What kinds of institutions are needed to make FDI conducive of inclusive growth and, theoretically, how can these institutions bring about such results?
- 2.2. How is the capacity of central government's regulations in managing FDI to promote inclusive growth?
- 2.3. In multi-level government systems, what role does district government play in planning, implementing, and controlling FDI to make it inclusive?
- 2.4. To what extent do institutions affect the relationship between FDI and inclusive growth in district regions?
- 2.5. How do society's values affect the inclusiveness of institutions in district regions?

To address the above research questions, the overall dissertation will refer to a theoretical framework combining existing theories related to FDI, inclusive growth, and institutions. This theoretical framework will be presented in Chapter 2, and will provide a comprehensive link between FDI and inclusive growth and describe the role of institutions in promoting this link. This combination of a theoretical framework and ample empirical research is a major contribution of this dissertation.

1.3. Scientific and Social Significance of the Research

The study of FDI, inclusive growth, and institutions not only contributes to the existing literature but also delivers insights for policy makers and society. For the existing literature, this dissertation fills a gap by constructing a theoretical background to explain the specified channels of FDI to inclusive growth and the role of institutions in promoting FDI for inclusive growth. The dissertation also considers how the values of stakeholders influence the characteristics of institutions. Since there is as yet no study examining the linkages between FDI, inclusive growth, and institutions, this study contributes to the existing levels of knowledge and understanding.

This dissertation not only develops a theory, but provides empirical evidence to support it. It also analyzes the condition of inclusive growth in Indonesia and the capacity of national government's regulations to manage FDI and inclusive growth. Moreover, it also studies the interrelationship among the government levels (central, provincial, and district) in planning and controlling FDI. Analysis of the coordination among the levels of governments is important as, since 2001, Indonesia has entered the decentralization era, in which district governments have more authority to manage their regions, including FDI. The analysis here can help the government to find ways to improve coordination among its various levels to manage FDI for inclusive growth.

The case studies of the selected districts provide deeper insight into the contributions of FDI to inclusive growth through specified channels in the selected districts. The case studies also clarify the effect of institutions in each district on the relationship between FDI and inclusive growth. The institutions – the rules of the game – analyzed in this dissertation are not only those of governments, but also of foreign companies and society. Therefore, the case studies will provide insights into how interaction among stakeholders – governments, foreign companies, and society – can shape the relationship between FDI and inclusive growth.

1.4. Research Design and Methodology

To address the research questions above, this dissertation employs a qualitative method. The first qualitative method is a literature review. Existing studies on FDI, inclusive growth, and institutions are used as a basis to construct a theoretical framework. In addition, this study conducts in-depth interviews in selected regions in Indonesia to explore the detailed linkages between FDI and inclusive growth. The interviews also focus on the role of institutions and the values of society in these districts.

Three districts were selected for the case studies – Badung, Mojokerto, and Tangerang Districts. These districts were selected based on data of FDI realization from national investment board (BKPM), and economic growth and income inequality provided by national statistic agency (BPS). Badung District has high inflows of FDI and economic growth, and moderate-income inequality compared to average of those at national level. Mojokerto District has high inflows of FDI and economic growth, and low-income inequality compared to average of those at national level. Meanwhile, Tangerang District has high inflows of FDI and economic growth, and high-income inequality compared to average of those at national level. By having those three selected districts, this dissertation can observe the impact of FDI on inclusive growth in those districts and role of institutions in FDI and inclusive growth relationship.

Related stakeholders – foreign companies, district governments, and society – are interviewed to gain their perspectives on the effect of FDI on inclusive growth in their regions and also on how institutions can influence contribution of FDI to inclusive growth. In order to grasp the interrelationship between government levels in managing FDI and inclusive growth, this dissertation also conducts interviews with the provincial and national government.

1.5. Dissertation Sections

This dissertation is organized into ten chapters, including this introduction. A brief review of each chapter follows:

Chapter 1: Introduction

This chapter presents a brief description of the background, research questions and methodology of this study. It also presents the contributions of this dissertation to the literature, and to policy makers and society.

Chapter 2: Foreign Direct Investment, Inclusive Growth, and Institutions: The Theoretical Analysis

This chapter mainly discusses the theoretical framework of the links between FDI and inclusive growth. The chapter starts by focusing on the controversies between theories and empirical evidence on the effect of FDI on the host countries. However, most studies focus only on assessing the impact of FDI on economic growth per se. Therefore, this chapter introduces a broader concept of economic growth, the so-called inclusive growth model. The concept of inclusive growth is explained briefly in this chapter and is linked to FDI. The theoretical framework provides the detailed channels through which FDI affects inclusive growth. The chapter also considers the role of institutions in fostering the contributions of FDI to inclusive growth. Inclusive institutions expand the opportunity for all members of society to gain benefits from FDI called as economic institutions and to engage in FDI policies called as political institutions. The concept of inclusive institutions is also adopted in multi-level governments whereby national government involves local government, especially district government, in public policy processes related to FDI. As district governments are the closest to society, they are assumed to understand more about the preferences of local people on FDI. Finally, this chapter considers the influence of the values of government, foreign companies, and society in managing FDI to promote inclusive growth.

Chapter 3: The Inclusive Growth Concept: Strengths, Weaknesses, and a Research Agenda for Indonesia

This chapter attempts to review the recent studies on inclusive growth. The review covers the definition of inclusive growth, its indicators, how they have been combined and to what extent existing research on inclusive growth can provide a better understanding of the economic development process of an emerging economy like Indonesia.

Chapter 4: The Capacity of Government Regulations to Manage FDI for Inclusive Growth in Indonesia

Chapter 4 provides the first institutional analysis of this dissertation. The chapter analyzes whether the central government's plans and regulations are able to achieve FDI which promotes inclusive growth. The Indonesian medium-term development plan (RPJMN) for 2015-2019 is analysed to observe its capacity to plan FDI for inclusive growth. Actually, the RPJMN 2015-2019 is the first document of the Indonesian government that states explicitly the objective of promoting FDI to bring about inclusive growth. Further, the other regulations such as Investment Law No. 25/2007, the General Investment Plans (RUPM) and the Negative Investment List (NIL) are examined to assess their capacity to promote FDI for inclusive growth. The capacity of these regulations is measured based on the extent to which the regulations state the channels and targets of FDI for inclusive growth, and coherent to other regulations.

Chapter 5: The Role of District Government on Foreign Direct Investment and Inclusive Growth in Indonesia: Multilevel Governance Analysis in Selected Districts

This chapter is focused mainly on the roles of district government in regulating FDI for inclusive growth. In this decentralization era, in which the district government has more authority to manage its own region, good coordination between district government and provincial as well as national government is required. The main question here is how does the district government manage FDI to achieve inclusive growth at each stage of the public policy process? For this analysis this chapter applies the multi-level governance theory, which emphasizes interdependence among different layers of government (vertical interdependence) and interdependence between government and non-government actors at various territorial levels (horizontal interdependence). This chapter focuses only on the vertical interdependence among the levels of government. If local government is involved by national government in the public policy process related to FDI, this indicates that the national government has adopted the concept of inclusive institutions. The analysis in this chapter is based on the existing regulations and their implementation.

Chapter 6, 7, 8, 9: FDI, Inclusive Growth, and Institutions: Case Studies of Badung, Mojokerto, and Tangerang districts, and Comparison of those case studies

The last three chapters of this dissertation provide case studies in selected districts. The selected districts include Badung District, Mojokerto District, and Tangerang District. The research questions addressed are: first, what is the effect of FDI on inclusive growth through employment creation, productivity improvement, MSME linkages, and CSR programs? Second, to what extent do institutions play a role in fostering FDI for inclusive growth? Are inclusive institutions present in the selected districts to make FDI inclusive? The methodology employed for the case studies includes in-depth interviews with related stakeholders of the selected districts: local government, foreign companies, and society. Local governments are represented by working units that are responsible for FDI and inclusive growth. Foreign companies are represented by companies owned by foreign investors, but which operate in those districts. Society is represented by the head of the traditional village or administration village. Besides the results of in-depth interviews, secondary data analysis is also provided, using the economic and social data of those districts. The data cover FDI flows, economic growth, income inequality, poverty rate, and the quality of human resources. After exploring the districts in chapters 6-8, chapter 9 provides a summary and comparative study of the districts as to the effect of FDI on inclusive growth through several channels, and the role of institutions and values in promoting FDI for inclusive growth.

Chapter 10: Conclusions

Chapter 10 is the last chapter of this dissertation. This chapter provides the outcomes of the dissertation based on the proposed theories on FDI, inclusive growth, and institutions. Moreover, the chapter emphasizes the contribution of the research not only by enriching current studies of FDI, inclusive growth, and institutions, but also by providing insights for national policy makers, especially the Indonesian government, on supporting FDI for the benefit of all members of society. In addition, this chapter discusses the limitations of this dissertation, thereby presenting subjects for further research.

Chapter 2 of this dissertation begins by presenting a theoretical framework to link FDI to inclusive growth and to examine the role of institutions in this process. The theoretical framework also considers how society's values help to shape the characteristic of institutions, which in turn affect the contribution of FDI to inclusive growth. Inclusive growth is a broader concept of economic growth, explored further in chapter 3, and used in this dissertation to assess the contribution of FDI to society. The

theoretical framework introduced to indicate the linkage between FDI, inclusive growth, and institutions is used as a basis for conducting the empirical research for this dissertation.

This study will be relevant for developing countries like Indonesia which highly depend on Foreign Direct Investment (FDI) in financing their development. The high FDI inflows could increase economic growth, but the experiences of particular countries like Indonesia have shown that a high economic growth is not followed by lower poverty and inequality. A persistent increase in poverty and inequality will influence the sustainability of economic growth in the long-run. Therefore, this study will be beneficial to provide insights for policy makers in Indonesia and the other countries to consider the broader concept of economic growth, the so-called inclusive growth in managing FDI. In addition, this study also will provide the theoretical and empirical analysis on the role of institutions in promoting FDI to inclusive growth.

Chapter 2

Foreign Direct Investment, Inclusive Growth, and Institutions: A Theoretical Analysis

Chapter 2 – Foreign Direct Investment, Inclusive Growth, and Institutions: A Theoretical Analysis

Abstract

This chapter aims to provide a theoretical framework on the relationship between FDI, inclusive growth, and institutions. Theoretically, FDI can contribute to inclusive growth through five channels: employment creation, health and education improvement, economic linkage to Micro Small Medium Enterprise (MSME), and the Corporate Social Responsibility (CSR) program. Through these channels, FDI is expected to provide benefits to all members of society, leading to less poverty and inequality. Inclusive institutions that include the aspects of voice, engagement, and accountability, are required to support contribution of FDI for inclusive growth. This chapter considers inclusive institutions not only in governments, but also in foreign companies and society. Inclusive institutions in government, foreign companies, and society can interact to influence the actual contributions of FDI to inclusive growth. Since most existing literature focuses only on the role of government institutions, this study, which includes the role of foreign companies and society, will provide a significant contribution to the literature.

2.1. Introduction

Most countries, especially developing countries, attempt to attract Foreign Direct Investment (FDI) into their economies because they expect economic benefits as a result. FDI is one way for developing countries to finance the gap between required investments and limited domestic savings. In addition, FDI can stimulate productivity and economic growth in host countries by creating opportunities for employment, transfer of technologies and skills, and economic linkage. FDI may also help to access foreign markets when host countries are used as an export platform to distribute products in their own regions (Lamsiraroj, 2016). Therefore, FDI plays an important role in host countries by financing the saving-investment gap, promoting productivity and economic growth, and expanding access to the foreign market.

Existing studies have shown that the above economic benefits of FDI cannot be gained automatically without the absorptive capacity of host countries (Borensztein et al., 1998; Wang and Wong, 2011; Lamsiraroj and Ulubasoglu, 2015; and Lamsiraroj, 2016). For instance, Borensztein et al. (1998) and Wang and Wong (2011) found that the positive impact of FDI on economic growth significantly depends on the ability of human resources to absorb technological transfer from FDI in host countries. Meanwhile, Lamsiraroj and Ulubasoglu (2015) found that other factors, such as degree

of trade openness and financial development, are important for promoting FDI for economic growth in host countries. However, institutions are expected to have the most influential impact on different economic performance across countries (Rodrik, 2000 and Acemoglu and Robinson, 2012).

Institutions, defined as “the rules of the game”, shape human interaction (North, 1981). Institutions can be formal, such as constitutions, laws, and property rights, and informal, such as sanctions, taboos, customs, traditions, and social norms (Helmke and Levitsky, 2004). Related to FDI performance, Aglobyor et al. (2016) and Azman-Saini et al. (2010) suggested the importance of institutions such as rule of law, regulatory quality, and control of corruption in fostering a positive effect of FDI on economic growth in host countries.

Unfortunately, the existing studies focus merely on examining the impact of FDI on economic growth. However, high economic growth is often not accompanied by less income inequality and thus lower poverty rates (Kusumawati et al., 2015). For instance, the more recent increase of economic growth in India was not accompanied by a decreasing mortality rate, nor lower income and gender inequality (UNDP, 2005). Likewise, although during the global financial crisis Indonesia experienced a remarkable economic growth, the country’s income inequality was the worst in the last 50 years. Therefore, international organizations like the United Nations Development Program (UNDP) and the Asian Development Bank (ADB) started focusing on broader concepts of economic growth, the so-called inclusive growth. Inclusive growth is defined as growth that can benefit all members of society on an equal basis, regardless of their individual circumstances (Felipe, 2012).

The introduction of the concept of inclusive growth has important consequences for understanding the impact of policies on development, including the role of FDI, in fostering benefits for host countries. In analyzing the impact of FDI on host countries the first main consequence is expanding the number of indicators of growth by taking into account not only economic growth but also the broader aspects of development such as income inequality and poverty. The second consequence is more fundamental, and involves linking the conceptual and theoretical effects of FDI on inclusive growth. So far, the majority of the literature on the effect of FDI deals with economic consequences, such as productivity and economic growth. However, the third consequence involves the role of institutions in fostering the impact of FDI on inclusive growth. In the new development paradigm, the role of institutions is fundamental in the development process (Dunning and Fortanier, 2006). Institutions are defined by North (1981) as the rules of the game that govern the way in which human beings structure their interactions.

Institutions can be formal (laws and institutions) and informal (sanctions, taboos, customs, traditions, and social norms).

Considering the consequences mentioned above, this chapter is aimed to construct a theoretical framework of the relationship between FDI, inclusive growth, and institutions. First, this chapter presents the definition, the link, and the impact of FDI on economic growth. Second, the chapter will briefly explain the concept of inclusive growth to give an overview about inclusive growth. Third, the chapter presents a theoretical analysis of the link between FDI and various aspects of inclusive growth. Fourth, the chapter will explain the role of institutions in promoting FDI for inclusive growth. Finally, the chapter will present a theoretical framework of the relationship between FDI, inclusive growth, and institutions, and discuss how this framework is used as a basis for empirical case studies in the next chapters.

2.2. Foreign Direct Investment (FDI)

2.2.1. Definition of FDI

Based on OECD (2008), FDI is defined as “a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is a resident in an economy other than that of the direct investor”. ‘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 management of the enterprise. The direct or indirect ownership of 10 percent or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship (OECD, 2008: 17, and IMF, 2003: 9-10).

The definition of FDI in each country can differ from the standard OECD and IMF definitions. In Indonesia, there are two types of FDI data: the FDI data in Balance of Payment (BoP) based on OECD and IMF definitions, and the FDI data based on the Law No.25/2007 definition. As already mentioned, ownership of 10 percent or more of a resident company by a foreign investor can be included as FDI (OECD, 2008, p.17). The definition of FDI based on Indonesian Law No.25/2007 is broader than the OECD and IMF definitions. According to the Indonesian Law, FDI is a foreign investment activity aimed at creating a business in Indonesia, whether the business is fully owned by a foreign investor or jointly with a domestic investor (article 1.3). The foreign investor can be a foreign resident, enterprise, or government (article 1.6). Moreover, based on the law, the FDI enterprise is required to have the status of a limited liability company (article 5.2).

This study will follow the FDI definition based on Law No.25/2007 for two reasons. The first reason is data coverage. FDI based on the Indonesian law does not only cover transfers of money from foreign investors to a domestic company. The FDI data from the Indonesian investment board (BKPM) cover information on the entire process of foreign transfers, beginning with getting the principal license, then starting business activities, and finally carrying out normal business activities. The foreign companies provide regular reports of their business activities, every 3 months for their beginning investment process and every 6 months for their normal business activities. In addition, the FDI data provided by BKPM also covers the transfer of physical investment, such as machines, imported from foreign investors to domestic companies. The second reason to follow the Indonesian law is data availability. FDI data based on the IMF and OECD definitions is available only on a national level while FDI data from BKPM also includes the district level. District level data is suitable for this study since this study attempts to analyze the performance of FDI on inclusive growth at district level.

2.2.2. The Motivation of FDI

Based on the literature (see Dunning, 1998; Dunning and Lundan, 2008), generally foreign companies have four motives to invest in the host country: resource-seeking, market-seeking, efficiency-seeking, and strategic asset-seeking. First, FDI aimed at seeking natural resources invests abroad to gain resources at a lower cost than in the home country as well as to ensure a stable supply of these resources. FDI resource-seeking includes most minerals, raw materials, and agricultural products. These products are mostly exported to other countries, especially developed countries.

Second, FDI aimed at market-seeking is undertaken to supply goods or services to markets in host countries. The market-seeking investment attempts either to sustain or protect existing markets or to exploit or promote new markets. For that reason, market oriented FDI needs to adapt its products to local tastes or needs and familiarizes itself with local languages, business customs, legal requirements and marketing procedures.

Third, efficiency-seeking investment aims primarily to take advantage of the economies of scale and scope in a host country, such as low labor costs, access to markets, and government incentives. This type of FDI often invests in low-wage countries, and will provide only elementary skill training over a short time. Hence, its contribution to human capital development is limited. However, the main benefits of efficiency-seeking investment in a host country are employing low skill laborers and having links with local suppliers. In addition, in order to attract efficiency-seeking investment it is necessary to improve the investment climate and governance.

Fourth, FDI with strategic-seeking motivation focuses on long-term strategic objectives like sustaining or advancing its international competitiveness. Building long-term relationships with government and society in a host country is a main policy of a strategic-seeking FDI. Based on Te Velde and Xenogiani (2007), this type of investment is perceived as more beneficial to human capital development. For instance, high-tech manufacturing operations are likely to be engaged in improvement of particular skills and in research and development (R&D) cooperation.

Regardless of a company's economic motives, it will attempt to have social activities. Currently, companies pay more attention to close engagement with local people by implementing Corporate Social Responsibility (CSR). CSR is an integrated social and environmental concept (European Commission, 2006) whereby companies can combine profitable and social activities. According to Kotler and Lee (2005), companies should not consider CSR as an obligation but as a part of a company's strategy. For instance, by having CSR, companies can have good relationships with local people, thereby creating an environment conducive to business operations.

2.2.3. The Impact of FDI on Economic Growth

Theoretically, the impact of FDI on domestic economy is still debatable. There are two competing theories concerning this issue: *modernization and dependence theories*. On the one hand, *the modernization theory*, rooted in economic liberalism, argues that developing economies tend to benefit from economic linkage with advanced economies through FDI. This argument is based on the assumption that the market mechanism works perfectly and can allocate economic resources efficiently. FDI provides developing countries with access to capital and technology that are essential for development. In addition, FDI can contribute to the host country by employing local people, cooperating with domestic enterprises, and providing training and health security to improve the productivity of local employees. The modernization theory is supported by the neoclassical growth theory (Solow, 1956 and Swan, 1956) which argues the importance of the labor force, capital accumulation, and technological progress to achieve long-term economic growth. According to the neoclassical growth theory, FDI is an exogenous factor which can increase labor absorption, capital accumulation and technological progress in host countries.

However, according to the *dependency theory*, economic liberalization through FDI distorts the economies of host countries. FDI flows to host countries destroy local entrepreneurship, stifle technological innovation, crowd out domestic firms, and increase unemployment (Mihalache-O and Li, 2011). The negative effect of FDI on domestic economies is caused by the 'market stealing' activities of foreign companies.

A technologically superior FDI may take market shares from domestic enterprises and force them to produce at a lower output per unit cost. The dependence theory is supported by the endogenous growth theory, which argues that the positive effect of FDI on economic growth is not exogenously determined by FDI. The creation of employment, technological progress, and economic linkage depend on the ability of human resources in the host countries to absorb the positive effect of FDI, the so-called absorption capacity. The positive impact of FDI on economic growth in host countries, which is dependent on the quality of human resources, has been proved by existing studies such as by Borensztein et al. (1998) and Wang and Wong (2011).

Besides the quality of human resources, Lamsiraroj and Ulubasoglu (2015) reported other absorption capacities which are important to promote FDI for economic growth, such as degree of trade openness and financial development. The host country that tends to be open to international trade activities can benefit from FDI as FDI may help to expand access to foreign markets whereby host countries are used as an export platform to distribute products in the regions. Moreover, a well-developed financial market can also promote the benefits of FDI in host countries by facilitating the activities of foreign companies, reducing transaction costs, and increasing domestic savings. Aglobyor et al. (2016) found, for example, that FDI has no significant impact on economic growth in Sub-Saharan African countries because the financial market there is less developed.

Furthermore, North (1981) suggested institutions as the fundamental factor behind sustained economic growth. This is a new stream of economic literature, the so-called new institutional economics (NIE). North (1981) defined institutions as “the rule of the game of a society, that is, the humanly-devised formal and informal constraints that shape human interactions”. Regarding FDI, Azman-Saini et al. (2010) argued that a host country can receive benefits from FDI inflows when the host country has good quality institutions like property rights security, corruption control, and regulation quality. Institutions can drive the technological transfer, employment creation, and economic linkage from FDI to host countries.

Unfortunately, the aforementioned studies were focused merely in examining the impact of FDI on economic growth. Based on Kusumawati et al. (2015), high economic growth is often not accompanied by a reduction in income inequality and poverty. For example, high economic growth in Great Britain during the industrial revolution was not followed by improvements in life expectancy and infant mortality (Crafts, 1997). Similarly, the more recent increase of economic growth in India was not accompanied by a decreasing mortality rate or less income and gender inequality (UNDP, 2005). Likewise, while Indonesia experienced a remarkable economic growth during the global

financial crisis, it reached the worst income inequality of the last 50 years. These examples indicate that economic growth is too narrow an indicator of development and cannot ensure benefits for all members of society; in this case, economic growth is not inclusive.

Therefore, the analysis of the impact of FDI on host countries should include the broader concept of economic growth, or so-called inclusive growth. Below will follow the definition of inclusive growth based on existing studies by international organizations. The theoretical background of the links between FDI and inclusive growth will also be explained.

2.3. Inclusive Growth Concept and the Link between FDI and Inclusive Growth

The introduction of the concept of inclusive growth has important consequences for understanding the impact of policies on development, including the role of FDI in fostering benefits for host countries. The first main consequence is expanding the number of indicators used to analyze the impact of FDI on host countries by considering not only economic growth but also broader aspects of development such as income inequality and poverty. The second consequence is more fundamental, and involves linking conceptually and theoretically the effect of FDI on inclusive growth. This section will address these issues.

2.3.1. Inclusive Growth Concept

When it became clear that economic growth was not being accompanied by improvement in other developmental factors like poverty and inequality, international organizations and policy makers started focusing on broader concepts of economic growth. Certainly, as a broader concept, inclusive growth aimed at delivering higher income gains for lower-income groups, including the poor, as well as stimulating economic expansion. In 2004, the United Nations Development Program (UNDP) established the International Policy Centre for Inclusive Growth (IPC-IG) research group, which focuses specifically on inclusive growth issues. Moreover, in its 2020 strategy, the Asian Development Bank (ADB, 2008) put inclusive growth explicitly on its agenda. The 2006 India development policy review was entitled “Inclusive Growth and Service Delivery: Building on India’s Success”. India also included inclusive growth as an objective in its Eleventh Five Year Plan. Similarly, the Indonesian government has considered the concept of inclusive growth as part of Indonesia’s medium development plan for the period of 2010-2014 (Bappenas, 2010).

However, despite the increasing popularity of the inclusive growth concept, both its definition and measurement are still under discussion, and will therefore be explained briefly in this section. Moreover, because of its importance, a detailed definition, a

discussion of its measurement, and its strengths and weaknesses will be explored in Chapter 3.

Initially inclusive growth was broadly and imprecisely defined as growth that benefits all of society. Later, international organizations and policy makers started to define inclusive growth based on their own policy strategies. The World Bank (World Bank, 2008), for instance, defines inclusive growth as that which provides opportunities for society to become productive and creative. The Organization for Economic Cooperation and Development (OECD, 2014) considers inclusive growth to be that which brings improvements not only in income but also in living standards and people's quality of life. However, these concepts of inclusive growth remain too general. Many studies therefore try to explain the concept more precisely, and to measure it. For instance, Habito (2009) identifies inclusive growth as that which can reduce poverty. Other studies define it as the relationship between growth and equity (Anand et al., 2013; Balakrishnan et al., 2013), or between growth and opportunities (Ali and Son, 2007); or they try to include even more components of economic development such as health and nutrition; sanitation and water; and social protection (McKinley, 2010). However, among the various definitions that of Felipe (2012) is more precise: inclusive growth is growth that allows all members of society participate in and contribute to the growth process on an equal basis regardless of their individual circumstances. Implicitly, this definition stresses that inclusive growth should benefit all members of society, including the poor. It is growth accompanied by lower poverty and less inequality.

This study proposes using poverty and inequality as measurements of inclusive growth. The importance of dealing with inequality is supported by Piketty (2014), who explained that sometimes economic growth was not accompanied by a similar speed in reduction of inequality. This was mainly because the benefits of economic growth were not equally distributed to society. Rich people who already had more capital became richer, while poor people who had no capital tended to have less or even no benefit from the economic growth. In addition, Felipe (2012) pointed out that although most Asian countries experience high economic growth, not all members of society benefit from this growth, and many continue to suffer poverty and inequality. Felipe therefore emphasized that all members of society should have meaningful jobs (Felipe, 2012); inclusive growth can be achieved when all members of society have the opportunity to participate in the economy by being employed. Moreover, having a job is not only economically beneficial. Having a job provides people with income to fulfill their needs, but it also increases their self-esteem and creativity.

The importance of employment is also supported by Ramos et al. (2013). They proposed that only when people are employed can they participate in and contribute to

the economy. However, employment itself is not sufficient to lead to inclusive growth since poor people tend to have many other disadvantages (Bhalla, 2007, and Tang, 2008) like low levels of education and health; they thus have lower productivity and receive lower wages. Therefore, employment, education, and health become important factors in reducing poverty and inequality, and are thus indicators of inclusive growth (OECD, 2013, and OECD, 2014). The OECD (2013, 2014) further explained the importance of income in enabling people to choose their living conditions. Moreover, jobs provide opportunities for people to improve their skills and abilities and to participate in economic and social activities. In addition, good health gives people greater chances to find jobs.

In summary, scholars have many different perspectives on the indicators of inclusive growth. Even though the concept generally stands for economic growth that benefits the entire society, international organizations often transform it to fit their own preferred economic strategies. However, if we define inclusive growth as that which benefits all members of society (especially vulnerable and marginalized people such as women, indigenous people, people with disabilities, and children and youths) and if we consider inclusive growth to include both income- and non-income-related aspects, this study suggests that reduction of income inequality and poverty are appropriate indicators of inclusive growth (Kusumawati et al., 2015).

The theoretical link between growth, poverty, and inequality is also justified by the proposed indicators. Inclusive growth will allow the marginalized to be actively involved in economic activities which will provide them with regular incomes to meet their basic needs and help them to move out of poverty. Moreover, based on Balakhrisnan et al. (2013), the pace and persistence of economic growth in reducing poverty is strongly related to low income inequality. Therefore, both poverty and income inequality are appropriate indicators of the inclusiveness of economic growth. In addition, the vulnerable or marginalized groups mentioned above include those who are commonly excluded from receiving benefits from foreign investments. This study will use these indicators for further discussions of inclusive growth. Chapter 3 will explore in detail the concept of inclusive growth and its strengths and weaknesses.

2.3.2. The Link between FDI and Inclusive Growth

Based on the definition and measurement of inclusive growth, this part establishes the theoretical relationship between FDI and inclusive growth. As already mentioned, income inequality and poverty rate will be used as the indicators of inclusive growth. Here we will explain how FDI generates a positive impact on the local people, including marginalized people such as the poor and disabled people to reduce income inequality

and poverty. We will also explore the channels through which FDI can promote inclusive growth. This theoretical background is based on the existing literature and on this study's empirical exploration.

The impact of FDI on inclusive growth can be analyzed through direct and indirect channels (see figures 2.1 and 2.2). Direct channels are identified as benefits received by local people either from direct engagement in FDI business or benefits provided directly to them by the FDI without their being involved in FDI business. The direct channels consist of labor and non-labor benefits. Labor benefits include employment opportunities and labor income, as well as health and education benefits. The existence of FDI can provide employment opportunities for local people and they receive a regular income. By having a job and income, local people can improve their welfare, including the quality of education and health. In addition, as employees of foreign companies, the local people will receive non-income benefits such as education and health benefits. The education benefits include training programs like on the job training, general education training, and safety training to increase the knowledge, skills, and security of the employees. The increased capacity and security of employees can improve their productivity, income, and welfare, which in turn reduce poverty and income inequality. In addition, the productivity of employees can be enhanced by providing programs such as health insurance and health facilities. Health insurance and access to health facilities like clinics and hospitals in turn increase the health condition of employees. Like better education, better health leads to higher productivity and income of employees, which eventually help to reduce poverty and income inequality. The labor benefits provided by FDI through employment absorption and income creation, as well as educational and health programs, can improve the productivity and quality of life of local people who work in foreign companies. Consequently, better productivity and quality of life will lead to lower poverty and less income inequality.

FDI can also directly contribute to inclusive growth through non-labor benefits which are provided for the local people who are not involved in FDI business as employees. Non-labor benefits can include community income or philanthropic benefits which are not integral to the FDI operation itself. These types of benefits are provided by conducting a Corporate Social Responsibility (CSR) program. According to the European Commission (2006), CSR is "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". The concept implies that the private sector can play a key role in generating not only economic profits for itself, but also economic and social benefits for society. International organizations such as the United Nations and the World Bank have included CSR as a program of private sectors to achieve

development goals aimed at poverty alleviation. A sense of social responsibility in the private sectors will force economic growth to be more inclusive, equitable, and poverty reducing (Utting, 2007).

For CSR programs to effectively contribute to inclusive growth they should aim to increase the capacity and productivity of local people so that they can have jobs and receive regular incomes. Based on Kotler and Lee (2005), there are many programs of CSR such as philanthropy programs, community volunteering programs, and Corporate Social Marketing (CSM) programs. Corporate philanthropy programs, through which companies can contribute directly to society by providing cash grants (for instance scholarships) and other services (such as regular internships at the company), are essential to improve the knowledge and skills of local people. Hence, local people can be absorbed in foreign companies and receive a good income, which in turn increases their welfare and quality of life. Eventually poverty and income inequality can be reduced. In addition, a community volunteering program which involves employees of the foreign company in providing vocational training for local people will be beneficial for skills and knowledge enhancement. Besides education program, the CSR programs in health are also beneficial to promote inclusive growth. A corporate social marketing (CSM) program in which the companies attempt to change society's behavior towards health will also increase the quality of human resources and productivity. Moreover, building health infrastructures such as water sanitation is also essential to improve the quality of life of a local people.

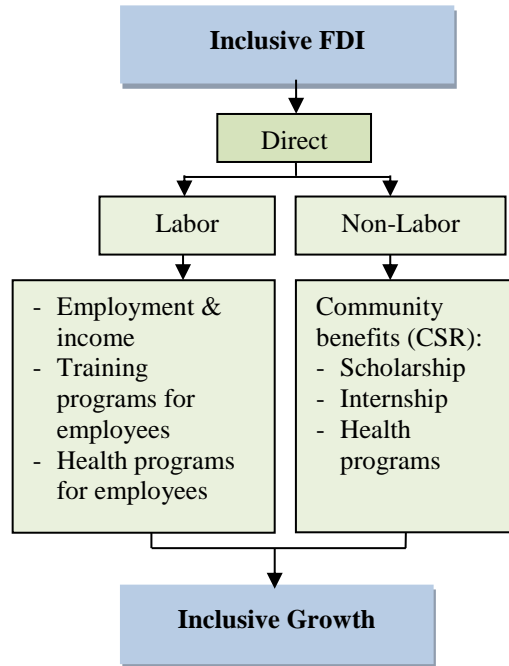


Figure 2.1. The Direct Channels of FDI to Inclusive Growth

According to the figure below, FDI can have an indirect impact on inclusive growth through linkage to domestic firms, especially to Micro Small-Medium Enterprises (MSME). FDI can do this by generating income to MSME as a supplier for and consumer of foreign companies. Mitchell and Ashley (2010) describe, for example, how international tourism indirectly affects MSME in other sectors such as agriculture and industry by supplying food or furniture to hotels and restaurants. The positive economic impact of FDI on MSME will improve the welfare of vulnerable groups like poor local people who work in MSME sectors (International Trade Centre, 2015).

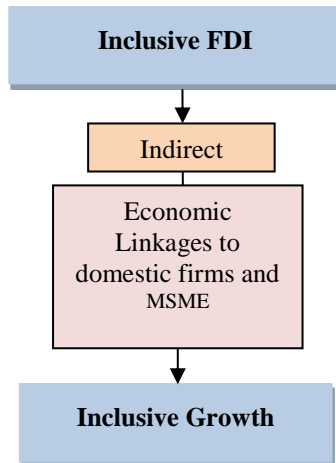


Figure 2.2. The Indirect Channels of FDI to Inclusive Growth

However, based on new institutional economics (NIE), in practice the above channels through which FDI contributes to inclusive growth cannot work automatically and perfectly. Therefore, institutions, defined as the rules of the game which regulate the behavior of private sectors, government, and society, play a significant in driving FDI to become inclusive. The importance of the role of institutions in fostering the benefits of FDI to a host country's development has also been discussed by Dunning and Fortanier (2006). The next section will discuss the definition of institutions and the quality of institutions required to achieve inclusive growth.

2.4. The Role of Institutions for Inclusive Growth

2.4.1. Concept of Institutions

North (1981) defines institutions as “the rules of the game of a society, that is, the humanly-devised formal and informal constraints that shape human interactions”. Institutions consist of formal and informal institutions. Formal institutions are created, communicated, and enforced through official channels including constitutions, laws, and property rights. Informal institutions, on the other hand, are usually unwritten, and are created, communicated and enforced through unofficial channels, such as sanctions, taboos, customs, traditions, and social norms (Helmke and Levitsky, 2004). In practice, formal institutions work together with informal institutions to manage the behavior of agents in the economy (Williamson, 2009). The interaction of formal and informal

institutions produces operational ‘rules of the game’ that shape how the various agents (private sector, government, and society) act in an economy.

Most existing studies focus on measuring the quality of governmental institutions which regulate the interactions of government with private sectors and society. The most popular and widely used indicators of the quality of institutions are the Worldwide Governance Indicators (WGI) provided by the World Bank. The indicators include voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. However, the measurements and the indicators of institutions provided by the World Bank have drawbacks in terms of their concepts and scopes. Hence, a lack of conceptual background and limitations in the scope of institutions cause mixed results in empirical studies that relate institutions with development outcomes, such as inequality. For instance, Chong and Gradstein (2004) found that better quality of government institutions leads to a decrease in inequality, whereas Lopez (2004) found the opposite result.

According to Rothstein and Teorell (2015), in order to measure the quality of institutions, the concept of impartiality should be included. The impartiality of institutions is procedural, which means it can encompass very different policies and does not rule out support for specific groups or interests. To the degree that government institutions are impartial, government can promote development for all members of society. For instance, to have a democracy a majoritarian rule alone is not sufficient to give quality to a government, either theoretically or empirically. Related to impartiality, democratic legitimacy requires that a government upholds political rights such as freedom of association and of expression. As a consequence, democracy as an expression of political equality requires impartial government institutions which can accommodate the aspirations of society when formulating and implementing policies.

Another concern is about measuring the scope of institutions. Indicators like those used by the World Bank are merely focused on measuring the quality of government’s institutions. In practice, other economic agents such as private sectors and society have their own rules of the game or institutions that regulate their behavior or policies. Society has its institutions, the so-called informal institutions which are represented by values, customs, traditions, and social norms that restrict the behavior of society. Related to FDI, Dunning and Fortainer (2006) highlight the role of Institutional Ownership-advantage of foreign companies, in addition to the traditionally distinguished Ownership-advantages related to resources and capabilities. These institutions refer to a firm’s norms and values of ethical and responsible behavior which are reflected in formal regulations of the firm regarding social relationships or environmental standards. The motivations of FDI highly affect the institutional advantages of foreign companies.

For instance, FDI with strategic-seeking motivation tends to be more concerned with its relationship to society and the host country's government than FDI with resource-seeking motivation.

Therefore, the next sections will discuss the relationship between institutions and inclusive growth by considering the impartiality aspect of institutions. Acemoglu and Robinson (2012) have discussed the impartiality aspect of institutions by introducing the concept of inclusive institutions. The concept of inclusive institutions will be used in this study to analyze the effect of FDI on inclusive growth. In addition, this study expands the scope of institutions by considering not only institutions in government but also in foreign companies and society.

2.4.2. Inclusive Institutions for Inclusive Growth

As already mentioned above, inclusive growth is growth that benefits all members of society. Inclusive growth is indicated by economic growth with more equal income distribution and lower poverty rates. The OECD (2015) emphasizes that inclusive growth requires the participation of all groups, including the poorest and most marginalized people, in decision-making processes. Since institutions play a fundamental role in fostering development, the type of institutions required to achieve inclusive growth is an important issue to be addressed here.

Acemoglu and Robinson (2012) introduced the concept of inclusive institutions, which is defined as institutions which grant equal rights and equal opportunities, and are based on principles of universality, non-discrimination, and targeted action. This definition is in line with the impartiality aspect of institutions emphasized by Rothstein and Teorell (2015). By means of inclusive institutions, the members of society, especially marginalized people, are involved in policy processes and have equal rights to gain benefits from economic activities. On the other hand, extractive institutions are institutions in which a "small" group of individuals do their best to exploit the rest of the population. Countries with extractive institutions are expected to have higher income inequality and poverty. Acemoglu and Robinson (2012) argued that differing levels of inclusiveness of institutions is the reason behind differences in countries' economic performances and inequality.

Based on Acemoglu and Robinson (2012), institutions are divided into economic and political institutions. Inclusive economic institutions are those that allow and encourage participation by all members of society in economic activities so that development can be beneficial for all. Meanwhile, inclusive political institutions are institutions which allow society broad participation and freedom to express their aspirations and interests in politics and in the decision-making process. Acemoglu and

Robinson (2012) argue that inclusive economic institutions are the product of inclusive political institutions. Hence, considering both economic and political institutions, inclusive institutions can be “process” and “product” for inclusive growth.

Inclusive institutions as a “process” for inclusive growth should encompass three important aspects: engagement, voice, and accountability. Engagement means that society should be involved in the decision-making process. Voice means that society has freedom to express their aspirations in the decision-making process. Accountability means that society has to be informed about the policies or regulations produced. Meanwhile, inclusive institutions as a “product” of inclusive growth should contain the aspects of engagement and impartiality which ensure that all members of society have equal rights to engage in and gain benefits from economic activities. Therefore, the aspects of institutions as both process and product are required for inclusive growth.

2.4.3. Inclusive Institutions in Multilevel Governance

In the case of multi-level governments (national and local governments), especially in the decentralization era, the degree of adoption of inclusive aspects of inclusive institutions is indicated by the engagement of local government in public policy processes at a national level (engagement aspect). In addition, local government also has a voice to express its aspirations and interests in the policy process because local government is assumed to better understand society’s preferences (voice aspect). Finally, local government has the right to be informed about national government policies (accountability aspect). Adoption of these inclusive aspects in the public policy process at different government levels will lead to government policies that support inclusive growth. The interdependence between different levels of government and the adoption of inclusive institution aspects has been postulated in the Multilevel Governance (MLG) theory. Based on the MLG theory, vertical interdependence among different levels of government (multi-level) contains ‘governance’ or inclusive aspects of institutions.

According to OECD (2011), vertical involvement of local governments in the public policy process can be clustered into three types: a dominant or main role, a joint role, and an implementing role. First, local government has a dominant role in public policies if it has autonomy or independence to make decisions at each stage of the public policy process (planning, implementation, and evaluation). In a dominant role, the local government is more powerful than the central government. Second, the local government plays a joint role in public policies if local government and central government have equal power to make decisions in each stage of the public policy process. Third, the local government becomes an implementer if it has no power but just

implements policies formulated by the central government. In order to make FDI inclusive and consider the aspects of inclusive institutions, it is necessary for local government to play a joint role in the public policy process.

The section below will present the theoretical framework of the relationship between FDI, inclusive growth and institutions. The scope of inclusive institutions will be expanded to include not only institutions in government, but also those in foreign companies and society. By expanding the scope of inclusive institutions, the theoretical framework constructed in this part will contribute new insights to those in the existing literature, since most studies until now have focused on governmental institutions.

2.5. Theoretical Framework of FDI, Inclusive Growth, and Inclusive Institutions

Based on the theoretical explorations above, this section will present the theoretical framework of the relationship between FDI, inclusive growth, and institutions. The theoretical framework is represented in figure 2.3. The framework is aimed to address two main issues in this study: first, the actual effect of FDI on inclusive growth through several channels and second, the role of institutions and how they promote FDI for inclusive growth. Before discussing the links between FDI and inclusive growth, the indicators of inclusive growth should be specified (as suggested by Dunning and Fortanier, 2006).

As already specified above, this study uses income inequality and poverty as the indicators of inclusive growth. Income inequality is measured by the gini index, which measures how much the distribution of income among individuals or households within a country/region deviates from a perfectly equal distribution. A gini index of 0 indicates that income is distributed equally among the individuals. A gini index value of 1 implies that the income distribution is totally unequal. Based on the World Bank classification, a gini value index lower than 0.4 is categorized as low income inequality, a gini index between 0.4 and 0.5 is categorized as medium income inequality, and a gini index higher than 0.5 is categorized as high income inequality.

The other indicator, poverty, is represented by the poverty rate, measured by the ratio of people (in a given age group) whose income falls below the poverty line. High economic growth accompanied by a high poverty rate indicates that economic growth is not inclusive. On the other hand, high economic growth followed by a lower poverty rate indicates that economic growth is beneficial for the low-income people, and therefore inclusive. Inclusive growth is also indicated by high economic growth with a lower gini index, which represents less inequality.

2.5.1. The Impact of FDI on Inclusive Growth

FDI can contribute to inclusive growth, indicated by poverty rate and income inequality, through two channels: direct and indirect (see figure 2.3). Direct channels include labor benefits (employment opportunity and labor income, health and education benefits) received by local people from involvement in FDI activities, and non-labor benefits received by local people through CSR programs provided by FDI companies (community income or philanthropic benefits). FDI can generate employment for local people and they can receive sustainable income to improve their welfare. In addition, by being employed in the FDI business, local people will also receive education benefits (such as job training, general education, and safety training) that can increase their knowledge, skills, and security. By having greater knowledge and skills, local people who work in FDI companies can improve their productivity, potential income, and welfare, and have a chance to rise above poverty and reduce their income inequality. Besides education benefits, local people who work in FDI companies will also receive health benefits such as full coverage health insurance, and health facilities like access to good quality clinics and hospitals. Full coverage health insurance and good access to health facilities will increase the productivity and performance of the employees, and consequently improve their welfare and reduce poverty and income inequality.

Another direct channel of FDI to inclusive growth is non-labor benefits received by local people from CSR programs. CSR programs which are effectively promoting inclusive growth by reducing poverty and income inequality, include corporate philanthropy programs, community volunteering programs, and health infrastructure programs. Corporate philanthropy programs like sustainable scholarships and vocational internships will increase the capacity of local people in term of skills and knowledge. Accordingly, having greater skills and knowledge, local people can be employed in foreign companies and receive higher incomes and better education and health facilities. Eventually, better welfare leads to reduced poverty and income inequality. Other CSR programs which also effectively promote inclusive growth are community volunteer programs which involve employees of foreign companies in providing vocational training for local people, and corporate social marketing (CSM) programs in which the companies attempt to change society's health behavior. Finally, the CSR program to build health infrastructures will improve the health conditions and quality of life of local people.

Indirect channels through which FDI can contribute to reduce poverty and income inequality include FDI linkages to MSME. These linkages will generate employment and income for local people who work in MSME sectors. Since most of the people working in MSME are vulnerable and marginalized, strong linkages between FDI and

MSME will improve their welfare. However, based on the survey of this study in the three districts in Indonesia, the main challenges faced by MSME in building collaboration with foreign companies are fulfilling the requirements of quality and supply sustainability. In addition, the availability of the data of MSME is also a constraint for foreign company to collaborate with MSME.

In order to estimate the impact of FDI on inclusive growth, qualitative approaches will be employed. Case studies for selected districts will be provided to address in detail the contributions of FDI to inclusive growth in those districts (chapters 6, 7, and 8). The opinions of stakeholders, such as foreign companies, government, and society will be employed to support the evidence of FDI's contribution to inclusive growth.

2.5.2. The Role of Institutions in Promoting FDI for Inclusive Growth

The contributions of FDI to inclusive growth through the above channels can be promoted by institutions. In this case, the role of institutions is as moderator in FDI-inclusive growth relationships. Institutions as the rules of the game regulate the interaction between FDI, government, and society. As discussed above, inclusive institutions are required to promote the positive effects of FDI on inclusive growth. Central to inclusive institutions are engagement, voice, and accountability; inclusive institutions allow the members of society, especially local people, to engage, express their aspirations, and be informed about policies related to FDI. Such institutions can be part of both “process” and “product” for inclusive growth. As part of the process, inclusive institutions allow and encourage the engagement of local people in policy processes related to FDI. As a product, inclusive institutions ensure that all members of society have equal rights to benefit from FDI activities.

North (1981) defines institutions as humanly devised constraints that structure political, economic and social interaction. These constraints can be both formal (constitutions, laws, property rights) and informal (sanctions, taboos, customs, traditions, and social norms). Dunning and Fortainer (2006) perceived the importance of institutions in fostering a positive impact of FDI on host countries. Moreover, OECD (2014, p.162) suggested that institutions should be inclusive to achieve inclusive growth. In 2012, Acemoglu and Robinson introduced this concept of inclusive institutions, which allow all members of society to participate and gain benefits from development. In line with this, institutions should become inclusive in order to fit in the same important model of FDI-inclusive growth.

According to Acemoglu and Robinson (2012), inclusive institutions can be both economic and political. Inclusive economic institutions allow the members of society to be involved in and gain benefits from development, and inclusive political institutions

allow them to be involved (engagement), express their aspirations (voice), and be informed about development policies (accountability). OECD (2014: 162) also emphasized the importance of these latter three aspects of inclusive political institutions for economic development. In the model of FDI-inclusive growth, inclusive institutions must exist not only in governments but also in foreign companies and society. Therefore, the analysis of institutions is relevant for all stakeholders.

However, Acemoglu and Robinson (2012) point out that institutions are sometimes not inclusive, but rather extractive, providing benefits for only a small group of society while sacrificing other members of the population. This also applies to FDI: many members of society are prevented from being involved in FDI programs or policies. As a result FDI tends to increase poverty and inequality in the economy of the host country. Acemoglu and Robinson explain that one cause of extractive institutions is a lack of political freedom. Non-democratic countries, where society has no voice and engagement in government policies, tend to have extractive institutions. Extractive institutions can lead to the existence of “a middle man” who has access to a foreign company and restricts the sharing of FDI’s positive effects with other members of society, and especially the marginalized. This results in greater inequality and poverty.

Most studies assume that institutions are an exogenous variable, not influenced by other factors. However, the study of Hofstede (1980) suggests that the values of society influence the structure and functioning of institutions. Moreover, the existence of inclusive institutions is influenced by the values of all stakeholders, including foreign companies and government, as well as society. Bobo (1991) found, for example, that people with individualistic values are less likely to support redistributive policies than people with social responsibility values. On the other hand, foreign companies which take into account the welfare of local people, rather than focusing only on extraction of resources and maximization of profits, will promote inclusive growth. Therefore, in the next section, this study will describe the effects of FDI on inclusive growth and how institutions have assisted in this process. The analysis will also consider how social values affect the characteristics of institutions.

How institutions and the values behind them influence the impact of FDI on inclusive growth is shown in figure 2.3. The framework of this study includes inclusive institutions not only in the government, but also in foreign companies and society. The inclusiveness of institutions in each agent will determine the behavior of each agent toward inclusive growth and shape the relationships among agents in fostering FDI to become inclusive. For example, the capacity of government institutions to promote FDI for inclusive growth should be supported by appropriate laws and regulations. This subject will be further analyzed in chapter 4. The capacity of government regulations is

measured by whether the regulations have covered the channels of FDI to inclusive growth and whether coherence exists among government regulations regarding the relationship between FDI and inclusive growth.

Inclusive institutions in government lead the government to involve the members of society in the public policy process, from planning and implementation to evaluation. The involvement of society in the public policy process will accommodate society's needs and preferences. Hence, government policies related to FDI can benefit all members of society through FDI channels. For instance, government can provide the required training programs for local people so that they can be employed in foreign companies. Moreover, government can establish a forum in which all stakeholders can discuss CSR programs to make the program beneficial for the targeted people.

In the decentralization era and with a multi-level government system, the inclusiveness of institutions is indicated by the engagement of local governments in the public policy process at the national level. For instance in Indonesia, where government consists of three levels: national, provincial, and district, international affairs including FDI policies are mostly still under the authority of national government. However, although managing FDI is still under the authority of central government, FDI operates at the district level and deals with local people and local government. Therefore, engagement of the local government in the public policy process is important to encourage FDI policies that are beneficial for local people. It requires good coordination among levels of governments to ensure coherent governmental regulations and policies. Therefore, the role of local government in formulating FDI policies based on regulations and actual practice will be discussed in chapter 5.

In practice, the impact of FDI on inclusive growth is not only determined by government policies but also by the rules of the game in the foreign company itself. The inclusiveness of institutions in foreign companies is determined by the motivations of the foreign company. For example, FDI with strategic-seeking motivation tends to provide more social benefits for local people than FDI with resource-seeking motivation. The strategic-seeking FDI tends to maintain its relationship with stakeholders in the host country to support its long-term competitiveness. The values and the motives of FDI can be analyzed by looking at its visions and objectives. Moreover, programs conducted by the foreign company related to society and environment can be used as an indicator of whether the institutions of the company are inclusive. An analysis of FDI institutions in some selected districts will be provided in the case studies (see chapters 6-8)

The values of local people regarding FDI also influence how the benefits of FDI can be absorbed by local people. These values can be treated as informal institutions.

Local people who are more open to foreign companies (more inclusive institutions) can be expected to receive more benefits from FDI than those who are resistant to foreign companies. Therefore, the inclusiveness of social institutions, represented by their values on accepting foreign companies, is important to determine the capacity of local people to absorb the benefits of FDI. Moreover, as already explained above, the region where the people have individualism value is less likely to support redistributive policies than the region with social responsibility value. An analysis of local people's values in selected districts will be provided in the case studies (see chapters 6-8).

Overall, the impact of FDI on inclusive growth through the various channels is determined by the role of institutions. Inclusiveness of institutions in government, foreign companies, and society influences the contributions of FDI to inclusive growth. Moreover, the inclusiveness of the institutions of each agent determines how the foreign company, local government, and society interact to encourage FDI to become inclusive. The important aspects of inclusive institutions are engagement, voice, and accountability. Those aspects will be used to analyze the role of institutions in promoting FDI for inclusive growth. Finally, inclusiveness of institutions is influenced by the value of all stakeholders, such as government, foreign company, and society.

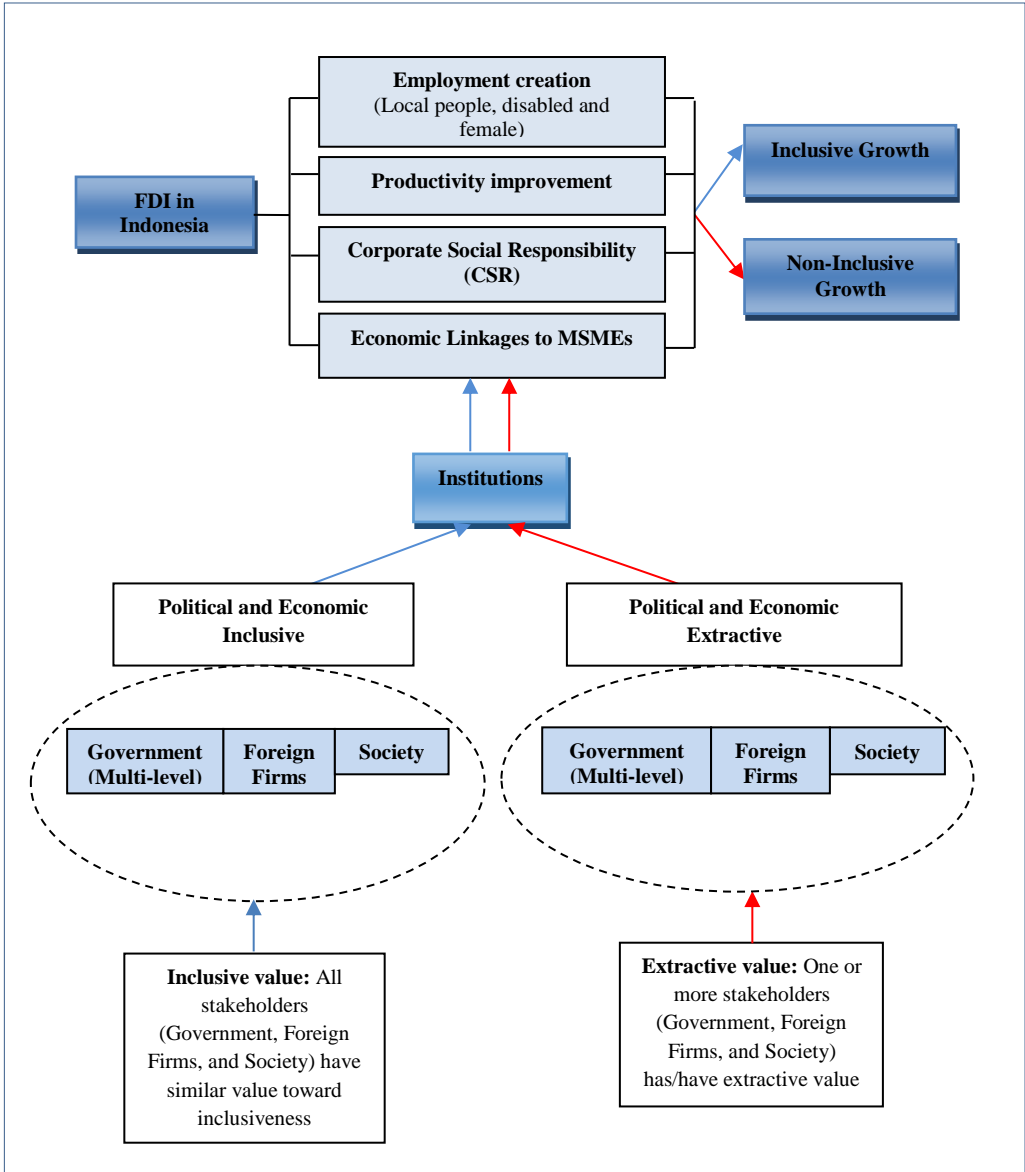


Figure 2.3. Theoretical Framework of the Relationship between FDI, Inclusive Growth, and Institutions for an Indonesian Case

2.6. Conclusions

This chapter has presented a theoretical framework on the relationship between FDI, inclusive growth, and institutions. First, the chapter has provided a definition of inclusive growth and given indicators to be used to measure inclusive growth. Second, the chapter has described the channels through which FDI contributes to inclusive growth. Third, the chapter has examined how institutions can influence FDI to become inclusive.

Theoretically, FDI can contribute to inclusive growth through the following channels: labor benefits, non-labor benefits from CSR programs, and economic linkages to MSME. Through these channels, FDI is assumed to provide benefits to all members of societies. The existence of FDI contributes to inclusive growth through labor benefits for local people who work for FDI companies. Income, health insurance, health facilities, and training provided by FDI companies increase the welfare of local people and reduce poverty rates and income inequality. In addition, CSR programs including corporate philanthropy programs, community volunteering programs, and health infrastructure programs increase the capacity of local people to be employed in FDI companies and receive higher income. In the end, having jobs and sustainable incomes will reduce people's poverty and income inequality.

The contributions of FDI to inclusive growth can also be transmitted through indirect channels such as economic linkages to MSME. Strong economic linkages between FDI and MSME can generate income for local people who work in MSME sectors. Mostly the people who work in MSME sectors are vulnerable and marginalized people such as poor or having a low income. Hence, a strong linkage between foreign companies and MSME will help to reduce poverty and income inequality in the regions. Moreover, the positive impacts of FDI on inclusive growth through those channels can be further promoted by institutions.

In this study, institutions are moderators in the FDI-inclusive growth relationship. Based on Acemoglu and Robinson (2012), inclusive institutions are required to achieve inclusive growth. The important aspects of inclusive institutions are engagement, voice, and accountability. By adopting these aspects, inclusive institutions allow the members of society, especially local people, to engage, to express their interests, and to be informed about policies related to FDI for inclusive growth. In addition, in the case of multi-level governments (national and local governments), especially in the decentralization era in Indonesia, inclusive institutions is indicated by the engagement of local government in public policy processes at the national level (engagement). In addition, local government also has the voice to express its aspirations and interests in policy processes since local government is assumed to better understand society's

preferences (voice aspect). Finally, local government has the right to be informed about national government policies (accountability). Hence, according to the multilevel governance (MLG) theory, local government has the authority in managing FDI to become inclusive.

Finally, in practice, the impact of FDI on inclusive growth is determined not only by government policies but also by similar institutions in foreign companies themselves and in society. FDI which has the motivation to provide social benefits for local people through all of the FDI channels will contribute greatly to inclusive growth. However, ensure that the policies of foreign companies will be beneficial for society it is crucial that society be engaged in FDI policies. Moreover, the values of local people regarding FDI also influence how these people can absorb FDI benefits. Local people who are more open to foreign companies (more inclusive) can be expected to receive more benefits from FDI than those who are resistant to foreign companies. In conclusion, the inclusiveness of institutions in government, foreign companies, and society will affect the actual contributions of FDI to inclusive growth. This theoretical framework will be used as a foundation for the overall analysis in this study.

The impact of FDI on inclusive growth will be analyzed using qualitative methods. For this study, we also conduct in-depth interviews with related stakeholders like local governments, foreign companies, and representatives of society in selected regions including Badung District, Mojokerto District, and Tangerang District. Based on these interviews, this study can capture in more detail the impact of FDI on inclusive growth through the various channels. Moreover, the interview results will also clarify the extent of the role of institutions in promoting FDI for inclusive growth. Besides analyzing the role of local government for inclusive FDI on the basis of multilevel governance theory, this study will also provide a case study analysis for each district. The case studies will address the role of inclusive institutions, covering the aspects of engagement, voice, and accountability.

Chapter 3

The Inclusive Growth Concept: Strengths, Weaknesses and a Research Agenda for Indonesia

Chapter 3 – The Inclusive Growth Concept: Strengths, Weaknesses and a Research Agenda for Indonesia¹

Abstract

In the last decade, inclusive growth, a broader concept of economic growth, came into vogue among international organizations and countries' policy makers. This chapter reviews recent studies on inclusive growth addressing the following issues: which indicators have been considered, how they have been combined, and to which extent can existing research on inclusive growth provide a better understanding of the economic development process in an emerging economy like Indonesia. Many studies use one index and a single equation approach to measure the determinants of inclusive growth. This chapter suggests an alternative approach for future research that can shed more light on (the drivers of) (the different components of) inclusive growth, i.e. using a simultaneous equations model or a structural equation modelling approach. We can, thereby, provide better analyses and policy recommendations to achieve inclusive growth.

Keywords: Economic growth, Inclusive growth, Measurement, Structural Equations, Indonesia

This chapter will provide a comprehensive analysis on the concept of inclusive growth which covers the definition, measurement, and the picture of inclusive growth in Indonesia. This chapter has been published in the book titled "Decentralization and Governance in Indonesia". The motivation of providing the analysis on the inclusive growth concept in a separated chapter is because its definition and measurement are still under discussion. Due to the relevance of using a broader concept of economic growth in assessing the quality of FDI, this chapter will be used as a basis of analysis for the overall parts of this dissertation. However, the quantitative approaches suggested in this chapter will not be applied in this dissertation. The main reason of not employing quantitative approaches because they could not address the main objective of this dissertation to examine the detail channels of FDI to inclusive growth. Moreover, there are variables like inclusive institutions and society's values in this dissertation which are difficult to be measured quantitatively. Therefore, this dissertation, further, will

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employ a qualitative approach based on in-depth interview with stakeholders to address the objectives of this dissertation.

3.1. Introduction

Development has been equated with economic growth for a long time. Unfortunately, high economic growth is often not accompanied by less income inequality and lower poverty. For example, high economic growth in Great Britain during the industrial revolution was not followed by improvements in life expectancy and infant mortality (Crafts, 1997). Similarly, the more recent increase of economic growth in India was not accompanied by a decreasing mortality rate, and less income and gender inequality (UNDP, 2005). Likewise, while economic growth has led to a rise in the average standards of living, it has also led to worries about the environmental consequences. There has been much debate over whether or not it is possible to achieve economic growth without unsustainably degrading the environment (see, for instance, Czech, 2013). For many years, the earth's limited natural resource base was viewed as an important source of constraints to growth. Nowadays, the focus has shifted from concern for the ultimate exhaustion of natural resources to climate change and poor environmental quality due to emissions of industrial production (see, for instance, Nordhaus, 2013). The view that economic growth may have negative environmental consequences, such as climate change and poor environmental quality, is widely shared. However, even though there is a link between GDP growth and emissions, this relationship is not linear. For instance, Ekins (2000) compares the GDP growth with the increase in emissions of several pollutants in seven developed countries between 1970 and 1993, and finds that while the GDP rose between 50 percent and 150 percent across these countries, emissions increased by less than the GDP in the majority of them (relative decoupling) and fell in the others (absolute decoupling). Moreover, climate change and environmental quality may also affect economic growth. Several recent studies have examined the link between climate change and economic outcomes, including economic growth. According to Dell et al. (2014: 770), the estimates of these studies "provide rigorous econometric evidence that weather—temperature, precipitation, and events such as windstorms and droughts—has manifold effects on economic activity. Poor economies appear particularly vulnerable to detrimental weather effects, while certain demographic groups, such as children and the elderly, appear especially sensitive on health-related dimensions." Likewise, several other recent studies have explored the relationship between environmental quality and economic growth. Summarizing the results of this research, Greenstone and Jack (2015: 21) conclude that "these papers indicate that the health burden of air and water pollution in

developing countries are substantial and that the productivity and income effects may also be important.”

For all these reasons, international organizations and policy makers started focusing on broader concepts of economic growth. Clearly broader concepts of economic growth, especially concerning pro-poor growth aiming to deliver higher income gains for lower-income groups next to stimulating economic growth, have been discussed before. But recently broader concepts of economic growth became known as inclusive growth. In 2004, the United Nations Development Program (UNDP) established the International Policy Centre for Inclusive Growth (IPC-IG) research group, which specifically focuses on inclusive growth issues. Moreover, in its 2020 strategy, the Asian Development Bank (ADB, 2008) put inclusive growth explicitly on its agenda. The 2006 India development policy review was entitled “Inclusive Growth and Service Delivery: Building on India’s Success”. Furthermore, India included inclusive growth as an objective in its Eleventh Five Year Plan.

The concept of inclusive growth has also become part of Indonesia’s medium-term development plan for the period 2010-2014 (Indonesia, 2010). This plan states that the realized economic growth rate of around six percent per year over the period 2004-2008 is inadequate in order to realize the goal of a prosperous Indonesia, since many communities are left behind and not able to benefit from economic growth (Indonesia, 2010: I.18). For this reason, main national development targets have also been formulated for education, health, food, energy, and infrastructure (Indonesia, 2010: I. 44-45).

Despite the increasing popularity of the inclusive growth concept, both its definition and measurement are still under discussion. Initially, inclusive growth was defined as growth that benefits the entire society. This is a rather broad and imprecise definition. Later, international organizations and policy makers started to define inclusive growth based on their own policy strategies. For instance, the World Bank (WB, 2008) considers inclusive growth as the growth that gives societies opportunities to be more productive and creative. The Organization for Economic Co-operation and Development (OECD, 2014) argues that to have inclusive growth, a country needs strong economic growth which induces improvements not only in outcomes but also in living standards and people’s quality of life. Although more specific, these concepts of inclusive growth are still rather broad and imprecise. Therefore, many studies try to describe inclusive growth more precisely and try to measure it. While some studies identify inclusive growth as growth that reduces poverty (Habito, 2009), other studies define inclusive growth as the relation between growth and equity (Anand et al., 2013; Balakrishnan et al., 2013) or between growth and opportunities (Ali and Son, 2007), or they try to capture even more components of economic development (McKinley, 2010).

Based on the discussion above, this study addresses four main issues: (1) which components of inclusive growth have international organizations and recent studies considered; (2) which methodologies have been applied to analyse inclusive growth; (3) to what extent can studies on inclusive growth provide a better understanding of the economic development process in an emerging economy like Indonesia; and (4) how can inclusive growth be analysed in future studies.

The complexity of the inclusive growth concept as well as the disagreement on the components to be covered and the proper indicators of these components impede future studies on inclusive growth. Therefore, this chapter elaborates on both the definition and the measurement of inclusive growth. A better understanding of (the drivers of) inclusive growth may contribute to better policy recommendations to achieve inclusive growth.

The literature that will be covered consists of official documents from the Asian Development Bank (ADB), the World Bank (WB), the Organization for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF), and official websites of the United Nation Development Program (UNDP) and the European Union (EU). In addition, individual contributions to the scientific literature focusing on inclusive growth and studies focusing on Indonesia's development will be considered.

This chapter is structured as follows. Section 2 provides an overview of the inclusive growth concept used by different international organizations. Section 3 discusses the main methodological problems of the inclusive growth concept. Section 4 zooms in on Indonesia's development problems. Section 5 suggests two approaches for future research that can shed more light on the determinants of inclusive growth and finally section 6 concludes the chapter.

3.2. Definition and measurement of inclusive growth

Table 3.1. gives an overview of the inclusive growth concept as suggested by different international organizations. It should be stressed that this table reflects our own interpretation of the inclusive growth concept, obtained by reading official documents published by these organizations and by consulting their websites. Since the definition of the inclusive growth concept is sometimes broad and difficult to summarize in one sentence, the key terms used by these organizations are also reported. Table 3.1. demonstrates that the inclusive growth concepts used by the different international organizations tend to cover both income and non-income components of development and vary widely.

Table 3.1. Overview of the inclusive growth concept by international organization

International Organization	Definition of Inclusive Growth	Key Terms
World Bank (http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0..contentMDK:21870580~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html)	Rapid pace of growth is unquestionably necessary for substantial poverty reduction, but for this growth to be sustainable in the long run, it should be broad-based across sectors, and inclusive of the large part of a country's labour force	<ul style="list-style-type: none"> - Economic growth - Poverty - Employment
ADB (The 2020 strategy)	Growth with equality of opportunity provided by having high sustainable growth that creates opportunities, broader access for members of society to participate in and benefit from growth, and strength social safety nets to avoid deficiency	<ul style="list-style-type: none"> - Economic growth - Equal opportunity - Broader access for participate - Strength social safety nets
IMF (IMF, 2011)	Growth that is not associated with an increase in inequality	<ul style="list-style-type: none"> - Economic growth - Income distribution of the poor and the rich
EU Commission (Europe 2020)	Growth with a high employment economy delivering economic, social, and territorial cohesion	<ul style="list-style-type: none"> - Economic growth - Employment - Education - Poverty
UNDP (http://www.ipc-undp.org/pages/newsite/menu/inclusive/whatisinclusivegrowth.jsp?active=1)	Growth that provides both equality in income distribution and opportunity to participate and have benefit from growth for society	<ul style="list-style-type: none"> - Economic growth - Equality in income distribution - Opportunity to participate and have benefit from growth.
OECD (OECD, 2014)	Growth that creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms fairly across society	<ul style="list-style-type: none"> - Economic growth - Household income - Health status - Jobs

Source: authors' own interpretation of international organizations' official documents and websites

This image is strengthened by table 3.2., showing how frequently different components are included in the inclusive growth concept. Both poverty and inequality in addition to the level of welfare measured by GDP per capita appear to be popular components of income, while commonly used components of non-income growth are employment, health and education. Less popular non-income growth components appear to be social safety nets, good government and institutions, and investment

barriers. It is quite remarkable that environmental indicators are generally not included, even though there are good reasons to consider them as argued in section 1.

Table 3.2. Inclusive Growth: Overview of components included by different international organizations and different studies

Study	Income		Non-Income							
	Poverty	Inequality	Employment	Infrastructure	Education	Health	Gender	Social safety nets	Good Gov and Inst	Investment Barriers
ADB (FIGI 2013)	√	√	√	√	√	√	√	√	√	
World Bank	√		√							
IMF (2011)		√								
EU (EC, 2015)	√		√		√					
UNDP		√	√							
OECD		√	√			√				
Ramos et al.(2013)	√	√	√							
McKinley (2010)	√	√	√	√	√	√	√	√		
Habito (2009)	√			√	√	√				
Balakrishnan et al. (2013)		√								
Anand et al. (2013, 2014)		√								
David and Petri (2013)		√								
Adedeji et al. (2013)					√	√				
Ianchovichina and Lundstrom (2009)	√		√	√	√	√			√	√
Tang (2008)	√									
Ali (2007)	√		√	√	√	√	√	√	√	
Ali and Son (2007)					√	√				
Bhalla (2007)	√	√	√			√				
Chakrabarti (2013)			√							
Felipe (2012)			√							

Source: authors' own interpretation of international organizations' official documents and websites

Arguments put forward by different studies to include the components reported in table 3.2. are the following. According to Felipe (2012), inclusive growth is achieved when all members of society participate in and contribute to the growth process on an equal basis regardless of their individual circumstances. This means that inclusive growth is synonymous with the lack of involuntary unemployment. By having a job, people will not only receive wages but will also feel they are important and contributing to society. Moreover, having a job makes people more creative. Unemployment and underemployment cause both economic costs (loss of potential income, output and tax revenues, and deterioration of labor skills and productivity) and social costs (poverty, misery, malnutrition, and injustice). Ramos et al. (2013) take a similar view: only when being employed can people participate and contribute to the economy. Bhalla (2007) argues, however, that full employment is not sufficient for inclusive growth. Since poor people tend to have lower levels of education and health, and as a result lower levels of productivity and wages, they face difficulties when trying to escape poverty. Apart from poverty and inequality, inclusive growth should therefore also cover education and health. This view is shared by Tang (2008), who points out that poor people do not benefit from economic development due to their disadvantaged position.

According to the OECD (2013, 2014), household income, having a job and health status are the three most salient components of inclusive growth. Although this organization initially identified eleven monetary and non-monetary dimensions as essential for people's well-being, among which income and wealth, jobs, skills and education, health, social connections, environmental quality, and security, not all of these dimensions are measurable or have a clear link to policy. Furthermore, the three selected components also overlap or partly cover other dimensions. By having resources in the form of income or wealth, people are able to satisfy their basic needs and can prefer under which circumstances they would like to live. It also protects them against economic and personal risks. By having a job, people can earn a living, develop new skills and abilities, and actively participate in a wide range of social activities. By being healthy, the probability of having a job increases. Apart from that, healthiness is highly valued by most people anyway. The OECD (2014) provides for each of these components an indicator, namely household real disposable income, the average rate of unemployment, and life expectancy, respectively.

Table 3.3. provides more information on the methodology that different studies use to analyse inclusive growth. A few of the studies are descriptive (Ianchovichina and Lundstrom, 2009, Tang, 2008, and Bhalla, 2007). They discuss the development of several indicators of inclusive growth for one or a set of countries over a particular period to judge whether the economic situation has improved. It is important to make a distinction here between components and indicators. Inclusive growth is a latent variable

meaning that it cannot be directly observed but only be inferred (often through statistical methods) from other variables that are observed (directly measured). However, the variables included in inclusive growth are often also latent constructs, such as poverty and inequality, which in turn depend on observable variables. To distinguish them, the term *components* is used to represent latent constructs that are included in inclusive growth and the term *indicators* to represent observable variables of these latent constructs. Figure 3.1. illustrates this distinction. For example, in the descriptive study of ADB (2013), the development of 20 different indicators is described under the heading of nine different components (see table 3.3.).

Table 3.3. Inclusive Growth: overview of indicators and methodology applied by international organizations and recent studies

Study	Components	Indicators
ADB (2013)(FIGI)	Poverty	1. Proportion of population living below \$2 a day at 2005 PPP\$
	Inequality	2. Ratio of income or consumption of the highest quintile to lowest quintile
	Employment	3. Employment-to-population ratio, youth (aged 15-24 years)
		4. Number of own-account and contributing family workers (per wage and salaried workers)
	Health	5. Under-five mortality rate per 1000 live births
		6. Diphtheria, tetanus toxoid, and pertussis (DTP3) immunization coverage among 1-year-old (%)
	Education	7. Average years of total schooling, adults (aged 25 years and over)
		8. School life expectancy, primary to tertiary (years)
		9. Pupil-teacher ratio (primary)
Infrastructure	10. Electricity consumption (per capita KWH)	
	11. Number of cellular phone subscriptions (per 100 people)	
	12. Proportion of population using an improved drinking water source	
	13. Proportion of population using an improved sanitation facility	
Gender	14. Gender parity in primary education	
	15. Gender parity in labour force participation (aged 15 years and over)	
	16. Percentage of seats held by women in national parliament	
Social Safety Nets	17. Social security expenditure on health as a percentage of government expenditure on health	
Good Governance and Institutions	18. Voice and accountability	
	19. Government effectiveness	
	20. Corruption	
OECD (2014) (Making Inclusive Growth Happen, 2014)	Income and Wealth	1. Average household income
	Employment	2. Average rate of unemployment
	Health	3. Life expectancy
EU (EC, 2015)	Poverty	1. Number of people living below national poverty lines
	Employment	2. Employment rate of population aged 20-64 years
	Education	3. The share of early school

Study	Components	Indicators
		4. The share of the population aged 30-34 having completed tertiary education
McKinley (2010)	Poverty	1. The proportion of the population living below nationality determined poverty lines 2. The proportion of the population living below \$2,5 per day per person international poverty line in 2005 prices
	Inequality	3. The GINI coefficient 4. The income share of the poorest 60% of the population
	Employment	5. Share of the employed in industry 6. Share of own-account workers and formally unpaid family workers in total employment
	Health	7. Under-5 mortality rate 8. Mortality rate under age 40 9. Percentage of those under age 5 years who are underweight
	Education	10. Net primary enrolment ratio 11. Net secondary enrolment ratio
	Infrastructure	12. Proportion of the population with access to electricity 13. Number of mobile phone subscribers per 100 people
	Sanitation and Water	14. Proportion of the population with access to safe water 15. Proportion of the population with access to adequate sanitation
	Gender	16. The ratio of literate females to literate males among those aged 15-24 years 17. The ratio of girls to boys in secondary education 18. The percentage of births attended by skilled health personnel 19. The share of women in non-agricultural wage employment
	Social Safety Nets	20. The total expenditures on all social protection programs as a ratio to GDP 21. The number of beneficiaries of social protection programs as a ratio to the reference populations for key target groups 22. The number of social protection beneficiaries who are poor as a ratio to the total poor population 23. The average social protection expenditure for each poor person as a ratio to the poverty line
Habito (2009)	Poverty	1. Income poverty headcount 2. Proportion of people living below \$1,25 a-day yardstick
	Health	3. Probability at birth of not surviving to age 40 4. Percentage of children under weight for age
	Education	5. Adult literacy rate
	Infrastructure	6. Percentage of population without sustainable access to an improved water source
Ianchovichina and Lundstrom(2009)	Poverty	1. Poverty headcount index
	Inequality	2. Mean shares if household income by source, income quintile rural and urban
	Employment	3. Number of people employed by sector in rural and urban areas 4. Structure of farming sector
	Health	5. Access health facilities 6. The HIV/AIDS epidemic
	Education	7. Mean years of schooling of household head 8. Percentage of households with access to education facilities within 5km

Study	Components	Indicators
		9. Ratio between emigration rate of skilled (%of all skilled) to tertiary educated (migrants and non-migrants) per 100 population of source country
	Infrastructure	10. Access to air transport 11. Number of household with access to facilities within 5 km for food market, input market, post office, public transport, public phone, and internet café
	Investment	12. Interest rate spreads 13. Capital credit ratio 14. Real cost of capital 15. Gross capital formation ratio to GDP 16. Aid (%of gross capital formation) 17. FDI net flow 18. Gross domestic savings (%GDP) 19. Nominal rate of assistance (indirect cost to agriculture)
	Good Governance and Institution	20. World Bank governance indicators
Balakrishnan et al. (2013)	Inequality	1. Average incomes of the poorest fifth of society 2. Average incomes of the richest fifth of the society
Anand et al. (2013, 2014)	Inequality	1. Income per capita for cumulative share of population
Adedeji et al. (2013)	Health	1. Access to health services for groups of income
	Education	2. Access to primary school enrolment for group income of people 3. Access to secondary school enrolment for group income of people
Ramos et al. (2013)	Poverty	1. Headcount ratio at \$2 a day PPP
	Inequality	2. GINI coefficient
	Employment	3. Employment-to- population ratio (EPR) 15+
Tang (2008)	Poverty	1. National poverty line 2. Share of population below the \$1-a-day 3. Share of population below the \$2-a-day 4. Poverty indices
Ali and Son (2007)	Education	1. Share of children currently attending primary schools 2. Share of children currently attending secondary schools
	Health	3. Share of population that have access to health facilities-hospital and clinics 4. Share of population that have access to health facilities-private hospital
Bhalla (2007)	Inequality	1. Gini ratio and Changes in Gini ratio for India's rural and urban
	Poverty	2. Absolute number of poor people and changes in absolute numbers in rural and urban 3. Head count poverty ratio and changes in head count poverty in rural and urban 4. Headcount poverty ratio by major states in India 5. Rural headcount poverty ratio in specified sectors 6. Person below poverty line among rural household by principal industry group 7. Poverty ratio by employment status

Study	Components	Indicators
	Health	8. Children under 3 years who are underweight by major states in India
	Employment	9. Employment growth rates rural and urban in specified sectors 10. Employment growth rates formal and informal sectors

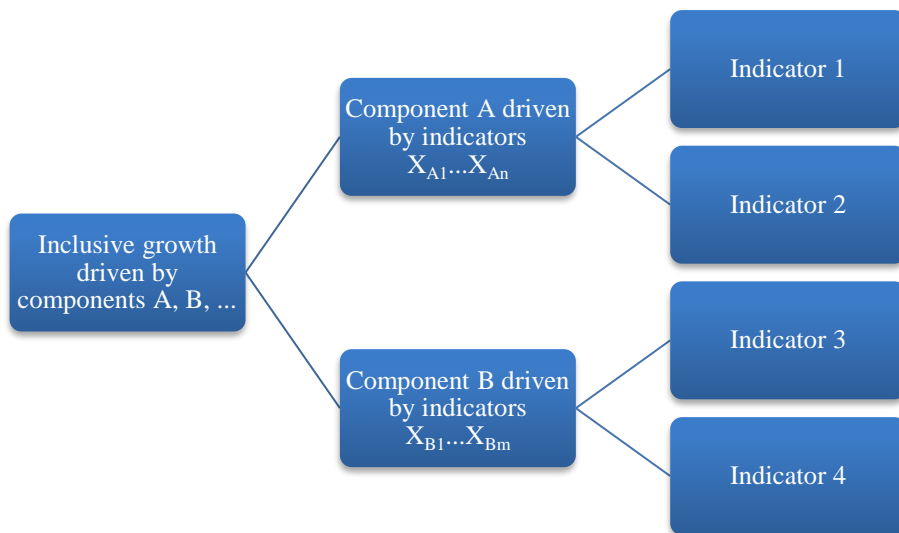


Figure 3.1. Inclusive growth is a latent variable explained by other latent variables, denoted as components, inferred from observable indicators

Several studies try to reduce the different components and indicators to one single index, using fixed weights, statistical or mathematical techniques, or a theoretical approach. McKinley (2010) reduces 23 indicators representing nine components to one single index by rescaling each indicator from 0 to 10 and then summing them up based on fixed weights. A weight of 25 percent is given to economic growth, 15 percent to employment and to sanitation and water, 10 percent to poverty, inequality, and social safety nets, and 5 percent to gender, health, and education. These weights are partly based on data availability. Ramos et al. (2013) uses a normalization procedure to reduce data on poverty, inequality, and employment to a single index of inclusive growth. Anand et al. (2013, 2014) employ a social mobility curve to model the relationship between income growth and income distribution. This social mobility curve, which may change over time due to changes in income growth and income distribution, is then used to determine a measure for inclusive growth and to regress this measure on a set of

explanatory variables (GDP per capita lagged in time, education, availability of infrastructure, macro-economic conditions, investment, and government consumption) using data of 143 countries over the period 1970-2010. A similar approach is used by Habito (2009). He analyses the degree to which poverty is reduced by economic growth depending on four components, each measured by one or two indicators, using data for 10 Asian countries over the period 1990-1996 and 15 Asian countries over the period 2000-2008. Other studies following this kind of approach where the inclusive growth concept is further explained using a single equation approach are of Anand et al. (2013, 2014), Adedeji et al. (2013), and Ali and Son (2007).

Finally, some other studies attempt to explain one or more of the components of inclusive growth. For instance, Balakhrisnan (2013) regresses the bottom and the top quintile income shares of the income distribution on GDP per capita income and an additional set of components (indicators): income (household income), employment (share of labour income to GDP, shares of employment in agriculture, manufacturing and services, and some interaction terms between these variables and income), education (education spending, percentage of people aged over 15 years of age having secondary education, average years of schooling, and interaction terms between these educational indicators and income), health (health spending), and financial openness (financial openness, financial reform index, and interaction terms with income). Inclusive growth is achieved if the income inequality between these two quintiles diminishes.

One exception to the setup of the above-mentioned studies is the OECD (2014) report, which considers only three components/indicators and provides separate estimates for each of them. Since one dependent variable is assumed not to affect the other, while the error terms in the different equations are assumed to be correlated, the model is estimated by seemingly unrelated regressions (SUR).

3.3. Methodological problems in analyzing inclusive growth

The rather arbitrary method of using particular indicators of inclusive growth, the sometimes rather arbitrary weighting scheme that is used to reduce different indicators of inclusive growth to one single index, and the aggregation bias that might occur by not analysing the different indicators separately are the main drawbacks of using a single index and applying a single equation approach to analyse this index.

First, inclusive growth is a latent variable consisting of several components that are also latent constructs. The basic question is which components and which indicators of these components to include. In the previous section, it was shown that there are large differences in this respect.

Second, transforming these indicators and components to one index is a challenge and it is questionable whether or not this is even useful. A composite index may lead to

loss of information and could provide misleading policy recommendations if an index is poorly constructed or misinterpreted (Jollands et al., 2003; OECD, 2008; Marozzi, 2014). The main reason to consider inclusive growth was to gain a broader view on the economic conditions of a particular country. By translating this information back to one single index, this broader view might be lost again. Moreover, McGillivray (1991) found that there is a positive correlation among education, health, and income per capita determining the Human Development Index (HDI). This means that these indicators of economic development when covered by inclusive growth will also have close relations with each other and therefore will be partly redundant. Consequently, highly correlated indicators need to receive lower weights when combined with other indicators of economic development. To determine these weights, they may set by the researcher themselves, but preferably, they are derived from probability distributions to avoid arbitrariness a statistical approach.

Some studies provide an index to measure inclusive growth. Ramos et al. (2013) developed an index combining poverty, inequality, and employment by taking the average of these three components. However, according to Sagar and Najam (1998), this aggregation approach is biased if these components are not substitutes. Moreover, McKinley (2010) sets different weights to inclusive growth indicators based on their importance and data availability. However, giving different weights to different components or indicators of these components will be difficult because of the subjectivity and lack of theory to determine the weights.

The third problem is a potential aggregation bias. If, for instance, a particular indicator has a negative impact on one component and a positive impact on another component, the result of the overall impact on inclusive growth will be nearly zero. Consequently, it might be erroneously concluded that this indicator is not an important determinant of inclusive growth. It is clear that these problems may lead to incorrect interpretation and, a turn to ineffective policies.

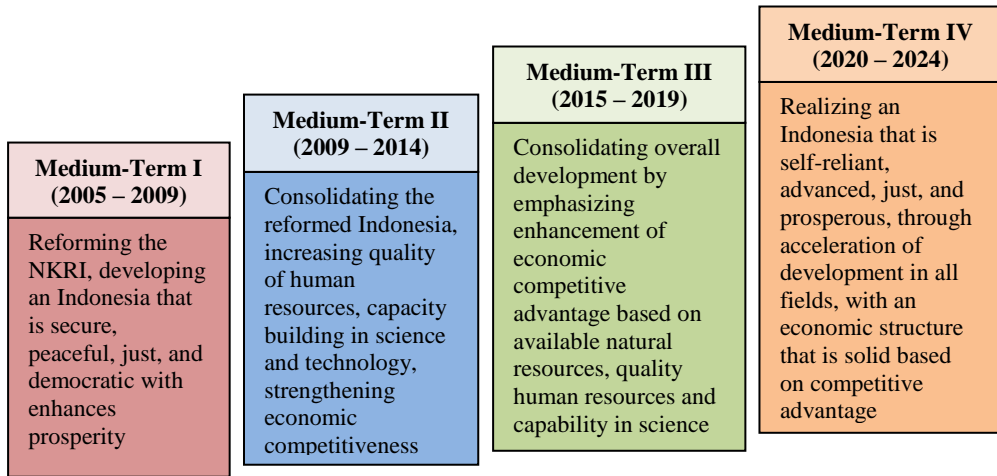
3.4. Indonesia's Development

Inclusive growth became a widespread concept among many countries. In contrast to many developed countries, several developing countries realized high economic growth rates during the last decade, but unfortunately many groups in society and numerous regions were not able to benefit from this. For these reasons, many developing countries, including Indonesia, formulated broader policy targets. This section focuses on Indonesia's development plans and the results that have been realized based on descriptive data and result from previous studies on inclusive growth. Section 5 offers an alternative approach for analyzing inclusive growth that we suggest for future research on inclusive growth.

3.4.1. An overview of Indonesia's development planning

The development planning strategy of Indonesia consists of three parts. The first part is the national long-term development plan (known as *Pembangunan Jangka Panjang Nasional*, PJPN). This plan represents the vision and mission of Indonesia's long-term goals based on Indonesia's Constitution (UUD 1945). The current plan covers the period 2005 – 2025. The second part of Indonesia's development planning strategy consists of the national medium-term development plan (*Pembangunan Jangka Menengah Nasional*, PJMN) describing the President's vision and mission for the next five years, keeping in line with the goals of the long-term development plan. The last part includes the government's working plan (*Rencana Kerja Pemerintah*, RKP), which gives further details of the medium-term development plan that will be conducted in each year.

Figure 3.2 shows that Indonesia has just completed its second medium-term development plan for the period 2010 – 2014. The goals of this development plan were to consolidate Indonesia's reform process, to increase the quality of human resources, to build up more capacity in science and technology, and to strengthen the country's competitive position. Moreover, five national development agendas were addressed to realize the national medium-term development plan's mission. The first of these five agendas focused on economic development and an increase of people's welfare. The fifth of these agendas focused on development which is inclusive and just, defined as development that is actively carried out by all of the people, and whose fruits come to the benefit of all people. The other agendas focus on good governance, democracy, and law enforcement. Finally, to formulate these agendas in a more operational way, eleven national priorities are considered: reform of the bureaucracy and governance; education; health; reducing poverty; food security; infrastructure; investment climate and business climate; energy; environment and management of natural disasters; left-behind, frontier, outermost, and post-conflict areas; and culture, creativity, and technological innovation. The advantage of working with priorities rather than agendas is that it will be easier to implement the priorities and to measure the output of priorities.



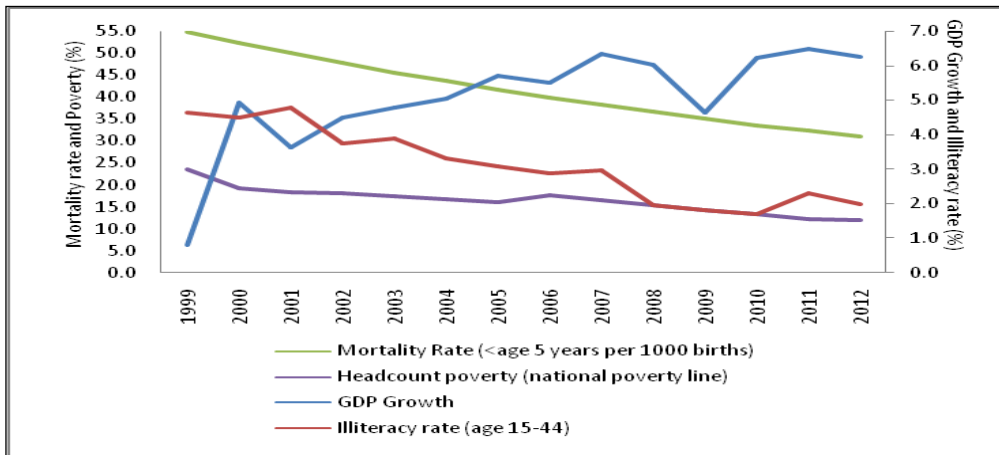
Source: Indonesia (2010)

Figure 3.2. Stages of National Long-Term Development Plan (2005 – 2025)

Since Indonesia's inclusive growth concept focuses on education, health, food, energy, and infrastructure, the paragraphs below will discuss those areas in more detail.

3.4.2. Indonesia's inclusive growth: results from recent studies

Figure 3.3 depicts basic trends on economic growth, education, health, and poverty, and shows that Indonesia's economic growth rate rose from 0.8 percent in 1999 to 6.3 percent in 2012. This increase, which was mainly driven by the manufacturing and service sectors, pushed poverty back considerably; the number of people living in poverty reduced from 23.4 percent in 1999 to 12.0 percent in 2012. It also had a positive effect on the educational attainment of the population and the health status. The illiteracy rate of people aged between 15 and 44, which is one indicator of education, fell from 4.6 percent in 1999 to 2.0 percent in 2012. One reason for this was the implementation of the mandatory nine-years primary education program. The mortality rate of children under five years of age per 1,000 live births, one indicator of health, declined from 55 in 1999 to 31 in 2012. This improvement was enhanced by the program to provide basic immunization to 90 percent of the infants in 2014. Despite these improvements, Indonesia still faces many income distribution problems.



Source: National statistic and World Development Indicator

Figure 3.3. Trends of Economic Growth, Education, Health, and Poverty

There are two types of inequalities that may be considered: vertical and horizontal (McKinley, 2010). Vertical inequality stands for the gap in the income distribution between the poorest and the richest, whereas horizontal poverty reflects income inequality across regions or sectors. Based on data provided by National Statistic Agency (BPS), the Gini index measuring vertical poverty increased from 0.36 in 1999 to 0.41 in 2013, with large differences among regions within Indonesia. Table 3.4 shows that the Gini index measuring horizontal inequality ranged from 0.26 in the region of Kepulauan Bangka Belitung to 0.41 in the region of Papua in 2007. Just as the national trend, this range increased to 0.29 and 0.44 respectively for the same two regions in 2012. It illustrates that these intra-regional disparities in income inequality are quite stable despite the several policy measures implemented to tackle them.

Table 3.4. Income inequality among regions in 2007 and 2012

Province	Gini Index		GRDP Growth	
	2007	2012	2007	2012
Aceh	0.27	0.32	-2.36	5.20
Sumatera Utara	0.31	0.33	6.90	6.22
Sumatera Barat	0.31	0.36	6.34	6.35
Riau	0.32	0.40	3.41	3.55
Kepulauan Riau	0.30	0.35	7.01	8.21
Jambi	0.31	0.34	6.82	7.44
Sumatera Selatan	0.32	0.40	5.84	6.01
Kepulauan Bangka Belitung	0.26	0.29	4.54	5.72
Bengkulu	0.34	0.35	6.46	6.61
Lampung	0.39	0.36	5.94	6.48
DKI Jakarta	0.34	0.42	6.44	6.53
Jawa Barat	0.34	0.41	6.48	6.21
Banten	0.37	0.39	6.04	6.15
Jawa Tengah	0.33	0.38	5.59	6.34
DI Yogyakarta	0.37	0.43	4.31	5.32
Jawa Timur	0.34	0.36	6.11	7.27
Bali	0.33	0.43	5.92	6.65
Nusa Tenggara Barat	0.33	0.35	4.91	-1.12
Nusa Tenggara Timur	0.35	0.36	5.15	5.42
Kalimantan Barat	0.31	0.38	6.02	5.83
Kalimantan Tengah	0.30	0.33	6.06	6.69
Kalimantan Selatan	0.34	0.38	6.01	5.73
Kalimantan Timur	0.33	0.36	1.84	3.98
Sulawesi Utara	0.32	0.43	6.47	7.86
Gorontalo	0.39	0.44	7.51	7.71
Sulawesi Tengah	0.32	0.40	7.99	9.27
Sulawesi Selatan	0.37	0.41	6.34	8.37
Sulawesi Barat	0.31	0.31	7.43	10.32
Sulawesi Tenggara	0.35	0.40	7.96	10.41
Maluku	0.33	0.38	5.62	7.81
Maluku Utara	0.33	0.34	6.01	6.67
Papua	0.41	0.44	4.34	1.08
Papua Barat	0.30	0.43	6.95	15.84
INDONESIA	0.36	0.41	5.67	6.30

Note: GRDP is Gross Regional Domestic Product.

Source: National Statistic Agency (BPS)

Similar results of higher income inequality despite poverty reduction or improvements to other inclusive growth components were found by studies discussed in Section 2. By considering the sensitivity of growth with respect to poverty and inequality, Dartanto (2014) found that during the 1990s and the 2000s not only the

impact of growth on poverty started to slow down, but also the impact of growth on inequality, which is positive rather than negative, increased. He also recorded that structural change, sectoral wage disparities, and misallocation of fiscal and monetary policies negatively affected Indonesia's concept of inclusive growth. Indonesia's economy is mainly driven by the manufacturing and service sectors, while the poor people mainly live in rural areas and work in the agricultural sector. The lower productivity in the agricultural sector compared to the manufacturing and services sectors explains why the income levels of people employed in the agricultural sector stays behind. Furthermore, higher-income families have benefited from government expenditure allocated to oil fuel subsidies more than lower-income families. Likewise, Anand et al. (2013) report that over the period 1990-2005, Indonesia's average annual economic growth rate exceeded the pace with which equality decreased, 2.9 versus 0.5 percent, since higher-income people benefited most from Indonesia's economic progress.

One of the studies on Indonesian inclusive growth which considers a broader concept of poverty (Habito, 2009) finds that the elasticity of head count poverty with respect to growth amounts to -1.65 over the period 2000-2006. This means that an increase of economic growth by one percent leads to a reduction of 1.65 percent in the number of people living below a poverty line. Table 3.5. shows that this is the highest elasticity compared to other Asian countries over that period. However, when considering a broader concept of poverty, such as the human poverty index (HPI) covering a long and healthy life, knowledge, and a decent standard of living, Indonesia drops to the penultimate position. This is because Indonesia's growth appeared to be less inclusive compared to other Asian countries, especially with respect to education and health improvements for the poor. According to Habito (2009), the impact of economic growth on poverty reduction is caused by three factors: sectoral changes in employment, the composition of public investments, and the quality of governance. In many Asian countries, and also in Indonesia, poverty declined due to employment opportunities offered by the manufacturing sector. However, poverty reduction also benefited from government expenditures on education and health and from good governance. According to Habito (2009), Indonesia performed poorly on these latter two factors in comparison to other Asian countries.

Table 3.5. Ranking of countries based on elasticity of growth on headcount poverty (left) and the Human Poverty Index (HPI) (right)

Country	Headcount poverty	Country	HPI
Indonesia	-1.65	Malaysia	-1.46
Pakistan	-1.64	Singapore	-1.23
PRC	-1.31	Thailand	-1.19
Malaysia	-0.81	Vietnam	-1.18
Thailand	-0.76	Nepal	-1.02
Vietnam	-0.64	Mongolia	-0.90
Sri Lanka	-0.59	PRC	-0.79
Nepal	-0.52	Cambodia	-0.58
Bangladesh	-0.47	Pakistan	-0.55
Cambodia	-0.16	Philippines	-0.49
India	-0.16	Bangladesh	-0.37
Philippines	0.15	India	-0.32
Mongolia	1.86	Myanmar	-0.29
Singapore	NA	Indonesia	-0.28
Myanmar	NA	Sri Lanka	-0.13

Source: Habito (2009)

Combining more components of inclusive growth is also conducted to analyse Indonesia inclusive growth. McKinley (2010) combines 23 indicators into one single index of inclusive growth for Bangladesh, Cambodia, India, Indonesia, the Philippines, and Uzbekistan. The index for Indonesia of 4.40 is very low; all other countries, except for the Philippines, perform better. According to this study, Indonesia's progress is unsatisfactory especially with respect to poverty and access to sanitation and water.

In conclusion, we may say that Indonesia's growth has only partly been inclusive over the 1999-2012 period. Inclusive growth components showing (marginal) improvements are poverty, education, and health, but compared to other Asian countries, Indonesia could have done better. Moreover, inequality increased rather than decreased, since especially the higher-income groups benefited from Indonesia's economic progress, while the poor, mainly living in rural areas and working in the agricultural sector, were left behind. In addition, improvements in the quality of governance are needed. Poor quality of governance may cause well-intentioned policies to have no impact due to ineffective services (Filmer and Pritchett, 1997), bribes, corrupt officials, and miss-procurement (Klomp and de Haan, 2008). However, this analysis of Indonesia's inclusive growth performance is based on descriptive statistics and a survey of the results from previous studies, which generally combine indicators of inclusive growth into a single index. As argued in section 3, existing approaches for analysing inclusive growth ignore simultaneity and the multidimensional character of inclusive

growth. Therefore, some alternative approaches to address these shortcomings in future research will be discussed below.

3.5. Further research on inclusive growth

Inclusive growth is a multidimensional, latent variable. This implies that approaches as used by most previous studies are problematic. Therefore, two alternative approaches will be proposed for further research on inclusive growth: a simultaneous equations model and a structural equation model.

First, in order to cover income and other dimensions of inclusive growth simultaneously, a simultaneous equations model can be applied. A simultaneous equations model, if based on theoretical relations behind the components of inclusive growth, will provide a better understanding of the several dimensions of inclusive growth and their relationships. These theoretical relations may be taken from economic theory, but due to dissatisfaction with the rather narrow definition of economic growth within the economics discipline, other disciplines should also be considered. Furthermore, the selection of the components that are considered in a particular study should also depend on the objective of that study and whether or not they are measurable, do not overlap, and have a clear link with policy.

As pointed out before, the OECD's concept of inclusive growth focuses on household income, labour (in particular unemployment) and health (in particular life expectancy). The OECD (2014) analyses these components by applying the Seemingly Unrelated Regression (SUR) method. Under this method, it is assumed that all the regressors are independent variables, explaining the term "Unrelated". Nevertheless, SUR uses the correlations among the errors in different equations to improve the efficiency of the coefficient estimates, explaining the term "Seemingly". However, the assumption that all regressors are independent is problematic, as the drivers of one particular component of inclusive growth may include one or more other dimensions of inclusive growth. For instance, health may be driven by income and income inequality (Klomp and de Haan, 2009), while income inequality is driven by income as well (Barro, 2000). Therefore, the SUR method might not be the proper method for analysing inclusive growth.

Endogeneity problems, discussed above, require a simultaneous equations model. Drawing on Wooldridge (2002), such a model can be written as:

$$y_{it1} = \alpha_1 y_{it2} + \alpha_2 y_{it3} + \dots + \alpha_n y_{itn} + z_{it1}\eta_1 + a_{i1} + u_{it1}$$

$$y_{it2} = \beta_1 y_{it1} + \beta_2 y_{it3} + \dots + \beta_n y_{itn} + z_{it2}\eta_2 + a_{i2} + u_{it2}$$

$$y_{it3} = \gamma_1 y_{it1} + \gamma_2 y_{it2} + \dots + \gamma_n y_{itn} + z_{it3}\eta_3 + a_{i3} + u_{it3}$$

$$\vdots \qquad \qquad \qquad \vdots \qquad \qquad \qquad \vdots \qquad \qquad \qquad \vdots$$

$$y_{itn} = \lambda_1 y_{it1} + \lambda_2 y_{it2} + \lambda_3 y_{it3} + \dots + \lambda_{n-1} y_{itn-1} + z_{itn}\eta_n + a_{in} + u_{itn}$$

where i refers to countries, t refers to time periods, a_{i1} up to a_{in} are time-invariant unit-specific effects, $z_{it1}\eta_1$ up to $z_{itn}\eta_n$ reflect a set of exogenous explanatory variables in each equation, while y_{it1} up to y_{itn} are endogenous explanatory variables. For example, based on our summary of the literature, employment, education, and health could be regarded as non-income components of inclusive growth, and income, income inequality and poverty as income components of inclusive growth, and these components could be treated as endogenous variables.

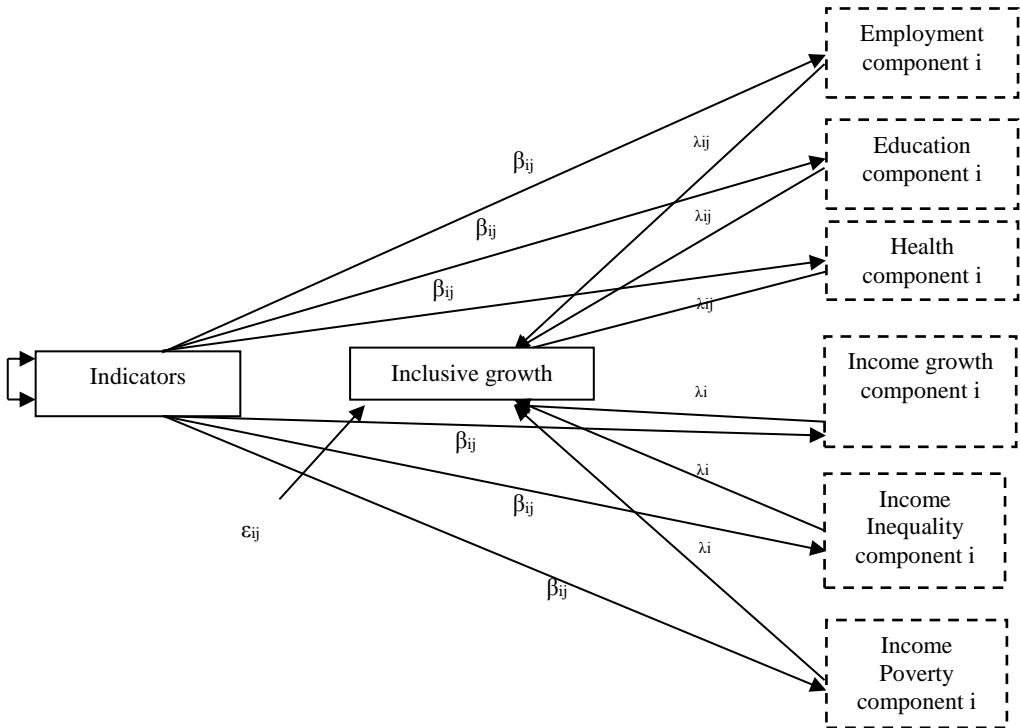
The specification of each equation in this model should be based on theory and previous empirical studies, taking into account that causality may potentially run in both directions. For example, although Klomp and de Haan (2009, 2013) point out that income per capita is positively related to education and health of labor (through its impact on labor productivity), there may also be a causal relationship between GDP growth and education (Danacica et al., 2010) and GDP growth and health (Li and Huang, 2009).

The other alternative approach that could be applied is the structural equation model (SEM). We used Figure 3.1. to illustrate that inclusive growth is a latent variable meaning that it cannot directly be observed but only be inferred from other variables. However, many of these variables cannot be observed either, since they are also latent constructs. This implies that the explanation of inclusive growth consists of two stages. First, observable indicators are required to construct the latent constructs explaining inclusive growth, and second, a regression model is needed in which inclusive growth is taken to depend on these latent constructs. Whereas the simultaneous equations model only covers the second stage, since it assumed that the explanatory variables are observable, the structural equation model covers both stages and thus generalizes the simultaneous equations model.

Unlike the simultaneous equations approach, the structural equation model approach uses factor analysis in the first stage and combines this with multiple regression analyses in the second stage (Hoyle, 2011). Components of inclusive growth are considered to be latent variables dependent on different indicators. To reduce the

number of these indicators, a factor analysis is applied. In the regression part, the relationships between the components and inclusive growth is determined.

To illustrate this approach, we draw on Klomp and de Haan (2009, 2013). Again, the same six dimensions of inclusive growth as used above can be considered: the non-income components (employment, education, and health) and the income components (income inequality, and poverty) as shown in Figure 3.4. . For each component other than income, several indicators can be used. The factor analysis can be employed to examine the underlying and common information from all indicators in each dimension (Lattin et al., 2003). The path diagram for the analysis is shown in Figure 3.4. The dashed squares represent the components of inclusive growth, while λ_{ij} s represent the strength of the effects and β_{ij} s are the estimated coefficients. The components of inclusive growth may be correlated, which is shown by the arrows from and to the determinant variables.



Source: Adopted and adjusted from Klomp and de Haan (2009, 2013)

Figure 3.4. Path Diagram Structural Equation Model for Inclusive Growth Analyses

3.6. Conclusions

There is no consensus in the literature yet on the precise definition and measurement of inclusive growth. Even though inclusive growth generally stands for economic growth that benefits the entire society, international organizations generally, transform the concept in such a manner that it fits best with their own preferred economic policy strategies. In policy strategies and existing studies on inclusive growth, employment, poverty, education, health, and income inequality are the most frequently identified dimensions of inclusive growth apart from economic growth. Moreover, for each dimension of inclusive growth, several indicators have been proposed by recent studies. All this illustrates that inclusive growth is a multidimensional latent variable, which has income and non-income dimensions. However, an important challenge is data availability, determining the number of dimensions that can be considered in measuring inclusive growth, notably in cross-country studies. Another challenge is also to bring in environmental components or indicators. Although the view that economic growth may have negative environmental consequences, these have generally not been included (yet) in inclusive growth studies.

Analyses of (the drivers of) inclusive growth should deal with this multidimensional latent variable characteristic of inclusive growth, as well as with simultaneity. Most recent studies on inclusive growth applied data description or used an aggregate index of inclusive growth, possibly in combination with a single equation model, thereby ignoring the requirements for proper inclusive growth analysis. This also applies to previous studies of Indonesia's inclusive growth, which have been discussed in the chapter.

In this chapter, we propose two alternative methodologies to analyze inclusive growth: simultaneous equations and structural equation modeling. Due to their complexity, these alternative approaches have not been applied in this chapter, but in future studies they could be applied to Indonesia, thereby providing a more accurate analysis of (the drivers of) inclusive growth and a better basis for policy advice.

Chapter 4

The Capacity of Government Regulations in Managing FDI for Inclusive Growth in Indonesia

Chapter 4 – The Capacity of Government Regulations in Managing FDI for Inclusive Growth in Indonesia

Abstract

As described the theoretical framework in Chapter 2, the rules of the game consist of economic and political institutions influencing the contribution of FDI to inclusive growth. Economically inclusive institutions are the rules of the game which enhance opportunity for members of society to be involved in FDI activity, while politically inclusive institutions are the rules of the game which allow members of society to express their aspirations (voice), engage (engagement), and be informed (accountability) about FDI decisions. Moreover, economic institutions deal with regulation, while political institutions deal with processes and policies. This chapter will analyze whether the Indonesian government's regulations on managing Foreign Direct Investment (FDI) have the capacity to direct FDI toward inclusive growth. This dissertation proposes that regulations that are inclusive have this capacity. Such regulations can enhance opportunity for all members of society to receive benefit from FDI activities. Moreover, regulations have the capacity to manage FDI to inclusive growth when there is coherence among them. According to analyses of medium term development planning (RPJMN) 2015-2019, Indonesia's investment law No.25/2007, General Investment Plan, and Negative Investment List, Indonesian regulations for FDI-led inclusive growth still have a rather weak capacity to support FDI to contribute to inclusive growth. This weakness has been caused by lack of a clear concept and strategies for FDI-led inclusive growth. It has also been triggered by lack of coherence among those regulations and their implementation.

4.1. Introduction

Based on the theoretical framework of this study, FDI could promote a positive effect on inclusive growth through several channels: employment creation, productivity improvement, CSR programs, and MSMEs linkages. To promote these channels, inclusive institutions play a significant role in expanding the opportunity of all members of society to benefit from FDI activities (economic inclusive institutions). Moreover, inclusive institutions are also necessary to involve society in the process of FDI policies so as to benefit from FDI (political inclusive institutions). The presence of inclusive institutions is demonstrated when government regulations have supported the objective of promoting FDI to inclusive growth through its channels. The presence of inclusive institutions is also represented by coherence among government regulations, which are the result of good coordination between governments and other stakeholders.

Therefore, this chapter will examine the capacity of government regulations in Indonesia to manage FDI for inclusive growth, based on whether the regulations clearly promote inclusive growth and whether they support the channels of FDI to inclusive growth.

We also analyze the coherence among government regulations in relation to FDI, first by examining the substance of the regulation, and then by discussing their capacity. This analysis will be supported by the results of in-depth interviews which will describe the challenges faced by Indonesia's government related to implementation of the regulations.

Since the central government has the main authority to regulate FDI in Indonesia, this chapter will focus on the capacity of its regulations related to FDI. The main regulations to be analyzed are the National Medium-Term Development Plan (RPJMN), Investment Law No.25/2007, the General Investment Plan (RUPM), and the Negative List of Investment (NIL). The RPJM is the national development plan which should be referred to by other regulations and policies. The previous development plan, the 2010-2014 RPJM, clearly stated that the objective of development in Indonesia is to achieve inclusive growth. In the current development plan, the 2015-2019 RPJMN, the term "inclusive investment" is for the first time introduced. Therefore, analyzing the capacity of the RPJMN is essential. Investment Law No.25/2007 is the regulation which regulates both domestic and foreign investments in Indonesia. This Investment Law in turn requires the government to have the General Investment Plan (RUPM) and the Negative Investment List (NIL). The RUPM describes the long-term plan of investment for Indonesia, while the NIL contains the list of sectors which are open or closed to foreign investment. Investigating the capacity of Investment Law, RUPM, and NIL is thus very crucial.

Research question

Based on the above, this chapter aims to address the following research question: "What is the capacity of central government's regulations to manage FDI to promote inclusive growth?"

Methodology

To analyze the capacity of government regulations, this chapter employs a qualitative method, first examining the essence of each regulation related to FDI and inclusive growth. It then examines whether those regulations have clearly considered the concept, programs, and channels through which FDI can promote inclusive growth. For that purpose, the contents of government regulations related to FDI and inclusive growth will be analyzed and matched with our theoretical framework. The coherence among government regulations related to FDI and inclusive growth will also be examined. Information from in-depth interviews will help to clarify problems faced by

government in the implementation of regulations. These in-depth interviews present the arguments of government officials from the National Development Planning Ministry (Bappenas), Indonesian investment board (BKPM), foreign investors, and district governments.

This chapter is divided into four sections. The first section provides a background of analyses, research question, and methodology. The second section discusses the content of regulations related to FDI and its linkages to inclusive growth. The third section analyzes the capacity of the regulations to manage FDI in Indonesia by focusing on the specific channels of FDI to inclusive growth and the coherence of government regulations. The last section provides conclusions.

4.2. Existing Regulations on Foreign Direct Investment in Indonesia

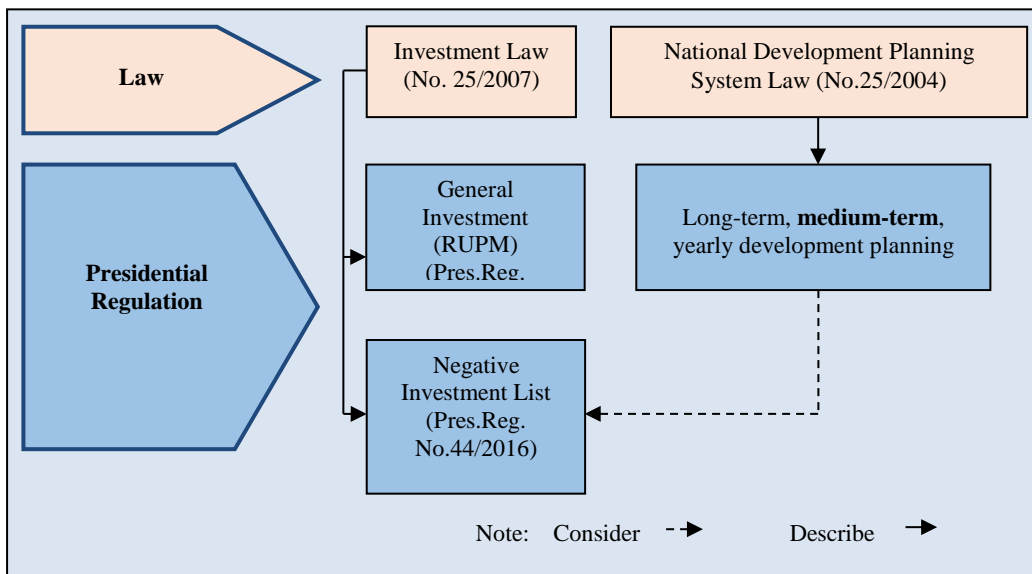
As discussed in chapter 3, Indonesian governments consider the broader concept of economic growth, the inclusive growth concept, in their development planning. Based on Indonesian law No.25/2004 on the National Development Planning System (figure 4.1.), central governments should establish national long-term, medium-term, and yearly development plans which mention the goals, strategy, and priorities of Indonesian development for periods of 25 years, 5 years, and 1 year, respectively. The term ‘inclusive growth’ was mentioned in the medium-term development plan for 2010-2014, called Rencana Pembangunan Jangka Menengah Nasional (RPJMN) 2010-2014. This indicates Indonesia’s intention to move toward inclusive growth. Since then the government has still focused on having inclusive growth by mentioning it in the RPJMN for 2015-2019. This plan includes the government’s intention to make investments, including Foreign Direct Investment (FDI), supportive of inclusive growth². In addition, according to Indonesian presidential regulation No.2/2015, the RPJMN 2015-2019 will be used as a guide to establish the strategic plans of ministries and agencies, local governments’ medium development plans, and the national yearly development plan. Hence, all of these plans also will be directed at achieving, inclusive growth, including inclusive FDI.

Besides being regulated by the RPJMN 2015-2019, Foreign Direct Investment (FDI) has been regulated by Indonesian’s investment law No.25/2007. Indonesian investment law becomes an umbrella of investment regulation to cover both domestic and foreign investments, and stipulates the rights and obligations of all investors. This law also requires two supporting documents to regulate investment in Indonesia (articles 4 and 12) –the general investment plan called Rencana Umum Penanaman Modal (RUPM), and the negative investment list (NIL) or Daftar Negatif Investasi (DNI).

² FDI that can contribute to inclusive growth is also called as inclusive FDI

These supporting documents are necessary to control the direction of investment in Indonesia. RUPM, ratified by presidential regulation No.16/2012, describes long-term general investment plans from 2012 to 2025, and NIL, established by an Indonesian presidential regulation, lists sectors that are either supported or prohibited for investment. The NIL will be used as an important guideline for providing investment license for FDI³. When established, the NIL has considered RPJMN.

In summary, RPJMN 2015-2019, Indonesian investment law No.25/2007, the Indonesian general investment plan (RUPM), and the negative investment list (NIL) are important regulations for managing FDI. Each of these regulations will be analysed as to whether it has clearly defined the concept and strategy of FDI-led inclusive growth, and whether it corresponds with the other regulations. The next section will describe how each investment regulation affects investments, including FDI, in Indonesia.



Source: Author's adjustment based on laws and regulations for investment

Figure 4.1. Regulations for Foreign Direct Investment

4.2.1. National Medium-Term Development Plan (RPJMN)

As previously discussed, Indonesia government's policy regarding inclusive growth has been stated in its medium-term development plans (RPJMN). Presidential Regulation No.5/2010 on the National Medium-Term Development Planning (RPJMN) 2010-2014, states that achieving inclusive growth is a priority of the national government. This target is represented by reducing unemployment, alleviating poverty,

³ Indonesia's NIL 2016 is ratified by presidential regulation No.44/2016

creating employment opportunities, improving the quality of health and education, and developing a basic infrastructure. In order to achieve inclusive growth, the government conducts several programs such as the community empowerment program, the so-called Program Nasional Pemberdayaan Masyarakat (PNPM), and a micro-small-medium enterprises development program. In addition, several programs related to productivity enhancement, such as health and education improvement programs, have also been undertaken. In general, the focus of inclusive growth is on improving the quality of education and health, and reducing income inequality. As inclusive growth is stated as a priority of RPJMN, all government policies, including those related to Foreign Direct Investment (FDI) should be directed toward inclusive growth.

Inclusiveness is still a key focus of national development. The current medium-term development plan (RPJMN) for 2015-2019 aims to make Indonesia politically sovereign, self-reliant, and Gotong Royong⁴. Moreover, RPJMN 2015-2019 states that Indonesia's development has to provide special attention to improving lower and middle class people's productivity without blocking, inhibiting, shrinking or reducing the flexibility of major actors to be agents of growth (Indonesia, 2015: 5-4). Specifically, the general direction of national development is to enhance inclusive and sustainable economic growth (p.5-13). The government believes that this can maximize economic potential and involve work forces in decent work and benefit poor families by decreasing inequality (Indonesia, 2015: 2-11). By having inclusive and sustainable economic growth, Indonesia is expected to move from a middle-income country to a high-income country.

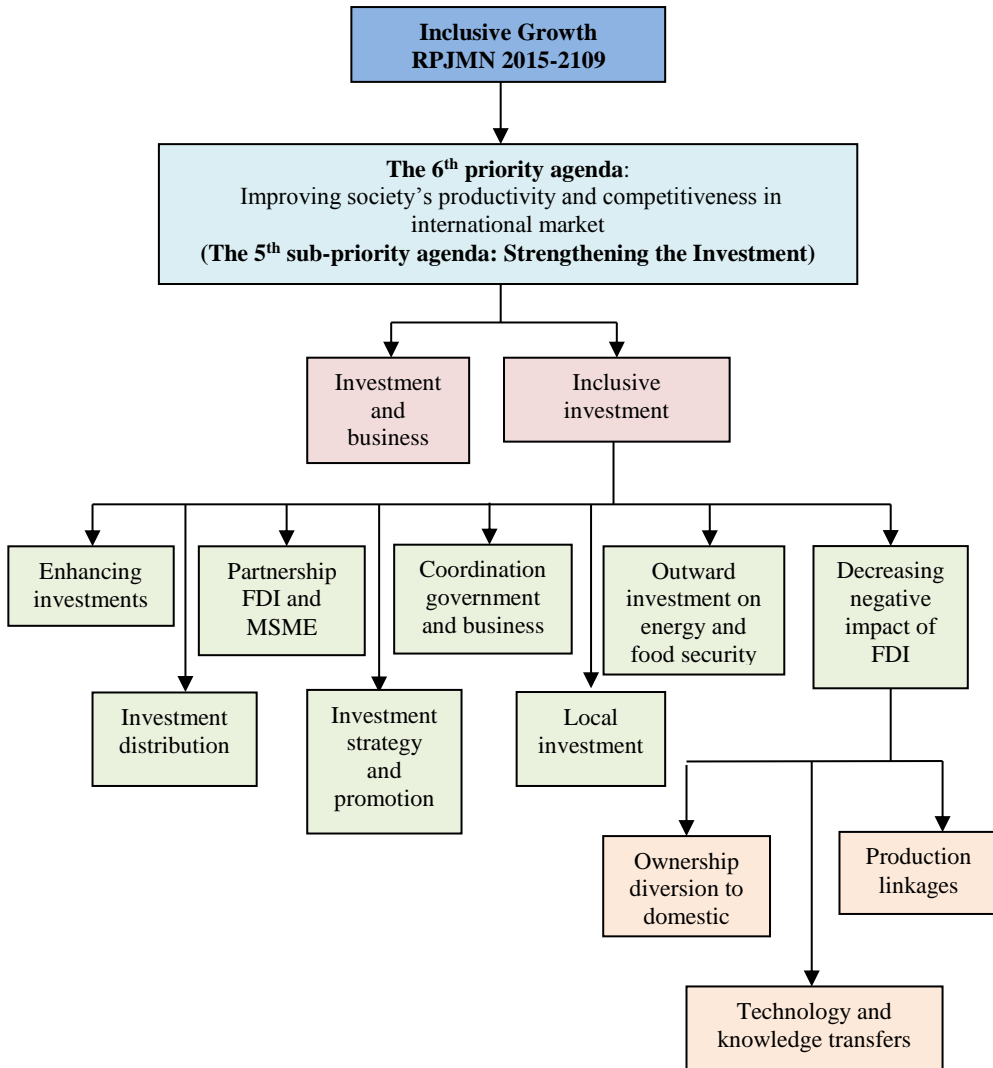
The importance of investment for inclusive growth has become one of the strategies in sub-priority agendas in Indonesia's development plan for 2015-2019. Indonesia has nine priority agendas, of which one sub-priority is to improve society's productivity and competitiveness in the international market. One strategy is to enhance the role of investment (Indonesia, 2015: 6-106). As shown in the figure below, the government proposes two pillars to enhance role of investment: enhancement of the investment and business climates by improving business license efficiency, and enhancement of inclusive investments, especially for domestic investors⁵. To do this the national government must improve the investment climate by simplifying investment procedures, reducing transaction costs, enforcing laws and regulations, and coordinating national and local government policies. Related to inclusive investment, Indonesia's

⁴ General ethos of mutual assistance (the "spirit" of the community), and as such it has become part of a "national culture" that is recognized throughout the nation (Bowen, J.R., 1986. On the Political Construction of Tradition: Gotong Royong in Indonesia. *Journal of Asian Studies*. Vol.14(3): 545-561

⁵ Investment which is inclusive will be called as inclusive investment.

government attempts to focus on enhancing investments, improving investment distribution, advancing partnership between FDI and MSMEs, increasing the effectivity of strategies and promotion for investment, improving investment coordination and cooperation between government and business, developing local investment, encouraging outward investment in energy and food security, and decreasing negative impacts of FDI on the national economy.

RPJMN 2015-2019 regulates some sub-strategies to create inclusive investment. To enhance investment, one sub-strategy is to support investments that lead to more employment for local people, and that provide raw materials for domestic industry. Distribution of investments is supported, for instance, by promoting investment and providing incentive for investors that want to invest to regions which still lack of investment. Further, Indonesia's government attempts to improve cooperation between FDI and Micro Small-Medium Enterprises (MSME), by indicating prospective, monitoring, and evaluating partnerships. In order to decrease possible negative impacts of FDI, the government supports for distribution of ownership of the capital market within domestic society; technology and knowledge transfers to domestic businesses and workers; and domestic linkages to production processes to support inputs of raw materials, semi-finished goods, and finished goods.



Source: Author's adjustment based on Indonesian presidential regulation No.2/2015 on the 2015-2019 Medium Term Development Plan (RPJMN 2015-2019)

Figure 4.2. Inclusive FDI based on RPJMN 2015-2019

4.2.2. Investment Law No. 25/2007

As already mentioned, investment law No. 25/2007 is an umbrella for investment regulation. This law has two important components lacking in the previous law. The first is that domestic and foreign investments are treated equally. Foreign investment

was previously regulated by laws No.1/1967 and No.11/1970, while domestic investment was managed by laws No.6/1968 and No.12/1970. Currently, investment law No.25/2007 regulates both domestic and foreign investments' rights, facilities and obligations. Equal treatment of domestic and foreign investments indicates the Indonesian government's support of a conducive environment to FDI inflows.

The second difference is, to solve coordination problem, current investment law provides greater authority to the national investment coordinating board, called Badan Koordinasi Penanaman Modal (BKPM), to manage investment, including FDI. Based on article 28 of investment law No.25/2007, BKPM is responsible to coordinate, analyze, propose, map, promote, supervise, and solve problems of investment. In addition, BKPM also provides one-stop investment service. As one stop investment service office, BKPM has authority over ministries or government agents that administer or deny licenses. In addition, both domestic and foreign investors must report their investment progress to BKPM. The better defined authority of BKPM and the one-stop investment service provide certainty for investing in Indonesia. This certainty will enhance FDI inflows.

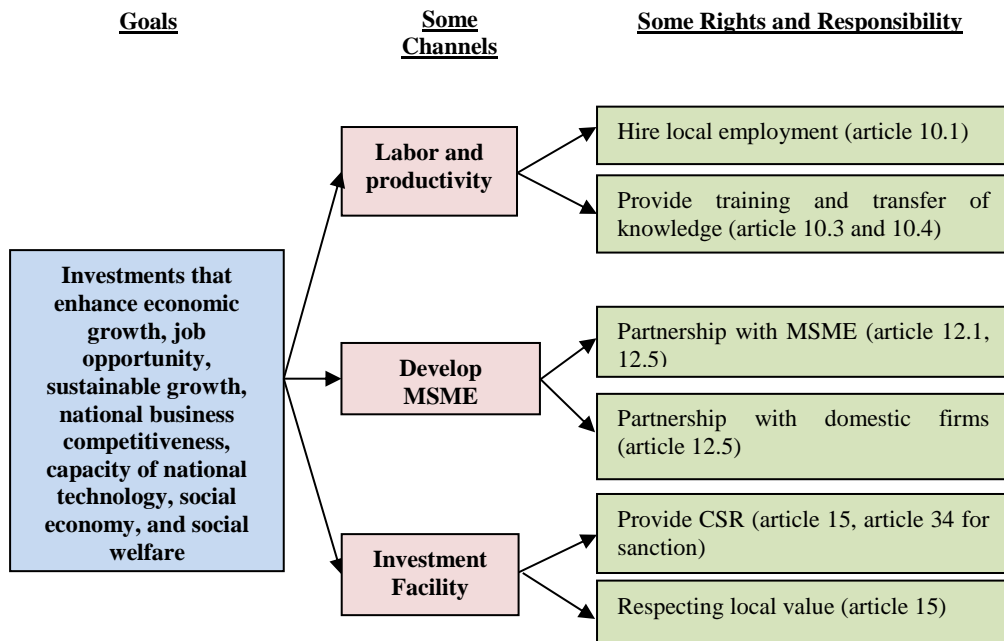
Investment law No.25/2007 has regulated investment, including FDI, to contribute to inclusive growth. As summarized in the figure below, in this law, investment stimulates inclusive growth by accelerating national economic development and sovereignty. Investment aims to support national economic growth, create job opportunities, enhance sustainable growth, increase business competitiveness, promote technology capacity, boost peoples' social economy or 'ekonomi kerakyatan', manage investment funds, and increase social welfare (Investment Law No.25/2007, article 3). Related to the social economy, economy that encourages participation by the marginalized (Panjaitan, M.S, 2012), investment law No.25/2007 supports investment that benefits society by improving workers' conditions and by partnership with Micro, Small, Medium Enterprises and with cooperatives.

Supports of investment laws on FDI-led inclusive growth has been shown by regulations related to the channels of FDI to inclusive growth proposed in Chapter 2 – employment creation, productivity improvement, Corporate Social Responsibility (CSR) programs, and linkages to Micro Small-Medium Enterprise (MSME). First, foreign companies have the obligation to provide employment opportunity for domestic workers. Based on investment law No.25/2007 (article 10), foreign investors are still allowed to hire a limited number of foreign workers with specific positions and skills. This means that foreign companies should prioritize local workers when starting their businesses. Second, foreign companies are obligated to improve the productivity of their workers by providing training and transfer of knowledge and technology.

Third, the Indonesian government supports foreign companies' contribution to society through CSR programs. As previously mentioned, the Indonesian government is willing to provide investment facilities to investors that conduct CSR, regularly report investment progress, respect local culture, preserve the environment, and create good conditions for workers (investment law no.25/2007, article 15). Moreover, these activities will be beneficial not only for the society but also for the investors' business. Society will more readily accept the existence of the business, thus ensuring its sustainability.

Lastly, foreign companies are directed to have partnerships with domestic companies, especially with MSME. Indonesian investment law No.25/2007 (article 12.1, 12.5), supports the development of MSME. This law also mentions that the government should reserve certain business fields only for MSME. The government is also required to provide a list of sectors that can lead to linkages between FDI and MSME. Furthermore, FDI is expected to establish linkages not only with MSME but also with domestic companies. Therefore, the government will require ownership of foreign companies' equities in some business fields. A detailed list of open and closed sectors for foreign investors will be described in discussion on the Negative Investment List (NIL).

In summary, investment law No.25/2007 as the main guide for investment in Indonesia directs FDI to inclusive growth. Channels for inclusive FDI based on investment law No.25/2007 are summarized in the figure below. Based on the figure, to be inclusive FDI investors must provide benefits for labor, the domestic economy, and society. With regard to the labor channel, inclusive FDI can be obtained if FDI employs local laborers and enhances their productivity through training and transfer of knowledge. Moreover, investment law No.25/2007 expects that inclusive FDI will have linkages to the domestic economy through partnerships with domestic companies, and especially MSMEs. Furthermore, the Indonesian government will support FDI contributions to inclusive growth by providing investment incentives and facilities, both fiscal and non-fiscal, such as free import tax and licenses to import, respectively, if foreign investors meet requirements like providing Corporate Social Responsibility (CSR) programs, preserving the environment and respecting local values. However, Investment Law No.25/2007 still regulates investment in general, and requires supporting regulations. These supporting documents are the general investment plans, or Rencana Umum Penanaman Modal (RUPM), and investment negative list (NIL), or Daftar Negatif Investasi (DNI).



Source: Author’s analyses of investment law No.25/2007

Note: MSME=Micro Small-Medium Enterprise

Figure 4.3. Inclusive FDI based on Investment Law No.25/2007

4.2.3. General Investment Plans (RUPM)

A general investment plan or Rencana Umum Penanaman Modal (RUPM) is one of the investment law’s supporting documents. In February 2012, by Indonesian presidential regulation No.16/2012, the government enacted RUPM. The RUPM has a function as a road map for long-term investment policies for until 2025. Similar to Indonesian investment law No.25/2007, RUPM also mentions that Indonesia’s investment policies are directed to enhance the investment climate and accelerate investment improvement. Besides that, RUPM is aimed at improving investment distribution; food, infrastructure and energy development; green investment; MSME empowerment, investment facilities and incentives, and investment promotion (article 2). RUPM programs supporting FDI to contribute to inclusive growth are summarized and explained in table 4.1.

Table 4.1. General Investment Plan (RUPM)

No.	Aspect for Inclusive FDI	Strategy
1.	Conducive investment climate	<ul style="list-style-type: none"> - Strengthening investment institutions - Regulating closed and open required business fields - Administering business competitiveness - Maintaining industrial relationships
2.	Investment distribution	<ul style="list-style-type: none"> - Developing center of economy outside Java - Providing incentives for investors outside Java - Creating special economic zone and Indonesian corridor - Developing renewable energy resources - Accelerating infrastructure development outside Java
3.	Food, infrastructure and energy development	<ul style="list-style-type: none"> - Improving sustainable self-reliance on foods, developing palm oil derivative industries, and switching raw to processed products for export. - Optimizing existing infrastructure, developing and extending infrastructure service, integrating national and regional infrastructure, accelerating infrastructure in all regions, expediting infrastructure needs. - Supporting compliance on electricity
4.	Green investment	<ul style="list-style-type: none"> - Persuading to invest in environmentally friendly sectors and technologies. - Handling renewable energy for business - Considering environmental development policy and program - Acknowledging spatial and environmental capacity
5.	MSME empowerment	<ul style="list-style-type: none"> - Enforcing next grade strategy: development of micro business to small business, then to large business - Supporting strategic alliance strategy: Partnership with both domestic and foreign large businesses
6.	Investment facilities and incentives	<ul style="list-style-type: none"> - Providing incentives and facilities for investors that: <ul style="list-style-type: none"> • invest in pioneer and prioritized sectors • absorb employment, develop infrastructure, transfer technology, partner with MSME, and locate in remote area.
7.	Investment promotion	<ul style="list-style-type: none"> - Promoting targeted investments - Improving coordination among ministries and government levels.

Source: Author's adjustment based on presidential regulation No.16/2012 on RUPM

According to table 4.1, there are four ways to improve the investment climate. The first is to strengthen central and regional investment institutions. Central and local governments, both provincial and district, should have a similar vision on division, devolution, and delegation of authority on investment. Moreover, central, provincial, and district governments should effectively coordinate. One way to strengthen the investment climate is to build a one-stop service office, called Perijinan Terpadu Satu Pintu (PTSP), at each level of government. The second is to regulate definite closed and open conditions for business fields. Besides protecting national interests such as MSME,

providing lists of forbidden and open under certain conditions for businesses can support business certainty. The third is to administer business competitiveness. In order to improve business competitiveness, regulations and monitoring of business practices are needed. The fourth is to maintain industrial relationships focused on improving human capital. Therefore, regulations and harmonizing negotiations are needed to enforce investors to provide training and maintain good relationships between companies and workers.

In order to distribute investments, Indonesia should target investments outside the Java area. Indonesia's government will develop centers of economy outside Java by developing strategic sectors which correspond to environmental and regional potencies. Moreover, investment incentives will be provided for investors willing to invest outside Java. In addition, creating a special economic zone and Indonesian corridor, developing renewable energy resources, and accelerating infrastructure development, like using public-private partnerships outside Java, are other ways to spread investment locations.

Long-term investment must also be addressed to food, infrastructure, and energy development. Improving sustainable self-reliance on rice, corn, sugar, soya products; developing palm oil derivative industries; and processing raw into processed products for export are targets for investment in the food sector. Moreover, investment in infrastructures is intended to optimize existing infrastructure quality and capacity, develop and extend infrastructure services, integrate national and regional infrastructures, accelerate infrastructure development in developed and undeveloped regions, and expedite compliance to infrastructure needs. Furthermore, investment in energy is expected to support compliances to electricity needs, especially by improving renewable energy.

Green investment is investment that considers environmental aspects. According to RUPM, green investors should develop priority sectors and technologies that environmentally friendly and use renewable energy throughout their businesses. In addition, they should consider environmental development policies and programs, and consider spatial and environmental capacities.

Related to micro small medium enterprise (MSME), there are two strategies for development: next-grade and strategic alliance strategies. By the next-grade strategy, the Indonesian government compels business development to switch from micro business to small business. Furthermore, business development supports small businesses to become large. However, a governmental approach to support a next-grade strategy for MSME has not yet been described in detail in RUPM. In the strategic alliance strategy, both large domestic businesses and foreign investors are driven to have partnerships with MSME. This means that MSME can have linkages to large-scale business chains and benefit from their progress.

Investment facilities, convenience, and incentives are also included in the long-term investment plan of RUPM. Indonesia's government realizes that these elements are needed to force investors to follow government policies. Based on RUPM, investment facilities and incentives are prioritized for pioneers of investment and prioritized investment sectors. Pioneers of investment are defined as investments that have global linkages, provide high added value and positive externalities, introduce new technology, and have strategic value for the national economy. High prioritized investment sectors are those that can diversify economic activity, strengthen the national industrial structure, compete in the international market, and link up with investments in food, infrastructures, and energy. However, other types of investment like absorbing employment, developing infrastructures, transferring technology, partnering with MSME, and locating in remote areas can also receive investment facilities. Governments – central, provincial, and district – can provide conveniences like one-stop investment service offices, and incentives like free-tax filing and retribution. Furthermore, the central government can provide fiscal facilities such as free customs for importing machines and raw materials.

Lastly, investment promotion is needed to build a strong image of an investment-conducive climate. Moreover, investment promotion is expected to focus more on targeted investment, in which case coordination on doing promotion is needed among ministries and/ agencies, both central and regional.

4.2.4. Negative Investment List (NIL)

Indonesian investment law No.25/2007 requires the government to establish a list of business fields that are closed and open under certain conditions for investment. This list is called the Negative List of Investment (NIL) or Daftar Negatif Investasi (DNI). The NIL is important not only for investors but also for governments. By analyzing NIL, investors can determine the types of business they are allowed to invest in. Moreover, guided by the NIL, BKPM and local government investment sections can decide whether or not investors should be provided with principle investment permits. Hence, NIL is the first guide for screening investment applications in Indonesia.

The NIL can be revised if it is no longer suitable to the Indonesian situation. Since ratification of investment law No.25/2007, the NIL had been re-established four times. The first NIL was established in 2007 and called NIL 2007. Then, NIL 2007 was revised in 2010, 2014, and 2016. The Indonesian government enacted NIL 2016 by Indonesian Presidential Regulation No.44/2016.

There are various reasons for having NIL 2016. According to table 4.2., NIL 2016 was established to increase protection of Micro, Small, Medium Enterprises and Cooperatives (MSME) and national strategic business fields, as well as the

competitiveness of Indonesia within the ASEAN Economic Community (AEC) (Indonesia, 2016a: consideration section). Moreover, the Indonesian government provides special treatment for FDI by ASEAN's members (Indonesia, 2016a: article 2.2.b) by allowing them to have higher ownership in some business fields and locations. In addition, NIL 2016 clearly mentioned types of partnership with MSME (Indonesia, 2016a: article 5.2). Partnership with MSME is one requirement under certain conditions for investment. Investors can select a type of partnership with MSME such as core-plasma⁶, sub-contract, agency, or franchise. Furthermore, NIL 2016 states who has the authority to develop, control, and evaluate the NIL 2016 (Indonesia, 2016a: article 12). NIL 2016 mentioned that the coordinating ministry for economy, called Menko Ekuin, will be assisted by a national team for improving export and investment, abbreviated as PEPI, in order to monitor and evaluate the implementation of NIL 2016.

Table 4.2. Negative Investment List (NIL) 2016

No.	NIL 2016	Explanation	Article
1.	Reasons for having NIL 2016	More MSME protection, consideration of national strategy and Indonesian competitiveness in ASEAN Economic Community (AEC)	Consideration section
2.	Privileges for ASEAN member countries	Higher ownership share	article 2.2.b
3.	Type of partnership with MSME	Plasma, sub-contract, agency, franchise, etc.	article 5.2
4.	Institutions for monitoring and evaluating implementation of NIL 2016	Coordinating ministry of Economy (Menko Ekuin) assisted by national team to improve export and investment (PEPI)	article 12

Source: Author's adjustment based on NIL 2016

Note: NIL (Negative Investment List), ASEAN (Association Southeast Asian), MSME (Micro, Small, Medium Enterprise).

NIL 2016 regulates all investments in Indonesia. As mentioned above, NIL regulates closed and open business fields under certain conditions for foreign companies wishing to invest; other business fields that are not mentioned are also open to investment by foreign companies. According to the figure 4.4, NIL 2016 consists of 20 closed business fields, with the addition of a prohibition of marine and fishery (removal of valuable objects from a sunken cargo ship), compared to 19 closed business fields in

⁶ A large company will become a core while MSME will become a plasma. The large company will assist and develop MSME business (Indonesian Law No.20/2008 on Micro Small-Medium Enterprise, article 27)

the 2014 NIL. The prohibition to invest in closed business fields is based on aspects like security and natural preservation.

In NIL 2016 the Indonesian government attempted to strengthen the contribution of Foreign Direct Investment (FDI). The government considers FDI to be important for economic development, and attempts to encourage FDI (Coordinating Ministry for Economic Affairs press release, Jakarta, 15 February 2016)⁷. NIL 2016 describes two channels to regulate FDI. The first channel is to open more business fields for FDI. Compared to NIL 2014, NIL 2016 increases the opportunity for foreign investors to invest in Indonesia by removing 35 business fields from NIL, making it possible for foreign investors to invest in those 35 business fields which were closed by NIL 2014. For instance, in NIL 2016, tourism, e-commerce valued higher than Rp.100 billion, cold storage, toll-road operators, and the crumb rubber industry are now open for FDI. By allowing FDI in these fields, the Indonesian government expects them to be improved and beneficial for other business fields, and this economic improvement is expected to provide more job opportunities for society⁸.

The second channel to allow FDI to contribute to Indonesian economy is by providing greater opportunities for foreign companies to invest in some business fields under certain conditions. As previously mentioned, the Indonesian government supports FDI inflows while providing protection for MSME by increasing investment opportunity for FDI in partnership with MSME (Coordinating Ministry for Economic Affairs' press release, Jakarta, 15 February 2016)⁹. In the NIL 2016, the business fields open under certain conditions: reserved MSMEs and Cooperatives, partnerships with MSME and Cooperatives, and certain conditions. The Indonesian government supports MSME by reserving 92 business fields for them. Moreover, the government regulates FDI's contributions to the economy by requiring FDI to have partnerships with MSMEs and under certain conditions. In NIL 2016, business fields that should have partnership with MSME increased from 48 in NIL 2014 to 110 NIL 2016, an additional 62 business fields¹⁰. According to the figure below, the Indonesian government wants FDI to have partnerships with MSME in four sectors – forestry, marine and fishery, industry, and trade. FDI's are allowed to invest in the forest management sector for rattan, pine, and

⁷ Press release on *Protecting Small Business, Provide Certainty on Limitation on Foreign Investors' ownership*

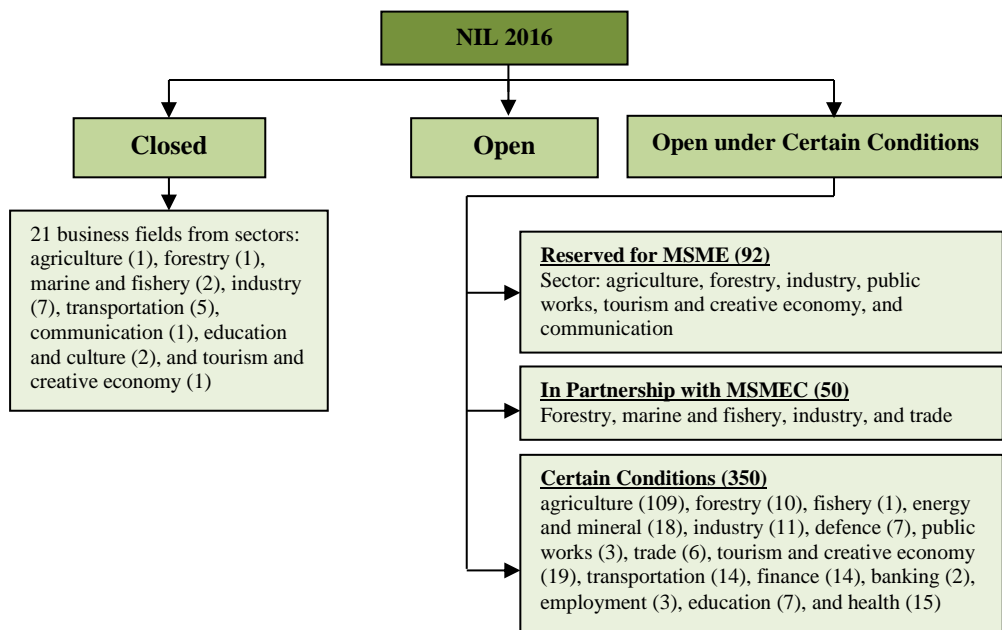
⁸ The Jakarta Post, (Thursday, 11 February 2016), *Indonesia opens 35 sectors to foreigners, closes 20 others*.

⁹ Press release on *Protecting Small Business, Provide Certainty on Limitation on Foreign Investors' ownership*

¹⁰ Tempo.co, (Friday, 12 February 2016), *Daftar Negatif Investasi Direvisi, Apa Saja Perubahannya?*

bamboo, and in the marine and fishery sector for fish hatcheries, but they have to partner with MSME. The Indonesian government expects that partnership between FDI and MSME will improve those sectors through technology and knowledge transfers.

In addition, FDI can contribute to the Indonesian economy by investing in some business fields under certain conditions. These conditions require a level of FDI ownership, location, and special licenses only for domestic investors and ASEAN country members. Based on NIL 2016, Indonesia's government regulates FDI's share of ownership in almost all business fields except communication. The range of ownership varies across sectors. For instance, in an area 25 hectares or more, foreign investors can have a maximum of 30 percent ownership of seed and vegetable cultivation investments, while they are allowed to have a maximum of 95 percent of ownership of businesses in the seedling plantation industry. According to data from the Coordinating Ministry for Economic Affairs, foreign investors currently have a greater opportunity to have more ownership in 29 business fields. For instance, foreign investors can now have 67 percent of ownership in distribution and warehousing, compared to only 33 percent in NIL 2014¹¹.



Source: Author's adjustment based on Indonesian Presidential Regulation No.44/2016 on NIL 2016

Note: 'Open under certain conditions' on figure 4.4 mentions only business fields that are possible for FDI

Figure 4.4. Negative Investment List 2016

¹¹ <https://ekon.go.id/press/view/siaran-pers-melindungi.2005.html>

Based on the above explanations of the essence of existing government regulations and plans, the next section will discuss the existence of inclusive institutions. Inclusiveness is measured by whether these regulations have clearly specified the channels of FDI to inclusive growth. The coherence among government regulations will also be analyzed.

4.3. Discussions

Indonesia as a developing country is highly dependent on Foreign Direct Investment (FDI) to support its growth. According to RPJMN 2015-2019, this dependency was caused by insufficient domestic funds to finance domestic development, as indicated by a saving-investment gap of about 3.1 percent of the Gross National Product (GNP) in 2014¹². During the period of 2005 - 2014, even though the contribution of FDI had gradually decreased, it still made a significant contribution of about 60 percent of the total investment realization of Indonesia (BKPM, 2014). This evidence shows that Indonesia's economy relies on FDI inflows to support its economic development. However, high inflows of FDI are expected to support not only economic growth, but also contribute to inclusive growth.

According to the theoretical framework in chapter 2, the role of inclusive institutions is vital to promote FDI for inclusive growth. Inclusive institutions include government regulations which enhance the opportunity of society to gain benefits from FDI business. Inclusive institutions also expand the opportunity for society to be involved in formulating FDI programs related to society. The previous sections have explained the essence of existing regulations to control FDI in Indonesia. This section discusses whether government regulations have clearly specified the concept of inclusive growth and the channels through which FDI can contribute to it. It also analyses the coherence among government regulations.

In general, Indonesian governments have the intention to regulate investments for achieving inclusive growth. The objective of achieving inclusive investments has been explicitly stated in the 2015-2019 RPJMN. In this plan, the government attempts to have investment contribute to inclusive growth by enhancing partnership between FDI and MSMEs and, reduce negative impacts through ownership diversion, technological and knowledge transfers, and production linkages to domestic companies.

Investment Law No. 25/2007, as the umbrella of investment regulations in Indonesia, has also supported the effort to promote investment that fosters inclusive

¹² Gross National Product (GNP) is the total value of a country's annual output of goods and services plus income earned by residents from investment abroad, minus the corresponding income sent home by foreigners who are living in the country (<https://www.economist.com/economics-a-to-z/g#node-21529914>)

growth. By the law, FDI is expected not only to contribute to economic growth but also to create job opportunities, enhance sustainable growth, increase business competitiveness, promote the capacity of technology, foster the economies of society, manage investment funds, and increase the welfare of society. In order to promote such contributions of FDI, the various levels of Indonesian government require foreign companies to prioritize Indonesian citizens as employees, train and transfer knowledge to improve employment productivity, have linkages with MSMEs, and contribute to society through CSR programs as requirements to receive investment facilities from government.

The other investment regulations – the General Investment Plan (RUPM) and the 2016 Negative Investment List (NIL) – also have supported FDI to contribute to society. For instance, the RUPM aims to support FDI's contribution by empowering MSMEs through partnerships with foreign companies and providing investment facilities and incentives only for companies which fulfil certain requirements, such as absorbing employment, developing infrastructure, transferring technology, partnering with MSME, and doing business in remote areas.

Nevertheless, these investment regulations still have a weak capacity to direct FDI to inclusive growth. First, the 2015-2019 RPJMN, although focusing on inclusive investment has not clearly defined who will be the targets of such investment and how it can contribute to inclusive growth. It does not match the theoretical framework of this study, which suggests that local people, especially the marginalized, be targeted to gain benefits from foreign investment. The 2015-2019 RPJMN has also not clearly specified the link between investment and inclusive growth. For example, the RPJMN mentions that to achieve inclusive investment, it is necessary to support outward investments in energy and food security. This is obviously not related to the objective of promoting investment for inclusive growth because outward investment means that the benefits of investment will be gained by people abroad rather than local people.

Second, in the 2015-2019 RPJMN, the strategy to promote inclusive investment has been focused more on domestic rather than foreign investment. In the plan, Indonesia government has eight strategies to achieve inclusive investment: of these, however, only two specific sub-strategies deal with FDI: strengthening partnerships between FDI and MSMEs and decreasing the negative impact of FDI by ownership diversion, technological and knowledge transfers, and production linkages to domestic business. The other sub-strategies have focused mostly on promoting the contributions of domestic investment. Based on interviews with government officials – central, province (Bali, East Java, and Banten), district (Badung, Mojokerto, and Tangerang) – and society, in general, interviewees agreed that domestic investments have mainly provided benefits like creating employment for local people. However, investments are

not only domestic investment but also foreign. Therefore, FDI also has to receive more attention by the government, since around 60 percent of investments in Indonesia are FDI (BKPM, 2014: 2).

A third reason for the inadequacy of government regulations is their weak coherence with each other. As previously explained, Investment Law No.25/2007 is the umbrella for other regulations regulating investment in Indonesia. The Investment Law has not mentioned the term of “inclusive investment”, but it has captured all channels of FDI to inclusive growth as proposed in our theoretical framework. Meanwhile, the 2015-2019 RPJMN, the first Indonesian regulations to mention the term ‘inclusive investment’ has not clearly proposed the channels of investment to inclusive growth. Moreover, the General Investment Plan (RUPM) does not correspond with the Investment Law. The RUPM has also not specified all the channels of FDI to inclusive growth; for example, it has omitted the objective of achieving inclusive investment through employment creation for local people. The RUPM also does not mention CSR programs, one of the most important channels of inclusive investment. Based on the results of the survey, district governments were not yet aware of the terms ‘inclusive growth’ and ‘inclusive investment’. As a result, in their development plans (RPJMD) these terms are not mentioned.

Fourth, the implementation of investment regulations is also not yet optimal. For instance, as previously mentioned, the Indonesian government aims to strengthen partnerships between foreign companies and MSMEs. However, such partnerships are still limited by a lack of information on the potential MSMEs, a lack of coordination among governments, and a lack of monitoring and controlling. This was mentioned during an interview as follows:

“We would like to have a partnership with MSMEs. However, we have no information about which MSMEs are suitable for our business.” (HRD of NT Corp., Tangerang District, 4 May 2016)

“Central government is still fragmented. For instance, if BKPM has a responsibility, BKPM alone should be responsible for it. For instance, NIL states that one requirement for investors to invest in Indonesia is having partnership with MSMEs. BKPM has a program to match MSMEs with big companies. However, these programs still have no link with programs of other ministries which also focus on MSME. Moreover, investors mostly ask what, where, and the capacity of MSMEs that can be partnered with. The Ministry of MSME does not provide that data. Hence, BKPM conducted a survey on those aspects to match MSME with investors.” (Central government official, Jakarta, 13 June 2016)

“We want to match MSME with big companies. However, after matching MSME to investors, there is no ministries that want to take over monitoring the partnerships.” (Central government official, Jakarta, 13 June 2016)

“The coordination of economic affair ministries has mapped the ministries that have a relation with MSME. As a result, there are 16 ministries related with MSME, but there is no communication among those ministries.” (Central government official, Jakarta, 13 June 2016)

Implementation of other sub-strategies also faces several problems. For instance, to support the strategy of investment promotion, the government attempts to use investment promotion centers in other countries, called Indonesian Investment Promotion Center (IIPC). However, according to an interview, as local governments have a problem of limited budgets, they will more likely promote their regions for domestic rather than foreign investments. Another problem is different levels of government have different targets of investment. This was mentioned during an interview:

“Central or provincial governments have an intention to distribute investments to other regions that still have limited investment. This means that districts which already have many investments will not become targeted for investment.” (Badung District’s government official, 26 May 2016)

4.4. Conclusions

Some regulations and development support investment, especially FDI, to become inclusive. The umbrella above all investment regulations is Investment Law No.25/2007. According to this law, the general planning of investment, the so-called called RUPM, and the negative investment list (NIL) are the main supporting documents to direct investment in Indonesia. Moreover, Indonesia’s government planning for inclusive growth was stated in the national medium-term development plan or RPJMN for the period of 2010-2014 and currently for the period of 2015-2019. In addition, in the current RPJMN, the government explicitly mentioned inclusive investment as a pillar for improving society’s productivity and competitiveness.

Based on analyses of Indonesia’s investment regulations and national development plans, they highly support investment to have positive impacts on society. Investment law No. 25/2007 attempts to promote inclusive growth by increasing labor productivity, improving domestic economy, and enhancing the welfare of society. In addition, RPJMN 2015-2019 tends to support inclusive investment by enhancing linkages, transfers of technology and knowledge, and partnerships between FDI and MSME.

As already explained in the theoretical framework, institutions are defined as the rules of the game which regulate the behavior of agents in the economy. By using this definition, chapter 4 has examined the capacity of national government regulations to manage FDI for inclusive growth in Indonesia. Four national government regulations related to foreign investments and inclusive growth have been analyzed in chapter 4: Investment Law No.25/2007, the 2015-2019 National Medium Term Development Plan (RPJMN), the General Planning of Investment (RUPM), and the Negative Investment List of Investment (NIL). The capacity of these regulations has been assessed by considering whether they support the channels of FDI to inclusive growth suggested in the theoretical framework. Coherence among those regulations and coordination among government officials in their implementation have also been examined in chapter 4.

Based on the analysis in chapter 4, Investment Law No.25/2007 has supported inclusive growth. The law stated that FDI should provide benefits for local labor, domestic economy, and society. This includes employing local laborers in foreign companies and improving their productivity through training and knowledge transfers. The Indonesian Investment Law also states that foreign investment should have partnerships with domestic firms, especially MSMEs. Furthermore, the law states that foreign companies should promote benefits to society, as through providing CSR programs, preserving the environment and respecting local values. By stating the channels of FDI to inclusive growth, the Indonesian Investment Law has a strong capacity to support FDI for inclusive growth in Indonesia.

The 2015-2019 Indonesian Medium-Term Development Plan (RPJMN) has stated explicitly that the government aims to increase the contribution of investments to the domestic economy through inclusive investment. However, this regulation does not clearly explain the definition and indicators of inclusive investment. Furthermore, the achievement of inclusive investment is focused on domestic investors. As a result, the channels through which inclusive investment can be achieved are also unclear. For example, the RPJMN suggests encouraging outward investment in energy and food to achieve inclusive investment. This is not related to the channels of FDI to inclusive growth suggested in our theoretical framework. In addition, the channels of inclusive investment stated in the RPJMN do not correspond with the channels suggested in the Investment Law.

Based on the Investment Law, to promote investment in the economy, the government had to formulate the Long Term General Investment Plan (RUPM) and the Negative Investment List of Investment (NIL). Based on RUPM, Indonesian investment policies are directed to improve the investment climate; improve investment distribution; promote investment in food, infrastructure, and energy; encourage green investment; strengthen MSMEs linkages; provide investment facilities and incentives;

and increase investment promotion. However, RUPM does not explicitly mention inclusive investment as an objective of this plan. Meanwhile, based on analysis on the 2016 NIL, the Indonesian government clearly attempts to increase protection for MSMEs and national strategic businesses, and improve the competitiveness of industries within the ASEAN Economic Community (AEC).

This chapter concludes that the existing regulations have suggested the channels of FDI to promote inclusive growth. However, coherence among investment regulations is weak. Moreover, the objective of achieving inclusive investment is only stated explicitly in the RPJMN but not in the other regulations. Based on in-depth interviews with national government officials, the main challenge faced in achieving inclusive investment is a lack of coordination among ministries and between ministries and local governments. In addition, local government lacks knowledge of inclusive growth and inclusive investment. Consequently, in their medium-term development plan (RPJMD), the term inclusive investment is not mentioned. The capacity of Indonesian regulations to managing FDI for inclusive growth should be strengthened by improving coherence on government regulations and coordination among government levels.

Chapter 5

The Role of District Government in Promoting FDI for Inclusive Growth in Indonesia: Multilevel Governance Analysis

Chapter 5 – The Role of District Government in Promoting FDI for Inclusive Growth in Indonesia: Multilevel Governance Analysis

Abstract

The available studies focus on the impact of Foreign Direct Investment (FDI) on inclusive growth. However, no study examines extensively the involvement of district governments in promoting the contributions of FDI to inclusive growth. After Indonesia entered the decentralization era, the authority to manage FDI remained in the hands of the central government. However, Indonesia consists of three layers of government (national, provincial, and district), of which district government is assumed to best understand the aspirations of society. District governments should thus be involved in public policy processes related to FDI and inclusive growth. This is in line with the theoretical framework in the previous chapter, which suggests the importance of inclusive institutions. Based on the Multilevel Governance (MLG) theory, district governments should be involved in public policy processes related to FDI and inclusive growth. Although according to existing regulations, district government should have a joint role with central government in the planning process for FDI, in actual practice, district government merely implements the central government's plans. District government does, however, have a joint role with the central government in controlling the performance of FDI related to inclusive growth.

5.1. Introduction

As explained by our theoretical framework in Chapter 2, institutions have an important role in making Foreign Direct Investment (FDI) contribute to inclusive growth. Institutions regulate interactions among stakeholders and shape the relationship between FDI and inclusive growth. Based on our theoretical framework, in order for FDI to foster inclusive growth, institutions must be inclusive. Studies such as those of Acemoglu and Robinson (2012), Balakrishnan et al., (2013) and OECD (2014, p.162) have defined inclusive institutions as the rules of the game that provide equal opportunity for all members of society to benefit from development (economic institutions) and to be involved in the process of development (political institutions). Regarding the FDI-inclusive growth relationship, inclusive institutions should lead to equal distribution of FDI benefits to society, including marginalized people, so that poverty and income inequality can be reduced.

In the case of Indonesia, which has three levels of government – central, provincial, and district – inclusive institutions are identified as those that involve district governments in national policies regarding FDI and inclusive growth. District government, as the lowest level of government, is assumed to be closest to society and

best able to understand society's aspirations. Therefore, inclusive institutions in multi-level governments will enhance the opportunity of district governments to express their voices, to be involved, and to be accountable in the public policy process related to FDI and inclusiveness. The public policy process of FDI moves from planning to implementing and controlling.

The involvement of district government in the public policy process of FDI is relevant for Indonesia, a country which has implemented decentralization since 2001, when central government delegated some of its authority to district governments. According to Indonesian law No.32/2004, later revised to Indonesian Law No.23/2014, during the decentralization era, the central government transferred all authority to local government, except for international relations, defense, safety, judiciary, national monetary and fiscal authority, and religion. Since FDI is related to international relations, the central government has the authority to manage it, but Law No.25/2007 requires the central government to cooperate with local governments in this task.

Based on the above, this chapter aims to investigate the role of district government in cooperation with provincial and central government to make FDI conducive to inclusive growth. Our analysis is based on the theoretical framework of Chapter 2 which finds that multi-level governments should have inclusive institutions in FDI policy processes. For this chapter we used a qualitative method based on national and local regulations and in-depth interviews with government officials from national, provincial, and district governments. The provincial governments were those of Banten, East Java, and Bali Provinces, and the district governments were those of Tangerang, Mojokerto, and Badung Districts. This chapter presents an analysis of the regulations and actual practice of district governments in managing FDI to foster inclusive growth.

Research question

This chapter is aimed to address one research question:

“In multi-level government systems, what role does district government play in planning, implementing, and controlling FDI to make it inclusive?”

Research Design and Methodology

In order to analyze the role of district government in managing FDI for inclusive growth in Indonesia, this chapter combines the concepts of inclusive institutions and multilevel governance (MLG) theory, as already explained in the theoretical framework. The MLG indicates the interdependence among different layers of government (vertical interdependence) and interdependence between government and non-government actors at various territorial levels (horizontal interdependence). This chapter will focus on the vertical interdependence among levels of government in managing FDI for inclusive growth.

The role of district government in promoting FDI for inclusive growth will be analyzed in the public policy process, from planning to implementing and controlling. The methodology employed in this chapter is qualitative, reviewing the existing regulations related to FDI and inclusive growth and conducting in-depth interviews with government officials at national, provincial, and district levels. A review of regulations reveals the legal authority of the local government in managing FDI for inclusive growth. Meanwhile, the interview discloses the perspective of local governments on the implementation of the regulations.

As already mentioned, three provinces were surveyed: Banten, East Java, and Bali provinces, as well as three districts: Tangerang, Mojokerto, and Badung districts. The government officials interviewed deal with FDI and inclusive growth policies. Most interviewees were interviewed in person, but some were interviewed by phone. Some interviewees were not willing to be recorded. A total of 15 government officials were interviewed for this study.

This chapter is organized into four sections. Section 1, the introduction, consists of background, main research question, research design and methodology. Section 2 briefly explains the theoretical framework, based on Chapter 2. Section 3 analyzes the role of each level of government in managing FDI and inclusive growth in the public policy process by employing the concept of MLG and inclusive institutions. The analysis is based on regulations and actual practices. Section 4 concludes the findings of this study.

5.2. Role of Government in FDI and Inclusive Growth: Framework of Analysis

As already mentioned in Chapter 2, inclusive institutions play an important role in promoting the contributions of FDI to inclusive growth. Based on Acemoglu and Robinson (2012), Balakrishnan et al., (2013) and OECD (2014, p.162), inclusive institutions are the rules of the game that provide equal opportunity for all members of society to gain benefits from FDI (economic institutions) and to be involved in the FDI policy process (political institutions). Related to the MLG theory, which explains the interaction between different layers of government, the level of inclusiveness is indicated by the involvement of local government in the FDI policies of the national government. In the case of Indonesia, which consists of three levels of government (national, provincial, and district) and which entered an era of decentralization in 2001, the inclusiveness of institutions is shown by the level of cooperation between district, provincial and national governments in managing FDI and inclusive growth.

According to OECD (2011), in the MLG theory local government involvement can be clustered into three types: dominant or main role, joint role, and implementing role. First, local government has a “dominant role” in public policies when it can make autonomous decisions at each stage of the public policy process (planning,

implementation, and controlling). In a dominant role, the local government is more powerful than the central government. Second, local government plays a “joint role” in public policies if it shares equal power with the central government to make decisions at each stage of the public policy process. Third, local government becomes an “implementer” if it has no power but just implements policies formulated by the central government. As an implementer, local government can only accept instructions/directions from central government.

Combining the three types of local government involvement with the concept of inclusive institutions, district and provincial governments should be involved in all public policy processes – planning, implementing, and controlling/monitoring – to promote FDI for inclusive growth. Despite the central government’s authority to manage foreign investment, the district government should be involved in public policy processes related to FDI because it better understands society’s preferences and can directly interact with foreign companies and society. Therefore, the inclusiveness of institutions in the MLG theory is indicated by the “joint role” of district government. As already mentioned, playing a “joint role” means that district governments are involved in public policy processes related to FDI at the national level and may also express their aspirations (voice), engage in policy processes (engagement), and be informed about the policies of FDI and inclusive growth (accountability).

Based on the theoretical framework above, this chapter examines the role of district government in relation to provincial and national governments in promoting FDI contributions to inclusive growth. The role of district government will be analyzed in the three stages of the public policy process, from planning to implementing and controlling. The role of local government in planning FDI will be investigated in the planning process of the national medium-term development plan or Rencana Pembangunan Jangka Menengah Nasional (RPJMN) and the Negative Investment List (NIL). The reason to focus only on planning RPJMN and NIL is because these two regulations are strongly related to managing FDI in Indonesia. In the implementation stage, the role of district government will be analyzed based on regulations related to government responsibilities on FDI-inclusive growth relations. The implementation stage includes attracting FDI, providing licenses, providing investment facilities, and regulating corporate social responsibility (CSR). Furthermore, the role of the district government in the controlling stage will be determined by considering the responsibility of government in evaluating the performance of FDI. After analyzing the district government’s role as seen in its regulations, we will analyze the actual practice of the local government in managing FDI and inclusive growth. The analysis of actual practice is based on the results of in-depth interviews with stakeholders. The framework of the analysis can be seen in the following figure.

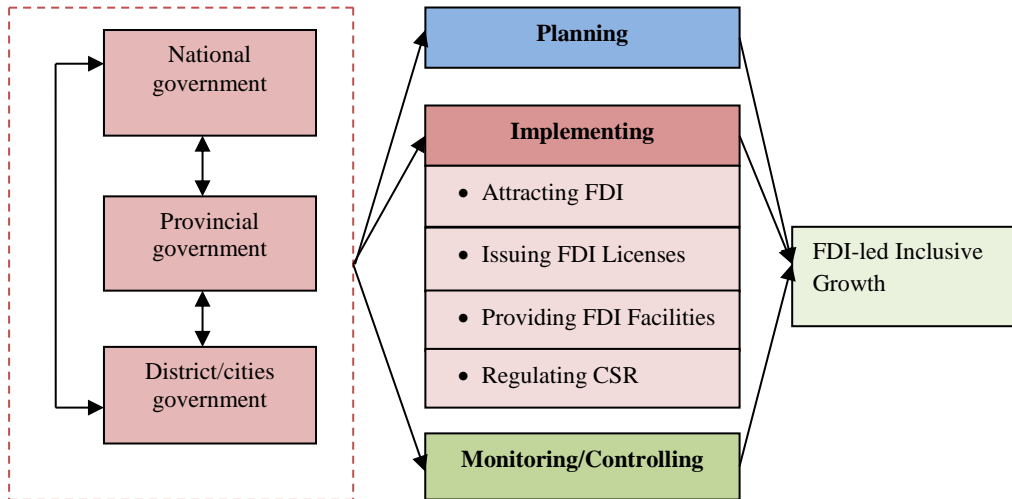


Figure 5.1. Multilevel governance for analyzing FDI-led inclusive growth

5.3. The Role of District Government in Promoting FDI for Inclusive Growth: Regulations and Actual Practice

Based on the MLG theory, the role of district government can be divided into three types of involvement (OECD, 2011). The first is a dominant role if district governments independently regulate FDI for their own regions. The second type is a joint role if the district government must coordinate with the central government to regulate FDI. The last type is an implementer role if the district government merely implements the policies of central government. Government institutions are inclusive when the district government coordinates with the provincial and national governments to manage FDI for inclusive growth. The role of the district government will be analyzed in the public policy process, from planning to implementing and controlling. To begin with the analysis is based on the existing regulations. Later the analysis is based on actual practice as described during in-depth interviews.

5.3.1. The Role of District Government in the Planning Process

The role of district government in the planning process includes the process of formulating the national medium term development plan or Rencana Pembangunan Jangka Menengah Nasional (RPJMN) 2015-2019 and the Negative Investment List (NIL). The main reason for considering the 2015-2019 RPJMN is because the document states clearly that the government has an objective to achieve inclusive investment, which means that the investment must contribute to inclusive growth. The NIL is also considered a planning document, which regulates restrictions and requirements for

foreign investment in Indonesia. Understanding the process of formulating RPJMN and NIL will disclose the role of the district government in the planning process of those documents. The next section will start by discussing the process of formulating RPJMN.

5.3.1.1. The Role of District Government in Formulating RPJMN

Based on Investment Law No.25/2007 and Local Government Law No.13/2014, the authority to manage FDI is still in the hands of the national government. However, local governments, and especially district governments, have an important role in formulating RPJMN, which mentions the investment plan and its objective. Based on National Development Planning System No.25/2004, in formulating RPJMN all stakeholders are involved, including local governments. The 2015-2019 RPJMN explicitly states that investment in Indonesia should be inclusive. This means that investment, including FDI, should be directed to promote inclusive growth. The 2015-2019 RPJMN is the first document to state that investment should lead to inclusive growth. Therefore, analyzing the role of the district government in formulating RPJMN is crucial because it discloses whether inclusive institutions exist in the planning process of RPJMN, which includes investment plans.

Based on Law No.25/2004, five approaches should be applied to formulate RPJMN: political, technocratic, participative, top-down, and bottom-up approaches. The political approach means that development planning should refer to the elected president's campaign visions and missions. The technocratic approach means that a preliminary RPJMN should be formulated based on a technocrat's research and analysis. The preliminary development plan should be communicated by the central government to local governments. The regional development plans should refer to RPJMN. The planning process from national to local governments is called a top-down approach. The RPJMN should also accommodate the aspirations of local governments and the other stakeholders, the so-called bottom-up approach. These five approaches should be adopted in formulating the RPJMN. The existence of inclusive institutions is represented by the bottom-up approach, where district government is involved in the planning process.

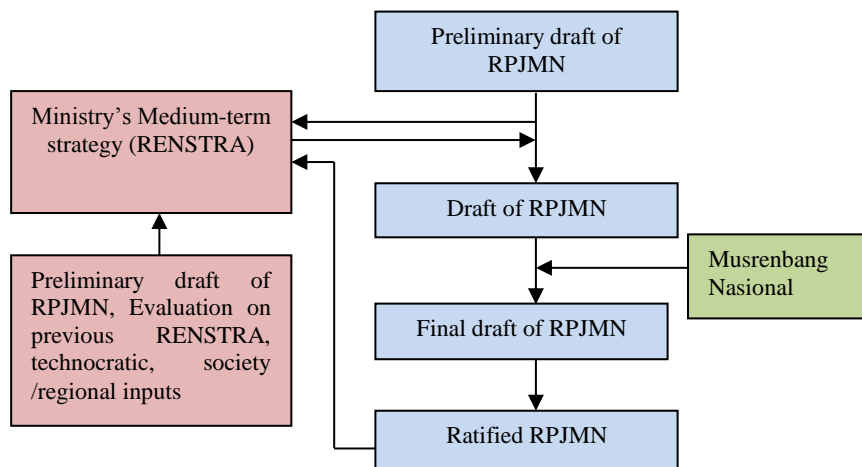
According to the guide for RPJMN formulation, there are four stages in the RPJMN process (see figure 5.2). The first stage involves production of a preliminary draft of RPJMN by the National Development Planning Ministry (Bappenas). The preliminary draft for the next year's RPJMN is prepared in the last year of the current RPJMN. The preliminary draft of the RPJMN is based on a technocratic process, which should begin about two years before the current RPJMN is to end. The technocratic process includes evaluation of previous RPJMN implementation, the visions and missions of the elected president, and the aspirations of society. The preliminary draft of RPJMN describes

general governmental policies, development strategies and the president's priority programs, and provides a macroeconomic framework.

After completion of the preliminary draft of the RPJMN, the second process is to prepare the final draft. The preliminary draft is presented during a cabinet meeting, in which ministers should refer their ministries' medium-term plans (Renstra) to the draft of RPJMN. During the cabinet meeting, ministries provide further inputs for the preliminary draft of RPJMN. The inputs of ministries are prepared based on technocratic analysis and local government aspirations related to the authority of the ministries. With respect to FDI, the Investment Coordinating Board (BKPM), which has authority to manage investment in Indonesia, provides inputs about their investment agenda to the preliminary draft of RPJMN. The inputs of BKPM are based on the aspirations of local governments in the Regional Development Forum, known as Musrenbang Regional. After accommodating inputs from the ministries, the draft of the RPJMN is finished. Further, BKPM should also refer to RPJMN in formulating its medium-term investment plan (Renstra).

The third process is to establish a final draft of the RPJMN. In order to produce the final draft, the draft is distributed by Bappenas to the local governments in the National Development Forum, known as Musrenbang Nasional. In the Musrenbang Nasional, the central government represented by Bappenas discusses the draft of RPJMN with all stakeholders to produce the final draft. Local governments represented by provincial governments can provide inputs for the final draft of RPJMN based on the situation in their regions and aspirations of their society. In the Musrenbang Nasional Forum, Bappenas also synchronizes the agendas of RPJMN with those of the Provincial and District Medium-Development Plan. Synchronization of development plans is aimed to enhance the congruity between the national development plan and regional development plans.

The last process is to ratify the RPJMN after accommodating inputs from local governments in Musrenbang Nasional. Bappenas as a coordinator has the task of accommodating and analyzing inputs from local governments gathered from Musrenbang Nasional. Afterward, the final draft will be discussed with the ministries and submitted for approval by the President.



Source: Author's adjustment based on National Development Ministry regulation No.1/2014

Figure 5.2. Process of Indonesia's Medium-Term Development Plans (RPJMN)

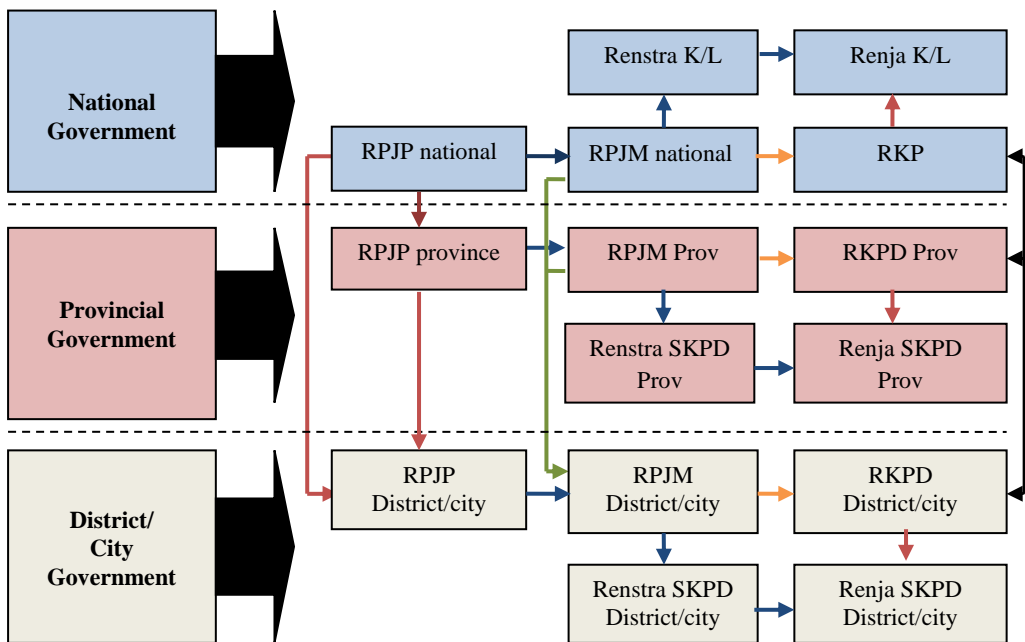
As Indonesia's government consists of three jurisdictions – national, provincial, and district – coherence among the policy objectives in development planning at different government levels is required (European Commission, 2009). Based on Law No. 25/2004 on the National Development Planning System in Indonesia, the priorities of local governments in regional development plans should be consistent with those in the national government's development plan. Since one priority of national government in RPJMN is to achieve inclusive growth, local government should have the same priority in their medium-term development plan (RPJMD). In addition, since investment, including FDI, is directed to achieve inclusive growth based on the 2015-2019 RPJMN, the regional plans on investment at province and district levels should also be directed to achieve inclusive growth.

The above process of formulating RPJMN can also be seen as the process of formulating and investment plan involving FDI because RPJMN states the direction of the national government's programs for investment. Referring to the planning process above, regarding foreign investment plans government actors are involved in the process at national and local levels. At the national level, Bappenas and BKPM are the main actors who have the authority to plan investments, including FDI. At the provincial level, the key actors are the Provincial Development Planning Agency (Bappeda Provinsi), the other Provincial Government Working Units (SKPD Provinsi), and Provincial Investment Unit (PDPPM). At the district level, the key actors are the District

Development Planning Agency (Bappeda Kabupaten/Kota), the other District Government Working Unit (SKPD Kabupaten/Kota), and the District Investment Unit (PDKPM).

Having the above approaches and stages of the RPJMN planning process, it is expected that an investment plan including FDI at a national level will be in coherence with investment plans at provincial and district levels. More understanding about the relationship among government development plans in Indonesia is provided in figure 5.3. Based on the figure, the national long-term development plan (RPJP) is the highest level of development planning for Indonesia. RPJP will become a reference for the provincial and district governments in formulating their long-term development planning (RPJP Province and District). In addition, RPJP at each level of government will provide guidelines for each government level's medium-term development plans – RPJM national, RPJMD province, and RPJMD district.

At the national level, RPJMN should be the model for formulating the Strategic Medium-Term Plan of Ministries (Renstra K/L), including the Renstra of BKPM, which contains the government plan for investment, including FDI. As already mentioned, since investments are directed at achieving inclusive growth (inclusive investment) in the 2015-2019 RPJMN, BKPM's Renstra should be directed at achieving inclusive investment as well. In addition, referring to BKPM's Renstra at the national level, the investment plan of provincial and district governments should be aimed at achieving inclusive investment. The 2015-2019 RPJMN is described into the annual development plans at national (RKP) which is synchronized to the annual development plans at provincial (RKPD Provinsi), and at district (RKPD Kabupaten/Kota) levels.



Source: Author’s adjustment of Ministry of Bappenas regulation No.1/2014 on guidance for formulating a national medium-term development plan (RPJMN) 2015-2019

Note: RPJP is a long-term development plan, RPJM is a medium-term development plan, Renstra K/L is ministry and non-ministry’s medium-term planning, Renstra SKPD is a strategic medium-term plan for regional unit work, RKP is an annual national government development plan, RKPD is an annual regional government development plan, Renja K/L is an annual working plan for ministry and non-ministry, Renja SKPD is an annual working plan for regional unit work. Reference (→), guidance (→), description (→), synchronization (↔), attention (→).

Figure 5.3. Coherence among government levels’ development plans

The explanations above show that district government is involved in the planning process of RPJMN, which also includes an investment plan. The involvement of district and provincial governments in the planning process is expected to enhance coherence among investment plans at national, province, and district levels. Since investment, including FDI, is in the RPJMN directed at achieving inclusive growth, this should also be the priority of provincial and district governments. Moreover, based on the explanations above, district governments can contribute by expressing their interests in the two forums: Musrenbang Regional and Musrenbang Nasional. Such involvement of district governments in the process of formulating the RPJMN and the Investment Plan indicates that district government plays a “joint role”, showing that inclusive institutions

have been adopted. We will next explain the actual practice of the process of RPJMN and investment planning, based on in-depth interviews with stakeholders.

In practice, the process of RPJMN planning had been implemented for the 2015-2019 RPJMN, which includes the objective of achieving inclusive investment. Based on an in-depth interview, Bappenas had facilitated the two forums – Musrenbang Regional and Musrenbang Nasional. The two forums are aimed at socializing the initial draft of RPJMN from the central government to local governments. Moreover, in the forums, national government accommodates the aspirations of local governments, including provincial and district governments, for the RPJMN. The process of socializing the draft of RPJMN is called a top-down approach, while the process of accommodating the aspirations of district governments is called a bottom-up approach.

The Musrenbang Regional was held by Bappenas in December 2014 in five regions – Sumatra, Sulawesi, Java-Bali-Nusa Tenggara, Kalimantan, and Maluku-Papua¹³. The Musrenbang Regional was attended by representatives of central, provincial and district governments, and also societies. At Musrenbang Regional, the ministry of Bappenas explained the draft of RPJMN and the other ministries explained their policies and targets. Then local governments – provincial and district, religious leaders, and academics had an opportunity to add their aspirations as inputs to the draft of RPJMN.

Another forum facilitated by Bappenas to accommodate the local governments' aspirations is Musrenbang Nasional. Related to the formulation of the 2015-2019 RPJMN, the Musrenbang Nasional was held after implementation of Musrenbang Regional. Unlike Musrenbang Regional, which was held in a selected province, the Musrenbang Nasional was held in Jakarta, the capital of Indonesia. The provincial and district governments were invited to the Musrenbang Nasional, where the President of Indonesia presented the general policies of the RPJMN draft. Then there was opportunity for both provincial and district governments to give their input to the draft of RPJMN. The aspirations of local governments expressed at Musrenbang Regional and Musrenbang Nasional were compiled and analyzed by the national government to see whether they could be accommodated in the final draft of RPJMN 2015-2019.

Specifically for investment plans, BKPM as the agency responsible for managing investment, including FDI, also formulates its strategic five-year plans, the so-called Renstra, referring to the investment agendas stated in RPJMN. In order to formulate Renstra, BKPM facilitates forums to accommodate the aspirations of local governments and other stakeholders. According to interviews, BKPM invited both provincial and district governments to the forum to express their aspirations in formulating the Renstra. However, one interviewee from central government said that “only provincial

¹³ Bappenas. 2014. *Rangkuman Musrenbang Wilayah Jawa, Bali, dan Nusa Tenggara*. Retrieved from <https://bappenas.go.id/index.php?cID=4981>

government levels are invited to the forum of BKPM, because there are too many districts”.

Besides facilitating forums aimed at planning Renstra, BKPM also has regular forums in order to interact regularly with local governments, both provincial and district. The two forums held by BKPM are the National Investment Consolidating Forum (KP3MN) and the Regional Investment Forum (RIF). The KP3MN is aimed at coordinating with local governments about investment plans and their implementation. Meanwhile, the RIF is aimed at assessing the investment prospects of each region. In the two forums, provincial and district governments have an opportunity to express their aspirations and present their regions’ investment prospects. The existence of the two forums indicates that central government involves district governments in the planning process of investment at the national level, including planning for FDI. Based on our theoretical framework, this involvement of district governments in the planning process indicates the existence of institutions aimed at making investment inclusive.

The KP3MN forum has been held regularly by BKPM. For instance, in 2015, the KP3MN forum was held in East Java Province and attended by investment working units from all provincial and district governments¹⁴. Besides local governments, the ministries, ambassadors of partner countries, were also invited to the forum. The local governments were given an opportunity to raise questions and express their opinions about national government policies on investment. The involvement of district governments in the forum is supported by an in-depth interview as follows:

“In 2015, there was a forum facilitated by BKPM for local governments, including district governments, to socialize and receive inputs for evaluating investment plans. Moreover, during the forum there were group discussions about grant assessment and development, licensing services, and controlling. Some district governments provided inputs to formulate national investment policies.” (Badung District’s government official, Badung District, 26 May 2016)

According to the explanations above, district governments were involved in formulating national investment policy, also for FDI. These inputs by local governments can influence national investment policy. The effectiveness of the forum was mentioned in interviews:

“At that time, in 2013, in the KP3MN forum, local governments raised the issue of no standardization of investment structure at the local level. Eventually, to accommodate the inputs from local governments, Presidential Regulation No.90/2014 on Investment

¹⁴ Junida, A.I. (2015, April 10). Jalin harmonisasi pusat-daerah, BKPM akan gelar KP3MN. Antara News.com.

and License Board was enacted.” (Badung District’s government official, Badung District, 26 May 2016)

However, based on interviews with East Java Province’s and Tangerang District’s government officials, most interviewees argued that the forums for investment planning were only a formality, as indicated by aspirations of district governments which probably have no impact on investment plans. There are four issues related to the ineffectiveness of forums like Musrenbang and other investment forums: time constraints, money-motivated participation, unclear follow-up of aspirations, and lack of human capital capacity.

The first issue is a time constraint. Based on an interviewee from the central government, time was insufficient to invite and accommodate all of local governments’ aspirations in the forums facilitated by central government. For RPJMN planning, the central government attempts to have some meetings, such as a quarterly meeting between Bappenas and local development planning agency (Bappeda), before holding the Musrenbang Nasional. The quarterly meeting is aimed at discussing inputs from local governments related to ministries’ priorities and programs (Bappenas, 2014). Then, after RPJMN is ratified, BKPM must describe the investment strategies of RPJMN into BKPM’s strategies for the next five years (Renstra). BKPM needs to finish its medium-term investment plan within two months after RPJMN is ratified. Therefore, because of these time constraints, BKPM does not involve local government in formulating Renstra. Moreover, since Renstra refers to RPJMN, which has already accommodated the aspirations of local governments, BKPM need not involve local governments in formulating its Renstra. This was mentioned during an interview with a BKPM representative, as follows:

“With the limited time, it would take time to ask inputs from district governments. BKPM assumed that RPJMN had already accommodated local government inputs. Hence, referring Renstra to RPJMN, BKPM does not need to accommodate local governments’ inputs again. Only provincial governments are involved because it is too much to cover 500 districts in one forum.” (Central government official, Groningen, 4 August 2016)

Interviewees from local governments – Tangerang, Mojokerto, and Badung Districts – also agreed that central government’s existing forums are not adequate to discuss problems faced by local governments. An interviewee from East Java province mentioned that:

“Too many local governments, both provincial and district governments, should be invited to one forum such as KP3MN. Hence, local governments cannot provide and discuss their aspirations.” (East Java Province’s government official, Surabaya, 11 May 2016)

In addition, the differing times for electing local government leaders and president make it difficult to synchronize national and regional development plans. Moreover, a mismatch between the vision and mission of local government leaders and those of the president is another problem in promoting coherence between national and regional development plans. The different times for local and presidential elections was mentioned during an interview:

“Different times for elections among levels of government could be the main problem in reaching coherency among development planning documents. Therefore, the central government attempts to have election of local leaders in one time.” (Central government official, Groningen, 28 July 2016)

The second reason for the ineffectiveness of the existing forums is money-motivated participation. In forums like Musrenbang Nasional and Regional, local governments only discuss programs which are national and can be financed by the national government budget, in other words, priorities and programs related to national development plans. There is not enough time to hear the aspirations of local governments. However, the interviewee mentioned that the existing forums are still necessary for local governments to socialize the priorities and programs of national development. .

The third reason for the ineffectiveness of the government forums is the national government’s unclear follow-up of local governments’ aspirations. Most interviewees from local governments agreed that the forums focus only on central government policies, including investment policies. Although there input is proposed raised in the forums, the follow-up is not clear. This makes local governments less likely to express their aspirations for the national development plan during the forums. Most of them prefer informal discussions with central government. However, another interviewee mentioned that this is also not effective.

“Even informal consultation and discussion do not ensure that local government’s aspirations will be accommodated. Local governments should find an effective link to influence central government policies. The aspirations of local government might be considered by central government when they are expressed by the local leaders.” (East Java Province’s government official, Surabaya, 11 May 2016)

Interviewees from central government realized that some inputs from local governments cannot be accommodated in the central government’s development plans. An interviewee explained this as follows:

“If central government feels that the activities are not in line with national priorities, those activities will not be approved.” (Central’s government official, Groningen, 31 July 2016)

In addition, from the central government’s perspective, during the forums, local governments were only interested in central government programs and activities which could be delegated to local governments. The existence of too many local governments makes it difficult to accommodate their aspirations. Therefore, interviewees from local governments suggested having more regional forums, to reach all regions in Indonesia.

The last reason behind the ineffectiveness of government forums is a gap in human capital capacity. Indonesia has a large diversity of government officials. Alm, et al. (2010) analyzed that Indonesia’s decentralization results in a problem of inequality in government capacity, especially at district levels. Because the capacity of local government is not sufficient, it has limited ability to analyze society’s needs when formulating plans and policies. Therefore, local government just uses the targets of central government. This was mentioned during an interview:

“Most local governments ask and wait for information about investment potency and targets from BKPM because they have no concept of and targets for investments.” (Central’s government official, Groningen, 4 August 2016)

The interviewee also mentioned that district governments have enough information about their own regions, but less capacity of human resources. This was supported by an interview presenting the district government’s perspective. District governments need more time to analyze the problems and issues in their regions. They also need time to understand the targets and strategies of national government.

“When central government socialized national targets and strategies for development, especially investment, we (district government) needed time to absorb and analyze the information. Hence, district governments usually do not raise questions and aspirations in the forums. We (district governments) will informally consult with the provincial government or directly with the central government.” (Tangerang District’s government official, Groningen, 20 December 2016)

According to these comments, district governments have their own approaches to communicate with central government (see figure 5.4). Based on the interview with one of government officials from Tangerang District, Tangerang District’s government prefers to communicate directly with central government rather than with the provincial government. The interviewee also said, “Sometimes the provincial government cannot answer questions raised by Tangerang District. Hence, with provincial permission,

Tangerang District directly communicates with central government”¹⁵. Meanwhile, Badung District government usually communicates and provides inputs to central government through the Bali Province government. This is another reason why district government does not get involved in BKPM’s forums – because Badung District government has already communicated with Bali Province government¹⁶.

Like Badung District government, Mojokerto District also has good communication with the government of East Java Province to provide inputs to central government. An interviewee mentioned that regular meetings are conducted by East Java Province to discuss issues and problems faced by district governments in the province. However, the interviewee emphasized that good coordination between district governments and provincial government depends on the district government’s effort. If district governments actively consult with provincial government, communication between the two will be easy. The interviewee mentioned that not all district governments do this. Consequently, to accommodate the aspirations from districts governments are only decided by central government.

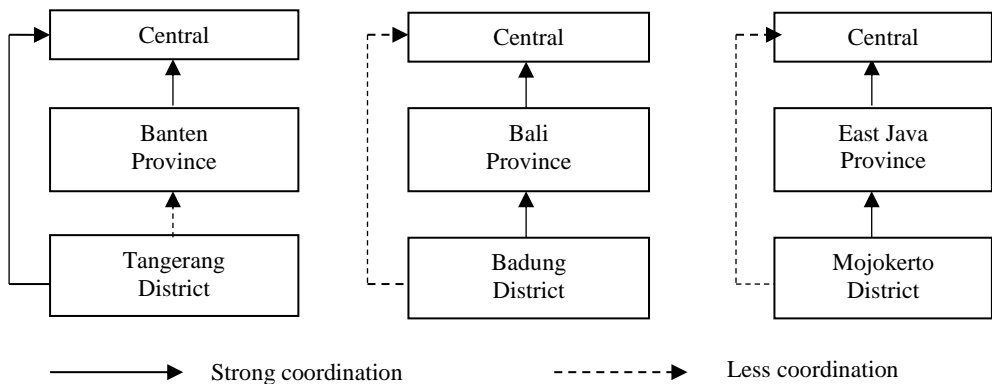


Figure 5.4. District government path to communicate with central government

In conclusion, based on regulations, central government should involve district governments in the planning process of the national development plan, including its investment plan. In practice, central government has facilitated forums to communicate national agendas and accommodate local government aspirations. However, central government forums are perceived as only formalities. Time constraints, money-motivated participation, unclear follow-up, and gaps in the quality of human resources are the main reasons behind the ineffectiveness of these forums. Therefore, even though

¹⁵ Tangerang District’s government official (Groningen, 20 December 2016)

¹⁶ Badung District’s government official (Groningen, 2 August 2016)

district governments have been involved in forums such as Musrenbang Nasional, Musrenbang Regional, KP3MN, and RIF, district governments still have no power to influence national policies, especially those related to foreign investment. Hence, local governments use an informal approach instead of the forums to communicate with central government. Badung District and Mojokerto District governments tend to communicate and coordinate their aspirations to national government through provincial governments. Meanwhile, Tangerang District government usually coordinates directly with central government. Unfortunately, in the end, local governments do not have power to influence national policies on investment. This authority lies with the central government. From the discussion above, in practice, in the planning process of foreign investment the district government plays the role of implementer. This contradicts the conclusions from analysis of regulations, which prescribe a joint role between local government and central government in the planning process for FDI. The next section will discuss the role of government in planning process of NIL.

5.3.1.2. The Role of District Government in The Process of Establishing NIL

As proposed in the theoretical framework in Chapter 2, the inclusiveness of institutions in multilevel governance is indicated by the involvement of local government in the planning process of FDI. The previous section analyzed the involvement of district government in the planning process of RPJMN. It also analyzed the role of district government in formulating national investment plans. This section will analyze the involvement of district government in formulating NIL. The NIL is another regulation of central government to manage investment in Indonesia by providing lists of open and closed business fields and certain conditions in the field of investment. The last amendments of NIL were stipulated in Presidential Regulation (Perpres) No.44/2016. Establishing NIL is required by Investment Law No.25/2007. Based on the mechanism of establishing NIL, the Coordinating Ministry for Economic Affairs (Menko Ekuin) is the coordinator of the formulation process. Menko Ekuin must form a team to execute the formulation process, and implementation is coordinated by BKPM. Unfortunately, the process of formulating NIL is not explained clearly in the mechanism. In addition, the role of district government in the planning process of NIL is not stated. Hence, based on our theoretical framework, district government can be categorized as an implementer of the NIL after it is ratified by central government.

In practice, based on interviews, the process of constructing the current 2016 NIL is similar to that used for the previous NIL, in 2014. Hence, the process of establishing NIL in 2014 is still relevant. Based on interviews, there were three steps in establishing NIL. The first was to formulate a preliminary draft two years before implementing a new NIL. To indicate the start of the process Menko Ekuin and BKPM sent a formal announcement to stakeholders. The stakeholders include ministries related to

investment, international private sector associations such as the American Chamber of Commerce and Industry, and private Indonesian association such as the Indonesian Chamber of Commerce and Industry (KADIN) and the Indonesian Entrepreneur Association (APINDO). These stakeholders could submit their inputs to BKPM and Menko Ekuin on several subjects: previous NIL evaluations, international agreements such as with the Asean Economic Community (AEC), and program priorities stated in the RPJMN. Among these subjects, RPJMN as a national development plan became a main issue in revising the NIL. This was mentioned during an interview, as follows:

“If one sector is the priority sector in RPJMN, NIL will be revised by opening the sector to foreign investors. In addition, in order to develop the sector, more capital is needed. If the policy on the priority sector is still restrictive, how can the sector be improved?”(Central’s government official, Groningen, 26 October, 2016)

Since RPJMN is a main subject for revising the NIL, the objective to achieve inclusive investment in the 2015-2019 RPJMN should be reflected in the 2016 NIL. Based on the earlier RPJMN, one way to achieve inclusive investment is by strengthening linkages between foreign investment and Micro-Small and Medium Enterprises (MSME). Consequently, the 2016 NIL was revised to open more sectors to foreign investments and have partnerships with MSMEs. However, based on interview results, the main problem here was limited information about the potential MSMEs. In addition, the criteria and monitoring mechanisms for partnership had not been clearly designed by the related ministry.

The second step in planning NIL is producing the final draft of NIL. After receiving input from all stakeholders, Menko Ekuin and BKPM evaluate the previous NIL and discuss all input from stakeholders at the bilateral and multilateral meetings. Establishing the final draft of NIL requires many discussions because each stakeholder has different interests. The meetings therefore included a process of negotiation among stakeholders (Hidayat and Paramitha, 2015). Consideration of the aspirations of all stakeholders when formulating NIL has been highly influenced by the democratic regime in Indonesia.

The last step is finalizing the final draft of NIL in the cabinet meeting before it is ratified. During the cabinet meeting, each ministry can check the final draft. Based on an interview, there will not be many changes because the final draft has already been reviewed in bilateral and multilateral discussions with related ministries and associations from private sectors. Subsequently the final NIL will be ratified by presidential regulation

In the process of formulating NIL, Menko Ekuin and BKPM are the coordinators. Related stakeholders such as related ministries and associations of private sectors are

also involved in the process. However, no local governments, either provincial or district, are involved in the formulation process of NIL. Based on interview results, central government does not formally request the input from provincial and district governments because establishing NIL comes under the authority of central government. However, if local governments have inputs, they can submit these sending an official letter to the central government.

To conclude, local governments are not involved in the process of NIL formulation. Hence, they are just implementers of NIL after it is ratified by central government. As explained in the theoretical framework, the involvement of local governments, especially district governments, is essential in the process of investment plans, including NIL. The involvement of district governments is one aspect necessary for institutions to promote FDI for inclusive growth. The next section will discuss the role of district government in the implementing stage of FDI.

5.3.2. Role of District Government in the Implementation Stage

As discussed above, the 2015-2019 RPJM promotes investment, including FDI, to achieve inclusive growth. Based on the regulations, district government should have an important role in planning investment, in cooperation with central government. However, in actual practice, district government has but a limited role in the planning process of FDI through RPJMN and DNI. This section will provide an analysis of the role of district government in the implementation stage. Implementation includes the policies of government in attracting FDI, issuing investment licenses, providing facilities, and regulating CSR programs. The objective here is to examine the role of each policy of the district government in managing FDI to achieve inclusive growth. As suggested in our theoretical framework, inclusive institutions, represented by the involvement of district government in managing FDI, are required to achieve inclusive growth. The analysis is based on a review of regulations and the results of in-depth interviews.

5.3.2.1. Attracting FDI

Based on the 2015-2019 RPJMN, foreign investments are required to finance savings investment gaps and for development. Moreover, according to Investment Law No.25/2007 (article 3), investment is directed to drive economic growth, create employment opportunity, generate economic linkages to society, and improve the welfare of society. By this law investment, including FDI, is directed toward providing FDI-inclusive growth channels, as suggested in the theoretical framework. In order to attract FDI inflows, improvement and promotion of the investment climate are considered to be imperative (Law No. 25/2007, article 4). Based on the General Planning of Investment (RUPM) and the 2015-2019 RPJMN, the investment climate can be

improved by strengthening the quality of institutions and enhancing coordination between national and local government.

To improve investment climate, the Indonesian government created an integrated one-stop service center (in Indonesian, *Pelayanan Terpadu Satu Pintu* (PTSP)) at BKPM. This new service aims to simplify licensing procedures for investment projects. The PTSP was developed based on a presidential instruction issued by President Widodo (28 October 2014) in an effort to create a more conducive investment climate. The PTSP consolidates the processing of main business licenses from separate ministries into one location, and aims to provide faster, simpler, and cheaper licensing services for firms. The presence of PTSP allows firms to avoid visiting many different ministries to obtain permits, and this should reduce registration costs. The centers also aim to streamline business licensing by integrating the authority to issue licenses, commonly located in disparate ministry offices, into one government department (Steer, 2006). Currently, the program is supervised by Indonesia's Investment Coordinating Board (*Badan Koordinasi Penanaman Modal*, or BKPM).

The PTSP is also established at provincial and district levels to strengthen coordination between PTSP at national and local governments. The PTSPs in provincial and district governments are called as DPMPTSP (*Dinas Penanaman Modal dan Pelayanan Terpadu Satu Pintu*). The objective of DPMPTSP is to simplify licensing procedures for investment at local levels to improve the regional investment climate. The DPMPTSP integrates investment-related working units at provincial or district levels into one office. The presence of DPMPTSP at provincial and district levels is also expected to improve vertical coordination between local and national governments in managing investment licenses.

With regard to investment promotion, based on Law No.23/2014 and the Head of BKPM Regulation No.25/2013, the BKPM in cooperation with other related ministries is responsible for investment promotion at the national level. At the provincial level, each provincial investment unit (PDPPM) is also responsible for conducting investment promotion for its province, including all districts/cities. Meanwhile, at the district level, each district investment unit (PDKPM) has the responsibility to promote its districts to attract foreign investments. In conducting investment promotion, national and local governments should consider the objective of achieving inclusive investment, as stated in the 2015-2019 RPJMN and the list of business fields open to foreign investment with the stipulation that they collaborate with MSMEs. National and local governments can collaborate to design national investment maps and provide information on the potential investments of the regions in Indonesia.

In summary, based on the laws and regulations, in attracting FDI, central and local governments have the authority to improve the investment climate through PTSP and

DPMPTSP, respectively. As already mentioned, the purpose of PTSP and DPMPTSP is to simplify the procedures of investment licenses, reduce costs, and shorten the time of investment administration. Meanwhile, with regard to investment promotion, governments at provincial and district levels can independently conduct investment promotion to attract foreign investments to their regions. Therefore, referring to how the role of district government in simplifying procedures for investment licenses should be categorized, district governments play a “joint role” because they should coordinate with provincial and central governments through PTSP and DPMPTSP. In investment promotion, district governments play a “dominant role” because they can independently conduct investment promotion for their own regions.

In implementation, the main problem faced by the Indonesian government in improving the investment climate through PTSP is the lack of coordination between national and local governments related to investment licenses (KPPOD, 2017). This is indicated by the presence of overlapping investment policies between national and local governments. In addition, at local levels, the government working units related to investment tend to be reluctant to transfer their authorities to DPMPTSP. Therefore, based on the data of 2016, 50 out of 542 districts/cities in Indonesia had not yet established PTSP in their regions. Moreover, the presence of bribery in dealing with local governments to get business licenses is a serious problem faced by the Indonesian government in trying to improve the investment climate. In terms of the MLG theory, in this case district government plays a dominant role in the effort to enhance the investment climate. Consequently, there is a lack of coordination between local and central governments, which increases uncertainties for investors. As suggested by the theoretical framework, lack of coordination among governments indicates that inclusive institutions are not present to promote foreign investment for inclusive growth.

Regarding investment promotion, based on in-depth interviews, district governments were not able to independently carry out investment promotion for their own regions because most of the regions interviewed have only a limited budget for this. As a result, district governments prefer to cooperate with provincial and central governments in promoting their regions to investors. For this purpose district governments can provide information about the potential investment sectors of their regions to provincial and central governments. District governments are also invited by provincial and central governments to promote their own regions at investment events. For example, Badung District and Bali Province governments were invited by BKPM to present their investment potentials to foreign investors at an investment forum. Meanwhile, provincial governments can also carry out investment promotion for all districts in their provinces at international investment events. For instance, East Java Province government in cooperation with the Indonesian Embassy for the Netherlands

held a one day investment event called the East Java Investment Business Forum in the Netherlands on December 15, 2016¹⁷. At the forum, the chairman of East Java Province Investment Board presented the potential investment sectors of its region to foreign investors in the Netherlands. Investors who were eager to ask specific questions could have a meeting with East Java government officials during a special discussion section. Based on an interview with Dutch investors, the forum was beneficial and informative because beforehand the investor had no information about the investment climate, procedures, and potential investment sectors in Indonesia, especially in East Java Province.

Therefore, based on the discussion above, district government has good collaboration with provincial and central governments in conducting investment promotion. Based on the MLG theory, district government plays a “joint role” with provincial and national governments in promoting its regions. Currently, the Indonesian government has the Indonesia Investment Promotion Center (IIPC), which is the official representative of BKPM in charge of promoting Indonesian investment to potential investors abroad. The main tasks of the IIPC are increasing investments from foreign countries into Indonesia and facilitating investments from Indonesia into the other countries.

5.3.2.2. Providing Investment Licenses

In order to starting business in Indonesia, foreign companies should apply for investment licenses. Based on Law No.25/2007 and the Head of BKPM regulation No.12/2013, two investment licenses are required to start business in Indonesia: a principle license (Izin Prinsip) and a business license (Izin Usaha). A principle license is the initial permission from BKPM that allows foreign investors to invest (but not yet operate) in Indonesia. On the principle license, the total amount of the investment should be presented to BKPM as part of the investment plan. After obtaining a principle license, in order to conduct business activity, the foreign investor should obtain a business license, which is mandatory for investors in Indonesia. The business license is becoming critical to companies because it legalizes their business activities in Indonesia.

In order to obtain a business license, foreign investors are required to submit an investment realization report (LKPM) regularly every three months. The LKPM is aimed to ensure that the investor realizes the initial investment plan stated on the principle license. In addition, to obtain a business license, the foreign investor has to get permits from both provincial and district governments. The local permits include a location permit, an agreement on area utilization, a building construction permit, an

¹⁷ the author also attended the event on 15 December 2016 held from 09.00-14.00 at NH hotel, Schiphol, the Netherlands

occupancy worthiness permit, and an environmental permit. Issuing local permits is the authority of DPMPTSP at both provincial and district/city levels. After investors fulfill all requirements, PTSP at the national level provides them with a business license. Therefore, based on our review of the investment licenses required, district and provincial governments play an important role in issuing local permits. As suggested by the MLG theory, district and provincial governments play a “joint role”, coordinating with national government in providing business licenses.

According to the results of in-depth interviews with BKPM officials and district government officials in Badung, Mojokerto, and Tangerang, the district government has a strong authority in providing local permits. The district government will issue local permits if the investors fulfill all requirements. The strong role of district government in providing local permits is mentioned by a Badung District government official, as follows:

“The Indonesian investment board (BKPM) only provides a recommendation for foreign investors to invest in Indonesia by issuing a principle license...In the principle license, there is information on the value of the foreign investors’ investment...no location of investment stated...and there is a statement that investors should follow local regulations. Therefore, if the location of the foreign investor’s operation does not suit local regulations, they should find other locations.” (Badung District’s government official, Badung District, 25 May 2016)

The strong role of district governments in approving local permits was also supported by statements of a BKPM official:

“Local governments have the authority to close foreign investors’ business operations when foreign investors’ business operations violate local regulations. Afterwards, the Indonesian BKPM has the authority to revoke the foreign investors’ investment licenses.” (Central’s government regulation, Groningen, 14 August 2016)

Regarding the issuing of local permits, the interviews with district government officials strictly refer to the Regional Spatial Plan (RTRW) at the district level, which proposes strategies to implement choices related to land-use, natural resources, settlement, and infrastructure. The RTRW is needed to regulate space utilization to overcome competition and conflict between different utilizations within a limited area. The RTRW also reflects the aspirations of stakeholders, such as government, society, and private sectors. Based on Indonesian Law No.26/2007 on Spatial Plans (article 26), a District Spatial Plan (RTRW) is a long-term plan, in place for 20 years, but it can be revised every 5 years. If foreign investors and governments violate the RTRW in providing local permits, there will be financial punishment and imprisonment. Therefore, district governments strictly follow the RTRW in issuing local permits. This

was mentioned by a Badung District government official during an interview, as follows:

“All investment permits, such as location permits, agreements on area utilization, and building construction permits are related to the RTRW. Therefore, the district’s RTRW is a plan which regulates investment permits.” (Badung District’s government official, Badung District, 25 May 2016)

District governments are reluctant to provide local permits for foreign investors if they cannot match their business, location, and other requirements with the RTRW. Based on an interview, for instance in Mojokerto District an investor wanted to invest in the hotel business. However, the location was not in line with the Mojokerto District’s RTRW. Consequently, Mojokerto District government could not provide a location permit for the investor. Otherwise, the district government would be punished. In this case, BKPM could not interfere with the decision of the district government. A similar case was found in Badung District, where a foreign company running a business in the industrial sector had a location outside the industrial area. The location of the company violated the RTRW. As a result, the district government could not provide a location permit for the company until the problem was solved. The interviewee suggested revising the location on the principle license or changing the RTRW. The later solution was less likely to be executed because changing the RTRW needs approval from all stakeholders, including government, private sectors, and society.

The examples above indicate that district government plays a “dominant role” in providing business licenses for foreign investors. District governments decide independently (only in regard to the RTRW) whether local permits can be provided for investors. In this case there is a lack of coordination between district and central governments. This lack of coordination in providing business licenses creates uncertainty for investors. As suggested by the theoretical framework in Chapter 2, such lack of coordination implies that there are no inclusive institutions to ensure the voice, involvement, and accountability aspects of district government in providing local permits. The absence of inclusive institutions in business license provision blocks the efforts of district government to promote FDI for inclusive growth. In addition, such lack of coordination has a negative impact on the investment climate.

Besides inappropriateness of business locations in relation to the RTRW, lack of coordination between district and central governments is shown by a mismatch between a principle license issued by BKPM and its actual implementation. According to an in-depth interview with the DPMPSTP of Tangerang District, there was a case in which a foreign investor obtained a principle license from BKPM. The principle license stated that the location of the business should be in an industrial area. However, the foreign

company would operate outside the industrial area. Although the location of the company outside of industrial area was in line with the RTRW, the district government could not provide a location permit because the location was different than what was stated on the principle license. The interviewee suggested that the company find another location in an industrial area or approach the central government to revise the principle license. This case showed that there was no coordination between local and central governments in business license provision. The next section will discuss the role of district government in providing investment facilities, based on regulations and actual practice.

5.3.2.3. Providing Investment Facilities

According to Investment Law No.25/2007, foreign investors have the right to receive investment facilities from national government through the Ministry of Finance and other related ministries. These investment facilities include a reduction in income tax, freedom from import duties, ease of land access, and import licenses. In addition, based on Government Regulation No.45/2008 on Guidance of Incentive Provision, provincial and district governments can also provide facilities to companies, such as a reduction in local taxes and retributions, ease of land access, and technical assistance. In order to receive facilities from governments, foreign investors are required to fulfill several criteria. The foreign investor is required to employ local workers, increase local income, use local content, contribute to sustainable environment, provide technological/knowledge transfer, and cooperate with MSMEs. These requirements actually match the channels of FDI to inclusive growth suggested in our theoretical framework in Chapter 2. Therefore, based on regulations, both national and local governments have a vital role in promoting FDI for inclusive growth through providing facilities.

However, in practice, this role of the district government is constrained by a limited budget. Because of this the district government is less likely to provide investment facilities, especially fiscal facilities, to companies. The central government is more likely than local governments to provide fiscal facilities, such as tax reduction and freedom from import duties. Based on an interview, the district government tends to provide non-fiscal facilities, such as easier and faster investment procedures. For instance, Badung District Government offers easier investment procedures if the investors conduct a Corporate Social Responsibility (CSR) program. The criteria and mechanisms of CSR are mentioned in Badung District Government Regulation No.83/2013 on CSR. CSR programs held by the company must be consistent with the priority of the Badung Development Plan to improve the quality of human resources through education and health. This is an example of the role of district government in promoting FDI for inclusive growth through provision of investment facilities.

5.3.2.4. Managing the Corporate Social Responsibility (CSR)

As explained in the theoretical framework in Chapter 2, the CSR program is one of the channels through which FDI can contribute to inclusive growth. Based on Law No.25/2007, both domestic and foreign investors have the responsibility to conduct CSR programs. However, according to Law No.40/2007 on Limited Liability Companies (article 74), CSR should be conducted by companies involved in businesses related to natural resources. Meanwhile, according to Government Regulation No.47/2012 on Social and Environmental Responsibilities of Limited Liability companies, all companies have social and environmental responsibilities (article 2). Here is inconsistency regarding the obligations of the company to provide a CSR program. Based on the law, the authority to regulate the CSR program is in the hands of central government. The authority of local governments to manage CSR programs by companies is not mentioned.

Although the law does not mention the role of local government in regulating the CSR programs of companies, district government regulates CSR programs through local regulations. For instance, Badung District government enacted Badung Regulation No.6/2013 and Head of Badung District Regulation No.83/2012 to deal with the obligation of companies in its region to provide CSR programs. Based on these regulations, companies, including foreign companies, can provide CSR programs by empowering society, enhancing partnership, and developing a sense of community. In addition, FDI can choose the type of its CSR program but it has to consider the development priorities of Badung District government. Unfortunately, not many district governments have regulations related to managing CSR programs. Hence, based on the explanations above, both national and district governments have a responsibility to regulate the CSR programs of a company. However, since district government is not required to coordinate with central government in managing CSR, the role of district government in CSR programs is categorized as “dominant”.

In practice, based on an in-depth interview, district government can cooperate with provincial and central governments in conducting CSR programs. For instance, Badung District government, in cooperation with foreign companies and central government, successfully implemented a CSR program, called One Village One Product (OVOP). The OVOP program was initiated by The ICDF (The International Cooperation and Development Fund) from Taiwan, in collaboration with the Ministry for Cooperatives and Micro Small-Medium Enterprises. The Ministry informed and assisted all district governments in Indonesia to get financing for CSR programs. To receive financing, Badung District government had to design a program which would contribute to society, and especially poor people.

Badung District government had to compete with other regions in Indonesia. Eventually, Badung District won the competition and received financing to plant asparagus as a potential product in Pelaga Village. Through this program, Badung government empowered farmers in Pelaga village. The program was successfully implemented and asparagus was produced to supply the demand of hotels and restaurants in Bali. The program was implemented for 5 years, from 2010 to 2014. Afterward, the farmers continued the program independently without receiving funds from ICDF Taiwan. Considering the prospects of the program, Badung government supported the promotion of asparagus products, not only for domestic markets but also for international markets. This collaboration is an example of how district government can play a “joint role”, having cooperation with central government and foreign investors to conduct a CSR program. The role of district government in the controlling stage of investment will be discussed in the next section.

5.3.3. Role of District Government in the Controlling Stage

Our theoretical framework suggested the importance of inclusive institutions in promoting FDI for inclusive growth. Inclusive institutions are represented by the involvement of district government in public policy processes related to FDI (from planning to implementing and controlling) to achieve inclusive growth. In the previous sections we have analyzed the role of district government in the planning and implementing stages. This part will examine the role of district government, together with provincial and central governments, in controlling the performance of foreign investment. The controlling stage consists of monitoring, educating, and supervising – and is aimed at overcoming the gap between the initial investment plan (RKPM) as stated on the principle license and the realization of investment (Head of BKPM Regulation No.3/2012). In addition, reporting RKPM regularly to the government is a way for government to control the performance of foreign investors.

Based on the Head of BKPM regulation, in the monitoring process, all levels of government share the responsibility to monitor the realization of investment. Foreign investors should submit RKPM regularly to all levels of governments – district, provincial, and central. Central government, through BKPM, will verify LKPM and coordinate it with the relevant ministries. At the local level, district government through PDKPM and provincial government through PDPPM are also involved in verifying LKPM. When governments find a gap between the realization of investment on RKPM and the initial plan of investment, a further educating process is undertaken by the government.

According to the regulation, in the educating process, national, provincial, and district governments have important roles. At the district level, the educating process is organized by PDKPM, at the provincial level it is organized by PDPPM and at the

national level it is organized by BKPM. All government levels discuss the main constraints faced by foreign investors. Moreover, in the education process, governments socialize and offer foreign investors consultation about correct procedures of investment. If foreign investors still cannot fulfill the requirements and procedures, the district government are to report to provincial or national government. Afterward, the foreign investors enter a process of supervision.

In this process, after district and provincial governments have found a foreign investor unable to fulfill the requirements, both governments have equal opportunity to suggest to the central government an administrative punishment for the foreign investor. Without recommendations from district and provincial governments, the central government can also directly give punishment if complaints from society about foreign investment are reported directly to central government.

Considering the controlling process above, all levels of government – national, provincial, and district – have an equal role in controlling the progress or performance of foreign investors. District government cooperates with provincial and central governments in controlling the realization and the performance of investment. Therefore, in the controlling stage, district government can be categorized as playing a joint role. This indicates that the institutions at the controlling stage are inclusive, as district government is involved by central government in controlling the performance of FDI.

In practice, based on in-depth interviews, central government (BKPM) has full responsibility to monitor foreign investors. However, BKPM has insufficient time and human resources to control all foreign investments in Indonesia. Therefore, BKPM decentralizes its task to provincial governments in order to control and reach all foreign investors. BKPM also provides financial supports for this purpose. Provincial governments also coordinate with district governments to control foreign investors in their regions. The coordination between central, provincial, and district governments in controlling foreign investment was mentioned during an interview, as follows:

“Deconcentrated funds are provided for provincial levels. The funds are aimed to help national government (BKPM) in collecting the realization investment report (LKPM) from the companies. For that purpose, the provincial government should coordinate with district/city governments.” (East Java Government official, Surabaya, 11 May 2016)

Based on in-depth interviews, district governments also have an important role in controlling the performance of foreign companies, together with provincial and central governments. For instance, Tangerang District government accompanied provincial and central government officials to directly control foreign companies in its region. Meanwhile, in Badung District, central government and Bali Province government sent

a letter directly to foreign companies which had not reported their investment progress. The letter was also sent to Badung District government. In the letter, foreign companies were given an additional 3 months to report their investment progress; otherwise their principle licenses would be revoked. After receiving the letter from central government, Badung District government visited the foreign companies to monitor and assist them. Afterward, Badung District government was to report the evaluation results to the central government and give suggestions to provincial and central governments as to whether the principle license of the foreign company should be revoked. The role of the district government in controlling the performance of foreign companies and suggesting the possibility of punishment was mentioned by interviewee as follows:

“Local government, including district government, can stop foreign companies’ business if the foreign companies are committing an offense. However, only the investment board (BKPM) can revoke foreign companies’ principle investment license. When there is a serious offense, such as manipulation of environmental impact analyses (AMDAL), the district government can write a letter to BKPM to recommend the possibility of punishment for the foreign investor. Afterwards, some delegations from BKPM will directly investigate the company. If BKPM has found that a district government’s suggestion for revocation makes any sense, BKPM will revoke the foreign company’s principle business license.” (Central’s government official, Groningen, 4 August 2016)

However, based on an in-depth interview, the process of controlling foreign companies by district and provincial governments is limited by a lack of funds and human resources. As a large region with large numbers of companies, Tangerang District requires more funds than the smaller regions. Moreover, a government official from East Java Province also explained that the funds provided by central government to control foreign companies’ investment progress are not sufficient. This is because East Java Province has a big area and large number of foreign companies. In addition, the limited number of human resources keeps the district government from controlling the performance of foreign investors. Consequently, many companies, including foreign companies, cannot be monitored directly by governments.

Besides lack of funds and human resources, lack of coordination among government levels is also a main challenge faced by governments in controlling the performance of foreign companies. According to an in-depth interview, foreign investors usually only report their business activities to central government since the companies expect that the investment report will be passed on to provincial and district governments. However, there is lack of coordination among levels of governments in controlling the progress of investment. Based on an interview, controlling investment

progress depends on the initiative of district government to request regular data from provincial and central governments:

“Before I worked for this working unit in 2014, there was no monitoring and controlling of investment activities. Afterwards, I actively coordinated with provincial and central governments. Actually, we only need information on the principle license lists provided by the central government, which indicate the number of foreign companies that will come to our region. Therefore, we can check the activities of companies from the beginning of their investment, such as having an office or not. Further, district government can assist foreign companies and monitor their investment progress.” (Badung District’s government official, Badung District, 26 May 2016)

Moreover, lack of coordination happens not only among government levels, but it also occurs among the working units at the same level of government. Based on an interview, working units in the district government have no coordination in controlling companies’ performance. For instance, the head of the labor empowerment working units of the three districts had no information on the number of workers employed by foreign companies when the companies applied for principle licenses. Moreover, the actual numbers of workers employed by the companies are reported only to the provincial labor empowerment working unit and central government labor empowerment ministry.

In conclusion, according to both regulations and actual practice, district government has an important role in controlling foreign companies. Based on in-depth interviews, district governments can control foreign companies’ performance together with provincial and central governments. In order to support the task of investment control, the central government provides funds to provincial governments, which will be also distributed to district governments. In addition, based on the evaluation results, district governments have an authority to provide suggestion to central government whether foreign companies’ principle business licenses should be revoked. The final decision is still under the authority of the central government. The descriptions of the role of district government in the controlling process indicate that district government has a “joint role” with the central and provincial governments. As suggested in our theoretical framework, this involvement of district government indicates the presence of inclusive institutions. However, lack of funds and human resources, and lack of coordination among working units and among government levels are some challenges faced in controlling foreign companies’ performance. Those factors limit the role of district government in promoting FDI for inclusive growth.

5.4. Conclusions

The main question addressed in this chapter is: what is the role of district government in managing FDI to achieve inclusive growth at each stage of the public policy process, from planning to implementing and controlling? In order to address this research question, this chapter has mainly aimed to observe the roles of district government in the public policy process based on an analysis of existing regulations and actual practice. According to the theoretical framework of this study, the presence of inclusive institutions is required to promote FDI for inclusive growth. Referring to the MLG theory, the presence of inclusive institutions is indicated by the involvement of district government in the public policy process of central government related to foreign investment and inclusive growth. Based on the MLG theory, there are in public policies three possible roles for district government: dominant, joint and implementing. The presence of inclusive institutions is in line with the joint role, whereby district government in cooperation with provincial and central government is involved in the process of determining public policies to make foreign investment conducive to inclusive growth.

This chapter has reported that district government has a vital role in the planning process of the 2015-2019 RPJMN and BKPM Renstra, in which the objective of inclusive investment has been stated. District government is involved in government coordination forums, such as Musrenbang Regional and Musrenbang Nasional. Therefore, based on our theoretical framework, the involvement of district government in the planning process can be described as a “joint role”, shared with the provincial and national governments. This indicates that inclusive institutions exist in the planning process of FDI to promote FDI for inclusive growth. However, in the planning process of NIL, which regulates the open and closed sectors, district government is not involved. The district is just an implementer of national government decisions on NIL.

Based on in-depth interviews, this chapter has shown that the involvement of district governments in formulating RPJMN and Renstra BKPM through the Musrenbang Regional and Musrenbang National is only a formality. The time constraint, money-motivated participation, unclear follow-up of local governments’ aspirations, and the gap in the capacity of human resources are indicated by interviewees as primary constraints preventing national government from involving district governments in the planning process of FDI and inclusive growth. The regular forums of investment held by BKPM, like KP3MN and RIF, are also just formalities. Based on interviews, Tangerang District prefers to have direct communication with central government, while Mojokerto and Badung Districts tend to communicate indirectly with the central government through the provincial government.

In the implementation process, based on regulations, the district government should coordinate with provincial and central government in attracting foreign investment through the integrated one-stop service center, or PTSP, at the national level and DPMPTSP at the provincial and district levels. Meanwhile, with regard to investment promotion, the governments at provincial and district levels can independently conduct investment promotion to attract foreign investments to their regions. However, the main problems faced by Indonesian government to improve the investment climate through PTSP are lack of coordination between national and local governments, overlapping of investment policies between national and local governments, and unwillingness of related working units to transfer their authorities to DPMPTSP. These factors limit the role of district government in promoting FDI for inclusive growth. Moreover, with regard to investment promotion, district governments cannot independently carry out investment promotion for their own regions because of the limited budget for investment promotion.

In providing local permits for investment, the district government plays a “dominant role” and decides independently (this only refers to the RTRW) without coordination with provincial and central governments. In other words, there is a lack of coordination between district and central governments, which creates uncertainty for investors and worsens the investment climate. Meanwhile, in order to provide facilities for investors, the district government is constrained by an insufficient budget. Consequently, the ability of district government to promote FDI for inclusive growth through investment facilities, especially fiscal facilities, is limited. Based on an in depth interview, although regulations do not mention the role of district government in the CSR programs of companies, a case exists where district government in collaboration with central government and foreign investors is successfully conducting CSR programs.

In the controlling stage, according to regulations and actual practice, district government has an important role in controlling foreign companies. Based on in-depth interviews, district governments can control foreign companies’ performance together with provincial and central governments. District governments also have the authority to provide suggestions to central government as to whether foreign companies’ principle business license should be revoked. As suggested by the theoretical framework, in the controlling process district government plays a “joint role” with the central and provincial governments. However, lack of funds and human resources, and lack of coordination among working units and among government levels are some challenges faced in controlling the performance of foreign companies. The role of District governments’ involvement on public policy for FDI-Inclusive growth has been summarized in table below.

Table 5.1. Role of Government in a FDI-Inclusive Growth Policy Based on Regulation and Actual

Process	Role of Government			Type of District/city Government Involvement	
	National Government	Provincial Government	District/city Government	Regulation	Actual
Planning	<ul style="list-style-type: none"> - Formulating national long-term, medium term, and annual plans - Accommodate aspirations of provincial and district/city government through national musrenbang (actors: Bappenas, BKPM, relevant ministries/non-ministries)	<ul style="list-style-type: none"> - Formulating provincial long-term, medium term, and annual plans by considering national development plans - Accommodate district/city aspirations through provincial musrenbang (actors: Bappeda Province, PDPPM, provincial unit works)	<ul style="list-style-type: none"> - Formulating district/city long-term, medium term, and annual plans by considering national and provincial development plans, and their own capacity and potency (actors: Bappeda District/city, PDKPM, district unit works)	2 nd type (Joint role)	3 rd type (Implementer role)
Implementation - Attracting and promoting FDI	<ul style="list-style-type: none"> - Investment and business climate - Investment promotion (actors: BKPM, ministries/non-ministries, PTSP)	<ul style="list-style-type: none"> - Investment and business climate - Investment promotion (actors: PDPPM, DPMPTSP, provincial unit works,)	<ul style="list-style-type: none"> - Investment and business climate - Investment promotion (actors: PDKPM, DPMPTSP, district unit works)	2 nd type (Joint role) for investment climate, while 1 st type (dominant role) for promotion	1 st type (Dominant role) for investment climate, while 2 nd type (Joint role) for promotion
- Providing licenses	<ul style="list-style-type: none"> - Principle license - Final business license (actors: BKPM, PTSP, ministry of finance,	- Pre-business license: <ul style="list-style-type: none"> • location license, • agreement on area utilization, 	- Pre-business license: <ul style="list-style-type: none"> • location license, • agreement on area utilization, 	2 nd type (Joint role) through PTSP	1 st type (Dominant role)

Process	Role of Government			Type of District/city Government Involvement	
	National Government	Provincial Government	District/city Government	Regulation	Actual
	ministry of manpower, relevant ministries/non-ministries)	<ul style="list-style-type: none"> • building construction license, • occupancy worthiness permit, • environmental permit (actors: PDPPM, DPMPTSP, provincial unit works such as revenue unit works, spatial unit works)	<ul style="list-style-type: none"> • building construction license, • occupancy worthiness permit, • environmental permit (actors: PDKPM, DPMPTSP, district unit works such as revenue unit works, spatial unit works)		
- FDI facilities	Financial and non-financial facilities such as: <ul style="list-style-type: none"> - Income tax facility - Import tax facility (actors: BKPM, ministry of finance, ministry of trade, relevant ministries/non-ministries)	<ul style="list-style-type: none"> - Limited non-financial facility such as shorter procedures (actors: PDPPM, provincial unit works)	<ul style="list-style-type: none"> - Limited non-financial facility such as shorter procedures (actors: PDKPM, district unit works)	1 st type (Dominant role)	3 rd type (Implementer role)
- CSR	<ul style="list-style-type: none"> - Regulate CSR obligation at national level (actors: BKPM, other ministries/non-ministries)	<ul style="list-style-type: none"> - Regulate CSR obligation at provincial level (actors: PDPPM, provincial unit works)	<ul style="list-style-type: none"> - Regulate CSR obligation at district/city level (actors: PDKPM, district unit works)	1 st type (Dominant role)	2 nd type (Joint role)
Controlling	<ul style="list-style-type: none"> - Take role on monitoring, educating, and supervising at national level and at provincial 	<ul style="list-style-type: none"> - Take role on monitoring, educating, and supervising at provincial level and at 	<ul style="list-style-type: none"> - Take role on monitoring, educating, and supervising at district/city level 	2 nd type (Joint role)	2 nd type (Joint role)

Process	Role of Government			Type of District/city Government Involvement	
	National Government	Provincial Government	District/city Government	Regulation	Actual
	and district levels when there is violation - Provide administrative punishment (actors: BKPM, other ministries/non-ministries)	district/city level in cases of violation (actors: PDPPM, DPMPTSP, provincial unit works)	(actors: PDKPM, DPMPTSP, district unit works)		

Source: Author's compilation based on law and regulation on investment, CSR, limited liabilities companies, role of local government (see references)

Chapter 6

Foreign Direct Investment (FDI), Inclusive Growth, and Institutions: a Case Study of Tourism Sector in Badung District

Chapter 6 – Foreign Direct Investment (FDI), Inclusive Growth, and Institutions: a Case Study of Tourism Sector in Badung District¹⁸

Abstract

This chapter observes the impact of FDI on inclusive growth in tourism sectors through the channels of employment creation, health and education improvement, economic linkages, and CSR programs. The chapter also examines the role and characteristics of institutions that are supposed to facilitate FDI toward inclusive growth. We have examined Badung District in Bali, Indonesia well known as an international tourism region and foreign investment destination. Our focus of observation is on the Nusa Dua area, which was developed as a world-class international tourism accommodation. Using a qualitative method we found that in the tourism sector of Badung District FDI contributes significantly to inclusive growth through its various channels. We have also found that inclusive institutions, which give an equal opportunity for the members of society to gain benefits from tourism activities and to be involved in FDI policies, are essential to make FDI inclusive. Interestingly, in line with an inclusive growth concept the values of Tri Hita Karana (THK) have supported the existence of inclusive institutions.

6.1. Introduction

As already discussed in the previous chapters, international organizations and policy makers have come to focus on a broader concept of economic growth, so-called inclusive growth. International organizations such as the World Bank, the United Nations Development Program (UNDP), and the Asian Development Bank (ADB), have considered inclusive growth in their agendas. Indonesia has also started to focus on inclusive growth in its first Medium-Term Development Plan (RPJMN) for the period of 2010-2014. This growing focus on inclusive growth comes from an awareness that high economic growth is often not followed by lower poverty and inequality. Therefore, government policies are aiming more at providing benefits for all members of society and helping to reduce poverty and inequality.

Introduction of the inclusive growth concept has important consequences for assessing the quality of FDI. As Indonesia is strongly dependent on foreign investment,

¹⁸ A slightly different version will be published as: Kusumawati, P.N.L., Herman, J., and Holzacker, R.L. (2018). Foreign Direct Investment, Inclusive Growth, and Institutions: A Case Study of the Tourism Sector in Badung District. In R.L., Holzacker, and W. Tan (Eds), *Challenges of Governance Development and Regional Integration in Southeast Asia and ASEAN*. New York: Springer.

its government has begun to acknowledge that investment should be inclusive, leading to inclusive growth (RPJMN, 2015-2019). The World Tourism Organization (UNWTO) has also begun to promote investment in tourism to contribute not only to economic growth but also to its inclusiveness. According to the theoretical framework of this study, the contribution of FDI to inclusive growth can be achieved through several channels, such as employment creation, productivity improvement, Corporate Social Responsibility (CSR) programs, and Micro Small-Medium Enterprise (MSME) linkages.

As already explained, the benefits of FDI for a host country are not automatic, and require sufficient absorptive capacity. Borensztein et al. (1998) and Wang and Wong (2011) found that the positive impact of FDI depends on the capacity of human resources to absorb transfer of technology from FDI to host countries. Lamsiraroj and Ulubasoglu (2015) referred to other factors such as degree of trade openness and financial development. However, behind these absorptive capacities, institutions play a fundamental role in fostering economic development (North 1981; Rodrik, 2000). Dunning and Fortainer (2006) pointed to their importance in fostering the positive impact of FDI on host countries. Acemoglu and Robinson (2012) introduced the concept of inclusive institutions, which allow all members of society to participate in and benefit from development. Balakrishnan et al., (2013) and OECD (2014, p.162) affirmed this idea. All agree that institutions should become inclusive if FDI is to contribute to inclusive growth, unlike extractive institutions, which benefit only a small group and lead to greater poverty and inequality.

Chapter 4 has examined the capacity of the Indonesian government's regulations to regulate FDI for inclusive growth. Chapter 5 discussed how inclusive institutions involve district governments in national public policy processes related to FDI and inclusive growth. However, this study has not yet examined the importance of these processes at the district level. Although the authority to manage foreign investment is still in the hands of central government, foreign investors operate in districts, in a dynamic interaction with district government and local society.

To investigate the effect of FDI on inclusive growth and how institutions can assist in the process, for a case study this study has chosen Badung District in Bali Province, a region well-known for international tourism and foreign investment. This study will focus on the Nusa Dua area, developed by the Indonesian government as a world-class destination for international tourism. This study employs a qualitative method involving interviews with stakeholders such as foreign companies, local government, and members of the local community. These interviews will show detailed links of FDI to inclusive growth and discuss the effects of institutions on all stakeholders. Moreover,

this study will also examine the influence of the values of the Balinese people on the existence of inclusive institutions in Badung District.

Research Questions

This study addresses two research questions. First, what is the impact of FDI on inclusive growth in Badung District through channels such as employment creation, education and health improvement, economic linkages, and CSR programs? Second, how do institutions foster FDI to become inclusive through those channels? This chapter will assess whether institutions of stakeholders in Badung District are inclusive or extractive. It will also examine how the values of society and other stakeholders affect these institutions.

Research Design and Methodology

To address these questions, we will refer to our theoretical framework on the effect of FDI on inclusive growth and the role of institutions in assisting the process. This chapter will provide empirical evidence of the effect of FDI on inclusive growth in Badung District. This evidence covers all the specified channels through which FDI is linked with inclusive growth – employment creation, productivity improvement, Corporate Social Responsibility (CSR) programs, and MSME linkages. In addition, this chapter will analyze how institutions promote inclusive growth among all stakeholders including government, foreign companies, and society. Lastly, this chapter will examine the influence of society's values on the existence of inclusive institutions.

This study employs a qualitative method involving in-depth interviews with related stakeholders: government officials from Bali Province and Badung District; an international hotel in the Nusa Dua Area; the Indonesia Tourism Development Corporation (ITDC) of the Nusa Dua area; the traditional village head; the academics of Udayana University; and staff from the school for the deaf, Sekolah Luar Biasa Bagian B (SLBB). The in-depth interviews support our analysis of the contribution of FDI and the role of institutions in promoting inclusive growth in Badung District. In addition to the interviews, this chapter will also refer to relevant existing studies.

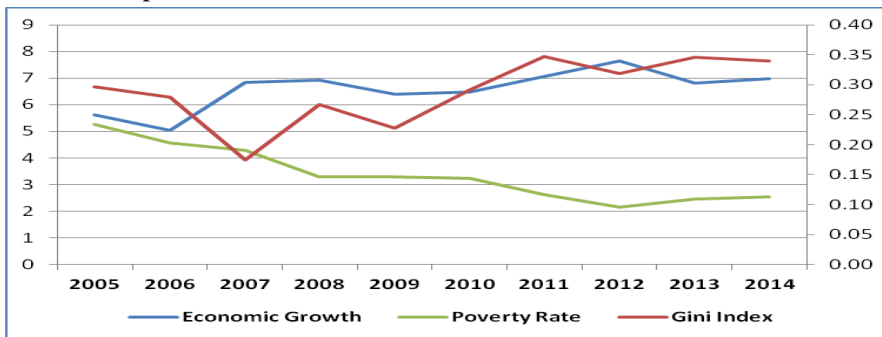
6.2. Badung District Profile and Inclusive Growth Performance

Badung is one of the districts in Bali Province which covers 7.43 percent of the total area of Bali island. Based on data provided by statistics of Bali Province and Badung District, the contribution of Badung District to the overall Bali Province's economy is significant, around 23 percent on average. Moreover, the economy of Badung District is dominantly driven by tourism activities such as hotels, restaurants, transportation, and communication. During the period of 2005-2014, Badung District's economy grew 6.58 percent per year, higher than the 5.72 percent national economic

growth. The tourism sector plays a dominant role and contributes around 50 percent to Badung District's overall economy. In addition, the contribution of tourism to Badung's economy tends to increase every year. Therefore, this sector has become attractive for both foreign and domestic investments.

From 2005 to 2014, FDI, and especially tourism, contributed about 95 percent of total investments in Badung District, and is perceived to be a key driver of the district's economic activities. FDI inflows have promoted high economic growth and created employment for local people. Based on employment data, Badung District had an average labor force of 333 thousand¹⁹ between 2013 and 2015, and most (about 331 thousand) were absorbed in the economy. In employment absorption, only a small gender bias exists, and males and females have equal opportunity to be involved in economic activities. Data show that both female and male laborers were able to be absorbed in the economy.

According to the social indicators of Badung District, the poverty rate tended to decrease between 2005 and 2014. Moreover, income inequality in Badung District as indicated by the Gini coefficient²⁰ is also significantly lower than that of average regions in Indonesia. This indicates that economic growth in Badung District is inclusive, also beneficial for the poor.



Source: Badung District's statistical data provided by BPS Badung District and BPS Bali Province
Figure 6.1. Economic Growth, Poverty Rate, and Gini Coefficient of Badung District

Based on our quantitative data analysis, Badung's economic growth already seems to satisfy the criteria of inclusiveness – high economic growth with low poverty rate and

¹⁹ Persons of 15 years old and over who, in the previous week, were working, temporarily absent from work but having jobs, and those who did not have work and were looking for work (www.bps.go.id)

²⁰ Gini ratio or Gini coefficient is an inequality measurement. The value ranges from 0 as perfect equality to 1 as perfect inequality; source: <http://siteresources.worldbank.org/PGLP/Resources/PMch6.pdf>

relatively low inequality compared to the national level. However, quantitative analysis cannot separately distinguish the role of FDI in promoting inclusive growth. Moreover, the data provided above do not describe the detailed channels through which FDI contributes to inclusive growth. Therefore, this study will observe qualitative points of view as to whether FDI contributes to inclusive growth. Qualitative analyses will be based on the results of in-depth interviews with related stakeholders – government, foreign companies, and society – followed by analysis of the role of institutions in directing FDI toward inclusive growth.

6.3. FDI and Inclusive Growth in Badung District

Badung District has since the 1970's become a well-known region, after the southern part of Badung District was chosen to be a center for mass tourism. In the 1980s, the touristification of Bali, as well as the deregulation of the banking sectors in Indonesia, facilitated the development of tourism in Badung District through a sharp increase in tourism investments. In a relatively short period the Badung economy grew significantly, with tourism as the dominant sector. This was indicated by an increase in the number of hotels, both domestic and international, accompanied by a rapid increase in restaurants and art shops.

Nusa Dua is an area in southern Badung District designated by the Indonesian government in 1973 to be a center of world-class international tourism. To manage the Nusa Dua area and create an environmentally sustainable and integrated model for tourism, the Indonesia Tourism Development Corporation (ITDC), an Indonesian state-owned company, was developed. Currently, several international star hotels in the Nusa Dua area together offer 5,000 rooms, a shopping center, museum, cultural venues, golf course, hospital and other tourism-related businesses. Below this chapter will explore in detail the effects of one international hotel on inclusive growth in the Nusa Dua area.

6.3.1. Employment Opportunity

Based on the theoretical framework, FDI can contribute to inclusive growth through employment creation for marginalized people, such as the poor, the disabled, and women. These people are usually not able to benefit from and be involved in FDI activities. According to our interviews, the international hotel in Nusa Dua has supported inclusive growth in Badung District by creating employment opportunities for marginalized people and giving priority to local people to work at the hotel. The hotel currently has 572 employees, most of whom live in the surrounding Nusa Dua area and Badung District.

In addition, the number of foreign employees working at the hotel is limited to only six employees. These foreign employees hold positions as general and executive

managers. Meanwhile, local employees most often have positions as staff, and some are supervisors, managers, and even members of an executive committee. These opportunities for local people have been described by interviewees:

“My husband has worked for an international hotel in Nusa Dua area from the beginning of its establishment. At that time, local people had opportunities to be employed.” (Badung District’s local people, Nusa Dua area, 31 July 2017)

“Many local people can be accommodated to work at hotels in accordance with their ability.” (Badung District’s local people, Nusa Dua area, 5 June 2016)

In addition, many students from vocational schools for tourism have the opportunity to work at international hotels in the Nusa Dua area after finishing their study. The hotels’ internship programs also increase vocational students’ skills, knowledge, and opportunities to find jobs. This has been affirmed by an interviewee:

“We (a vocational school on tourism) have internship programs in cooperation with hotels in the Nusa Dua area. Internships will increase students’ skills. Afterwards, students can have the opportunity to be employed by hotels in the future. After graduating from this school, many students who have gained international standardized skills through their internships can easily find jobs abroad.” (Badung District’s local people, Nusa Dua area, 5 June 2016)

The international hotel in Nusa Dua also provides job opportunities for disabled people. According to an interview, the hotel has employed around 6 disabled or deaf people. This number fulfills the minimum requirement as stated by Indonesian government law No. 13/2003. Based on this law, the hotel should employ at least 1 percent disabled people. The disabled work as staff in the kitchen and in room service. Their work at the hotel provides them with income, which can further be used to improve their living conditions. This opportunity for disabled people is supported by an interviewee, as follows:

“At one of our school events, alumni from this school also came. One of our alumni who works for an international hotel in the Nusa Dua area came to me and said that now he has a lot more money than me. He also feels happy and comfortable with the job at the hotel. I am happy to hear about his situation...some alumni have also been accepted as permanent workers.” (Teacher at school for the deaf, Badung District, 2 August 2017)

In summary, international hotels in Nusa Dua have contributed to inclusive growth by providing employment opportunities especially for local people and the disabled.

Moreover, vocational students also have greater opportunities to be hired after they finish their study. In addition, the experiences received during internship programs improve students' skills and knowledge and expand their opportunities to find jobs. As a result local people and the disabled can create income and improve their living conditions.

6.3.2. Labor productivity improvement

Besides creating employment opportunities for local people, FDI can contribute to inclusive growth by increasing their productivity. By providing educational programs and health facilities, the hotel can improve the skills and health of the employees, which enhances their productivity. Greater productivity gives the employees a chance to be promoted to higher positions and receive higher salaries. It also increases their competitiveness in the labor market.

Based on an interview, most of the hotel's current employees have been working there for 30 years. As a result, employees who originally had low education levels have been able to improve their skills through educational programs. Currently, some of these people have reached higher positions as supervisors or managers. The hotel also offers employees the opportunity to follow external training abroad, for example by regularly sending its chefs abroad to learn the techniques of international standard cuisine. Local employees have also become more competitive in the labor market, both local and international.

“After having a training program abroad, when the hotel opened a new branch in Shanghai, China, the employees who had international qualifications were sent to work in Shanghai.” (Manager of international hotel's Human Resource Department, Nusa Dua area, 31 May 2016)

Besides providing training programs, to further improve the productivity of local employees the hotel provides them and their families with health facilities. According to interviewees²¹, the international hotel has double coverage for health insurance: both government and private insurance programs. The health insurance covers health services not only for employees but also for their families. The hotel also provides good quality clinical services. Employees have greater access to doctors, medical check-ups and treatments.

Other international hotels in the Nusa Dua area also provide training and health facilities for their employees to improve their skills, knowledge, and health.

²¹ Managers of the international hotel's Human Resources Department and Marketing Department (Nusa Dua, May 2016)

“My husband only graduated from junior high school. The international hotel gave him English language training. Currently, he has a position at the airport to pick up guests for the hotel... The international hotel covers half of the health costs of a family with three children, at a good private hospital.” (Badung District’s local people, Nusa Dua area, 31 July 2017)

In summary, international hotels in the Nusa Dua area contribute to inclusive growth through providing education programs and health facilities for their employees. Such programs improve the skill and knowledge of employees, enabling them to get higher positions and better incomes. The hotels also provide health facilities not only for employees but also for their families, thereby improving their living conditions.

6.3.3. Corporate Social Responsibility (CSR) Programs

As mentioned in our theoretical framework, FDI can contribute to inclusive growth through short-term and long-term CSR programs. These programs can promote inclusive growth if they are aimed at increasing the capacity and productivity of local people. Interviews describe one CSR program provided by the hotel: cash transfers for traditional villages or “*desa pekraman*”. According to the head of a *desa pekraman*, funds received from the international hotels in Nusa Dua are saved in a non-banking institution owned by society, called Lembaga Perkreditan Desa (LPD). These funds can be used to finance cultural activities, community empowering programs, and scholarships for poor students. In this way the hotel’s cash transfer program improves the community’s welfare. In addition, most international hotels in Nusa Dua area provide funds to support the education of local children, including long-term scholarships for poor children.

“Hotels in the Nusa Dua area support the education of children who have good grades at school, or children from poor families. Some hotels provide scholarships for students from poor families until they graduate from school.” (Badung District’s local people, Nusa Dua area, 5 June 2016)

The international hotel also has a house refurbishment program for poor families in Badung District. The program is designed to make their houses clean and healthy, with good sanitation. The hotel also provides health programs based on community requests. For instance, the head of *desa pekraman* recommended that the hotel use fogging to prevent the spread of dengue. Another program provided by the hotel was counseling to increase local awareness about AIDS. The hotel also regularly participates in community services to preserve a healthy environment.

“We support the Tri Hita Karana association in doing community services. We send our employees to participate in community services and consider this as part of their job. For example, today five of our employees have to go to Beratan temple in Bedugul for community services.” (Manager of international hotel’s Human Resource Department, Nusa Dua area, 31 May 2016)

The international hotel also has a regular educational program for deaf students at the senior high school, Sekolah Luar Biasa bagian B (SLBB), located near Nusa Dua. The students are trained by hotel employees once a week to increase their skills in English, flower arrangement, aerobics and basic massage. The hotel also gives students the opportunity to work at the hotel after graduation. The hotel employs six deaf students from the SLBB in room service and restaurants. Because of its successful CSR programs, this hotel received an award from the Indonesian government for actively supporting the government’s program to alleviate poverty. The CSR programs for deaf students were described by an interviewee:

“Our hotel has provided training of the spa therapy since 2014. Even though, in the future, deaf students will not work for our hotels, the skills in the spa will increase opportunity for students to find jobs.” (Manager of the international hotel’s Human Resource Department, Nusa Dua area, 31 May 2016)

“Not all students work in hotels. It depends on their skills. One of the spa companies wants our students to be their employees.” (Teacher at school for the deaf, Badung District, 2 August 2017)

In summary, international hotels have contributed to inclusive growth in Badung District through providing Corporate Social Responsibility (CSR) programs for society. These include cash and non-cash programs. Based on interviews, the cash-CSR programs provided by the hotels are not used only for consumption. Local people manage the cash to finance ritual activities, support poor children’s education, and empower local businesses. Moreover, the international hotels provide CSR programs on education and health for local people and the disabled, enabling them to have better living conditions.

6.3.4. Economic Linkages to MSME

As mentioned in the theoretical section, Chapter 2, FDI can contribute to local communities through linkages with domestic enterprises, especially MSMEs. According to interviews, the international hotel in the Nusa Dua area has linkages to MSMEs in the service sector. According to managers in its Human Resource Department (HRD), the hotel employs local traditional musicians and dancers to perform at the hotel. The hotel

also cooperates with local taxi drivers to provide transportation services for its guests. Through such linkages to MSME the hotel has created employment and income for local people, especially the poor, who usually work at MSMEs.

To strengthen the links between hotels in the Nusa Dua area and MSMEs, all the hotels collect and provide revolving funds for MSME in all the regions of Bali Province. Besides providing revolving funds, the Indonesia Tourism Development Corporation (ITDC) as management of the Nusa Dua area, has the responsibility to monitor and train the local MSMEs. This was mentioned during an interview:

“In order to empower local MSMEs, ITDC together with hotels in Nusa Dua area provides not only revolving funds, but also mentoring program. The mentoring program includes monitoring, training, and regular coaching. The revolving funds will be directly transferred to local entrepreneurs located not only in the surrounding Nusa Dua area but also in other regions in Bali.” (Manager of ITDC, Nusa Dua area, 6 June 2016)

Besides having linkages to local dancers and taxi drivers, international hotels in Nusa Dua also provide access for street vendors to sell their products. According to interviews, the Indonesia Tourism Development Corporation (ITDC) and international hotels develop special places for street vendors and local people to open their businesses. This opportunity for local people to create greater income is supported by interviewees:

“Before having the Nusa Dua area, local people only became farmers and fishermen. They only graduated from elementary school and could not eat properly.” (Badung District’s local people, Nusa Dua area, 31 July 2017)

“Local people could not read, and worked as farmers. Since the establishment of the Nusa Dua area, they can provide services such as massages and sell souvenirs.” (Badung District’s local people, Nusa Dua area, 5 June 2016)

Street vendors can profit from the existence of the hotels by selling souvenirs to the guests, and the hotel provides trainings for street vendors to improve their knowledge and skills. These benefits are described by an interviewee:

“We learn massage from international hotels. After training, we improve our service in massage by using towels and oils made especially for the spa. In addition, we can also offer pedicure and manicure services by using good quality of nail polishes.” (Badung District’s local people, Nusa Dua area, 31 July 2017)

The international hotel also purchases local products such as vegetables, meats and furniture. However, linkages between the hotel business and the agricultural sector are

still limited because local farmers face problems with product quality and sustainability. As a world class hotel, the hotel requires farmers to supply products which meet international standards. Due to their limited scale, local farmers can only supply products in small quantities. The issues of product quality and sustainability were confirmed by the manager of the international hotel:

“We are willing to buy products from local people, but Nusa Dua is a dry area and cannot produce vegetables and fruits. Hence, we are looking for vegetables from other agricultural areas in Bali Province, such as Bedugul, and meats from Denpasar city. Mostly, food suppliers are from Bali province but during some seasons we import foods from other countries. Some people can supply foods directly to us but most are supplied by big suppliers who can collect the products.”(Manager of international hotel’s Human Resource Department, Nusa Dua area, 31 May 2016)

This section can conclude that FDI, as represented by the international hotel in Nusa Dua, has contributed to inclusive growth in Badung District. The hotel has provided all channels of FDI to inclusive growth as proposed in our theoretical framework. However, the linkage of the hotel with local farmers is constrained by the quality of the products and sustainability of the supply.

6.4. The Role of Institutions in Promoting FDI for Inclusive Growth

Based on the theoretical framework, the New Institutional Economics (NIE) proposes the importance of institutions in promoting economic growth and welfare. In relation to FDI-inclusive growth nexus, inclusive institutions are required to foster FDI’s benefits for inclusive growth. OECD (2014, p.162) affirmed this. Acemoglu and Robinson (2012) also referred to the importance of both economic and political inclusive institutions. To analyze the role of institutions in the Nusa Dua area, one must understand Balinese values. As suggested in our theoretical framework, the characteristics of institutions are not independent but are influenced by the values of society in the region.

6.4.1. Values of Balinese People

Bali’s unique identity as a touristic region has had a long history. Especially since the 1930s measures have been taken to preserve Bali in a steady state of supposed authenticity, while at the same time a set of new categories was introduced by which the Balinese were invited to think about themselves (Nordholt, 2007). Therefore, in order to preserve special customary arrangements an institutional distinction was made at the village level between custom (*adat*), currently called *pekraman*, and administration, or *dinas*. *Pekraman* village was based on religious and cultural values and is regulated by community rule, the so-called *awig-awig*. On the other hand, the administrative village

was established by a central government act and regulated by formal rules. Until now, the *pekraman* and administrative villages still exist as the lowest level of government in Bali.

The existence of the *pekraman* village is based on the Balinese philosophy of Tri Hita Karana (THK). Based on this philosophy, happiness and wealth can be attained by maintaining harmonious and balanced relationships between humans and God (*parhyangan*), humans and other humans (*pawongan*), and humans and the environment (*palemahan*). These three aspects of the THK are holistic approaches in line with the concept of sustainable and inclusive development suggested by international organizations. Respecting local culture, empowering the local community and preserving the environment are the main concepts of the THK. Specifically the community aspect of THK (*pawongan*), maintaining a harmonious and balanced relationship between human and human, supports inclusive development of the tourism sector in Badung District.

Based on interviews, the values of the international hotel in Nusa Dua include commitment to the environment, sharing local culture, and contributing to local society. Moreover, the hotel always attempt to communicate with stakeholders, listen to them and maintain dialogue with them. The hotel also internalizes in its business the principles of THK, which match its values of inclusiveness and sustainability. The Bali Province government granted a THK award to the hotel for its implementation of THK principles in its operations and policies, including the *pawongan* principle – to maintain and give contributions for local people.

Interestingly, Badung District government also has internalized THK principles in its Medium-Term Development Plan (RPJMD) for the period of 2016-2021. The vision of this plan is to strengthen an advanced, peaceful, and prosperous society based on the THK philosophy. Based on this vision, the government seeks to involve all stakeholders in formulating, implementing, and evaluating its policies.

The integration of such values among the Balinese people, the international hotel, and local government is an example of the *pawongan* principle. Having such values makes stakeholders more aware of the impact of their decisions on other human beings; according to one interviewee, the values of THK help the international hotel to consider other stakeholders' perspectives on its decisions²². Another interview, with the head of the *pekraman* village, shows that THK values have been internalized by society in their daily activities. This makes them more open to the international hotel and supportive of its business. The integration of such values among stakeholders in Badung District

²² Managers of the international hotel in Nusa Dua for Human Resource Department and Marketing Department (Nusa Dua, 31 May 2016).

supports inclusive institutions, thereby helping to make FDI inclusive. The next section will discuss the evolution of institutions, based on an analysis of Nusa Dua history.

6.4.2. The Dynamic of Institutions as seen in Nusa Dua's History of Development

In spite of what we have seen as a positive impact of the development of the Nusa Dua area on inclusive growth, the involvement of local community was little involved in the initial planning process of the area. Based on an interview with the head of *pekraman* village, the government's initial plan to make Nusa Dua a world-class tourism area was not well communicated to the local community. The Indonesia Tourism Development Corporation (ITDC), representing the national government, merely informed the local people that their area would be developed to bring benefits from international tourism to the local community.

For that purpose, ITDC suggested that the local people hand over their land to ITDC and then they would receive compensation based on the type of land. However, the amount of compensation was decided by ITDC without considering the local community's aspirations. The local people accepted the amount not because they supported the program but because they felt intimidated and threatened (Madiun, 2010). This demonstrated that the planning process was not inclusive and central government played a dominant role. The centralistic planning process (top-down approach) reflected a strongly authoritarian regime at the national level.

In addition, the head of *pekraman* village realized that local people were afraid that ITDC would not only take their lands but also change their livelihood. At that time, as most local people in the Nusa Dua area worked as fishermen and farmers, land and open access to the beach were important for their livelihood. After the Nusa Dua area was developed as a center for international tourism, local people had limited access to the area. This changed the source of livelihood for local people, who instead of fishermen and farmers became street vendors, taxi drivers and performed other work related to tourism.

During this centralistic regime, the Balinese people just accepted the policies of government and enjoyed the economic benefits of the fast growth of tourism. However, the failure to involve local people in the process of Nusa Dua development and blocking them from access to the area indicated that institutions were extractive. Growing feelings of discontent about the intrusion of investors gave rise to a protest movement by Balinese people. For instance in 1994 there was a protest against the realization of the Bali Nirwana Resort in the Tabanan District, close to the holy sea-temple Tanah Lot. These demonstrations were soon brought to a halt by military intervention and a heavy hand on the press. However, in 1997 the public again protested against the building of a hotel at Padanggalak Beach, which was an important religious site. These two public

protests indicated that the Balinese people were becoming increasingly aware of the effect of touristic activities on the local culture, environment, and economy.

After entering the democratization era initiated by the fall of the authoritarian regime in 1998, institutions in Badung District changed from being extractive to being more inclusive. Based on an interview with street vendors in the Nusa Dua area, before the democratization era, local government security (Ketertiban Umum/Tibum) and hotel security did not allow street vendors to enter the Nusa Dua area. Street vendors had to sell their souvenirs illegally, or they would be arrested. However, democratization gave society more of a voice to bargain with the government and international hotels, who in turn had more concern for society. The hotels provided a place for society to be involved in economic activities, local government enacted a regulation to legalize the work of street vendors in the Nusa Dua area, and a street vendor association was also formed in Nusa Dua. The formation of this association and its function was explained during an interview:

“The head of the village, local government, and the police had an initiative to form a street vendor association, called ‘paguyuban’. By having a paguyuban, street vendors’ activities could be coordinated. At the same time, having ‘paguyuban’ allowed local government, society, and hotels to cooperate in monitoring terrorist and other activities in the Nusa Dua area. Therefore, the members of paguyuban could also monitor activities which could potentially affect tourism safety in the Nusa Dua area.”
(Badung District’s local people, Nusa Dua area, 31 July 2017)

Analysis of the history and the development of Nusa Dua area before and after the democratization era shows that the characteristics of institutions in the area also changed from extractive to inclusive. The rise of awareness among local people to protect their culture and values from the fast growth of the tourism sector also played an important role in bringing about more inclusive institutions. The next section discusses the role of institutions in all channels of FDI related to inclusive growth in the Nusa Dua area. The existence of inclusive institutions will be investigated not only in government, but also in the international hotel.

6.4.3. Economic Institutions

Economic institutions have been defined in this study as the rules of the game which provide opportunities for all members of society, including marginalized people, to gain benefits from FDI activities. By adopting Acemoglu and Robinson’s (2012) concept of economic institutions, this study will observe whether all stakeholders, especially government and the international hotel, support the opportunities of society, especially marginalized people, to be involved in FDI activities and gain benefits from FDI

business through employment creation, productivity improvement, CSR programs, and linkages to MSMEs.

6.4.3.1. Employment Opportunity

Interviews have indicated that all stakeholders (government, international hotels, and society) have inclusive economic institutions that provide employment for local people. In the international hotel in Nusa Dua area, inclusiveness is represented by the policy to employ local people. One of the examples of economic inclusive institutions is an agreement between the international hotel and local people to hire at least 30 percent of all employees. By having the agreement, local people have opportunities to work at the international hotel in Nusa Dua.

Governments support such policies. Previously, in the centralistic era, the central government had more authority to manage the tourism sector in Badung District. Central government represented by state-owned enterprise, the so-called Indonesia Tourism Development Corporation (ITDC), has introduced Tri Hita Karana concepts into the international hotels. When these hotels attempt to invest in the Nusa Dua area, ITDC requires them to implement the Tri Hita Karana philosophy. The ITDC requires every foreign investor to prioritize local people for employment. An interviewee explained:

“One of the requirements for foreign investors to invest in the Nusa Dua area is to employ local people. When they (investors) decide to invest in the Nusa Dua area, they should employ local people; otherwise they cannot invest in the area.” (Manager of ITDC, Nusa Dua area, 6 June 2016)

The international hotel also hires at least 1 percent disabled people, in compliance with national government law No.13/2003 on labor empowerment. An interview confirms this. The district government also has a program to provide training and education for job seekers, in cooperation with international hotels. The hotel manager also mentioned that males and females have equal opportunity for employment, and explained that society in Badung District is becoming more open-minded about females working at the hotel. With the decreasing former negative image of this situation the number of females now working at the hotel has increased.

By the above programs of international hotels and the regulations of government, economic institutions have expanded the opportunity of local people, including marginalized people such as the disabled and women, to work at international hotels. The agreement to hire at least 30 percent local people as employees is an example of an inclusive economic institution in a foreign company. The government regulation requiring employment of at least one percent disabled people at the company is another

example of an inclusive economic institution which drives foreign companies to contribute to inclusive growth.

6.4.3.2. Productivity improvement

Regarding the channel of productivity improvement, the existence of inclusive economic institutions in Badung District is supported by government and the international hotel regulations. Indonesian government law No.13/2003 states that every company has to provide training and facilities for its employees. Moreover, as already explained, the international hotel in Nusa Dua has regular training programs and health facilities for its employees. That these programs can improve the skills and health condition of employees so that their productivity is increased was affirmed by an interviewee as follows:

“The hotel has a target to provide training of a minimum 40 hours per year for each employee. Every month, every worker should have 3-4 hours of training.” (Manager of international hotel’s Human Resource Department, Nusa Dua area, 31 May 2016)

Moreover, to standardize the quality of workers in Badung District, the District government has a free certification program for workers, which also increases their competitiveness in the labor market. This program is the result of cooperation between Badung District government and international hotels. Workers who get certificates can be employed by the hotel, in line with the policy of government to link workers with the hotels.

In addition, to improve the productivity of local employees, the hotel provides health facilities such as health insurance to cover the health costs of employees and their families. The full-coverage health insurance, BPJS, provided by the central government, has also supported the effort to achieve inclusive growth. As already mentioned, the international hotel joined a government insurance program and provided insurance programs for its employees. Moreover, to increase the health quality of poor families in Bali Province and in Badung District, the Balinese Province and Badung District governments have provided health insurance for poor families, known respectively as Program Jaminan Kesehatan Bali Mandara (JKBM) and Program Jaminan Kesehatan Krama Badung (JKKB) Manguwaras.

In summary, economic institutions in the international hotel have increased the opportunity of local employees to benefit from training programs and health facilities which enhance their productivity. The hotel employs dominantly local employees, including disabled people and women, and these people greatly benefit from the training programs and health facilities. Moreover, the training programs are also supported by Badung District government by a certification program which standardizes the quality

of employees. The national, Bali Province and Badung District governments have also provided health insurance programs to improve the health quality of the poor. In the case of Badung District, the explanations above illustrate that inclusive economic institutions have already become internalized and integrated in both foreign company and government.

6.4.3.3. Corporate Social Responsibility (CSR) programs

Foreign companies and government in Badung District have supported the implementation of CSR programs for society, especially marginalized people from the area surrounding Nusa Dua. The national government requires companies to contribute to society through CSR programs, according to regulation No.47/2012. Moreover, Badung District government also supports the implementation of CSR programs by regulation No.6/2013, which requires establishment of a forum to synchronize foreign companies' CSR programs with governmental development programs. The forum is aimed to increase the contribution of private sectors to society, and forum includes representatives from hotels, government, and society. The forum is also directed to synchronize foreign companies' CSR programs with governmental development programs.

As explained earlier in this chapter, the international hotel has provided CSR programs for society, such as cash transfers for people from traditional villages, a house refurbishment program for poor families, scholarship programs for local children, and a regular educational program for deaf students at the senior high school. These CSR programs provided by the hotel as well as the existence of a CSR forum are evidence that economic institutions are already integrated in the hotel and the government to promote the benefits of CSR programs for society.

6.4.3.4. Linkages to Micro Small-Medium Enterprise

That economically inclusive institutions exist in Badung District is also shown by the efforts of local governments (provincial and district) to increase linkages between the tourism sector and MSMEs. For example, the Bali provincial government ratified Provincial Regulation No.3/2013 on local fruit protection. The regulation mentions that to increase the demand for local fruits, companies in the tourism sector must consume local fruits²³. Moreover, Bali Provincial government enacted regulation No.16/2009 on the Bali Provincial Spatial Plan, requiring all buildings in Bali, including hotels, to use Balinese architecture²⁴. In fact, this is a requirement that investors must fulfill before the government will issue investment licenses. This requirement increases links between the

²³ Bali provincial regulation No.3/2013 on local fruit protection, article 56.

²⁴ Bali provincial regulation No.16/2009 on Bali provincial level spatial plan, article 122 (2g).

tourism sector and MSMEs, especially those MSMEs which have businesses in architecture, crafts, and furniture.

We can here conclude that economic institutions play an important role in promoting FDI for inclusive growth. In the Nusa Dua area both the international hotel and the local government have inclusive economic institutions. This is demonstrated by the programs of the hotel and the governmental regulations which support all channels of FDI to inclusive growth. These inclusive economic institutions are in turn the result of inclusive political institutions, which we will discuss in the next section in relation to Badung District, and especially the Nusa Dua area.

6.4.4. Political Institutions

As explained in our theoretical framework, the existence of inclusive political institutions is in line with the FDI-inclusive growth model. Inclusive political institutions are the rules of the game which involve society in FDI programs (Acemoglu and Robinson, 2012). The OECD (2015) suggested that inclusive political institutions include voice, engagement, and accountability. Such institutions involve all members of society in FDI programs/policies. On the other hand, extractive political institutions mean that FDI benefits only a small group of society. We will here analyze whether political institutions in Badung District been inclusive by providing opportunity for society to have voice, engagement, and accountability regarding FDI programs, or extractive by restraining society from involvement in FDI programs. We will discuss political institutions related to the FDI channels to inclusive growth: employment opportunity, productivity improvement, Corporate Social Responsibility (CSR) programs, and linkages to MSMEs.

6.4.4.1. Employment Opportunity

Based on interviews, in Badung District, inclusive political institutions are found in all of these channels, including that of employment creation. As already mentioned, the hotel has made an agreement with the local community to hire least 30 percent local employees. The agreement is a result of negotiation process between hotel and local people. According to interviewees²⁵, the hotel also allowed local people to express their voices and engage in negotiating the agreement, thereby accommodating the interests of both stakeholders.

To implement the agreement the hotel first informs local people about job opportunities before publishing them to the public. In this way the hotel shows accountability.

²⁵ Interviewees are a manager of the international hotel's Human Resource Department (Nusa Dua area, 31 May 2016), and Badung District's local people (Nusa Dua area, 5 June 2016)

“When there is a job vacancy, we will inform local people. Local people who meet the requirements will be accepted to work for us.” (Manager of international hotel’s Human Resource Department, Nusa Dua area, 31 May 2016)

The statement has been supported by the head of the village, as follows:

“Most of our children who have a vocational education background in tourism have been accepted to work for hotels in the Nusa Dua area.” (Badung District’s local people, Nusa Dua area, 5 June 2016)

The explanations above indicate that the international hotel has involved society in the agreement about the number of local employees in the hotel. The hotel also demonstrates accountability by always informing the local people of new vacancies at the hotel. This shows that political institutions have played an important role in stimulating foreign investors to create employment for local people.

6.4.4.2. Productivity improvement

In Badung District, inclusive political institutions also have been implemented in the channel of productivity improvement. For instance, the international hotel has regulated that each employee has to participate in training programs at least 40 hours per year. Employees can also propose internal or external training programs which they consider necessary; they have a voice to express their preferences on the training programs.

“Every month, every worker should have 3-4 hours of training. The training can be internal or external training. The types of training depend on the departments’ proposal; adjusted according to standard operational procedures...workers also can propose their own individual external trainings.” (Managers of international hotel’s Human Resource Department and Marketing Department, Nusa Dua area, 31 May 2016)

Regarding health facilities, especially health insurance, the international hotel decided to use health insurance provided both by government and a private company. Using both is the result of discussion between the hotel and its employees. Since government health insurance has not been well developed, employees recommended that the manager also use insurance provided by a private company. The involvement of employees in deciding health insurance is an example of the hotel’s adopting of inclusive political institutions.

“We have a double insurance for workers. In the beginning, workers were reluctant to join BPJS insurance since workers also have to pay an insurance premium. We tried

to persuade workers to support the national program for social security. Finally, workers could accept BPJS programs. However, currently, workers still prefer to use our health insurance programs rather than those of BPJS since coverage by our insurance program is broader than BPJS.” (Managers of the international hotel’s Human Resource Department and Marketing Department, Nusa Dua area, 31 May 2016)

The international hotel and Badung District government also interact to improve workers’ productivity. They work together with the Social and Labor Empowerment working unit to provide training for workers. Related to the requirements of the international hotel, at least 50 percent of workers in housekeeping, pantry, kitchen, and front office should have certificates of competency. Therefore, the hotel provides the training and Badung District government provides the certificates. This coordination between the hotel and the government is supported by an interviewee:

“For the last three years, our hotel has cooperated with Badung District’s Social and Labor Empowerment working unit in achieving the target of certification. For instance, on June 2016, Badung District government certified 100 workers for free. We trained the workers, while assessors expert in the standards of labor competencies gave written and practical tests to the workers. The Social and Labor Empowerment working unit provided the opportunity for us to choose the place of assessment. When the number of workers was too great, the tests were held at our hotel.” (Managers of international hotel’s Human Resource Department and Marketing Department, Nusa Dua area, 31 May 2016)

Based on the explanations above, employees of the hotel have an opportunity to propose the types of training which they consider beneficial to increase their own capacities. In addition, the international hotel also discusses with its employees which of its health insurance policies are most appropriate. Badung District government’s provision of training and health insurance is an example of how the local government and the hotel cooperate to increase the quality of health and education of the hotel’s employees. Discussing the training and insurance programs with employees and coordinating these programs with government policies illustrate how inclusive political institutions can enhance the contributions of foreign companies to inclusive growth.

6.4.4.3. Corporate Social Responsibility (CSR) programs

Inclusive political institutions have also been adopted for deciding the international hotel’s CSR programs. For instance, as already explained, the international hotel has a

CSR program to give regular training to deaf students. Based on interviewees²⁶, the hotel always accommodates the wishes of the school as to what training programs are needed. Moreover, the hotel always informs the school about vacancies open for disabled students. This inclusiveness of institutions in providing training for deaf students is supported by an interviewee:

“Sustainable CSR programs for deaf students at SLBB have been started by us since 2004. We thought that a contribution to help disabled children is not always expressed in terms of money. Therefore, we asked the school what we could provide to help deaf students. Based on discussion with the school’s head master, our GM’s wife taught English language in the beginning. Then, based on requests and discussion with the school, we together developed florist courses. Moreover, currently, our therapist has been training deaf students about basic SPA massages since 2014.” (Managers of international hotel’s Human Resource Department and Marketing Department, Nusa Dua area, 31 May 2016)

Other CSR programs conducted by the international hotel are always discussed first with the head of *desa pekraman*. As a result, these programs match the demands of society. Society can also propose to the hotel an activity which is beneficial for them. However, the decision is always discussed. For instance, in providing cash transfers and the use of funds, the hotel always involves society. In turn, society always reports its activities and the use of CSR budgets to the hotel. This was mentioned during an interview:

“We welcome everyone from the local people to come and propose activities that we can help with.” (Manager of international hotel’s Human Resource Department, Nusa Dua area, 31 May 2016).

An interviewee from society also informed that:

“We desire to benefit from the existence of hotels in Nusa Dua area. However, we realize that hotels also have their limitations and not all of our requests can be fulfilled. Therefore, we have to discuss our proposals with the hotel and ask the hotel about its preferences. Therefore, both (local people and hotels) will gain benefits from the agreement...Every year we make a report to hotels on the amount of funds received and their use, such as for financing religious and cultural activities, supporting young

²⁶ Interviewees are managers of the international hotel’s Human Resource Department and Marketing Department (Nusa Dua, 31 May 2016), and teachers from senior high school for disabled (Nusa Dua, 2 August 2017).

people's traditional activities, financing poor students, and managing the environment.” (Badung District's local people, Nusa Dua area, 5 June 2016)

Based on the explanation above, inclusive political institutions have played an important role in the CSR programs provided by the hotel. This inclusiveness is shown by the involvement of society in designing the CSR programs and by the transparency of their implementation. The hotel is always open to discuss activities needed by and beneficial for society. The involvement of society in the CSR program increases the success of the program in improving the welfare of society.

6.4.4.4. Linkages to Micro Small-Medium Enterprises (MSMEs)

The existence of political institutions is also found in MSME channels of FDI. As already explained, the international hotel in Nusa Dua has linkages with MSMEs to provide traditional dancers and musicians. Based on an interview, before employing traditional dancers and musicians, the hotel informs local people about the vacancies through the head of *desa pekraman*. Then, the head of *desa pekraman* discusses the vacancy with the members of *desa pekraman* during a regular village meeting. This shows that both the hotel and *pekraman* village have involved the members of society in the FDI programs:

“We will support our village's groups of traditional musicians and dancers. Therefore, every hotel in the Nusa Dua area can have Balinese dancers and musicians from us.” (Badung District's local people, Nusa Dua area, 5 June 2016)

“We arranged a competition for traditional dancers and musicians. The winner of the competition will perform at the lobby and restaurants of our hotel.” (Manager of international hotel's Human Resource Department, Nusa Dua area, 31 May 2016)

As already mentioned, local people have an agreement with hotels in the Nusa Dua area that the hotels will be transparent in providing job opportunities to society. This strengthens the linkages between international hotels and society. One of the international hotel's managers mentioned this:

“We commit with local people village to give priority to local suppliers. We have two people to decorate our hotel in the Balinese style, called *penjor*. Dancers are from local villages and surrounding sub-districts. We also have a taxi group which is managed with our cooperation. The taxi drivers are local people.” (Manager of international hotel's Human Resource Department, Nusa Dua area, 31 May 2016)

The discussion above shows that inclusive political institutions play an important role in strengthening the links between the international hotel and MSMEs. Informing

local people about vacancies at the hotel and allowing them to discuss these vacancies indicate that inclusive political institutions have been implemented.

With respect to the influence of society's values on institutions, based on our theoretical framework, the characteristics of institutions are not exogenous, but are affected by society's values. The existence of inclusive institutions in Badung District, especially in Nusa Dua, is significantly influenced by the Balinese philosophy known as Tri Hita Karana (THK). Based on this philosophy, happiness and wealth can be attained by maintaining harmonious and balanced relationships between humans and God (*parhyangan*), humans and other humans (*pawongan*), and humans and the environment (*palemahan*).

These three aspects of the THK illustrate a holistic approach in line with the concept of sustainable and inclusive development suggested by international organizations. Specifically in relation to *pawongan*, international hotels in Nusa Dua always maintain their relationship with society and the other stakeholders. Involving local people in formulating CSR programs is one example that the international hotels have adopted the THK principle. To control the implementation of THK principles and increase the contributions of hotels in Bali to the Balinese people, the Bali Province government and Badung District government formed the THK forum. The forum consists of representatives of hotels, society, government, and academics. The forum regularly assesses whether the hotels in Bali apply THK principles in their business. The existence of the forum has also accommodated the aspirations of society, government, hotel, and other stakeholders.

6.5. Conclusions

Currently, the concept of inclusive growth is the focal point of international organizations, but also national governments, such as that of Indonesia. The growing concern about inclusive growth, especially in developing countries, is the result of evidence that high economic growth is often not accompanied by reduced income inequality and poverty rates. Based on our research, less income inequality and poverty per definition determine the quality of economic growth. In the tourism sector, the UNWTO has promoted investment as a main driver not only for economic growth, but also for inclusiveness. FDI in the tourism sector is, therefore, expected to benefit all members of society, especially the marginalized, in host countries. Nevertheless, the real impact of FDI on inclusive growth is still being debated in the literature. Existing studies perceive that institutions, defined as the rules of the game regulating the behavior of stakeholders, are significant to contribute to inclusive growth. However, the quality of institutions required to drive FDI to become inclusive is questionable.

Therefore, firstly, this paper has observed the impact of FDI on inclusive growth in tourist sectors through the channels of employment creation, health and education improvement, economic linkages, and CSR programs. Badung District in Bali, Indonesia, well known as an international tourism region and foreign investment destination, has been examined. The focus of observation has been on the Nusa Dua area, located at the southern part of Badung District and developed as a world-class international tourism accommodation. By means of qualitative research this study has found that FDI in the tourism sector in Badung District contributes significantly to inclusive growth through employment creation, productivity improvement, Corporate Social Responsibility (CSR) programs, and linkages to Micro Small-Medium Enterprise (MSME).

Secondly, this study has also examined the role and characteristics of institutions that are supposed to facilitate FDI toward inclusive growth in Badung District. Besides using the definition of institutions suggested by North (1981), this paper also considers the concept of inclusive institutions proposed by Acemoglu and Robinson (2012). Inclusive institutions are defined as institutions that allow all members of society to benefit from and be involved in economic activities (economic institutions). The aspects of voice, engagement, and accountability (political institutions) have been examined in this paper to evaluate the role of institutions in promoting FDI to become inclusive. We have found that inclusive institutions (both economic and political institutions) which give an equal opportunity for the members of society to gain benefits from tourism activities and to be involved in FDI's policies are essential to make FDI inclusive. Interestingly, in Badung District, the values of Tri Hita Karana (THK), which are in line with an inclusive growth concept, have been internalized not only in the Balinese people but also in international hotels and local government. In Badung District this integration of inclusive values in all stakeholders has supported the existence of inclusive institutions. The overall findings regarding the Badung District case study are summarized in the following figure.

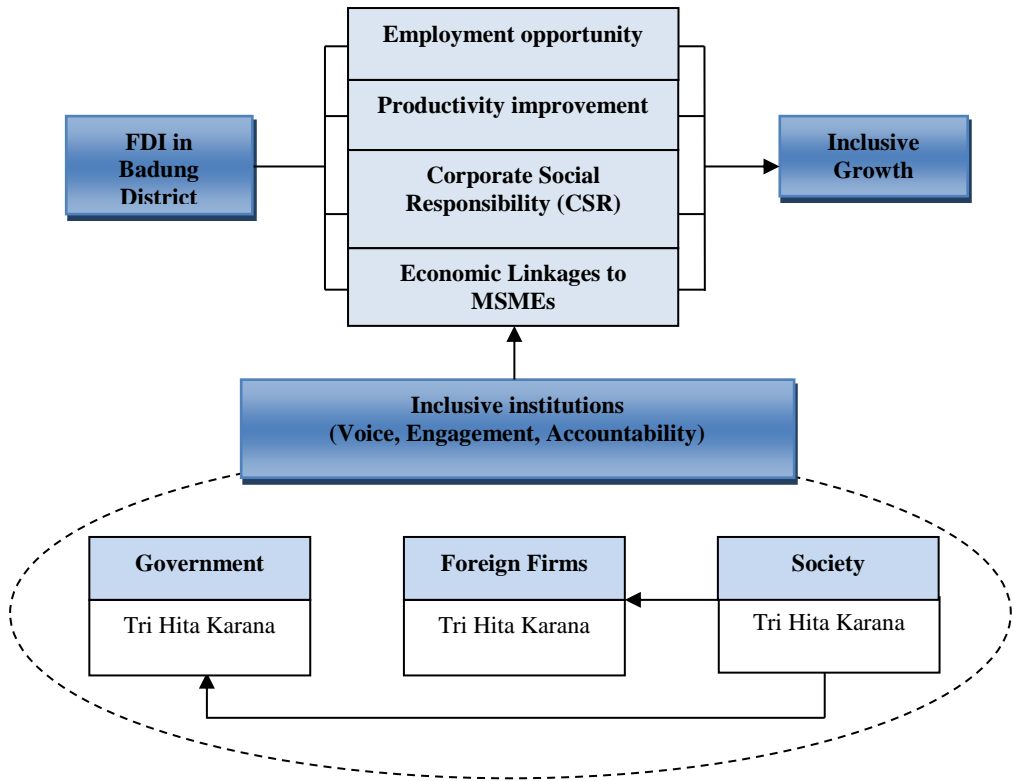


Figure 6.2. FDI, Inclusive Growth, and Institutions of Badung District

Chapter 7

Foreign Direct Investment (FDI), Inclusive Growth, and Institutions: a Case Study of Industrial Sector in Mojokerto District

Chapter 7 – Foreign Direct Investment (FDI), Inclusive Growth, and Institutions: a Case Study of Industrial Sector in Mojokerto District

Abstract

This chapter examines the impact of FDI on inclusive growth and the particular role played by institutions in promoting this growth. We conducted an investigation into the Mojokerto District, one of the largest districts in East Java Province, which relies highly on its industrial sector. As an industrial region, Mojokerto District is attractive for investors, especially from foreign countries. Using qualitative research, we found that although FDI in Mojokerto District has several channels through which to contribute to inclusive growth, its effect is limited, especially in the areas of employment creation and MSME linkage. This is the result of a lack of inclusive institutions to support employment creation and MSME linkage. Moreover, the existing institutions are extractive, preventing society from benefiting from and being involved in FDI activities. Such institutions are influenced by the values of stakeholders such as foreign investors themselves, society, and government. The advent of industrial development in the region has affected the values of local people, making them more individualistic and materialistic. These values encourage individual members of society to take benefits for themselves at the cost of others.

7.1. Introduction

As already discussed in the theoretical framework of Chapter 2, FDI can promote inclusive growth through employment absorption, productivity improvement, economic linkages to the local economy, and Corporate Social Responsibility (CSR) programs. These channels lead FDI to foster the economic growth of the domestic economy and also to reduce poverty and income inequality, as so-called inclusive FDI. Inclusive FDI creates income and employment for local people, especially marginalized people such as the poor, women, and the disabled. In order to achieve inclusive FDI, our theoretical framework suggests the importance of inclusive institutions as proposed by Acemoglu and Robinson (2012). These institutions include economic institutions which allow all members of society to gain benefits from FDI, and political institutions which allow society to have a voice, engagement, and accountability in FDI programs or policies.

However, in practice institutions are not always inclusive, but are often extractive. A lack of participation and involvement by society in FDI activities or in government policy processes will cause FDI tend to have a negative effect on poverty and income inequality. Extractive institutions restrain local people, especially marginalized people, from gaining benefits from FDI activities. Therefore, as suggested in the theoretical

framework in Chapter 2, the presence of inclusive institutions not only in government but also in the other stakeholders like foreign companies and society is important to make FDI inclusive. In addition, whether all stakeholders have inclusive institutions depends on the strength of stakeholders' values on inclusiveness, as for instance, foreign companies' concerns not only to maximize profits but also to improve the welfare of local people. Likewise, the government and local people need to value openness and be supportive of the existence of foreign companies.

Based on our theoretical framework, this chapter first attempts to examine the impact of FDI on inclusive growth through employment opportunity, productivity improvement, CSR programs, and economic linkages to MSME. Inclusive growth will be measured by how much FDI leads to less income inequality and lower poverty rates through these channels. Second, this chapter investigates the extent to which institutions influence FDI to become inclusive. By adopting the concept of inclusive institutions, the chapter assesses whether institutions are indeed inclusive, or extractive. The chapter analyzes here the existence of economic and political institutions in all stakeholders, such as foreign companies, government, and society. This chapter also explores the integration of values of stakeholders which support the existence of inclusive institutions.

The investigation will be conducted for Mojokerto District, one of the largest districts in East Java Province. Mojokerto District is a region which relies highly on an industrial sector which during the period of 2010-2016 contributed around 52 percent to Mojokerto's economy. As an industrial region, Mojokerto District is attractive for investors, especially from abroad. Mojokerto is located close to Surabaya, the capital city of East Java Province, and has good access to infrastructures such as a sea port and an airport. In order to promote the industrial sector in Mojokerto, in 1991 the Indonesian government developed an industrial area called Ngoro Industrial Park (NIP). Currently, foreign investors from various countries operate their businesses in the NIP area. Therefore, the focus of the analysis will be directed to FDI operating in the NIP area and the society living in the surrounding area. For comparison, some foreign investors operating outside the area will also be observed.

Research questions

Based on the above background, this chapter aims to address two research questions. First, what is the impact of FDI on inclusive growth in Mojokerto District through channels such as employment creation, education and health improvement, economic linkages, and CSR programs? Second, what is the role of institutions in fostering FDI to become inclusive through those channels? This chapter will assess whether institutions of stakeholders in Mojokerto are inclusive or extractive. It will also

examine how the values of stakeholders on inclusiveness affect the existence of inclusive institutions.

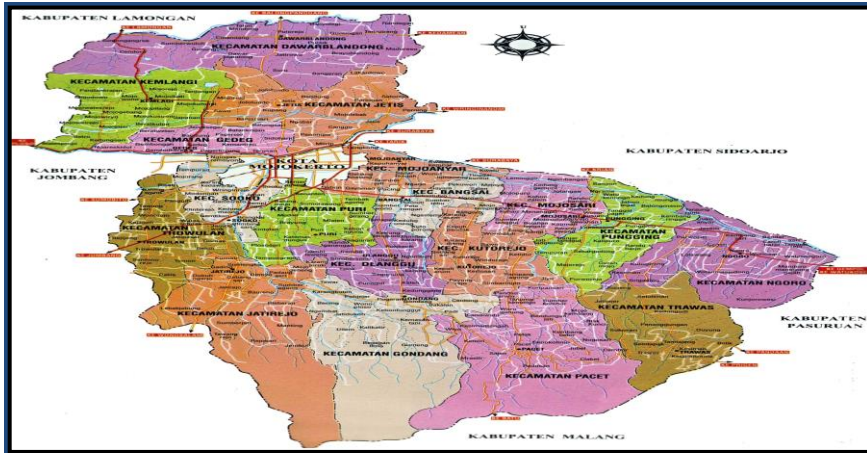
Methodology

In order to answer the two research questions, this chapter employs a qualitative method, involving in-depth interviews with stakeholders, including foreign investors, society, and local government. The NIP area becomes a main focus of this study. For foreign investors, managers of three companies operating in Ngoro Industrial Park (NIP) were interviewed. Representatives of foreign companies operating outside NIP were also interviewed as a comparison. In total, six foreign companies were interviewed: SA Corp., BS Corp., MB Corp., YK Corp., CH Corp., and MT Corp.²⁷ All companies interviewed are involved in the manufacturing sector except one company, which is involved in the agricultural sector. Moreover, people living near NIP including the head of the village, the leader of the religious community, and local people were interviewed. For local government, this study included representatives of related working units of the Mojokerto District government, such as the development planning unit, investment and license unit, manpower unit, industrial unit, education unit, and social working units. The analysis in this chapter is also supported by economic and social data from the Mojokerto District and a review of the existing literature on FDI and inclusive growth.

7.2. Mojokerto District Profile and Inclusive Growth Performance

Mojokerto District is one of the 38 districts in East Java Province which covers 2.09 percent of the total area of East Java Province. As shown in the map below, Mojokerto District is surrounded by six other districts: Lamongan and Gresik districts in the north, Jombang district in the west, Pasuruan and Sidoarjo districts in the east, and Malang district in the south. Most of the area is used for agriculture, but the contribution of the agricultural sector tends to decrease over time. Meanwhile, the area devoted to industry and residence tends to increase as the population increases.

²⁷ Corp. is an abbreviation of corporation.



Source: Mojokerto District's website²⁸

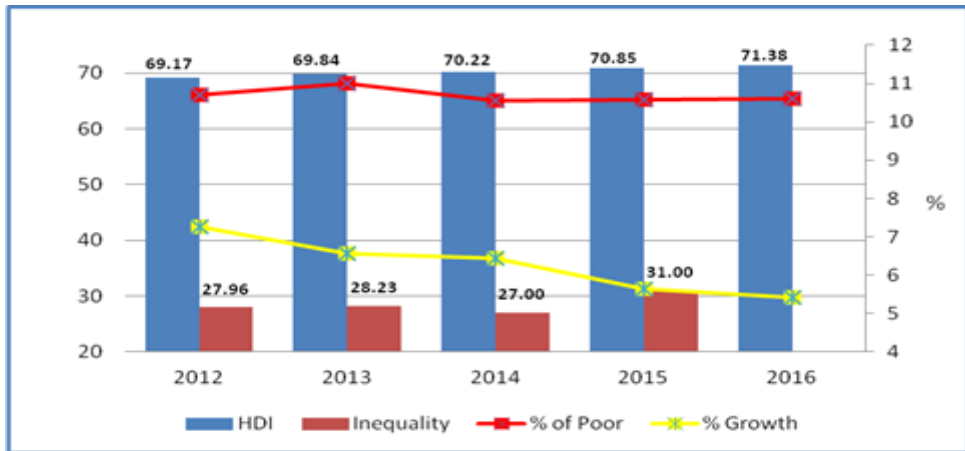
Figure 7.1. Map of Mojokerto District

Based on economic data provided by Mojokerto District statistics, Mojokerto's economy is driven by an industrial sector which contributes around 52.5 percent to the total economy. This contribution led to an economic growth of 6.32 percent per year during the period of 2011-2016, and was supported by a large number of FDI inflows to Mojokerto District, especially to the industrial sector. The economic growth of Mojokerto was significantly higher than that at the national level, which was 5.44 percent. In addition, Mojokerto has a good quality of human resources, as indicated by a high value on the Human Development Index (HDI). In 2016, the HDI of Mojokerto District (71.38) was higher than that of East Java Province (69.74) and of the nation as a whole (70.18). The availability of good quality human resources supports the development of industry and fosters economic growth.

However, the trend of economic growth in Mojokerto District decreased from 6.61 percent in 2011 to 5.41 percent in 2016. The decreasing economic growth was followed by higher income inequality, as indicated by the gini index, which was 0.27 in 2011 and 0.31 in 2015. Nevertheless, it was much lower than the national gini index (0.40) and East Java Province gini index (0.42) in 2015. In addition, in 2016, Mojokerto District had a low poverty rate (10.61 percent), much lower than that of East Java Province (12.05 percent) and national (10.86 percent). Unfortunately, the poverty rate tended to be stagnant during the period of 2012-2016 (see the following figure). High economic growth followed by low income inequality and poverty indicates that the economic growth of Mojokerto was inclusive. However, a constant rate of poverty and an

²⁸ <http://www.mojokertokab.go.id/thm/v1/?vi=geografis>

increasing trend of income inequality indicate that the economic growth of Mojokerto became less inclusive.



Source: BPS Mojokerto District and BPS East Java Province

Figure 7.2. Economic growth, inequality, poverty, and human resource quality of Mojokerto District, 2012-2016

However, the data presented cannot explain in detail the channels through which FDI affects inclusive growth. Hence, the next section will investigate the links between FDI and inclusive growth based on the results of in-depth interviews with related stakeholders, such as foreign companies, local governments, and society. The focus of this analysis is the Ngoro Industrial Park (NIP) area, which has been developed since 1991. Previously, the area was a rain-fed field, a dry land where most people worked as farmers. The farmers cultivated corn and seeds, and were well known for producing cashews. Ngoro was known as the Ngoro cashew area.

7.3. FDI and Inclusive Growth in Mojokerto District

As already mentioned in the theoretical framework in Chapter 2, FDI can promote inclusive growth through several channels, such as employment creation, productivity improvement, economic linkages, and CSR programs. Inclusive FDI can create income and improve the welfare of local people, especially marginalized people, so that poverty and inequality are reduced. This section examines how FDI affects inclusive growth through those channels. The focus of our analysis is foreign companies in the NIP area, the society living in the surrounding area, and the role of local government. The final

objective of this section is to determine whether FDI in Mojokerto District has adequately provided channels to make FDI inclusive.

7.3.1. Employment opportunity

As mentioned in the theory, the business activities of FDI in a host economy can absorb employment from local people so that they have jobs and receive a regular income. By working for foreign companies, local people also have an opportunity to be promoted to higher positions and receive higher incomes. In addition, related to inclusive growth, which is growth beneficial for all members of society, FDI can create employment and income for marginalized people like the poor, women, or the disabled. These people are usually excluded from the labor market and restrained from FDI activities. This section assesses whether FDI actually does have a positive effect on inclusive growth by creating employment for local people.

Based on in-depth interviews, representatives of foreign companies explained that they tend to employ local people who meet particular requirements, such as minimum education and skills. For instance SA Corp., involved in the manufacturing industry, employs 5700 workers. Half of the workers are local people, from Mojokerto District. The minimum education required for employment at the company is vocational senior high school or a similar level. Since Mojokerto District has a good quality of human resources as indicated by the Human Development Index (HDI), many local people can be hired by the company. However, although local people can meet the requirements, the company realizes that they cannot entirely meet the demand for employees. Hence, it hires workers from the regions surrounding Mojokerto or outside the East Java Province. This was explained during an interview by the HRD of SA Corp. as follows:

“SA’s workers come from different regions in Indonesia. However, 50 percent of the total workers are filled by people from Mojokerto District. The rest of the workers come from other regions in East Java, and even from Central Java. We need workers who are responsible and have good skills. So they will have a good position. All requirements can be fulfilled by workers from Mojokerto District. However, we need many workers for operating machines of productions. The numbers of workers from the Mojokerto District are not sufficient to meet the demands.” (HRD of SA Corp., Mojokerto District, 18 May 2016)

Local people who work at SA Corp. have equal opportunities to be promoted to higher positions such as supervisor and deputy manager. However, the highest positions in the company such as senior manager, president director, and factory manager are filled by foreign workers; but based on one interview, of the total workers in the company, only six are foreign workers. Moreover, the company prioritizes domestic

workers to be promoted to the higher positions. This is supported by the statements of the HRD of the company during the interview.

“We have six people as foreign workers. The rest of the workers are Indonesian people. Foreign workers have high positions in management. However, there is one Indonesian who has become a deputy manager in the company. For being supervisors, we give priority to domestic workers. If there is no qualified domestic worker, we are open to external people.” (HRD of SA Corp., Mojokerto District, 18 May 2016)

The other foreign companies interviewed also tend to employ local people from Mojokerto District. However, most of them are temporary workers for whom the demand fluctuates depending upon seasonal production processes. Based on the interview, only a few people were employed permanently. For instance, CH Corp. employs around 1000 workers during the high season but only 300 during the low season. As temporary workers, the local people face uncertainty in their incomes. Therefore, they hope to be permanent workers. This is supported by statements of a member of society during the interview:

“Many parents want a situation where their children can work permanently in companies. Currently, most of the laborers have been hired as contract workers. They need around 2 years to become permanent workers.” (Mojokerto District’s local people, Wetonmas Jedong Village, 27 July 2017)

The main issue faced by companies, including foreign ones, in Mojokerto District is a high minimum wage. According to data from 2016, among the other regions, Mojokerto District has the fifth-highest minimum wage in East Java Province. A high minimum wage increases the costs of the company and leads to job losses among the workers. In addition, a high minimum wage also increases the incentive of the company to hire temporary workers rather than permanent workers. Based on an interview with a member of the Employers’ Association in Mojokerto District, the problem of a minimum wage in Mojokerto District is caused mainly by a lack of coordination between government levels in formulating the minimum wage.

Although the status of most local workers in the company is temporary, the current situation is better than the previous one when the local people worked as farmers. By working for the foreign company, local people receive higher incomes and other facilities. The existence of FDI also expands the opportunities of the local people to have other jobs than being farmers. This was expressed by an interviewee:

“In the past, our people were farmers...when considering the process of cultivation, the value of the output produced cannot cover the cost of cultivation. However,

farmers already felt happy if they could do harvesting time ... previously, providing grass for cows to eat was already considered as working.” (Mojokerto District’s local people, Wetonmas Jedong Village, 27 July 2017)

Besides creating employment for local people, the contribution of foreign companies to inclusive growth is shown by their tendency to employ female rather than male workers. Based on Buvinic and Gupta (1997), private sector programs targeted at females are effectively reducing poverty. For instance in SA Corp., of the total workers 90 percent are female. This is influenced by the characteristics of the company which demand workers who have skills, thoroughness, and perseverance. The HRD of SA Corp. explained this as follows:

“92 percent of our workers are females. SA Corp. operates on wire harness business activities which require thoroughness and perseverance. SA Corp. believes that females are better for those tasks and positions. Therefore, females work on production while males work on maintaining machines.” (HRD of SA Corp., Mojokerto District, 18 May 2016)

Although other companies also provide opportunities for females to work, the percentage of male workers is higher than of females. For instance, CH Corp. employs 30 percent females and 70 percent males. Similarly, BS Corp. has 40 percent female workers and 60 percent males. Other foreign companies such as MB Corp. and MT Corp. are dominated by male workers. The composition of male and female workers in the companies depends on the business characteristics of the companies. Another factor that keeps women from working in some companies is the negative image of women who work in positions like marketing staff. This was also mentioned by the interviewees:

“Our company has 30 percent female workers and 70 percent male workers. Some areas of the production process are not suitable for females. Employing females for the marketing position will also have a negative image in society.” (HRD of BS Corp., Mojokerto District, 19 May 2016)

The SA Corp. also has the intention to employ disabled people. Currently, the company employs only one disabled worker in the production unit. However, the number of disabled workers employed by the company is still lower than 1 percent of the total workers as required by Government law No.8/2016 on Persons with Disabilities. In order to comply with the government regulation the company has a plan to employ more disabled people by signing an agreement with a school for the disabled. However, so far the company has not been informed by the disabled schools about the

applications. The intention of the company to hire disabled people was mentioned during an interview:

“Currently, we have a disabled person as a worker. She only has a small defect on her legs and still can work very well. In the future, we will have more disabled workers. We prefer to have more disabled workers who are deaf and speech impaired. Therefore, they can still work as operators in production. The recruitment process for disabled staff has been conducted since the end of 2015. We just have to wait for the results.”(HRD of SA Corp., Mojokerto District, 18 May 2016)

Unfortunately, the other foreign companies interviewed have no intention to hire disabled people. Based on an interview, the companies also do not have particular policies regarding employment of disabled people.

Overall, the foreign companies in Mojokerto District contribute to inclusive growth through employment absorption for local people. By being employed in a foreign company, local people have higher incomes than when being a farmer. However, the foreign companies interviewed tend to -hire temporary workers rather than permanent workers. The most serious issue in Mojokerto District is the high minimum wage, which is caused by a lack of coordination among government levels regarding formulation of the minimum wage. The minimum wage problem affects the performance of manufacturing industries in Mojokerto District, especially labor-intensive industries. As a result, the data show that the contribution of the industrial sector to Mojokerto District’s economy tends to decrease over time.

Based on an interview, one of the foreign companies interviewed employs mostly female workers. It creates employment and income for female workers who are treated as vulnerable and marginalized people. However, hiring of female workers is highly dependent on the characteristics of the company’s business. Moreover, most foreign companies have less incentive to employ disabled people even though this is required by government regulations. Therefore, although foreign companies in Mojokerto District promote inclusive growth through creating employment for local people, it is still limited for disabled people.

The next section will observe foreign companies’ programs in training and health to improve their laborers’ productivity. As explained in the theoretical framework, local people who are employed by foreign companies also have an opportunity to improve their productivity through education and health facilities.

7.3.2. Productivity improvement

According to the discussion in Chapter 2, FDI can contribute to inclusive growth by providing educational and health programs for their employees to improve their

productivity. For example, on-the-job training provided by the company can improve the skill of employees, making them more productive. Furthermore, by having higher productivity, employees have the possibility to be promoted to higher positions and receive higher incomes. In addition, higher productivity can also increase the competitiveness of employees in the labor market. Since most employees are local people, educational programs and health facilities will promote inclusive growth for local people. In addition, health insurance and facilities provided by a company can also improve the health of employees and make them more productive.

Based on an interview, foreign companies provide training courses and health facilities to improve the productivity of workers. The companies provide general and specific training courses. General training courses include safety and production training, and are provided for new workers. Training courses related to safety are important for new workers, especially in the industrial sector, to reduce the possibility of accidents during the production process. During the interview, one interviewee mentioned:

“We are concerned about a safe and comfortable situation for our workers. That is why we received an award for zero accidents from the government.” (HRD of SA Corp., Mojokerto District, 18 May 2017)

Moreover, training related to production processes is also important because it provides workers with knowledge on the whole process of production in the company. Such knowledge of workers on the production process will also make it easier for the company to rotate workers from one position to another.

Foreign companies also provide specific training, so-called on-the-job-training, based on the worker's position in the company. For instance, SA Corp. provides two-month on-the-job training for its new workers. After the training, workers will get a certificate based on their skills. Further, the company uses the certificate as a base to place its workers in particular positions. The certificates are also used by the company to promote its workers to higher positions. Another foreign company provides training whenever the company introduces a new technology. During the interview, the company representative mentioned that:

“Higher job positions require more certificates for particular skills. For instance, a group leader who supervises around 20-60 workers should have all types of certificates since the leader should be ready to substitute a worker who is absent.”(HRD of SA Corp., Mojokerto District, 18 May 2016)

Training provided by the company can also transfer knowledge from foreign workers to local workers. These knowledge transfers improve the skill of local workers and increase their chances to be promoted to a higher position. One interviewee emphasized the importance of training for knowledge transfer, as follows:

“In the beginning, the company had around two or three foreign workers at the Mojokerto District site. Recently, all workers here are local workers. No foreign workers anymore. The position has been filled by local workers.” (HRD of BS, Corp., Mojokerto District, 19 May 2016)

“Workers can have a possibility to have a higher position. For example, we have a worker who was a basic technician... our company provided training such as leadership training. Now he is a leader of our branch company in Mongolia. So far, we have successfully promoted 5 workers to fill strategic positions.” (HRD of MB Corp., Mojokerto District, 19 May 2016)

Regarding health facilities, based on an interview foreign companies provide health insurance not only for their workers but also for workers’ families, including their children. In addition, a health facility, such as a 24-hour health clinic and doctors, is provided in order to anticipate any accident during working hours. For instance, an interviewee from one of the foreign companies explained that:

“Our company provides health insurance for our workers. We combine national (government) with private (company) health insurance. We have cooperation with a hospital which is located near the company’s area. In addition, we have a 24- hour health clinic and daily doctors that can help workers. Besides that, we provide a comfortable room for break time...we have concern for the safety and comfort of our workers.” (HRD of SA Corp., Mojokerto District, 18 May 2016)

The policy of SA Corp. to provide a comfortable working environment is mentioned by a member of the local community. Based on an interview, the main obstacle for female workers to work in industries is that they have to leave their families, especially their children. In order to increase the incentive for females to work, SA Corp. provides a childcare and early childhood education program (Pendidikan Anak Usia Dini (PAUD)).

“Workers who work for SA Corp. receive some facilities. Workers who have children are facilitated by establishing PAUD and childcare. Other companies do not provide this facility for their workers.” (Mojokerto District’s local people, Kutogirang Village, Mojokerto District, 28 July 2017)

In conclusion, by employment in foreign companies, local people receive benefits through training and health facilities. Training includes safety, general, and specific training; health facilities include health insurance, a 24-hour clinic and comfortable working conditions. The training provided by the companies is successfully increasing the skills, competitiveness, and productivity of local workers. Moreover, health facilities such as insurance and clinics guarantee that local workers receive better health services and have better health.

The next section, as mentioned by the theoretical framework in Chapter 2, explains how foreign companies can also contribute to inclusive growth through CSR programs. This section will analyze whether the CSR programs of foreign companies in Mojokerto District have a positive effect on the welfare of local people, and especially marginalized people.

7.3.3. Corporate Social Responsibility (CSR) Programs

The CSR program is one of the channels through which FDI can contribute to inclusive growth. Based on an interview, foreign companies conduct CSR programs in health and education for local people. For a health program, SA Corp. and YK Corp. cooperate with local government to provide mobile health services to the local community, the so-called as Gepuk Emas. Other foreign companies provide CSR sanitation programs for society; for instance, YK Corp. developed a water pipe so that the community has healthy water for their daily life.

“We built a water pipe for a local village nearby NIP. We not only developed the pipe but also continuously maintained it. Through this program the local community will have sufficient and healthy water for their daily life and activities.” (HRD of YK Corp., Mojokerto District, 18 May 2016)

Another CSR program, called WASH (Water Access Sanitation Hygiene) is provided by BS Corp. in collaboration with the non-government organization Habitat for Humanity Indonesia and with the Mojokerto District government. The program is aimed to improve the welfare of 3000 households by developing healthy houses, toilets, and water. The interviewee explains that the WASH programs are effectively improving the quality of life of local people, especially farmers.

“An example of foreign companies that have been successfully implementing CSR programs is BR Corp. The programs had been conducted for 3 years in providing house refurbishment and water access. The conditions of houses provided by the program are good and local people are enthusiastic about the programs. By this program, the budget of the national and the Mojokerto District governments can be

reallocated to other regions in Mojokerto District.” (Mojokerto District’s government official, Mojokerto District, 12 May 2016)

Another CSR program which is successfully implemented by foreign companies is called the GENTA program. The program is financed by groups of foreign companies that collect funds to provide social programs for poor people and old widows. Three interviewees from local communities mentioned that the program is successfully implemented to improve the quality of life of the poor.

“Previously there was a program called as GENTA. In the program, some companies provided a contribution to society by providing a package of basic food items. This was conducted since 1997.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

“There was a funding from GENTA which was provided for the poor and old widows.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

“Previously, there was a GENTA which collected funds from companies in Ngoro Industrial Park. It also conducted a cataract surgery.” (Mojokerto District’s local people, Kutogirang Village, Mojokerto District, 28 July 2017)

Most of the foreign companies interviewed mentioned that their CSR programs are related to health programs. However, companies also provide CSR programs in education. According to an interview, foreign companies have internship programs for students so that they can gain working experiences in industries. The internship programs are not only for senior high school students but also for university students. In addition, some foreign companies provide company visit programs for students to give them knowledge of the business activities of the companies. According to an interviewee, the company visit program is provided not only for students but also for the local community. The possibility to visit the company is supported by the interviewee from local community, as follows:

“Actually, local people cannot distinguish between foreign and domestic companies. I had an opportunity to visit one foreign company in Ngoro Industrial Park. From the visit, I know that the company is a foreign company and business. In addition, the foreign company also attempts to expand its markets by showing its business process to local people. It is good and positive for the company and local community since all people can understand and know about the company.” (Mojokerto District’s local people, Wetonmas Jedong, Mojokerto District, 27 July 2017)

Another CSR program related to education is provided by the MB Corp., which teaches English conversation to senior high school students regularly once a month. The program trains the students to speak in English for 2 hours and provides an opportunity to speak with a native speaker.

“Every month, our new general manager has an English conversation class for 2 hours. He tells stories and asks questions. Therefore, students have an opportunity to speak to foreigners.” (HRD of MB Corp., Mojokerto District, 19 May 2017)

In summary, through CSR programs, foreign companies in Mojokerto District can contribute to inclusive growth. The types of CSR programs conducted vary among the companies. In general, the programs consist of education and health programs. Health programs are targeted for local people including the poor, females, and children. Meanwhile, the education programs are targeted mostly to local people and students. Based on the interview, health programs are successfully improving the quality of the targeted people, for instance through sanitation development.

Besides contributing to inclusive growth through CSR programs, according to the theoretical framework in Chapter 2, foreign companies can also benefit local people through their linkages to the local business, especially micro small-medium enterprise (MSME). The MSME represents the business that is mostly accessible to the poor. The next part will explore the linkages of foreign companies with local business, especially MSME.

7.3.4. Linkages to Micro Small-Medium Enterprise (MSME)

Foreign companies in Mojokerto District, especially in Ngoro Industrial Park (NIP), have economic linkages to Mojokerto District economy. Related to inclusive growth, the foreign companies have economic effects on the other sectors, especially Micro Small-Medium Enterprises (MSME) where most poor people work. The linkages of foreign companies can be forward and backward linkages. A forward linkage means that output from a foreign company is used by MSME to produce final product. A backward linkage means that a foreign company requires inputs supplied by MSME to produce final output.

For the backward linkages, NIP has economic linkages to the other sectors surrounding the NIP area such as housing, restaurants, trade, and agriculture. As already mentioned, before the development of NIP most of the local people, especially those living near the NIP area, worked as farmers. After NIP developed, local people living nearby started businesses such as housing for company workers, restaurants, and catering. These businesses created a more stable and sustainable income than that from their previous jobs as farmers.

In addition, BS Corp., involved in the agricultural sector in producing corn seeds, has both forward and backward linkages to local farmers. For backward linkages, BS Corp. cooperates with farmers to cultivate raw corn seeds. The farmers who cultivate raw seeds are called grower farmers. Based on an interview, BS Corp. employs grower farmers and creates income for them. During the interview, the staff of BS Corp. explained as follows:

“We cooperate with small grower farmers with an area of land around 2 hectares. In 2015, one hectare of corn field was owned by five to seven people. Therefore, by having around 2,800 hectares of fields from the Banyuwangi district (the eastern part of East Java) to the Middle of Java province, we involved around 20,000 – 30,000 grower farmers.” (Public Relation of BS Corp., Mojokerto District, 19 May 2016)

BS Corp. also has a forward linkage to corn farmers. After corn seeds produced by grower farmers are harvested, they are ready to be sold to corn farmers. The buyers of corn seeds are not only farmers from the Mojokerto Districts but also from outside Java Island. The largest markets for corn seeds are in East Java province, including Mojokerto District. Besides engaging in the corn seed business process, BS Corp. provides training for grower farmers and corn farmers. The official website of BS Corp. states that farmers are important for its business. Therefore, BS Corp. provides training for farmers not only on how to produce and use corn seeds, but also on financial management.

One of the linkage programs initiated by BS Corp. tried to link the supply, financing, and demand for corn. The linkage program incorporated the banking sector that provides soft loans to farmers, and CG Corp., which buys corn from farmers. The program was implemented for 2 years, from 2014 to the beginning of 2016. However, an interviewee explained that the program cannot be continued because no soft loan was provided.

“Small farmers mainly faced three problems: technology, financial access, and the market. By considering those problems, we provide linkage programs for small farmers. Unfortunately, the soft loan program with a 2 percent interest rate has been replaced. The new loan program has higher interest rates. Hence, the program could not be continued.” (Manager of BS Corp., Jakarta, 13 June 2016)

Besides the above linkages, one foreign company in NIP also has a forward linkage to local people by processing waste, such as metals, boxes, plastics. The wastes can be processed by local people, providing them with significant incomes. An interviewee from a local community mentioned that:

“Previously, waste from foreign companies would be thrown away. Currently, people are smart. The waste has value. Some people who recycle waste can have a big house like a showroom.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

According to the explanations above, FDI in Mojokerto District has beneficial linkages with local people, especially the MSME. Foreign companies indirectly create employment and income for local people, who develop businesses such as housing, restaurants, and catering. Foreign companies also have direct linkages with local people, both forward and backward linkages. Through these linkages, and especially with MSME, the presence of foreign companies in Mojokerto can contribute to inclusive growth.

In summary, this section can report that FDI in Mojokerto, especially in the industrial area called NIP, has promoted inclusive growth through channels such as productivity improvement and the CSR programs. FDI also creates opportunities for employment for local people, especially marginalized people like the poor. However, the problems of high minimum wages and temporary workers keep local people from gaining benefits from FDI activities. Moreover, the backward and forward linkages of FDI to MSME are also limited. These findings support the data of Mojokerto District presented in the previous section, which showed that the current poverty rate is stagnant and income inequality is increasing. The findings from in-depth interviews and the analysis of secondary data indicate that FDI has become less inclusive in Mojokerto District.

The next section will observe the role of institutions in directing FDI to become less inclusive in particular channels and more inclusive others. The analysis will be directed to assess whether the institutions in Mojokerto are inclusive or extractive. Moreover, stakeholders’ values regarding inclusiveness will also be analyzed.

7.4. The Role of Institutions for Inclusive FDI

Based on the theoretical framework discussed in Chapter 2, inclusive institutions, both economic and political, are expected to play an important role in promoting FDI to become inclusive. Economically inclusive institutions are defined as the rules of the game that provide opportunities for all members of society, especially the marginalized, to benefit from FDI activities. Politically inclusive institutions are the rules of the game that provides opportunities for all members of society to have a voice, to be engaged, and to be informed on FDI policies/programs. The existence of inclusive institutions is influenced by how well inclusiveness is integrated in the values of all stakeholders including foreign companies, local government, and local people.

However, in practice institutions are often not inclusive but rather extractive. According to Acemoglu and Robinson (2012), extractive institutions benefit a small group of individuals while exploiting the rest of the population. Extractive institutions disregard the involvement of members of society in their economic activities, including FDI activities. Consequently, the existence of extractive institutions keeps FDI from becoming inclusive or beneficial for all members of society. Extractive institutions will lead to higher income inequality and poverty rates.

Based on the theoretical background above, this section investigates to what extent institutions influence FDI to become inclusive in Mojokerto District. Analysis of the role of institutions will seek to indicate whether institutions in Mojokerto are inclusive or extractive. Inclusive economic institutions allow the members of society to gain benefits from FDI activities, and inclusive political institutions provide an opportunity for all members of society to have a voice, to engage, and to be informed on FDI decision processes. Before analyzing the role of institutions, next part will examine the integration of stakeholders' values on inclusiveness.

7.4.1. The Values of Mojokerto's People, Foreign Investors, and Government toward Inclusive FDI

The integration values of stakeholders – government, foreign investors and society – are important for having inclusive institutions. As already mentioned, if the values of stakeholders are supportive of inclusive growth, they tend to have inclusive institutions. On the other hand, if the values of stakeholders do not support inclusive growth, those stakeholders will tend to be extractive. The values of stakeholders will be identified based on analysis of in-depth interviews, literature reviews, and official documents.

The Value of Mojokerto Society

Mojokerto District is highly influenced by the history of the Majapahit Kingdom, since Mojokerto District was at the center of that kingdom. Majapahit Kingdom was one of the greatest kingdoms in Indonesia and South East Asia. It was established in 1293 and reached its most magnificent period between 1350 and 1389. Majapahit Kingdom was famous because it had extended its territories to almost all of Southeast Asia. According to Mojokerto District's official website, the district's establishment date is the same as that when Majapahit Kingdom was established, which was May 9, 1293²⁹.

Based on Niswansari et al. (2013), Majapahit Kingdom's society was heterogeneous in religion, social, culture, and government system. Research based on its historical heritage found that Majapahit Kingdom's society could live harmoniously, even though they had different religions. Moreover, Majapahit Kingdom's society

²⁹ <http://mojokertokab.go.id/thm/v1/?vi=sejarah>

engaged in many social and economic activities, and was open to foreigners. In addition, this society had a culture to appreciate everyone regardless of their family background. The study also discovered that the King of Majapahit had democratic values, and always consulted with his officials about his decisions and policies. Thus, the Majapahit Kingdom's society was heterogeneous, respectful with pluralism, open to foreigners, and democratic. As a result, the society lived harmoniously.

Living harmoniously in a heterogeneous society is the value of Majapahit Kingdom that has been inherited by the society of Mojokerto District. According to interviewees, togetherness is the main value of people in the Mojokerto District, enabling them to live harmoniously in a pluralistic society. The interviewee mentioned that:

“Mojokerto District society is heterogeneous. Many people come to Mojokerto District especially because of the establishment of Ngoro Industrial Park (NIP), but we do not care about the origins of immigrants. Society is open to new-comers. We have a value of togetherness that helps us to mingle and accept differences.” (Mojokerto District's local people, Ngoro Village, Mojokerto District, 26 July 2017)

Another interviewee mentioned that the value of togetherness helps people to be more open to foreigners:

“The society of Mojokerto District is open to foreigners. Muslims and non-muslims can live harmoniously. Expatriates who work at Ngoro Industrial Park have married with local people. They are accepted by the community. If society is not open to foreigners, the marriage will not be accepted.” (Mojokerto District's local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

The values of Mojokerto's society on togetherness, openness, and democracy are in line with the aspects of inclusive institutions: voice, engagement, and accountability. Hence, with these values, Mojokerto's society is expected to support FDI to become inclusive. However, the value of togetherness has been eroded gradually, especially in the villages surrounding the NIP area. The development of NIP has created opportunities for local people to have jobs in the industries and receive higher incomes, but as workers in the company, local people tend to have less leisure time and social life than when they were working as farmers.

According to Kartika and Sari (2017), after the development of NIP, societies living near NIP became more materialistic and individualistic. Trust and commitment within the society, even among relatives, gradually decreased. Materialistic and individualistic values in society influence how society benefits from the existence of industries, especially foreign companies. The materialistic and individualistic values of industrial

society create extractive institutions which benefit small groups of people at the cost of the rest.

The Value of Foreign Companies

By examining the visions and objectives of the foreign company representatives interviewed, all companies indicated a concern with their contributions to society. Moreover, the companies also considered the aspect of environment. Companies' contributions to society and concerns for the environment are the main principles of inclusive and sustainable development. For instance, one foreign company in NIP has a vision to care for the environment, to contribute to society and to enhance trust with stakeholders. Another foreign company also has a principle to grow with communities through community partnership. Those examples indicate that these foreign companies aim not only at promoting profits but also at benefiting society and preserving the environment. With such values, foreign companies are expected to have inclusive institutions, leading to policies or programs that benefit all members of society and involve society in the policy process.

The Value of Mojokerto District Government

The value of Mojokerto District's government is identified by looking at its medium-term development planning (RPJMD). Based on the RPJMD for the period of 2016-2021, the government of Mojokerto District has a vision "to achieve Mojokerto society that is independent, democratic, equal, prosperous, and dignified". According to this vision, and especially its emphasis on equality and prosperity, local government has the objective of improving the welfare of society, without exception, and distributing the development equally to all members of society. Although inclusive growth is not explicitly stated in this vision, the aspects of prosperity and equality are principles of inclusive growth.

The above analysis shows that there are integrated values of inclusiveness among stakeholders in Mojokerto Districts. However, the transformation from an agricultural to an industrial society has eroded the values of this society, making it more materialistic and individualistic. This change in the society's values influences how FDI contributes to inclusive growth. The next section will discuss the economic and political institutions in Mojokerto District. The main question is whether institutions of stakeholders in Mojokerto District are inclusive or rather extractive.

7.4.2. Economic Institutions

As already mentioned, economically inclusive institutions are the rules of the game that provide opportunities for all members of society, and especially marginalized people, to gain benefits from economic activities, including FDI. The existence of

economically inclusive institutions will be observed in the channels of FDI leading to inclusive growth and in the values of all stakeholders, such as government, foreign companies, and society. Economic institutions here include governmental regulations, foreign company programs, and the supporting values of society. As suggested by our theoretical framework, economically inclusive institutions will promote FDI to become inclusive, while extractive institutions will restrict FDI from becoming inclusive.

7.4.2.1. Employment creation

The theoretical framework on inclusive FDI suggests that FDI can create employment for local people, especially marginalized people like the poor, disabled, and women. The national government's law No.25/2007 on investment and law No.13/2003 on labor empowerment gives Indonesian people the right to work in companies, including foreign companies. The laws also state that foreign companies can hire foreign workers only for particular periods and certain positions. Furthermore, there should be knowledge transfer from foreign workers to domestic workers, making it possible for foreign workers to be gradually replaced by local workers. Related to employing a disabled worker, the Indonesian governmental law No.8/2016 on Persons with Disabilities requires companies to employ at least 1 percent disabled people among their total employees. By such laws, the national government stimulates FDI to become inclusive through employment creation.

The intention to hire more local people is also supported by most foreign companies. During the interviews, the representative of one of these companies expressed their intention to employ local employees from Mojokerto District. In fact, this company employs only limited numbers of foreign workers.

“In the beginning, this company had around two or three foreign workers on the Mojokerto site. Lately, all workers here are local workers. No foreign workers anymore. The position has been filled by local workers.” (Public relation of BS Corp., Mojokerto District, 19 May 2016)

Specifically, during the interview, foreign companies were convinced that they provide work opportunities for the local people. Most foreign companies hire more than 50 percent of their total workers from Mojokerto District. Therefore, having an opportunity to work for foreign companies can increase local people's income and standard of living. Receiving a higher income for working at foreign companies is supported by the statements of interviewees:

“People who work for foreign companies can feel that foreign companies are more beneficial. Foreign companies produce good quality products and have more

sustainable companies, good working systems, and high salaries.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

“SA Corp. is well known for providing high salaries for its workers.” (Mojokerto District’s local people, Kutogirang village, Mojokerto District, 28 July 2017)

In addition, providing comfortable working conditions for workers has been influenced by foreign company policies and government regulations. For instance, an interviewee from one company explained that the program for labor welfare improvement is mostly influenced by the parent company. Hence, the international standard treatment for laborers is also implemented in the branch companies. The interviewee mentioned that:

“Our parent company is concerned with aspects of creating a great place to work and human rights.” (HRD of SA Corp., Mojokerto District, 18 May 2016)

Mojokerto District’s government also supports foreign companies in providing comfortable working conditions. According to Indonesian Law on labor empowerment No.13/2003, every company should provide comfortable working condition such as sufficient break time and absent. Mojokerto District government through its labor empowerment-working unit regularly monitors facilities provided by foreign companies for laborers.

Based on the analysis above, national government and foreign companies have regulations and programs to support FDI to become inclusive through employing local people. Moreover, the government requires companies, including foreign companies, to employ a minimum of 1 percent disabled people. However, based on an interview, although some local people might have the opportunity to work in foreign companies, others do not have these possibilities. During the interview, one of the interviewees realized that not many people can be absorbed by foreign companies:

“It is very difficult for our people to work in companies in Ngoro Industrial Park. Until now, our people might be hired only for cleaning the street.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

In addition, among the foreign companies interviewed, only one company intended to employ disabled people even though in practice the company employs fewer than required. The government also does not enforce companies, including foreign companies, to hire disabled people in spite of government regulations.

In conclusion, economic institutions for employment absorption are not very inclusive because foreign companies are less likely to employ marginalized people like

disabled people. Although the national government by its regulations requires companies to hire local people and disabled people, unfortunately, there is no enforcement by the government. Moreover, there are no specific regulations or policies of local government concerning employment absorption for local people. The next section will examine the role of economic institutions in promoting FDI to become inclusive through productivity improvement.

7.4.2.2. Productivity improvement

With respect to economic institutions for productivity improvement, national government Law No.13/2003 on labor empowerment requires all companies to provide training for their employees. Each company can provide training which has been adjusted to the company's demand. Mojokerto District government through its labor empowerment working unit supports the implementation of training by monitoring the training and the relationship between company and labor³⁰.

Based on the interviews, all foreign companies provide safety and on-the-job training. Besides regulations required by the government, foreign companies also have their own values to improve the productivity of their workers. For instance, one foreign company's head office has a principle related to the relationship between the company and its employees. The principle states that the company will actively pursue human resource development and improve the capacity and creativity of its employees. In addition, an interviewee from the company argued that training is important for the company.

“All training courses will be funded by the company since the result of training will be beneficial for the company itself.” (HRD of SA Corp., Mojokerto District, 18 May 2016)

Training courses are not only beneficial for companies but also for the workers, helping them to increase their skills and capacities. By improving their skills and capacities, workers can be more productive and achieve higher positions. Those workers can achieve higher positions after training programs is supported by the statements of an interviewee:

“Workers have the possibility to have a higher position. For example, we have a worker who is a basic technician. He is a hard-working person and eager to learn English and presentation. Now he is a senior manager. Our company provided training courses such as on leadership. Currently, he is a leader of our branch company in

³⁰ Based on interview with Mojokerto District's government official (Mojokerto District, 12 May 2016).

Mongolia. So far we have successfully promoted 5 workers who fill strategic positions.” (HRD of MB Corp., Mojokerto District, 19 May 2016)

According to the analysis above, economic institutions in the channels of productivity improvement are inclusive. The facts show that the government requires companies to provide training for their workers, and foreign companies provides extensive training which effectively improve the skills and productivity of employees. The next section will examine economic institutions in CSR programs.

7.4.2.3. Corporate Social Responsibility (CSR) Programs

Implementation of CSR programs by foreign companies is supported by the values of these companies and by government regulations. Most foreign companies interviewed have values of inclusiveness and sustainability which support their programs to consider the welfare of neighboring communities and to preserve the environment. One interviewee from a foreign company mentioned that:

“We have three commitments: more concepts, work more, and improve community life. The CSR is one way to improve community life.” (Public relation of BS Corp., Mojokerto District, 19 May 2016)

In addition, all levels of government: national, East Java province, and Mojokerto District government have regulations for managing CSR programs. For instance, government regulation No.47/2012 on CSR of Limited Corporations states that all limited corporations with business activities related to natural resources are responsible for implementing CSR programs. Moreover, East Java province regulation No.4/2011 also regulates the CSR programs of the companies. Based on this regulation, the CSR program of the companies should aim to create harmonization by considering the environment, values, norms, and culture of the community. In addition, Mojokerto District’s government also regulates CSR by ratifying regulation No.7/2012. This regulation requires the establishment of a CSR forum to coordinate the CSR programs of companies and development programs of government.

As already explained, the CSR programs of foreign companies are mostly directed at marginalized people. In general, CSR programs are directed at improving the quality of health and education for the people who live in villages surrounding the company. For example, one interviewee mentioned that:

“There was an old person who was ill. He could not get treatment because he was poor and had no health insurance. I helped him to register with one of foreign company’s health programs. Fortunately, all of the medical costs of that old person were paid by

the foreign company.” (Mojokerto District’s local people, Kutogirang Village, Mojokerto District, 28 July 2017)

In conclusion, the economic institutions of CSR programs are inclusive. All levels of government support the implementation of CSR programs by companies. In addition, foreign companies conduct extensive CSR programs for communities surrounding the company. Based on the interviews, local people feel that these CSR programs are effective in improving their quality of life. The next section assesses economic institutions in inclusive FDI through MSME linkages.

7.4.2.4. Linkages to Micro Small-Medium Enterprise (MSME)

Result of interviews discussed in previous section has indicated that both foreign companies and government have the intention to strengthen links between foreign and domestic companies, especially MSME. For instance, one foreign company would like to develop business opportunities for local communities. Another foreign company wants to grow together with communities through community partnership programs. This can be expected to strengthen the economic links between the company and MSME. In addition, with its law on investment No.25/2007 the national government supports investors, including foreign investors, to have linkages with MSME as a prerequisite for receiving investment facilities. These regulations or policies to promote linkages between FDI and MSME, which is mostly assessable by poor people, indicate that government and foreign companies have inclusive economic institutions.

Having business linkages with foreign companies increases the opportunity of the local community not only to create income but also to improve their business standards. For instance, one interviewee from a foreign company mentioned that:

“Previously, one of our outsourcing partners was a small business. We have assisted the partner to become a limited corporation in order to avoid problems with the auditing process. We help the partner until it grows and becomes independent.” (HRD of MB Corp., Mojokerto District, 19 May 2016)

Based on another interview, society also agrees that business linkages of foreign companies with MSME will benefit the local community. The interviewee mentioned that:

“If society has competency, it will be beneficial to have cooperation with companies such as those processing wastes and supplying inputs.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

Overall, according to the analysis above, we can conclude that the inclusive economic institutions for inclusive FDI exist in all channels except employment

creation. Lower inclusiveness of economic institutions in employment creation is caused by the low intention of foreign companies to employ marginalized people. The next section will explore the inclusiveness of political institutions in Mojokerto District.

7.4.3. Political Institutions

As mentioned in the theoretical part, politically inclusive institutions are the rules of the game that provide opportunities for all members of society to have a voice, engagement, and accountability in FDI programs or policies. Voice means that people can express their aspirations. Engagement means that people can be involved in the decision-making process. Accountability means that people are informed about policies or programs. Therefore, if political institutions for FDI are inclusive, they can drive FDI to benefit all members of society, including the marginalized.

This section will analyze how politically inclusive institutions can influence FDI to become inclusive. As already explained, FDI in Mojokerto District can contribute to inclusive growth through hiring local people, improving labor's productivity, having linkages to micro small-medium enterprises (MSME), and providing Corporate Social Responsibility (CSR) programs. Therefore, this section will observe the presence of the aspects of voice, engagement, and accountability in the links of FDI with inclusive growth. However, before observing the current political institutions, this part will explain the dynamics of political institutions since the initial establishment of Ngoro Industrial Park (NIP).

When NIP was first established inclusive institutions played no role. People had no voice or engagement in the process. There was also no accountability aspect because the government did not discuss the plan for NIP establishment with the local people. This fact is supported by statements by an interviewee from Ngoro village:

“At that time, I was only asked to find lands, but I had no idea what the lands would be for. Neither the head of the village nor the district government inform us of the plans. Only the provincial government (East Java Province) with its governor, Pak Sularso, knew about the plan.” (Mojokerto District's local people, Ngoro village, Mojokerto District, 26 July 2017)

Local people also had no opportunity to express their aspirations. Land acquisition was the first step in the establishment of NIP. Some local people might agree but others disagree on the process of land acquisition. However, according to the interviewee, the local people could not do anything because at that time a centralistic government was in power.

“Actually, most of Ngoro sub-district’s citizens are high temperamental people. However, at that time our president was Pak Harto, who had a centralistic government. Hence, people did not dare to resist. People could not demonstrate. However, this did not mean that people took it for granted.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

After NIP was established, political institutions were not yet inclusive in hiring laborers. Local people had only limited opportunities to work in NIP because originally they worked as farmers and had a low education. Because that time was the period of centralistic government, local people had little opportunity to express their voices to the companies in NIP. This was mentioned by an interviewee:

“It was difficult for us to meet and communicate with company owners in the NIP area. At that time, I and the head of the sub-district (Camat) went to one company in NIP to discuss the dry bamboo problem. However, we did not meet the owner of the company, but we were welcomed by Indonesian staff.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

Upon initial establishment of NIP, the education of local people did not match the company’s requirements; hence, the unemployed people carried out criminal activities. However, the awareness of local people of the value of skills and education increased. In line with improvement in these areas, more local people were able to be employed at the NIP.

“In the beginning, people had limited education. They wanted to have money without working hard. They stole things from factories. Fortunately, recently, people have better understanding of the importance of education.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

“Parents always support their children to have a higher level of education if they want to be accepted to work in factories.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

However, even though the era of centralistic government ended in 1998 and Indonesia entered the decentralized era in 2001 and democratization era in 2005, political institutions were still not very inclusive. One reason is that the values of openness and togetherness among the local people, especially those living near NIP, had been eroded. As already mentioned, local people took on the values of an industrial society, and became more consumptive, individualistic and materialistic. These values kept local people from gaining benefits from FDI activities.

The next section explores the role of political institutions in the channels of FDI aimed at inclusive growth. As already mentioned in the theoretical framework, political institutions become inclusive if the rules of the game give opportunities for all levels of people to have a voice, be engaged, and have accountability with respect to foreign investors' decision-making processes.

7.4.3.1. Employment creation

As mentioned above, local people have greater opportunities to work in foreign industry. Based on interviews, foreign companies admitted that they employed more than 50 percent of their workers locally. In the hiring process, interviewees realized that political institutions can be either inclusive or extractive. One interviewee confessed that was a middleman who made the hiring process elitist. This middleman had better information than other people about the vacancies. He then took advantage of the existence of asymmetric information. The possibility of local people being employed depended on their connection with the middleman. The middleman could also be a member of the government, as mentioned during the interview:

“Until now, a head of village had an important role in recruiting laborers. The head of the village is still trusted to provide a supply of laborers. However, his position as a head of the village could become a political position. If the applicants did not select him during an election, their application process would take longer. On the other hand, when people have fulfilled the criteria, applications from people who are loyal to the head of the village will be immediately processed.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

“There was also a sub-village (Kelurahan) government official who used his position to recommend 13 people from outside Ngoro Village, while people from Ngoro Village were obstructed.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

“The role of the village’s official government is important. People can be recommended by the head of the village to work for companies. So that the head of the village is very influential since he knows the requirements. Usually, there is an agreement between head of village and companies.” (Mojokerto District’s local people, Kutogirang Village, Mojokerto District, 28 July 2017)

Besides being a government official, a middleman can be an internal worker in the company. In this case, the opportunity for local people to work in a company depends on their relationship with the internal worker. An interviewee mentioned that:

“If the personnel of the company come from Kediri, they will accept more applicants from Kediri. So, nepotism exists. In addition, I heard that the applicants had to pay.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

The head of the village plays a vital role in promoting local people to be employed in foreign companies. His choices depend on his intentions to strengthen his cooperation with the companies and his tendency to propose local people for employment. If he takes advantages for himself, he will select applicants based on his relationship with them. On the other hand, if he wants to give equal opportunity to villagers to be employed in the company, he has to support villagers to fulfill the requirements of the companies. An interviewee suggests that:

“Cooperation between village and companies should be increased. However, society has to improve its human capital capacity so that they can fulfill the companies’ requirements. The head of the village has information on the requirements for employees. If it is possible, he can recommend companies to accept local people who have the education and skills that meet the companies’ requirements.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

When the head of a village provides equal opportunities for local people to be employed in a company, the local people gain voice and engagement with village officials. At the village consultation meetings, called *rembug desa*, local people can express their aspirations to the company through village officials. However, the village officials have no accountability. An interviewee explained:

“Besides discussing job opportunities, the society can make complaints at the village consultation meeting (*rembug desa*) and Badan Perwakilan Desa (BPD), or directly to the head of village. However, whether the head of village will inform companies about these complaints is still questionable.” (Mojokerto District’s local people, Ngoro Village, Mojokerto District, 26 July 2017)

As for foreign companies in the NIP area, they leave the process of recruitment to a market mechanism and treat the local people and migrants equally. Foreign companies in the NIP area did not give special privileges of employment to local people³¹. For instance, SA Corp. announces its vacancies on internet and cooperates with Special Job Fair, called Bursa Kerja Khusus (BKK)³². The BKK is located at a vocational school where students can apply directly for the vacancies. On the one hand, leaving the

³¹ Author’s conclusion based on interviews with all Human Resource Departments of the foreign companies

³² BKK helps students from vocational schools to find a job.

recruitment process to the market minimizes the need for a middleman. On the other hand, by leaving the hiring process to the market mechanism, marginalized or unqualified local people cannot be absorbed into the labor market. In the case of Badung district in Chapter 6, the foreign company gives local people the privilege to fill vacancies. The company also provides training to local people so that they can fulfill the job qualifications.

Based on the analysis above, the employment creation channel for inclusive FDI lacks inclusive political institutions. The existence of a middleman in the recruitment process limits the opportunity of local people to be employed in the company. In this respect, political institutions are neither inclusive nor extractive. The role of the head of the village is central in determining whether local people have a voice, engagement, and accountability in the programs of FDI. More inclusiveness of political institutions will help to ensure that local people gain benefits from FDI.

7.4.3.2. Productivity Improvement

FDI can demonstrate inclusive growth through productivity improvement channels like trainings courses and health facilities. The involvement of workers themselves in designing training programs or providing health facilities determine whether the programs effectively improve the productivity of the workers.

As already mentioned in the previous section, SA Corp. provides on-the-job training for all of its workers. In designing the training, workers have the right to decide what is needed, and the company supports the training proposed by the workers. The process of designing training which considers the preferences of workers is mentioned in an interview:

“Every worker is asked to fill in a form about what training is needed and give it to the supervisors. Then the supervisors will inform us about what type, when, and also the cost of training. So that each section can have its own training. All trainings courses will be funded by the company because we believe that the result of training will also be beneficial for the company.” (HRD of SA Corp., Mojokerto District, 18 May 2016)

Based on this interview, the company has inclusive political institutions whereby the company involves workers in designing the training programs. As suggested in our theoretical framework, inclusive political institutions will promote FDI programs which help workers to improve their productivity. The next section will explain how political institutions affect the inclusiveness of FDI by their support of CSR programs. The implementation of CSR programs of foreign companies involves the aspects of voice, engagement, and accountability.

7.4.3.3. Corporate Social Responsibility (CSR) Program

Inclusive political institutions play an important role in the CSR programs of foreign companies. For instance, YK Corp. provides long-term CSR programs for the community in Jedong Village by building a water pipeline. The planning process for water pipeline construction involves the Mojokerto District government, which is represented by village officials and the society of Wetonmas Jedong. Society has a voice and is involved in the process of CSR planning. The opportunity for society to express their needs and preferences in the CSR program are supported by an interviewee's statements:

“At that time, YK Corp. needed to have our permission for business expansion. We gave permission and asked YK Corp. to help our village. YK Corp. agreed and asked about village needs. We said that we needed healthy water.” (Mojokerto District's local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

The interviewee from YK Corp. also confirmed that society had been involved in the process of the CSR program. YK Corp. consulted with the people about the CSR program most needed. This was mentioned by the HRD of YK Corp. during the interview, as follows:

“This company consults with village officials. We asked what kind of programs the village needs. In the village, there are some areas that have limited healthy water. Enough water is available but the water cannot get down to the village because there is a leak. The community asked us about the solution for having healthy water. So, we suggested the idea to build a sanitary water pipeline.” (HRD of YK Corp., Mojokerto District, 18 May 2016)

Inclusive political institutions play an important role in designing effective CSR programs. Members of society have a voice to express their needs to the company. In addition, the company also engages society in discussing and proposing the CSR programs most needed by the people. Inclusive political institutions help to make CSR programs beneficial for society by including the people in planning the programs.

7.4.3.4. Linkages with Micro Small-Medium Enterprise (MSME)

As already explained in the theoretical framework, FDI can promote inclusive growth through its linkages with MSME, where most poor people work. However, the links between FDI and MSME depend on political institutions which allow members of society to have voice, engagement, and accountability. Otherwise, political institutions become extractive, providing benefits for a small group of society but sacrificing the other members of the population.

Based on the interviews, not all members of society have access to link with foreign company activities. As with the previous channel, the head of the village plays an important role in creating linkages between the foreign company and MSME. The vital role of the head of the village was mentioned by an interviewee.

“The first person who knows companies’ demands is the head of the village since companies require permits from the head of the village.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

However, it depends on whether the village leader is willing to distribute the information. An interviewee mentioned:

“The previous head of village was too smart and tidy, so that not all people knew about the opportunity. He had a house that looked like a show room ...even currently he has a strong economy. The current head of the village does not want to take advantages for himself. Therefore, the local people have more opportunity to have a relationship with the companies.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

It is clear that when some people dominate the access to business linkage, others have limited opportunity to be involved. One interviewee confirmed that great effort is required to have business linkage:

“I have the opportunity to be involved in managing waste products. Someone else gets the opportunity to have business links while I only support him ... I learn, but I cannot directly have business links with companies. If I seize the opportunity, I have to compete and fight with others. That is why I do not want to have business linkages.” (Mojokerto District’s local people, Wetonmas Jedong Village, Mojokerto District, 27 July 2017)

Based on this explanation, in the channel of inclusive FDI through MSME, political institutions are not inclusive, or they are actually extractive. The absence of voice, engagement, and accountability in the foreign company’s program related to MSME linkage causes FDI benefits for a small group of society who have good connections with the head of the village. As with the previous channel, the existence of extractive institutions keeps the members of society from gaining benefits from FDI activities through MSME linkages.

In conclusion, in channels of FDI such as CSR programs and trainings, political institutions are inclusive. Meanwhile, in the other channels, such as employment absorption and MSME linkage, the political institutions are extractive. The existence of “a middle man” who has more information and a close relationship with the company

keeps the local people from expressing their voices and engaging in FDI activities. These extractive institutions keep FDI from becoming inclusive.

7.5. Conclusions

Based on the analysis above, FDI in Mojokerto District provides channels through which FDI can contribute to inclusive growth. These channels are employment creation for local people, especially marginalized people; productivity improvement for workers; CSR programs for poor people; and MSME linkages (see following figure). However, the effect of FDI on inclusive growth is limited, especially in the areas of employment creation and MSME linkage. This conclusion is also supported by the indicators from secondary data, which show that high economic growth in Mojokerto is not followed by lower income inequality and poverty rates. It means that economic growth is less inclusive.

As suggested by our theoretical framework, the effect of FDI on inclusive growth is determined by inclusive institutions which allow the members of society to gain benefits from FDI activities (economic institutions) and allow the members of society to have a voice, to engage, and to be informed of FDI policies or programs (political institutions). However, in practice, institutions can be extractive when they only benefit a small group of people at the expense of the rest. Extractive institutions prevent many members of society from gaining benefits from FDI activities and also keep them from being involved in FDI programs or policies. Based on our theoretical framework, the existence of inclusive institutions among stakeholders is influenced by how well values regarding inclusiveness are integrated in their thinking and activities.

By examining the role of institutions in promoting FDI to become inclusive, this chapter can report that inclusive economic institutions exist and contribute to almost all channels of inclusive FDI, except that of employment creation. The lack of inclusive economic institutions for employment creation is caused by the minimal intention of foreign companies to employ marginalized people, such as the disabled. The government requires companies, including foreign companies, to employ a certain percentage of local people and disabled people. However, in practice enforcement by the government is weak. Hence, this lack of inclusiveness of economic institutions in employment creation cause local people, especially marginalized people, to gain fewer benefits from FDI activities.

Moreover, this chapter suggests that although political institutions are inclusive in channels of FDI such as CSR programs and trainings programs, in the other channels, such as employment absorption and MSME linkage, the political institutions are extractive. This is shown in those channels by the existence of “a middle man” who has more information and a closer relationship with the foreign companies, especially in

industries. These extractive institutions prevent society from expressing its voice, and from engaging and being informed of FDI programs. Hence, extractive institutions keep FDI from becoming inclusive.

The absence of inclusive institutions in particular FDI channels is influenced by the values of stakeholders, such as the foreign company itself, society, and government. Before the region was developed as an industrial region, Mojokerto's society had strong values of togetherness and openness. However, since the advent of industrial development in the region, the values of local people have become more individualistic and materialistic. These values give the society less incentive to participate in social activities, including FDI programs. Moreover, the new values also encourage individual members of society to take benefits for themselves at the cost of other people.

In addition, based on in-depth interview, although foreign companies may have a vision to contribute to the community, in practice they have little incentive to employ marginalized people, such as the poor and disabled. Especially in employment creation, foreign companies have more motivation to seek cheap resources like inexpensive labor rather than to contribute to society. With respect to local governments, although they may have a vision for equality and welfare, the findings of this chapter are that the role of local government makes but a limited contribution to inclusive FDI. For instance, in the case of minimum wage formulation, there is a lack of coordination between local government and other levels of government, investors, and society. By its regulations, national government makes relatively more effort to drive FDI to become inclusive, but enforcement of these regulations is often inadequate.

Finally, this study indicates that a lack of integrated values on inclusiveness among stakeholders in Mojokerto means that institutions in particular channels of FDI are extractive. The existence of extractive institutions keeps FDI from becoming inclusive and members of society from benefiting from FDI activities and getting involved in FDI programs or policies. The actual links between FDI, institutions, and inclusive growth in Mojokerto District are presented in the following figure.

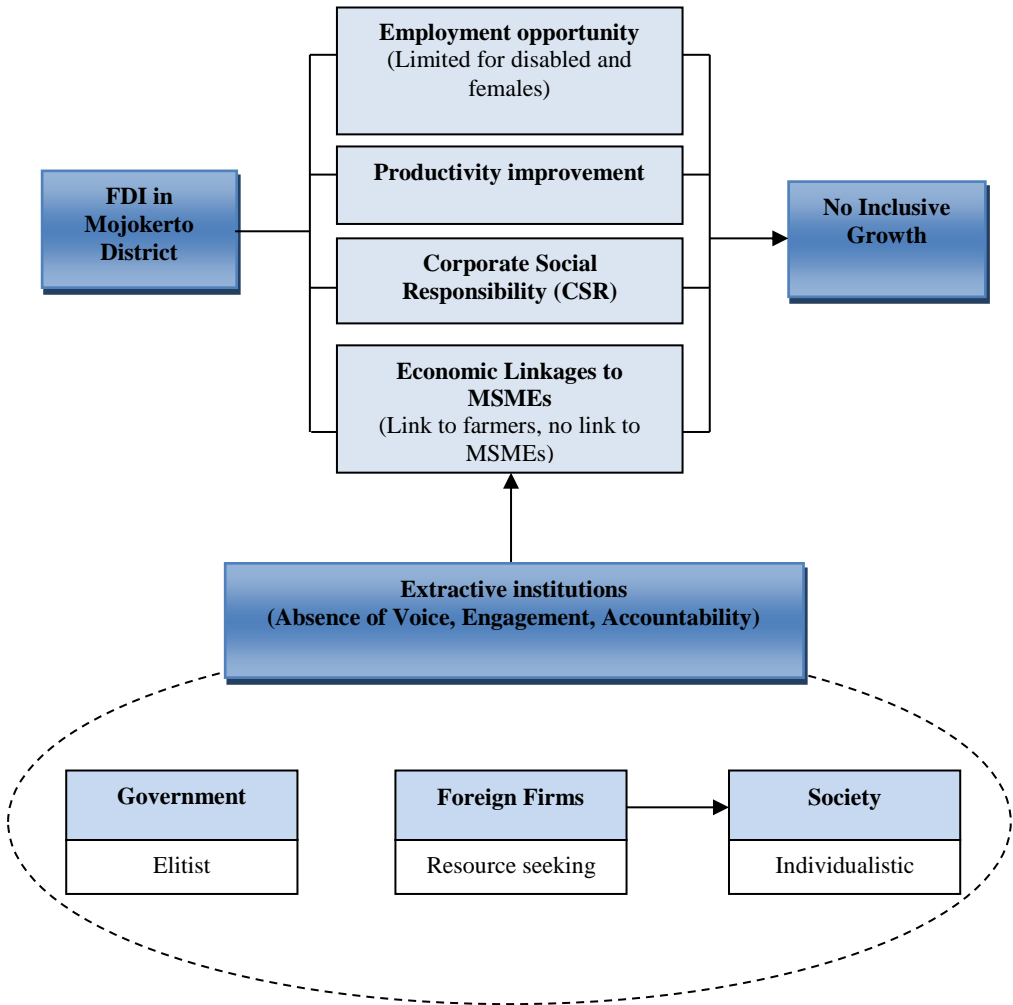


Figure 7.3. The actual links between FDI, institutions, and inclusive growth in Mojokerto District

Chapter 8

Foreign Direct Investment (FDI), Inclusive Growth, and Institutions: a Case Study of Industrial Sector in Tangerang District

Chapter 8 – Foreign Direct Investment (FDI), Inclusive Growth, and Institutions: a Case of Industrial Sector in Tangerang District

Abstract

This chapter explores the impact of FDI on inclusive growth and the role played by institutions in Tangerang District, Banten Province. Tangerang District is an industrial region where foreign investors make a dominant contribution to the economy. In addition, the industries operating in Tangerang are mostly heavy industries which use high technology and highly skilled labor. Based on overall analysis, we found the contribution of FDI on inclusive growth to be limited, largely because of a mismatch between the demands made on labor by high-capital intensive industries and the quality of human resources. Moreover, the lack of access of MSME to foreign companies has hindered MSME from linking with these companies. Meanwhile, CSR programs conducted by foreign companies are also less effective because society is not involved in designing the programs. These constraints indicate that the existing institutions are extractive, restricting the opportunity of society to gain benefits from and be involved in FDI activities. The existence of these extractive institutions in Tangerang District is highly influenced by the values of local people which have shifted from togetherness, kinship, and communality to individualism.

8.1. Introduction

In the previous chapters, the links between FDI, inclusive growth, and institutions have been examined in the two districts, Badung and Mojokerto District. Badung District as a touristic region has a strong value of inclusiveness, the-so called *Tri Hita Karana*, which is internalized in society and adopted by private sectors including FDI and local governments. The existence of inclusive values among all stakeholders has created institutions which provide opportunities for society to participate and be involved in activities to make FDI inclusive and beneficial for all of society, especially local people. On the other hand, Mojokerto District as an industrial region has been found to have extractive institutions which cause FDI activities to benefit only a small group of people. A fast growth of industrial sectors and the shifting values of Mojokerto society from “communalism” to greater “individualism” has influenced the degree of inclusiveness of institutions and kept FDI from being inclusive for local people.

Employing the same methods as previous chapters, this chapter explores the effects of FDI and inclusive growth in Tangerang District. This chapter also examines the role of institutions in making FDI inclusive in the district. Tangerang District as an industrial region located near Jakarta, makes an interesting case study. First, Tangerang is an

industrial region where foreign investors make a dominant contribution to the economy. This is actually relevant for this study because it gives a focus on the contribution of FDI. Second, unlike in Mojokerto District, the industries operating in Tangerang are mostly heavy industries which use high-technology and highly-skilled labor. This heavy industry is predicted to make less of a contribution to the local economy, especially in creating employment, because the local people are mostly low-skilled laborers. Third, Tangerang is a modern industrial region with a high growth of population caused by a huge flow of migrant workers into the region. Tangerang District is thus an industrial region with many migrant workers who influence the shape of institutions in Tangerang and the effects of FDI on local people.

Research questions

Based on the above background, this chapter aims to address two research questions. First, what is the impact of FDI on inclusive growth in Tangerang District through several channels: employment creation, education and health improvement, economic linkages, and CSR programs? Second, what role do institutions play in encouraging FDI to become inclusive through these channels? This chapter will assess whether institutions in Tangerang are inclusive or extractive, which in turn influences the effect of FDI on inclusive growth in the region. The chapter will also examine how the values of stakeholders on inclusiveness affect the existence of inclusive institutions.

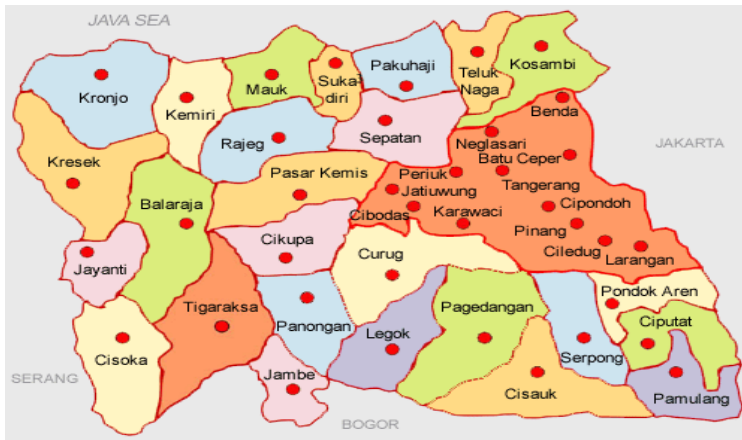
Methodology

To address the two research questions, this chapter employs a qualitative method by conducting in-depth interviews with stakeholders, including foreign investors, society, and the local government in Tangerang District. In total, five foreign companies were interviewed: VC Corp., NT Corp., DT Corp., PM Corp., and HL Corp.³³ All of these companies are involved in manufacturing. To collect information and capture the opinions of society on FDI, heads of villages and representatives of the local people were interviewed. In addition, for the local government, representatives of the related Tangerang government's working units were interviewed, such as the Development Planning unit, Investment and License unit, Manpower unit, Education unit, Health unit, and Cooperation unit. The analysis in this chapter is supported by economic and social data from Tangerang District and a review of the existing literature on FDI, inclusive growth, and institutions. The next section presents a profile of Tangerang District and its inclusive growth performance based on secondary data.

³³ Corp. is an abbreviation of corporation.

8.2. Tangerang District Profile and Inclusive Growth Performance

Tangerang District is one of the 8 districts/cities in Banten Province and covers 10.47 percent³⁴ of the total area of Banten Province. As shown in the map below, Tangerang District is surrounded by Java Sea in the North, and six other regions: Tangerang Selatan City, Tangerang City, and Jakarta in the East, Bogor District in the South, and Serang and Lebak Districts in the West³⁵. Most of the area is used for the agricultural sector, but the contribution of this sector tends to decrease over time. Meanwhile, the area devoted to industry and residential purposes tends to increase as the population increases.



Source: Google³⁶

Figure 8.1. Map of Tangerang District

Tangerang District's economy is dominantly driven by the industrial sector, which contributed around 41.03 percent to the total economy during the period of 2010-2016. The dominant contribution of the industrial sector to Tangerang District's economy led to a growth in its economy of 5.9 percent per year between 2011 and 2016. This growth was supported by a great number of FDI inflows to Tangerang District, especially to the industrial sector. In 2015 636 foreign investors were operating in Tangerang District and providing job opportunities for around 120,974 workers³⁷. The economy of Tangerang

³⁴ http://banten.bps.go.id/backend/pdf_publikasi/Provinsi-Banten-Dalam-Angka-2017.pdf page 6

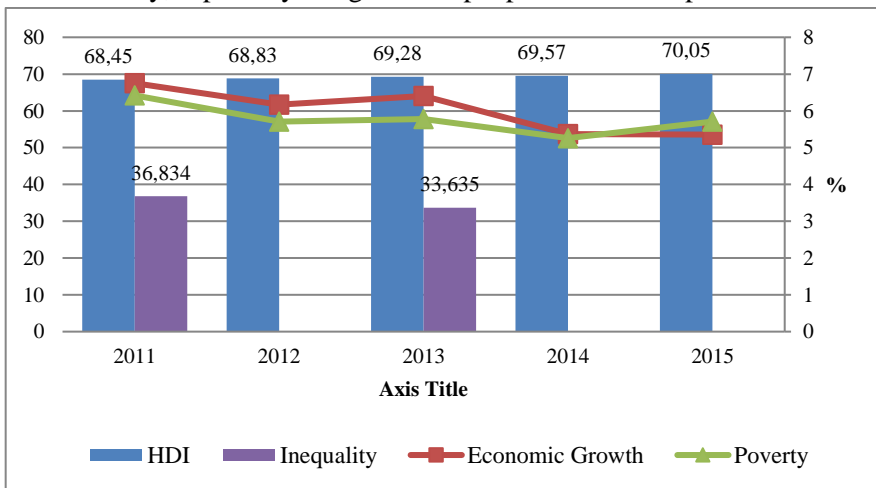
³⁵ https://tangerangkab.bps.go.id/website/pdf_publikasi/Kabupaten-Tangerang-Dalam-Angka-2017.pdf page 4

³⁶ <https://www.foreid.co/tag/bisnis-mlm/page/4/>

³⁷ https://tangerangkab.bps.go.id/website/pdf_publikasi/Kabupaten-Tangerang-Dalam-Angka-2017.pdf page 52

District grew by 5.44 percent in 2015 and was significantly higher than the 4.75 percent national economic growth. However, the trend of economic growth in Tangerang District decreased from 6.75 percent in 2011 to 5.32 percent in 2016, which was similar to the trend of national economic growth. Moreover, in comparison with the regions in the previous case studies, the economic growth of Tangerang District (5.9 percent) was lower than that of Mojokerto (6.3 percent) and Badung (6.9 percent) in the period between 2011 and 2016.

The economic growth of Tangerang District was followed by low income inequality, as indicated by the low gini index (0.34) in 2013. The gini index of Tangerang District was much lower than the national index (0.40) and Banten Province index (0.39). However, the income inequality of Tangerang District is greater than that of Badung and Mojokerto, the regions examined in previous case studies. In addition, Tangerang District had a low poverty rate (5.71 percent), much lower than that of Banten Province (12.05 percent) and the national level (10.86 percent) in 2015. Unfortunately, the poverty rate tended to be stagnant during the period of 2012-2015 (see following figure). This indicated that the economic growth had little power to reduce poverty. A constant rate of poverty and an increasing trend of income inequality showed that economic growth in Tangerang District was less inclusive and less beneficial for all members of society, especially marginalized people such as the poor.



Source: BPS Tangerang District and BPS Banten Province

Figure 8.2. Economic growth, inequality, poverty, and human quality of Tangerang District, 2011-2015

The less inclusive economic growth of Tangerang District can also be explained by the quality of its human resources. In 2016, the Human Development Index (HDI) of Tangerang District (70.44) was relatively the same as that of Banten Province (70.96) and the national level (70.18). However, the quality of human resources of Tangerang District is lower than in Mojokerto (71.38) and the Badung District (79.80). The quality of human resources supports the development of industries in Tangerang District, especially soft industries which employ low skilled labor. However, Tangerang District is driven dominantly by heavy industries which require more high-skilled than low-skilled labor. The mismatch between the demand of heavy industries for high-skilled labor and the lack of availability of this labor means that the growth of the industrial sector in Tangerang District creates less employment, especially for low-skilled labor. This is one reason why economic growth in Tangerang District is not very inclusive.

However, statistical data alone cannot explain the real situation of inclusive growth in Tangerang District. In addition, the secondary data also cannot explain the detailed channels through which FDI affects inclusive growth, such as employment creation, productivity improvement, and economic linkages. Therefore, the next part will investigate the links between FDI and inclusive growth based on the results of in-depth interviews with related stakeholders, such as foreign companies, local governments, and society. The information from these interviews will be used to assess the effect of FDI on inclusive growth in Tangerang District through the several channels.

8.3. FDI and Inclusive Growth in Tangerang District

As already mentioned in the theoretical framework in chapter 2, FDI can promote inclusive growth through several channels, such as employment creation, productivity improvement, economic linkages, and CSR programs. Inclusive FDI can create income and improve the welfare of local people, especially marginalized people, to reduce poverty and inequality. Based on our framework, this section examines the effect of FDI on inclusive growth through the channels named above. The focus of analysis is foreign companies, the society living in the surrounding the area and the role of local government. The final objective of this part is to conclude whether FDI in Tangerang District has provided channels to make FDI inclusive.

8.3.1. Employment creation

Our theoretical framework in Chapter 2 explained that an important channel through which FDI has a positive effect on inclusive growth is employment creation for local people, especially marginalized people like poor and disabled people and women. By having jobs, people receive income which can be used for consumption or spent on education or health to increase their welfare. For marginalized people, having jobs and

sustainable income will improve their living conditions and move them out of poverty. Marginalized people usually have limited access and opportunities to involve in economic activity. Therefore, this part analyzes whether FDIs in Tangerang District are inclusive for local people, especially the marginalized, in terms of job creation. The analysis is based on in-depth interviews with stakeholders in Tangerang District including foreign investors, local government, and society.

In interviews with foreign companies in Tangerang District, their representatives said that they have created employment for local people. The minimum education requirement for a job is senior high school or a similar level. For instance, VC Corp., which produces footwear, employs 15,000 workers who have a senior high school educational level. Moreover, PM Corp., which has business activities related to wire harnesses, employs around 7218 workers. The other foreign investors such as DT Corp. and HL Corp. hire around 1200 workers and 300 workers, respectively. Senior high school is sufficient for being workers in those companies. The two interviewees mentioned about the education requirement of their employees during the interview, as follows:

“We do not need skilled workers since we will give our workers internal training. Therefore, general senior high school will be no problem.” (HRD of DT Corp., Tangerang District, 4 May 2016)

“Senior high school workers will be positioned in the production process. The workers first will be trained for basic production process. Workers are not required to graduate from senior vocational school; at least they have education similar to senior high school. Workers with a senior madrasah school education background also will be no problem since they already have sufficient understanding. We need employees who can quickly absorb information and changes. We think employees with a senior high school education level are sufficient for meeting those requirements.” (HRD of PM Corp., Tangerang District, 4 May 2016)

Another interview states that foreign investors have the intention to employ more domestic workers than foreign workers. This claim is supported by the numbers of foreign workers employed in their companies, which are relatively small, constant and decreasing. For instance, DT Corp. has gradually decreased the number of foreign workers from 25 workers in 1995 to 2 in 2016, with positions as president director and Research and Development (R&D) manager. According to the interviewee, the DT Corp. intentionally decreases the number of foreign workers:

“Previously we had more than 25 foreign workers, while currently we only have 2 foreign workers. We have a knowledge transfer program. This program provides

training courses and on-the-job training in the field. The programs are mandatory and important, especially when we need to have a license from Tangerang District's Empowerment Working Unit on hiring foreign workers." (HRD of DT Corp., Tangerang District, 4 May 2016)

Moreover, the NT Corp. employs no foreign workers. The main reason for this is their expensive wages. An interviewee from the NT Corp. mentioned this during interview:

"We do not have foreign workers and, especially since 2012, all workers are Indonesian. The cost to pay foreign workers is too expensive." (HRD of NT Corp., Tangerang District, 3 May 2016)

Foreign companies also have a tendency to employ domestic workers because the quality of these workers already meets the requirements. In addition, the companies realize that a salary gap exists between foreign and domestic workers. During the interview, the VC Corp. mentioned reasons for employing domestic workers rather than foreign workers:

"The number of foreign workers should be restricted because Indonesia already has good quality human resources. Foreign workers receive a higher salary than Indonesian workers. For instance, for a manager's position, foreign workers can receive a salary of around Rp25-30 million while Indonesian workers only receive a salary of around Rp12-13 million." (HRD of VC Corp., Tangerang District, 3 May 2016)

However, based on the theoretical framework, FDI contributes to inclusive growth if it creates employment for the local people, and especially the marginalized, such as the poor and disabled, and women. In this case, the local people are those who are originally from Tangerang District and residents of the district. Based on an interview, most foreign investors claim that of their total workers they hire 50 percent local people. For instance, VC Corp. employs 60 percent local people from a total of 15,000 workers. HL Corp., which is a capital intensive company, mentioned that 90 percent of its total workers are local people. The main reason why the investors employ local people is that the quality of human resources in Tangerang District sufficiently fulfills the requirements. The companies mentioned this during the interview:

"Many local people from Tangerang District can fulfill the requirements. In addition, previously, Tangerang District had a big industry similar to ours. Local people have skills and experiences and can be accepted as our workers." (HRD of VC Corp., Tangerang District, 3 May 2016)

“Currently, Tangerang District has sufficient human resources in term of quantity and competency. We faced a problem when for the first time we settled in Tangerang District. Our company is a labor-intensive industry, and 80 percent of production is processed manually. At that time, we had an obstacle in finding workers in Tangerang District. We had to find workers from Serang District. Currently, we find it relatively easy to find workers from Tangerang District.” (HRD of PM Corp., Tangerang District, 4 May 2016)

“So far we have no obstacles in finding appropriate workers. Our company’s head said that Indonesia’s educational system is already good now in terms of subjects, theory, and skills.” (HRD of HL Corp., Tangerang District, 4 May 2016)

Besides the quality of human resources, foreign investors give priority to employing local people because buyers require them to do so. Moreover, one foreign company mentioned that it has an agreement to employ at least 30 percent of its total workers locally.

“We comply with our buyers. Based on Indonesian law, local people who are 16 years old can be employed as workers, while our buyers require us to employ workers who are 18 years old. We have to make sure the workers are local people, based on their family card. New applicants should submit their family card. Therefore, we have local people as around 60 percent of our total workers.” (HRD of VC Corp., Tangerang District, 3 May 2016)

“We attempt to prioritize local people as our workers. In this area, it is mandatory to employ at least 30 percent local people as new workers. For instance, of 10 new workers, we employ 3 workers from this village. We comply with this and we cannot hire workers only from outside the village. The quality of local people is sufficient. The village does not force us. As long as local people are qualified and meet our requirements.” (HRD of HL Corp., Tangerang District, 4 May 2016)

However, controversies about job creation for local people are mentioned in an interview. On the one hand, representatives of society agrees that foreign companies create jobs for local people:

“I ask companies to help our people who need to have jobs. Fortunately, all companies give a positive response to this, given their capacity. The existence of companies becomes beneficial for local people ... if I see, in CP Corp.³⁸, fortunately, the number

³⁸ CP Corp. is one of the foreign companies in Kadu Jaya village

of local people workers is higher than the number of migrant workers.” (Tangerang District’s local people, Kadu Jaya Village, Tangerang District, 9 August 2017)

“Most local people in this village work for PF Corp.³⁹ The number of local people working for PF Corp. is around a thousand people. However, currently, the company faces financial problems and will close its business this year.” (Tangerang District’s local people, Sukadamai Village, Tangerang District, 9 August 2017)

“Foreign investors, usually prioritize local people as their workers.” (Tangerang District’s local people, Kadu Jaya Village, Tangerang District, 9 August 2017)

On the other hand, other interviewees argued that it is difficult for local people to be employed in foreign companies. The main reason is that local people cannot compete with migrant workers from different regions in Indonesia. Local people have less perseverance than migrant workers.

“If I observe, most of the workers are from outside Kadu village. They even come from outside Tangerang District.” (Tangerang District’s local people, Kadu Village, Tangerang District, 9 August 2017)

“Foreign investors can be beneficial if they provide job opportunities for us. However, our people cannot compete with migrants. This might be caused by our lower work perseverance or spirit.” (Tangerang District’s local people, Sukadamai Village, Tangerang District, 9 August 2017)

A different reason for less employment creation for local people is a mismatch between the requirements of the company and the educational background of local people. As already explained in the previous section, Tangerang District is dominantly driven by capital-intensive industries which demand skilled and highly educated workers. For instance, NT Corp., which has around 250 workers, employs a limited number of local people. According to the interview, the main reason is that the NT Corp. is a capital intensive industry and its business activities are related to machinery. The NT Corp. requires workers with a minimum 3-year diploma education background. The workers will be assigned to handle not only production processes but also machinery. The mismatch between a company’s requirements and the level of local people’s education is also mentioned by Tangerang District government during interviews:

“A foreign company such as NT Corp. requires high-level educated workers. For administrative staff, most of the workers come from regions outside Tangerang

³⁹ PF Corp. is one of the foreign companies in Sukadamai village.

District. Local people can work only as security and blue-collar workers.” (Tangerang District’s government official, Tangerang District, 9 April 2016)

“A company wants to open its business in Tangerang District. The company has a training program for 40 workers who will have on-the-job training in China for 1 year during the preparation of their operations. The workers should meet one of the requirements, such as be graduated with a bachelor of industrial engineering, finished with vocational education in the machinery industry, have a bachelor of accounting degree, and be graduated from senior high school with sewing and cutting skills...however, there is no one from the local people who can meet the requirements. There are many local people who graduated from vocational school but no one has graduated from a vocational school of the machinery industry. In addition, many local people graduate from senior high school but, again, no one has sewing and cutting skills. Therefore, no local people can join the company’s training program.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

Employment creation for local people is not limited only in capital intensive industries but also in labor-intensive industries. Based on an interview, another reason for low employment absorption by a labor-intensive industry is the temporary contract offered by most companies. The companies tend to offer a short-term or temporary contract for low-skilled laborers. The temporary contract creates uncertainty about workers’ future income. Meanwhile, local people prefer to have a permanent contract rather than a temporary contract. An interviewee also mentioned this problem of temporary contracts:

“I did a survey with young local people. They said that the main problem they faced was the difficulties in finding jobs. Most companies use an outsourcing system which employs workers only for 3-6 months. After that, they do not have jobs. Our people do not want to have a short term contract, whereas companies only want to hire workers temporarily.” (Tangerang District’s local people, Kadu Village, Tangerang District, 9 August 2017)

The interviewee also mentioned that temporary workers receive low wages and prefer to have permanent jobs:

“A 3-month contract with income of Rp500,000 per month is only sufficient to pay recruitment costs. If the working period is longer, workers can save their income to buy motorcycles which can be used for generating future income.” (Tangerang District’s local people, Kadu Village, Tangerang District, 9 August 2017)

According to an in-depth interview, employment absorption for local people is also influenced by the existence of local staff working in the Human Resource (HR)

Department at foreign companies. If the staff of the HR department is made up of local people, society at the village level can communicate with foreign companies easily, especially about job opportunities. Otherwise, it is difficult for local people to communicate with foreign companies. This is supported by the statements of interviewees who represent society in the villages in Tangerang District:

“If the person working in the HR department is originally from our village, it will be easier for us to communicate.” (Tangerang District’s local people, Kadu Jaya Village, Tangerang District, 9 August 2017)

“Communication with foreign investors is difficult since, on average, they have a higher level of human resources. Therefore, they feel that their companies are better than others. Local people face difficulties in communicating with them.” (Tangerang District’s local people, Kadu Village, Tangerang District, 9 August 2017)

“It is easy for us to communicate with NT Corp., especially if the person who works for the HR Department is from our village.” (Tangerang District’s local people, Bitung Jaya Village, Tangerang District, 9 August 2017)

Related to the composition of women working in foreign companies, most of companies explained that they do not give priority to female workers. However, for a company to employ more female workers is highly dependent on the characteristics of the company. For example, of its 15,000 total workers the VC Corp. employs around 80 percent females. The VC Corp. employs more female workers because its type of business is related to women’s tasks such as stitching and sewing. Limited job creation for woman by foreign companies is supported by the statements of interviewees:

“Actually, we attempt to have gender equality. However, there is no female who applies for operator positions. We use automatic machines and females actually can also operate the machines.” (HRD of NT Corp., Tangerang District, 3 May 2016)

“We have more male than female workers. We need male workers since our machines should not be turned off for a whole day. Therefore, we need to have shift work to operate the machines. We cannot give shift work to female workers.” (HRD of HL Corp., Tangerang District, 4 May 2016)

“Our company is dominated by male workers. We need male workers in production processes which relate with machines and chemicals. Female workers are positioned in designed sections.” (HRD of DT Corp., Tangerang District, 4 May 2016)

Regarding disabled workers, based on interviews, foreign investors attempt to hire disabled workers. However, the number of disabled people employed by foreign

companies is still limited. The Indonesian government by its law No.8/2016 requires companies to employ at least one percent disabled workers out of their total workers. Based on interviews, several factors influence the number of disabled workers employed in foreign companies. Those factors are the willingness of disabled people to apply for a job, the internal value which foreign investors place on humanitarian values, and pressures from external parties such as government and buyers. All of these reasons were mentioned during an interview, as follows:

“We employ a small number of disabled workers because most people applying for jobs are healthy people. We accept disabled people applying for work in this company because of humanitarian reasons. In addition, there is an Indonesian governmental law which requires hiring disabled people. Thus, we have to be more focused on hiring disabled people.” (HRD of DT Corp., Tangerang District, 4 May 2016)

“Our company is willing to hire disabled workers because there is a regulation to hire a minimum of 1 percent disabled workers. In addition, our buyers force us to hire disabled workers.” (HRD of VC Corp., Tangerang District, 3 May 2016)

In summary, based on the explanations above, there are mixed results on the contribution of foreign companies to employment creation for local people, especially marginalized people, in Tangerang District. On the one hand, most foreign companies mentioned that they tend to employ local people because foreign workers are too expensive. Moreover, local people have sufficient capacity to be employed in the foreign companies. On the other hand, based on the other interviewees, several factors limit the ability of foreign companies to create employment for local people. Those factors are the mismatch between the company’s requirements and the education of local people, lower tendency of local people to work as temporary workers, and the existence of local people working in the HR department of foreign companies. Foreign companies also realized that they employ only limited numbers of disabled and female workers. Overall, in Tangerang District, the contributions of foreign companies to inclusive growth through employment channels are still limited.

The next section will observe the contributions of FDI to inclusive growth through productivity improvement. Based on the theoretical framework in chapter 2, it is expected that local people, specifically marginalized people, can improve their productivity by being employed in foreign companies. The local people who work in foreign companies will receive educational and health benefits which help to improve productivity.

8.3.2. Productivity improvement

According to our theoretical framework, foreign investors can contribute to inclusive growth through providing education and health programs for local people who work for foreign companies. For instance, educational programs provided by foreign companies are expected to increase the competency and skills of local workers. In addition, health facilities like full coverage health insurance provide benefits for local workers to improve their health condition. By having more competency and skills and also better health, the workers can work more productively and have possibilities to gain a higher position and income. This section examines the contributions of foreign companies in Tangerang District to inclusive growth through providing health and educational programs for local workers to increase their productivity. The analysis is based on in-depth interviews with stakeholders such as foreign companies, government, and society.

One interview reported that foreign companies provide training for their workers, consisting general and specific training. General training courses are conducted internally and aimed to give an overview of the production process and working procedures, especially for new workers. The general training leads the new workers to understand the whole process of production. It also provides knowledge on company rules and policies, and on safety rules. By understanding safety rules, the companies can avoid accidents during working hours. Those types of general training provided by foreign companies are mentioned during an interview as follows:

“We train our new workers for 10 days to introduce production, company rules, and targets of the production process. If the production target has been achieved, workers will receive up skill training on production lines in order to improve their capacities.” (HRD of NT Corp., Tangerang District, 3 May 2016)

“New workers will have general training on the production process for 1 month ... we also have standards for occupational health safety. Therefore, we have received an award for zero accidents.” (HRD of DT Corp., Tangerang District, 4 May 2016)

Besides general training, foreign companies also provide specific training for their workers. The specific training relates to workers' job positions and are called on-the-job training. Similar to general training, on-the-job training is conducted in the companies internally. On-the-job training can improve the skills of the workers related to their job positions. Moreover, the training is provided by senior workers and foreign experts to transfer knowledge to new and local workers. Knowledge transfer from foreign to local workers leads to a lower demand for foreign workers. The process of knowledge transfer through on-the-job training is mentioned by the interviewee:

“Previously we had more than 25 foreign workers, while currently we only have two foreign workers. We have a knowledge transfer program by providing training and on-the-job training in the field.” (HRD of DT Corp., Tangerang District, 4 May 2016)

“As I observe, the company prefers to have fewer foreign workers. When I joined the company in 2011, this company had eighty expatriates and currently this company has half of them. Domestic workers have been trained. The training is more about the job position (on-the-job training) so that workers can learn how to solve the problems in their positions.” (HRD of VC Corp., Tangerang District, 3 May 2016)

Another type of specific training, managerial training, is also provided by foreign companies to improve the competency of the workers. For instance, the VC Corp. provides managerial training since the company employs 15,000 workers and needs many leaders for the production process. Meanwhile, the NT Corp. also provides managerial training for selected and potential workers. The selected workers have an opportunity to take external training abroad. For example, the selected workers of the NT Corp. are sent to Japan to have long-term managerial training for one year. By taking managerial training, the workers can be become managers and take over the positions of foreign workers. As mentioned by the HRD of the company during an interview:

“We need many leaders. We will search for competent workers. We will hold managerial training for the workers and evaluate them. If they are good, they will be positioned as leaders. Their benefits and career developments will follow. We from the human resource department (HRD) support managerial trainings so that workers can be promoted. Expatriates can return to their countries and they can be replaced by domestic workers.” (HRD of VC Corp., Tangerang District, 3 May 2016)

Besides providing training for their workers, foreign companies also have educational programs for workers’ families. For instance, the HL Corp. provides rewards every year to workers’ children who have good achievements at school. In order to motivate its workers, the company also rewards the children of workers who are loyal and have good working performance. In addition, the PM Corp. has a summer camp program for workers’ children who are in their first year of junior high school. The summer camp program enables the children to travel to Japan to mingle with the children of workers in subsidiary companies from other countries. By providing family programs, the company expects workers to be more motivated to work for the company. This was mentioned during an interview with the staff of the company:

“Summer camp is aimed to motivate workers. We select the children whose parents have good performance. The workers will receive awards and their children will also

receive benefits. In addition, good workers also have an opportunity to join regular training courses.” (HRD of PM Corp., Tangerang District, 4 May 2016)

According to another interview, foreign investors provide private health insurance for their workers. Since the Indonesian government also has a national health insurance program for employees, foreign companies such as PM Corp. and VC Corp. combine their private health insurance with the national program. Moreover, the health insurance provided by the companies covers not only workers but also their families. The VC Corp., which employs 80 percent female workers, combines its health insurance program with other health programs such as medical check-ups and health education. The VC Corp. cooperates with a community health center, the so-called Puskesmas, to have health education and check-up programs for pregnant and lactating female workers. This program is supported by the local government. It was also mentioned by an interviewee:

“The health working unit also assists us in providing health programs for female workers. We also participate in “a love mother and acceptor” competition at provincial level. Health working units of the government will visit us to ask what we need.” (HRD of VC Corp., Tangerang District, 3 May 2016)

NT Corp. likewise provides free medical check-ups and a consultation program. The medical check-up is compulsory for its workers. The company takes workers’ health conditions seriously. The HR department of the NT cop. explained this during the interview:

“Every year, we have a routine medical check-up program for all workers. Afterward, workers can consult about the result directly with the doctor to have information on their health condition and what they should take into consideration. The program is mandatory. If workers are absent during the medical check-up, our company will accompany them to the hospital.” (HRD of NT Corp., Tangerang District, 3 May 2016)

As explained above, local people who work in foreign companies benefit from education and health programs provided by the companies. The general and specific training courses can improve the capacity and skills of the workers so that their productivity is also improved. Higher productivity helps workers to be promoted to higher positions and have higher incomes. Foreign companies also provide additional health programs such as health insurance and health education. The health programs ensure good health for the workers and support their job performance. In these ways, foreign companies improve the quality of life of local people who work for them. The

next section will examine the link between foreign companies and inclusive growth through CSR programs.

8.3.3. Corporate Social Responsibility (CSR) Programs

Another channel through which foreign companies can contribute to inclusive growth is Corporate Social Responsibility (CSR) programs. Based on the theoretical background in Chapter 2, CSR programs can be implemented by providing cash transfers as well as health and education programs. CSR programs are aimed to empower local people surrounding the companies, especially the poor, so as to improve their welfare. This section examines the CSR programs provided by particular foreign companies in Tangerang District and the benefits of these programs for the local people. The analysis is based on in-depth interviews with stakeholders such as foreign companies, society, and local governments.

According to the interviews, most foreign companies prefer to provide non-cash CSR programs such as education and health programs for people in their areas. For example, the VC Corp. and PM Corp. focus their CSR programs on the health and education of elementary school pupils. The VC Corp. built a library for a local elementary school and has designed a program to renovate the school's sanitation. PM Corp. also has regular health and education programs for elementary schools. Each year, the company has a target to build libraries, renovate sanitation, and develop the unit of school health for elementary schools.

Another company focuses on improving the knowledge and skills of senior high school students. For example, the NT Corp. provides skill and competency programs for local students. The program provides scholarships to give selected students one year of manufacturing training in one of the universities as well as six months of on-the-job training in the NT Corp. The scholarships cover tuition fees, allowance, housing, and transportation costs. The main objective of the program is to improve the skills of local people, especially senior high school students. Improvement of their skills can increase the probability that the students will have jobs and generate incomes. This was supported by the statements of interviewees:

“Last year we started providing education programs for four students. We hope that those children will have more skills and competencies in manufacturing besides general senior high school knowledge. After finishing their studies, they are free to choose where they will work. We also will provide them an opportunity to become our employees, but it depends on their preferences.” (HRD of NT Corp., Tangerang District, 3 May 2016)

The CSR programs provided by the NT Corp. help to improve the quality of local human resources, and especially young people. The program is also flexible in allowing the students to find better jobs in other companies. The benefits of these programs are supported by an interview with the representative of a local village, as follows:

“The education program provided by NT Corp. is very beneficial to improve quality of our human resources. Children just have to study hard, since all the costs, facilities, and allowances are paid by the company. NT Corp. does not force those children to work for NT Corp. if they have other job offers. The children who join the training currently work for NT Corp.” (Mojokerto District’s local people, Bitung Jaya village, Tangerang District, 9 August 2017)

Beside the CSR programs for children, foreign companies also consider the health effects of the environment surrounding the company. For instance, DT Corp. provides clean water for mosques and religious buildings located near its factory. The company constructed a water pipeline to channel clean water from the factory to the religious places during the whole year. The company also provides programs in waste management and water sanitation for the nearby village. The local people, especially the young, are taught about waste management. These programs involve cooperation between NT Corp. and a non-governmental organization (NGO). The benefits of the program for young people in the village were mentioned in an interview:

“Local young people can manage wastes. Now, not all waste products are thrown away. Young people can split wastes which still have economic value and thereby they can reduce the accumulation of rubbish.” (HRD of NT Corp., Tangerang District, 3 May 2016)

Regarding water sanitation management, NT Corp. built two water pumps for the local people. Based on an interview, the NT Corp. in cooperation with an NGO also trained local people to maintain the water pumps. However, the program cannot be continued because the local people cannot maintain and manage the water pumps independently. They have a mindset that all maintenance costs will be paid by the company and therefore have no incentive to maintain the water pumps themselves. This was mentioned during an interview with the HRD staff of the company:

“NGO had educated local people. Unfortunately, local people still have a mindset that if the water pumps are broken, we [company] will fix the machines. Meanwhile, the pumps were donated to the local people. They had to independently manage the pumps and the income generated was to be used for maintenance. The pumps eventually could not be used anymore.” (HRD of NT Corp., Tangerang District, 3 May 2016)

Overall, based on the explanations above, foreign companies in Tangerang have CSR programs to support local people to improve their quality of life. Foreign companies in Tangerang have CSR programs in health and education. CSR programs aimed at high school students help them to improve their skills and increase their probability of getting jobs. These conclusions are supported by the results of interviews. Moreover, the companies also have regular CSR programs for schools involving construction of school facilities and sanitation. However, the CSR program in water management has not been successfully implemented because local people could not manage and maintain the water pumps independently. The local people have a mindset that all maintenance is paid by the company, even though the company has educated the people about the program. The next section will analyze how foreign companies contribute to inclusive growth through their linkages with domestic companies, especially Micro Small-Medium Enterprises (MSME).

8.3.4. Linkages to Micro Small-Medium Enterprises (MSME)

The effect of FDI on inclusive growth can also be analyzed through its linkage with Micro Small-Medium Enterprises (MSME). MSME is a business activity where mostly poor people work and generate income. FDI can contribute to inclusive growth by generating income for MSME as a supplier for and consumer of foreign companies. As a supplier of foreign companies, MSME provides inputs to foreign companies for their operations. The greater the production of foreign companies, the greater the demand for MSME's products – these are the so-called backward effects. Meanwhile, as a consumer, MSME uses the products of foreign companies to process them into final products. Moreover, foreign companies also have indirect effects on local businesses which are not directly related to foreign companies. For example, industrial development leads to the creation of other businesses such as housing, restaurants, transportation, and other activities. This section explores the linkage between FDI and local businesses, especially MSME, in Tangerang District.

As explained above, fast development of the industrial sector in Tangerang District creates employment and income for local people. Because the demand for workers is high, people from outside Tangerang District are attracted to come and work in Tangerang District. The increasing number of migrant workers creates business opportunities for local people who can offer housing, restaurants, transportation, and trade. The demand of migrant workers for housing rental in Tangerang District is increasing. This was mentioned by interviewees from society and the local government, as follows:

“People can offer house rental services. Previously, many rental houses were empty. Since many companies demand a lot of workers, the rental houses are becoming full.” (Mojokerto District’s local people, Kadu Village, Tangerang District, 9 August 2017)

“The multiplying effects of the existence of foreign companies are significant for the Tangerang economy. For instance, of the total 15,000 workers, 70 percent are from outside Tangerang District. When workers from outside Tangerang District migrate to Tangerang, they need places to live. So, local people build rental houses and also other businesses such as restaurants, etc.” (Tangerang District’s government official, Tangerang District, 9 April 2016)

Besides the indirect effects mentioned above, foreign companies also have backward linkages to local people. For instance, PM Corp. cooperates with three local catering businesses to supply food for its workers. Having links with foreign companies should make the owners of catering businesses improve their quality to meet the requirements of the company. The HRD of PM Corp. explained this during an interview:

“For canteen facilities, we have catering services owned by local people. We have three. All of the owners come from this district. We have hygiene education for the catering businesses in cooperation with our health clinics, doctors, and Tangerang District’s health working unit.” (HRD of PM Corp., Tangerang District, 4 May 2016)

Another example of backward linkage between foreign companies and local people is the cooperation between HL Corp. and local suppliers of plastic bottles. After use, the plastic bottles supplied by local suppliers are used by the company to produce another product. However, the number of plastic bottles supplied by local people is not great enough to fulfill the demand of the company. Therefore, HL Corp. uses plastic bottles produced by another big company. An interviewee from HL Corp. mentioned the linkage of the company with local people as follow:

“Our main input of production is fiber. We can get fiber from recycling the plastic bottles. Local people can only supply ten percent of the total plastic bottles needed because they collect the bottle manually and there are not many plastic bottles from home waste.” (HRD of HL Corp., Tangerang District, 4 May 2016)

HL Corp. also cooperates with local tailors who provide sewing services. These tailors are housewives who have sewing machines and run individual businesses. The housewives’ sewing businesses have groups which are coordinated by group leaders. During the interview, a representative of HL Corp. mentioned its cooperation with sewing businesses in Tangerang as follows:

“We cooperate with a sewing service business. The sewing service business hires housewives who help us to sew and produce blankets. The blankets will be returned to us. These are individual businesses of housewives who have sewing machines. A group leader distributes the jobs to housewives in our neighborhood.” (HRD of HL Corp., Tangerang District, 4 May 2016)

However, the cooperation between the company and the home sewing services is temporary. Moreover, the home businesses have a limited capacity to meet the demand of the company. The cooperation between the company and the sewing business is also seasonal, because the demand of the company fluctuates. During the low demand period, HL Corp. uses the services of home sewing businesses, but during the high demand period, the company produces products with their own machines. Based on an interview, the demand of the company for home sewing services is decreasing because the company is also facing a decreasing demand for its products.

The above examples of backward linkages indicate that a local company has a limited capacity to meet the demands of foreign companies. Besides the factor of limited capacity, other foreign companies also mentioned that most of their inputs are imported from other countries. Consequently, local businesses gain limited benefits from foreign companies. Based on interviews, the quality of local products is also a reason for foreign companies to import their inputs from the other countries. This was mentioned during an interview:

“Our inputs are mostly supplied from imports. We have to fulfill European quality standards.” (HRD of DT Corp., Tangerang District, 4 May 2016)

“Our input materials are mostly imported. Only 20 percent of our inputs can be supplied by the industries in Cikarang, Bekasi. Actually, local MSMEs have possibilities to supply our inputs if the quantities and qualities of products can meet our requirements. So far, there is no MSME that can supply us.” (HRD of PM Corp., Tangerang District, 4 May 2016)

“There is no supplier from domestic companies. The inputs used in our company have been recommended by our buyers. We have to do all production steps by ourselves. We cannot sub-contract tasks to other companies.” (HRD of VC Corp., Tangerang District, 3 May 2016)

Regarding forward linkages, most foreign companies explained that they do not have forward linkages with local businesses. The main reason is that most foreign companies' products are exported to the international market rather than being sold on the domestic market. For instance, an interviewee from DT Corp. mentioned that:

“Our products are too expensive for domestic markets since the prices are in dollars.” (HRD of DT Corp., Tangerang District, 4 May 2016)

Another reason is that the foreign companies produce products based on the orders. This was supported by interviewees:

“Buyers are from abroad. They order to our parent group. We comply with our buyers who order the products. If we do not comply with the buyer’s requests, the orders may be decreased.” (HRD of VC Corp., Tangerang District, 3 May 2016)

“80 percent of our final goods will be exported to Japan and some of them to the USA. Only 20 percent of our products support one local automotive industry.” (HRD of PM Corp., Tangerang District, 4 May 2016)

However, based on interview, some other foreign companies do have forward linkages to local businesses who collect and recycle their waste products. The waste from production activities of foreign companies is used by local businesses to produce other products. Interviewees mentioned their linkages to local businesses in waste recycling as follows:

“We have a contract with one of the local businesses to collect and recycle our valuable wastes. The wastes will be used to produce sandals or shoes.” (HRD of VC Corp., Tangerang District, 3 May 2016)

“We prioritize local business. One of the local businesses collects our waste to produce vases or ashtrays.” (HRD of DT Corp., Tangerang District, 4 May 2016)

“We have cable waste. One of local businesses collects the cables. The local business splits the rubber and copper of the cables, and then sells them.” (HRD of PM Corp., Tangerang District, 4 May 2016)

In order to recycle the waste from the companies, local companies must fulfill some requirements such as hygiene and employment standards, including minimum wages and health insurance. In addition, the recycling products and the profits gained from the recycling activities are also expected to contribute to the revenues of the villages. This was supported by interviews as follows:

“As required by our buyer, all businesses which manage our waste should be certified by our buyer and auditors. The buyer and this company will educate and explain all requirements to the local businesses. Requirements related to employment standards are minimum wages and health insurance.” (HRD of VC Corp., Tangerang District, 3 May 2016)

“We prioritize a local business which not only collects but also recycles our waste into valuable products. We hope our waste can be useful for society.” (HRD of DT Corp., Tangerang District, 4 May 2016)

“We have a legal contract with one local business. Part of the profit gained by the local business is contributed to village’s revenues. The local business employs local people who cannot be absorbed by the industrial sector. Hence, local people still have opportunities to work.” (HRD of PM Corp., Tangerang District, 4 May 2016)

Besides the above requirements, another constraint faced by local businesses involved in waste recycling is the capital requirement. Based on an interview, local businesses that can be involved in the waste recycling business are those that have large capital. In addition, local people have limited access to communication with foreign companies about getting involved in waste recycling. The capital constraint faced by local businesses was mentioned during an interview:

“Actually, I am interested to have linkages with foreign companies. But that requires a large capital and capacity. Because I do not have them, I cannot get involved in the recycling business.” (Tangerang District’s local people, Tigaraksa Village, Tangerang District, 8 August 2017)

The explanations above show that foreign companies in Tangerang District have limited linkage with local businesses because of their limited capacity and capital. In addition, the local businesses must fulfill other requirements such as quality and employment standards like minimum wages and health insurance. This limited access of local people to foreign companies is also the reason why local people cannot benefit from foreign companies.

In conclusion, this section explains that the contributions of foreign companies to inclusive growth in Tangerang District are still limited. Through the employment creation channel, the company’s contribution to employment is inadequate because of a mismatch between the skills of the local people and the demands of the companies. The employment contribution of foreign companies to marginalized people such as female and disabled workers is also limited. Other issues faced in the employment creation channel are the minimum wages and temporary contracts offered by foreign companies. For local people, greater competition from migrant workers has also become a serious issue. With respect to their linkages to MSME, local businesses are faced with two main problems: limited capacity and limited capital. In addition, most foreign companies export their products to international markets and use input from foreign countries. Consequently, forward and backward linkages of foreign companies with the local

economy are limited. However, based on an interview, society feels that the CSR health and education programs of foreign companies are beneficial.

The next section will observe the extent to which institutions influence the inclusiveness of FDI in Tangerang District. The aim of the analysis will be to assess whether the institutions in Tangerang District are primarily inclusive or extractive. In addition, the values of stakeholders (society, foreign companies, and local government) regarding inclusiveness, and which influence the degree of inclusive institutions in Tangerang, will also be analyzed in the next section.

8.4. The Role of Institutions for Inclusive FDI

Based on our theoretical background in Chapter 2, institutions which provide opportunity for all members of society to gain benefits from FDI activities and to be involved in FDI policies are important for inclusive growth. However, in practice institutions are not always inclusive, but rather extractive. Extractive institutions tend to provide benefits only for a small group within the society. Extractive institutions prevent the benefits of FDI from being distributed equally to the members of society. Hence, because of extractive institutions, FDI activities are expected to increase income inequality and poverty. Moreover, as already explained in the theoretical framework, the existence of inclusive institutions is influenced by how deeply the values of inclusiveness are integrated in the thinking of stakeholders. Hence, before analyzing the role of institutions, the next section will examine the values of inclusiveness of stakeholders in Tangerang District.

8.4.1. The Values of Tangerang people, Foreign Investors, and Government toward Inclusive FDI

The integrated values of stakeholders – government, foreign investors, and society – are important as a basis for inclusive institutions. As already mentioned, if stakeholders have values that support inclusive growth, they tend to have inclusive institutions. On the other hand, if the values of stakeholders do not support inclusive growth, those stakeholders will tend to be extractive. The values of stakeholders will be identified based on in-depth interviews, literature review, and analysis of official documents.

The Values of Tangerang Society

As already described, Tangerang District is in a strategic location because it connects two trade regions – Jakarta and Banten. For this reason many people come to the region. Historically, Tangerang's original people were only Sundanese. Then many

people from Banten, Bogor and Priangan went and settled in Tangerang District⁴⁰. Therefore, historically, Tangerang District society welcomes and accepts differences.

The social conditions of Tangerang District in previous times were influenced mostly by agricultural values, whereas currently they are influenced by industrial values. In the agricultural society, people were related and close to each other. In addition, the district was famous for its culture of having gatherings in a public house, called an *ampihan*⁴¹. People in the village used the *ampihan* to gather, communicate, and solve problems together. However, this culture of gathering and communicating has disappeared since the coming of the industrial area. Tangerang District, which is known for a thousand industries, has also become an attractive destination for migrants to live or work. Tangerang District society has become heterogeneous. This is supported by an interviewee:

“We cannot separate Tangerang District’s local people from migrants since most migrants have become Tangerang District residents.” (Tangerang District’s government official, Tangerang District, 9 April 2016)

Moreover, people have become more individualistic because of having no time to gather and communicate with each other. Tangerang District’s change in social values is confirmed by an interview:

“Previously we assisted our own community center in the village. There, society could discuss concepts and solve problems...interestingly, society has developed. They do not have time for discussion anymore. If they have time, they lack resources. It becomes a trade-off between gathering with friends and earning a living.” (Tangerang District’s local people, Tangerang District, 20 April 2016)

Having values of kinship and openness, Tangerang District’s society is expected to have inclusive institutions to support inclusive growth. This means that the society is expected to be welcoming to the existence of foreign companies and to communicate easily with other stakeholders. However, decline in kinship and even a switch from kinship values to individualistic values will change the interaction between society and foreign companies and governments.

The value of foreign companies

All foreign companies interviewed were concerned about society and the environment. These companies’ contributions to society and concerns about environment are main principles of inclusive and sustainable development. For instance,

⁴⁰ <http://ozzychastello.blogspot.nl/2012/02/asal-mula-nama-daerah-tangerang-dan.html>

⁴¹ *ibid*

one foreign company –VC Corp. – has the motto "We are family". This means that the VC Corp. will grow together with local people and the community as a family. The VC Corp. also implements green concepts such as energy saving and waste recycling. Another company, NT Corp., also has a vision to share the company's values with the community so that the existence of the company will benefit the community. These examples show that besides having profit orientations, foreign companies can also consider their surroundings, and especially the welfare of society and the environment. Having these values, foreign companies are expected to have inclusive institutions for designing and implementing their policies or programs. In such a way the existence of foreign companies can be beneficial for all members of society, including marginalized people.

The value of Tangerang District's government

The values of Tangerang District's government can be observed in its medium-term-development plans (RPJMD). The Tangerang District government has a vision to bring about a Tangerang District society that is smart, prosperous, religious, and environmentally friendly. Even though inclusive growth has not been mentioned explicitly in Tangerang District's vision of development, its vision supports the inclusive growth concept: to provide opportunity for all members of society to be involved and engaged in economic activities. For instance, Tangerang District's government attempts to provide equal access and facilities of education and health to all its citizens⁴². Having these values, the district's government is expected to have inclusive institutions that will direct FDI to become inclusive or beneficial for all members of society.

According to the observations above, stakeholders – society, foreign companies, and government – in Tangerang District initially had integrated values. Tangerang District society had openness and kinship values which supported inclusive growth. Moreover, the district's government and foreign companies aimed at achieving a prosperous and environmentally friendly society that would contribute to inclusive growth. However, the value of kinship has relatively disappeared since the society became more individualistic. These changes in the society's values will affect how FDI can support inclusive growth. The next section will analyze whether the economic and political institutions in Tangerang District are inclusive or extractive.

8.4.2. Economic Institutions

Our theoretical framework suggests that institutions should be economically inclusive to promote inclusive FDI. Economically inclusive institutions are rules of the

⁴² <https://tangerangkab.go.id/sekilas-tangerang/show/2>

game that provide an opportunity for all members of society, including marginalized people, to gain benefits from economic activities, in this case FDI activities. Economic institutions include government regulations, foreign company programs, and also the values of society. However, based on our theoretical framework, economic institutions are not always inclusive. Economic institutions can be rather extractive, providing benefits only for a small group of people. Therefore, in this section, the existence of economically inclusive institutions will be observed in all channels through which FDI can be inclusive, and for all stakeholders.

8.4.2.1. Employment creation

As already mentioned in the theoretical framework, economic institutions can be inclusive if institutions stimulate FDI to provide employment opportunity for all members of society, especially marginalized people like the poor and disabled, and women. This is supported by Indonesian government law No.25/2007 on Investment and law No.13/2003 which states that all companies, including foreign companies, have to allow Indonesian people to work in their companies. However, this does not mean that the companies are forbidden to hire foreign workers. The laws still allow the companies to employ foreign workers for particular periods and certain positions. Moreover, companies have to support knowledge transfer from foreign workers to domestic workers so that the position of foreign workers can gradually be replaced by local workers.

Tangerang District government also considers that employment opportunity is important for local people. Therefore, by local government regulation No.12/2016, the Tangerang District government requires companies to give priority to local people to be employed. Companies, including foreign companies, have to disclose the total number of workers employed and needed to the Empowerment Working Unit of the Tangerang government. In addition, foreign companies must first inform the Empowerment Working Unit about vacancies at least fourteen days before opening recruitment to the public. Afterwards, the government will inform society about the vacancies⁴³. However, if there are no suitable applicants from among the local people, foreign companies may open the vacancies to people outside Tangerang District. In addition, if companies do not disclose job vacancies to the Empowerment Working Unit, the companies will receive administrative sanctions⁴⁴. The support of Tangerang government for local people being employed in the companies was mentioned in the following interview:

⁴³ Tangerang District regulation No.12/2016 on empowerment implementation, article 6.1.

⁴⁴ Tangerang District regulation No.12/2016 on empowerment implementation, article 6.5.

“We require all companies including foreign companies to report their laborers’ needs. Foreign companies also have to report their planning on hiring foreign workers and local workers.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

“We and the foreign companies that will open their business had a meeting with local people living near the company’s area. We informed them about vacancies and requirements. We had to inform local people, because if the company recruits people from outside Tangerang District, then there will be no resentment from local people. If local people cannot meet the requirements, the company can open the recruitment to the public” (Tangerang District’s government official, Tangerang District, 2 May 2016)

However, in practice, this law could not be well implemented. Tangerang District’s government realizes that companies prefer to use their own internal recruitment systems without involving the Empowerment Unit. In addition, Tangerang District can also not force foreign companies to provide priority to local people because other Indonesian people also have equal rights to be employed in the companies. These constraints are mentioned during the following interview:

“Actually, companies do not want to recruit through the empowerment unit, but according to law, the Empowerment Working Unit is responsible for empowerment.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

“How can we prioritize our people? We are not allowed to establish regulations to hire 40 percent of local people because all citizens in Indonesia have equal rights. All Indonesian citizens are allowed to work in Tangerang District.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

In addition, regarding job vacancies, in practice Tangerang District’s government has no authority to punish the companies that do not disclose their job vacancies to the Empowerment Working Unit. This is because Indonesian Law No. 13/2013 does not mention punishment, whereas the local regulation does speak of administrative sanctions. In this there is no synchronization between national government law and local regulations. The interviewee from the local government also mentioned this during the interview:

“However, there is no punishment if they do not inform the Empowerment Working Unit about job opportunities because Indonesian law No.13/2013 also does not mention any punishment. Punishment is given only to companies that violate norms

or have industrial conflicts which cannot be mediated.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

Although implementation of the above-mentioned government laws faces constraints, the interview makes a good case that a foreign company has an informal agreement with society. Based on the agreement, the company is required to hire at least 30 percent local people. For instance, an interviewee mentioned:

“We also have a responsibility to local people. If there are new vacancies, a minimum of 30 percent of workers are local people. For instance, if we need 10 workers, 3 of the workers are local people. We comply and we cannot hire workers from outside. So far, they have sufficient quality. The village also does not force us. It depends on workers’ quality and whether they meet the requirements.” (HRD of HL Corp., Tangerang District, 4 May 2016)

However, as mentioned in the previous section, employing local people has several constraints, such as mismatch between a company’s requirements and the education of local people, less tendency of local people to work as temporary workers, and difficulties in communicating with foreign companies.

With respect to female workers, the national government has no specific regulation which requires companies to give priority to female workers. However, certain amenities should be provided by companies for female workers. For instance, Indonesian law No.13/2003, article 76 regulates the rights of female workers younger than 18 or pregnant workers to have no working hours at night. If companies have night shifts for female workers they should provide food, comfortable working conditions, and shuttle buses for pickup and drop-off from their houses to their work.

Regarding disabled workers, job opportunities for them are regulated by Indonesian law No.8/2016 on persons with disabilities. According to this law, disabled people have the right not to be discriminated in terms of jobs opportunities and wages. The law further states that companies are obligated to employ at least one percent disabled workers. This national government law is supported by a local government regulation which offers protection for female, child, and disabled workers.

However, as explained in the previous section, implementation of the laws on female and disabled workers is still limited. Employing female workers depends greatly on the characteristics of the foreign company. For employing disabled workers, foreign companies realize that they have not yet fulfilled the minimum requirement of the law. Interviewees from foreign companies admit that the number of disabled workers employed is less than one percent of their total workers. Moreover, they also acknowledge that they do not give special privileges for disabled people who are

employed in the companies. Tangerang District government also realizes that government facilities to support disabled people are still limited.

“Honestly, we still have not trained the disabled. Companies are willing to employ the disabled because it is obligatory as regulated by Indonesian law and presidential regulations to provide opportunities for disabled people. However, there is no training for the disabled. We can start hiring disabled. We can assign people with a handicap as operators. In the future, we also want to provide access for wheel chairs. Currently, we still have no facilities for the disabled.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

In conclusion, economic institutions are still inadequate in promoting inclusive FDI through employment creation for local people, especially marginalized people such as the poor, women and the disabled. Tangerang District government enacted local regulations to require companies to give priority to local people. However, this contradicts the national government law which grants equal rights for all Indonesian people to get a job. With respect to disabled workers, both national and local governments already require companies to employ a minimum of one percent of their total employees. However, foreign companies and local government acknowledge that the laws have not been optimally implemented. The next section will examine the inclusiveness of economic institutions in the channel of productivity improvement.

8.4.2.2. Productivity improvement

Improvement of labor productivity through training is supported by the national and Tangerang District governments. National government law No.13/2003 (article 9), regulates that all companies should provide training to improve the capacity of their employees, and this requirement is supported by Tangerang District regulations. Based on regulation No.12/2016 (article 19), companies, including foreign ones, should provide training internally with certified instructors. In case of insufficient facilities for giving training, companies can cooperate with Balai Latihan Kerja (BLK),⁴⁵ government-owned or private.

As already mentioned, foreign companies have training programs for their workers. Based on an interview, trainings are important not only for workers but also for the companies themselves. Cooperation between the Tangerang District government and foreign companies in providing training contributes to improvement of workers’ productivity. Tangerang District government provides a program to train and

⁴⁵ Technical and Vocational Education and Training (TVET) centers
http://www.ilo.org/dyn/ilossi/ssimain.viewScheme?p_lang=en&p_scheme_id=3159&p_geo_aid=360

standardize the quality of private trainers. These trainers give training not only for companies but also for the government when needed. For instance, Tangerang government has a poverty alleviation program which provides training for job seekers. The government employs certified trainers from foreign companies to teach in this program.

Besides training, workers' productivity can be increased by improving their health. National government law No.13/2003 and Tangerang government regulation No.12/2016 state that all companies, including foreign companies, should provide health insurance and health facilities for workers and their families. As already mentioned above, all foreign companies provide health insurance for their workers. The companies combine national health insurance provided by national government and private insurance provided by the companies.

In conclusion, economic institutions are already inclusive in promoting inclusive FDI in Tangerang District through the channel of productivity improvement. National and Tangerang District governments have laws and regulations requiring companies to improve the skills and competencies of their laborers. The national government also has full coverage health insurance programs for all people in Indonesia. Governmental education and health programs help to make FDI in Tangerang District inclusive. For implementation, foreign companies have internal training for their workers. They also cooperate with Tangerang District government in standardizing the quality of trainers. By being employed in foreign companies, local people can receive health and education facilities. The resulting improvement of the skills and capacities of local people will eventually increase their productivity and incomes.

8.4.2.3. Corporate Social Responsibility (CSR) programs

CSR programs by foreign companies are mentioned in national law No.47/2012 on Corporate Social Responsibility. This law requires all companies, especially those with businesses closely related to natural resources, to allocate funds for social programs. Based on interviews, all foreign companies have social programs for society. The main goals of CSR programs are sustainability and safety. This intention was supported by an interviewee:

“We comply with local regulations. By conducting CSR, we directly receive the result, which is safety. We implement CSR from the beginning. The CSR program is targeted at people who need it. We have information about people who need the program from RT/RW. By providing CSR, there will be a good and safe relationship with society.”
(HRD of DT Corp., Tangerang District, 4 May 2016)

“When society needs something, they can come to our company ... we have been here since 1989; society supports us and we have no problems with society.” (HRD of HL Corp., Tangerang District, 4 May 2016)

Besides for sustainability and safety, foreign companies also conduct CSR programs to meet international requirements. Companies must fulfill international standards to be accepted in the international market. This impetus for foreign companies is supported by an interviewee:

“If companies want to have International Organizational Standards (ISO), the companies will be assessed. Big companies are willing to conduct CSR since they want to go public. They will not be accepted if they do not implement CSR. So, CSR is in companies’ interest, not just because they are concerned about it.” (Tangerang District’s government official, Tangerang District, 9 April 2016)

Tangerang District government also encourages companies to conduct CSR programs. According to regulation No.15/2011 on CSR, companies must cooperate with Tangerang District government to support community empowerment. The law also requires the government to establish a CSR forum consisting of companies, the district government, and a non-governmental organization (NGO). In this forum, CSR programs can be synchronized with government development programs. The forum should also report to the government the planning, implementation, and evaluation of each company’s CSR program.

However, the CSR forum has not been successfully implemented. Only a limited number of companies participate in the forum, and in interviews, all foreign companies mentioned that they had not been well informed about the forum. Moreover, although the regulation mentions administrative sanctions, Tangerang District government still cannot enforce sanctions on companies that do not report their CSR programs because the national law on CSR does not provide details about such sanctions. In this case, there is no synchronization between national law and local regulations. Moreover, information about the CSR forum is insufficient, and governmental coordination to implement the CSR forum is lacking. These problems are mentioned by interviewees:

“Our company has no information telling to whom we should report about our CSR programs. We do not know the procedures for reporting CSR programs.” (HRD of PM Corp., Tangerang District, 4 May 2016)

“So far, we have not reported our CSRs. Maybe this is caused by lack of socialization on reporting CSRs. The working unit in Tangerang District could organize a meeting

to gather the companies and socialize about CSR. That way, we could receive information on socialization.” (HRD of DT Corp., Tangerang District, 4 May 2016)

The lack of coordination among working units of the government was explained by the government itself during the interview:

“We cannot give rewards to companies that conduct CSR since we do not have adequate information on their CSR programs...when we socialize and ask the companies about their CSR data they wonder why the working units that cooperate with them did not report to the CSR working unit...we also face difficulties in getting information from the other working units.” (Tangerang District’s government official, Tangerang District, 19 April 2016)

In addition, some CSR programs cannot achieve their targets. Because of the low quality of information about society, there is a tendency for free riders to receive CSR benefits they actually do not need. This situation was expressed by an interviewee:

“Society actually is aware of social funds. If we talk with people, they know about the funds, but they do not know who receives the funds. There are some people who receive the funds, such as village officials, local figures, and the parliament member. In the end, the goals of the CSR programs are not achieved.” (Tangerang District’s local people, Tangerang District, 15 April 2016)

In conclusion, Tangerang District has the intention to have inclusive FDI through CSR programs. However, based on interviews with stakeholders, the economic institutions of Tangerang District inadequately support FDI to become inclusive through CSR programs. National and local government laws and regulations support CSR programs, and local government promotes CSR programs by developing a CSR forum. However, because of lack of coordination and too little socialization, the forum is not effectively implemented. Lack of coordination between government working units is also a reason why the CSR forum is not effectively implemented. The next section will discuss whether the economic institutions of Tangerang District enhance inclusive FDI by linkage with Micro Small-Medium Enterprises (MSME).

8.4.2.4. Linkages to Micro Small-Medium Enterprise (MSME)

Based on interviews, national government has a concern to promote inclusive FDI through its linkages with MSME. Indonesian government Law No.25/2007 on investment states that every company, including foreign companies, should have business linkages with MSME, especially companies which want to receive investment facilities from the government. In addition, President Regulation No.44/2016 on the Negative Investment List (NIL) also requires all companies to have links with MSME

if they plan to invest in sectors required to have partnerships with MSME. However, Tangerang government has no specific regulation requiring companies to have linkages with MSME.

In practice, as discussed earlier, some foreign companies in Tangerang have linkages with domestic companies to manage their waste products. Most domestic companies are medium scale companies. Based on an interview, foreign companies want links with domestic companies because domestic companies have links to small businesses. An interviewee mentioned that:

“We cooperate with a medium scale company. The company will cooperate with MSME. We prefer to have business links with local people’s business. Therefore, we cooperate with the local company, which also has complete licenses.” (HRD of DT Corp., Tangerang District, 4 May 2016)

However, standing in the way of developing links between foreign companies and local businesses, especially MSME, is the problem of asymmetric information. In interviews, foreign companies explained that they do not know enough about the data of MSME in Tangerang. These companies are also concerned about the sustainability of supplies and quality of products produced by MSME. Currently, these problems constrain foreign companies from having linkages with MSME. The information problem was mentioned by an interviewee:

“We have no business linkages with MSMEs since we still have no adequate information on MSMEs that have business activities related to our inputs. Therefore, our business linkages are between industries.” (HRD of PM Corp., Tangerang District, 4 May 2016)

Based on the explanations above, economic institutions in Tangerang District are not yet promoting FDI to become inclusive. Although the national government requires all companies to have linkages with MSME, Tangerang District government does not have supporting regulations to promote the linkage between FDI and MSME. In addition, although foreign companies intend to cooperate with MSME, they face several problems, including information, sustainability, and the quality of MSME. One interview mentioned that no specific policy or program has been initiated by foreign companies to handle the problems and strengthen their links with MSME.

In summary, based on the analysis above, economic institutions in Tangerang District are generally not inclusive. The economic institutions are inclusive only in productivity channels in which foreign companies and government have regulations and programs directed at providing local people with health and education benefits. In the

other channels such as employment creation, CSR, and linkages to MSMEs, economic institutions are not yet inclusive. Lack of coordination between national government and local government is one hindrance to developing inclusive institutions. Moreover, law enforcement for implementation of existing regulations is weak. In practice, foreign companies have a limited role in employing local people, especially females and disabled workers. Foreign companies also have insufficient information about CSR forums and MSME. As a result, economic institutions in Tangerang District are not inclusive. The next section will explore the inclusiveness of political institutions in Tangerang District.

8.4.3. Political Institutions

This section will observe political institutions in Tangerang District. As explained in the theoretical background in Chapter 2, political institutions are inclusive if the rules of the game ensure that all members of society, including the marginalized have a voice, engagement, and accountability in FDI policies or programs. However, in practice many political institutions can be extractive. This means that political institutions cannot provide an opportunity for all members of society to engage in formulating and implementing FDI programs/policies. Consequently, there will be only a small group of people who will benefit from FDI activities.

As in the analysis of economic institutions, political institutions will be analyzed in relations to all channels of FDI to inclusive growth. Moreover, this analysis will also be applied to all stakeholders, including foreign companies, government, and society. The analysis will be based on in-depth interviews with all stakeholders in Tangerang District. The main objective of this section is to examine to what extent political institutions in Tangerang District provide opportunities for society to have a voice, engagement, and accountability in FDI policies. Otherwise, political institutions are extractive, involving only a small group of society in FDI policies.

8.4.3.1. Employment creation

As already discussed, foreign companies in Tangerang District create employment for local people, but only to a limited extent. Foreign companies in Tangerang District also employ only a limited number of marginalized people. Therefore, foreign companies are not yet inclusive in creating employment for local people. This section discusses the role of political institutions in the channel of employment creation.

Based on Tangerang District's regulations, foreign companies are required to communicate their job vacancies to the Empowerment Working Unit of the Tangerang government. Then the working unit can inform the local society about the vacancy and recommend people to be hired by foreign companies. According to this process, the regulation demonstrates aspects of inclusive political institutions whereby a foreign

company involves local government and society in filling vacancies in foreign companies.

However, in practice not all companies comply with the regulation. Based on interviews, some companies do not disclose their job vacancies to Tangerang District government because they already employ local people recommended by the head of the village. Here, the head of local village plays an important role in selecting people to work in the foreign company. If the company hires workers other than those recommended by the head of the village, the companies are afraid of the reactions of the local people. This example indicates a lack of participation and involvement by members of society in the employment creation channel of FDI. An interviewee supports this analysis:

“Companies have to communicate their plans for employment recruitment to the Empowerment Working Unit. However, in reality, this might not happen. There is a possibility that heads of local villages are willing to put local people into companies. Some companies, sometimes, are afraid to inform the Empowerment Working Unit. They are afraid if they do not cooperate with those heads of villages, their company’s business and environment will be disturbed.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

However, one good case exists of local government accommodating and engaging local people in fulfilling vacancies in a foreign company. Such involvement of local people in the hiring process can reduce potential conflicts between foreign companies, local people and migrant workers. However, although local people were involved in the recruitment process, locals are still not employed in the company because none of them meet the qualifications. Unfortunately, the local government does not make policies to improve the skills and capacities of local people so that they can be employed by the foreign company. This was mentioned during an interview:

“We went to village A. In Tangerang District, every village is willing to recruit its people for companies. This means job opportunities are prioritized for its local people. We informed about the job vacancy and requirements. There are 3 heads of local villages and village officials. We said that, they have 2 weeks to find job applicants from their villages, but they bargained for 3 weeks. Finally, yesterday we had a meeting with those heads of villages, village officials, and prospective applicants...However, no applicants met the requirements.” (Tangerang District’s government official, Tangerang District, 2 May 2016)

Low participation of society is also evident in investment planning by the local government. Indonesian Law No.25/2004 on national development planning systems

maintains that public participation is important in the planning process. Society can participate in development meetings held from village level to district level. However, in practice, investment is not a main topic discussed during development meetings. Interviewees explain that most development meetings discuss physical infrastructure programs because society's main concern is with infrastructures rather than investment. Moreover, society has not been included by the government in investment policies.

“Society is involved in development planning, but they are not involved in investment process, both domestic and foreign investment. In my opinion, there are many problems with investment process. Society has not been asked about investment. Investors will ask permits from the local government. Then, the local government gives the permits and suddenly building is constructed. Hence, foreign investments, such as in properties, are developed without asking whether society needs it or not.” (Tangerang District's local people, Tangerang District, 15 April 2016)

Related to communication between society and foreign companies, the interviews suggest that society lacks the possibility to communicate directly with foreign companies. An interviewee mentioned that foreign companies mostly prefer to communicate only with the local government because they think that the government has the authority to determine investment policies. In addition, local people think that the gaps in human resource quality between foreign companies and local people tend to increase difficulties in communication. This situation was mentioned by the interviewee:

“Communication with foreign companies is more difficult since on average their human resources are more educated and they feel better than other companies. Therefore, it is difficult for villages and local people to communicate with foreign companies. It is different for domestic companies which are led by our people.” (Tangerang District's local people, Kadu village, Tangerang District, 9 August 2017)

The government also experiences difficulty in communication with foreign companies. According to an interview, sometimes Tangerang District government has no opportunity to communicate with foreign companies. This lack of communication between a foreign company and the local government was mentioned as follows:

“In some cases, sometimes we only can meet the companies' securities. We want to meet their heads or leaders but they said that we have to contact an official person. Therefore, as I mentioned before, there are many people who have intentions which can hinder the effectiveness of our duty on monitoring.” (Tangerang District's government official, Tangerang District, 2 May 2016)

“We had complained to a company about why so many people from outside Kadu village work for the company. We had never been informed about the vacancy. The company informed that there would be open recruitments this week. In the end there was no open recruitment. It became a problem for our village...The company promised that they would evaluate, but it still happened. The company made small changes but, then the company still carried on as before. The company only accommodates some part of the complaint. Around 10-20 percent” (Tangerang District’s local people, Kadu Village, Tangerang District, 9 August 2017)

In conclusion, Tangerang District’s political institutions for employment creation are not inclusive. The head of the local village plays an important role in selecting local people to work at foreign companies. However, society does not participate in the process of recruitment. This limits the opportunity for local people to be employed in the companies. Moreover, society, and sometimes the local government, faces difficulties in communication with foreign companies. In the government’s development planning process, the issue of investment is not discussed intensively because society is less concerned about investment. In addition, when the government discusses investment policies, local government is not involved. Therefore, local people are not engaged in FDI planning and policies in Tangerang District.

8.4.3.2. Productivity improvement

This section will observe the effect of political institutions of Tangerang District on the improvement of workers’ productivity. As mentioned in our theoretical framework, foreign companies can support inclusive growth through productivity improvement channels. Productivity improvement of workers can be achieved through providing training and health facilities.

According to our interviews, political institutions in Tangerang District are relatively inclusive on in channels related to improvement of productivity. The previous section noted that all foreign companies interviewed provide trainings and health facilities for their workers. Involvement of workers in designing facilities such as trainings courses is expected to improve workers’ productivity by giving them better understanding of their needs. For instance, PM Corp. has a management training program in which they sending their most competent worker abroad. The worker has an opportunity to design additional training needed besides the compulsory training programs. As an interviewee mentioned:

“We have global training programs which send the best worker for 1 year’s training in Japan. The training programs not only relate to the job but also to culture and the working environment. We will ask the worker what he/she is interested in. Some

people are interested in cultivating plants and designing Kimonos⁴⁶. Those activities are possible ... the worker will be sent to a place that is famous for the activity. For instance, if the worker wants to learn to make Kimonos, the worker will be sent to a village which is famous for Kimono fashion. The worker will learn for around 2-3 months. Afterwards, the worker can continue training related to his job.” (HRD of PM Corp., Tangerang District, 4 May 2016)

This section can conclude that political institutions for improving workers’ productivity are inclusive in Tangerang District. Foreign companies usually already have their own standard for the necessary training. However, workers are also offered an opportunity to design their own additional training. The workers’ interests are also taken into consideration. The next section will analyze the relationship between political institutions in Tangerang District and Corporate Social Responsibility (CSR) programs.

“When we open more lines of production, we require more workers. In addition, we need many production leaders. We first open the recruitment for internal workers. We inform our workers by distributing leaflets and brochures in the canteen, by email, and on broadcasts... we conduct management trainings courses and evaluate them. If the workers work well, we will assign them as leaders. Benefits and career development will follow.” (HRD of VC Corp., Tangerang District, 3 May 2016)

8.4.3.3. Corporate Social Responsibility (CSR) programs

Corporate Social Responsibility (CSR) is one of channels that help FDI to contribute to inclusive growth. Based on the discussion in the previous section, foreign companies provide CSR programs for local people and communities. Some of them provide social funds, while others have educational and health programs for their community. This section will discuss the way in which foreign companies provide their CSR programs. It is expected that when local people can raise their aspirations, and become engaged and accountable, the CSR programs can be well implemented.

In Tangerang District, political institutions for CSR programs are relatively inclusive but still need improvement. Based on interviews, all foreign companies provide CSR programs for local people and communities. One example is a program of PM Corp. to develop school facilities such as a library, health care, and musical arts for 2 elementary schools each year. The program was designed by communicating with local people, especially headmasters of schools. The involvement of headmasters was supported by an interviewee:

⁴⁶ The kimono is Japan’s traditional clothing.

“CSR programs were decided based on our observation. We went to elementary schools. Then we discussed with the schools’ headmasters. If the schools’ facilities needed to be synchronized with our programs, we facilitated that. The program resulted from observation and discussion with representatives of schools... we also asked what kinds of arts were taught to students. If the school teaches *angklung*⁴⁷, we will provide 1 set of *angklung*.” (HRD of PM Corp., Tangerang District, 4 May 2016)

However, some foreign companies design their CSR programs by themselves. For instance, NT Corp. has varieties of health and education programs for local people or communities surrounding its factory. One health program involved the company building two water pumps for local people while an education program provided 1.5 years of education for local people graduating from senior high school. When designing the programs, the NT Corp. did not involve the local people and communities. The programs are the company’s programs.

“CSR programs are our own initiatives. We target the programs of the local community and sub-district surrounding our factory. I observe by myself what kinds of programs are suitable for the community...at that time; our company had a healthy walk event. I saw houses with waste pipes from their kitchen to a water pool...I proposed programs to our company ... local people lack clean water since they are surrounded by factories. This is inline with our Indonesian headquarters’ education programs to improving the community’s human resources.” (HRD of NT Corp., Tangerang District, 3 May 2016)

Lack of communication between the foreign companies and society influences the implementation of CSR programs. For instance, based on interviews, PM Corp. has planned to build facilities for two elementary schools each year since 2008. This means that, until 2016 when the interviews were held, the company had to developed facilities for 16 elementary schools. However, the PM Corp. has not achieved its targets. One reason is lack of communication with the elementary schools’ headmasters:

“We have not achieved our targets. Sometimes we only could develop one elementary school of the two elementary schools that were our targets. Usually, this missed target is caused by our being busy and our lack of coordination with schools.” (HRD of PM Corp., Tangerang District, 4 May 2016)

Even though a CSR program is well designed, it will face difficulties in implementation without communication with local people. This was the case with NT Corp., which designed the CSR program by itself. Based on interviews, the local people

⁴⁷ *Angklung* is a traditional instrument from West Java, made of bamboo.

hardly accepted the NT Corp.'s educational program. The local people had to be convinced about the program many times. The main reason was that the people had different desires than the company. They wanted to work, while the NT Corp. offered them opportunities to study. This required more effort from the NT Corp. to socialize and communicate to schools, village officials and households about the program. Eventually, the NT Corp. was able to implement its program after undertaking communication with local people and village officials. This situation was described by an interviewee:

“Last year, we had 4 people who were taught at the Academy of Technological Manufacture for 1 year and trained in our company for 6 months...Local people and communities knew about our education programs from me because I actively search for prospective students from schools. However, on average, they had not well responded in the beginning. They asked whether they would be paid or not. We only offered education. Most of them rejected the offer. They preferred to work, while we already had an education program covering all costs and preparing all the needed facilitiesWe had to go to a remote area in this region to offer the program, but no one wanted to participate. I was sad. I was not informing about money. I only said we would not abandon them. Even, I had to give my name card to prove that I also come from this region...I contacted heads of RT (Rukun Tetangga), heads of RW (Rukun Warga), and heads of the village. Finally, we had 4 prospective students from 10 required students.” (HRD of NT Corp., Tangerang District, 3 May 2016)

Related to accountability, the degree of inclusiveness of political institutions can be observed by whether foreign companies informed society about results or decisions related to CSR programs. For instance, as already mentioned, the NT Corp. provided 1.5 years of educational programs for 4 local people who had graduated from senior high school. The education included 1 year at an academy for technological manufacturing and required 6 months of on-the-job training in the NT Corp. Based on interviews, after the students finish the program, the NT Corp. will not force those students to work in the company if they find better job opportunities elsewhere. However, if the students want to work for the NT Corp they will have priority to do so. The political inclusiveness of institutions related to the accountability of the NT Corp.'s educational programs is supported by an interviewee:

“The NT Corp. informed the head of our village that the children who were trained had finished their study. On graduation day, our village head was asked to attend their graduation. He traveled with NT Corp. to the graduation place. The NT Corp. said that he had to attend the graduation because those children were his citizens...currently, those children work for the NT Corp. ... It had been promised by the NT Corp. The

NT Corp. promised to us that if the children's skills were suitable, they would be accepted to work for the NT Corp. If they had other skills and preferred to work for another company that was also welcome." (Tangerang District's local people, Bitung Jaya village, Tangerang District, 9 August 2017)

However, political institutions have also not been inclusive in encouraging relations between foreign companies and Tangerang District's government. As already mentioned in the economic institutions section, Tangerang District government established local regulations for CSR. Based on interviews, most foreign companies interviewed have not yet disclosed their CSR programs directly to the district government's working unit for CSR. The companies design and implement their CSR programs directly to in the community. Then, they report their programs only to the working unit related to their programs. This was supported by an interviewee:

"All CSR programs are our company's initiative...we observe by ourselves what society needs...Then, we inform Unit Pelayanan Terpadu (UPT),⁴⁸ the education working unit in the sub-district." (HRD of NT Corp., Tangerang District, 3 May 2016)

In conclusion, political institutions in Tangerang District have not been fully inclusive in directing FDI toward inclusive growth through CSR programs. Some foreign companies have involved local people and the community to design the CSR programs. However, other foreign companies have designed the CSR programs by themselves. This means that local people have limited opportunity to engage in the companies' CSR programs. In addition, foreign companies and the local government still have limited communication and cooperation in conducting the companies' CSR programs. The next section will discuss whether the political institutions of Tangerang District support inclusive FDI through linkages with Micro Small-Medium Enterprises (MSME).

8.4.3.4. Linkages to Micro Small-Medium Enterprise (MSME)

The theoretical framework in chapter 2 explained that FDI can support inclusive growth through its linkages with MSMEs. Strengthening these linkages is important because MSMEs are usually owned by poor people. In this section, political institutions in Tangerang District will be analyzed to determine whether they are inclusive. Political institutions are inclusive if they ensure that all members of society, and especially the poor, can have a voice, engagement, and accountability in relation to foreign companies' linkages with MSMEs.

⁴⁸ UPT is an integrated service unit.

The interviews indicated that not all members of society can have direct links with the activities of foreign companies. MSMEs, which are mostly owned by poor people, lack sufficient capital, capacity, and information to cooperate with foreign companies. As already mentioned, one foreign company in Tangerang has forward linkages with a local company to manage its waste products. However, only one local company can work together with the foreign company. This company is big, and owned by the head of the local village. Because the head of the village has good connections with the foreign company, it was selected to manage the company's waste. Unfortunately, MSMEs do not have enough capital, capacity, or access to manage the waste of foreign companies. Our example shows that the links between foreign companies and MSME is exclusive. The poor people or MSMEs do not have the opportunity to participate in the company's activity. This was mentioned during an interview:

“I am interested to have a business link with a foreign company (CP Corp.), but it requires big capital and capacity, which I do not have.” (Tangerang District's local people 5, Tigaraksa Village, Tangerang District, 8 August 2017)

“We have a regulation from our buyers that only a certified company can manage our waste. We have a cooperation with CV.G. CV.G is managed by the head of our village and local authorities. The CV.G is big company and employs many workers. It not only manages our waste.” (HRD of VC Corp., Tangerang District, 3 May 2016)

In another interview, a foreign company also mentioned that it has no direct cooperation with MSME. Beside the problem of sustainability and the quality of MSME, the company also mentioned that there was no information available about MSME. Therefore, the local company which cooperates with the foreign company was actually proposed by the head of the village. The owner of the selected local company is a well-known person with a good network. The central role of the head of the village in proposing the company without involving other members of society indicates that the political institutions are not inclusive. They are extractive and provide benefits for only a small group of people. During another interview, a foreign company supported this argument:

“Actually, MSMEs can supply our inputs if they can fulfill quality requirements. We have no cooperation with MSMEs since we do not have information about which MSMEs are suitable. The village official recommends one local entrepreneur to manage our waste products. The CV.RJ is actually owned by a person who is well known as a waste ‘boss’.” (HRD of PM Corp., Tangerang District, 4 May 2016)

In conclusion, in Tangerang District the role of political institutions in promoting FDI are not inclusive, but extractive. There is no opportunity for members of society, and especially the poor and MSME, to be involved in FDI activities. Lack of capital, capacity, and access are the main factors preventing MSME to have links with a foreign company. The central role of village heads who have close relationships with foreign companies determine whether FDI will have links with MSMEs.

In summary, based on the analyses above, Tangerang District's political institutions are not inclusive for almost all channels except that of productivity improvement. In the channels of employment creation and MSME links, political institutions have been found to be extractive. Society is not involved and informed by foreign companies about vacancies in the companies. In addition, the head of the village plays an important role in selecting workers from local people. However, these heads of local villages do not consider participation by their people. Consequently, the opportunity of the people to be employed at foreign companies is limited. Extractive institutions are also found in MSME channels. Lack of information and communication between foreign companies and MSME causes foreign companies cooperate with the company recommended by the head of the local village.

8.5. Conclusions

This chapter explores the impact of FDI on inclusive growth in Tangerang District. In addition, this chapter also examines whether institutions play role in directing FDI to become inclusive. The analysis covers all channels through which FDI contributes to inclusive growth, such as employment creation, productivity improvement, CSR programs, and the links between MSME and foreign companies. The analysis is based on in-depth interview conducted in Tangerang District with all stakeholders, such as foreign companies, local government, and society.

Based on overall analysis, this chapter concludes that FDI in Tangerang District makes less of a contribution to inclusive growth. This is evident in the data of income inequality and poverty, which tend to be stagnant in the last four years. In addition, secondary data also indicate that there is a mismatch between the labor demands of high-intensive capital industries and the quality of human resources in Tangerang District. High-capital intensive industries tend to hire skilled and educated laborers. Meanwhile, the supply of high skilled labor is limited in the district.

In addition, based on an in-depth interview, the contribution of FDI in creating employment for local people, especially the marginalized, is limited. As already mentioned, the mismatch between the demand of labor from high-capital intensive industries and the quality of human resources is one of the main reasons. Moreover, the tendency of foreign companies to offer temporary contracts is not matched with the

preference of local people, who prefer permanent contracts. Interviews indicate that foreign companies realize that they employ fewer female and disabled workers but they intend to employ more disabled workers in the future.

The contribution of FDI on inclusive growth through MSME linkages and CSR programs is also still limited. The lack of access of MSME to foreign companies and also the low capital owned by MSME have become constraints for MSME to link with foreign companies. Meanwhile, CSR programs conducted by foreign companies are also less effective because the companies do not involve society in designing the programs. Of all the channels, only the productivity improvement channel is beneficial for inclusive growth. By their education and health programs, such as training and health insurance, foreign companies benefit their local employees.

Economic institutions which are based on our theory should be inclusive in promoting inclusive FDI, but this chapter does not find this to be the case in Tangerang District. In addition, political institutions are also extractive in several channels, such as employment creation and MSME linkages. Foreign companies do not involve and inform society about open vacancies. In addition, the heads of villages play an important role in selecting workers from among the local people; these village heads do not consider the participation of society. Consequently, the opportunity of local people to be employed at foreign companies is limited. Extractive institutions are also found in MSME channels. Lack of information and communication between foreign companies and MSME cause foreign companies to cooperate with companies recommended by the head of the local village, who in turn benefits from his contact with the companies. Meanwhile, local people and local government face problems in communicating with foreign companies. The existence of extractive institutions in Tangerang District is highly influenced by the values of the local people, which have already shifted from togetherness, kinship, and communality to individualism. In addition, foreign companies are motivated by resource seeking and location seeking because Tangerang District has a strategic location and good infrastructure. The findings from the Tangerang District case study are represented in the figure below.

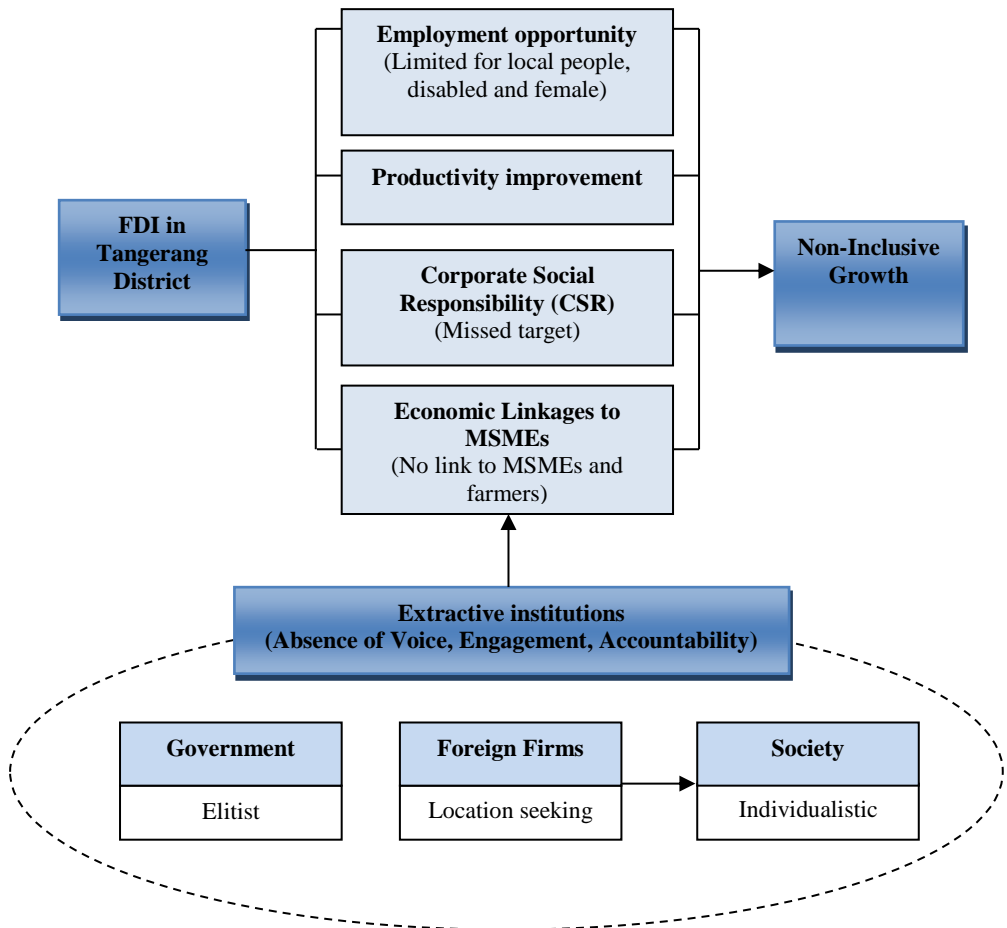


Figure 8.3. The actual links between FDI, institutions, and inclusive growth in Tangerang District

Chapter 9

A Comparative Analysis of Badung, Mojokerto, and Tangerang Districts

Chapter 9 – A Comparative Analysis of Badung, Mojokerto, and Tangerang Districts

Abstract

This chapter is aimed at comparing the effect of FDI on inclusive growth and the role of institutions in the three districts: Badung, Mojokerto, and Tangerang. Our comparative analysis is based on the case studies in the previous three chapters. We found the impact of FDI on inclusive growth to vary for each district. In Badung District FDI contributes to inclusive growth because it has provided all possible channels to encourage such growth. The economic growth of Mojokerto and Tangerang Districts has, on the other hand, not been inclusive because those districts have not provided all channels of FDI for inclusive growth. Our case studies support the conclusion that institutions play an important role in determining whether FDI is inclusive or extractive. The institutions in Badung District contribute to inclusive growth because they are inclusive, but the institutions in Mojokerto and Tangerang are extractive, restricting society from gaining benefits from FDI activities. Evidence shows that in Badung District the Tri Hita Karana values, which are in line with the inclusive growth concept, support the existence of institutions which lead to inclusive FDI. However, the fast growth of the industrial sector in both Mojokerto and Tangerang Districts has eroded society's values of inclusiveness and created extractive institutions.

9.1. Introduction

The effect of FDI and the role of institutions on inclusive growth have been explored in the last three chapters of this dissertation: Chapter 6 for Badung District, Chapter 7 for Mojokerto District and Chapter 8 for Tangerang District. The case studies have addressed two research questions. First, what is the effect of FDI on inclusive growth through several channels, such as employment creation, productivity improvement, Micro Small Medium Enterprises (MSMEs) linkages, and CSR programs? Second, to what extent do institutions foster FDI for inclusive growth? Are the institutions in the three districts inclusive or rather extractive?

In order to answer the two research questions, we have used a combination of secondary and primary data analysis. The secondary data analysis is based on economic and social data as well as the existing literature. The primary data analysis is based on the results of in-depth interviews with stakeholders of the districts including local government, foreign companies, and society. Local government is represented by working units responsible for FDI and inclusive growth. Foreign companies are those owned by foreign investors, but operating in the three districts. Society is represented by the head or administration of the traditional village and local people.

In the previous chapters, the case studies have been analyzed separately for each district. This chapter provides a comparative analysis of the outcomes of those districts focusing on two issues: first, what is the effect of FDI on inclusive growth through specified channels – employment creation, productivity improvement, CSR programs, and MSME linkages in those districts; second, what is the influence of institutions on FDI and inclusive growth in those districts. The methodology used in this chapter is summarizing and comparing the two issues in the districts based on the results of the case studies.

9.2. Comparisons of FDI's Effects on Inclusive Growth

9.2.1. The Effect of FDI on Inclusive Growth through an Employment Creation

As explained in the theoretical framework in Chapter 2, one of the channels through which FDI can contribute to inclusive growth is employment creation for local people, especially marginalized people such as poor people, disabled people, and women. Table 1 presents the results of FDI's contributions to inclusive growth in Badung, Mojokerto, and Tangerang Districts. Based on the results of case studies in previous chapters, FDI in Badung District is inclusive because the selected international hotel in the Nusa Dua area employs more local workers than foreign and migrant workers. In addition, based on an in-depth interview, the international hotel employs more than one percent disabled workers, thereby fulfilling government requirements. Moreover, the number of female workers employed in the hotel is increasing. However, the employment for females is limited by a negative idea regarding females working in a hotel. Still, by working at an international hotel, local people, especially disabled and female workers, can receive permanent incomes and use these to finance consumption, education, and health. Hence, the welfare of these people can be improved. As already explained in the theoretical framework, improving the welfare of marginalized people can help to reduce poverty and inequality.

Table 9.1. Employment Creation of FDI in Badung, Mojokerto, and Tangerang Districts

Criteria	Badung	Mojokerto	Tangerang
	Inclusive	Not Inclusive	Not Inclusive
- More local people	Foreign company employs dominantly local people (>50%)	Foreign companies employ local people but they face problems such as temporary employment and minimum wage.	Foreign companies tend to employ migrant workers because there is a mismatch between education level of local people and foreign companies' requirements.
- Opportunity for females	Increasing number of female workers working in hotel. However, the negative image of female workers working in hotel becomes a constraint.	A limited number of female workers are employed in foreign companies. However, it depends on the characteristics of the companies.	A limited number of female workers are employed in foreign companies. However, it depends on the characteristics of the companies.
- Opportunity for disabled	Foreign company employs more than 1 percent disabled workers, as stated in government law.	Foreign companies employ less than one percent disabled workers. It depends on the characteristics of the company.	Foreign companies employ disabled workers by less than one percent. It depends on the characteristics of the company.

In contrast with the case of Badung, foreign companies in Mojokerto and Tangerang Districts are not inclusive in terms of employment creation for local people, especially disabled and female workers. The main problems faced in Mojokerto District are the tendency of foreign companies to offer only temporary jobs and the trend of increasing minimum wages. Based on the interviews, foreign companies are more likely to offer temporary jobs, which are not attractive for local people, who prefer to have permanent jobs. Consequently, local people prefer to be unemployed than to be employed as temporary workers. In addition, the increase of the minimum wage is a serious problem, as increasing minimum wage leads to higher production costs and reduces employment. Therefore, international companies in Mojokerto District are kept from creating employment for local people, including the marginalized.

In Tangerang District, foreign companies also face problems in contributing to inclusive growth through employment creation. Since Tangerang District is driven

primarily by capital-intensive industries, there is a mismatch between the skills required by foreign companies and the skills of local people. Therefore, foreign companies employ more migrant workers than local workers. Based on the interviews, Tangerang District prefers to employ male workers rather than female workers. However, this depends on the characteristics of foreign companies. For instance, foreign companies that have processing activities related to machine usage tend to hire more males than females. Meanwhile, foreign companies with precision tasks and art design activities prefer to employ more females than males. With respect to disabled workers, foreign companies in Tangerang District employ disabled workers, but still less than one percent of the total employees. However, some foreign companies in Tangerang have the intention to employ more disabled workers to fulfil the requirement of the government law.

9.2.2. The Effect of FDI on Inclusive Growth through Productivity Improvement

Based on the theoretical framework in Chapter 2, by being employed at foreign companies, local people can receive training provided by foreign companies to improve their skills and competencies. Foreign companies also provide a good standard of health facilities for their employees, by which local workers are expected to become more healthy and comfortable at work. Workers with better health will be more productive and have more opportunities to receive higher incomes.

Based on our case studies, all foreign companies interviewed in Badung, Mojokerto, and Tangerang Districts are inclusive in terms of providing training and health facilities for local workers, especially disabled and female workers (see table 9.2). The companies provide both basic and specific training. The basic training is related to safety and the company's business processes and procedures. Specific training includes on-the-job training and management training. The foreign companies have regular trainings programs the capacity and skills of their employees.

Foreign companies also provide health insurance for their workers. As already explained in previous chapters, the Indonesian government has a full coverage health insurance program for all Indonesian citizens. All companies, including foreign companies, are required to join the government health insurance program for their employees. Some of companies prefer to have double coverage, insurance provided by both private and government, since the government health insurance program is not yet well established.

Besides training and health insurance, most foreign companies in Badung, Mojokerto, and Tangerang Districts also provide additional facilities for their employees, such as a prayer room, restroom, and childcare. Based on in-depth interviews, these additional facilities can create comfortable working conditions for

workers. More comfortable working conditions increase workers’ the sense of belonging and performance. Overall, trainings programs, health facilities, and other facilities provided by international companies can improve the productivity and performance of the local workers, especially disabled and female workers.

Table 9.2. FDI Channel through Productivity Improvement

Criteria	Badung	Mojokerto	Tangerang
Improve laborer’s skills and conditions	Inclusive	Inclusive	Inclusive
Training	Min 40 hours per year		
- Basic training	Safety and on the job training	Safety, production, and on the job training	Safety, production, and on the job training
- Training for higher position	Skills and management, certification, to become chefs in international branch	Management training	Management training
Health coverage	Double insurance: private and government insurance	Some double insurance, some only government insurance	Some double insurance, some only government insurance
- Additional facility	<ul style="list-style-type: none"> - Comfortable prayer room - Health clinics - Family and pension are invited to hotel’s religious event 	<ul style="list-style-type: none"> - One provides a comfortable rest area and PAUD for child - Health clinics 	<ul style="list-style-type: none"> - Health clinics - One gives reimbursement for laborer’s educational costs - One gives summer camp for children

9.2.3. The Effect of FDI on Inclusive Growth through CSR Programs

FDI can contribute to inclusive growth through providing Corporate Social Responsibility (CSR) programs for society living near the companies. In this dissertation, CSR activities are divided into two types: short- and long-term programs. Short-term CSR programs are those that affect society for a short period such as cash transfers, while long-term CSR programs are those that have a long-term impact on society, such as education and health programs. In addition, as mentioned in the theoretical framework, inclusive growth is aimed at benefits for all members of society, especially marginalized people such as the poor, females, and disabled people, hence CSR programs are expected to be beneficial for these people.

Based on our case studies, foreign companies in Badung, Mojokerto, and Tangerang Districts are inclusive in how they provide CSR programs (see table 9.3). Most foreign companies in these three districts regularly provide short-term CSR

programs, such as cash transfers or donations of goods at special events, such as religious or company events. The local people of Mojokerto and Tangerang Districts usually use the funds for consumption. On the other hand, cash transfers in Badung District have a long-term impact on society because they not used only for consumption but to finance productive activities. The international hotel in Badung District provides cash transfers for *Adat* village, near the hotel⁴⁹. *Adat* village deposits the funds in a traditional financial institution, the so-called as *Lembaga Perkreditan Desa* (LPD), which is owned by *Adat* Village people⁵⁰. The LPD manages the funds received from CSR programs to support local society's activities and businesses, such as loans for community empowerment, scholarships for poor students, and funds for religious activities.

As mentioned above, most foreign companies in Badung, Mojokerto, and Tangerang Districts provide long-term CSR programs including health and education programs. With respect to health programs, the case studies found that foreign companies in Badung, Mojokerto, and Tangerang have similar programs, such as house refurbishment for poor people, school sanitation, and local community water sanitation. These CRS programs are expected to contribute to the health of the local people. Regarding CSR programs in education, the foreign companies in Badung, and Mojokerto, and some foreign companies in Tangerang District, regularly grant internships to students from vocational schools and universities. Internship programs offer students more skills and competencies, which are beneficial for finding jobs after they graduate from school. Moreover, some of the foreign companies often offer the students who have performed well during their internships to work at the companies. Besides internship programs, foreign companies also provide other types of education programs, such as education programs for deaf students in Badung District, English conversation programs for senior high schools in Mojokerto District, and scholarships in Tangerang District. All these types of CSR programs are designed to improve the skills and capacity of local people, thereby increasing their opportunities to find jobs.

⁴⁹ Also called as *desa pakraman*, which is the union of the customary legal community. Hauser-Schaublin, 2013 on *Adat* and Indigeneity in Indonesia, p.134. <http://www.oapen.org/search?identifier=610301>

⁵⁰ Seibel, 2008 on ProFI working paper series. [https://www.hf.uni-koeln.de/data/aef/File/PDF/Community-owned/Bali%20-%20Desa%20Pakraman%20and%20LPD%20\(Seibel%202009\).pdf](https://www.hf.uni-koeln.de/data/aef/File/PDF/Community-owned/Bali%20-%20Desa%20Pakraman%20and%20LPD%20(Seibel%202009).pdf)

Table 9.3. FDI Channel through CSR Programs

Criteria	Badung	Mojokerto	Tangerang
Improve community's condition	Inclusive	Inclusive	Inclusive
- Cash transfers	- Cash transfers for Adat village to finance religious activities, community empowering programs, and scholarships. - Revolving funds for MSME	- Cash and basic goods for the poor and old widows, every month or during celebration	- Prefer non-cash transfer
- Health programs	- House refurbishment programs - Seasonal health programs requested by community - Health education	- House refurbishment - Mobile health services for local community - Clean water and pipe sanitation - Health education	- Renovate sanitation and facilities at elementary schools - Clean water - Health education
- Education Programs	- Educational programs for deaf students at senior high school - Internship for vocational students	- Internship programs for senior high school and university - Company visit programs - English conversation programs for senior high school	- Internship programs for students. - Provide facilities and scholarships

9.2.4. The Effect of FDI on Inclusive Growth through MSME Linkages

The last channel of FDI to inclusive growth is through its linkages to MSMEs. The linkages between foreign companies and MSMEs are beneficial for promoting inclusive growth since most working in MSMEs are poor. Through business linkages with foreign companies, the poor people working in MSMEs can have sustainable income from their businesses. Based on our theoretical background, the links between foreign companies and MSMEs can be indirect or direct. Indirect linkage refers to effects of foreign companies on MSMEs which are not related to the companies' activities. Meanwhile, direct linkages include backward linkages where MSMEs are a supplier of foreign companies and forward linkages where MSMEs are consumers of foreign companies.

Based on our case studies, foreign companies in Badung, Mojokerto, and Tangerang Districts contribute to inclusive growth through their indirect effects on MSMEs (see table 9.4). For example, the existence of the international hotel in Badung District has a positive indirect effect on other sectors of the economy, such as restaurants, tour travels, souvenir shops, and street vendors. Similarly, foreign companies in Mojokerto and Tangerang Districts, indirectly generate a positive effect on the other sectors such as rental accommodation and restaurants. The fast growth of the industrial sector in Mojokerto and Tangerang Districts attracts migrants to work in those districts, thereby creating a demand for housing. Thus, the housing sector benefits from the growth of industrial sectors which are dominantly driven by foreign companies.

Foreign companies in Badung, Mojokerto, and Tangerang Districts also have direct effects on MSMEs. For example, the international hotel in Badung District has backward linkages to taxi drivers, traditional dancers, musicians, and sculptors. The international hotel also requires inputs from the agricultural sector such as rice, vegetables, fruits, and meats. However, based on an interview, in supplying goods for the international hotel farmers face problems of sustainability and standardized quality. Therefore, the international hotel has less linkage to the agricultural sector, where most poor people work.

Meanwhile, in Mojokerto linkages of foreign companies to MSME are constrained by limited access of MSME to cooperate with foreign companies, and insufficient MSME capital. Similarly, in Tangerang MSMEs also have problems of limited access and insufficient capital to cooperate with foreign companies. Some foreign companies also do not have enough information about the availability and quality of MSME in Tangerang District. Linkages of foreign companies with MSMEs are further limited because the industrial sector in Tangerang exports most of its products, and imports its raw materials from other countries.

Table 9.4. FDI Linkages to MSME

Criteria	Badung	Mojokerto	Tangerang
Business linkages to MSME	Not fully inclusive: Foreign company cooperates with MSME. The main constraint faced by MSMEs is sustainability and quality of products.	Not fully inclusive: Foreign companies have cooperation with farmers but not with MSME. The main constraints are access and capital.	Not inclusive: Foreign companies have limited cooperation with MSME and farmers. Most companies have export orientation and their inputs are exported from other countries.

Criteria	Badung	Mojokerto	Tangerang
Indirect Linkages to FDI business	Restaurants, tour travel, street vendors, shops, souvenir shops, hotel.	Rental of accommodation, restaurants.	Rental of accommodation, restaurants.
Direct Linkages to FDI business: - Forward		<ul style="list-style-type: none"> - Linkages to farmers - Company wastes (metals, boxes, and plastics) are used by other companies 	<ul style="list-style-type: none"> - No forward because of export orientation of companies - Company waste (leather, cable, ceramics) are used by other companies
- Backward	<ul style="list-style-type: none"> - Agricultural sector - Traditional dancers and musicians - Balinese sculptors 	<ul style="list-style-type: none"> - Grow farmers - Catering for laborers 	<ul style="list-style-type: none"> - Catering for laborers - Supply of plastic bottles, cooperation with local tailors

9.3. The Role of Institutions in Managing FDI to become Inclusive

This section compares the influence of institutions on FDI and inclusive growth in three districts: Badung, Mojokerto, and Tangerang. Based on our theoretical framework, in order to make FDI become inclusive, inclusive institutions are required. FDI will be beneficial for all members of society and able to reduce poverty and inequality if institutions provide equal opportunities for society to be involved in FDI activities. Based on Acemoglu and Robinson (2012) these are called inclusive economic institutions. Moreover, inclusive economic institutions are the product of inclusive political institutions which give a voice to society and involve society in policy processes. However, institutions can also be extractive, benefitting only a small group of society. Extractive institutions create an elitist system whereby privileged groups become wealthier while others are suffering. Extractive institutions keep the benefits of FDI from being inclusive and exacerbate inequality.

This section also compares the values of stakeholders in the three districts, which theoretically affect the existence of inclusive institutions.

9.3.1. Economic Institutions in All Channels of Inclusive FDI

As already explained above, the international hotel in Badung District employs mostly local people. The hotel also employs at least one percent disabled people. By employing local people, FDI brings benefits to reduce poverty and inequality, and is

therefore inclusive. The contributions of FDI in Badung District through by creating employment are promoted by the existence of inclusive economic institutions. An Example of such institutions in Badung District is an agreement by which the international hotel hires at least 30 percent local people, as well as one percent disabled workers, according to a national government law. The local government also has a program to provide training and educationsfor job seekers in cooperation with international hotels.

Meanwhile, in Mojokerto and Tangerang Districts, the contribution of FDI in employment creation for local people, especially marginalized people, is limited. In Mojokerto District, foreign companies have an agreement with the heads of local villages to hire local people in the companies. However, this agreement is informal, not formalized by a contract. Hence, implementation of the agreement is not guaranteed. As already explained in the previous section, employment creation for local people in Mojokerto faces the problems of job opportunities that are only temporary, and minimum wage levels that are increasing. These two policies harm low-skilled workers, who are more likely to be employed as temporary workers and be easily fired for reasons of efficiency. Moreover, employment creation for local people in Tangerang District is limited by a temporary job policy which is not preferred by local people. In addition, based on a survey, heads of villages put informal pressure on foreign companies to employ certain local people when the companies need local licenses, to be issued only by the head of the village. This creates uncertainty and reduces the investment climate in Tangerang District. The above employment policies in Mojokerto and Tangerang Districts are extractive because they will benefit a particular group of workers, but can harm local people, especially unskilled workers.

Regarding productivity improvement, the existence of inclusive economic institutions in the three districts is shown by their trainings programs and health facilities provided by foreign companies. These programs increase the productivity and incomes of local people. Inclusive economic institutions are also represented by national government regulations which require private sectors to provide training and health facilities for employees. Local governments in Badung and Tangerang Districts have certification programs to standardize the quality of employees.

With respect to CSR programs, economic institutions in Badung, Mojokerto and Tangerang Districts are already inclusive. Based on interviews, CSR programs provided by foreign companies in those districts benefit society, especially the poor. In general, foreign companies tend to offer CSR programs in health and education, such as scholarships, house refurbishment, and sanitation improvement. Local governments in those districts are very supportive CSR programs by developing forums for government and companies to synchronize their development and CSR programs. Such programs

and local government regulations make economic institutions in Badung, Mojokerto, and Tangerang inclusive.

Lastly, regarding FDI linkages to MSMEs, an international hotel in Badung District cooperates with local people, who provide traditional dancers and musicians, furniture, and Balinese sculptures for the hotel. This cooperation enhances the increasing performance of the tourism sector and will result in higher income for MSMEs. Moreover, local government regulations also require hotels to use local products and Balinese architecture. By such investment of international hotels in local traditions and cultures, FDI brings indirect positive effects to MSME. Meanwhile, in Mojokerto and Tangerang Districts, the linkages between foreign companies and MSMEs is limited because of the problems of product quality and supply sustainability. In Tangerang, industries which are export oriented have limited linkage to local companies. Moreover, the local governments of Mojokerto and Tangerang Districts make little effort to strengthen the link between FDI and MSMEs. In summary, in Badung District economic institutions are already inclusive in their promotion of linkages between FDI and MSMEs, whereas in Tangerang and Mojokerto Districts economic institutions are not inclusive. Summary of economic institutions in FDI channels to inclusive growth can be seen on table below.

Table 9.5. Economic Institutions in FDI Channels to Inclusive Growth

Criteria	Badung	Mojokerto	Tangerang
Employment opportunity (ensure that local people, females, and disabled have job opportunities)	<p><u>FDI:</u> Inclusive:</p> <ul style="list-style-type: none"> - Agreement with local people to hire at least 30% local people - Internal policy to give priority to internal workers' family - Internal policy to give opportunity for deaf students - Internal policy to have harmonious relationship with local people. <p><u>Govt:</u></p> <ul style="list-style-type: none"> - National law on labor empowerment - Policy to have training and 	<p><u>FDI:</u> Extractive:</p> <ul style="list-style-type: none"> - Informal agreement with head of village to hire local people - Agreement with vocational school to hire students High minimum wage - Temporary employment <p><u>Govt:</u></p> <ul style="list-style-type: none"> - National law on labor empowerment - Provincial and local policy for BLKI on each vocational school 	<p><u>FDI:</u> Extractive:</p> <ul style="list-style-type: none"> - Informal forces to hire local people when asking license - Mismatch education level - Temporary employment <p><u>Govt:</u></p> <ul style="list-style-type: none"> - National law on labor empowerment - Local policy for BLKI - National regulation for disabled - Socialization to hire disabled

Criteria	Badung	Mojokerto	Tangerang
	certificate programs for job seekers in cooperation with FDI - National regulation for disabled.	- National regulation for disabled	
Productivity improvement (ensure that all laborers have opportunity to improve productivity)	<u>FDI:</u> Inclusive: - Internal training and insurance programs for workers - Each laborer should have min.40 hours of trainings per year - House star classification award requires 50% of employment should be certified - Kinship relationship because of THK value <u>Govt:</u> - The national government by its law No.25/2007 on Investment and the law No.13/2003 on labor empowerment and facilities - Local government policies to provide 100 free certificate freely for hotel security	<u>FDI:</u> Inclusive: - Internal training and insurance programs for workers <u>Govt:</u> - National government law No.25/2007 on Investment and law No.13/2003 on labor empowerment and facilities	<u>FDI:</u> Inclusive: - Internal training and insurance programs for workers <u>Govt:</u> - National government by law No.25/2007 on Investment and law No.13/2003 on labor empowerment and facilities - Certifying programs
CSR programs (ensure local people, poor, receive benefit from CSR programs)	<u>FDI:</u> Inclusive: - Intentions to share benefits and improve society - Internal interest (GM) for deaf students/children <u>Govt:</u> - National and local Regulation on CSR	<u>FDI:</u> Inclusive: - Intention to share benefits and improve society <u>Govt:</u> - National and local regulations on CSR - Establish CSR forum	<u>FDI:</u> Inclusive: - Intention to share benefits and improve society <u>Govt:</u> - National and local regulations on CSR - Establish CSR forum

Criteria	Badung	Mojokerto	Tangerang
MSME linkages (ensure that MSME have opportunity to have business linkages)	<p><u>FDI:</u> Inclusive</p> <ul style="list-style-type: none"> - Commitment with <i>Adat</i> village to prioritize local supplier <p><u>Govt:</u></p> <ul style="list-style-type: none"> - Support for provincial regulation on using local products, Balinese architecture - Policy to give space for street vendor - National government's requirements on negative investment regulation (NIL) 	<p><u>FDI:</u> Not Inclusive</p> <ul style="list-style-type: none"> - Willingness to prioritize local businesses <p><u>Govt:</u></p> <ul style="list-style-type: none"> - National requirements on NIL - No awareness of MSME working unit to have link to FDI - Local government attempts to link CSR to provide business facility for MSME 	<p><u>FDI:</u> Not Inclusive</p> <ul style="list-style-type: none"> - Willingness to prioritize local businesses <p><u>Govt:</u></p> <ul style="list-style-type: none"> - National requirements on NIL - No awareness of MSME working unit to have link to FDI - Combine with CSR on providing business facility for MSME

9.3.2. Political Institutions in all Channels of Inclusive FDI

As already explained in the theoretical framework, to promote FDI to become inclusive, inclusive political institutions are needed. These political institutions are defined as the rule of the game that involves all members of society, especially marginalized groups, to be involved and to have a voice in FDI programs. Based on our theory, inclusive political institutions include the aspects voice, engagement, and accountability. The existence of inclusive political institutions is influenced by the values of society, foreign companies, and government. This part analyzes the existence of inclusive political institutions in all channels of inclusive FDI. The analysis is based on in-depth interviews with stakeholders in Badung, Mojokerto, and Tangerang districts.

The case study of Badung District in Chapter 6 revealed inclusive political institutions in all channels of inclusive FDI. The first example of this was in the employment creation channel. As already mentioned, an international hotel agreed to hire at least 30 percent local people. This agreement was a product of negotiation between the hotel and the people. The hotel allowed local people to express their opinions and engaged them in negotiating the agreement to accommodate the interests of both parties. In addition, to implement the agreement, the hotel first informed local people about job vacancies before publishing them to the public. This shows that the hotel has accountability in the implementation of the agreement.

The existence of inclusive political institutions in all FDI channels in Badung District is influenced by Balinese values, expressed in Tri Hita Karana. These values emphasize harmonious relationships between human and human, human and God, human and environment. In Bali, specifically in Badung District, Tri Hita Karana values are also adopted by foreign companies which maintain good relationships with local people, respect local culture, and environment. Based on interviews, the international hotel realizes that the values of Tri Hita Karana correspond with the sustainability values of the hotel. Moreover, the values of Tri Hita Karana are also adopted by local government in its development plans and objectives. The integration of values of inclusiveness in all stakeholders affects the existence of inclusive political institutions in Badung District to promote inclusive FDI. The influence of local people’s values on the values and policies of foreign companies and government, which in turn affect the existence of inclusive institutions, can be seen in the following figure:

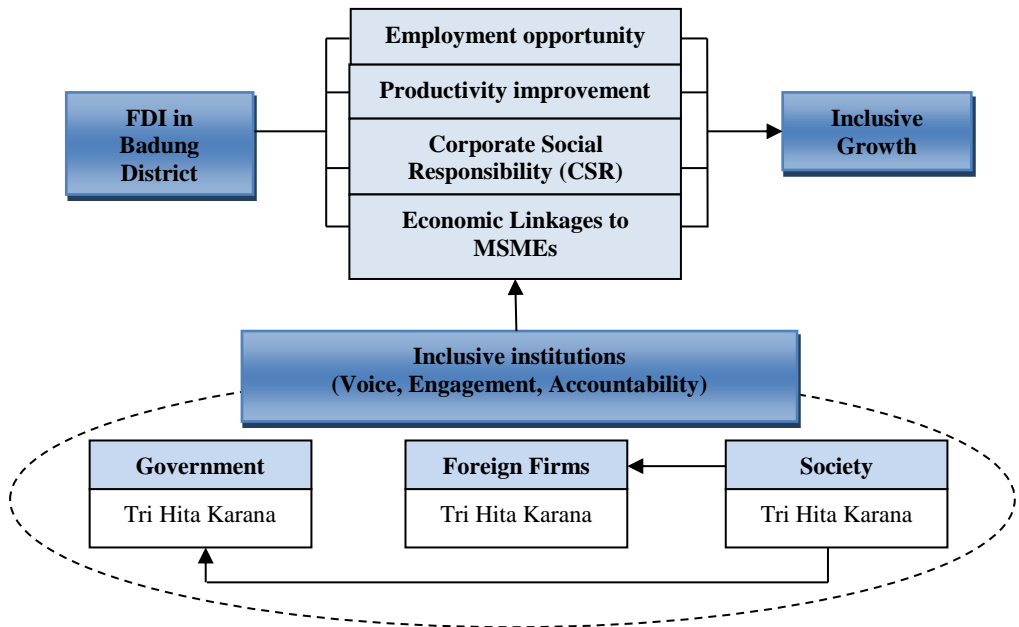


Figure 9.1. FDI, Inclusive Growth and the Existence of Inclusive Political Institutions in Badung District

Meanwhile, in Mojokerto District, the contribution of FDI to inclusive growth is limited. As seen in the case study of Chapter 7, contributions of foreign companies to inclusive growth are found in productivity improvement and CSR channels. However, in employment creation and MSME linkage channels, FDI makes limited contributions. For example, foreign companies employ less than one percent disabled workers. In

addition, in employing local people, foreign companies in the district face problems of temporary employment and high minimum wages. The temporary jobs offered by foreign companies do not match the preference of local people to have permanent work. Moreover, based on in-depth interviews, there is an elitist process in hiring local employees. A 'job broker' offers job opportunities to a small group of people, especially migrant workers. The job brokers ask money for their services. The lack of engagement, voice, and accountability in employment creation indicates that political institutions in Mojokerto tend to be extractive. Consequently, FDI benefits a small group rather than all members of society.

The existence of extractive institutions in Mojokerto is influenced by the social values in Mojokerto. In line with the fast development of the industrial sector, values of togetherness, democracy, and openness in society are eroding. Currently, the values of society in Mojokerto are more individualistic and materialistic. Such values contribute to the existence of extractive institutions because there is not sufficient time for people to meet, communicate, and respect each other. Foreign companies in Mojokerto District tend to have resource-seeking motives because Mojokerto has abundant unskilled laborers and a good infrastructure. However, the concern of foreign companies to improve the welfare of local people, especially marginalized people, is still limited. The head of the village as a representative of government has special privileges in communicating with foreign companies. Such access by the head of village to the companies can be misused to benefit only a small group of society. There is no participation and engagement of society related to FDI programs. Hence, in this case, the government tends to be extractive (see figure 9.2).

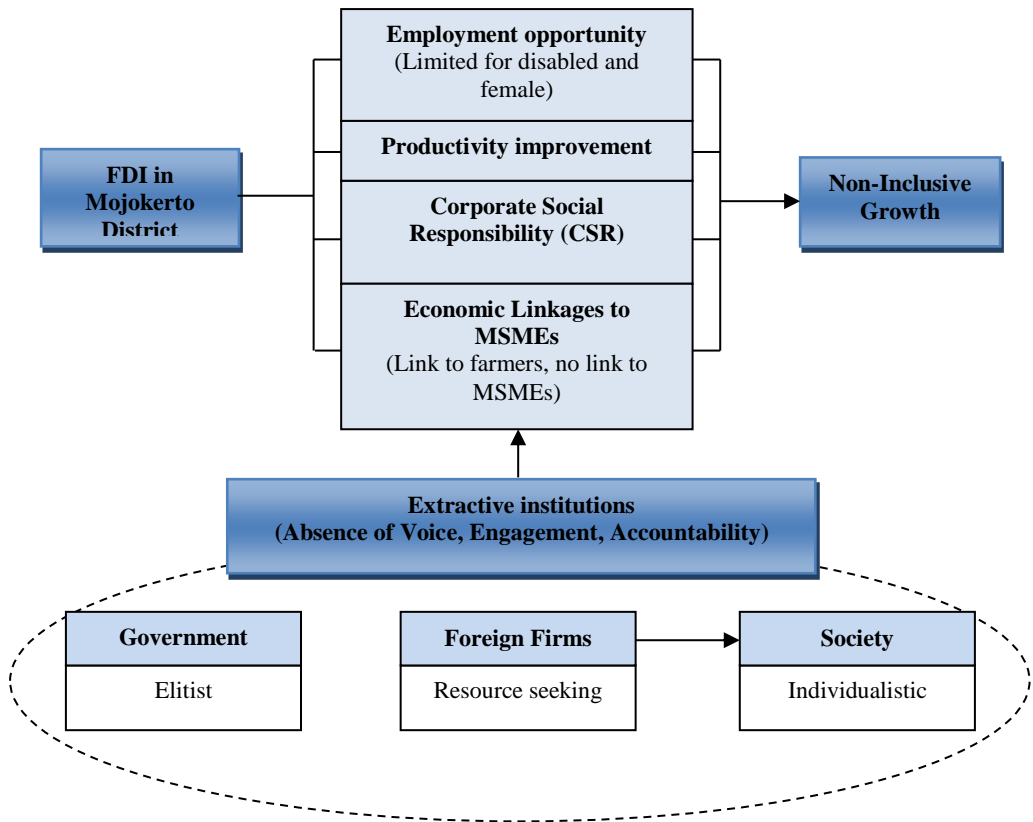


Figure 9.2. FDI, Inclusive Growth and the Existence of Inclusive Political Institutions in Mojokerto District

Similarly, in Tangerang District, FDI is not inclusive, especially for employment creation, CSR programs, and MSME linkages. The limited employment creation for local people is caused by a mismatch between the educational level of local people and the requirements of foreign companies. For CSR programs, as shown in Chapter 8, the programs miss their targets because of a lack of participation and engagement by society in formulating CSR programs. For MSME linkages, as already explained, this lack of FDI linkages to society is caused by the characteristics of industry in Tangerang District, which is export oriented and imports its resources from other countries.

Based on the case study, political institutions in Tangerang District are extractive in several channels such as in employment creation, CSR programs, and MSME linkages. In MSME linkage, lack of information and communication between foreign companies and MSME cause foreign companies to cooperate with the company recommended by the head of the local village. This person benefits from his access to

the companies. The individualistic values of the local people and the pragmatic location-driven motives of the foreign companies in Tangerang have shaped the existence of extractive institutions in the district. As in Mojokerto District, the fast evolution of the industrial sector in Tangerang District has shifted the values of society from togetherness and communality to individualism and materialism (see figure 9.3).

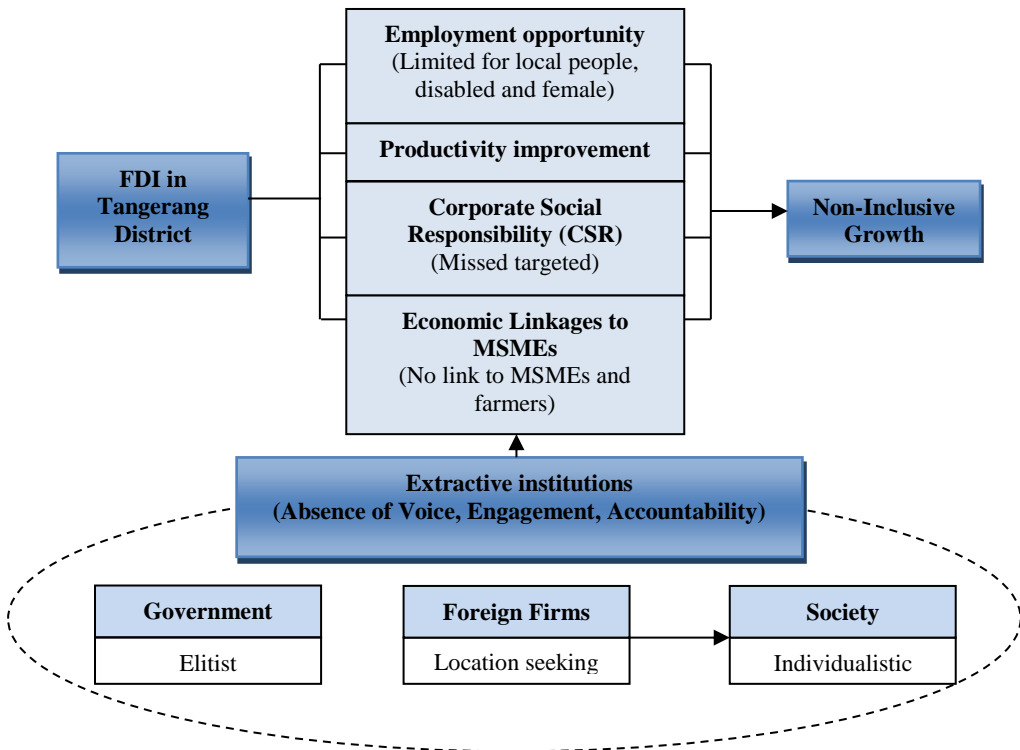


Figure 9.3. FDI, Inclusive Growth and the Existence of Inclusive Political Institutions in Tangerang District

9.4. Conclusions

This chapter has aimed to compare the effects of FDI on inclusive growth and the related role of institutions in three districts: Badung, Mojokerto, and Tangerang Districts. This comparative analysis has been based on the case studies in the previous chapters, which separately explored the issue of FDI and inclusive growth in each district. As mentioned in our theoretical framework, FDI can support inclusive growth through some channels, such as employment opportunities for local people, disabled, and females; productivity improvement; Corporate Social Responsibility (CSR)

programs, and linkages to Micro Small-Medium Enterprises (MSMEs). However, the impact of FDI on inclusive growth varies for each district. The economic growth in Badung district has been inclusive because FDIs in Badung district have provided all channels of FDI to encourage inclusive growth. On the other hand, the economic growth of Mojokerto and Tangerang districts has not been inclusive because those districts have not provided all channels of FDI for inclusive growth. For instance, FDIs in Mojokerto district offer limited employment opportunities to disabled people and limited links to MSMEs. FDIs in Tangerang district also offer limited work opportunity for local, disabled, and females and have limited links to MSMEs.

Based on the theoretical framework in Chapter 2, the focus has now turned to institutions that have an important role in directing FDI toward inclusive growth. Institutions – the rules of the game – can be inclusive or extractive. Inclusive economic institutions which expand opportunities for all members of society to be involved in FDI activities, are vital if FDI is to become inclusive. Moreover, inclusive economic institutions are the result of political institutions which provide opportunities for all members of society to have voice, engagement, and accountability in FDI policies. On the other hand, institutions which are beneficial only for small groups of people, extractive institutions, will cause FDI business not to be inclusive.

The case studies of three districts (Badung, Mojokerto, and Tangerang) support the conclusion that institutions have an important role in determining whether FDI is inclusive or extractive. FDI in Badung District is inclusive since its institutions, both political and economic, are inclusive. Meanwhile, the institutions in Mojokerto and Tangerang Districts are extractive, especially their political institutions. Moreover, our case studies have found that values of stakeholders also influence whether institutions will be inclusive or extractive. For instance, when all stakeholders – government, foreign firms, and society – have similar values of inclusiveness, institutions will become inclusive, and support FDI to become inclusive. Strong evidence showed that the Tri Hita Karana values in Badung District, adopted by foreign hotels and government, support the existence of inclusive institutions for inclusive FDI. On the other hand, in Mojokerto and Tangerang Districts, the fast growth of the industrial sector has eroded the society's value of inclusiveness. This phenomenon has created extractive institutions among all stakeholders; cause FDI not to be inclusive for society. The relationships between FDI and inclusive growth, and the role of institutions in promoting FDI to be inclusive, are summarized in the following figure:

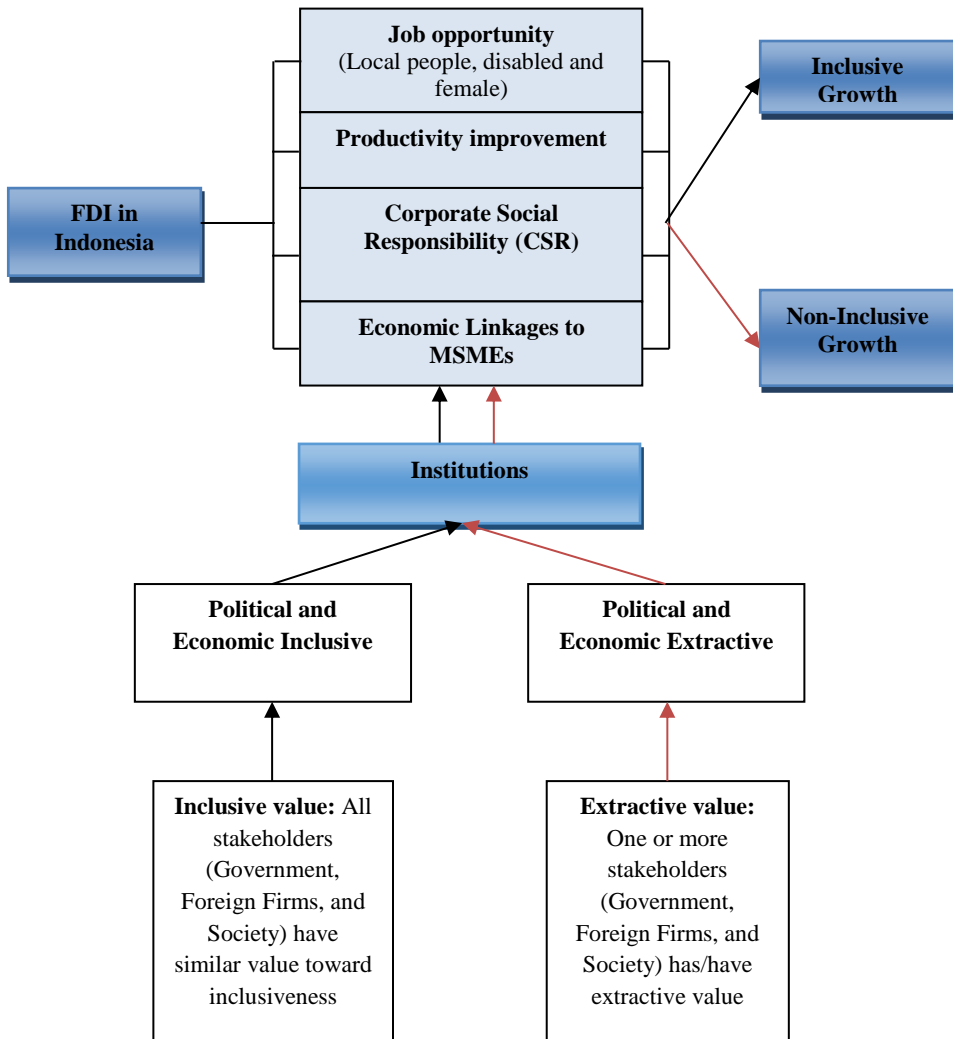


Figure 9.4. FDI, Inclusive Growth and Institutions in Indonesia

Chapter 10

Conclusions

Chapter 10 – Conclusions

10.1. Introduction

Most developing countries attempt to attract Foreign Direct Investment (FDI), expecting it to contribute to the development of their economies. As these countries have only limited domestic savings, FDI can make a significant contribution to their domestic economies. According to the United Nations Conference on Trade and Development (UNCTAD), developing countries have become attractive places for foreign investments, as represented by significant FDI inflows to developing countries, which between 2005 and 2016 became 40.3 percent of the total FDI inflows in the world. Moreover, during the periods, among developing regions, Asia is most attractive for foreign investors, and receives 26.3 percent of total FDI.

The actual impact of FDI on a host country's economy is, however, still debatable in both theory and practice. On the one hand, according to the *modernization theory* FDI can contribute to the host countries' development, through employment creation, technological transfers, and economic linkages (Borensztein et al., 1998; Bengoa and Sanchez-Robles, 2003; Durham, 2004; Li and Liu, 2005; Solomon, 2011). On the other hand, according to the *dependency theory*, FDIs are considered to distort the economies of host countries because they can destroy local entrepreneurship, stifle technological innovation, crowd out domestic firms, and increase unemployment (Mihalache-O and Li, 2011). In any case, the existing studies have focused only on the contribution of FDI to economic growth per se. Focusing only on economic growth in assessing the impact of FDI is indeed too narrow an approach, as empirical evidence indicates that economic growth is often not accompanied by reductions in income inequality and poverty rates (World Bank, 2008; Kusumawati et al., 2015; Fuso, 2017). Therefore, the concept of economic growth needs to be discussed from a much broader perspective, the so-called inclusive growth concept.

Inclusive growth is defined as growth which benefits all members of society equally, regardless of their individual circumstances (Felipe, 2012 and Kusumawati et al., 2015). International organizations like the World Bank, the United Nations Development Programme (UNDP), and the Asian Development Bank (ADB) have begun to focus on inclusive growth in their programs. In 2004, the United Nations Development Program (UNDP) established the International Policy Centre for Inclusive Growth (IPC-IG) research group, which focuses specifically on inclusive growth issues. Moreover, for its 2020 strategy, the Asian Development Bank (ADB, 2008) has put inclusive growth explicitly on the agenda. Moreover, the country of India included inclusive growth as an objective in its Eleventh Five-Year Plan. The concept of inclusive

growth also became part of Indonesia's medium-term development plan for the period 2010-2014 (Indonesia, 2010).

The increasing focus on inclusive growth in the agendas of international organizations and countries like Indonesia and India is understandable. As mentioned above, empirical evidence has shown that economic growth is often not accompanied by reduced income inequality and poverty rates. For example, the high economic growth in Great Britain during the industrial revolution was not followed by improvements in life expectancy and infant mortality (Crafts, 1997). Similarly, during the current global financial crisis, Indonesia experienced a remarkable economic growth but also had the worst income inequality of the last 50 years. A growing body of research has suggested that rising poverty and inequality lead to economic and social ills, ranging from low consumption to social and political instability, and are damaging to the sustainability of economic growth and well-being (Dartanto, 2014; Kawachi, I., et al, 1997 and Martinez, 1996; Dabla-Norris, et al., 2015). Therefore, in order to assess the contribution and quality of economic policies and businesses, including FDI, the inclusive growth concept should be considered. In the tourism sector, the World Tourism Organization (UNWTO) has promoted investment to contribute not only to economic growth but also to inclusiveness. In addition, the next Indonesian medium-term development plan for the period of 2015-2019 has explicitly stated that investment should be directed to achieve inclusive growth (Indonesia, 2015).

Despite the increasing popularity of the inclusive growth concept and its relevance when assessing the quality of FDI, a theoretical basis for links between FDI and inclusive growth has not yet been developed. According to the existing studies, host countries do not automatically gain benefits from FDI. For FDI inflows to be beneficial, countries must have absorptive capacity, defined as the ability of an organization or region to identify, assimilate, and exploit knowledge from the environment (Cohen and Levinthal, 1989). The absorptive capacity of host countries allowing them to benefit from FDI is usually indicated by the quality of its human resources, level of financial development, investment climate, and trade openness. According to Akinlo (2004), FDI can contribute to a host's economy only when the economy has a sufficient stock of human capital to absorb the advanced technologies. Furthermore, the beneficial impact of FDI is enhanced in a country with open trade, advanced financial development, and a friendly investment climate (Borensztein et al., 1998; Wang and Wong, 2011; Lamsiraroj and Ulubasoglu, 2015; and Lamsiraroj, 2016).

According to the perspective of the New Institutional Economics (NIE), institutions are the key factor in the success of a country's development (North 1981; Coase, 1998; Rodrik, 2000; Williamson, 2000; Acemoglu and Robinson, 2008). North (1981) defines institutions as "the rules of the game of a society, that is, the humanly-devised formal

and informal constraints that shape human interactions”. With respect to the benefits of FDI, Azwan-Saini et al. (2010) and Dunning and Fortainer (2006) argued that a host country can receive benefits from FDI inflows when it has good institutions like property rights, corruption control, and regulations. The most recent studies by Acemoglu and Robinson (2012) and OECD (2014: 162) discussed in this respect the importance of inclusive institutions to provide equal opportunities for all members of society to gain benefits from economic activities and be involved in economic policies. Such institutions can further the inclusiveness of FDI.

Because as yet no study has applied the concept of inclusive growth to assess the effect of FDI on a host country this dissertation has comprehensively explored and analyzed the links between FDI, inclusive growth, and institutions in Indonesia, using case studies of three selected regions of the country: Badung, Mojokerto, and Tangerang Districts. The purpose of this study has been to answer two main research questions, as explained below.

10.2. Research Questions

This dissertation has addressed two main research questions. First, what is the contribution of Foreign Direct Investment (FDI) to inclusive growth in Indonesia? Second, to what extent do institutions play an important role in promoting FDI for inclusive growth in Indonesia? In order to pursue these two research questions, this dissertation has divided them into eight sub-research questions.

For the first research question are three sub-research questions:

- 1.1. Theoretically, how and through which channels does FDI affect inclusive growth?
- 1.2. Based on existing studies, what is the inclusive growth concept and how is it measured?
- 1.3. Empirically, how does FDI affect inclusive growth through specified channels in three selected regions: Badung, Mojokerto, and Tangerang Districts?

For the second research question are four sub-research questions:

- 2.1. What kinds of institutions are needed to make FDI conducive of inclusive growth and, theoretically, how can these institutions bring about such results?
- 2.2. How is the capacity of central government’s regulations in managing FDI to promote inclusive growth?
- 2.3. In multi-level government systems, what role does district government play in planning, implementing, and controlling FDI to make it inclusive?
- 2.4. To what extent do institutions affect the relationship between FDI and inclusive growth in Badung, Mojokerto, and Tangerang Districts?

2.5. How do society's values affect the inclusiveness of institutions in Badung, Mojokerto, and Tangerang Districts?

10.3. Scientific and Social Significance of the Research

By addressing the research questions above, this dissertation contributes to the existing literature, the insights of policy makers, and society. Examining the relationship between FDI, inclusive growth, and institutions by constructing a theoretical framework and performing empirical investigation, this dissertation has added a new perspective to the existing literature. The theoretical novelty of this dissertation lies in its comprehensive analysis of the concept of inclusive growth and its importance for assessing the quality of FDI. The dissertation has, moreover, discussed the role of institutions in making FDI inclusive.

Our theoretical framework has been the basis for all further analysis. The dissertation has also provided empirical evidence of the capacity of the Indonesian government's plans and regulations to make FDI conducive to inclusive growth. Indonesia consists of multi-level governments – central, provincial, and district. This dissertation has also analyzed how district governments are involved in the public policy process related to FDI and inclusive growth, from planning, to implementation, to controlling. To analyze and illustrate the effects of FDI on inclusive growth, including the role of institutions and values, this dissertation has presented case studies of three selected districts – Badung, Mojokerto, and Tangerang.

Besides the theoretical and empirical academic contribution, this dissertation has also aimed to inform policy makers involved in promoting the benefits of FDI for society. The empirical evidence on inclusive growth and the role of institutions in Indonesia could be a lesson in managing FDI and promoting its contribution to society not only for Indonesia but also for other developing countries. The analysis here is highly relevant for Indonesia, which experienced an increase in FDI inflows from USD 8.3 billion in 2005 to USD 16.6 billion in 2015. This significant growth in FDI inflows has led to accelerated economic growth, but has not been followed by improvement in other indicators such as poverty and income inequality. Indonesia's income inequality, represented by the Gini ratio, reached its highest level in 50 years between 2011 and 2013. Indonesia's government has therefore declared that investment, including FDI, should be directed to contribute to inclusive growth by means of a Medium-Term Development Plan (RPJMN) for the period of 2015-2019. As Indonesia has since 2001 entered a decentralization era whereby district governments have more authority to manage their own regions, the case studies provided in this dissertation can serve as a basis for recommendations to district governments for managing FDI in their regions and for strengthening their coordination with the central government.

10.4. Research Design and Methodology

To address the research questions, this dissertation has employed a qualitative method to explore the perspectives and experiences of stakeholders related to FDI and inclusive growth. Based on the data on FDI and indicators of inclusive growth, such as income inequality and poverty, the three regions – Badung, Mojokerto, and Tangerang Districts were selected for investigation. The economies of these regions have received significant FDI inflows. Moreover, to capture the capacity of the national government and the role of provincial as well as district governments in the public policy process related to FDI and inclusive growth, we have included interviews with members of national and provincial governments.

Besides interviews with government officials, this dissertation also includes interviews with other stakeholders like foreign companies and members of society. The perspective of foreign companies provides important insight into how their policies and programs relate to society, how the companies interact with society and involve society in the formulation and implementation of their programs. Also, to assess the effect of FDI on the welfare of local people, especially marginalized people, this dissertation has interviewed heads of local villages and academies. To strengthen the analysis based in these in-depth interviews, this dissertation also presents a review of the existing literature and provides economic and social data related to FDI, inclusive growth indicators, and institutions.

10.5. Sections of Dissertation

As previously mentioned, the dissertation addresses two main research questions, further elaborated into seven sub-research questions. Chapter 2 discusses the question of how FDI affects inclusive growth and what kinds of institutions are needed to make FDI inclusive at a theoretical level. Since inclusive growth is a new concept and its definition and measurement are still debatable, Chapter 3 discusses the concept and measurement of inclusive growth. After explaining the concept and constructing a theoretical framework, this dissertation provides in Chapter 4 an analysis of the capacity of central government to manage FDI and inclusive growth. Then, applying the multilevel governance theory, Chapter 5 has explained the role of district government, together with provincial and central government, in managing and directing FDI toward inclusive growth. An in depth investigation of the effect of FDI on inclusive growth and the role of institutions is provided in Chapters 6 to 9 in the case studies of the districts Badung, Mojokerto, and Tangerang. Lastly, this chapter provides the conclusions, limitations and policy implications of the study.

10.6. Summary and Conclusions

As already explained, the dissertation consists of ten chapters, including this conclusion, which summarizes the findings and conclusions of all of the other chapters. This chapter concludes with a discussion of the policy implications and limitations of this dissertation.

10.6.1. Theoretical Framework of FDI, Inclusive Growth, and Institutions (Chapter 2)

Chapter 2 describes the theoretical framework of the relationship between FDI, inclusive growth, and institutions. This framework suggests that the contribution of FDI to a host country should be assessed not only on the basis of economic growth per se, but on a broader concept of economic growth, the so-called inclusive growth concept. Based on the existing literature, inclusive growth is growth which benefits all members of society on an equal basis, regardless of their individual circumstances. However, evidence has indeed shown that economic growth is often not accompanied by a reduction in income inequality and poverty. Therefore, inclusive growth, which already includes the indicators of poverty and inequality, is a more appropriate measurement of the quality of FDI.

Our theoretical background includes four channels through which FDI can promote inclusive growth: employment creation, productivity improvement, Corporate Social Responsibility (CSR) programs, and linkages to Micro Small-Medium Enterprises (MSMEs). Through these channels, FDI is expected to provide benefits for local people, especially marginalized people who normally have limited access to FDI activities, such as the poor, the disabled, and women. Through employment creation, FDI can enable local people to receive a sustainable income to finance their consumption, education, and health expenditures. This also applies to poor and disabled people and female workers who are otherwise marginalized and excluded from the labor market. Working for foreign companies also makes it possible for local people to receive educational and health benefits which can in turn improve their productivity. Educational benefits include training provided by foreign companies to increase the skills and competencies of local employees. Health benefits include health insurance and facilities which support employees' performance and productivity.

Other channels by which FDI contributes to inclusive growth are CSR programs and linkages to MSMEs. CSR programs to improve the welfare of local people, especially the marginalized, included both short- and long-term programs. One short-term program involves cash transfers for local people, enabling them to finance short-term consumptions. Meanwhile, the long-term programs include education and health programs to improve local people's quality of life. Finally, FDI contributes to inclusive

growth through its linkages to MSMEs. In a direct way, FDI can generate employment and income for MSMEs which supply inputs to foreign companies. FDI can also create income and employment to MSMEs which are indirectly connected to FDI businesses. Since most of the people who work at MSMEs are poor, a strong linkage between foreign companies and MSMEs will generate income and improve the welfare of the poor people.

According to the New Institutional Economics (NIE), institutions, defined as the rules of the game which regulate the behavior of economic agents including foreign companies, are an important factor in fostering the positive effect of FDI on inclusive growth. This dissertation has adopted the concept of inclusive institutions from the important model of the FDI-inclusive growth nexus (Acemoglu and Robinson, 2012 and OECD, 2013). Inclusive institutions can be both economic and political. Inclusive economic institutions are rules which expand the opportunities of all members of society to benefit from economic activities, and inclusive political institutions allow society to participate in policies and programs related to FDI.

Our theoretical framework as presented in Chapter 2 has extended the concept suggested by Acemoglu and Robinson (2012), who focused only on inclusive institutions in government. The theoretical framework in Chapter 2 extends the scope of inclusive institutions to apply to multi-level government cases and the institutions of other stakeholders, such as foreign companies and society. Unfortunately, however, in practice institutions are not always inclusive but can also be extractive, benefiting and involving only a small group of people. The existence of extractive institutions is expected to make FDI a source of income inequality and poverty. With respect to the influence of stakeholders' values on the existence of inclusive institutions, Bobo (1991) found that individualistic values are less likely to support redistributive policies than values related to social responsibility. A study by Hofstede (1980) suggested that social values in turn influence the structure and functioning of institutions. Furthermore, our theoretical framework suggests that foreign companies which take into account the welfare of local people, society, are more likely to promote inclusive growth than companies which focus only on maximizing profits.

To apply the theoretical background to our empirical analysis, Chapter 2 has also designed the operationalization of the theory. Inclusive growth, as a broader concept of economic growth, results in lower income inequality and poverty. Income inequality is assessed by the Gini index, which measures how far the distribution of income among individuals or households within a country/region deviates from a perfectly equal distribution. A Gini index value of 0 indicates an equal income distribution among the individuals. A Gini index value of 1 implies that the income distribution is completely

unequal. Based on the World Bank classification, a Gini index value lower than 0.4 indicates low income inequality, a Gini index between 0.4 and 0.5 indicates medium income inequality, and a Gini index higher than 0.5 indicates high income inequality. Meanwhile, the poverty rate is indicated by the ratio of the total population (in a given age group) whose income falls below the poverty line.

In examining the relationship between FDI and inclusive growth, this dissertation has analyzed the trends in data on FDI, economic growth, the Gini index and the poverty rate. The data were provided by Statistics Indonesia, known as Badan Pusat Statistik (BPS). The trends indicated have been presented in Chapter 3. Chapters 6 to 8 present, at the beginning of the case study for each district, the trends of FDI, economic growth, Gini index, and poverty rate of Badung, Mojokerto, and Tangerang Districts. High FDI inflows and economic growth which are not followed by a decreasing trend in the Gini index and poverty rate indicate that FDI does not contribute to inclusive growth. However, analyzing the data alone was insufficient to capture the detailed channels through which FDI promotes inclusive growth. This dissertation has therefore used in-depth interviews with stakeholders to explore the four possible channels of FDI to inclusive growth.

As already explained in the theoretical framework, the contribution of FDI to inclusive growth can be promoted through the channels of employment creation, productivity improvement, Corporate Social Responsibility (CSR) programs, and linkages to Micro Small-Medium Enterprises (MSMEs). An analysis of these channels has been presented in the case studies in Chapters 6 to 8. The main concern is whether, through those channels, FDI could improve the welfare of local people, especially marginalized people such as the poor, the disabled, and women. Our analysis is based on the results of in-depth interviews with stakeholders in the Badung, Mojokerto, and Tangerang Districts, including government officials, representatives of foreign companies, and society.

With respect to the first channel, FDI promotes inclusive growth by creating employment for local people, especially the marginalized, who work at foreign companies and receive sustainable income to improve their welfare. By working at these foreign companies, local people can also receive education benefits, such as job training, general education, and safety training to increase their knowledge and skills. By having greater knowledge and skills, these people can improve their productivity, potential income, and welfare, finally becoming able to leave poverty and overcome their inequality. Besides education benefits, local people who work at foreign companies can also receive benefits such as health insurance and health facilities. Full coverage health insurance and good access to health facilities can also increase the productivity and performance of the employees.

Other channels through which FDI can promote inclusive growth are CSR programs and MSMEs linkages. CSR programs which effectively promote inclusive growth include corporate philanthropy programs, community volunteering programs, and health facilities. Examples of corporate philanthropy programs are sustainable scholarship and vocational internships which can increase the skills and knowledge of local people, enabling them to be employed in foreign companies and get higher incomes, better education, and health facilities. Other CSR programs which effectively promote inclusive growth are volunteer programs in which employees of foreign companies provide vocational training for local people. In addition, corporate social marketing (CSM) programs by which companies attempt to change society's health behavior also effectively promote inclusive growth. CSR programs aimed at building health facilities like clinics or hospitals can also improve the health and quality of life of local people. The last channel between FDI and inclusive growth is its linkages with MSMEs. The effects of FDI on MSMEs have been analyzed in terms of direct and indirect linkages. Direct linkages include the positive effect of FDI on MSMEs which provide inputs to foreign companies or purchase products of FDI; indirect linkages include the effects of FDI on MSMEs which operate in sectors other than those of the FDI.

To analyze the influence of institutions on the above channels of FDI related to inclusive growth, the concept of inclusive institutions has been applied in an empirical analysis. The existence of economic and political institutions in each channel of FDI has been explored in case studies of each district. We have analyzed whether the economic policies and programs of foreign companies and governments have expanded the opportunities of society to gain benefits from FDI activities. We have also examined whether the political institutions of foreign companies and local government have allowed members of society, especially local people, to be involved (engagement), express their aspirations (voice), and be informed (accountability) about policies related to FDI and inclusive growth.

The existence of inclusive institutions related to FDI and inclusive growth has first been analyzed, in Chapter 4, by assessing the capacity of central government's regulations. The regulations of national governments are supportive of inclusive growth if they mention the four channels – employment creation, productivity programs, CSR programs, and MSMEs linkages – through which FDI promotes inclusive growth. The synchronization between government regulations related to FDI and inclusive growth has also been evaluated. In addition, in the case of multi-level governments and decentralization, the existence of inclusive institutions is indicated by how much the central government involves provincial and district governments in public policy

processes – planning, implementing, and controlling – related to FDI and inclusive growth. For instance in Indonesia, which has since 2001 entered the decentralization era, the authorities related to foreign investment are still mostly on the hand of the national government. Although managing FDI still comes under the authority of central government, at the district level FDI operates and interacts with local governments and local people. Therefore, to accommodate the aspirations of local people the involvement of district government in the public policy process is highly important. Good coordination among levels of governments is necessary to ensure coherence of government regulations and policies in managing FDI and inclusive growth. An analysis of these issues can be found in Chapter 5.

In practice, at the district level, the contribution of FDI to inclusive growth is determined not only by the existence of inclusive governmental institutions but also by the institutions of foreign companies. Whether these institutions are inclusive is determined by whether the companies' policies allow all members of society, including the marginalized, to gain benefits from FDI activities (economic inclusive institutions). The inclusiveness of institutions in foreign companies also depends on whether the companies involve society in all channels linking FDI to inclusive growth.

Our theoretical framework suggested that values of stakeholders – government, foreign companies, and society – play a significant role in the existence of inclusive institutions. The inclusiveness values of foreign companies could be analyzed by looking at their visions and objectives. The inclusiveness of local people could be analyzed by studying their values and culture. The inclusiveness value of district governments could be identified by examining the objectives behind their development plans. Specific analyses of the institutions and values of districts was provided in the case studies in Chapters 6 to 9.

10.6.2. The Inclusive Growth Concept: Strengths, Weaknesses, and a Research Agenda for Indonesia (Chapter 3)

After Chapter 2, explaining the theoretical framework on FDI, inclusive growth, and institutions, in Chapter 3 we presented a review of existing studies on the definition and measurement of the inclusive growth concept. Despite the increasing popularity of this concept, both its definition and measurement are still under discussion. Initially, inclusive growth was defined as growth that benefits the entire society, a rather broad and imprecise definition. Later, international organizations and policy makers started to define inclusive growth based on their own policy strategies. For instance, the World Bank (World Bank, 2008) considers inclusive growth to be growth that gives societies opportunities to be more productive and creative. The Organization for Economic Co-operation and Development (OECD, 2014) argues that for inclusive growth, a country

needs strong economic growth to improve not only outcomes but also living standards and people's quality of life. However, since these concepts of inclusive growth are still rather broad and imprecise, many studies try to describe inclusive growth more precisely and to measure it. Based on policy strategies and existing studies, income inequality, poverty, employment, education, and health are the most frequently identified dimensions of inclusive growth apart from economic growth. All of this illustrates that inclusive growth is a multidimensional variable, with income and non-income dimensions.

Because the concept is broad and imprecise, analyses of (the drivers of) inclusive growth should deal with its multidimensional aspects as well as with their simultaneity. Most recent studies on inclusive growth applied data description or used an aggregate index of inclusive growth, possibly in combination with a single equation model; they thereby miss the requirements for proper inclusive growth analysis. This also applies to earlier studies of Indonesia's inclusive growth, discussed in Chapter 3. To deal with multidimensional aspects of inclusive growth, the chapter proposed two alternative methodologies: simultaneous equations and structural equation modelling. Because of their complexity these approaches have not been applied in this dissertation, but in future studies they could be applied to Indonesia, thereby providing a more accurate analysis of (the drivers of) inclusive growth and a better basis for advice on policy. For further analysis in this dissertation, poverty rate and income inequality are used, as they are the two indicators used in most existing studies to measure inclusive growth.

However, using quantitative data description of those two indicators to assess the contributions of FDI to inclusive growth has limitations. The main limitation is the inability of quantitative analyses to separately observe the role of FDI in supporting inclusive growth. Moreover, quantitative data cannot assess the detailed channels through which FDI contributes to inclusive growth, as well as the vital role played by institutions. This dissertation has therefore employed a qualitative method to analyze the channels of FDI and the role of institutions in promoting the relationship between FDI and inclusive growth. As explained in the theoretical framework, the channels of FDI to inclusive growth include employment creation, productivity improvement, CSR programs, and linkages to MSMEs. Qualitative analyses of those channels and of the role of institutions have been provided in the remaining chapters of the dissertation.

10.6.3. The Capacity of Government Regulations to Manage FDI for Inclusive Growth in Indonesia (Chapter 4)

As already explained in the theoretical framework, institutions are defined as the rules of the game which regulate the behavior of agents in an economy. Using this definition, Chapter 4 has examined the capacity of national government regulations to

manage FDI for inclusive growth in Indonesia. Four national government regulations related to foreign investments and inclusive growth have been analyzed in Chapter 4: Investment law No.25/2007, the 2015-2019 National Medium Term Development Plan (RPJMN), the General Planning of Investment (RUPM), and the Negative Investment List of Investment (NIL). The capacity of these regulations has been assessed by considering whether they support the channels of FDI to inclusive growth mentioned in the theoretical framework. Coherence among the regulations and coordination among government officials in their implementation have also been examined in Chapter 4.

Based on the analysis in Chapter 4, Investment Law No. 25/2007 as the main guide to investment in Indonesia supports promotion of FDI's contribution to inclusive growth. The law states that FDI should provide benefits for local labor, the domestic economy, and society. The benefits for local labor can be promoted by employing local laborers in foreign companies and improving their productivity through training and knowledge transfer. The Indonesian Investment Law also states that foreign investors should have partnerships with domestic firms, especially MSMEs. The law further states that foreign companies should benefit society through providing CSR programs, preserving the environment, and respecting local values. By naming these channels of FDI to inclusive growth, the Indonesian Investment Law has a strong capacity to support FDI for inclusive growth in Indonesia.

The 2015-2019 Indonesia Medium-Term Development Plan (RPJMN) stated explicitly that the Indonesian government attempts to increase contributions to inclusive investments to the domestic economy. However, the RPJMN does not clearly explain the definition and indicators of inclusive investment, and the focus is on domestic investors. As a result of this lack of clarity, the channels through which inclusive investment can be achieved are also unclear. For example, the RPJMN suggests encouraging outward investment in energy and food to achieve inclusive investment. Such investment is not related to the channels of FDI to inclusive growth suggested in our theoretical framework. Moreover, the channels of inclusive investment stated in the RPJMN do not correspond with the channels suggested in Investment Law.

Based on Investment Law, in order to promote investment in the economy, the Indonesian government is required to establish a Long Term General Investment Plan (RUPM) and Negative Investment List (NIL). Based on the RUPM, Indonesian investment policies are directed to improve the investment climate; improve investment distribution; promote investment in food, infrastructure, and energy; encourage green investment; strengthen MSME linkages; provide investment facilities and incentives; and increase promotion of investment. However, the RUPM does not here explicitly mention inclusive investment as an objective. Meanwhile, based on analysis of the 2016 NIL, the Indonesian government clearly attempts to increase protection of MSMEs and

national strategic businesses, and improve the competitiveness of its industry within the ASEAN Economic Community (AEC).

Following comprehensive analysis of these national government regulations in Indonesia, Chapter 4 concludes that even though the existing regulations have defined the specific channels of FDI to promote inclusive growth proposed by this dissertation, coherence between development plans and regulations and coordination among ministries and government levels are rather weak. For instance, the objective of achieving inclusive investment is stated explicitly only in the RPJMN but not in the other regulations. Moreover, based on in-depth interviews with national government officials, the main challenge in achieving inclusive investment is lack of coordination among ministries and between ministries and local governments. Moreover, based on interviews, local governments lack knowledge of the concepts of inclusive growth and inclusive investment. Consequently, their medium-term development plan (RPJMD) does not mention the term inclusive investment. Therefore, the capacity of Indonesian regulations to manage FDI for inclusive growth must be strengthened by improving the coherence between the government regulations and coordination between government levels.

The role of district government in promoting FDI for inclusive growth in the case of multilevel governments was examined in Chapter 5.

10.6.4. The Role of District Government in Promoting FDI for Inclusive Growth in Indonesia: Multilevel Governance Analysis in Selected Districts (Chapter 5)

This chapter described the role of district government in managing FDI to become inclusive. The role of the district government has been analyzed at each stage of the public policy process, from planning to implementing and controlling. This analysis has been based on existing laws and regulations related to foreign investments and inclusive growth. In addition, the content of laws and regulations has been compared with their actual implementation, based on in-depth interviews with representatives of the selected districts – Badung, Mojokerto, and Tangerang.

This chapter has employed the multilevel governance theory, which describes the interdependence among different levels of government (vertical interdependence) and interdependence between government and non-government actors at various territorial levels (horizontal interdependence). This chapter has focused on the vertical interdependence among different levels of government – national, provincial, and district. Based on the multilevel governance theory, governments can be involved in public policies in three possible ways: dominant, joint and implementing. According to the concept of inclusive institutions in our theoretical framework, the inclusiveness of

institutions is indicated by the involvement of district government in managing FDI to become inclusive. Hence, according to the multilevel governance theory, district governments must have a joint role in the public policy process for FDI-led inclusive growth.

Based on analysis of the existing laws and regulations, this chapter concludes that district governments have significant roles in driving FDI to inclusive growth at all stages of the public policy process (planning, implementation, and controlling). In the planning process, the priorities of the national development plan should be consistent with those of provinces and districts. According to Indonesia's medium term development planning (RPJMN) for the period 2010-2014, achieving inclusive growth is the priority of national government and should be consistent with the objectives of provincial and district development plans. Consistency of development plans at all government levels indicates that governments have the same objectives. Hence, government policies, including those related to FDI should be directed toward achieving inclusive growth. In the process of formulating national development plans, district governments can contribute by participating and expressing their aspirations in the regional development forum, known as the Musrenbang Regional. That district governments are required by law to be involved in the national planning process suggests that they play a joint role or adopt inclusive institutions.

In the implementation process, the district government shares a joint role with national and provincial government. In issuing licenses, national government has the authority to approve principle licenses while district governments have responsibility to provide business licenses. In order to regulate FDI to achieve inclusive growth, district government can provide facilities to foreign investors with certain stipulations such as employing local workers, using local resources, providing technological/knowledge transfer, and cooperating with micro-small medium enterprises (MSME). The government can also regulate and drive CSR programs to attain inclusive growth in its region. Therefore, the involvement of district government in CSR programs can be categorized as a joint role.

In the controlling process, all levels of government have equal roles in evaluating the progress or performance of foreign investors. Hence, the involvement of district government in controlling the activities of FDI related to inclusive growth can be categorized as a joint role. Involving society in the controlling process will increase social awareness in monitoring FDI operations. The involvement of district government in FDI-led inclusive growth suggests that inclusive institutions are adopted in the public policy process to direct FDI to become inclusive.

In practice, however, in-depth interviews indicate that the involvement of district governments in the public policy process related to FDI and inclusive growth has been

limited, especially in the planning process. In this process the involvement of district governments in the central government's forums such as Musrenbang Regional, Musrenbang Nasional and investment forums is only a formality. Time constraints, money-motivated participation, unclear follow-up of local governments' aspirations and gaps in human capital capacity are indicated by interviewees as the main impediments to adopting inclusive institutions in the development planning process. Without the involvement of district government in the planning process, national development plans fail to correspond with district development plans. Related to the other public policy processes – implementation and controlling – in practice, district governments have important roles, especially in providing investment licenses and CSR programs, but they still have a limited role in providing investment facilities and promotion because of limited funds.

As this chapter has shown, district governments have roles in managing FDI for inclusive growth according to the law, but in practice, their roles are limited. Deep analysis of inclusive institutions at the district level is thus essential. Therefore, the next three chapters (Chapters 6 to 8) present a study of the existence of inclusive institutions in selected districts. The chapters also explore the detailed channels through which FDI contributes to inclusive growth. A comparison of the three districts on the relationship between FDI, inclusive growth, and institutions has been provided in Chapter 9.

10.6.5. Case Studies and Comparison of FDI, Inclusive Growth and Institutions in Badung, Mojokerto, and Tangerang Districts (Chapters 6, 7, 8 and 9)

Chapters 6 to 8 present a comprehensive analysis of the effect of FDI on inclusive growth and the role of institutions in Badung, Mojokerto and Tangerang Districts. Using the case studies of these districts, this dissertation addresses two main research questions: First, what is the contribution of Foreign Direct Investment (FDI) to inclusive growth? Second, what role do institutions play in making FDI conducive to inclusive growth?

In order to address the two research questions, Chapters 6 to 8 provide analysis based on the results of interviews with stakeholders in the selected districts. In addition, Chapter 9 presents a comparison between the districts. The effect of FDI on inclusive growth is referred to in the theoretical framework of Chapter 2, which identified the four channels of FDI to inclusive growth: employment creation, productivity improvement, CSR programs, and MSME linkage. To examine the role of institutions in promoting these channels, this dissertation has adopted the concept of inclusive institutions introduced by Acemoglu and Robinson (2012). Whether or not institutions are inclusive has been investigated by analyzing whether foreign companies and government have programs which expand the opportunities for local people, especially marginalized

people, to gain benefits from FDI activities. The inclusiveness of institutions has also been examined by analyzing whether foreign companies and government involve members of society in the planning, implementing, and controlling of their programs and policies (political institutions).

According to the case studies of Badung, Mojokerto, and Tangerang Districts, the performance of FDI in promoting inclusive growth varies across districts. In Badung District, FDI contributes to inclusive growth because it provides all channels of inclusive growth, such as employment creation, productivity improvement, CSR programs, and MSME linkages. International hotels in Badung District have created employment for local people, including the disabled. The hotels have employed more than 50 percent local people. They also employ more than one percent disabled people, as stated by the law. By working at international hotels, local people can receive sustainable incomes and benefit from the education and health programs provided by the hotels.

The international hotels in Badung District also provides CSR programs aimed at improving the welfare of local people. For example, the hotel provides cash transfers for the people of *adat* village or called also as *pekraman* village, near the hotel. *Adat* village or *pekraman* village is a village which is based on religious and cultural values and is regulated by community rule, the so-called *awig-awig*. *Adat* village deposits the funds in traditional financial institutions owned by the village people, known as LPD. The LPD manage the funds to finance the community's religious activities and provide loans for community empowerment and scholarships for poor students. The international hotel also provides CSR programs in health and education for poor people, such as house refurbishment, training programs for disabled students, and internship programs for vocational schools. The contribution of this hotel to inclusive growth is also indicated by its strong linkage with MSMEs. The direct effect of FDI on MSMEs is indicated by the role of the latter in supplying fruits, vegetables, and furniture to the international hotel. The hotel also creates direct income for local people by employing sculptors, traditional dancers, and musicians. Furthermore, the existence of the international hotel has indirectly generated a positive effect on other sectors, such as street vendors, housing, and restaurants.

To the contrary, FDI in Mojokerto and Tangerang Districts has made limited contributions to inclusive growth because FDI in those districts could not provide all channels of inclusive growth. In terms of employment creation for local people, the main problem faced by foreign companies in Mojokerto is increases in the minimum wage. Higher minimum wages lead to higher production costs, which make foreign companies reduce their number of employees. In addition, foreign companies in Mojokerto are more likely to offer temporary jobs, which are not attractive for local people who prefer to have permanent jobs. Consequently, local people prefer unemployment to temporary

employment. Meanwhile, in Tangerang, employment creation is limited by a mismatch between the skills of the local people and the skills required by foreign companies. Since industries in Tangerang are mostly high-technological industries which demand skilled laborers, local people, who are mostly unskilled, cannot be employed by foreign companies. Moreover, based on in-depth interviews, foreign companies in Mojokerto and Tangerang are less likely to employ disabled people because they cannot meet the demands of the jobs.

With respect to MSME linkages, in Mojokerto and Tangerang such linkages with foreign companies are limited. The MSMEs in the two districts have limited opportunity to interact with foreign companies and also insufficient capital to fulfill their demands. Moreover, in Tangerang, foreign companies have too little information about the availability and quality of MSMEs. Furthermore, FDI has limited linkages with MSMEs in Tangerang because industries in Tangerang are mostly export-oriented, and also import their inputs from abroad rather than purchasing them from domestic companies. Other problems, such as limited access, insufficient capital, lack of information on availability and quality of MSMEs, cause FDI in Mojokerto and Tangerang to have less linkage to MSMEs.

Our theoretical framework has suggested that the positive contributions of FDI to inclusive growth are influenced by the existence of inclusive institutions in the regions. Inclusive institutions include the programs and policies (economic institutions) of foreign companies and local governments that expand opportunities for all members of society, including marginalized people, to gain benefits from FDI activities. Inclusive institutions also encourage foreign companies and local government to involve all members of society in their programs (political institutions) related to inclusive growth. The Badung District experience provides the best example of inclusive institutions which can promote FDI's contributions to inclusive growth. Interestingly, such institutions in Badung District exist both in the foreign companies and in the local government.

With respect to employment creation, the international hotel in Badung has an agreement with *Adat* village to hire at least 30 percent local people. This agreement is a result of negotiation between the hotel and local people. The international hotel allows local people to express their voices and engages them in the negotiation process. As a result, the agreement has accommodated the aspirations and interests of both the people and the hotel. To enhance the aspect of accountability, the international hotel has been transparent by informing local people of vacancies before announcing them to the public. Besides this agreement, the hotel also commits to employ at least one percent disabled workers, as required by national government law.

In order to promote employment creation, Badung District government supports the policy of the international hotel by providing a regular training program for job seekers. Based on interviews, this training program has successfully improved the skills of the job seekers, most of whom can be employed in the hotel. Moreover, the national government in collaboration with the local government built a vocational school to educate local people in tourism so as to supply skilled workers to international hotels. Students from vocational schools can also have internships at the international hotel and afterward find employment there. The case of Badung District shows that the involvement of local people in a foreign company's employment programs can enhance the contributions of FDI to inclusive growth.

Inclusive institutions have also played an important role in the CSR programs provided by the international hotel in Badung District. For example, the hotel has a CSR program providing regular training for deaf students, thereby accommodating the aspirations of the school's headmaster to help this group of people. The hotel also informs the school about vacancies opened for disabled students. In addition, the international hotel has involved the *Adat* village people in formulating CSR programs. The hotel also allows *Adat* village people to propose CSR programs and discuss the viability of their implementation. To enhance accountability, local people represented by the head of *Adat* village regularly report to the hotel about the implementation of the CSR programs and the use of funds. The involvement of *Adat* village people and the practical application of accountability in CSR programs have shown that inclusive institutions play an important role in promoting the contribution of FDI to inclusive growth.

Based on our theoretical framework, the inclusiveness of institutions is not exogenous⁵¹, but is determined by the values of inclusiveness held by each stakeholder – governments, foreign investors, and society. In Badung District, the existence of inclusive institutions in the international hotel and government has been influenced by the Balinese people's philosophy known as *Tri Hita Karana* (THK). Based on this philosophy, in order to achieve happiness, humans should maintain harmonious relationships with God (*parhyangan*), with other humans (*pawongan*), and with the environment (*palemahan*). Indeed, the principles of THK have been internalized in the daily life of Balinese people. The three aspects of THK are holistic approaches in line with the concept of sustainable and inclusive development suggested by international organizations. International hotels in Badung District have internalized THK principles in their businesses. For example, these hotels always maintain their relationship with

⁵¹ exogeneous variable means a variable which is not influenced by other variables in the system.

society by involving the *Adat* village people in formulating and implementing their programs, such as CSR programs.

In addition, Badung District's government has also stated that THK is the objective of Badung District's Development Plan. To control implementation of THK principles, Badung District government in cooperation with Bali's Provincial government has formed the THK forum. This forum consists of representatives from *Adat* village, governments, academies, and hotels. The forum regularly evaluates the performance of hotels in Bali in implementing the THK principles, including preserving the environment, protecting Balinese culture, and contributing to society. Hotels in Bali which have adopted THK principles in their business will receive awards from the THK forum. The existence of the THK forum is one way for government to promote the positive contribution of hotels to society, culture, and environment.

On the other hand, in Mojokerto and Badung Districts, as mentioned above, foreign companies have made limited contributions to inclusive growth because the companies in those districts could not provide all channels of FDI for inclusive growth. Based on our theoretical framework, the weak contribution of FDI to inclusive growth is caused by the absence of inclusive institutions in the region. Instead, institutions tend to be extractive, benefiting only a small group in society and sacrificing the rest. Extractive institutions also do not allow all members of society to gain benefits from FDI activities nor to be involved in FDI programs or policies. In Mojokerto, the existence of extractive institutions is evident in the low intention of foreign companies to employ marginalized people, such as the disabled. The existence of extractive institutions has also been indicated by the role of "middlemen" in employment creation and MSME linkage channels. The "middleman" has more information and a closer relationship with the foreign companies. Therefore, the involvement of society in FDI programs is limited. Extractive institutions which are represented by the middleman have kept society from gaining benefits from FDI and restricted the involvement of society in FDI programs.

As in Mojokerto District, institutions in Tangerang District are also rather extractive in employment creation and MSME linkage channels. Local people are not involved and informed by foreign companies about open vacancies in the companies. Based on interviews, the head of the village plays an important role in selecting workers to be employed in foreign companies. As a middleman, he does not allow participation of all members of society in the process of recruitment. Consequently, the opportunity for local people to be employed at foreign companies is limited. In addition, extractive institutions also have been found in MSME linkages. Less information and communication between foreign companies and MSMEs cause foreign companies to cooperate only with companies which are recommended by the head of the local village.

The village head in turn benefits from his close relationship with foreign companies. The existence of a middleman in employment creation and MSME linkage has shown that institutions in Tangerang are extractive, restricting members of society from gaining benefits and being involved in FDI activities. The existence of extractive institutions in Tangerang District has been highly influenced by the shift in values of local people from togetherness, kinship, and communality to individualism. In addition, foreign companies in Tangerang tend to be motivated by a desire for favorable resources and locations, as Tangerang District has a strategic location and good infrastructure.

Overall, the case studies of the three districts showed mixed results as to the effect of FDI on inclusive growth. In Badung District, the international hotel as a representation of FDI has promoted inclusive growth through all channels – employment creation, productivity improvement, CSR programs, and MSME linkage. On the other hand, in Mojokerto and Tangerang Districts the case studies showed that FDI makes less of a contribution to inclusive growth because FDI could not provide all channels of inclusive growth, especially in creating employment for local people and linking to MSMEs.

The positive contribution of FDI to inclusive growth in Badung District has been promoted by the existence of inclusive institutions not only in the foreign companies but also in the government. The established institutions in Badung District are highly influenced by the values of society, and particularly of *Tri Hita Karana*, which has been internalized in the objectives of both the international hotel and the government. Meanwhile, the limited contribution of FDI to inclusive growth in Mojokerto and Tangerang Districts is caused by a lack of inclusive institutions and by institutions which are extractive. The extractive institutions tend to restrain the opportunity of society to gain benefits from FDI activities and to be involved in FDI programs. The existence of extractive institutions in Mojokerto and Tangerang Districts is highly influenced by the values of local people, which have shifted from togetherness, kinship, and communality to more individualistic values.

In conclusion, the outcome of this dissertation is that FDI is important for developing countries like Indonesia because it helps to finance domestic economies given a limited domestic savings. However, attracting more FDI is not in itself enough to ensure that FDI will contribute to the domestic economy. Therefore, policy makers should be concerned about the quality of FDI, assessing it not only for its contribution to economic growth but also to the broader concept of economic growth, inclusive growth. Indeed, considering the inclusive growth concept when assessing the quality of FDI is highly relevant since evidence has shown that large inflows of FDI and economic growth in host countries like Indonesia are often not followed by reduced poverty and inequality. Examined by use of a qualitative method, case studies in the three selected

regions have shown varied results on the contributions of FDI to inclusive growth. On the one hand, in Badung District, an international hotel provides all channels of inclusive growth for FDI to benefit local society including marginalized people. On the other hand, foreign companies in Mojokerto and Tangerang Districts do not provide all channels of inclusive growth.

Institutions have indeed played an important role in promoting the contributions of FDI to inclusive growth. This dissertation has found evidence that inclusive institutions are needed to expand the opportunities of all members of society to be involved in FDI programs (political institutions) and to gain benefits from FDI activities (economic institutions). Since central government has a main responsibility in FDI, the capacity of regulations and government planning to support links between FDI and inclusive growth is essential. Strong government regulations should mention all the channels through which FDI can promote inclusive growth. In addition, coherence is needed among governmental regulations and developmental plans at both national and local levels. This dissertation has suggested that Indonesia has to improve the clarity of inclusive growth concept, its targets, and the links through which it can be promoted by FDI. Strengthening coordination among ministries and between ministries and local governments is highly necessary to enhance coherence among regulations and development plans related to FDI and inclusive growth.

At the district level, where local government, foreign companies, and society interact, this dissertation has proposed the need for inclusive institutions for all stakeholders. This proposal is supported by the case study of Badung District, where all stakeholders have adopted the concept of inclusive institutions. International hotels in Badung District actively involve society in formulating their programs. In regular meetings, members of society can voice their aspirations and interests related to the activities of the hotels and their benefits to society. Moreover, the hotels have contributed to society through employment creation, productivity improvement, CSR programs, and MSME linkages. In addition, the local government has strengthened the linkages between international hotels and society by sound policies and programs. Local government has also involved society in the public policy process related to FDI, from planning to implementation to evaluation.

Interestingly, this dissertation has found that the existence of inclusive institutions in Badung District is strongly influenced by the values of society. The Tri Hita Karana (THK) principle, a value of the Balinese people to always maintain harmony between human and God, human and human, and human and environment, has been internalized by international hotels and the local government. These principles are in line with the concepts of sustainable development and inclusive growth which have been widely

adopted by international organizations. The integration among all stakeholders of values which support the existence of inclusive institutions is greatly needed to make FDI conducive to inclusive growth. These findings are unique to this dissertation because up to now most studies have focused only on the existence of institutions in government, and institutions have been assumed to be an exogenous factor.

10.7. The Contributions and Limitations of the Dissertation

The issue of FDI, inclusive growth, and institutions as investigated in this dissertation is highly relevant for Indonesia for three reasons. The first is that Indonesia faces great income inequality in spite of its high economic growth. The evidence of this study indicates that Indonesia's economy is not inclusive, which means that many people are still excluded from economic activity. The second reason is that Indonesia still relies upon foreign investment to support its economy. Central government, which is responsible for managing FDI, provides policies to attract more FDI. However, the evidence from some regions in Indonesia shows that appreciable FDI has not ensured the prosperity of those regions. The evidence also demonstrates that expected positive impacts of FDI on society have not been achieved. The third reason is that Indonesia has been implementing decentralization since 2001. As the decentralization era has provided more room for district governments to manage their own regions, observing institutions – the rules of the game – at the district level has become important.

The relevance of this issue and the lack of study about it make this dissertation a valuable contribution not only to the existing literature, but also for policy makers and society. For the existing literature, this dissertation fills the gap between the theory and empirical evidence of the links between FDI, inclusive growth, and institutions. This dissertation has constructed a new theoretical framework to explain in detail the channels by which FDI can contribute to inclusive growth and the role of institutions in promoting inclusive growth. The dissertation has also considered how the values of stakeholders influence the characteristics of institutions. The theory developed here can be used in further studies aimed at examining the relationship between FDI, inclusive growth, and institutions.

Our empirical findings have also underlined the importance of a broader concept of economic growth, so-called inclusive growth, in assessing the quality of FDI. Based on this concept, the contributions of FDI to host countries should be analyzed not only on the basis of economic growth but also by considering poverty and income inequality. Policy makers in the world, including the Indonesian government, should focus on the contributions of FDI to inclusive growth through four channels: employment creation, productivity improvement, CSR programs, and MSME linkages. Through these channels, policy makers can manage FDI inflows so that they can benefit all members

of society, including marginalized people who would otherwise have limited access to foreign companies' activities.

The main limitation of this dissertation is that it focuses on FDI without considering the role of domestic investment, which could have a significant impact on inclusive growth. Moreover, this dissertation is focused only on three districts as case studies, whereas Indonesia consists of many districts with different characteristics. For future research, case studies could be undertaken in other regions with different characteristics, such as districts in the eastern part of Indonesia which are less represented in this dissertation.

10.8. Policy Recommendations

Based on our theoretical development and empirical analysis, a number of policy recommendations can be made to policy makers, foreign investors and other stakeholders in Indonesia to promote a positive impact of FDI on society.

First, this study suggests that the Indonesian government should consider the inclusive growth concept when assessing the contributions of FDI to society. Inclusive growth is indicated by high economic growth which is followed by lower poverty and inequality. FDI which contributes to inclusive growth benefits all members of society through several channels: employment creation, productivity improvement, the CSR programs, and MSMEs linkages. To increase the concern of governments about the importance of inclusive growth in assessing the quality of FDI, the National Development Planning Ministry (Bappenas) and the Investment Coordinating Board (BKPM) play a vital role in communicating and socializing the concept of FDI for inclusive growth. The Bappenas and BKPM should require the other ministries as well as local governments to consider inclusive growth concept as an objective of their investment plans and policies.

Second, this study would recommend that national government strengthen the coherence among government regulations and plans in managing FDI for inclusive growth through better coordination among ministries and non-ministries. Analysis of the capacity of national regulations revealed a lack of coherence among national government regulations and developmental plans regarding FDI and inclusive growth. The Indonesian medium-term development plan (RPJMN) for 2015-2019, which first introduced the concept of investment for inclusive growth, has not clearly defined the concept, target, and institutional aspect of the relationship between FDI and inclusive growth. Moreover, the focus of inclusive investment in RPJMN is directed more at domestic investment than foreign investment. In order to strengthen the coherence of government regulations and development plans at the national level, horizontal coordination among ministries and non-ministries is needed. This coordination can be

facilitated by the Government Investment Forum. Bappenas and BKPM can be coordinators of the forum to synchronize regulations and development plans related to foreign investment and inclusive growth. In the forum, to strengthen the channels of FDI to inclusive growth, Bappenas and BKPM should cooperate with related ministries, such as the Ministry of Manpower (for employment creation), the Ministry of Health and Education (for productivity improvement), the Ministry of Social Affairs (for the CSR program), and the Ministry of SMEs and Ministry of Industry (for linkages with MSMEs).

Third, besides strengthening coordination among ministries, national government should strengthen coordination between central and local governments in the Regional Investment Forum. According to our analysis of multilevel governance, besides coordination among ministries, vertical coordination between ministries and local governments (provincial and district governments) is needed to ensure coherence of government plans and policies regarding FDI and inclusive growth. The involvement of provincial and district governments in the national public policy process (from planning to implementing to controlling) is essential. In the planning process, the Ministry of Bappenas, in cooperation with BKPM, should socialize the concept of FDI for inclusive growth to the provincial and district governments. Intensive socialization about the concept is required since the case studies in this dissertation have revealed that most district government officials do not understand or have never even heard about the concept of inclusive growth. This indicates that socialization of the inclusive growth concept and its relation to investment has not been communicated by the central government to local governments.

The Regional Investment Forum can be used to strengthen the coordination between national and local governments in formulating investment plans, implementing investment policies, and promoting the contribution of FDI to inclusive growth. The Regional Investment Forum can also be used to improve the understanding of local governments about the concept of FDI for inclusive growth by conducting regular training programs and workshops. To cover all government districts, the forum should have branches in each province, coordinated by the Provincial Government Agency (Bappeda) and Provincial Investment Coordinating Board (BKPMMD). To increase the inclusiveness of the forum, the Indonesian government can also apply information and communication technology (ICT), or so-called E-governance.

Fourth, district government should involve society in formulating investment plans, approving investment licenses, and evaluating the performance of foreign investments. Of the case studies of this dissertation, Badung District can be a model of the best practice. Badung District government always involves the traditional head of the village, the so-called as *desa pekraman*, in assessing the viability of investment proposals.

Badung District government requires investors to present their proposals in front of government officials and the head of *desa pekraman*. Moreover, to internalize the concept of investment for inclusive growth, Bali Province and Badung District Government have created the Tri Hita Karana (THK) Forum, which has the responsibility to evaluate how well hotels implement THK principles in their business activities. The THK forum consists of representatives of local governments, investors, academics, and *desa pekraman*. The THK forum regularly rewards hotels in Bali which have adopted THK principles in their businesses. Receiving THK awards increases the credibility of the hotels with the public because the awards indicate that the hotels are committed to implementing the principles of THK, which are associated with the concepts of sustainable and inclusive development.

Fifth, this study suggests that foreign investors involve local people, including marginalized people, in their business activities. Related to employment creation and productivity improvement, foreign companies can make agreements with society about employment opportunities, inform about job vacancies, and link the companies with vocational schools through internship programs. As the best example, in Badung District international hotels in the Nusa Dua area have an agreement to employ about 30 percent local people. To enhance accountability and develop trust between international hotels and society, the hotels always first inform the head of *desa pekraman* of job vacancies. The head of *desa pekraman* then communicates this information to the members of the *desa pekraman* during its regular meetings, and reports the results of the meeting back to the hotel. This is an example of how inclusive institutions have been adopted by international hotels and local society.

In order to strengthen employment creation for its local people, Badung District government, in collaboration with provincial and national governments, built a vocational school to provide hotels with skilled employees. To integrate the vocational school with the international hotel business, hotels in the Nusa Dua area also provide internship programs for the students. Moreover, international hotels have a commitment to employ at least one percent disabled employees, as stated in the national government law. The commitment of the owners of the hotel significantly influences hotel policies regarding disabled employees. The international hotels also have good communication with schools for the disabled to accommodate their needs in training programs and to inform of the possibility of internships and vacancies.

Sixth, in order to be effective, foreign investors are advised to adopt the principles of inclusive institutions – voice, engagement, and accountability – to accommodate the aspirations of society in formulating and implementing CSR programs. In the example of Badung District, international hotels open communication with society to discuss the

CSR programs needed. Through regular meetings, society can propose CSR programs to the hotels and then the hotels can assess the viability of the programs. This discussion process takes into account both the aspirations of society and the preferences of the hotels. Also, during implementation of the CSR program, international hotels and society collaborate with a traditional micro finance institution called LPD. The LPD is owned by *desa pekraman* to facilitate deposits and lending activities for its members. *Desa pekraman* saves the funds of the CSR program at LPD and regularly reports the use of funds to the members of society during the regular *desa pekraman* meeting, known as *sangkep*. The results of the meeting about implementation of the CSR program and the use of funds are reported by the head of *desa pekraman* to the international hotels. Providing reports between the members of society and the hotel enhances accountability and builds trust between the two groups. To coordinate and match the CSR programs of the companies with the development programs of the government, Badung District government plans to create a CSR forum made up of companies, government, and the heads of society. This forum is expected to minimize the possibility of overlap between the CSR programs of companies and the development programs of government.

Seventh, to strengthen the linkage between FDI and MSMEs, district government is advised to enact regulations requiring foreign companies to collaborate with local MSMEs. However, we first suggest that local government map the potential of local MSMEs. Then the government can provide the mapping of MSMEs to foreign companies to be used to design ways for the companies and local MSMEs to collaborate. Valid information about the potential of local MSMEs can make foreign companies accessible to MSMEs to design an empowerment program. Based on the results of our case studies, limited information about local MSMEs has necessitated the presence of ‘middle men’, in turn limiting the access of MSMEs to foreign companies. Coordination between Bappeda, investment working unit, and the MSME working unit is necessary to promote linkages between foreign companies and local MSMEs. For example, Bali Province Government enacted local regulations requiring companies to adopt traditional Balinese architecture in their buildings. This regulation created income for local MSMEs, who were able to provide Balinese furniture to the hotels. In addition, the management of Nusa Dua area (ITDC) has a program to empower local MSMEs, financed by collective funds from the hotels in the Nusa Dua area.

Lastly, foreign companies and local governments are urged to consider the importance of local values when developing inclusive institutions in their regions. Internalization of local values in the policies of local governments and foreign companies will enhance effective communication and coordination with society. Badung District can be a reference point for how foreign companies and local

government have internalized THK principles in their policy objectives. International hotels have internalized the THK principle in their businesses because it corresponds with their own intention to promote sustainability and inclusiveness. In addition, Badung District and Bali Province governments have incorporated the THK principle in the objective of their development plans. The management of the Nusa Dua area (ITDC) and the local government require companies to adopt the THK principle in their businesses as a prerequisite for getting an investment permit. Moreover, as already mentioned, the THK forum also continuously evaluates the implementation of the THK principle in actual business practice. We would suggest that other local governments and foreign companies in Indonesia likewise internalize the concept of inclusive growth in their investment plans. Moreover, the creation of a stakeholder forum is important to coordinate and stimulate foreign companies and local governments to promote inclusive growth.

This dissertation has stressed the importance of a broader concept of economic growth, known as inclusive growth, in assessing the contributions of FDI to society. This concept requires that government and policy makers analyze the quality of FDI not only on the basis of economic growth, but also on how it affects poverty and inequality. FDI which helps to reduce inequality and poverty allows all members of society to benefit from and be involved in FDI activities. To strengthen this positive impact inclusive institutions are essential. Such institutions expand opportunities for society, including marginalized people, to gain benefits from FDI activities. The most significant contribution of this dissertation its emphasis on the importance of inclusive institutions, not only in government but also in foreign companies and society. Its most novel contribution is its theoretical framework and empirical evidence, which indicate how the values of society, foreign companies, and the government influence whether institutions are inclusive or extractive. Inclusive values on the part of stakeholders are indispensable to bring about inclusive institutions, leading in turn to inclusive FDI.

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Appendix 1. List of Interviewees

Level of Government	No.	Position of the interviewees	Place	Date of interviews
Central	1	Director of Trade, Investment, and International Economic Cooperation, Bappenas	Jakarta	May 2, 2016
	2	Director of Agribusiness Industry and Natural Resources Planning, BKPM	Jakarta and Groningen	June 13, 2016 and August 4, 2016
	3	Head of division for investment license, BKPM	Jakarta	June 13, 2016
	4	Head of Sub-Directorate for investment of Trade, Investment, and International Economic Cooperation, Bappenas	Groningen	July 31, 2016
	5	Planner at Regional Autonomy Directorate, Bappenas	Groningen	July 28, 2016
	6	Member of team for NIL 2014 establishment, BKPM	Groningen	October 26, 2016
Bali Province	7	Head of Regional Development Planning, Bappeda	Bali Province	May 30, 2016
	8	Head of Investment and License Working Unit	Bali Province	May 29, 2016
	9	Head of Education Working Unit	Bali Province	June 7, 2016
	10	Head of Health Working Unit	Bali Province	June 3, 2016
	11	Head of Employment and Immigration unit	Bali Province	June 1, 2016
	12	Head of Micro, Small, and Medium Enterprise Working unit	Bali Province	May 30, 2016
	13	Head of Social Working unit	Bali Province	June 2, 2016
	14	Head of Trade and Industrial Working unit	Bali Province	June 1, 2016
	15	Head of Commission 3 of Regional Parliament	Bali Province	June 7, 2016
Badung District	16	Head of Social Welfare Division, Regional Development Planning Working Unit (Bappeda)	Badung District	May 27, 2016

Level of Government	No.	Position of the interviewees	Place	Date of interviews
	17	Head of Economic Division at Regional Secretary Working Unit	Badung District	May 26, 2016
	18	Head of Investment sub division at Regional Secretary Working Unit	Badung District and Groningen	May 26, 2016 and August 2, 2016
	19	Head of Division for Investment License, One Stop Service Office	Badung District	May 25, 2016
	20	Head of Education Working unit	Badung District	May 27, 2016
	21	Head of Health Working unit	Badung District	May 27, 2016
	22	Head of Employment, Immigration, and Social Welfare Working unit	Badung District	May 25, 2016
	23	Head of Division for Micro, Small, and Medium enterprise unit	Badung District	June 2, 2016
	24	Manager of HRD and Marketing International hotel	Badung District	May 31, 2016
	25	Manager and Marketing of ITDC	Badung District	June 6, 2016
	26	Head of Nusa Dua Village	Badung District	June 5, 2016
	27	Head of Parliament Secretary	Badung District	June 1, 2016
	28	Local people from Badung District (Retired employment of International hotel at Nusa Dua)	Badung District	June 3, 2016
	29	Local people from Badung District (Street vendor)	Nusa Dua area	July 31, 2017
	30	Local people from Badung District (Street vendor)	Nusa Dua area	July 31, 2017
	31	Local people from Badung District (Head of Street vendor association)	Nusa Dua area	July 31, 2017
	32	Teachers of SLB B	Badung District	August 2, 2017
	33	Academics from Udayana	Badung District	August 1, 2017
East Java Province	34	Head of CSR division, Bappeda	Surabaya	May 13, 2016
	35	Head of Economic Division, Bappeda	Surabaya	May 9, 2016

Level of Government	No.	Position of the interviewees	Place	Date of interviews
	36	Head of Investment and License Working Unit	Surabaya and the Den Haag	May 11, 2016 and December 15, 2016
	37	Head of Division Health unit	Surabaya	May 16, 2016
	38	Head of Division Employment and Immigration unit	Surabaya	May 23, 2016
	39	Head of Division for Micro, Small, and Medium Enterprise unit	Surabaya	May 16, 2016
	40	Head of Division for Social Working unit	Surabaya	May 23, 2016
	41	Head of Commission C, Parliament	Surabaya	May 10, 2016
	42	Head of Commission A, Parliament	Surabaya	May 13, 2016
	43	Head of Trade and Industrial Working unit	Surabaya	May 23, 2016
Mojokerto District	44	Head of Economic Division, Bappeda	Mojokerto District	May 12, 2016
	45	Head of Investment Working Unit	Mojokerto District	July 27, 2017
	46	Head of Division for Education, Education working unit	Mojokerto District	May 17, 2016
	47	Head of Employment and Immigration Working unit	Mojokerto District	May 18, 2016
	48	Head of Micro, Small, and Medium Enterprise unit Working unit	Mojokerto District	May 12, 2016
	49	Head of Division for Social Welfare, Social Working unit	Mojokerto District	May 20, 2016
	50	Head of Division for CSR unit	Mojokerto District	May 17, 2016
	51	Head of sub-division of Industrial Working unit	Mojokerto District	May 12, 2016
	52	Public relation of HRD of BS Corp.	Mojokerto District	May 19, 2016
	53	Manager of Marketing BS Corp. (head office)	Jakarta	June 13, 2016
	54	Manager of HRD and Marketing of MB Corp.	Mojokerto District	May 19, 2016
	55	Manager of HRD of YK Crop.	Mojokerto District	May 18, 2016
	56	Manager of HRD of CH Corp.	Mojokerto District	May 18, 2016

Level of Government	No.	Position of the interviewees	Place	Date of interviews
	57	Manager of HRD of SA Corp.	Mojokerto District	May 18, 2016
	58	Manager of HRD MT Corp.	Mojokerto District	May 19, 2016
	59	Member of LSM Fitayat NU	Mojokerto District	May 20, 2016
	60	Head of Indonesian Entrepreneur Association for Mojokerto District	Mojokerto District	July 28, 2017
	61	NGO	Mojokerto District	May 20, 2017
	62	Local people from Ngoro village	Mojokerto District	July 26, 2017
	63	Local people from Kutogirang Village	Mojokerto District	July 28, 2017
	64	Local People from Ngoro Village	Mojokerto District	July 26, 2017
	65	Local people from Wetonmas Jedong Village	Mojokerto District	July 27, 2017
Banten Province	66	Head of Economic division, Bappeda	Serang city	April 11, 2016
	67	Head of Investment and Industrial Unit	Serang city	April 11, 2016
	68	Staff at Employment and Immigration Working unit	Serang city	April 14, 2016
Tangerang District	69	Secretary of Regional Development Planning, Bappeda	Tangerang District	April 9, 2016
	70	Head of Economic Division, Bappeda	Tangerang District	April 9, 2016 and August 9, 2017
	71	Head of Investment Division	Tangerang District and Groningen	April 11, 2016 and December 20, 2016
	72	Head of Subdivision for Education Working unit	Tangerang District	April 19, 2016
	73	Head of Division for Health Working unit	Tangerang District	April 26, 2016
	74	Head of Employment and Immigration unit	Tangerang District	May 2, 2016
	75	Head of Division for Cooperation	Tangerang District	April 19, 2016
	76	Head of Division for Micro, Small, and Medium enterprise unit	Tangerang District	April 26, 2016
	77	Manager of HRD of DT Corp.	Tangerang District	May 4, 2016
	78	Manager of HRD of PM Corp.	Tangerang District	May 4, 2016

Level of Government	No.	Position of the interviewees	Place	Date of interviews
	79	Manager of HRD of HL Corp.	Tangerang District	May 4, 2016
	80	Manager of HRD of VC Corp.	Tangerang District	May 3, 2016
	81	Manager of HRD of NT Corp.	Tangerang District	May 3, 2016
	82	Local people from Tangerang District (NGO)	Tangerang District	April 20, 2016
	83	Local people from Tangerang District (Individual consultant)	Tangerang District	April 15, 2016
	84	Local people from Tangerang District (Tigaraksa Village)	Tangerang District	August 8, 2017
	85	Local people from Tangerang District (Kadu Jaya Village)	Tangerang District	August 9, 2017
	86	Local people from Tangerang District (Kadu Village)	Tangerang District	August 9, 2017
	87	Local people from Tangerang District (Bitung Jaya Village)	Tangerang District	August 9, 2017
	88	Local people from Tangerang District (Sukadamai Village)	Tangerang District	August 9, 2017

Appendix 2. The Guidance of Interviews

This dissertation has addressed two main research questions. **First**, what is the contribution of Foreign Direct Investment (FDI) to inclusive growth in Indonesia? **Second**, to what extent do institutions play an important role in promoting FDI for inclusive growth in Indonesia? In order to find answers of those research questions, this dissertation has implemented qualitative method by having in-depth-interview from stakeholders – governments (national, provincial, and district), foreign companies, and society. The in-depth-interview has been conducted by using semi-opened unstructured interview with a guidance of interview listed below:

1. Government

National, provincial, and district governments

- a. In the National Medium-Term Development Plan (RPJMN) for the period of 2010-2014, Indonesian government has an agenda of achieving inclusive growth. Can you explain briefly about inclusive growth?
- b. Specifically about investment, in the 2015-2019 RPJMN, Indonesian government has programs to drive investment for inclusive growth, called as inclusive investment. Can you explain about inclusive investment?
- c. Who are stakeholders involved by central government in formulating national development plan, especially related to FDI?
- d. How central government involves local governments (provincial and district governments) in public policy process – planning, implementing (license, facility, promotion, and CSR), controlling – for FDI?
- e. How do national and local governments (provincial and district) interact and coordinate to each other in public policy process for FDI – planning, implementing (license, facility, promotion, and CSR), and monitoring/controlling?
- f. What are challenges faced by national, provincial, and district government in public policy process (planning, implementing, and monitoring) for FDI? What future improvement should be taken?

Additional questions for district government

- a. What are the programs conducted by district government to increase the contribution of FDI to society? How?
- b. How does district government coordinate with companies to achieve inclusive growth?
- c. How does district's government involve society in promoting the contribution of FDI to inclusive growth?

- d. What is the objective of government's development plan, especially related to investment?
- e. What are challenges faced by local government to promote the contribution of FDI for inclusive growth and how to improve it in the future?

2. Foreign firm

- a. Can you explain briefly about the company's profile in term of investment, business process, employment, and the other characteristics?
- b. Does the company have programs to improve its contributions to society, including marginalized people through the following channels: employment, health and education, MSME links, and CSR programs?
- c. How the company involves society in the planning and implementation of those programs?
- d. How does company interact with governments (national, provincial, or district) and to what extent government supports the company?
- e. What are challenges faced by company in the implementation of the programs related to society?
- f. What is the motivation/objective/value of company which influence the contribution of company to society?

3. Society

- a. What is the contribution (employment, health, education, MSME linkages, and CSR programs) of foreign companies in the region from the perspective of society?
- b. What programs have been received by society from FDI?
- c. What are the negative effects of FDI on society?
- d. How society being involved by foreign company in formulation and implementation of the programs related to society?
- e. How the existence of foreign company in the region expands the opportunity of society to gain benefits from FDI activities?
- f. How local government involves society in public policy process related to FDI?
- g. How the value of society supports or restricts the contribution of FDI to society?
- h. In general, what aspects should be improved to increase the contributions of FDI to society?

English Summary

Developing countries like Indonesia highly rely on foreign direct investment (FDI) in order to finance their economic development. A high dependency on FDI is mainly caused by insufficient domestic savings to finance the development. However, impacts of FDI on host countries' economies are still debatable. On one hand, the modernization theory proposes that FDI will be beneficial for host countries through elements such as employment creation, technology transfer, and economic linkage (Borensztein et al., 1998; Bengoa and Sanchez-Robles, 2003; Durham, 2004; Li and Liu, 2005; Solomon, 2011). On the other hand, the dependency theory argues that FDI will distort the host countries' economies since FDI can destruct local entrepreneurship, stifle technological innovation, crowd out domestic firms, and increase unemployment (Mihalache-O and Li, 2011; Amin, 1974; Alschuler, 1976; Bornschieer et al., 1978, and Frank, 1979). Unfortunately, the existing studies have focused only on the contribution of FDI to domestic economies using a narrow concept of economic growth.

Indeed, focusing only on economic growth in assessing the impact of FDI is too narrow an approach, as empirical evidence indicates that economic growth is often not accompanied by reduction in income inequality and poverty rate (World Bank, 2008; Kusumawati et al., 2015; Fuso, 2017). For example, high economic growth in Great Britain during the industrial revolution was not followed by improvements in life expectancy and infant mortality (Crafts, 1997). The more recent increase of economic growth in India was not accompanied by a decreasing mortality rates, and less income and gender inequality (UNDP, 2005). Similarly, during the recent global financial crisis, Indonesia experienced a remarkable economic growth but also had the worst income inequality of the last 50 years. Therefore, international organizations and policy makers attempt to consider a broader perspective of economic growth, the so-called inclusive growth concept in assessing the contribution and the quality of economic policies and business, including FDI. Inclusive growth is briefly defined as growth which benefits all members of society regardless their circumstances (Felipe, 2012; Ramos et al., 2013; ADB, 2008; and OECD, 2014). Empirically, inclusive growth is indicated by the growth which is accompanied by lower poverty and inequality.

According to the New Institutional Economics (NIE), institutions are the fundamental factor in the success of a country's development (North 1981; Rodrik, 2000; Acemoglu and Robinson, 2012). North (1981) defines institutions as the rule of the game which formally and informally structures the human interaction. The most recent studies by Acemoglu and Robinson (2012) and OECD (2013) have introduced the concept of inclusive institutions which allow all members of society to gain benefits from economic activities and be involved in economic policies. Regarding the benefits

of FDI, Dunning and Fortainer (2006) perceived the important role of good institutions, concerning for example property rights, corruption control, and rule of law, in promoting the positive impact of FDI on host countries. However, there is no study that has applied the concept of inclusive growth to assess the effect of FDI on a host country. Therefore this dissertation has comprehensively explored and analyzed the links between FDI, inclusive growth, and institutions in Indonesia.

This dissertation has addressed two main research questions. Firstly, what is the contribution of FDI to inclusive growth in Indonesia? Secondly, to what extent do institutions play an important role in promoting FDI for inclusive growth in Indonesia?. In order to address the research questions, this dissertation has employed a qualitative method to explore the perspectives and experiences of stakeholders related to FDI and inclusive growth. Using the data of FDI and indicators of inclusive growth, such as poverty and inequality, the three regions – Badung, Mojokerto, and Tangerang Districts were selected for investigation. This dissertation has interviewed related stakeholders, such as government officials at national and regional levels, foreign companies, and the members of society. In addition, this dissertation also has presented a review of the existing literature and regulations and provides economic and social data related to FDI, inclusive growth indicators, and institutions.

A theoretical framework of the relationship between FDI, inclusive growth, and institutions has been created in this dissertation. The theoretical framework suggests that the contribution of FDI to a host country should be assessed not only on the basis of economic growth per se, but also on the inclusive growth concept. Based on the existing literature, inclusive growth is the growth which benefits all members of society on an equal basis. The inclusive growth is indicated by growth which lowers poverty and inequality. The theoretical framework includes four channels through which FDI can promote inclusive growth: employment creation, productivity improvement, Corporate Social Responsibility (CSR) programs, and the linkages to Micro Small-Medium Enterprises (MSMEs). Through those channels, FDI is expected to provide benefits for local people, including marginalized people who normally have limited access to FDI activities, such as the poor, the disable, and woman. To promote those channels, our theoretical framework has considered the important role of inclusive institutions suggested by Acemoglu and Robinson (2012). Inclusive institutions are the rules which expand the opportunities of all members of society to gain benefits from economic activities (economic institutions) and to participate in policy formulation (political institutions). In this dissertation, the theoretical framework has extended the scope of inclusive institutions to apply to multi-level government cases and institutions of other stakeholders, such as foreign companies and society. In addition, the theoretical

framework also has suggested that inclusiveness of institutions is influenced by the value of society, government, and foreign companies.

For empirical investigation, firstly this dissertation has examined the capacity of national government regulations to manage FDI for inclusive growth in Indonesia. Four national government regulations related to foreign investments and inclusive growth have been analyzed, including Investment Law No.25/2007, the current National Medium Term Development Plan (RPJMN), the General Planning of Investment (RUPM), and the Negative Investment List of Investment (NIL). The capacity of these regulations has been assessed by considering whether they support the channels of FDI to inclusive growth. Moreover, coherence among the regulations and coordination among government official in their implementation have been analyzed. This dissertation has found that coherence between development plans and regulations and coordination among government levels are rather weak. The main challenge in achieving inclusive investment is lack of coordination among ministries and between ministries and local governments. In addition, local governments lack knowledge of the concept of inclusive growth and inclusive investment.

Furthermore, this dissertation has observed the inclusiveness of institutions in promoting FDI for inclusive growth by exploring the role of district governments at each stage of the public policy process, from planning to implementing and controlling. Based on the multilevel governance theory and the concept of inclusive institutions, the inclusiveness of institutions is indicated by the involvement of district government in promoting FDI for inclusive growth. The analysis is based on existing laws and regulations and their actual implementation. Based on the analysis of existing laws and regulations, this dissertation has concluded that district governments have significant roles in driving FDI towards inclusive growth at all stages of public policy process. In practice, however, the involvement of district governments in the public policy process related to FDI and inclusive growth has been limited, especially in the planning process. The involvement of district governments in the central government's forum such as Musrenbang Regional, Musrenbang Nasional, and investment forums is only a formality. Time constraints, money-motivated participations, unclear follow-up of local governments' aspirations and gaps in the quality of human resources are the main constrain to optimize the involvement of district governments in public policy process related to FDI and inclusive growth. In the implementation and controlling stages, in practice, district governments have significant roles, especially in providing investment licenses and managing CSR programs.

In order to investigate the effect of FDI on inclusive growth and the role of institutions, this dissertation has provided case studies in selected districts: Badung,

Mojokerto, and Tangerang. According to the case studies of those districts, the performance of FDI in promoting inclusive growth varies across districts. In Badung District, FDI contributes to inclusive growth because it provides all channels of inclusive growth, such as employment creation, productivity improvement, CSR programs, and MSME linkages. For example, the international hotel in Badung District has employed more than 50 percent local people and also employed more than one percent of disable people. By working at international hotels, local people can receive sustainable incomes and benefits from the educational and health programs provided by the hotels. In addition, the international hotel also has collaboration with Adat village (or called Pekraman village), near the hotel in order to provide CSR programs. The existence of the international hotel has directly generated a positive effect on other sectors.

To the contrary, FDI in Mojokerrto and Tangerang Districtshas made limited contributions to inclusive growth as FDI in those districts could not provide all channels of inclusive growth. In terms of employment creation for local people, the main problem faced by foreign companies in Mojokerto is increases in the minimum wage which have led to higher costs and lower employment absorption. Meanwhile in Tangerang, employment creation is limited by a mismatch between the skills of the local people and the skills required by foreign companies. With respect to MSME linkages, in Mojokerto and Tangerang such linkages with foreign companies are limited. Limited access, insufficient capital, lack of information on availability, and quality of MSMEs are the factors causing FDI in Mojokerto and Tangerang have less linkage to MSMEs. However, based on the theoretical framework, the weak contribution of FDI to inclusive growth is caused by the absence of inclusive institutions in the regions, or otherwise the institutions tend to be extractive. Extractive institutions do not allow all members of society to gain benefits from FDI activities nor to be involved in FDI programs or policies.

In Mojokerto, the existence of extractive institutions is evident indicated by the limited involvement of society in FDI programs. Foreign companies have low intention to employ marginalized people, such as the disabled. The existence of extractive institutions is also indicated by the role of so-called “middlemen” in employment creation and MSME linkages. The middleman has more information and a closer relationship with the foreign companies. Extractive institutions which are represented by middlemen restrict society from gaining benefits from FDI and constrain the involvement of society in FDI programs. Similarly, the institutions in Tangerang District are also rather extractive, especially in employment creation and MSME linkages. Less communication between foreign companies and local people and the existence of middlemen are also the main factors which restrict society to gain benefits from FDI

activities and to involve in FDI programs. The existence of extractive institutions in Tangerang Districts has been highly influenced by the shift in values of local people from togetherness, kinship, and communality to individualism. In addition, foreign companies tend to be motivated by a desire for favorable resources and locations.

In contrast, in Badung District, the positive contribution of FDI to inclusive growth has been promoted by the existence of inclusive institutions not only in the foreign companies but also in government. For example, the hotel always involves the Adat village people in formulating CSR programs. The hotel also allows Adat village people to propose CSR programs and discuss the viability of their implementation. To enhance accountability, local people represented by the head of Adat village regularly report to the hotel about the implementation of the CSR programs and the use of the funds. The existence of inclusive institutions in Badung District has been influenced by the Balinese people's philosophy known as *Tri Hita Karana* (THK), which suggests maintaining harmonious relationships with God, with other humans, and with the environment. Indeed, the principles of THK have been internalized not only in the daily life of Balinese people, but also in the business activities of international hotels and the objective of Badung District's Development Plan.

In conclusion, the outcome of this dissertation is that FDI is important for developing countries like Indonesia because it helps to finance domestic development. However, attracting more FDI is not in itself enough to ensure that FDI will have a positive effect on the domestic economy. Therefore, policy makers should be concerned about the quality of FDI by assessing its contribution not only to economic growth but also to the broader concept of economic growth, being inclusive growth. The case studies of the three regions in Indonesia have shown that inclusive institutions play an important role in promoting the contributions of FDI to inclusive growth. Involving society in FDI programs and government's policies related to FDI will expand the opportunities of society to gain benefits from FDI activities. At the national level, the involvement of district governments in public policy processes and coherence among government regulations are required to promote FDI to become inclusive. Lastly, foreign companies and local governments are urged to consider the importance of local values when developing inclusive institutions in their regions.

Nederlandse Samenvatting

Buitenlandse directe investeringen (FDI), inclusieve groei en instellingen in Indonesië

Ontwikkelingslanden zoals Indonesië zijn in hoge mate afhankelijk van directe buitenlandse investeringen (FDI, foreign direct investment) om hun economische ontwikkeling te financieren. Een hoge afhankelijkheid van FDI wordt voornamelijk veroorzaakt door onvoldoende binnenlandse besparingen om de ontwikkeling te financieren. De effecten van FDI op de economieën van gastlanden zijn echter nog steeds discutabel. Aan de ene kant stelt de modernisatietheorie dat FDI voordelig is voor gastlanden door bijvoorbeeld het creëren van werkgelegenheid, technologie-overdracht en economische koppeling (Borensztein et al., 1998; Bengoa en Sanchez-Robles, 2003; Durham, 2004; Li and Liu, 2005; Solomon, 2011). Anderzijds beweert de afhankelijkheidstheorie dat FDI de economie van gastlanden zal verstoren, omdat FDI lokaal ondernemerschap kan vernietigen, technologische innovatie kan verstikken, binnenlandse bedrijven kan verdringen en de werkloosheid kan verhogen (Mihalache-O and Li, 2011; Amin, 1974; Alschuler 1976, Bornschieer et al., 1978, en Frank, 1979). Helaas hebben de bestaande studies zich alleen gericht op de bijdrage van FDI aan de binnenlandse economie met behulp van een beperkt concept van economische groei.

Alleen focussen op economische groei bij het beoordelen van de invloed van FDI is inderdaad een te enge benadering, omdat empirisch bewijsmateriaal aangeeft dat economische groei vaak niet gepaard gaat met een vermindering van inkomensongelijkheid en armoedepercentages (World Bank, 2008; Kusumawati et al., 2015, Fuso, 2017). Zo werd de hoge economische groei in Groot-Brittannië tijdens de industriële revolutie niet gevolgd door verbeteringen in de levensverwachting en kindersterfte (Crafts, 1997). De meer recente toename van de economische groei in India ging niet gepaard met een dalend sterftcijfer en minder inkomen en genderongelijkheid (UNDP, 2005). Evenzo heeft Indonesië tijdens de recente wereldwijde financiële crisis een opmerkelijke economische groei ervaren, maar tegelijkertijd ook de grootste inkomensongelijkheid van de afgelopen 50 jaar. Daarom trachten internationale organisaties en beleidsmakers een breder perspectief van economische groei in overweging te nemen, het zogeheten inclusieve groeiconcept, bij de beoordeling van de bijdrage en de kwaliteit van economisch beleid en bedrijfsactiviteiten, waaronder FDI. Inclusieve groei wordt kort gedefinieerd als groei die alle leden van de samenleving ten goede komt, ongeacht hun omstandigheden (Felipe, 2012; Ramos et al., 2013; ADB, 2008; en OECD, 2014). Empirisch wordt inclusieve groei aangegeven door de groei die gepaard gaat met lagere armoede en ongelijkheid.

Volgens de New Institutional Economics (NIE) zijn instellingen de fundamentele factor in het succes van de ontwikkeling van een land (North 1981, Rodrik, 2000; Acemoglu en Robinson, 2012). North (1981) definieert instellingen als de regel van het spel dat formeel en informeel de menselijke interactie structureert. De meest recente studies van Acemoglu en Robinson (2012) en de OECD (2013) hebben het concept geïntroduceerd van betrokken instellingen die alle leden van de samenleving in staat stellen te profiteren van economische activiteiten en betrokken te zijn bij economisch beleid. Met betrekking tot de voordelen van FDI zagen Dunning en Fortainer (2006) de belangrijke rol van goede instellingen, zoals inzake eigendomsrechten, corruptiebestrijding en de rechtsstaat, bij het bevorderen van de positieve invloed van FDI op gastlanden. Er is echter geen studie die het concept van inclusieve groei heeft toegepast om het effect van FDI op een gastland te beoordelen. Daarom worden in dit proefschrift de verbanden tussen FDI, inclusieve groei en instellingen in Indonesië uitgebreid onderzocht en geanalyseerd.

Dit proefschrift heeft twee hoofdonderzoeksvragen behandeld. Ten eerste, wat is de bijdrage van FDI aan inclusieve groei in Indonesië? Ten tweede, in hoeverre spelen instellingen een belangrijke rol bij het bevorderen van FDI voor inclusieve groei in Indonesië? Om de onderzoeksvragen te beantwoorden, heeft dit proefschrift een kwalitatieve methode gebruikt om de perspectieven en ervaringen van belanghebbenden met betrekking tot FDI en inclusieve groei te onderzoeken. Aan de hand van de gegevens van FDI en indicatoren voor inclusieve groei, zoals armoede en ongelijkheid, werden de drie regio's - Badung, Mojokerto en Tangerang-districten geselecteerd voor onderzoek. Dit proefschrift heeft belanghebbenden geïnterviewd, zoals overheidsambtenaren op nationaal en regionaal niveau, buitenlandse bedrijven en de leden van de samenleving. Daarnaast presenteert dit proefschrift ook een overzicht van de literatuur en regelgeving en biedt het economische en sociale gegevens met betrekking tot FDI, inclusieve groei-indicatoren en instellingen.

Een theoretisch kader van de relatie tussen FDI, inclusieve groei en instellingen is beschreven in dit proefschrift. Het theoretische kader heeft gesuggereerd dat de bijdrage van FDI aan een gastland niet alleen moet worden beoordeeld op basis van economische groei, maar ook op inclusieve groei. Gebaseerd op de literatuur, is inclusieve groei de groei die alle leden van de samenleving op gelijke basis ten goede komt. De inclusieve groei wordt aangegeven door de groei met lagere armoede en ongelijkheid. Het theoretische kader heeft vier wegen aangemerkt waarlangs FDI inclusieve groei kan bevorderen: werkgelegenheidscreatie, productiviteitsverbetering, CSR-programma's (Corporate Social Responsibility) en de koppelingen naar Micro Small-Medium Enterprises (MSME's). Via die kanalen wordt verwacht dat FDI-voordelen zullen

opleveren voor de lokale bevolking, inclusief de gemarginaliseerde mensen die normaal gesproken beperkte toegang hebben tot FDI, zoals armen, gehandicapten en vrouwen. Om deze kanalen te bevorderen, heeft het theoretisch kader de belangrijke rol van inclusieve instellingen overwogen, die door Acemoglu en Robinson (2012) wordt gesuggereerd. Inclusieve instellingen zijn de regels die de kansen van alle leden van de samenleving vergroten om te profiteren van economische activiteiten (economische instellingen) en om deel te nemen aan beleidsformulering (politieke instellingen). In deze dissertatie heeft het theoretisch kader de reikwijdte van inclusieve instellingen uitgebreid tot toepassingen op meer niveaus van overheidszaken en instellingen van andere belanghebbenden, zoals buitenlandse bedrijven en de samenleving. Daarnaast heeft het theoretisch kader betoogd dat de inclusiviteit van instellingen ook wordt beïnvloed door de waarde van de samenleving, de overheid en buitenlandse bedrijven.

Voor empirisch onderzoek is in de eerste plaats in dit proefschrift de capaciteit onderzocht van nationale overheidsvoorschriften FDI te beheren voor inclusieve groei in Indonesië. Vier nationale overheidsvoorschriften met betrekking tot buitenlandse investeringen en inclusieve groei zijn geanalyseerd, waaronder de investeringswet nr. 25/2007, het huidige nationale ontwikkelingsplan op middellange termijn (RPJMN), de algemene investeringsplanning (RUPM) en de negatieve investeringslijst van Investering (NIL). De capaciteit van deze voorschriften is beoordeeld door na te gaan of ze de kanalen van FDI ondersteunen voor inclusieve groei. Bovendien is de samenhang tussen de regelgeving en de coördinatie tussen de overheidsfunctionarissen bij de uitvoering geanalyseerd. In dit proefschrift is geconstateerd dat de samenhang tussen ontwikkelingsplannen en voorschriften en coördinatie tussen overheidsniveaus vrij zwak is. De belangrijkste uitdaging bij het realiseren van inclusieve investeringen is het gebrek aan coördinatie tussen ministeries en tussen ministeries en lokale overheden. Bovendien ontbreekt het de lokale overheden aan kennis van het concept van inclusieve groei en inclusieve investeringen.

Verder heeft dit proefschrift de inclusiviteit van instellingen onderbouwd bij het bevorderen van FDI voor inclusieve groei door de rol van districtsregeringen te onderzoeken in elke fase van het openbare beleidsproces, van planning tot uitvoering en controle. Gebaseerd op de multilevel governance theorie en het concept van inclusieve instellingen, is de inclusiviteit van instellingen waargenomen door de betrokkenheid van de districtsregering bij het bevorderen van FDI voor inclusieve groei. De analyse is gebaseerd op bestaande wet- en regelgeving en haar daadwerkelijke implementatie. Gebaseerd op analyse van de bestaande wet- en regelgeving, concludeert dit proefschrift dat districtsbesturen een belangrijke rol spelen bij het stimuleren van FDI tot inclusieve groei in alle stadia van het openbare beleidsproces. In de praktijk is de betrokkenheid

van districtsoverheden bij het proces van openbaar beleid met betrekking tot FDI en inclusieve groei echter beperkt gebleken, vooral in het planningsproces. De betrokkenheid van districtsregeringen in het centrale overheidsforum zoals Musrenbang Regional, Musrenbang Nasional en investeringsforums is slechts een formaliteit. Tijdbeperkingen, geldgemotiveerde participaties, onduidelijke opvolging van de ambities van lokale overheden en tekortkomingen in de kwaliteit van het personeel zijn de belangrijkste beperkingen de betrokkenheid van districtsregeringen bij het overheidsbeleid met betrekking tot FDI en inclusieve groei te optimaliseren. In de uitvoerings- en controlefasen hebben districtsoverheden in de praktijk een belangrijke rol, vooral bij het verstrekken van investeringslicenties en het beheren van CSR-programma's.

Om het effect van FDI op inclusieve groei en de rol van instellingen te onderzoeken, heeft dit proefschrift gevalsstudies in drie districten geselecteerd: Badung, Mojokerto en Tangerang. Volgens de gevalsstudies van die districten varieert de prestatie van FDI bij het bevorderen van inclusieve groei van district tot district. In het district Badung draagt FDI bij tot inclusieve groei, omdat het alle kanalen voor inclusieve groei aanboort, zoals het creëren van werkgelegenheid, productiviteitsverbetering, CSR-programma's en MSME verbindingen. Het internationale hotel in het district Badung heeft bijvoorbeeld meer dan vijftig procent lokale, en meer dan één procent van de invalide bevolking in dienst. Door te werken in internationale hotels, kan de lokale bevolking duurzame inkomsten en voordelen ontvangen van de educatieve en gezondheidsprogramma's die door de hotels worden aangeboden. Daarnaast heeft het internationale hotel ook een samenwerking met het Adat-dorp, ook wel Pekraman genoemd, in de buurt van het hotel voor CSR-programma's. Het bestaan van het internationale hotel heeft direct een positief effect gehad op andere sectoren.

Daarentegen hebben FDI in de districten Mojokerto en Tangerang een beperkte bijdrage geleverd aan inclusieve groei, omdat FDI in die gebieden niet alle kanalen van inclusieve groei kon bieden. Op het gebied van het creëren van werkgelegenheid voor de lokale bevolking, is het grootste probleem van buitenlandse bedrijven in Mojokerto de stijgingen van het minimumloon, die leiden tot hogere kosten en een lager aanbod van werkgelegenheid. Ondertussen wordt in Tangerang het creëren van werkgelegenheid beperkt door een verkeerde match tussen de vaardigheden van de plaatselijke bevolking en de vaardigheden die buitenlandse bedrijven nodig hebben. Met betrekking tot MSME-koppelingen zijn in Mojokerto en Tangerang dergelijke koppelingen met buitenlandse bedrijven beperkt. Beperkte toegang, onvoldoende kapitaal, gebrek aan informatie over beschikbaarheid en kwaliteit van MSME's zijn de

factoren waardoor FDI in Mojokerto en Tangerang minder gekoppeld is aan MSME's. Op basis van het theoretisch kader wordt de zwakke bijdrage van FDI aan inclusieve groei echter vooral veroorzaakt door het ontbreken van inclusieve instellingen in de regio's; ook zijnde instellingen vaak 'extractief'. Met andere woorden, extractieve instellingen staan niet toe dat alle leden van de samenleving voordeel halen uit FDI of betrokken zijn bij FDI-programma's of -beleid.

In Mojokerto wordt het bestaan van extractieve instellingen duidelijk aangetoond door de beperkte betrokkenheid van de samenleving bij FDI-programma's. Buitenlandse bedrijven hebben een lage intentie gemarginaliseerde mensen in dienst te nemen, zoals gehandicapten. Het bestaan van extractieve instellingen wordt ook aangegeven door de rol van 'de tussenpersoon' bij het creëren van werkgelegenheid en MSME-verbanden. De tussenpersoon heeft meer informatie en een nauwere relatie met de buitenlandse bedrijven. Extractieve instellingen die door de tussenpersoon worden vertegenwoordigd, beperken de samenleving baat te vinden bij FDI, en beperken de betrokkenheid van de samenleving bij FDI-programma's. Evenzo zijn de instellingen in de wijk Tangerang nogal extractief, met name wat betreft het creëren van werkgelegenheid en MSME-verbindingen. Minder communicatie tussen buitenlandse bedrijven en lokale mensen en het bestaan van tussenpersonen zijn ook de belangrijkste factoren die de maatschappij ertoe aanzetten voordeel te halen uit FDI-activiteiten en te betrekken bij FDI-programma's. Het bestaan van extractieve instellingen in de districten van Tangerang is sterk beïnvloed door de verandering in waarden van lokale mensen van saamhorigheid, verwantschap en gemeenschap tot individualisme. Daarnaast worden buitenlandse bedrijven vaak gemotiveerd door een verlangen naar gunstige bronnen en locaties.

In Badung District daarentegen is de positieve bijdrage van FDI aan inclusieve groei bevorderd door het bestaan van inclusieve instellingen, niet alleen in de buitenlandse bedrijven, maar ook binnen de overheid. Het hotel betreft bijvoorbeeld altijd de dorpsmensen van Adat bij het opstellen van CSR-programma's. Het hotel biedt ook Adat-dorpsmensen de mogelijkheid CSR-programma's voor te stellen en de uitvoerbaarheid van hun uitvoering te bespreken. Om de verantwoordingsplicht te vergroten, brengen lokale mensen die door het hoofd van het dorp Adat worden vertegenwoordigd, regelmatig verslag uit aan het hotel over de uitvoering van de CSR-programma's en het gebruik van de fondsen. Het bestaan van inclusieve instellingen in het district Badung is beïnvloed door de filosofie van het Balinese volk, die bekend staat als Tri Hita Karana (THK) en die suggereert een harmonieuze relatie te handhaven met God, met andere mensen en met de omgeving. De principes van THK zijn inderdaad niet alleen eigen gemaakt in het dagelijks leven van Balinese mensen, maar ook in de

zakelijke activiteiten van internationale hotels en in het doel van het ontwikkelingsplan van Badung District.

Samenvattend, de uitkomst van dit proefschrift is dat FDI belangrijk is voor ontwikkelingslanden, zoals Indonesië, omdat het helpt de binnenlandse ontwikkeling te financieren. Het aantrekken van meer FDI is echter niet voldoende ervoor te zorgen dat FDI een positief effect op de binnenlandse economie zal hebben. Daarom moeten beleidsmakers zich zorgen maken over de kwaliteit van FDI door niet alleen de bijdrage aan economische groei, maar ook aan het bredere concept van economische groei en inclusieve groei te beoordelen. De gevalsstudies van de drie regio's in Indonesië hebben aangetoond dat inclusieve instellingen een belangrijke rol spelen bij het bevorderen van de bijdragen van FDI aan inclusieve groei. Door de samenleving te betrekken bij FDI-programma's en het overheidsbeleid met betrekking tot FDI zullen de kansen van de samenleving worden vergroot baat te vinden bij FDI. Op nationaal niveau is de betrokkenheid van districtsoverheden bij het openbare beleidsproces en de samenhang tussen overheidsregelingen vereist te bevorderen dat FDI inclusief worden. Ten slotte worden buitenlandse bedrijven en lokale overheden aangespoord het belang van lokale waarden te overwegen bij het ontwikkelen van inclusieve instellingen in hun regio's.

Ringkasan Bahasa Indonesia

Penanaman Modal Asing (PMA), Pertumbuhan Inklusif, dan Institusi di Indonesia

Negara-negara berkembang seperti Indonesia masih sangat tergantung pada investasi langsung asing atau dikenal dengan penanaman modal asing (PMA) untuk membiayai pertumbuhan ekonomi negaranya. Ketergantungan yang tinggi terhadap PMA terutama disebabkan oleh ketidakcukupan tabungan dalam negeri untuk membiayai pembangunan. Namun demikian, dampak dari PMA terhadap perekonomian negara tujuan PMA masih dalam perdebatan. Pada satu sisi, teori modernisasi mengatakan bahwa PMA dapat bermanfaat untuk negara tujuan PMA antara lain melalui penciptaan tenaga kerja, transfer teknologi, dan keterkaitan ekonomi (Borensztein et al., 1998; Bengoa and Sanchez-Robles, 2003; Durham, 2004; Li and Liu, 2005; Solomon, 2011). Di sisi lain, teori dependensi berargumen bahwa PMA akan mengganggu perekonomian negara tujuan PMA dikarenakan PMA akan menghambat jiwa usaha domestik, inovasi teknologi, usaha dalam negeri, dan meningkatkan pengangguran (Mihalache-O and Li, 2011; Amin, 1974; Alschuler, 1976; Bornschieer et al., 1978, and Frank, 1979). Namun demikian, studi-studi yang ada selama ini hanya melihat kontribusi dari PMA terhadap pertumbuhan ekonomi negara tujuan PMA.

Menganalisa dampak PMA hanya terhadap pertumbuhan ekonomi merupakan pendekatan yang sempit karena bukti-bukti empiris mengindikasikan bahwa pertumbuhan ekonomi seringkali tidak dibarengi dengan pengurangan ketimpangan pendapatan dan tingkat kemiskinan (World Bank, 2008; Kusumawati et al., 2015; Fuso, 2017). Sebagai contoh, pertumbuhan ekonomi di Inggris saat revolusi industri tidak dibarengi dengan perbaikan angka harapan hidup dan penurunan angka kematian bayi (Crafts, 1997). Peningkatan pertumbuhan ekonomi yang dialami India juga tidak dibarengi dengan penurunan tingkat kematian dan penurunan ketimpangan pada pendapatan dan gender (UNDP, 2005). Demikian pula, pada saat krisis keuangan global baru-baru ini, Indonesia mengalami pertumbuhan ekonomi yang tinggi, namun disaat bersamaan Indonesia mengalami ketimpangan pendapatan yang terburuk sejak 50 tahun terakhir. Oleh karena itu, organisasi-organisasi internasional dan para pembuat kebijakan mulai mempertimbangkan konsep pertumbuhan ekonomi, yang dikenal dengan sebutan pertumbuhan inklusif, dalam menganalisa kontribusi dan kualitas kebijakan ekonomi dan usaha, termasuk PMA. Pertumbuhan inklusif secara ringkas didefinisikan sebagai pertumbuhan yang memberi manfaat untuk seluruh anggota masyarakat terlepas dari kondisi mereka (Felipe, 2012; Ramos et al., 2013; ADB, 2008; and OECD, 2014). Secara empiris, pertumbuhan inklusif ditunjukkan dengan

pertumbuhan ekonomi yang dibarengi dengan tingkat kemiskinan dan ketimpangan yang menurun.

Berdasarkan *New Institutional Economics* (NIE), institusi adalah faktor fundamental dalam keberhasilan pembangunan suatu negara (North 1981; Rodrik, 2000; Acemoglu dan Robinson, 2012). North (1981) mendefinisikan institusi sebagai aturan main yang secara formal dan informal membentuk interaksi antar manusia. Studi terbaru yang dilakukan oleh Acemoglu dan Robinson (2012) dan OECD (2013) telah memperkenalkan konsep institusi inklusif yang memungkinkan semua anggota masyarakat untuk menerima manfaat dari kegiatan ekonomi dan terlibat dalam kebijakan ekonomi. Mengenai manfaat PMA, Dunning dan Fortainer (2006) merasakan peran penting dari institusi, seperti hak milik, pengendalian korupsi, dan penegakan hukum dalam mempromosikan dampak positif PMA di negara tujuan PMA. Namun demikian, belum terdapat studi yang menerapkan konsep pertumbuhan inklusif dalam menilai dampak PMA di negara tujuan PMA. Oleh karena itu, disertasi ini secara komprehensif menganalisis hubungan antara PMA, pertumbuhan inklusif, dan institusi di Indonesia.

Disertasi ini membahas dua pertanyaan utama penelitian. Pertama, bagaimana kontribusi PMA terhadap pertumbuhan inklusif di Indonesia? Kedua, sejauh mana institusi berperan penting dalam mendukung PMA untuk pertumbuhan inklusif di Indonesia? Dalam menjawab pertanyaan penelitian tersebut, disertasi ini menggunakan metode kualitatif untuk melihat hubungan PMA dan pertumbuhan inklusif dari sudut pandang dan pengalaman para pemangku kepentingan yang terkait. Dengan menggunakan data PMA dan indikator pertumbuhan inklusif, seperti kemiskinan dan ketimpangan, terdapat tiga wilayah yang dipilih dalam penelitian ini yaitu Kabupaten Badung, Kabupaten Mojokerto, dan Kabupaten Tangerang. Penelitian ini dilakukan dengan wawancara para pemangku kepentingan terkait seperti pejabat pemerintahan di pusat dan daerah, perusahaan asing, dan masyarakat. Selain itu, disertasi ini juga melakukan tinjauan terhadap literatur dan peraturan-peraturan, serta menyampaikan data ekonomi dan sosial yang terkait dengan PMA, pertumbuhan inklusif, dan institusi.

Hubungan antara PMA, pertumbuhan inklusif, dan institusi disampaikan pada kerangka teori pada disertasi ini. Kerangka teori menunjukkan bahwa kontribusi PMA ke negara tujuan PMA haruslah dianalisa tidak hanya terhadap pertumbuhan ekonomi semata, tetapi juga terhadap pertumbuhan inklusif. Berdasarkan literatur yang ada, pertumbuhan inklusif adalah pertumbuhan yang menguntungkan semua anggota masyarakat atas dasar kesetaraan. Pertumbuhan inklusif ditunjukkan oleh pertumbuhan dengan kemiskinan dan ketimpangan yang lebih rendah. Pada kerangka teori ditunjukkan bahwa terdapat empat jalur agar PMA dapat mendorong pertumbuhan

inklusif yaitu melalui penciptaan lapangan kerja, peningkatan produktivitas, program Tanggung Jawab Sosial Perusahaan (CSR), dan keterkaitan dengan Usaha Mikro Kecil Menengah (UMKM). Melalui jalur-jalur tersebut, PMA diharapkan dapat memberi manfaat bagi penduduk setempat, termasuk orang-orang yang terpinggirkan, seperti orang miskin, penyandang cacat, dan wanita, yang memiliki keterbatasan akses terhadap kegiatan PMA. Untuk mendukung jalur-jalur tersebut, disertasi ini mempertimbangkan pentingnya peran institusi yang inklusif sebagaimana diajukan oleh Acemoglu dan Robinson (2012). Institusi yang inklusif adalah aturan main yang memperluas kesempatan bagi seluruh anggota masyarakat untuk mendapatkan manfaat dari kegiatan ekonomi (institusi ekonomi) dan untuk berpartisipasi dalam perumusan kebijakan (institusi politik). Dalam disertasi ini, ruang lingkup institusi inklusif diperluas tidak hanya diterapkan pada kasus dengan pemerintahan yang berjenjang (*multi level government*), namun juga mencakup institusi dari para pemangku kepentingan lainnya, seperti perusahaan asing dan masyarakat. Selain itu, disertasi ini mengajukan pemahaman dimana keinklusifan suatu institusi dipengaruhi oleh nilai masyarakat, pemerintah, dan perusahaan asing.

Dalam melakukan analisa secara empiris, pertama, disertasi ini menganalisa kapasitas peraturan pemerintah nasional dalam mengelola PMA dalam mencapai pertumbuhan inklusif di Indonesia. Empat peraturan pemerintah nasional terkait investasi asing dan pertumbuhan inklusif telah dianalisis. Peraturan tersebut yaitu Undang-undang Investasi No.25/2007, Rencana Pembangunan Jangka Menengah Nasional (RPJMN), Perencanaan Umum Investasi (RUPM), dan Daftar Investasi Negatif dari Investasi (DNI). Kapasitas dari peraturan-peraturan tersebut dianalisa dengan mempertimbangkan apakah peraturan tersebut telah mendukung terciptanya jalur-jalur PMA menuju pertumbuhan inklusif. Selain itu, kapasitas dari peraturan-peraturan dianalisa melalui kesesuaian antar peraturan dan koordinasi di antara pejabat pemerintah dalam melaksanakan peraturan. Berdasarkan penelitian tersebut, disertasi ini menemukan bahwa kesesuaian antara rencana pembangunan dan peraturan, serta koordinasi antar tingkat pemerintah dirasakan masih lemah. Tantangan utama dalam mencapai investasi yang dapat mendorong pertumbuhan inklusif adalah kurangnya koordinasi antar kementerian serta koordinasi antara kementerian dan pemerintah daerah. Selain itu, pemerintah daerah dirasakan kurang memiliki pengetahuan tentang konsep pertumbuhan inklusif dan investasi inklusif.

Selain itu, disertasi ini menganalisa keinklusifan dari institusi dalam mendukung PMA untuk pertumbuhan inklusif dengan melihat peran pemerintah kabupaten pada setiap tahapan proses kebijakan publik, mulai dari tahapan perencanaan hingga tahapan pelaksanaan dan tahapan pengendalian. Berdasarkan teori *Multi-level governance* dan

konsep institusi inklusif, institusi yang inklusif ditunjukkan oleh keterlibatan pemerintah kabupaten dalam mendorong PMA untuk mencapai pertumbuhan inklusif. Dalam melakukan analisis, disertasi ini menganalisa keterlibatan pemerintah kabupaten berdasarkan hukum dan peraturan yang ada serta membandingkan keterlibatan tersebut dengan pelaksanaan sesungguhnya. Berdasarkan analisis terhadap hukum dan peraturan yang ada, disertasi ini menemukan bahwa pemerintah kabupaten memiliki peran penting dalam mendorong PMA menuju pertumbuhan inklusif pada seluruh tahapan kebijakan publik. Namun dalam pelaksanaan sesungguhnya, keterlibatan pemerintah kabupaten dalam proses kebijakan publik yang terkait dengan PMA dan pertumbuhan inklusif masih terbatas, terutama dalam tahapan perencanaan. Keterlibatan pemerintah kabupaten dalam forum pemerintah pusat seperti Musrenbang Regional, Musrenbang Nasional, dan forum investasi hanyalah formalitas. Keterbatasan waktu, partisipasi karena alasan pendanaan, ketidakjelasan tindak lanjut pemerintah pusat terhadap aspirasi yang diberikan pemerintah daerah, dan kesenjangan dalam kualitas sumber daya manusia merupakan kendala utama dalam mengoptimalkan keterlibatan pemerintah kabupaten dalam proses kebijakan publik yang terkait PMA dan pertumbuhan inklusif. Dalam pelaksanaan sesungguhnya, pada tahapan pelaksanaan dan tahapan pengendalian, pemerintah kabupaten memiliki peran penting terutama dalam memberikan izin investasi dan mengelola program CSR.

Dalam menganalisa dampak PMA terhadap pertumbuhan inklusif, serta peran dari institusi terhadap hubungan tersebut, disertasi ini melakukan studi kasus pada kabupaten-kabupaten terpilih yaitu Kabupaten Badung, Kabupaten Mojokerto, dan Kabupaten Tangerang. Berdasarkan hasil dari ketiga studi kasus tersebut, dampak dari PMA terhadap pertumbuhan inklusif beragam antar kabupaten. Di Kabupaten Badung, PMA dapat memberikan pengaruh positif terhadap pertumbuhan inklusif melalui semua jalur menuju pertumbuhan inklusif, seperti penciptaan lapangan kerja, peningkatan produktivitas, program CSR, dan hubungan UMKM. Sebagai contoh, hotel internasional di Kabupaten Badung telah mempekerjakan lebih dari 50 persen penduduk setempat dan juga mempekerjakan lebih dari satu persen orang cacat. Dengan bekerja di hotel internasional, penduduk setempat dapat menerima pendapatan dan merasakan manfaat dari program pendidikan dan kesehatan yang disediakan oleh hotel. Selain itu, hotel internasional juga memiliki kerja sama dengan desa adat atau disebut sebagai desa pekraman di sekitar hotel dalam menyediakan program CSR. Demikian pula, keberadaan hotel internasional secara langsung menghasilkan pengaruh positif pada sektor ekonomi lainnya.

Sebaliknya, PMA di Kabupaten Mojokerto dan Kabupaten Tangerang memiliki kontribusi yang terbatas terhadap pertumbuhan inklusif disebabkan PMA di kedua

kabupaten tersebut tidak dapat menciptakan jalur-jalur pertumbuhan inklusif. Dalam hal penciptaan lapangan kerja bagi masyarakat lokal, masalah utama yang dihadapi oleh perusahaan asing di Mojokerto adalah peningkatan upah minimum yang menyebabkan biaya tinggi dan penyerapan tenaga kerja yang rendah. Sementara itu, pada Kabupaten Tangerang, penciptaan lapangan kerja yang terbatas disebabkan oleh ketidaksesuaian antara keterampilan yang dimiliki masyarakat sekitar dan keterampilan yang dibutuhkan oleh perusahaan asing. Selain itu, PMA di Kabupaten Mojokerto dan Kabupaten Tangerang juga memiliki keterkaitan ekonomi yang terbatas dengan UMKM. Akses yang terbatas, modal yang tidak mencukupi, kurangnya informasi tentang ketersediaan, serta belum memadainya kualitas produksi UMKM merupakan faktor penyebab PMA di Kabupaten Mojokerto dan Kabupaten Tangerang memiliki hubungan yang terbatas dengan UMKM. Berdasarkan kerangka teoretis, keterbatasan kontribusi PMA terhadap pertumbuhan inklusif disebabkan oleh tidak inklusifnya institusi di daerah tersebut atau dapat dikatakan institusi di daerah tersebut cenderung bersifat ekstraktif. Dengan institusi yang ekstraktif, anggota masyarakat tidak memiliki kesempatan untuk memperoleh manfaat dari kegiatan PMA dan untuk terlibat dalam program atau kebijakan PMA.

Pada Kabupaten Mojokerto, keberadaan institusi ekstraktif ditunjukkan oleh terbatasnya keterlibatan masyarakat dalam program PMA. Perusahaan asing hanya memiliki sedikit minat untuk mempekerjakan orang-orang yang terpinggirkan, seperti orang cacat. Keberadaan institusi yang ekstraktif juga ditunjukkan adanya peran ‘perantara’ atau *middleman* dalam penciptaan lapangan kerja dan hubungan UMKM. ‘Perantara’ memiliki informasi lebih banyak dan memiliki hubungan yang lebih dekat dengan perusahaan asing. Institusi ekstraktif yang terlihat dari keberadaan ‘perantara’ membatasi masyarakat untuk mendapatkan manfaat dari PMA dan untuk terlibat dalam program PMA. Demikian pula pada Kabupaten Tangerang. Institusi pada Kabupaten Tangerang juga bersifat ekstraktif, terutama dalam penciptaan lapangan kerja dan hubungan dengan UMKM. Kurangnya komunikasi antara perusahaan asing dan masyarakat lokal serta keberadaan ‘perantara’ juga merupakan faktor utama yang membatasi masyarakat untuk mendapatkan manfaat dari kegiatan PMA dan untuk terlibat dalam program PMA. Keberadaan institusi yang ekstraktif tersebut di Kabupaten Tangerang dipengaruhi oleh pergeseran nilai-nilai masyarakat sekitar dari nilai kebersamaan, kekerabatan, dan komunalitas menjadi individualisme. Selain itu, perusahaan asing cenderung termotivasi oleh keinginan mencari sumber daya dan lokasi yang menguntungkan.

Sebaliknya, pada Kabupaten Badung, kontribusi positif PMA ke pertumbuhan inklusif didukung oleh keberadaan institusi yang inklusif tidak hanya pada perusahaan

asing tetapi juga pada pemerintahan. Sebagai contoh, hotel internasional selalu melibatkan warga desa Adat dalam merumuskan program CSR. Hotel internasional juga memungkinkan penduduk desa Adat untuk mengusulkan program CSR dan mendiskusikan kelayakan pelaksanaannya. Untuk meningkatkan pertanggungjawaban, penduduk setempat yang diwakili oleh kepala desa Adat secara rutin melaporkan pelaksanaan program dan penggunaan dana CSR kepada hotel-hotel internasional. Keberadaan institusi yang inklusif di Kabupaten Badung dipengaruhi oleh filosofi hidup masyarakat Bali yang dikenal dengan sebutan Tri Hita Karana (THK) yaitu menjaga hubungan harmonis manusia dengan Tuhan, dengan manusia lain, dan dengan lingkungan. Sesungguhnya, prinsip-prinsip THK telah diinternalisasi tidak hanya dalam kehidupan sehari-hari masyarakat Bali, tetapi juga dalam kegiatan bisnis hotel internasional dan tujuan dari rencana pembangunan pemerintah Kabupaten Badung.

Secara ringkas, disertai ini menemukan bahwa PMA penting bagi negara-negara berkembang seperti Indonesia karena PMA dapat membantu negara tujuan PMA untuk membiayai pembangunan dalam negeri. Namun demikian, upaya menarik lebih banyak PMA yang masuk tidak cukup untuk memastikan bahwa PMA akan memberikan pengaruh positif terhadap ekonomi dalam negeri. Oleh karena itu, para pembuat kebijakan harus mempertimbangkan kualitas PMA dengan menilai kontribusinya tidak hanya untuk pertumbuhan ekonomi melainkan untuk konsep pertumbuhan ekonomi yang lebih luas yaitu pertumbuhan inklusif. Studi kasus dari tiga wilayah kabupaten di Indonesia telah menunjukkan bahwa institusi yang inklusif memainkan peran penting dalam mendorong kontribusi positif PMA ke pertumbuhan inklusif. Melibatkan masyarakat baik dalam program perusahaan asing PMA maupun kebijakan pemerintah yang terkait dengan PMA akan memperluas peluang masyarakat untuk mendapatkan manfaat dari keberadaan PMA. Di tingkat nasional, keterlibatan pemerintah kabupaten dalam proses kebijakan publik serta kesesuaian antar peraturan pemerintah diperlukan untuk mendorong PMA agar dapat mendorong pertumbuhan inklusif. Terakhir, perusahaan asing dan pemerintah daerah perlu didorong untuk mempertimbangkan pentingnya nilai lokal masyarakat dalam menciptakan institusi yang inklusif di daerahnya.

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