A CRITICAL REVIEW OF THE IMPACT OF MULTINATIONAL CORPORATIONS (MNCS) ON INDONESIAN ECONOMY

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Abstract

Multinational Corporations (MNCs) undoubtedly have an important contribution to the development of national economy of a particular country. Indonesia is not without exception. Nevertheless, many experts are critical on the negative effects brought by MNCs. This study is set to survey the extant literatures on the impact of FDI/MNCs on Indonesian economy. Based on the critical review of these literatures, the study suggets that MNCs might bring both favorable and unfavorable impacts on the national economy of Indonesia. The economic spillovers, technology transfer, and boosting trade performance are mostly higlighted favorable impacts. The involvement of MNCs in the country's economy is considered to be an easy way or short-cut for the government to engineer economic growth. On the other hand, MNCs are also considered harmful to the country's economy. Some of mostly highlighted negative impacts of MNCs are creating dependent development, limited technology transfer, labor exploitation, encouraging government collusive practices, and environmental damage.

Keywords: Multinational Corporations, Economy, Indonesia.

A. INTRODUCTION

Asia and East Asia in particular has been one of the most attractive region for FDI in the world (Yoe, 1997). Nevertheless, Indonesia being a largest economy with a market of 270 million people and vast natural resources is attracting less FDI than other emerging economies within the region and without. Though FDI inflows to the country have been steadly increasing over the past decade. According to Indonesia Investment Coordinating Board (BKPM) which records gross inflows based on approved FDI projects, FDI has been rising from 2 percent of GDP in 2000 to 3.4 percent in 20014 (World Bank, 2017). While according to BKPM recent quarterly report total investment realisation of FDI in quarter II 2017 has made up to IDR 206.9 Trillion (BKPM, 2017). Yet Indonesia still lags behind Thailand, Malaysia and Vietnam which made up to 3.2, 3.5 and 5.1 percent of GDP respecctively (World Bank, 2017).

The above economic anomali of Indonesia indeed requires a comprehensive understanding. A number of studies offer some sound explanations behind the phenomanon mainly such as less absortive capacity of workforce and unskilled labor, poor infrastructure, low quality of institutions, prevalent corruption issues and ambivalent policiies or regulations (Lipsey and Sjohom, 2009).

Government policies or regulations have been much accounted for modest inflows of FDI to Indonesia. Often changing policy of Indonesian government towards foreign investments is indeed sending ambiguous signal to the potential foreign investors. In between 1967-1974 was marked as a period of large inflows of FDI/MNCs into Indonesia. The Foreign Capital Investment Law No. 1 of Januari 1967 under the new order regime was a focal point to invite foreign capital or MNCs into the country. It was not untill 22 of January 1974 when the goverment took some protectionist measures. Thus, from 1974 to 1982 Indonesia underwent a period of resurgent economic nationalism. There were factor behind it. But it was upheld by many due to both domestic pressure and the phenomenon of rising oil price. Since then, Indonesian economy was more or less driven by export-led growth policy. The 1997 Asian financial crises which hit Indonesian economy bedly, indeed reversed Indonesia's attitude towards foreign capital. From 2000 onward, Indonesia relativele consistently pursues deregulized economic policies in order to create more friendly investment climate. A large number of foreign companies flowed to the country accordingly. Nevertheless the issue of regulations and corruptive practices remains empeding the maximum inflows of FDI. To this end, Warld Bank recommends the government to take more deregulation reforms to attract more FDI.

That is one story or explanation regarding current trends of FDI/MNCs in Indonesia. There may be other way to understand determinents behind the relatively modest inflows FDI/MNCs into Indonesia. That is measurement, or perception of policy makers and the public about merit and demerit that FDI/MNCs bring to the economy. The question that follows is whether FDI/MNCs good for the Indonesian economy or not. To address the question differently means we have to measure the impact of FDI/MNCs on Indonesian economy. So, this article tries to survey the existing literatures on the impact of FDI/MNCs on Indonesian economy.

B. IMPACT OF MNCS ON INDONESIAN ECONOMY: A CRITICAL REVIEW

1. Favorable Impact

Upgrading Trade Performance

One of the important role or significant impact of FDI and MNCs on Indonesian economy is to bolster the trade and in turn faster the economic growth. The impact of MNCs on trade performance can be measeured by MNCs more involvement in export-oriented projects. Although Foreign firms' role as a catalysts for manufactured exports in Indonesia is often indiretc but still significant.

The assumption that MNCs have a huge positive impact on upgrading manufacture sectors are of three forlds. First, MNCs or foreign firm will bring relatively high productivity. A research by Takii (2004) comparing foreign and domestic plants in manufacture on total factor productivity (TFP) reveals that foriegn firms have higher productivity than their domestic counterparts. It also shows that wholly foreign owned firms relatively have a high productivity. That finding is suported by Akamoto and Sjoholm (2005) who investigated total factor productivity in between 1990-95 and finds that foreign firms have high productivity growth. Arnold and Javorcik's (2009) research which was surveying the data in 1983-1996, further confirms that foreign acquisitions of domestic plants inrease productivity. While another research by Takii and Ramstetter (2005) focusing on labor productivity found that foreign firms have high productivity though it varies by time and industry. All those studies go to the same line of argument that MNCs bring a huge positive impact on Indonesia trade performance through bolstering productivity lavel.

The second argument is export intensity. Ramstetter (1999) who investigated export intensity of both domestic and foreign fims in manufacture in between 1990, 1992 and 1994 finds that foreign firm have high export intensities. Foreign firms are not not only good at intensifying the export of manufactured goods but also able to initiate the export (Sjoholm and Takii, 2008).

The last argument that MNCs have positive impact on Indonesian manufacturing is about wages and employment. Some research findings on labor market and wages per employee in manufacture sector show that foreign firms pay high wages than domestic one (Lipsey and Sjolholm, 2006). Beside of high wages, more involvement of foreign firms in manufacture sector in Indonesia also have halped to open more employment opportunities. A research by Sjoholm and Sun (2010) on growth in employment in between 1975-2005 revealed that foreign firm have high growth in employment.

Spillovers from FDI in Indonesian Manufacturing

Blomstrom and Sjöholm (1999) research on value added per employee in 1991 concluded that foreign firms have positive spillovers. The result are also demonstrated by Todo and Miyamoto (2002) and Takii (2005) that forign firms caused psotive spillovers on value added per employee. While another research by Sjoholm (1999) focusing on growth in value added found that foreign firms have positive spillovers.

Some researches on wages or wages per employee streghthen the assumption of spillovers impact of MNCs. For instance, a research by Lipsey and Sjoholm (2004b) on wages per employee confirms that foreign firms have postive spillovers. More recent research by Takii (2009) investigating spillovers from MNCs on wages in 1990-1995 also confirms positive result.

Some studies also demonstrate that there have been spillovers from MNCs on the ouput. Two important researches are pertinent to recall here. A research by Blalock and Gertler (2009) surveying the output in between 1988-1996 reveals that foreign firm have postive spillovers. The other research by Temenggung (2008) on the same variable in between 1975-2000 also find that foreign firms cause positive spillovers.

Technology Transfer

Succesful industrial upgrading is an indicator of of the on-going process of technology transfer. Low performance of the industrial upgrading in Indonesia is matched by a relatively limited technological transfers resulting from FDI. A number of studies find that technology transfer has taken place mainly through on-the-job training and has been limited to basic technological capabilities (Saad; 1995). In addition, FDI and its related technology transfer have not generally been effective at upgrading national and local industrial technological capacity, in stark contrast to the performance of economies such as Singapore (Thee, 1998).

Studies offer several possible explanations for this poor performance. Thee (1998) suggests that frequent shift in foreign investment policies have given conflicting signals to foreign investors of what was expected from them. Further more, the emphasisi on export-oriented investment have brought unintended effect of discouraging technology transfer. Sjoholm (1998) suggests That the joint ventures with minority ownership might likely not be a favorable option or offer to foreign export-oriented affiliates. That is due to requirment of international quality standard and consequently rely on relatively new or sophisticated proprietary technoloies.

The weak capacity of local workforce and firms is considered as another negative factor or barrier on the technological transfer in Indonesia. The country has been facing a serious problem of graduates shortage of tertiary and vocational education in many sectors, and the problem has become more accute since Indonesia shifted its economic orientation to export promotion (Thee, 1998).

To sum up, those studies support the contention that MNCs contribute to Indonesia economy countries through opening more employment opportunities, paying higher wages, generating increased productivity, acting as an entry point for firms to access export markets, and generating productivity spilovers to domestic firms.

2. **Unfavorable Impact**

The above argument that MNCs have been credited for upgrading trade performance and bringing the so called spillovers and trickle down effect is not without critics. Many other studies show different findings which suggest the unfavorable impact of MNCs on Indonesia economy.

Dependent Development

The idea of devendent development proposed by Cardoso (1973) which says although the developing countries undergo some sorts of industrialization, yet their economic nature is still dependent on the developed one. In term of FDI/MNCs the idea goes further by arguing that what MNCs do in the developing countries is indeed exploiting them by collaborating with *compradore class*. That explanation to some extent also takes place in Indonesia. Heryanto (2003) suggests that although FDI/MNCs have successfuly operated their production plants in Indonesia, but key componants have to be purchased or supplied from their home parent plants/firms. One example is the case of PT. Astra International, Indonesia largest integrated automotive company. In order to maintain the production, it has to import their mechines from Japan. The other case is PT. Boma-Bisma Indra which produces Deutz diesel mechine, it have to import their key komponants from Germany, and so on. In most cases, MNCs are reluctant to produce or purchase intermediate products from domestic market. They prefer of importing them from their overseas affiliates.

Subsequently, they used to manipulate the price of those items in order to avoid local tax which is known as transfer pricing.

Besides, MNCs, according to Heryanto, also cause some major problems in Indonesian economy such as a declining dosmectic investement and firms due to oligopolistic nature of MNCs. He further argues that instead of reinvesting the profits in the domestic plants, MNCs prefer to transfer them to their home parent firms. In short, inspite of likely industrialization and postive economic growth caused by the inflows of MNCs into Indonesia, in fact the whole production processes are controled, dominated by and dependent on their home parent frims. It means these industrialization and economic growths are very vulnurable. This is suported by Fauzi and Mudji (2014) who find that MNCs in oil sector which are dominated by US and Western firms have been holding bigger share of return than Indonesian. It is due to government weakness and lack of capability in negotiating favorable terms. Up to that point, Robert Gilpin (1975) put it correctly:

"There is a common pool of managerial, financial and technical resources, and most importantly, the parent operates the whole in term of a coordinated global strategy. Purchasing, production, marketing, research and so forth are organized and managed by the parent in order to achieve its long-term goal of corporate growth."

Limited Technology Transfer

One conventional wisdom of the benefits of FDI or MNCs to LDC is technology transfer. A large body of literatur on chanels through which technology is tranferred from Developed countries to LDCs is through FDI or MNCs. The presence of MNCs in LDCs is seen as a proper route and favorable chanel of technology tarnsfer (Saggi, 2002; Yusuf, 2003).

Technology transfer is in fact not so masive and prevalent as has been assumed by many. Further survey on the existing studies will show us that technology transfer through MNCs to domestic firms is very limited and uneven. In Indonesia, government policy to faster industrialization through the process of technology transfer by MNCs generally was not a very successful. Although there did arise some big corporates in macro level but overall MNCs failed to upgrade viable domestics firms. This is due to some possible reasons as follows. First, most MNCs in Indonesia are operating in natural resources sector and they are highly concentrated geographically and have high import content. So they are less integrated into domestic economy. Second, most of domestic firms do not have enough absortive capacity and their human resources have less adequete skill (Rajan, 2005).

Labor Exploitation

Of the contested issues on the impact of FDI or MNCs on LDC is job opportunity and high wage. The proponent of MNCs see that these international firms will create more job opportunities and in turn decrease unemployment. At the same time, they also argue that such credible international firms are committed to high wages. That is one face of MNCs in LDCs, a good face. The other shocking face is in fact MNCs has been more percieved as a threat and rival to the organized labor. Vernon (in Kudrle, 1985) has observed that most European unions oppose the MNCs because they feel that their bargaining power is threatend by their mobilily. Martinelli (in Kudrle, 1985) also argues that because multinational corporations usually respond to the volatility in the global market, labor become threatened and have no many options to bargain with them.

In LDCs the problem is more acute that labor are usually less organized and have no bargaining position to negociate with MNCs. Consequently, labor become victim of human exploitation. Some big foreign firms in Indonesia are alleged of committing exploitation practices. Nike, for instance, an athletic shoes company is allegedly exploiting child and women labor, inhuman working hours and so forth (Cohen, 2007).

That unfavorable condition for labor is by and large due to both internal and external weaknesses. Internally, labor unions in Indonesia have no clear strategy to deal with MNCs. While externally, firms or companies create a strict working environment by tightening rules for the labor. A study by Rachmawati (2009) on Trade Unions Behaviour Towards Multinationals In Indonesia finds that the unions did not have clear strategy on one hand to deal with company management. On the other hand, continuing high unemployment and a deteriorating external environment have served to mollify unions' demands and objectives: a fastened and moderate orientation towards management.

Encouraging Collusive Government Practices and Environment

The main motive of MNCs in foreign countries is to generate more profits, no matter of what and how. In most developing countries, the political power stucture and bureaucratic pratices are mainly arbitrary. In turn it allows more chances and rooms for MNcs to make a necessary moves to get their project done, legally or illegally. This condition in fact makes unholly collusion between opportunist politicians and bureaucrats, and foreign firms. In Indonesia it is a common practice that in order to get the approval one has to pay the under table fee to the relevant officials or politicians. Harold Crouch observed this condition as follows:

"There are countless stories of foreign investors in Indonesia being discouraged by the need to get the approval of a large number of agencies and to make a large number of pay off."

A study by Purbasari (2006) on political connection, trade protection and multinational corporations in Indonesia finds strong evidence that politically connected firms are more likely to be awarded licenses to import raw material. Therefor, it further says, MNCs are more likely to choose politically connected partners. It concludes that firms actually create demands for corruption.

Such environment, in long run will help to create and even perpetuate what is called as an authoritarian bureaucratic system. It is to some extent similar to Helio Jaguaribe's concept of facist colonial state that is an authoritarian state which is collaborating with international capitals in order to survive (Heryanto, 2003).

An interesting study by Desbordes and Vauday (2007) on the political influence of foreign firms finds that political influence increases the likelihood that foreign firms will be able to shape government policies in a form that suits their private interests. Such political strategic of foreign firms will probably have more negative consequencies for the poeple. This is suported by Hellman et al. (in Desbordes and Vauday, 2007) who have shown that foreign investors from OECD countries are more likely than domestic firms to engage in corrupt forms of influence in countries where bribing public officials is common and their behavior does not appear to be affected by home country regulations to prevent bribery.

Listing a long number of benefits and harms of MNCs to LDCs is not really a good way to measure and compare whether they are good fo LDCs or not. Indeed there is no such aggreed upon standards to accurately measure the real impact of MNCs on LDCs. The only proper answer to that problem is "It depends." The equivocation inherent in the "it depends" approach derives from a two-pronged heterogeneity: (I) the idiosyncratic nature of 16o developing or and in-transition economies, and (2) the distinctive objectives and operations of the various kinds of FDI and MNCs. Peter Nunnenkamp and Julius Spatz of the uestion Kiel fnstitute in Germany (2005) put it this way: "The link between FDI and economic growth varies between different types of FDI and host-country characteristics have an important say in this respect." (Cohen, 2007).

C. CONCLUSION

The critical review of the extant studies on the MNCs in Indonesia suggets that they might bring both favorable and unfavorable impacts on the economy of the country. The economic spillovers, technology transfer, and boosting trade performance are mostly higlighted favorable impacts. The arguement behind this story flows from the economic development agenda in LDCs which proposed that in order to narrow the development gap between them and developed countries, they need to expediate the industrialization by openning the door widely to the MNCs/FDI. The involvement of MNCs in the country's economy is considered to be the easiest way or short-cut for the government to create economic boom. On the other hand, MNCs are also considered harmful to the country's economy. Some of mostly highlighted negative impacts of MNCs are creating dependent development, limited technology transfer, labor exploitation, encouraging government collusive practices, and environmental damage. On this regard, although marxists view that MNCs indeed brought positive impacts, yet they argue that such impacts are artificial, limited, and short-run. On the contrary, in the long run the excessive inflow of MNCs to LDCs will create economic dependency.

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