Comments on ‘Foreign Direct Investment and Growth in East Asia: Lessons from Indonesia’
By Lipsey and Sjoholm’

Chandra Athukorala

Arndt-Corden Department of Economics
Crawford School of Economics and Government
E-mail: prema-chandra.athukorala@anu.edu.au
Purpose and Scope

Examine the role of FDI in the Indonesian economy from a comparative East Asian perspective

Three key issues

1. How does FDI impact on economic performance?
2. Why FDI inflows have been lower to Indonesia than to the other East Asian countries?
3. What are the policy options/strategies to increase FDI inflows

(1) specifically focuses on manufacturing; (2) and (3) deal with aggregate FDI
How does FDI impact on economic performance?

A comprehensive survey of the existing literature, focusing on productivity growth, export performance, wages, employment, spillover to local firms.

Ideally this discussion should have come upfront (after the introduction).

I have no specific comments.
(2) Why FDI inflows have been lower to Indonesia than to the other East Asian countries?

Two-pronged approach,

• Comparative analytical narrative of FDI inflows to East Asia countries:

  Stock of inward FDI as a percentage of GDP

  FDI inflows as a share of gross capital formation

  Employment in majority-owned affiliates of US manufacturing MNEs
• Econometric analysis: estimating the ratio of actual to predicted inward FDI stock.

Individual-country predictions are based on a cross country regression estimated for developing countries (over the period …? )

` Model

FDI inward stock = f(GDP (t-5), per capital GDP growth, Openness (t-5))`
What is the logic behind the use of “FDI stock as a percentage of GDP” as an FDI performance indicator?

Inter-country companion of this measure is problematic because of the ‘vintage effect’ (The magnitude of accumulated stock partly depend on the FDI history. GDP is a ‘flow ‘ variable).

“FDI inflows to gross capital formation” is not susceptible to this problem.

Inter-country comparison of employment in US MNE affiliates (based on USBEA data) is an important novel contribution.

The same data source could have been used for an inter-country comparison of export performance (This could have been an interesting extension to the discussion on global production networks)
The estimation equation used here is basically representative of market-seeking FDI, but the bulk of FDI inflows to East Asian countries (other than Indonesia) over the past few decades have been of the efficiency seeking type.

Omitted variable bias:
Other relevant variables
  relative labor cost
  infrastructure quality
  FDI policy regime
  possibly a variable to represent mineral resource endowment
(3) What are the policy options/strategies to increase FDI inflows?

Provides a useful inventory of policies for making Indonesia more attractive to FDI.

- Some attempt to highlight the relative importance of these policy options (rather than simple listing) would have significantly improved the policy relevance of this paper.
‘Property rights, including enforcement of contracts’ is an important missing item in this otherwise comprehensive list of policy options. Particularly important given Indonesia’s ‘troubled’ historical record in dealing with MNEs, (as has been discussed in detailed in Wells, L.T. and R. Admed (2007), Making Investment Safe: Property Rights and National Sovereignty, Oxford University Press)

• Is ‘domestic technological capacity’ a prerequisite for attracting FDI to Indonesia at this stage? (I do not think so)

• Can FTZs be a viable second best option given the political-economy constraints to the needed economy-wide reforms? (Looking at the experience of Batham may be relevant here)