Executive Summary: FDI White Paper

Ten years after an economic catastrophe of epic proportions, Indonesia has made impressive gains to solidify its status as an up-and-coming middle-income economy. However, despite its strong performance, Indonesia is faced with both tremendous opportunities and significant challenges as it looks to consolidate this position in the coming years.

The opportunities are by now well known: tremendous natural resources; a burgeoning domestic consumer class; stable and democratic political leadership; and a stable financial system, among others. However, the risks are also very real, including a partially reformed legal and regulatory environment, crumbling infrastructure and systemic labor market rigidities. Moreover, in terms of attracting foreign direct investment (FDI), despite its remarkable potential as an investment destination, in recent years Indonesia has fallen dramatically off the blistering pace set by its economic competitors.

As an essential element of any strategy to overcome the structural challenges that accompany economic transformations, FDI provides capital, technology transfers and productivity gains to host countries. If targeted within the framework of a wider strategy, the successful attraction of FDI can bring immense benefits to the host's domestic economy. Despite contrary popularly held conceptions about FDI, empirical research demonstrates that FDI has brought job growth to many developing countries including China, Mexico and several countries in Central Europe. Therefore, the importance of a coherent FDI strategy cannot be overemphasized, as FDI is by nature finite and most effective when channeled to sectors with specific competitive advantages and when oriented towards specific development goals.

Investment promotion intermediaries (IPIs), when successfully empowered to guide FDI strategy and promotion, can influence foreign investor perceptions about a given investment destination. Studies show that a 10% increase in an IPI's promotional efforts corresponds with a 2.5% increase in FDI, and the use of sector targeting causes a 41% gain in the growth rate of a given targeted sector. IPIs stand at the nexus of business and government, a privileged position that can influence the host country's positive rapport and image with foreign investors as well as positive policy outcomes for investment promotion. High-performing IPIs, especially when they possess a multi-layered organizational structure, effectively facilitate FDI that is likely to succeed (and return), while also identifying domestic champions—in terms of localities, industries, and firms—that will become the host country's greatest success stories.

However, in the case of Indonesia's IPI, the Investment Coordinating Board of the Republic of Indonesia (BKPM), changes are necessary to fully capture these benefits and realize Indonesia's full FDI potential. Considering the potential dividends—such as infrastructure projects, high quality job creation, and technology transfers—that Indonesia stands to gain from the successful facilitation of FDI, strengthening BKPM is a pressing need, with large opportunity costs for inaction. Investments in BKPM's human and information technology resources, policy advocacy influence, structure, and strategic capacity are long overdue and absolutely necessary to welcome FDI to Indonesia. Given the transitional state of Indonesia's economic position and the importance of the next decade in solidifying this status, the role and responsibilities of BKPM demand a penetrating and comprehensive review.