Coercive Bargaining and Communication Acts of Local Government in Foreign Direct Investment

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ABSTRACT
This research will analyze how communication mechanism implemented by local government in conducting coercive bargaining with the foreign investors. It aims to describe the coercive bargaining mechanism and communication actions in the process of managing FDI in Indonesia. This research covers areas that lack academic research, namely the mechanism of coercive bargaining in FDI negotiations in the regions. By studying the mechanism of coercive bargaining, this research reveals the input side of FDI process in influencing people’s economy. This research also shows the considerations used in encouraging coercive bargaining and its relation with the bargaining power of the local government and investors.

Keyword: Coersive Bargaining; FDI; Communication Act; Investment

INTRODUCTION
Global foreign direct investment (FDI) is currently experiencing a marked decline. In 2018, the global trend of FDI decreased by 13% to as much as $1.3 Trillion (UNCTAD, 2019). This is the third year of sustained decline, allegedly caused by large-scale repatriation by large US
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companies along with tax reforms in the country (UNCTAD, 2019). Despite global decline, the FDI flows in Southeast Asia have increased. In 2017, the value of FDI to ASEAN countries reached its peak in $137 billion, and it was accompanied by increased FDI in 8 of the 10 ASEAN member countries (UNCTAD, 2018). In 2018, this value reached $149 billion, $10 billion higher than that of China minus Hong Kong (Roughneen, 2019a). In that year, one-third of global investment was carried out in the ASEAN region, exceeding the FDI entering Europe, China, and three times FDI entering South Asia. Moreover, this investment is responsible for almost all the values driving global FDI growth.

Indonesia is an anomaly in Southeast Asia. In this shared growth, Indonesia is a country that has experienced a decline in FDI growth for three consecutive years (Roughneen, 2019b). Of the 33 countries that relocated the business from China, none chose Indonesia, 23 preferred Vietnam and the rest chose Malaysia, Cambodia, and Thailand. Similarly, the contribution of FDI in Indonesia was only 22.1% of its GDP, lower than the Philippines (25.1%), Malaysia (43%), Thailand (45.7%), and Vietnam (60.1%) (Atmoko & Haryati, 2019).

Various causative factors have been stated. The friendly regulatory environment and strong macroeconomic performance are most likely the reasons why half of the FDI to Southeast Asia is directed to Singapore. Supporting demographic factors, low costs, fast growth, and good governance are the overall factors driving FDI to ASEAN. On the other hand, the FDI decline in Indonesia was attributed to the lack of policy reforms to create an investment-friendly bureaucracy (Atmoko & Haryati, 2019). It takes years in Indonesia to manage investment, while it takes only 2 months in Vietnam (Atmoko & Haryati, 2019). This leads to legal uncertainty because many licenses provides neither clear time limits nor procedures (The Jakarta Post, 2019).

The complex bureaucracy at various levels raises the risk on FDI which reduces investment interest. This will make Indonesia vulnerable to capital outflows, which in turn weakens the currency and increases the burden of public debt (VNA, 2019). One source of this complex bureaucracy is the decentralized Indonesian state system. Research shows that decentralization increases the efficiency of FDI in regional development and social sustainability in society, but without a clear intergovernmental relationship mechanism, it makes the region unattractive to investors (Kuswanto, Hoen, & Holzhacker, 2016).

Even in this uncertain situation, investors can still exploit loopholes to carry out their investments in Indonesia. Investors might bribe the government to eliminate bureaucracy so as to speed up the investment process. This reduces costs and increases the company’s business opportunities (Simon, 2017). Studies in Vietnam reveal that corruption occurs in regions with extreme investment environments, namely environments with very low investment and very high investment (Kim, 2019).

If the bureaucracy is upheld through law enforcement, the gaps of corruption will close and investors inevitably have to follow the procedures. This does not necessarily attract investment. Although it does not simplify the bureaucracy, law enforcement provides legal certainty for investors, and hence, eliminates one obstacle in investing in Indonesia. Studies show that a good legal framework has a positive influence on investment success (Tykvova, 2018).

Law enforcement efforts are parts of coercive bargaining concept (Ciftci, 2018). Local governments and investors can be seen as in a bargaining process where each offers benefits in exchange for the other’s advantages. Coercive bargaining occurs when one party has a much higher bargaining position than the other, so the other party is forced to comply with the conditions of the ruling party. In FDI context, the ruling party here is the regional government.
imposing its conditions on investors. Investors need to obey these or they will get sanctions for not complying. In this process, investors may withdraw if they find the conditions too hard. Good communication skills in bargaining will keep the investors interested and be positive to invest. However, there has never been any definite research to show this positive relationship.

Oftentimes the government’s regulations set for investors are burdensome. Problems arise when investors choose to withdraw if one party has a much higher bargaining position than the others. Given the situation faced by investors, this research seeks a new perspective, focusing on coercive bargaining, and shows how communication in the coercive bargaining process affects the FDI situation occurring in regions in Indonesia. This research will analyze how communication mechanism implemented by local government in conducting coercive bargaining with the foreign investors. It aims to describe the coercive bargaining mechanism and communication actions in the process of managing FDI in Indonesia.

This approach allows a better understanding on how to best enforce regulations while encouraging foreign investment in developing countries such as Indonesia. By studying the mechanism of coercive bargaining, this research reveals the input side of FDI process in influencing people’s economy. This input side is often regarded as an entry barrier for companies that want to invest in Indonesia. This research also shows the considerations used in encouraging coercive bargaining and its relation with the bargaining power of the local government and investors.

To the researcher’s best knowledge, there has been no research that focuses on coercive bargaining mechanisms in FDI, let alone involving communication actions. This research covers areas that lack academic research, namely the mechanism of coercive bargaining in FDI negotiations in the regions. Previous research focused only on conflict resolution (Sechser, 2018), law (Covey, 2016), mechatronics (Zhang, Mao, & Du, 2016), and other aspects. Meanwhile, very few are investigating coercive bargaining in the context of economists. This few research includes Cho, Ke, Chu, & Han (2018) who investigated coercive bargaining in trade during the financial crisis. In addition, the previous research did not reach the context of local government as this current research does.

LITERATURE REVIEW

The policy transfer approach by Ciftci (2018:46) offers a perspective to understand FDI process. In it, the policy is transferred from the more powerful authority to the less in several alternative mechanisms. There are five mechanisms with different coercivity degrees: lesson drawing, socialization, monitoring, legal obligations, and coercive bargaining. Lesson drawing is a mechanism in which both parties are actively willing to mimic what the first party is doing. Socialization is a logic-based mechanism, where the second party is logically convinced that certain measures are worth taking. Monitoring is an information-based mechanism where the first party supervises the second as well as provides suggestions for the latter’s betterment. Legal obligation is a mechanism where the second party is obliged to obey rules. In it, disobedience leads to sanctions while obedience has no rewards. This is different from coercive bargaining. Coercive bargaining is a mechanism of rewards and sanctions over obedience to certain conditions. This is often termed as “carrots and sticks” because the obedient one gets rewards and the disobedient gets sanctions.

When the policy transfer approach is applied in the FDI context, the first party is the local government while the second is the investor. Similar to the general mechanism of the policy transfer, transfer of rules from the government to the investor can also be in lesson drawing,
socialization, monitoring, legal obligations, and coercive bargaining mechanisms. In other words, investors may willingly adopt the local government’s regulations, be advised by the local government to obey the regulations, being shown by scientific data to obey the regulations, be forced to obey the regulations by sanctions, or being offered sanction and incentives at the same time to obey the regulations.

The researcher specifically focuses on coercive bargaining mechanism. This mechanism is relevant in the FDI context since the government does not only enforce the regulations by sanctioning like in the legal obligations’ mechanism, but they also provide incentive for investors complying to the regulations. The incentives may take form of tax relief or promotion fee or others (Barry, 2019; di John & Meisel, 2016).

This option is in line with the relation evolution between the country and FDI. Sauvant and Hamdani (2015) and Eden (2016) stated that this relation has gone through four phases analogous to a swing (Eden, 2016; Sauvant & Hamdani, 2015). The first phase, post World War II, is the legal obligation phase in which countries were so distrustful of FDI that they monitored and limited it. In the 1980s, FDI gained positive view and countries began to open up to it taking a win-win solution. This was a phase where coercive bargaining took place. In the 1990s, FDI was the golden child. Countries widely opened themselves to FDI. Emphasize was given to “carrots” rather than “sticks.” From the policy transfer framework, this phase is on the lesson drawing, socialization, and monitoring sides. Various FDI negative effects, especially social unrest and environmental pollution, bring about the fourth phase in the 2010s, where the swing returns to its center point and known as the coercive bargaining. At this point, investors need to adjust to sustainable development principles profitable and inclusive to investment destination countries (UNCTAD, 2015). In this period, coercive bargaining mechanism is crucial in understanding the FDI.

This mechanism requires good communication between the local government and investors. That way, investors comprehend and comply to the offered mechanism to get rewards and avoid sanctions. In countries not fully open to FDI, lobbying is more important (Dellis & Sondermann, 2017; Sevin & Karaca, 2016), to ensure the future of investments.

The theoretical framework applied in this research is the two-tier bargaining model from Ramamurti (2001) (Figure 1). This model conceptualizes investment as a two-way relationship. The first tier is a bargaining path between the home country and the host country through bilateral agreements or through multilateral institutions to outline the main rules for FDI. The second is the bargaining route between the investor company and the investment destination country. The bargaining process in the latter is influenced in part by the bargaining process in the first pathway. The existence of the first tier increases the bargaining power of foreign investors because the investment constraints that exist in the destination country have first been reduced by the bargaining process in the first route.
The model in Figure 1. has been applied in some research (Bakir, 2015; Lu, Huang, & Muchiri, 2017). Those studies revealed that foreign investors using the FDI agreement instrument between the home country and host country to relieve the general regulations pressure applied on them in investments. Besides, foreign companies can also use supranational institutions such as the World Bank or IMF. They can also use international aids given to the home countries as an excuse to lighten the regulations for them.

The two-tier bargaining model replaces the obsolescing bargaining model (Vernon, 1971) which values the FDI bargaining in the route between the investing companies and the host countries. The old model is obsolete because the initial agreement between the host country and the investor will eventually be outdated as the host country possesses bigger bargaining power due to the many investments by foreign countries. The host countries may easily change regulations and force them to the foreign companies. Those companies are obliged to comply with regulations as they have invested too much with no satisfying return on assets or because they have gained massive profits (Lu et al, 2017).

**METHODOLOGY**

This is a qualitative empirical research. It aims to reveal the mechanism occurring in the complex real-world setting. There are five regencies and one city in the ex-Kedu Residency Central Java Province. The samples are taken by applying adequate sample strategies of eight people, each representing one local government. In a qualitative research, seven or eight is an adequate number fulfilling the data saturation point (Willis, 2005). A participant is a local government official whose duty is to negotiate with the foreign investors who intend to invest in the capital in the area concerned. (demographic data such as age, years of service, sex, and civil servant position).
This research designs this as qualitative research using interviews as the data collection technique. The researchers contacted the concerned local government secretariat to ask for a research permit. The regency/city government agreeing to voluntarily participate is informed that the research provides benefits in terms of fairer FDI policy development for the society, local government, central government, and investors.

The research is conducted at the agreed locations where the interviewees (source person) elaborate their regency’s/city’s FDI policies, coercive bargaining, and communication, that is the bargaining process between the investors and the local government (Carbaugh et al., 2015). They are convinced that their participation will not affect their professional relationship. All sign the informed consent and agree to confidentiality. They are also informed that no information will be shared to the third party and that their comments and institutions will be randomly labelled with different initials that reveal neither their names nor institutions. The result will not be published prior to research process completion. The research is conducted in line with the permit from researcher’s university and the concerned local government.

Data are collected flexibly and unstructured to maintain their natural features. However, the researcher adhered to the interview guidelines to avoid deviations. It also ensures the questions required to obtain data are fully involved in the conversations. In-depth interviews enable a wider as well as deeper information. Thus, the language used is free, whether formal or informal, conceptual or practical, metaphoric or concrete.

In-depth interviews were carried out with every source person. Open conversations allow further and more private comments. The researcher maintains professional interview by keeping the tone and customary norms in the conversations. Whenever more times are available, the researcher clarifies the answers given (Rubin & Rubin, 2012). The researcher carries notes/memos to be filled during and after the interviews. The notes are filled with things emphasized in the interview and observations relevant to the study. Nevertheless, the memo is not a part of the analysis as it functions only as a tool to aid the data collection process.

In-depth interviews are recorded and transcribed verbatim. Interviews are carried out and analyzed deeply to achieve data saturation point. The sessions are categorized and analyzed using NVivo software. Data analysis are conducted independently applying four-stage qualitative analysis namely general analysis, code confirmation, line-by-line code, and code reordering. Data are interpreted by identifying and formulating the themes’ connections. These are then linked to the research problem.

Previous Studies

Very few studies on the current subject, Central Java province, are available in the FDI context. The existing studies are local research quantitatively examining the effects of FDI on various economic aspects. They do not investigate the process enabling the FDI to enter Central Java province.

Among the studies internationally published on Central Java province is the annual review of Indonesia’s provinces competitiveness by the National University of Singapore (Giap, Mulya, & Nursyahida, 2017). A study in 2016 revealed that the overall Central Java’s competitiveness is the third largest in Indonesia. Central Java highly attracts investors value (0.79) with high regional economic vibrancy (0.85). However, its openness to trade and service score is extremely low (0.11). Moreover, out of the 103 measured indicators, the average FDI for the last three years is a part of the 20% weakest, scoring 0.52 below the national average. On the
other hand, employment in the primary sector becomes the strongest indicator, scoring 2,75 above the national average.

Other studies are the local ones which generally acknowledge FDI’s significant effect to economic growth in Central Java’s regencies/cities (Fauzan, 2015; Puntri, 2016). Higher foreign investments lead to higher PDRB in the province’s regencies/cities (Yustisia, 2016). Sasana (2018) found that FDI has also negative impact in one economic variable, the income gap, suggesting that FDI lifts economic welfare only to one certain society (Sasana, 2018). When broken down by agricultural sector, research finds that FDI only has a positive effect on PDRB in the livestock sector while other sectors such as fisheries, plantations and agriculture are not influenced by FDI (Salqaura, Mulyo, & Darwanto, 2018). When locally generated revenue acts as a bound variable, FDI has no significant effect (Pamungkas, 2019). Research employing FDI as the bound variable finds that only IHK affects FDI significantly. UMR (Regional Minimum Wage) weakly affects FDI (p < 0,10), while PDRB has no effect (Briwantara, 2018).

One qualitative research identifies investment problems in Central Java Province and finds that regulation overlaps at various governmental levels, human resources’ limited ability to address policies, and facilities and infrastructure quality are FDI inhibiting factors in Central Java Province (Abib, Triwati, & Aryaputra, 2016). In summary, the available studies are parts of global FDI quantitative studies. They do not explore more specific aspects such as home countries or negotiation processes as the current research does.

Research Novelty

Problem Complexity

Bargaining in investment is a complex issue that makes it a rare research object. The complexity derives from various regulations and economic interests of the transacting parties. The researcher tries to disregard the significance of this process to avoid complicated analysis which might lead to a quantitative study using macro data as they are easily found. Nevertheless, the qualitative study answers the challenge by elaborating the factors and mechanisms engaged in the bargaining process. Owing to this reason this study applies the qualitative design to answer the research problem.

Previous Findings

Previous studies find diverse factors influencing the bargaining power of a foreign company. In a study of bargaining power between a foreign investing company and a local business, Nakamura dan Zhang (2018) revealed that the ability to import goods and services from affiliations out of the host country, the ability to export goods, and research and development investment affect the power. Meanwhile, a foreign company’s bargaining power weakens when its local partner has strong research and development and high asset return. It also happens when there is high domestic competition (Nakamura & Zhang, 2018).

If these findings apply in a bargaining context between foreign companies and local government, the companies own a strong bargaining power when they have international trade based on their investment location with advanced technological infrastructures. The condition will loosen the forced regulations as the governments regard the investors as an important part of boosting their local economy.

On the other hand, foreign companies will find it a bit difficult to bargain when they invest in an area with many foreign investors and/or have strong economic power. Local governments might strictly force the regulations as they have worries about losing engines in their economic growth.
However, regulation enforcement is not decided by whether or not foreign investment is important because the regulations apply universally. As a result, the governments have two mindsets in determining coercive bargaining. The first is the legal mindset aiming to reinforce regulations with no exceptions. The second is the economic mindset whose aim is to loosen foreign investments whenever the economy is in a weak condition and to tighten regulations during strong economic conditions.

Another relevant finding is the research by Neumayer, Nunnenkamp, & Roy (2016) on the strength of investment regulations in international trade. They observed that there is a mimic effect in the developing countries. When an investment finds a strict regulation in one country, it will find a similar condition in other countries that have not been invested. Likewise, when the regulations are loose in one country, the other countries will also loosen their regulations.

In the local governments’ context, it means they will look at a country’s or companies’ track records in their previous investments in other locations. If they were not strictly forced to comply with the regulations in the former location, they will likely get similar treatment from the new local governments.

A study by Lu et al (2017) can also provide illustrate this qualitative research’s results. The study revealed that foreign companies’ bargaining power becomes stronger when the home country provides humanitarian aid to the host country. The aids induce a kind of debt of gratitude in the host country and ease companies from the home country to invest.

These results could have implications for the possibility of considering humanitarian assistance or education provided by the home country as a factor to weaken regional governments’ coercive bargaining on foreign investment in their region. Facilities for investors’ companies from the home country can be interpreted not only as a debt of gratitude but also as an effort to boost more aid.

It can be concluded from previous research that there have been clues for the current research related to the factors considered by the local government in conducting coercive bargaining with foreign companies.

REFERENCES


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