

CHAPTER I

INTRODUCTION

1.1 Background

Foreign Direct Investment or FDI is known for their importance in the world of economy, especially in this era of globalization. FDI itself has become the driving factors of the world ultimate economic growth, technological updates, number of employments, and productivity improvements.¹ As time goes by, followed by globalization, the existence of FDI has become a more important factor for every country, especially for least developed and developing countries. FDI itself is different from a company that puts their money into assets in another country, they are directly involved with the daily operations, bringing money, knowledge, skills and technology with them.²

As FDI is a very important part of today's international cooperation and globalization, many countries are competing with each other to attract foreign investors to invest in their country. However, to compete with other countries, there are many factors that the government needs to deal with where most of the factors that might affect investor interest are coming from the state backgrounds which are the state economy, technology, infrastructure, human resources, risk, space, legality, space, cultural, institutional and political factors.³

¹ John C, Anyanwu. "Why Does Foreign Direct Investment Go Where It Goes?: New Evidence From African Countries." *Annals of Economics & Finance* 13, no. 2 (2012).

² "What Is 'Foreign Direct Investment'?" *Economy*. Accessed February 21, 2020. <https://www.ecnmy.org/learn/your-world/globalization/foreign-direct-investment/>.

³ Sebastian, Tocar. (2018). Determinants of Foreign Direct Investment: A Review. *Review of Economic and Business Studies*. 11. 165-196. 10.1515/rebs-2018-0069.

Looking at the backgrounds, emerging countries who are developing and having transition on their economies have been the most viable and suitable countries to gain FDI's attractions since emerging countries are trying to pursue their policies and modify their foreign capital regulations to attract the foreign investment in order to generate the economic growth.⁴ Developing country also considering FDI to be less prone to crisis since most direct investors are having a long-term perspective when engaging a host country and provides stronger stimulus than other typical types of capital inflows.⁵ Based on this reason, I choose Vietnam and Indonesia as the main actors of this research paper since Vietnam and Indonesia are one of many developing countries in South East Asia countries that are having their commitment to push the economic liberalization by attracting FDI. Vietnam and Indonesia are also showing and knowing their interest in manufacturing sector as the driving force of the economic progress where manufacturing sector have their own competitive advantage in reducing the unemployment rate, gaining tax revenues, and technological spillovers. Based on the World Economic Forum (WEF) report from 128 nations itself, it is highlighted that manufacturing sector plays an important factor to the prosperity of nations where 70% of the income variations were explained by differences in manufactured product export data.⁶

⁴ Chaudhuri, Sarbajit & Mukhopadhyay, Ujjaini. (2014). Role of FDI in Developing Countries: Basic Concepts and Facts. 10.1007/978-81-322-1898-2_1.

⁵ Peter, Nunnenkamp. Foreign direct investment in developing countries: What policymakers should not do and what economists don't know. No. 380. Kieler Diskussionsbeiträge, 2001.

⁶ Emilia, Herman. The Importance of the Manufacturing Sector in the Romanian Economy, 2015. <https://doi.org/10.1016/j.protcy.2016.01.121>.

Knowing that both Vietnam and Indonesia are having the same commitment to the economic liberalization, interest, and knowledge about the role of manufacturing sector, Vietnam and Indonesia are having a big differences on their FDI inflows output, especially in the manufacturing FDI. Because of that, this topic between Vietnam's and Indonesia's FDI growth in manufacturing sector become an interesting comparable topic to discuss.

Knowing the differences that Vietnam and Indonesia had, this research paper will also highlight the reasons behind the disparity that happened between Vietnam's and Indonesia's FDI growth where Vietnam recorded a growth of their FDI on the number of 74.16 percent in the last four years, 2014-2018. Much higher than Indonesia which only recorded their growth of 16.79 percent.⁷ This disparity comes up to raises a lot of questions such as on how Vietnam could increase their FDI growth more than 50% over Indonesia in the range of 4 years and could the small number of FDI growth in Indonesia is occurred as the effects of the raise of Vietnam FDI growth number or not. On the other hand, some factors like Vietnam's position in ASEAN Free Trade Areas (AFTA), exchange risk, cheap labor, cultural foundations, geographic, electricity, diplomatic, natural disaster and political stability are believed might have their roles on supporting this number of FDI growth.⁸ All of these factors are also become a question for Indonesia whether they run it effectively as what Vietnam did or not.

⁷ Citradi, Tirta Widi Gilang. "Pak Jokowi, Ini Penyebab Investor Pilih Vietnam Dibanding RI - Halaman 2." news, September 5, 2019. <https://www.cnbcindonesia.com/news/20190905105249-4-97273/pak-jokowi-ini-penyebab-investor-pilih-vietnam-dibanding-ri/2>.

⁸ "Vietnam vs Indonesia - Foreign Direct Investment." BestAsiaTours, November 24, 2019. <https://www.bestasiatours.com/vietnam-vs-indonesia-foreign-direct-investment/>.

In line with the growing number of FDI in Vietnam, more than 19 sectors in Vietnam showing their benefits on giving capital to its country. The manufacture sector of Vietnam has made US\$10.5 billion in the early of 2019, from January to May where it was worth as 72 percent of the total FDI in Vietnam. Followed by real estate with the number of US\$1.1 billion as their runner up and retail and wholesale with US\$742.7 million on the third position.⁹ This number shows that the manufacturing sector of Vietnam is playing an important role in investment sector of Vietnam. Contradict with Vietnam, supported by the smaller number of FDI growth, Indonesia's manufacturing is declining over 2018-2019. For now, the dominance sector of Indonesia's FDI have been moving to the real estate, renewable energy, mining, real estate, metals and chemicals that left the manufacturing sector at the number 10.¹⁰ Therefore, while identifying the manufacturing sector and its roles for both Vietnam and Indonesia, this disparity will somehow bring up an impact on Indonesia's economy.

⁹ "Vietnam's Record FDI - Where Is the Investment Going?" Vietnam Briefing News, July 18, 2019. <https://www.vietnam-briefing.com/news/fdi-in-vietnam-investment-by-sector.html/>.

¹⁰ Edimon, Ginting. "Foreign Direct Investment Is Not Coming to Indonesia. Really? - Edimon Ginting." Asian Development Bank. Asian Development Bank, September 18, 2019. <https://www.adb.org/news/op-ed/foreign-direct-investment-not-coming-indonesia-really-edimon-ginting>.

1.2 Research Question

Based on the information that was previously mentioned, I suggest the following research questions:

1. How can FDI in manufacture sector play their important role for Vietnam and Indonesia?
2. What makes Vietnam a more viable country to invest in manufacturer sector compared to Indonesia
3. How do Vietnam's dominancy on foreign direct investment affect Indonesia's economic aspect?

1.3 Research Objective

The main objective of this research paper is to identify the reasons behind the interest of investors to invest their manufacturers in Vietnam rather than Indonesia while also identifying the weaknesses of Indonesia in attracting FDI to their country. This research paper also seeks to highlight the effects of Vietnam dominancy on foreign direct investment towards Indonesia's economy, especially from the manufacturing sector. Based on this research, the outcome would provide the importance of the manufacturing sector in foreign direct investment and aware Indonesia about their current condition of foreign direct investment that was left behind by Vietnam, especially in manufacturing sector.

1.4 Research Contribution

The findings from this research proposal would give a broader understanding on how foreign direct investment gives impact to both Vietnam and Indonesia, especially on their manufacturing sector. This research proposal covers

the reason, impact, strategy, and the government intervention on dealing with the foreign investors on the manufacturing sector. By describing the aspects above, I believe that this paper could contribute as a guidance, reference toward the upcoming policies, ideas that would be implemented by the government on attracting investors where most of the decisions that the government made would impact the development of their country both Vietnam and Indonesia, especially from the economic and political point of views. I also hope that my research proposal could contribute to the study of International Relations on analyzing the strengths and weaknesses of a country foreign direct investment.

1.5 Structure of Writing

The first chapter, which is the introduction, gives a general overview of the main topic of the thesis, which includes the background of the thesis topic, the research question that will be addressed, the objectives of the research and the purpose of the research.

The second chapter, which is the theoretical framework, explains the international relations theory and concepts as a framework that are used to analyze dynamics of Indonesia and Vietnam's FDI in manufacturing sector such as the concepts of national interest and international organization. This chapter also complies several peer-reviewed that is in relation with the topic.

The third chapter, which is the methodology, gives a brief explanation on the research approach, research method, data collection technique, and data analysis technique that are being used in gathering data and information to answer the research question of the research.

The fourth chapter, which is the analysis, is the peak of this research. This chapter provides the analysis of the highlighted topic which is the comparisons between Vietnam's and Indonesia's foreign direct investment growth in manufacturing sector in 2014-2018. This chapter analyzes and presents all the data collected regarding the topic in a systematic manner that is based on the theory and concepts of international relations. The outcome of the analysis is used to answer the research question within this thesis.

The fifth chapter, which is the conclusion and recommendation, provides a brief summary on the analysis of the previous chapters. The chapter will also point out some recommendations for future studies to analyze and compare Vietnam's and Indonesia's foreign direct investment growth in manufacturing sector.

