The role of Japanese foreign direct investment (FDI) and joint ventures as instruments of its economic diplomacy has been pivotal in meeting, promoting and furthering the various political and economic objectives of Japan in Indonesia and outside in the postwar period. The Japanese foreign direct investment and joint ventures have come to occupy an important place in Indonesia after 1966 when the Old Order regime of Sukarno gave way to Suharto's New Order regime.

For the Japanese nation and government World War II was a bitter experience. For a time the Japanese nation seemed to lose its self confidence. But an able and strong leadership provided the Japanese with a new sense of direction and purpose to rebuild Japan into a modern and economically strong nation that would require the respect of other nations. All energy and capabilities were directed to this purpose. As a part of this rebuilding, political stability was ensured through the merger of conservative liberal parties into the Liberal Democratic Party (LDP), which has given the nation the required leadership and political stability to rebuild the country economically.
stated as follows:

(a) to secure and diversify source of raw materials, &
(b) to expand and secure export markets in order to
pay for its imports comprising mainly of the raw
materials.

These two main goals are a result of Japan's
economic structure and in order to pursue them, Japan
has to expand its sphere of economic influence across
all national boundaries. Its economic diplomacy based
on aid, trade, investment and joint ventures are
seemingly directed towards maintaining and expanding
this sphere of economic influence.

Japanese trading corporations have the respon-
sibility of translating these national goals in terms
of expanding Japan's sphere of economic influence chiefly
in Southeast Asia in general and Indonesia in particular.
In order to do so, these firms have to design detailed
programmes, supported by the concerned government agen-
cies, the banking community, a politically stable govern-
ment, a close link between the top management of business
and government decision makers and a conducive climate.
This challenging task has been undertaken and implemented
successfully and the government and other concerned
organizations have made the required funds available for
the development of resources, manufacturing, trading and banking. This has given an additional boost to the Japanese direct investment and joint ventures in Indonesia and outside.

Role of Sogo Shosha

To secure the continuity and diversification of the raw material supply, the Japanese government and the State Trading Corporation have assisted in the development of resources. Besides, the need for an outlet for Japanese manufacturing products led the State Trading Corporation to establish operations and invest outside Japan, activities only made possible with the support of the trading and banking arms of the Japanese economy.

The general trading houses, Sogo Shosha, are the main mechanism in implementing resource development and manufacturing, and the vast investment abroad is only possible and effective because of the existence of these giant firms. Diversification of resources and internationalisation of business has been with a desire to promote marketing overseas or overcome barriers of exports".\(^2\)

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The objectives of Japanese Foreign direct Investment and Joint Ventures in Indonesia

The Japanese foreign direct investment and joint ventures in Indonesia have been guided to fulfil various economic objectives of Japan. First, Japanese investment aims at securing and diversifying sources of raw materials in Indonesia for the industrial and overall economic development of Japan. Indonesia is a resource rich country endowed with precious raw materials and natural resources such as nickel, bauxite, rubber, iron-sands, oil, lumber and other mineral, and forest resources. The plantations too are valuable for the Japanese investors.

Second, another important objective of the Japanese direct investment and joint ventures is to secure a reasonable share in Indonesia's expanding market. Indonesia, being the largest country among all the ASEAN States—both in size and population—provides enormous scope for the absorption of Japanese capital, industrial raw materials like machinery, equipment and industrial manufactures.

Third, Indonesia being abundantly populated has the big reservoir of labour force. This abundant supply of labour has contributed to low wages. Japanese
investors and trading houses find this cheap labour highly attractive for keeping the price of their products low in order to make them competitive and highly attractive in the world market.

Furthermore, Indonesia is an strategic location. It is in a position to control the passage through the straits of Malacca or its alternative, the Lombok Straits. A hostile Indonesia could strangulate the Japanese economy by blocking those straits, through which passes the bulk of the oil that Japan consumes. 3

The objective of the Japanese investors is to keep this passage, the life line of the Japanese economy, secure through playing an important role in the economic development of Indonesia.

Thus the objectives of the Japanese foreign direct investment and joint ventures in Indonesia have been to promote marketing, to secure and diversify primary resources to secure cheap labour and overall diversification and internationalisation of Japanese business.

Factors responsible for the growth of Japanese foreign direct investment and joint ventures in Indonesia since 1966

The Japanese foreign direct investment and joint ventures in Indonesia took their shape in a particular economic setting, characterised by various economic and political changes which have taken place both in Japan and Indonesia since the late 1960s. These economic and political changes, existing in both these countries, guided and motivated the Japanese investment and joint ventures in Indonesia.

Economic Setting in Japan:

The most important factor which contributed to the emergence and growth of the Japanese foreign direct investment in Indonesia and outside has been the substantial increase in Japan's current account surplus in the late 1960s. This accumulation in current account reserves has been as a result of favourable balance of payments of Japan since the early 1960s made possible by the exports of the Japanese manufactures. Especially in the early 1970s, Japan was faced with the problem of how to dispose of rapidly increasing exchange reserves to avoid a drastic revaluation of its currency, Yen. At this time
Indonesia economy had both the economic potentiality as well as conducive political climate to invite and absorb the Japanese surplus exchange reserves in the form of direct investment and joint ventures.

Second, another important factor which has led to the emergence and growth of the Japanese foreign direct investment and joint ventures in Indonesia has been the removal of the restrictions on Japan's foreign investment by the Japanese government in the early 70s. This provided an opportunity for the Japanese trading companies and business houses to invest in Indonesia and outside.

Third, with its growing level of affluence and economic growth, Japan had started experiencing the problem of declining labour force in the country. The rural labour force, for example, had dropped from 16.5 million in 1955 to 9.8 million in 1970s.4

This decline in labour force resulted in manifold increase in the wage level in Japan. By locating industries in Indonesia, the Japanese entrepreneurs

hoped to solve this immediate problem of the rising wage levels, which notwithstanding productivity measures, have made certain industries in Japan no longer profitable. Since there are reservoirs of cheap and dexterious labour in Indonesia, the relocation of such factories affected by rising wage levels has become beneficial to Japan. 5

Fourth, another important factor which has led to the emergence of the Japanese foreign direct investment and joint ventures in Indonesia has been the introduction of strict anti-pollution laws in Japan and the consequent relocation of industries that are a hazard to environment, in other countries like Indonesia. Relocation of such Japanese industries in Indonesia has been a matter of serious debate and resentment among the Indonesians. This has been one of the factors responsible for the anti-Japanese riots in Indonesia when Prime Minister Tanaka paid a visit to Manila in 1974 on tour of Southeast Asian countries. 6

5 Ibid, p.9.

These new groupings comprising of Japan's big trading houses, called Sogo Shosha, are the main instruments to channelise Japanese investments and joint ventures in Indonesia, and other countries of the world.

The main idea behind these big corporations - Sogo Shosha is, as Sato Kiichiro of Mitsui Bank observes, "to serve customers, to take care of their employees and share-holders and their business as a whole should be for the good of the nation".  

These big trading companies deal with every thing from noodles to missiles and thus largely condition the nature and the volume of the Japanese foreign direct investment and joint ventures in Indonesia and outside. Today they have emerged as a mainstay of the increasing Japanese economic prosperity and superiority to be noticed globally.

Seventh, by far the most important factor which has contributed to the growth of the Japanese foreign direct investment and joint ventures in Indonesia, particularly in the latter's resource industries,

has been Japan's need for critical raw materials, caused by the post war economic growth and the resulting changes in the industrial structure of Japan in the late 1960s and the early 1970s. This becomes clear from the table I.

Table I


<table>
<thead>
<tr>
<th>Raw Materials</th>
<th>1960</th>
<th>1970</th>
<th>Average Annual Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Copper (1,000 tons)</td>
<td>320.0</td>
<td>833.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Load (1,000 tons)</td>
<td>108.0</td>
<td>213.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Zinc (1,000 tons)</td>
<td>109.0</td>
<td>634.0</td>
<td>12.3</td>
</tr>
<tr>
<td>Nickel</td>
<td>19.0</td>
<td>90.0</td>
<td>17.0</td>
</tr>
<tr>
<td>Aluminium</td>
<td>155.0</td>
<td>880.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Iron Ore(million tons)</td>
<td>17.5</td>
<td>59.3</td>
<td>13.0</td>
</tr>
<tr>
<td>Petroleum(million kilo-litres)</td>
<td>29.5</td>
<td>185.5</td>
<td>20.4</td>
</tr>
</tbody>
</table>

Source: Japan, Ministry of International Trade and Industry (MITI)
As table I indicates, the consumption of every critical raw material has increased at a rate surpassing the growth of the nation's gross national product. Between 1960 and 1970, Japan's dependence on foreign sources for iron ores increased from 68 to 88 per cent, for copper from 51 to 76 per cent and for coking coal from 36 to 70 per cent. For petroleum, aluminium and uranium, Japan is completely dependent on foreign sources. This is the reason why Japan is sometimes referred to as a "museum of minerals", being richly endowed with almost every variety of mineral, but usually in quantities only sufficient for museum displays. 9

In this context, emergence and growth of the Japanese foreign direct investment and joint ventures in Indonesia comes to occupy an important role as Indonesia is richly endowed with almost all the critical raw materials from nickel to petroleum which Japan needs for the sustenance of its economic prosperity and superiority all over the world.

And last but not the least, Japan's membership in major international financial and monetary institutions like the International Monetary Fund (IMF), the Asian Development Bank (ADB) etc has played a pivotal role in financing Japanese foreign direct investment and joint ventures in Indonesia. This role has been supplemented by Japan's leading membership of inter-governmental group of Indonesia (IGGI), an international monetary consortium established in February 1967 to finance the economic development of Indonesia.

Thus, in the background of this economic setting in Japan, existing in the late 1960s and the early 1970s and even today, that the Japanese foreign direct investment and joint ventures have emerged to play a role of catalyst in the economic development of Indonesia and economic prosperity of Japan.

Economic and political setting in Indonesia in 1966 and the emergence and growth of the Japanese foreign direct investment and joint ventures:

The political and economic changes which took place in Indonesia in the year 1965-66 created a conducive political and economic climate for the Japanese foreign direct investment and joint ventures to play a
decisive role in the fulfilment of Japan's various economic and political objectives in Indonesia.

The coup of September 30, 1965, popularly known as the Gestapu Affair was a turning point in Indonesia's policy on foreign investment. This coup led to the downfall of Sukarno who had nationalised all foreign property and largely made Indonesia's investment climate unattractive. During the time of Sukarno's administration (1945-1965), there was disapproval of foreign capital investment on ideological grounds. The people were revolting against foreign capitalism and therefore no permission was given for foreign capital to enter the country as it was considered to be the material form of capitalism, an instrument of colonialism and imperialism. 10

Sukarno did not lose his power immediately after the coup; he retained the title of President until April 1968. But by that time his former domestic and foreign policies had been reversed. This reversal began several months after the coup, when Sukarno

conferred emergency powers on Suharto and was further accelerated after February 1967 when Sukarno was forced to transfer all executive authority to Suharto. What emerged in Sukarno's place was a military regime which did not have Sukarno's charismatic appeal but which accepted Western liberalism in policy formulation and implementation. 11

Suharto, who succeeded Sukarno, was an arch enemy of communism. He was more concerned with the possibilities of communist subversive infiltration rather than the open influence of Western capitalism. Moreover, the country was badly in need of economic rehabilitation, in which foreign investments in infrastructure and private domestic capital were needed to boost trade and industries particularly agro-related industries.

Suharto invited foreign investment to supplement the domestic investment for the rehabilitation of the Indonesian economy which had been the victim of Sukarno's economic and political misrule. Throughout his rule, rather misrule, the country suffered from rampant inflation in the period 1958-1965, export

11 Ibid.
proceeds decreased significantly and the balance of payments suffered from chronic deficit. This deficit was met by borrowing from foreign countries, with no definite possibility of repayment. Food production did not keep pace with population growth. There was a shortage of many essential commodities, unemployment increased and the government budget was always in deficit. 12

Sukarno’s economic priorities were also wrong. While the people were suffering from rampant inflation and food shortages, he was building such monuments as the atomic reactor, international conference hall, sports arena, cement factory and iron and steel mill. 13

Sukarno’s rationale was that these monuments were needed as national symbols to unite the ethnically divergent Indonesians, but largely, his monuments were used to divert the people’s attention from the deteriorating economy.

In a country such as Indonesia whose population does not have a common cultural identity, national integration does require high priority but complete dis-

12 See Kunio Yoshihara, Japanese Investment in Southeast Asia, n.3, pp. 54-55.

13 Ibid.
regard of economy is also wrong. Contrary to Sukarno's belief that Indonesia was a rich country, it was in fact over-populated and suffering from the lowest per capita income in Southeast Asia. 14

In aggregate terms, Indonesia was richer in mineral and forest resources than other Southeast Asian countries, but on a per capita basis, this advantage was not apparent. Thus, Sukarno's approach to build political kingdom at the cost of economic development was erroneous and irrational.

However, Sukarno's seizure and nationalisation of foreign enterprises proved a major hindrance in the way of foreign investment in Indonesia. This policy of seizure and nationalisation began with the nationalisation of Dutch enterprises in December 1957 in connection with the dispute over west Irian. Until then, Indonesia's policy toward foreign investment was ambivalent; one group was in favour of expropriation of foreign enterprises, while other saw some good in foreign investment. The West Irian incident tipped the balance in favour of

Immediately after this, Chinese firms with Kumintang connections were nationalised. Then in 1963, in retaliation against British-sponsored Federation of Malaysia, British firms were seized. Finally in 1965, all other foreign (mostly American) enterprises were expropriated.

There were two factors responsible for Sukarno's nationalisation of foreign firms and his aversion to foreign investment. First he was not unlike many political leaders of emerging nations who felt that foreign investment was a covert method of dominating their nascent economies.  

Secondly, as Sukarno drifted toward Peking in the latter part of his rule, the people's Republic of China (PRC), which then rejected foreign investment and relied on mobilization of domestic resources for economic development, seemed to have become his ideal

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Due to this Sukarno's anti foreign investment approach, the Japanese foreign direct investment and joint ventures did not take place in Indonesia till 1965.

Suharto's New Order Regime and Policy Towards Foreign Investment:

However, Suharto rejected Sukarno's approach and decided to bid actively for foreign capital. In a way, this was the only course open to him at that time. Because he annihilated the PKI (Indonesian Communist Party) which he believed initiated the abortive coup which killed several of his military colleagues. He could not count the PRC, which had been assisting the PKI in various ways, as friend. Rather, soon after the coup, diplomatic relations between Indonesia and the PRC were suspended. Nor did his anti-communist attitude appeal to the Soviet Union. Thus, only Western countries and Japan were willing to provide the large economic aid which Indonesia needed to arrest the process of economic deterioration and to rehabilitate its economy.

The first and the most important step which Suharto regime took to invite foreign capital in Indonesia was its willingness to accept the conditions laid down by the Western countries, mainly the United States. The United States, for example, insisted that Indonesia should: (a) end the confrontation policy with Malaysia; (b) re-enter the United Nations and rejoin both the IMF and World Bank; (c) return the property nationalised by Sukarno to its original owners; and (d) open the country to private foreign investment.18

In this demand, the United States was supported by other industrial countries as well the International Monetary Fund (IMF).

In 1966, the Suharto regime decided to accept all these conditions. In doing so, it became possible for Indonesia to rely substantially on foreign investment and aid for economic rehabilitation. This measure of Suharto induced and encouraged the Japanese foreign direct investment and joint ventures in Indonesia.

Second, another positive and bold step in the direction of inviting foreign investment and other economic assistance to Indonesia was the enactment of the Foreign Investment Law in 1967. This law, the direct anti-thesis of Sukarno's policy, recognised the positive contribution, foreign capital can make to the development of the Indonesian economy. To encourage foreign investment and enterprise, the law granted various benefits. These benefits included (a) exemption from import duties on certain imports necessary for initial production such as machinery and equipment; (b) income tax exemption up to six years; (c) accelerated depreciation; (d) tax holidays; and (e) liberal transfer of earnings i.e. profits. It also guarantees that in the event of nationalisation, due compensation will be paid. 19

Third, to attract foreign investment, however, the economy had to be stabilised. For this he took a number of short-run and long run measures: (a) In February 1967, the Government invited non-communist friendly governments with advanced economies to form an inter-government group on Indonesia (IGGI) to provide credits inform of aid and investment to Indonesia;

19 Selo Soemandjan, Indonesia: A Socio-Economic Profile, no.9, p. 126.
(b) a year later, in 1968, a law on domestic private capital investment was issued in the same spirit as the foreign capital investment law. A special national investment board was established to render the best service needed by investors; (c) In the same year, Suharto regime launched the planning process with the First Five Year Plan, called Repelita I, (1969-1973) for increasing growth, stability and equity i.e. social justice.

All these measures gradually paid off. The rate of inflation declined from 100% to 10% in 1968-1969.

Attracted by the new investment policies, economic measures to stabilize the economy, the largely untapped natural resources, the vast market of population, the relatively low wages and over and above, a more ideologically close regime in power, Japanese and other foreign investors began to enter Indonesia with their investment capital.

Foreign investment is also imperative for Indonesia. Although, it is the best endowed of all the ASEAN (Association of Southeast Asian Nations) countries in natural resources, it is also the most populous and its per capita is the lowest.
It has many outstanding tasks in the economic sphere—providing job opportunities both to the urban unemployed and the rural unemployed, reducing the income and productivity gaps between the modern sectors and the traditional sectors of its economy, producing a better balance of economic power between native Indonesians and the Chinese population of Indonesia, and strengthening the manufacturing sector to broaden the industrial base. Thus, in order to meet these economic challenges, Indonesia needs to make enormous investment in infrastructures, agriculture and industry.

As the internal sources of investment capital needed to accomplish these tasks are limited, Indonesia depends on foreign sources both in the form of Official Development Assistance (ODA) and private investment. Indonesia also seeks foreign technology to increase the productivity of its economic activities. This technology enters the country primarily through direct foreign investment and joint ventures.

Japan provides largest share of Indonesia's direct foreign investment. Thus, the Japanese foreign direct investment in Indonesia assumes a significant place.
Characteristics of the Japanese Foreign direct investment and Joint Ventures in Indonesia:

The first and the most important characteristic feature of the Japanese foreign direct investment in Indonesia is that it ranks largest among all the countries which invests in Indonesia. It becomes clear from table 2.

Table 2

Approved Net FDI (Foreign Direct Investment) in Indonesia by country of Origin, 1986.

<table>
<thead>
<tr>
<th>Country</th>
<th>Cases</th>
<th>Value (US $ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>221</td>
<td>5,251,425</td>
</tr>
<tr>
<td>Hongkong</td>
<td>116</td>
<td>1,880,625</td>
</tr>
<tr>
<td>USA</td>
<td>91</td>
<td>1,215,832</td>
</tr>
<tr>
<td>Holland</td>
<td>52</td>
<td>685,173</td>
</tr>
<tr>
<td>UK</td>
<td>58</td>
<td>605,014</td>
</tr>
<tr>
<td>Germany (FRG)</td>
<td>30</td>
<td>501,256</td>
</tr>
<tr>
<td>India</td>
<td>17</td>
<td>444,714</td>
</tr>
<tr>
<td>Singapore</td>
<td>34</td>
<td>313,656</td>
</tr>
<tr>
<td>Australia</td>
<td>32</td>
<td>292,851</td>
</tr>
<tr>
<td>Others</td>
<td>154</td>
<td>3,930,516</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>805</strong></td>
<td><strong>15,808,774</strong></td>
</tr>
</tbody>
</table>

Source: Investment Coordinating Board of Indonesia (BKPM) 1987.
Table 2 clearly indicates and establishes the predominant place of the Japanese foreign direct investment in Indonesia over other investing countries. Compared to Hong Kong and the United States of America, Japanese cumulative investment in Indonesia in December 1986 was of the value of $5,252,424 million. Among all the countries listed in the table, Japan ranks first with its foreign direct investment in 221 cases in Indonesia.

There are various factors responsible for the Indonesian preference of Japanese investment and joint ventures to those of the United States. First, in contrast with the typical U.S. investor, majority of the Japanese investors are middle or small scale companies and most of them tend to invest in labour intensive industries in Indonesia and in other countries of the Southeast Asian region.

Second, there is often participation by Sogo Shosha (general trading companies) in the joint ventures as one of the partners, since they can make a valuable contribution in terms of marketing know-how as well as by virtue of their massive financial capability.
Third, whereas American investors prefer 100 per cent ownership, the Japanese have generally made joint venture arrangements sometimes even with minority Japanese ownership.

A second characteristic feature of Japanese foreign direct investment in Indonesia is that it is heavily concentrated in consumer goods (textile, miscellaneous goods, electric appliances, etc.), manufacturing and in timber-felling and fishery. This is because in the several years that followed the establishment of the Suharto regime Japanese corporations were defeated by US multinationals in competition for the far more rewarding and costly investment outlets like the mineral resources extracting sector, chiefly petroleum. 20

Among manufacturing sectors, it is in the textile industry that the impact of Japanese investment is more seriously felt. In the age of Sukarno this was considered a typical national industry but the picture began to change in the wake of the Japan-US textile war in the late 1960s when Japanese textile interests sought to start operations in Indonesia and

to secure an alternative market there. As a result by the end of 1973, Japanese textile companies had established 26 ventures in Indonesia with a total investment of more than $200 million, thus controlling two-thirds of Indonesian textile production.21

If we see the cases of Japanese foreign direct investment in Indonesia industry wise, we will find that maximum concentration is in manufacturing industry followed by chemical industry. Among all the consumer goods industries, the largest Japanese foreign direct investment is in textiles. This becomes clear from table 3. The table 3 indicates the cases of Japanese foreign direct investment in Indonesia by date, year and industries. Out of the total cases of 240, Japanese foreign direct investment is largely concentrated in manufacturing industry with 156 cases. In case of textile industry, it is 26 which is highest among the consumer goods industries.

For this, two factors have been responsible:
(a) a substantial increase in the labour cost in Japan and availability of cheap and abundant labour in Indonesia and (b) Indonesia becoming a large market for the Japanese produce - mainly manufactures and industrial raw materials like machinery, technology, etc.

21 Ibid.
The third notable feature of the Japanese foreign direct investment and joint ventures in Indonesia is that they are largely import substitution oriented. Japanese direct investment in Indonesia and other countries of Southeast Asia has been of three types:

(i) **Resource Oriented Direct Investment** - which is undertaken to increase the production of natural resource products needed by Japan in agriculture, fishery, forestry and mining. This resource oriented type investment has been undertaken by Japan in Indonesia to exploit and develop natural resources primarily for export.

(ii) **Import Substitution Oriented Direct Investment** - This type of investment is undertaken to produce for the domestic market of the host country (Indonesia in this case) manufactured products which were formerly imported from abroad, including Japan. The import substitution type of direct investment is usually undertaken when the host country introduces barriers against importing finished goods which it intends to produce itself.
Import substitution investment were enthusiastically received in the initial phase of industrialisation in Indonesia. In the earlier period, the economic activities of Indonesia and other South-east Asian countries were concentrated in the primary sector, and most manufactured goods were imported. Since they felt that this economic structure was primarily responsible for their economic backwardness and misery, industrialisation was the central theme of their development efforts in the post-war period. But this was not easy for a country like Indonesia where an industrial base was almost non-existent. The most readily available measure was to stop imports of certain manufactured goods, either by erecting a high tariff wall or by imposing quantitative restrictions, and to encourage production by the sheltered market. Foreign investment, mainly, the Japanese foreign direct investment complemented domestic investment in this endeavour.

But import substitution investment has gradually come to lose its original popularity, because of various reasons. First, import substitution replaced imports with domestic production of certain goods, but since it simultaneously induced import of their parts and raw materials, it usually became a burden on the balance of payments.
Generally, this export oriented type of direct investment is undertaken in low wage countries (relative to wage in home country) when the home country, with rising real wages is losing its comparative advantage in labour intensive products. Japan took this approach around 1960, when labour at home became scarce and wages in the manufacturing sector began to rise at an average rate of 10 per cent per annum.22

Indonesia is the least attractive for export-oriented investment. Because (a) wages are low, but since labour productivity is even lower, the cost of labour per unit of output is relatively high, (b) the infrastructure is underdeveloped, government efficiency in export and import clearance is far from satisfactory, and (c) the inter industrial structure is in the primitive stage of development.

Nevertheless investment has played some role in the export of manufactured goods from Indonesia. Among these three types of investment, Japanese direct investment in Indonesia in 1978 has been maximum in import substitution oriented. This is indicated by the following table (Table 4).

Table 4

CLASSIFICATION OF JAPANESE FIRMS BY TYPE OF INVESTMENT, 1978

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>No. of surveyed firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource Oriented</td>
<td>3</td>
</tr>
<tr>
<td>Import Substitution Oriented</td>
<td>26</td>
</tr>
<tr>
<td>Export Oriented</td>
<td>30</td>
</tr>
<tr>
<td>Total</td>
<td>32</td>
</tr>
</tbody>
</table>


Table 4 indicates that 26 out of 32 Japanese firms i.e. 81 per cent have been engaged in import-substitution oriented investment in Indonesia. This has been mainly because of the import substitution pattern of industrialisation pursued by Indonesia. Thus the main determinant of Japanese investment in these countries during the 1960s and early 1970s has been the import bans, imposed by Indonesian government.
Table 5 shows that heavy concentration of Japanese investment in Indonesian manufacturing has been in Java. This is so firstly because Japanese investment is attracted primarily by the availability of cheap and abundant labour in Java, which is the most populous of all Indonesian islands. Secondly, because the Japanese have shown their preference to locate their projects close to markets, infrastructure and urban amenities for their expatriate staff and, finally, in most cases the primary motive was to protect former export markets after imports of finished products were restricted by the Indonesian government.

The fifth characteristic features of the Japanese foreign direct investment and joint ventures in Indonesia is that among all the countries of ASEAN, Indonesia is the largest recipient of Japanese direct investment. This becomes clear from Table 6.

It becomes clear from table 6 that among the five countries of the Association of South East Asian Nations (except Brunei) i.e. Indonesia, Singapore, Malaysia, the Philippines and Thailand, largest number of cases i.e. 1,427, of Japanese direct investment are
Table 6

APPROVED JAPANESE FDI IN ASEAN
1951-1986

<table>
<thead>
<tr>
<th>Country</th>
<th>Fiscal year 1951-1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total number of cases</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1,427</td>
</tr>
<tr>
<td>Singapore</td>
<td>1,860</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1,009</td>
</tr>
<tr>
<td>Philippines</td>
<td>633</td>
</tr>
<tr>
<td>Thailand</td>
<td>1,111</td>
</tr>
</tbody>
</table>

in Indonesia. Moreover, Indonesia is also the largest recipient of Japanese investment in terms of money (amount) which is equal to US $ 8,673 million. There are various reasons for the preference of Indonesia for the Japanese investors. One reason for this is that Japanese consider Indonesia a large market for the goods they produce and plan to produce in future. Indonesia has a population of about 130 million. This is larger than Japan's and the fifth largest in the world. Indonesia is the largest of all the ASEAN countries. This large population can generate a large internal market for the Japanese goods.

Also, Indonesia is the richest of all the ASEAN countries so far natural resources are concerned. It is endowed with such precious resources as oil, timber, minerals and fish.

Also important in attracting such a large Japanese investment has been Indonesia's liberal policy towards foreign investment particularly till 1974-75 when some restrictions were put on foreign investment following anti-Japanese riots. Moreover, Indonesia's geostrategic location has by far been the single largest factor responsible for large Japanese
investment in Indonesia. Indonesia is in a position to control the passage through the straits of Malacca or its alternative the Lombok straits through which passes bulk of the oil that Japan consumes.

Another, the sixth, distinct feature of Japanese foreign direct investment is that it has emerged and grown and played a significant role in implementing Japan's economic diplomacy in Indonesia between 1966 and 1986 in three phases. In all these three phases we will notice a marked change in the nature and character of Japanese FDI necessitated by various economic and political changes which took place in both the countries during this period of twenty years.

The first phase of the growth of Japanese foreign direct investment has been between 1966 and 1969. In this phase, Japanese foreign direct investment concentrated heavily in textiles and electrical appliances and other consumer goods. This grew out of the crisis of rising real wages in Japan following the large capital accumulation on account of large surplus in foreign exchange reserves. This compelled the Japanese investors to look for areas where labour
the largest undertaking which Japanese took in Indonesia was the Asahan Aluminium smelter plant. It also included a powerful new thrust into the processing of raw materials as well as heavy industries that pollute a lot. 23

In this period, Japanese capital was involved at every level, primarily in joint ventures in resource development, textiles, car assembly and pharmaceuticals and also in loans for major projects in petrochemicals and natural gas. 24

The third phase which encompasses a period between 1975 and 1986 marks the downswing in the Japanese foreign direct investment in Indonesia. As table shows, Japanese FDI declined after 1970-74 period from 102 in 1970-74 to 86 in 1975-79 and from 86 from 86 to 28 in 1980-84 and finally from 28 to 16 in 1985-86.


Three major factors have been responsible for the decline in Japanese FDI in Indonesia. First the anti-Japanese riots of 1974 against, what the Indonesian perceived, over economic presence of the Japanese capital in the Indonesian economy. The burning down of Toyota’s joint venture company was most conspicuous of the many signs that the rush into Indonesia had received an anti-Japanese nationalism.

Second, as a consequence of the anti-Japanese riots, the government of Indonesia amended the Foreign Investment Act of 1967 by making it stricter for foreign direct investors. Foreigners were given strict limits within which to work, and only when the scale and technical requirements were such that local capital still could not do the job. There were requirements to achieve 51 per cent Indonesian ownership within ten years, to have all investment as joint ventures, to exclude foreign capital from sectors where domestic capital might take over.25

25 Rob Steven, "Japanese Foreign Direct Investment in Southeast Asia: From ASEAN to JASEAN" no. 23, p. 35.
And third and the most important factor responsible for decline in Japanese FDI was the extraordinary increase in government revenue due to manifold increase in Indonesian oil earnings caused by 1973 oil shock. The oil which provided around 60 per cent of government revenue and 70 per cent of export earnings during this period, allowed unprecedented independence from foreign capital. The result was, industry (manufacturing, mining, and construction) grew at a rate of 12.6 per cent in 1972-80 and realised domestic investment exceeded realised foreign investment reversing the previous trend.  

Although the investment climate in Indonesia was cooler towards Japanese capital after 1974, there have been forces in both countries which have maintained the economic alliance between these two countries. The Indonesian side needs the technology and finance that Japanese command while the latter needs resources, market and cheap labour and also an outlet for industries which they are phasing out domestically.  

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Although the Japanese FDI has declined in Indonesia, it still remains the largest investor (excepting investment in oil sector) and its predominance is unchallenged. With 221 cases and total value of $5,251,425 million in 1986 being the foremost among all the foreign investors in Indonesia. This is shown in table 2.

Role of joint ventures as instrument of economic diplomacy:

The role and area of activities of the Japanese joint ventures in Indonesia have increased after the anti-Japanese riots of 1974, when Indonesia's investment policy was changed. The new policy emphasised more on joint ventures than direct foreign investment. The most striking feature, of the Japanese joint ventures rely on loan capital to a greater extent than joint ventures with foreign investors from other countries. Table 7 represents the average debt equity ratios of the Japanese-Indonesian joint ventures by industry.

As table 7 shows, in the case of relatively small capital investment, and in light consumer goods industries, such as food and beverages, printing, textiles, electrical goods and batteries and pharmaceuticals, the role of loan capital is relatively small with average debt-equity ratios of less than one.

In the case of large scale, however, and in intermediate and capital goods industries, such as chemicals, automotive and parts, machinery and fabricated metal products, loan capital does play a very important role with an average debt-equity ratios of 1.2 to 3.4.

The greater importance of loan capital in heavier or more capital intensive industries as indicated by the higher debt-equity ratios, suggests the greater leverage with the Japanese partners vis-à-vis their Indonesian partners in these industries. Package deals are, therefore, common in these Japanese Indonesian joint ventures.

Under these package deals, raw materials, parts, components, machinery and equipment needed by the joint venture, are as a rule, purchased from Japan either
Another distinct feature of the Japanese joint ventures is that they have played a substantial role in almost all the economic activities of the Indonesian economy. In this, the general trading firms - Sogo Shosha -- have played a prominent role in the establishment of the joint ventures. They are in many cases the initiators and organisers in putting together hundreds of joint ventures established in Indonesia in accordance with their role in facilitating the operations of the Japanese economy.

By participating in hundreds of joint ventures, these general trading corporations have an important voice in directing their imports, exports and manufactures and are thus instrumental in implementing Japanese economic diplomacy i.e. to secure the continuity of supply of raw materials and an ever growing export market in order to be able to finance its total national economy. 29

Area of Activities of the Japanese Joint Ventures:

From table 7, their involvement is noticeable in resource oriented industries that is forestry,

29 Ibid, p. 257.
fisheries, fisheries, etc. in marketing oriented joint ventures like textiles as well as financial activities. In fact they are present in practically all industrial activities. The only exception is oil exploration where the field is dominated by American oil companies.

Moreover, Japanese activities are also evident in marketing and advertising areas. With their unorthodox and skilled marketing methods, they have captured the automobile and motor-bicycle market as well as markets for other consumer products such as refrigerators, television sets, house appliances, cosmetics, etc.

Besides, the joint ventures are also expanding their functions as industrial organisers, as exporters and importers of technology, and as organisers of new industries, by promoting software systems and by developing resources. All these core and expanded functions have been reflected in the hundreds of joint ventures between Japan and Indonesia.

Thus, the Japanese trading houses have formulated their strategies and objectives and acted accordingly. In implementing these strategies and functions effectively, they have contributed immensely
to Japanese growth and development and are rightly considered the backbone of the Japanese economy. Without these trading companies — Sogo Shosha — the Japanese would not have attained so strong a position in the Indonesian economy.

Thus Japanese foreign direct investment and joint ventures are the real implementors and the instruments of Japan's economic diplomacy in Indonesia. Their efforts during the period 1966 to 1986 have been to expand Japan's sphere of economic influence in Indonesia and beyond.