The Nature of Japanese
Foreign Direct Investment

Japanese Foreign Direct Investment (JFDI) which is like any other Foreign Direct Investment (FDI) particularly its most typical current form, expresses an alliance between two capitalist classes, that of the imperialist power and that of the neocolony, an alliance that helps each maintain its dominant position (Stevens, 1988, p. 33). However, a simpler view is that JFDI constitutes the flow of capital from Japan to host countries to establish production and service facilities and to conduct business activities.

1 The author would like to thank Prof. Dr. John McKay, the Director of Monash Asia Institute, Monash University, for the valuable comments in the earlier version of this article.
Japan's Foreign Direct Investment by Regions

<table>
<thead>
<tr>
<th>Regions</th>
<th>1991</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cases (unit)</td>
<td>Amount (US$ million)</td>
</tr>
<tr>
<td>Asia</td>
<td>1,261</td>
<td>5,944</td>
</tr>
<tr>
<td>Africa</td>
<td>76</td>
<td>748</td>
</tr>
<tr>
<td>Europe</td>
<td>789</td>
<td>9,372</td>
</tr>
<tr>
<td>Oceania</td>
<td>394</td>
<td>3,278</td>
</tr>
<tr>
<td>Middle East</td>
<td>10</td>
<td>90</td>
</tr>
<tr>
<td>N. America</td>
<td>1,734</td>
<td>18,823</td>
</tr>
<tr>
<td>L. America</td>
<td>290</td>
<td>3,337</td>
</tr>
</tbody>
</table>


1 JETRO (The Japan External Trade Organization) and The Japan Development Bank (JDB) are the institutions that actively promote Foreign Direct Investment. These organizations arrange regional investment seminars, trade fairs, and overseas information missions on a regular basis. With 77 offices in 56 countries, JETRO serves as the lead source of information for foreign investors interested in Japan (Ministry of Commerce, 1993, p. 1).

Japanese foreign direct investment...
"consolidation" decreasing JFJDI world total from US $41,745 million (1991) to only US $17,022 million (1990) (JETRO, 1995). However, some still predict, since the booms in the Japanese economy is continuing, that by the year of 2000 Japan will have overtaken America as the biggest gross foreign direct investor (Anonymous, 1988a, p. 75).

2. Reasons For Investing in Asia (and ASEAN)

From the Table 1 above, we can see that the largest amount of recent JFJDI was in North America (US $ 6,765), while the largest numbers of cases were in Asia. It is very obvious that North America still has the most sizeable amount of JFJDI princi- pally because its economy is huge. However, Asia has been receiving a greater share of the total JFJDI from Japanese firms, partly because Asia, particularly ASEAN, has the fastest economic growth in the world. Moreover, this region has lower labour cost, an incentive that has always attracted business investors. Despite this, Ganjar Kartasasmita, ex-director of the Indonesian Investment Coord- inating Board, feels that Japan has a moral duty to divert its surplus outflows to the United States to the developing countries for the development to the whole world economy (Anonymous, 1988a, p. 1). Fan and Shamsurraman (1992, p. 2) suggest that it is in Asian countries that JFJDI offers the greatest promise. For only Asia has given Japanese corporations a higher return on average than their investment in Japan. This is unsurprising since again the rapid growth of Japanese manufacturing investment in the regions since 1983 has been aimed primarily at achieving lower production costs. Another reason is that the increase in the value of the Yen against the value of ASEAN's currencies over the past two years gives powerful incentives for Japanese firms to set up medium-level operations; from television to instrument- ation components, in ASEAN. At the same time, the products from these investments are being sold in increasing num- bers in Japanese market, instead of being fed into Japan's export market. As an example, Aisw, a Sony subsidiary, is one company with long run plans to use its factory in Singapore as a source for Japanese sales (Anonymous, 1988c, p. 68).

Table 2. Ranking of The Investment Climate in The ASEAN Countries

<table>
<thead>
<tr>
<th>Rank</th>
<th>Asias JFJDI Assessment</th>
<th>Rank</th>
<th>Asias JFJDI Assessment</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Simple Score System</td>
<td></td>
<td>Complete Score System</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Singapore</td>
<td>1</td>
<td>Thailand</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Malaysia</td>
<td>2</td>
<td>Singapore</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>Philippines</td>
<td>3</td>
<td>Philippines</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>Thailand</td>
<td>4</td>
<td>Indonesia</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>Indonesia</td>
<td>5</td>
<td>Philippines</td>
<td>5</td>
</tr>
</tbody>
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IBM 803 789
Furthermore, assessing the investment, Tanboulerchel (1991, p. 19) suggests that there are very different positions among ASEAN countries in terms of investment climate. This position is shown in Table 2.

3. Foreign Trade Behaviour: Export and Import Share

However, according to Hakim, Japanese firms with investment in ASEAN export 70% of the total product to the U.S. - whereas 70% of the manufactured products of the U.S. investment are sold in the U.S. This is why, some people in ASEAN argue, the U.S. is their real friend, not Japan (Hakim, p. 401). This argument is generally supported by Nakamura who shows that in 1988 the pattern of intra-firm trade for manufacturing demonstrate a slower rate of export share to Japan (33.7%), with most of it going to local markets, although this percentage is considerably lower than the rest of the regions (North America (40%), and Europe (17%)). On the other hand, the subsidiaries' ratio of import from Japanese parent multinational corporations to their total procurement are highest for North America (65.8%) and lowest for ASEAN (41.5%) (shown in Table 4).

It is evident that IFDI in North America and Europe is intended primarily to serve the local market. On the other hand, IFDI in Asia appears to reflect the parent firms' strategic decision to implement, on the global basis, the international division of labour based on the level of technology. It is therefore often argued that this type of IFDI is generally accompanied by a significant strategy of transfer of managerial skills embodying essential production technologies from the home country to local subsidiaries.

4. The Fear

While the strategy is not dissimilar to that of U.S. investment in Asia since the late 1960s, Japanese investment in the region has been characterised by an increasingly complex and interdependent network of plants (Pun et al., 1992 p. 8). These have created networks of trading and operating relationships that are exclusive in nature and are of concern both in the U.S. and Europe. It is a fact that the

<table>
<thead>
<tr>
<th>Table 3. Foreign Trade Behaviour of Japanese Firms' Overseas Subsidiaries in Manufacturing: Export Share, 1988 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export/Sales</td>
</tr>
<tr>
<td>Local Sales</td>
</tr>
<tr>
<td>Exports Inc.</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>Other Regions</td>
</tr>
</tbody>
</table>

firms inside the networks will not do business with outside firms. This becomes an extension of the often heard complaint that businesses in Japan is characterized by extraterritorial relationships among domestic firms, such as those that exist among the major Japanese auto-producing firms and their principal suppliers and distributors. This makes it very difficult for Western firms to penetrate the Japanese market, either through export from their home nations or the establishment of business operations in Japan itself. Thus, the fear is that a Japanese-controlled network in East Asia will make it equally difficult for firms from outside the region to operate there.

On the other hand, the Japanese government also has a fear as the export of jobs often follows the export of capital. MITI (Ministry of International Trade and Industry) estimates that the increase in overseas production by Japanese companies will cost between 500,000 to 800,000 jobs in domestic manufacturing by the end of the 1990s. Whether or not the Japanese perceive this as “taking away our jobs” will depend on how much domestic employment is created by ever-higher technology manufacturing companies and by new information service industries (Anonymous, 1988b, p. 70). At the same time, however, Japanese manufacturing firms and their East Asian subsidiaries are increasingly sourcing inputs from firms other than their traditional suppliers, and this might in turn reduce the tradition of exclusionary relationships among the Japanese (Ozibaham, et al., 1994, p. 7).

In the home country, JFDI, in turn, with changes in comparative advantage, will accelerate structural adjustment in Japan, and lead to a contraction of traditional industries of the labor intensive type. It is in the parent company’s interests to make invested activity prosper by opening markets both in Japan and other advanced countries, even through taking advantage of general preferences provided only for developing country products (Kojima, 1973 p. 5). Furthermore, Graham argues that within many East Asian nations, there is a more parallel fear that the ubiquitous presence of Japanese firms will create excessive dependency upon Japan that, in the extreme, would be tantamount to reemergence of the “Greater Asian Co-prosperity Sphere” that Japan at-

<table>
<thead>
<tr>
<th>Export Sales</th>
<th>N America</th>
<th>NIES</th>
<th>ASIAN</th>
<th>Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Sales</td>
<td>36.9</td>
<td>41.9</td>
<td>46.5</td>
<td>37.2</td>
</tr>
<tr>
<td>Import from:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>60.8</td>
<td>39.2</td>
<td>41.9</td>
<td>51.6</td>
</tr>
<tr>
<td>Other Region</td>
<td>2.3</td>
<td>18.9</td>
<td>8.5</td>
<td>11.2</td>
</tr>
</tbody>
</table>

Sources: Ministry of Industry and International Trade as cited in Nakamura (interviewed), 199, p. 221.

Table 4. Foreign Trade Behaviour of Japanese Firms’ Overseas Subsidiaries in Manufacturing: Import Share, 1988 (%)
tempted to build by force during the late 1930s but that was undone with Japan’s defeat in World War II. In particular, there is a fear that rapidly expanding trade in the region will come to be dominated by large Japanese multinational firms.

5. Firms’ Behaviour

It is often asserted that multinational firms in manufacturing, as a form of foreign direct investment, start with assembly operations that have low local content, followed by increased local sourcing over time. This can be compared to the domestic firm’s behaviour. Krugman and Graham’s survey as cited in Hakim (1993, p. 397) explains how foreign firms behave in the U.S. and find that generally they look very much like U.S. firms. They are comparable in terms of value added, compensation, and Research and Development (R&D) per worker. The only major distinction between Japanese firms and other foreign manufacturer firms is that the Japanese firms are higher on the import propensity, about 2.5 to 3 just like the competitor of affiliates and the U.S. multinationals. Furthermore Hakim found that local procurement is still low while there is an increasing trend triggered by the yen appreciation and the domestic currency depreciation. The reasons for the low rate of local procurement include a lack of quality and technological precision and high cost. Japanese Direct Investment firms consider among other things the immaturity of related industries, such as subcontractors and part suppliers, as problems of investing in Indonesia. The local procurement is high in manufacturing firms and it consumes large amounts of energy for their production process.

The host governments usually require the firms to purchase a certain minimum percentage of their inputs from the local vendors rather than import them. A similar requirement that can be imposed is for a minimum percentage of the total added value of a product to be produced locally. Another requirement of the domestic authority is that some minimum percentage of the total value of output is to be exported. The Indonesian government for example imposes some monetary and fiscal instruments to encourage the use of larger local contents, which is very obvious in automobile assembling industries.

These phenomena are likely to lead to an inefficient allocation of resources. More importantly, the resources will be allocated not in industries where the nation has comparative advantage and to wards industries where local production is relatively inefficient. In the extreme, performance requirements could possibly deter the benefits of FDI.

6. Purpose and Categorisation of FDI

Some of the literature on the FDI proposes that FDI has two general purposes, namely, to increase investment and to relieve foreign exchange shortages, as exemplified by Cockeroff and Riddle (1991, p. 3). Unless it affects national savings, Foreign Direct Investment can increase domestic investment, or provide additional financing fora pre-existing current account deficit (net export-net import), or it can achieve some combination of two. Most of the FDI studies usually show these two effects as well.

Footnote 3: Import propensity is generally calculated by the increase of Import (I) divided by the increase in Gross Domestic Product (GDP).

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Fry (1993, p. 4-5) suggests that, to date, there have been roughly four categories for empirical studies on Foreign Direct Investment (FDI). They are: (1) macroeconomic studies of the determinants of aggregate FDI; (2) macroeconomic analysis of the benefits and other capital inflows affecting the rate of domestic economic growth; (3) critical studies in which government incentives and disincentives are analyzed; and (4) microeconomic studies of the effects of FDI on specific industries that examine the productivity or efficiency of FDI compared with domestically financed. 

The Theoretical View of FDI

It has been recognized that the theory of the firm, of industrial organization and international trade in combination provide a better framework for understanding FDI. The transfer of FDI from home to host countries is usually affected by a complex of motivations, although consistent with long run profit maximization. According to Sekiguchi and Kraemer (1980, p. 425), the companies decide to invest abroad rather than at home because: (a) foreign tariffs prevent the penetration of the market through exports; (b) special tax concessions or other inducements by host country are provided; (c) the host country offers an availability of cheap labour or other factors of production; (d) the firms need to protect their oligopolistic position, or (e) because of other reasons or combinations of them. Kojima, Professor of International Economics at Hitotsubashi University in Tokyo, has examined the nature and patterns of Japanese and U.S. direct investment and has developed a unique interpretation of the origin and nature of each country's investment behavior. Kojima indicates that FDI has produced a conflict of interests with national objectives in both investing and host countries alike, since national macroeconomic objectives remain dominant under circumstances where national populations cannot practically and institutionally move internationally with ease. Resolution of this conflict so that FDI may contribute harmoniously both to investing and recipient country development and promote an upgrading of industrial structure on both sides, thus accelerating trade between the two countries, requires a new analytical approach to the problem. Kojima then introduces the trade oriented and anti-trade approaches to FDI. To explain this, Kojima outlines five different motives of FDI. The first motive is natural resource oriented, which is actually trade oriented as he calls it, trade generated for its results from the investing country's desire to increase imports of its comparatively disadvantagesly produced or domestically unavailable commodities, and which causes growth in vertical specialization between producers of manufacturers and primary products. The second is the labour oriented motive that according to Kojima is trade oriented or trade reorganizing. As wages in the advanced countries become dearer relative to capital and as new products that are usually more capital and knowledge intensive than traditional goods are created one after another, then it becomes profitable and rational for the advanced country to contract its own traditional, labour intensive industries and transfer the location of production to low wage countries where cheaper labour cost prevails. Thus, the FDI with a labour intensive motive assists the reorganization of the international division of labour and
harmonious trade growth between labour scarce and labour abundant countries. The third active is market oriented. FDI induced by trade barriers in the host country is mainly trade oriented but in a different way. In this case, heavier tariffs on final products will lead to the substitution of export for parts and components, intermediate materials, machinery, equipment, and technology necessary to the production of final goods from the investing country. This type of investment means the host country’s interest in promoting import substituting activities. However, if import substitution grows successfully towards export orientation, then foreign direct investment of this type turns out to be a labour oriented motive. The fourth is a market oriented but oligopolistic. This is typically, as argued by Kojima, found in the U.S. enterprise that has a new manufacturing product industries in this decade and it is an anti trade oriented investment. The last type of FDI is the internalisation of production and marketing through vertical and horizontal integration of big multinational corporations. Kojima claims that whether this is anti-trade or trade oriented depends on whether the main activity countries oligopolistic investment or not.

Unlike the categorisation made by Kojima, Yoshihara, Professor of Kyoto University, classifies three major types of investment in Southeast Asia (Yoshihara, 1978, p. 4). They are: (a) resource oriented which is undertaken to increase the production of natural resources needed by Japan in agriculture, forestry, and mining; (b) export oriented which is usually undertaken to set up exporting manufacturing industries which serve as export platforms for exporting manufactured products to other countries, sometimes even to the home market of the investing country; (c) import substitution direct investment this is intended to produce for the domestic market of the host country manufactured products that 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 such goods which it plans to produce itself.

According to Kojima, FDI is trade oriented or, more exactly, reorganisation oriented. It transfers a package of capital, technology, and managerial skill from an industry that has a comparative disadvantage in the investing country to the recipient country in which it develops a comparative advantage. Also if FDI moves out from an industry in which there is a comparative advantage in the investing country, it prevents potential upgrading of the industrial structure and blocks the reorganisation of international trade. This is foreign direct investment of the anti-trade reorganisation oriented type (Kojima, 1973, p. 3). If FDI takes place in conditions of free competition, it follows lines of comparative advantage and is therefore trade oriented. The anti-trade reorganisation oriented FDI by contrast, is due to such factors as oligopoly, product differentiation, monopolopy of technology and so on.

The patterns of FDI from developed countries to developing nations are fundamentally explained theoretically by Raymond Vernon. He suggests that when the enterprises in the developed country expanded production at home, they risk fierce competition because of the oligopolistic market. Therefore the companies preserve their oligopolistic home market structure by expanding production abroad. These firms can compete in a higher level of prices because of their unique technolo-
giers and production methods. As the income levels of recipient countries increase, the domestic manufacturing companies in the host country lines to adopt the foreign technologies and production techniques of the foreign multinational firms to use of abundant factor endowments in the local economy, foresees a future, and a product which is less expensive and more closely tailored to local markets.

H. W. Arndt, professor at ANU, criticises the categorization made by Kojima to explain trade oriented and anti-trade oriented investment. He argues that one cannot help but feeling that that classification is a considerable oversimplification and particularly misleading if, with all the emphasis on the trade criterion, the labor welfare criteria are given little attention. Furthermore, Prof. Arndt suggests that FDI cannot be classified as trade oriented, merely because, as Prof. Kojima seems to imply at one point, it enables firms in the investing country to "...increase exports, substituting for exports of final products, exports of machinery and equipment" (Arndt, 1974, p. 27; Kojima, 1973, p. 4). He goes on to argue that Professor Kojima has become so persuaded of the evils of U.S. type of FDI that he wants to do away with it altogether (Arndt, 1974, p. 34). To quote Kojima, "...if all advanced countries liberalised imports of new goods and exporting countries make serious efforts at exporting, mutual trade in these goods among advanced countries will certainly expand and there is no need to undertake foreign direct investments. If firms still dare to undertake direct investment, it is still because of monopsonistic profits and they should not be allowed" (Kojima, 1973, p. 19).

However, a survey conducted by Allen (1973, p. 12) noted that the motive of securing, maintaining, and developing overseas markets has been dominant in Japanese overseas investment, and this enters the oligopolistic markets, accounting for 36% of the projects and 75% of the manufacturing projects.

**JFDI in Indonesia**

1. **The Japan Influence in Indonesia**

The influence of Japanese business in the Indonesian economy has been considerable. This influence has been applied through three main channels. Firstly, through Japanese International Trade (export and import activities); secondly, through Japanese Official Development such as loan or concessional debt; and, thirdly, via Japanese Foreign Direct Investment (JFDI) as shown in the Figure 1.

There are, of course, interrelationships between Japanese International Trade, Japanese Official Development Assistance, and Japanese Direct Investment. These interrelationships have been subject of many studies. Japanese trade, investment and ODA (Overseas Development Assistance) have influenced the transformation process in Indonesia, particularly in its technological progress. The technological development has two main strategies in Indonesia: (a) export promotion or outward looking strategy based on broad spectrum technologies, primarily in transforming natural resources to manufactured goods for export utilising manpower; (b) considering the larger and growing domestic market in line with the rise of personal income, Indonesia is nurturing its potential industries, mainly high technology based, using its domestic market as a 'steppingstone' for further expansion (Hakim, 1993, p.384).

Many studies have found that the most important section, not only for tech-
nological progress but also for increasing economic growth, of that above division has been the Japanese Foreign Direct Investment (FDI). The Japanese Foreign Direct Investment has long influenced the Indonesian economy, particularly since the New Order established by the Indonesian government. During the period of World War II, FDI in Indonesia was dominated by Netherlands’ companies and this contributed considerably to the opening of a country for modern economy and its development of natural resources. To discuss the FDI in Indonesia, one should note that there have been many economic policy characteristics in the stabilisation period after the New Order was established. These include: (a) emphasising the provision of basic needs; (b) giving incentives such as tax allowances, reduction of

Figure 1. The Japanese Business Influence in Indonesian Economy

Japan

International Trade

Increasing in Exports

Increasing in Foreign Currencies

Increasing in Export Capacity

Export Led Growth Strategy

Technological Development

Import Substitution

Formation of Fixed Capital

Increasing in Production Capacity

Machine and Intermediate Inputs

Increasing in Formation of Fixed Capital

Increasing in Machine and Intermediate Inputs

Japan Foreign Direct Investment

Japan Official Development Assistance


4 See for example, Wai (1989), Witz (1994), Hakim (1993); Sosasto (1993) and Hardjoewojoyono (1993) for reviews of this issue.
import duties, sales tax exemption on im-
ports of machinery and equipment, and
warranting repatriation of capital and prof-
its; (c) allowing foreign banks to open
branches domestically; (d) providing no
restriction on foreign equity and the em-
ployment of expatriate; (e) allowing 100%
of foreign ownership; and (f) preventing
foreign investors from distributing their
own products in the domestic market.

2. Long-standing History and
Regulations

The regulations on FDI in Indonesia,
during the oil boom period, became more
The rioters were reacting against the
government’s policy in increasing FDI,
especially IFDI, in Indonesia. They par-
ticularly objected to Japanese economic
domination. There were two aspects to the
Japanese problem; the first is the per-
ceived cultural arrogance of the Japanese
vis-a-vis the rest of Asia, and the second
aspect involves typically developed na-
tions versus low developed nations host
country conflicts of interest (Halverston,
199%, p. 93-94). Subsequently, the go-

ernment of Indonesia ruled that new in-
vestment had to be in the form of joint
ventures. Indonesian equity had to increase
to become a majority (51%) within a ten
year period; there were to be more limits to
the ‘open sectors’ for FDI; tax incentives
were reduced, and the employment of ex-
patriates was further restricted.

During the period 1982–1991, de-
regulation policies on investment were
introduced. Companies with a minimum of
75% Indonesian equity could distribute
products in the domestic market, and could
have access to credits from state banks.
All sectors were opened to export-oriented
joint ventures and these ventures have
enabled foreign companies to have up to
95% of total output. Export-oriented joint
ventures were eligible to apply for the
government subsidised export credit
scheme. Moreover, on April 1992, again,
100% of foreign ownership was allowed,
but restricted only to investment in the
provinces of the Eastern part of Indonesia
(Hartonoekarto, 1993, p. 426-427).

This ambivalence has therefore charac-
terised the Indonesian-Japanese eco-
nomic relationship. In World War II, Indo-
nesian suffered no less than others who
were occupied by the Japanese Imperial
Army. Yet, feelings towards the Japanese
are surprisingly mixed. There has been
much baying of the past. The harshness
of the occupation has been played down.
The fate of thousands of Indonesian conscripted
as romusha to contribute to the Japanese
war effort at home and overseas is never
raised, even though most perished. In-
stead, it has been mutually beneficial
to play up the role played by Japan in cul-
vating Indonesian nationalism, and later in
supporting with investment, the new Indo-
nesia which emerged after the chaos of the

Although the Japanese played a part in
encouraging Indonesian nationalism at the
outset of the Pacific War, their subse-
cquent actions disparaged such goodwill as
they might have won, and they faced mas-
sive demand for reparations. Finally, di-
plomatic relations were restored after the
Japanese had whittled the original claim
down to some $223 million, $400 million
in aid, and cancellation of debt on trade.
However, it was only after the succession
of Soskarno, the first president of Indone-
sia who had nationalised all foreign pro-

perty, that the Japanese saw opportunities
in Indonesia, anticipating that one day it
would be the most important part of the
region for them (Stevens, 1988, p. 43).

Soskarno’s nationalist regime had
delayed the influx of the textile FDI that
using Japanese wages had petered out in Asia in the 1960s, so that the mounting oil crisis began to force a new tide in the 1970s, the two currents combined into a tidal wave. Immediately after the new Foreign Investment Law, both the companies licensing the 1967 were in fisheries, while six of the nine licensed in 1971 were in resource exploitation, as were seven out of seventeen in 1970. Only in 1970 when the government revised the investment laws to set-up twelve priority categories did the lure of Indonesian wages result in a flood of manufacturing FDI.

Twenty-seven companies (twenty-two in manufacturing) were licensed that year. In 1971 another 27 were licensed; 25 in 1972 and a peak of 43 in 1973 (Stevens, 1988, p. 44). This figure reinforces the involvement of FDI at every level in this period, chiefly in joint ventures in resource development, car assembly, and pharmaceuticals, but also in tens for major projects in petrochemicals and natural gas.

Subsequent to the political failure of the non-capitalist solution to Indonesia’s underdevelopment, the new Soeharto regime resolved to tackle the crises within the constraints of capitalism. An alliance with imperialism was its sole expedient, and massive injections of capital flooded in from the U.S., the World Bank, and the IMF as well as the U.S. military aid the Indonesian regime required. When liberal foreign investment laws were passed, Japanese investment entered, particularly in the manufacturing sector (Stevens, 1988, p. 43).

3. Current Reasons for Investing in Indonesia

Why is Indonesia a potential gold mine for Japanese direct investment? There are various answers to that question, but most are focused on the fact that Indonesia is especially attractive because of its size. With a population of more than 180 million, Indonesia is the largest ASEAN country. The combination of a low-cost labour pool and a huge potential domestic market makes Indonesia the target of a massive influx of investment, particularly from Japan. This is why, presently, JFDI represents the largest form of foreign capital in Indonesia.

At the same time the government of Indonesia has planned to attract as much JFDI possible. To encourage JFDI and FDI, according to Halverson, the government has a number of reasons: (a) creating job for the local unemployed; (b) producing a diversified range of cheap consumer goods for the local market; and (c) establishing linkages with other enterprises to promote export and further economic growth. He further indicates that ideally the benefits of FDI to Indonesia are to provide technology, managerial and marketing skills, and to induce an increase in real income (Halverson, 1991, p. 80-82).

However, during the Yen appreciation in the late 1980s, most Japanese companies shifted gear, choosing to locate in Thailand or Malaysia instead. The main reason why Japanese enterprises have retracted from establishing a strong presence in the country has been the government’s harsh restrictions on FDI (Otsuki, 1994, pp. 26-27).

Satisfyingly, as noted by Otsuki, in June and October 1993, the Indonesian government eased restrictions on the introduction of overseas capital in response to requests by a number of local organisations. The relaxation of these regulations permitted wholly owned units of foreign companies to set up in Indonesia if the companies met one of two newly established conditions, which are: (a) if the country desiring entry invests in an area which is...
being developed by Indonesia and other nations (as was implemented with the idea of establishing joint development areas like that on Batam Island, which was set up in cooperation with Singapore); (b) if the company desiring entry invests in a local manufacturer that already supplies parts and semi-finished manufactured goods in the domestic market.

Japanese companies are very impressed with the new ease of restrictions. The senior economist at the Centre for Pacific Business Studies, Norto Kodani, argues that there has been a significant improvement in the regulation of FDI in Indonesia, although many JFDI companies are still worried since there is a particularly new point in the rule saying that following a fixed period after establishing a foreign capital affiliated firm in Indonesia, part of the company's capital must be transferred to local capital. This is one regulation that deters companies from becoming more active in investing in Indonesia (Ozaki, 1993, p. 27).

In June 1991, however, the Indonesian government again eased the investment procedure by giving overseas companies the opportunity to enter Indonesian industries with a 100% share and several restrictions formerly applied were reduced drastically. This deregulation on investment did increase the level of investment from Japan coming to Indonesia. By comparison, at the end of 1993 the JFDI to Indonesia was about US $43.3 million, and after deregulation JFDI was around US $625 million (1994) (JETRO, 1995). This still makes Japan the highest contributor of investment in Indonesia.

4. JFDI Performance in Indonesia

To further analyze JFDI in Indonesia, we need data on investment, particularly Japanese investment, whether it is approved investment or related data on investment. Table 3 below shows the surge in approved foreign investment into Indonesia in the late 1980s, particularly when compared with the low investment figures of the late 1970s and early 1980s. Since 1984 approved investment in Indonesia has been increasing steadily, while from 1967 - 1985 it fluctuated widely from US $127.5 to US $2,470.8. Only in 1982 and 1983 does the level of investment remain constant at about US $2,500 million. As a result of the tight money policy (TMP) pursued by the Indonesian government to control inflationary pressure and keep the current account deficit from growing beyond reasonable limits, foreign as well as domestic investment has declined again since 1991. This phenomenon has also affected JFDI in Indonesia, as shown in Table 6. The number of cases and the amount of JFDI in Indonesia has decreased since 1991, partly due to remaining non-tariff barriers (NTBs) and non-transparent regulations governing the non-tradable sectors still hindering export-oriented activities, thus adversely affecting FDI. However, when the deregulation of the investment sector was applied on June 1994, the number and amount of JFDI in Indonesia expanded.

Although the share of JFDI in Indonesia has not been very high compared to other nations (about 3 - 5%), the figure is the highest, compared to other ASEAN countries. Moreover, the share of JFDI in

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1The limitation is on commercial efforts born in September 1991 to keep Indonesia's large foreign debt under control, the constraints imposed by the indendous physical infrastructure and the growing attractiveness of other countries to foreign investors (see 64, example, Wice, 1994, p. 442).
Table 5. Approved Foreign Direct Investment in Indonesia 1967 - 1993, 31 May*

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Projects</th>
<th>Amount (US $ million)</th>
<th>Year</th>
<th>No. of Projects</th>
<th>Amount (US $ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>12</td>
<td>287.1</td>
<td>1981</td>
<td>24</td>
<td>706.5</td>
</tr>
<tr>
<td>1968</td>
<td>35</td>
<td>264.4</td>
<td>1982</td>
<td>31</td>
<td>2,416.5</td>
</tr>
<tr>
<td>1969</td>
<td>37</td>
<td>127.5</td>
<td>1983</td>
<td>46</td>
<td>2,470.3</td>
</tr>
<tr>
<td>1970</td>
<td>83</td>
<td>108.8</td>
<td>1984</td>
<td>23</td>
<td>1,096.9</td>
</tr>
<tr>
<td>1971</td>
<td>62</td>
<td>237.2</td>
<td>1985</td>
<td>45</td>
<td>813.2</td>
</tr>
<tr>
<td>1972</td>
<td>47</td>
<td>163</td>
<td>1986</td>
<td>93</td>
<td>847.6</td>
</tr>
<tr>
<td>1973</td>
<td>69</td>
<td>323.8</td>
<td>1987</td>
<td>130</td>
<td>1,320.3</td>
</tr>
<tr>
<td>1974</td>
<td>53</td>
<td>541.4</td>
<td>1988</td>
<td>115</td>
<td>4,481.6</td>
</tr>
<tr>
<td>1975</td>
<td>24</td>
<td>1,145</td>
<td>1989</td>
<td>294</td>
<td>4,718.8</td>
</tr>
<tr>
<td>1976</td>
<td>22</td>
<td>221</td>
<td>1990</td>
<td>432</td>
<td>8,751.6</td>
</tr>
<tr>
<td>1977</td>
<td>20</td>
<td>167</td>
<td>1991</td>
<td>376</td>
<td>8,778.2</td>
</tr>
<tr>
<td>1978</td>
<td>23</td>
<td>207.1</td>
<td>1992</td>
<td>305</td>
<td>10,312.2</td>
</tr>
<tr>
<td>1979</td>
<td>13</td>
<td>248.6</td>
<td>1993</td>
<td>99</td>
<td>3,973.2</td>
</tr>
<tr>
<td>1980</td>
<td>26</td>
<td>1,074.4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Investment Coordinating Board of Indonesia.  
*Excluding foreign investment in oil, banking, insurance, and trading.

Table 6. FDI in Indonesia 1991 - 1994

<table>
<thead>
<tr>
<th>Year</th>
<th>Cases</th>
<th>Amount (US $ million)</th>
<th>Share (%) to total FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>148</td>
<td>1,103</td>
<td>2.9</td>
</tr>
<tr>
<td>1992</td>
<td>112</td>
<td>676</td>
<td>4.9</td>
</tr>
<tr>
<td>1993</td>
<td>43</td>
<td>439</td>
<td>2.8</td>
</tr>
<tr>
<td>1994</td>
<td>53</td>
<td>625</td>
<td>3.7</td>
</tr>
</tbody>
</table>


Indonesia have been highest compared to other foreign investment coming to Indonesia from such countries as Hong Kong, Taiwan, and even Singapore. FDI share was 1.5% to 16.25% during 1991 - 1992 from total FDI in Indonesia. Some recent thinking and analysis in this area are exemplified by We, 1984.
1994). His analysis examined the export orientation motive of Japanese and NIC investment in Indonesia. He has found that Japanese and Asian NIC investment are on the whole more export oriented than those from other source countries. The evidence can be seen from Table 1. 46.7% of U.S. projects approved during 1992 were export oriented, while the corresponding figure for new Japanese projects was 69%. This was higher than that of the U.S. and even new Asian NIC (54.4%). Of the total planned export, however, new Asian NIC projects are still the highest; the majority 25.6% was generated by NIC projects, while 17.7% was generated by Japanese projects. Only around 3% was from U.S. projects and Australia and New Zealand contributed only 1.5% of total planned export.

The export orientation from Asian NIC investment is actually not surprising since NIC investors, especially Taiwan and Korea, have established business relations with buyers in developed country markets long before they moved their operations into lower-cost countries in Southeast Asia. Shifting to countries such as Indonesia did not affect their access to their traditional rich country markets (Wib, 1994, p. 446).

5. Employment Effect

With regard to the employment generated by FDI, it is logical that subsidiary firms provide employment to their workers in host countries. Correspondingly, Indonesia has gained benefits in employment from Japanese recent investment. The number of Indonesian workers planned to be absorbed by JFEI projects is 20,926 (Table 8).

This figure is higher than that of the U.S. (5,513), Netherlands (2,097), UK (939), France (1,059), and Australia (1,690), but lower compared to Korea.

Table 7: Planned Export of Newly Approved Foreign Investment in 1992

<table>
<thead>
<tr>
<th>Major Region or Country of Origin</th>
<th>Newly-approved Projects</th>
<th>Planned Export</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total (1)</td>
<td>Export-Oriented Projects (2)</td>
</tr>
<tr>
<td>Asia</td>
<td>166</td>
<td>93</td>
</tr>
<tr>
<td>Japan</td>
<td>40</td>
<td>26</td>
</tr>
<tr>
<td>Asian NICs</td>
<td>114</td>
<td>62</td>
</tr>
<tr>
<td>U.S.</td>
<td>15</td>
<td>7</td>
</tr>
<tr>
<td>Europe</td>
<td>82</td>
<td>17</td>
</tr>
<tr>
<td>Africa</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Australia &amp; N.Z.</td>
<td>11</td>
<td>5</td>
</tr>
<tr>
<td>Joint Countries*</td>
<td>24</td>
<td>12</td>
</tr>
</tbody>
</table>

Source: Indonesian Investment Coordinating Board, as cited by Wib (1993), p. 446.

* Joint countries include more than one source country.
Table 8. Employment with Newly Approved FDI Projects in Indonesia (Selected Countries, 1996)

<table>
<thead>
<tr>
<th>Source Country</th>
<th>No. of Projects</th>
<th>Planned Employment of Workers</th>
<th>Average No. of Workers per Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>76</td>
<td>20,926</td>
<td>275</td>
</tr>
<tr>
<td>Asian NICs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>86</td>
<td>37,550</td>
<td>437</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>36</td>
<td>16,853</td>
<td>458</td>
</tr>
<tr>
<td>Taiwan</td>
<td>94</td>
<td>39,574</td>
<td>421</td>
</tr>
<tr>
<td>Singapore</td>
<td>34</td>
<td>1,028</td>
<td>207</td>
</tr>
<tr>
<td>Other Asia</td>
<td>11</td>
<td>2,317</td>
<td>217</td>
</tr>
<tr>
<td>U.S.</td>
<td>16</td>
<td>3,513</td>
<td>220</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10</td>
<td>2,697</td>
<td>210</td>
</tr>
<tr>
<td>U.K.</td>
<td>10</td>
<td>959</td>
<td>94</td>
</tr>
<tr>
<td>France</td>
<td>6</td>
<td>1,055</td>
<td>177</td>
</tr>
<tr>
<td>Australia</td>
<td>8</td>
<td>1,490</td>
<td>186</td>
</tr>
</tbody>
</table>


(37,550 and Taiwan (39,574). This condition implies that FDI projects in Indonesia are fairly labour intensive.

Thus, although according to Exim Review, 67% of 222 production firms owned by Japanese operating in ASEAN countries were oriented towards the local market (Anonymus, 1992), one could still suggest that FDI in Indonesia (from Table 7 and 8) is both relatively export oriented and labour intensive. This condition should persist because of the future increase in population of Indonesia and growth orientation of the Indonesian economy. To sustain this situation, Indonesia, as suggested by Halvøron in his quantitative research (Halvøron, 1991, p. 224), has to export its product mostly to third world countries, rather than to Japan since this will largely increase the level of employment generated by FDI and raise the level of FDI itself from exporting to the home country (Japan) will.

Some Relevant Cases/Issues

Like any other Asian country, Indonesia is well ahead in the hunt for any park of the Japanese manufacturing base coming off-shore. In electronics, Hitachi, Toshiba, Sanyo, Panasonic and Sony are not only assembling the final product, but are also manufacturing the basic components. Sanyo for instance, has put US $20 - 30 million into three assembly plants at
Comangrip, near Jakarta, and has planned to diversify into other components as well. In addition, Sanyo has also started to make compressors for air conditioners and refrigerators. Panasonic intends producing 5 million loudspeakers units a year. Hitachi has invested a further US$10 million in the manufacture of electronic parts and is also producing electrical switching equipment for a country which will need 23,000 megawatts of extra power by the end of this decade (McBeth, 1994, p. 48).

In the area of textiles industries, one FDI analysis demonstrates that JFDI during 1968-1978 resulted in a negative impact on the traditional sector in Indonesia, although it was highly beneficial to the consumers. Another adverse effect was that JFDI, in raw material sectors, depleted Indonesia's natural resources and incurred environmental damage. The conflicts between these interests may be described as being old as the technological progress itself (Haverson, 1999, p. 93).

Another issue that arose in the FDI area is that most of the conglomerates in Indonesia, since the establishment of their business, have had joint venture with foreign investment, particularly with Japanese firms. It is therefore evident that most of them became prominent in the 1970s partly because of the benefits they gained from those ventures (Sweeves, 1988, p. 45). One of the leading conglomerates is the Lien's group (headed by Lien Sioa Liang) whose influence extends world-wide - at least 200 companies are bound by a variety of complex ties to the group. Its major business is the banking sector (Bia, Bank of Central Asia), the Lippo group which is controlled by Lien's right hand man, Muchtar Rady, and the Kenaca group which is directed by Lien's family.

William Soervadjono (Chinese name: Tjia Kian Lio) founded another group whose first business experience was in selling soft drinks and exporting agriculture products. But in 1962 he constituted General Motors (GM's) previously nationalised factory and established a car assembly company, Osa Motor (sell GM in abbreviation). After his plan to assemble GM cars failed, he turned to Toyota thereby beginning a very profitable series of ventures with Toyota, Datsun, and Mazda under the umbrella of the Asra group. This manufacturer has dominated the Indonesian automobile manufacturing sector. These Chinese-ancestry conglomerates have become outstandingly successful in Indonesia partly because of the crucial links with senior military officers they built during the independence struggles of 1945-1949. This complicated relationship accompanied by complex issues in the outstanding incentives has had considerable yields for all concerned.

Transfer of Technology

Transfer of technology is one of the issues related to Foreign Direct Investment. This issue usually becomes a concern since there are different views regarding the technology transfer from host and home countries. The home countries intend to gain as much profit as possible with the transfered resources they have. Consequently, technology, as one of the resources in the companies, is geared to be as efficient as possible, and if possible, the home countries will keep the technology to themselves. The firms need a lot of persuasion to transfer the technology to the host country, although Korea have been mutual benefits from giving technical assistance. On the other hand, the host countries want to acquire the enhanced technology from the multinational companies. This will increase the productivity of the country's
One resource or benefit for local enterprises to solve this conflict of interest, it is more useful to look for mutual advantages in the process of transferring technology by assisting each other in achieving the aim of the joint ventures.

In 1990, the Japanese had approximately 16,000 joint ventures in Indonesia. There is wide disagreement over what "transfer of technology" means, but there is considerable unanimity among Indonesians that there is not enough of it. Anecdotal evidence illustrates that Indonesians see their Japanese partners as being stingy with top-notch technology and uninterested in training local managers. However, economists are quick to point out that until recently Indonesian businesses were not particularly eager to acquire new skills. Until deregulation began in earnest in the late 1980s, many Indonesian businesses prospered largely because of restrictive licenses and monopolies. Hence, before 1985 the Indonesian environment forced people to become rent seekers to gain highly attractive returns. Therefore, the local firms did not care about developing their own capabilities (Schwarz, 1990, p. 58).

However, as the Indonesian macro-economy has grown rapidly, it demands lots of competitiveness. Thus, the local human resources and domestic companies have to pursue high technology if they want to win the market. Research and skill training, then, become increasingly important at this stage. Technological development is generally described in the literature as being acquired through three carriers (Habim, 1993), p. 405): (a) capital embodied technology which is transmitted through the export of equipment, (b) human embodied technology which is transmitted through education and training programs, personal contacts, professional mobility, technical assistance, etc.; and (c) disembodied technology that is forwarded through patents, literature, blueprints, patentability of project studies, operating instructions, etc.

The first type of technology transfer includes commercial high technology equipment for defense and research and development projects. The second type, human embodied technology, as mentioned in Kimishita (1986, p. 52), creates problems because of the manner in which this process is carried out, as well as how rapidly and completely it is done. Since the two sides in this educational process come from different sociocultural backgrounds, they may well have different concepts about how to transmit the process. Kimishita further suggests that in Indonesia a more active approach to communicating essential information and techniques is more likely to develop understanding in the learner and be more efficient in the long term.

The import technology payments for disembodied technology through patent, licensing, literature, etc. to Japan are increasing along with the increase in JEPs. The figures are shown in Table 2 as follows:

It is evident that the number of imported technology payments correlates with the number of investment projects. This means that the transfer of technology from Japan is mostly through JEP activity. Furthermore with regard to the technological sourcing, the direct cost of technology contracts for most of the companies, according to Habim (1993), p. 405-460, was not excessive, ranging from only 1% to 5%.
Table 9. Licensing Technology Transfer from Japan and JFDI 1981 - 1991

<table>
<thead>
<tr>
<th>Year</th>
<th>JFDI</th>
<th>Licensing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>76.3</td>
<td>34.65</td>
</tr>
<tr>
<td>1982</td>
<td>532.2</td>
<td>4.59</td>
</tr>
<tr>
<td>1983</td>
<td>457.5</td>
<td>63.79</td>
</tr>
<tr>
<td>1984</td>
<td>31.1</td>
<td>53.04</td>
</tr>
<tr>
<td>1985</td>
<td>62.9</td>
<td>67.84</td>
</tr>
<tr>
<td>1986</td>
<td>256.7</td>
<td>59.21</td>
</tr>
<tr>
<td>1987</td>
<td>221.9</td>
<td>122.74</td>
</tr>
<tr>
<td>1988</td>
<td>163.5</td>
<td>67.64</td>
</tr>
<tr>
<td>1989</td>
<td>499</td>
<td>72.06</td>
</tr>
<tr>
<td>1990</td>
<td>1,219.6</td>
<td>80.92</td>
</tr>
<tr>
<td>1991</td>
<td>1,155</td>
<td>157.25</td>
</tr>
</tbody>
</table>

Source: Indonesian Investment Coordinating Board.

Conclusion and Policy Implication

1. Conclusion

Whatever the views presented in assessing the JFDI, it is very clear that the transmission of a package of capital, managerial skill, and technical knowledge of JFDI is a potent agent for economic transformation and development. Thus, it is reasonable for JFDI firms to consider the lower labour cost, and the domestic market to be the strongest motivations for the flow of JFDI into Indonesia, followed by the investment incentives provided by the Indonesian government.

In Indonesia, JFDI is likely to be relatively export oriented and labour intensive compared to any other source of foreign investment. Hence, JFDI is comparatively trade oriented because it promotes the strategy of export orientation.

At this point, Kojima’s proposal could probably be right. However, from the point of view of Indonesia’s future policies, the issue of trade or anti-trade orientation is less important than the fact that the Indonesian government has been experiencing difficulty in keeping up an export orientation strategy for its non-oil exports. This is very important to the Indonesian economy since it makes a considerable contribution to economic development in Indonesia. For this reason too, Indonesia wants JFDI to be as high as possible.

Recent labour concentrated JFDI will indeed shift into industries which are technology intensive and brain power operation intensive in the near future. This is in line with Indonesia’s policies that will ideally jump ahead with the high technological progress and maturation in the primary sector. This issue has long been debated in Indonesia’s academia.
Since FDI does not constitute part of the national debt and can contribute significantly to the Indonesian economy by expanding the level of employment, promoting technological transfer and saving or earning foreign currency, it is likely that under the current regulations the Indonesian government should encourage further FDI, particularly JFDI, by improving information about economic behaviour as a whole on foreign investment since much is still unknown about it.

While the Indonesian government has been keen to attract more foreign investment, and while JFDI is considered to promote export oriented investment and favourable investment in Indonesia, Japanese investors should put a higher priority on more effective technology transfer to their Indonesian human resources. This transfer of technology should be maintained carefully based on improving benefits of “co-operation” both to the donor and the recipient country. The provision of management and technical training to local personnel can undoubtedly further a better mutual relationship between Indonesia and Japan, as well as improving the human capital of existing local firms.

2. Policy Implication

On the basis of these conclusions, one can propose many policy implications:

(a) the most efficacious way of encouraging FDI (and FDI generally) is to implement policies which principally improve the investment climate. While economically financed investment is booming, FDI, indeed, will seek to participate;
(b) to do (a) the Indonesian government has to ensure administration on all levels, for instance by the privatization of certain unproductive state-owned enterprises;
(c) optimum benefits from FDI seek to be achieved in an open economy system, free of domestic distortions, for example the existence financial repression and trade control. Under such conditions, the restriction on the sectoral allocation of FDI will possibly reduce its economic growth impact;
(d) tax incentives should be further applied to encourage domestic and foreign investment in export-oriented industries since Indonesia plans to pursue economic growth mostly by non-oil export orientation. For example, an exception of custom duties on import goods; and (e) finally, studies have to be made to establish effective methods of technology transfer, JFDI generated employment. JFDI originated economic growth, as well as in continuation and examination studies into the mutual benefits gained from JFDI.

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[and several anonymous articles]


