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Foreign Direct Investment in Indonesia: A Comparison of Industrialized and Developing Country Investors, 22 Law & Pol'y Int'l Bus. 75 (1991)

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FOREIGN DIRECT INVESTMENT IN INDONESIA: A COMPARISON OF INDUSTRIALIZED AND DEVELOPING COUNTRY INVESTORS

KAREN HALVERSON*

'Colonialism' has proven to be a much more subtle phenomenon than the rhetoric of the 1950s and 1960s suggested. . . . Third World countries have come to recognize that the problem of dependency on the First World requires . . . a restructuring of global economic systems; hence the call for a new international economic order.¹

Together, the twelve largest Asia/Pacific economies . . . now account for 24 percent of the world's GNP, roughly equal to that of the United States. These economies are playing an increasingly important role in the world's trading and financial systems. Indeed, they are becoming the engines of world economic growth through their . . . exportation of high-technology goods and capital.²

Foreign direct investment (FDI) by less developed countries (LDCs) in 1982 was fifteen times the LDC FDI in 1960. The rate of increase in FDI was 2.5 times faster than the rate of increase in investment by developed countries (DCs) in the same period.³ International development organizations, such as the United Nations International Development Organization (UNIDO), have high expectations that LDC multinational corporations (MNCs) will act as vehicles for changing the "asymmetrical

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3. Dunning, The Investment Development Cycle and Third World Multinationals, in MULTINATIONALS OF THE SOUTH: NEW ACTORS IN THE INTERNATIONAL ECONOMY 15, 22-23 (K.M. Khan ed. 1986). Dunning estimated the stock of FDI originating from select LDC investors at the end of 1982. Hong Kong was the largest investor with $2.5-3.0 billion, followed by Singapore with $1.5-1.75 billion. Id. at 23.
international economic order." Critics believe, however, that these new MNCs are as profit centered as DC-MNCs. Others are skeptical of the ability of LDC-MNCs to compete in DC markets or affect existing disparities in bargaining power among the various countries. The first passage cited above refers to a fundamental obstacle the developing world faces: the continued economic dependence of the LDCs on the DCs in spite of the political independence the LDCs have achieved over the past century.

Perhaps the LDC-MNCs are no less profit centered than DC-MNCs. Whether the interests of LDC-MNCs are more compatible with the needs of LDC host countries, however, is a different question. LDC-MNC investment may be a welcome alternative to DC investment. Moreover, the Asian experience suggests that a restructuring of the global economic system is underway. The second passage cited above refers to the phenomenal success achieved over the past fifty years by Asian developing countries: first Japan, then the newly industrialized countries (NICs), and now members of the Association of Southeast Asian Nations (ASEAN).

Indeed, Japanese economic success has pulled along with it the growth of other Asian countries so that today, the NICs are following Japan's lead by investing in ASEAN countries such as Indonesia.

This new Asian investment, which centers on manufacturing and processing sectors, is arguably more attractive to Indonesia's long-term economic goals than the traditional Western investment in resource extractive sectors. (Although petroleum exports are still an important source of foreign exchange to Indonesia, FDI in petroleum provides little to Indonesia in terms of providing stable economic development.) Moreover, Asian investors, including Japan, obtained an initial foothold in the Indonesian market as developing country investors employing mature, relatively labor-intensive technologies. If these Asian investors can still be characterized as LDC investors, the Asian experience suggests that, at least regionally, LDC-MNC investment will be increasingly important to Indonesia's economic development, particularly in light of Indonesia's recent push for export-led growth.

5. Id.
6. In this article (unless otherwise indicated), the Northeast Asian NICs are Hong Kong, South Korea, and Taiwan.
7. Member countries are Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Burma.
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Indonesia’s history in many ways typifies the development experience of Third World countries: a three hundred-year history as a Dutch colony; left-wing takeover and declaration of independence; subsequent military takeover and opening to foreign investment; and prosperity in the 1960s and 1970s as an oil producer followed by a debt crisis precipitated by a fall in oil prices.

Foreign direct investment in manufacturing has helped Indonesia to reorient its economy and mitigate its extreme vulnerability to world oil prices. Harmed by the soft market for oil in the 1980s (particularly the sudden drop in 1986), Indonesia changed the focus of its economic policy to boost non-oil exports. By liberalizing trade flows and encouraging foreign investment in manufacturing, Indonesia has succeeded in tripling its non-oil exports as a percentage of total exports, from twenty percent in 1982 to sixty percent in 1990.

Although Indonesia’s reforms have succeeded in attracting foreign investment, many Indonesians complain that the fruits of this investment have not been shared equally among Indonesians. Environmentalists also express concern over the damage foreign investment has wreaked on Indonesia’s natural resources.

Undesirable effects of increased Asian FDI, plus the fact that Asian development has followed a flying goose pattern, raise the question of whether Asian LDC-MNCs ultimately present the same problems to host governments that DC-MNCs do. The Japanese in many respects exhibit the same characteristics as U.S. investors. Indeed, the omnipresence of the Japanese in Indonesia’s manufacturing sector prompted students to riot in

8. See R. Dickie & T. Layman, supra note 1, at 11.

9. From 1986 to the present, the Indonesian government substantially deregulated its trade regime to promote FDI in export oriented industries. The government reduced to a minimum the list of industries prohibited to outside investors, simplified bureaucratic procedures for exporting, and reduced the price of inputs for exports through tariff exemptions. How Firms Can Maximize GSP Benefits in Indonesia, Bus. Asia, Jul. 24, 1989, at 242; Indonesia’s Repelita V Targets 5% Annual Growth, Stresses Private Sector, Bus. Asia, Feb. 20, 1989, at 59, 60; Deregulatory Reforms Herald a Simpler Life for Firms in Indonesia, Bus. Asia, Jan. 25, 1988, at 32.


12. The Japanese analogize their role in Asian development to a flock of flying geese: all nations fly forward as the NICs pick up the industries left behind by the Japanese, and the ASEAN countries pick up those industries left by the NICs. See Yang & Gross, Japan Builds a New Power Base: Its Emerging Clout in East Asia Could Come at America’s Expense, Bus. Wk., Apr. 10, 1989, at 42; see also infra text accompanying notes 121-23.
the streets of Jakarta during Japanese Prime Minister Tanaka’s visit to Indonesia in 1974. A major obstacle to increased foreign investment from ethnic Chinese investors in Hong Kong, Singapore and Taiwan has been deep-seated local resentment toward the ethnic Chinese minority who control a disproportionate share of Indonesia’s domestic capital.

Although academics have written extensively on the topic of LDC-MNCs, most of the literature focuses on the competitiveness of these companies vis-à-vis MNCs in industrialized countries. There is comparatively little written about the impact that LDC-MNCs have on host countries. Part of the reason for the dearth of research is a lack of data: the quantity of LDC-MNC investment is still small compared to that of DCs.13

This article attempts to explain the success of Asian foreign investment in terms of the theory behind the comparative advantages of LDC-MNCs. It also evaluates the impact LDC-MNC investment has had on Indonesia’s economic development, considering: (1) the costs and benefits of FDI in general;14 and (2) the unique costs and benefits associated with LDC-MNC investment. The article concludes that LDC-MNC investment does offer potential advantages to Indonesian development, but that a major obstacle to increasing such investment in Indonesia is a social and political one: government concern that foreigners, working with local ethnic Chinese entrepreneurs, will freeze out less competitive pribumi15 manufacturers.

A Very Brief Account of Indonesian History

For three hundred years, the Dutch ruled Indonesia as a colony. The colony (then known as the Dutch East Indies) served as a profitable source of crops and raw materials for Dutch trade.16 After Japanese occupation of Indonesia during World War II, Sukarno led Indonesian nationalists to proclaim independence in 1945. Believing that a cause of de-
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clining productivity in Indonesia was the intense hatred of local
Indonesians toward foreign enterprises established in Indonesia, Sukarno nationalized foreign-owned companies in the 1950s and 1960s. As Sukarno himself admitted, he was not an economist. During his rule, Indonesia’s economy stagnated and its inflation skyrocketed. After years of rioting between ethnic Chinese and pribumi Indonesians, and an attempted Communist coup in 1965, General Suharto led the military in assuming control of the government in March, 1966. The new government adopted an unambiguously development-oriented (i.e., market-oriented) economic strategy. Suharto is responsible for opening Indonesia to FDI.

THE PATTERN OF FDI IN INDONESIA

Japan and the United States are Indonesia’s primary source of FDI, together accounting for seventy-nine percent of the total (see Table 1). While the United States is Indonesia’s largest investor, the vast majority of U.S. investment is in the petroleum sector. Table 1 breaks down foreign investment by country and sector (between petroleum and other sectors of Indonesia’s economy). The United States, and to some degree, European companies, have invested in petroleum whereas Asian companies have invested in sectors regulated by the Badan Koordinasi Penanaman Modal (BKPM), which is primarily aimed at manufacturing concerns.

Table 1: Realized Foreign Investment* in Indonesia by Country in All Sectors 1967-1984**
(percentage of all foreign investment)

<table>
<thead>
<tr>
<th>Country</th>
<th>Petroleum</th>
<th>BKPM Sectors</th>
<th>All Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>3</td>
<td>68</td>
<td>21</td>
</tr>
<tr>
<td>United States</td>
<td>78</td>
<td>5</td>
<td>58</td>
</tr>
<tr>
<td>Europe</td>
<td>15</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>Other Asia</td>
<td>1</td>
<td>15</td>
<td>5</td>
</tr>
</tbody>
</table>

* The data include equity and loans
** Until September, 1985 for nonpetroleum sectors

17. Id. at 77.
20. The Indonesian government established the BKPM in 1973 to regulate all foreign investment except that in oil/gas, banking, and insurance.
Petroleum revenues have been the key source of Indonesia's foreign exchange. In 1981, oil and gas accounted for almost seventy percent of the total tax revenues and for eighty percent of Indonesian exports. Indonesia's dependence on oil revenues, however, made it extremely vulnerable to fluctuations in world oil prices. Indeed, as the price of oil declined from 1981 to 1982, Indonesia's oil export revenues fell by roughly $2.8 billion (an eighteen percent drop). Moreover, by skewing FDI too heavily toward investment in petroleum, Indonesia's economic policy benefits a small group of Indonesians at the expense of the rest of the country.

In addition to generating foreign exchange, host governments encourage FDI for a number of reasons: creating jobs for the local unemployed; producing a diversified range of cheap consumer goods for the local market; and establishing linkages with other enterprises to promote further economic growth. FDI in petroleum mining, however, strips Indonesia of its natural resources and wreaks environmental damage. Petroleum extraction is highly capital intensive and hence does not create labor opportunities. It cannot be linked to other sectors of the economy, and it supplies the industrialized world with raw supplies rather than supplying products to the local consumer. In short, FDI in Indonesia's petroleum sector furthers development by depleting a natural resource and incurring environmental costs without generating the countervailing benefits needed to fuel long-term growth. Foreign investors have thus been accused of exploiting Indonesia's natural resources without promoting economic development.

The taxes and export revenue which oil production generates have accrued largely to those closely linked to the Indonesian government. Oil revenues benefit Indonesia as a whole only to the extent that they are spent on social programs and infrastructure projects. In fact, the benefits of Indonesian economic development have disproportionately accrued to a

21. BKPM investment data refer primarily to investment in manufacturing. In most years, manufacturing investment is twice the combined total of the other BKPM sectors (nonpetroleum mining, agriculture, and services). H. Hill, supra note 13, at 54.


23. Id. at 10.

24. See Utrecht, An Outline of Indonesia's Corporate History: Development Without Real Growth, in 4 TRANSNATIONAL CORPORATIONS IN SOUTH EAST ASIA AND THE PACIFIC 65, 87 (E. Utrecht ed. 1982) (arguing that MNC investment deprives Indonesia of its natural resources while generating "hardly any take-off of economic growth").

small percentage of the Indonesian people, mainly to the well-educated living in urban areas who have access to government jobs.\textsuperscript{26}

Another problem associated with Indonesia's heavy dependence on oil exports is the effect it has on Indonesia's exchange rate. High revenues from oil exports push up the value of Indonesia's currency, making Indonesia's other tradable goods more expensive and hence less competitive. Economists consider this the main factor which hinders Indonesia's ability to manufacture goods for export.\textsuperscript{27}

In conclusion, Indonesia needs to diversify its economy away from the petroleum sector and into the manufacturing sector. Economists have called for Indonesia to expand its undeveloped manufacturing and resource processing sectors as vehicles for economic development.\textsuperscript{28} The weak market for oil has forced Indonesia to do so in an effort to boost non-oil exports. To the extent that Asian (particularly Japanese) investment has concentrated in the manufacturing sector, Asian investment has done more than Western (particularly U.S.) investment to promote Indonesian development.

Relative to its economic condition in 1967, Indonesia has industrialized rapidly: the country's share of gross domestic product (GDP) in agriculture decreased from fifty-four percent in 1960 to twenty-six percent in 1982.\textsuperscript{29} The corresponding increase in the manufacturing share of Indonesia's GDP, however, was only five percent.\textsuperscript{30} Moreover, this is the first sustained period of industrial growth Indonesia has known. In terms of industrialization, Indonesia is still behind the rest of ASEAN, particularly Singapore.\textsuperscript{31}

Commentators point to the relatively undeveloped state of Indonesia's manufacturing sector, even when compared to LDCs such as China and India.\textsuperscript{32} Some argue manufacturing in Indonesia should be a leading sector of economic growth in terms of: (1) introducing and adapting new

\textsuperscript{26} Id. at 202. Booth and Sundrum find that, although Indonesia's economy grew rapidly after 1966, income gaps widened from 1970 and 1976 between the urban and rural areas. They contrast this development with that of most industrializing countries (which experience an initial widening and eventual narrowing of income disparities), and explain the difference by noting that Indonesia's economic growth has been achieved by exploiting Indonesia's natural resources. Id. at 202-03.


\textsuperscript{29} M. ARIFF & H. HILL, supra note 27, at 8, table 2.2.

\textsuperscript{30} Id.

\textsuperscript{31} See id. at 17, 158.

\textsuperscript{32} McCawley, supra note 28, at 74.
technologies; and (2) supplying other sectors with relatively cheap and simple producer and consumer goods. Ideally, therefore, the benefits of FDI to Indonesia are to provide technology, managerial and marketing skills, and to induce an increase in real income as wages rise and consumer prices fall.

Critics accuse DC-MNCs, however, of investing in ways which do not advance these benefits. They bring to host countries technologies which were developed for industrialized country working conditions, where capital is relatively cheap and labor is expensive. They import relatively expensive inputs from other DCs rather than utilize local inputs. As for consumer goods, DC-MNCs compete by developing a brand name image and by marketing standardized goods designed for DC markets. When these companies invest in LDCs, often the technology they utilize and the goods they produce are ill suited to the host country's needs.

Indonesia's experience has been no different in this regard. The Western-developed technology brought into Indonesia via FDI has not been appropriate for Indonesia's working conditions. There is a need in Indonesia to develop intermediate technology, and relatively little has been done to adapt the currently available foreign technologies.

At least one economist has demonstrated that DC-MNCs in Indonesia operate inefficiently to the extent that they utilize capital-intensive production techniques which are inappropriate for Indonesia's factor endowments (abundant labor, scarce capital). Foreign firms in Indonesia can afford to utilize capital-intensive technology and imported inputs because they face little competition in the Indonesian market. In addition to the lack of competition, there are a number of reasons why DC-MNCs tend to utilize imported inputs and technology that are inappropriate for LDC conditions: (1) less experience in innovating; (2) lower marginal costs of affiliate-manufactured inputs; (3) opportunity to manipulate the transfer

33. Id. at 74, 77.
34. See id. at 90.
35. See L. Wells, Third World Multinationals: The Rise of Foreign Investment from Developing Countries 63, 65 (1983); Wells & Warren, Developing Country Investors in Indonesia, 15 BULL. INDONESIAN ECON. STUD., Mar. 1979, at 69, 74.
36. McCawley, supra note 28, at 87.
38. See id. at 90. This is particularly true in Indonesia, where MNCs have bargained for high levels of trade protection as a condition to investment. See infra text accompanying notes 70-71. If faced with international competition, DC firms might compete by reducing costs.
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prices of inputs; and (4) need to maintain brand name and standardized product reputation. 39

As a result, Indonesia spends precious capital importing technology and other inputs, and domestic workers are forced out of work as capital-intensive technology replaces labor-intensive production techniques. 40 In short, a fundamental problem with DC-MNC FDI is the lack of a fit between the characteristics of DC-MNCs and the needs of Indonesia as a host country. LDC-MNCs, on the other hand, possess comparative advantages which better address Indonesia’s development needs.

DISTINCTIVE CHARACTERISTICS OF LDC-MNC INVESTMENT IN INDONESIA

According to the product life cycle theory, 41 DC-MNCs operate in oligopolistic home markets. If these MNCs expanded production at home, they would risk triggering fierce competition. Hence they preserve their oligopolistic home market structure by expanding production abroad. DC-MNCs can invest in LDC markets and compete at much higher prices because of the unique technology and production methods DC-MNCs possess. As the income level of a recipient (host) LDC increases, domestic enterprises in the host country learn to adapt the foreign technologies and production methods of the DC-MNC investor to make use of abundant factor endowments in the local economy (e.g., cheap labor) and produce a product which is less expensive and more closely tailored to local consumer needs. 42

Although local LDC firms do not face the barriers to entry of traditional MNCs (i.e., high capital costs and research and development), these LDC-MNCs, like the DC-MNCs, operate in concentrated, oligopolistic-like markets. Managerial skills are scarce and marketing channels are

39. L. WELLS, supra note 35, at 40-41. FDI has the paradoxical effect of increasing rather than decreasing Indonesia’s dependence on foreign investors, by developing industries which require large imports of technology and capital. H. HILL, supra note 13, at 141.

40. In the 1970s, abundant foreign exchange (from oil exports) and an open-door investment policy resulted in modern technology production which not only failed to absorb increases in the labor force, but in some instances displaced workers in cottage industries and labor-intensive factories which could not compete with the more modern factories. G. HUGO, T. HULL, V. HULL & G. JONES, THE DEMOGRAPHIC DIMENSION IN INDONESIAN DEVELOPMENT 350-51 (1987).

41. This theory was first articulated in Vernon, International Investment and International Trade in the Product Cycle, 80 Q.J. ECON. 190 (1966), cited in Lecraw, Internationalization of Firms from LDCs: Evidence from the ASEAN Region, in MULTINATIONALS FROM DEVELOPING COUNTRIES 37, 39 (K. Kumar & M. McLeod eds. 1981).

42. See Lecraw, supra note 41, at 41 (modifying the product cycle theory to explain the development of LDC-MNCs).
controlled by a small group of families. Hence, like the DC-MNCs, LDC investors eventually venture abroad and introduce their adapted technologies and production methods downstream (to lesser developed countries) and compete at a price higher than the domestic producers, but lower than the DC-MNC producers.43

A key difference between LDC- and DC-MNCs is the way these companies compete in LDC markets. Whereas DC-MNCs possess new technological advantages, LDC-MNCs' comparative advantage is based on their innovations of mature technologies, i.e., adapting preexisting technologies to new conditions.44 Note that these LDC-MNC innovations create unique comparative advantages. That is, these companies specialize in ways which are not easily copied by other MNCs.45

Moreover, DC-MNCs cannot easily match and improve on LDC-MNC innovations because of the "localization and irreversibility of technological change."46 Because acquiring and changing technology is expensive, a firm's technological knowledge localizes around a limited range of production techniques. In addition, because technological progress also affects suppliers, distributors and users (i.e., the firm's linked industries), when a firm's technology advances, its linked industries' technologies irreversibly advance as well. Mature technologies, therefore, "while they may be 'known' in some abstract sense, cannot be efficiently reproduced or transferred once the entire industrial system has moved on to new technologies."47

In short, LDC-MNCs can compete in lesser developed host country markets by adapting mature technologies. Because these adaptations are designed for LDC (rather than DC) markets and working conditions,

43. See id. at 42-43. Another reason LDC-MNCs venture abroad is to diversify their investments against political risks at home. L. WELLS, supra note 35, at 83.

44. For a description of this process, see L. WELLS, supra note 35, at 15-16. Wells compares LDC-MNC innovations of mature technologies to the innovations made by European and Japanese manufacturers of U.S.-developed technology. Id.

45. Wells describes the experience of an LDC-MNC that acquired information about equipment suppliers:

[The firm] had drawn up a list of suppliers for various pieces of equipment. The list covered a wide range of European suppliers and included the capacity and cost of the equipment and the set-up time required to adjust the equipment to other kinds of output.

The supplying firms were evaluated according to their delivery and service records; the machines, according to their needs for maintenance.

Id. at 29. Wells uses this example to illustrate the value of LDC-MNC innovations. Id.


47. Id. at 5.
they are especially able to contribute to the economic development of LDC recipient countries. 48

Studies of Asian MNCs demonstrate that: (1) LDC-MNCs do indeed innovate; and (2) these companies possess additional competitive advantages which make them more suitable to Indonesia’s conditions and thus allow them to compete with DC investors.

Innovative Adaptations of Mature Technologies

Interviews with Hong Kong investors in 1982 revealed that 87.5% of Hong Kong MNCs modify technology used in their overseas subsidiaries: 25% modify extensively, 50% moderately and 12.5% slightly. 49 At least with respect to Hong Kong MNCs, the most typical adaptations are made to allow for less skilled labor to operate the machines, e.g., by converting manually operated machines into semi-automatic ones. For example, one Hong Kong firm uses smaller molds for pouring aluminum to allow for the use of hand-fed rolling equipment. 50 Other adaptations are made to suit the climate, working condition and labor force working habits of the host country. 51

Because they adapt their production techniques to suit the working conditions of the LDC host country, LDC firms are characteristically small in scale and labor intensive. LDC-MNCs downscale in order to increase efficiency by adapting their firm to the size of the consumer market. 52 A typical DC firm is operating at twenty-six percent of capacity, whereas

48. With regard to technological innovations, LDC-MNCs transfer these innovations to LDCs only when they invest to take advantage of mature technologies in the home country. When an LDC-MNC invests in order to secure supplies of raw materials in the host country (e.g., timber, fish), the LDC-MNC may supply management skills and capital, but not technological innovation. See, e.g., Chen, Hong Kong Multinationals in Asia: Characteristics and Objectives, in MULTINATIONALS FROM DEVELOPING COUNTRIES 79, 96 (K. Kumar & M. McLeod eds. 1981).


50. Wells & Warren, supra note 35, at 82.

51. Chen, supra note 49, at 122; see also Monkiewicz, Multinational Enterprises of Developing Countries: Some Emerging Characteristics, MGMT. INT’L REV., third quarter, 1986, at 67, 74 (concluding that LDC-MNCs’ most spectacular difference from traditional MNCs is their ability to integrate with the local technological base of the host country).

52. To the extent that the domestic market is inadequate to absorb goods produced by large-scale firms, small- to medium-scale firms are more efficient. Contrast downscaling for efficiency reasons to government policies aimed at promoting inefficient small-scale enterprise in an effort to increase employment. Little, for example, argues against government subsidies targeted at small firms. Little, Small Manufacturing Enterprises and Employment in Developing Countries, ASIAN DEV. REV., 1988, at 1. The size of an enterprise is not necessarily a measure of its labor intensity.
LDC firms operate at forty-eight percent of capacity. A firm might be downscaled in various ways, including using fewer pieces of equipment, substituting batch processing for mass production, substituting labor for machines, redesigning products (simpler component parts), or utilizing alternative technology (e.g., substituting fiberglass for steel).

The higher capital invested per worker by LDC-MNCs relative to DC-MNCs in Indonesia shows that LDC-MNCs are more labor intensive. Table 2 demonstrates how Asian LDC-MNCs have made more efficient use of Indonesia’s abundant, inexpensive labor and scarce capital than DC-MNCs.

Table 2: Capital Labor Ratios by Nationality of Investor 1967-75 (Realized Projects)

<table>
<thead>
<tr>
<th>Nationality</th>
<th>Average Capital Invested per Worker (thousands of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chinese*</td>
<td>8.3</td>
</tr>
<tr>
<td>Other Southeast Asia**</td>
<td>8.2</td>
</tr>
<tr>
<td>Japan</td>
<td>18.8</td>
</tr>
<tr>
<td>United States</td>
<td>16.9</td>
</tr>
<tr>
<td>Other Industrialized Countries</td>
<td>33.1</td>
</tr>
</tbody>
</table>

* Hong Kong, Taiwan, and Singapore  
** Burma, Malaysia, the Philippines, and Thailand


In short, there is substantial anecdotal as well as statistical evidence demonstrating that LDC-MNCs adapt older technologies to fit host coun-

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53. L. Wells, supra note 35, at 22 (citing Lecraw’s data of MNCs in Thailand).

54. Wells cites the example of a battery manufacturer in Indonesia that moves partly-finished products from station to station in batches instead of using an assembly line. Id. at 20.

55. Id.

56. Wells & Warren, supra note 35, at 75; see also H. Hill, supra note 13, at 69-70 (recognizing that important differences exist between LDC and DC investors’ tendency to use capital-intensive production techniques, and that these differences are supported in the Indonesian data).

Although labor intensiveness is important for efficiency considerations (use of factors of production in which Indonesia has a comparative advantage), in practical terms, labor intensiveness of manufacturing has a relatively insignificant impact on underemployment and unemployment. If the Indonesian manufacturing sector maintained a relatively high rate of increase in job creation (10% per year), it would still only provide jobs for a mere 7% of the annual increase in Indonesia’s job force. Balasubramanjam, supra note 37, at 71.
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try conditions and that such adaptation results in smaller and more labor-intensive firms.

**Adaptation to Local Conditions**

LDC firms tend to produce products that are tailored to the needs of the local market. In contrast, DC firms tend to manufacture standardized products that conform to a brand name image. A Hong Kong textile firm with a subsidiary in Indonesia, for example, responds to local market demand by supplying a broad range of products rather than manufacture a few products and convincing consumers to accept the standardized versions.

**Low Price as a Marketing Strategy**

In general, LDC-MNCs compete by keeping costs low. The LDC-MNCs target lower-income markets rather than spend capital on cultivating a brand name image. First, LDC-MNCs tend to invest more than DC-MNCs in industries which are less advertising intensive, i.e., industries which spend a small percentage of sales revenue on advertising. Table 3 compares the tendency of LDC- and DC-MNCs in Indonesia to invest in advertising-intensive industries. DC-MNCs predominated in seven times as many advertising-intensive industries, compared with only one and one-half times as many other industries.

**Table 3: Advertising Expenditures of Industries from LDCs and DCs with Subsidiaries in Indonesia—1967-76**

<table>
<thead>
<tr>
<th>Industries' expenditure on advertising as a percentage of sales</th>
<th>Number of industries in which LDC-MNCs were the most significant investors*</th>
<th>Number of industries in which DC-MNCs were the most significant investors*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 2%</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>2% or more</td>
<td>1**</td>
<td>7</td>
</tr>
</tbody>
</table>

* By number of subsidiaries
** Industry has only one LDC-MNC investor


57. See Chen, supra note 49, at 120.
58. L. Wells, supra note 35, at 28.
 Even within the same industry, marketing and maintaining a brand name image is generally less important to LDC-MNCs. Rather than spend money on advertising, a Singapore cola company, F&N Cola, competes with Coca-Cola's Fanta by establishing a market niche in the middle-price range. F&N also competes by reducing overhead. In contrast with Coca-Cola's expensive facilities, complete with glass windows for passersby to view the automatic bottling equipment, the Singapore company works in adequate but less spacious quarters. Another Singapore firm in Indonesia used to compete with Union Carbide by selling its batteries for thirty-five rupiah, close to half of Union Carbide's cost of fifty-five rupiah per battery. Subsequently, the Singapore firm captured such a large share of the market that Union Carbide withdrew its Indonesian operation.

Cultural Affinity

Asian MNCs, like most LDC-MNCs, tend to invest regionally. In 1980, seventy-one percent of the Asian NICs' FDI was within Asia. Chinese investors, particularly those from Hong Kong and Taiwan, draw on ethnic and family ties abroad to form joint ventures with Chinese in other Asian countries. These connections are another comparative advantage that LDC investors use to compete against DC-MNCs. Hong Kong investors consider their better understanding of conditions in the host country as one of the most important advantages Hong Kong MNCs have over DC investors, second only to lower management costs. Indonesia, with its ethnic Chinese minority, hosts many of these ventures.

The ethnic ties are both an opportunity to host a number of profitable investments and a source of tension between the Chinese and pribumi entrepreneurs in Indonesia. To the extent that the latter case holds true,

59. Id. at 60.
60. Id. at 33, 51. Wells suggests that Coca-Cola built the more expensive production facilities in part to cultivate an elite brand name image for Coca-Cola's products. Id. at 34.
61. Id. at 63.
62. Id. at 199.
63. Dunning, supra note 3, at 24.
64. L. WELLS, supra note 35, at 78-80.
65. Chen, supra note 49, at 95. In contrast, the Japanese are notoriously ignorant of their neighboring Asians. Infra text accompanying notes 96-98.
66. In fact, the data on FDI in Indonesia compiled by the BKPM understates the number of Chinese MNC subsidiaries in Indonesia because many of these investments are counted as domestic projects undertaken by Indonesians of Chinese descent. See H. HILL, supra note 13, at 34.
Chinese ethnicity actually acts as an impediment to LDC-MNC investment.  

**Other Benefits**

Technological adaptation, more appropriate goods, lower priced goods, and overseas connections are all competitive advantages of LDC investment which benefit Indonesia. Additional benefits to Indonesia in hosting Asian LDC-MNC ventures include encouraging export-oriented investment, and counterbalancing Japan's dominant role as an investor in Indonesia.

Until 1986, Indonesia's development policy had focused inward. Consequently, both DC and LDC investors targeted their investments for the domestic rather than the export market. Since the mid-1980s, this situation has changed as Indonesia has pursued an export-oriented development strategy by deregulating licensing and trade restrictions and encouraging nonpetroleum investment for export. While in the past, Asian FDI, like most FDI, was targeted for the Indonesian domestic market, much of the recent export-oriented investment has been from Asian MNCs.

In regard to counterbalancing the Japanese presence in Indonesia, there exists a problem of tariff bargaining under Indonesia's highly protective trade regime. Foreign investors who introduce advanced technology into Indonesia are able to reap above-normal, monopoly profits. Foreign MNCs are known to condition their investments on whether the government will erect barriers (tariffs, quotas, and licensing restrictions) to prevent competitors from entering the market. This policy has actually increased Indonesia's dependence on FDI by encouraging investments which require large imports of technology and capital.

A more direct solution for this problem would be to deregulate and encourage competition. Although the Indonesian government is beginning to do this, there is still a problem of unequal bargaining power. The DC-

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67. See infra text accompanying notes 127-41. Ironically, it is the very economic success of the ethnic Chinese minority in Indonesia that is the source of racial tension.

68. Related to encouraging exports is the need to promote an Asian economic market. Development of a complementary Asian economic market (rather than a situation in which Asian MNCs compete against each other for Western markets) is in itself a compelling reason for increasing Asian LDC-MNC investment in Indonesia. See infra text accompanying notes 115-20.

69. Export-oriented investments increased from 38% of FDI in 1986 to 72% in 1988. Indonesia's Industry Ministry cited Japan, Taiwan, and Korea as the most promising areas for export oriented FDI. *Indonesia's Repelita V Targets 5% Annual Growth, Stresses Private Sector, Bus. Asia*, Feb. 20, 1989, at 59, 60.

70. H. Hill, supra note 13, at 140.

71. Id.
MNCs may still have the leverage to force Indonesia to accede to unfavorable terms as a condition to FDI.\textsuperscript{72} The emergence of LDC-MNC investment as an alternative to Japanese investment will mitigate the problem of Japanese overreaching by increasing Indonesia's bargaining power.\textsuperscript{73}

\textbf{PATTERN OF ASIAN INVESTMENT IN INDONESIA}

The story of FDI in Indonesian manufacturing is mainly a story of Japanese investment.\textsuperscript{74} From 1977 to 1985, Japanese investment accounted for over seventy-five percent of foreign investment in Indonesian manufacturing.\textsuperscript{75}

\begin{table}
\centering
\begin{tabular}{|l|c|c|}
\hline
\hline
Japan & 52 & 79 \\
United States & 11 & 1 \\
Europe & 15 & 14 \\
Other Asia & 18 & 6 \\
\hline
\end{tabular}
\caption{Foreign Investment* in Indonesian Manufacturing by Country (percentage of total)}
\end{table}

\*Data refers to equity investments (excluding loans)


Similarly, the story of LDC-MNC investment in Indonesia is primarily one of Asian, particularly ethnic Chinese, investment. Of the sixty-four recorded\textsuperscript{76} LDC-MNC manufacturing investments realized in Indonesia between 1967 and 1975, forty-eight of these projects were made by Chinese (Hong Kong, Taiwan and Singapore) investors, and ten were made

\textsuperscript{72} Indeed, tariff bargaining is not the only instance where Japanese investors have used their economic strength to extract or coerce unfavorable terms from Indonesian investment partners. See infra text accompanying notes 102-06.


\textsuperscript{74} H. HILL, \textit{supra} note 13, at 151.

\textsuperscript{75} Id. at 59.

\textsuperscript{76} The data relied upon by Wells and Warren understated the actual number of projects in operation at the time of their research. Wells & Warren, \textit{supra} note 35, at 70 n.2.
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by Southeast Asian (Burma, Malaysia, Philippines and Thailand) investors. 77

Asian investment (excluding Japanese investment) decreased sharply after 1977. 78 This drop in investment may be attributed in part to a saturation of domestic demand for labor-intensive goods which competed with those produced by domestic manufacturers (mainly textiles), more restrictive government investment policies, and the bias of Indonesian trade policy against exports. 79 With regard to the last point, the Indonesian government’s reluctance to promote Chinese export-oriented investment 80 was most likely an additional factor which accounted for the drop in investment.

Characteristics of Japanese Investment

Japanese manufacturing investment in Indonesia is significant in both a static and a dynamic sense: the sheer magnitude of Japanese investment (see Table 4) demonstrates how the Japanese dominate the investment scene. In a dynamic sense, the original development of Japanese FDI marked the beginning of a pattern which is being repeated by the NICs and ASEAN. Japanese investment started out with the characteristics of

77. Id. at 70. Aside from ethnic Chinese investors, the only LDC investors that have established a substantial presence in Indonesia are Indian and South Korean. Thee compared country shares of approved (not realized) manufacturing investment in Indonesia between 1967 and 1981 (in millions of dollars):

<table>
<thead>
<tr>
<th>Country</th>
<th>Investment (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>2,331.0</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>515.7</td>
</tr>
<tr>
<td>United States</td>
<td>306.6</td>
</tr>
<tr>
<td>West Germany</td>
<td>192.5</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>169.8</td>
</tr>
<tr>
<td>Taiwan</td>
<td>134.8</td>
</tr>
<tr>
<td>Singapore</td>
<td>101.5</td>
</tr>
<tr>
<td>Australia</td>
<td>78.9</td>
</tr>
<tr>
<td>India</td>
<td>72.6</td>
</tr>
<tr>
<td>Britain</td>
<td>67.6</td>
</tr>
<tr>
<td>Belgium</td>
<td>60.1</td>
</tr>
<tr>
<td>South Korea</td>
<td>53.8</td>
</tr>
</tbody>
</table>


These figures demonstrate again the predominance of Japanese investors in the manufacturing sector as well as the strong role of the Chinese among the other Asian investors (together Hong Kong, Taiwan, and Singapore account for $752 million). Indian investors appear to exhibit characteristics similar to those of the Asian LDC investors: they have acquired considerable experience in adapting mature technologies to LDC conditions, and draw on ethnic ties in Indonesia to establish ventures. Thee, Indonesia as a Host Country to Indian Joint Ventures, in MULTINATIONALS FROM DEVELOPING COUNTRIES 134, 138 (K. Kumar & M. McLeod eds. 1981). Indian MNCs tend to invest in textiles and metal products. Id. at 141.

78. H. Hill, supra note 13, at 59.
79. See id. at 84.
80. See infra text accompanying notes 135-36.
LDCs—labor-intensive, innovative adaptation of mature technologies—and since then has resembled DC-MNC investment.

Professor Kiyoshi Kojima of Hitotsubashi University advanced the thesis in 1973 that Japanese investment in LDCs, such as Indonesia, “has been undertaken in industries in which Japan has been losing, and the developing host country gaining, a comparative advantage.” (e.g., labor-intensive industries utilizing mature technologies).81 Since this type of investment allows Indonesia to produce goods at a lower cost, it is trade-creating in that it is conducive to manufacturing for export. In contrast, U.S. investment in LDCs is concentrated in industries in which the United States (and not the LDC) has the comparative advantage.82

Some commentators reject the Kojima hypothesis as unsupported by Indonesian data.83 They argue that Japanese investment in fact resembles U.S. investment. Japanese investment is on average more capital intensive than U.S. investment and, like U.S. investment, focuses on the domestic rather than export market.84 Nonetheless, the Japanese have invested in labor-intensive industries such as textiles, automotive assembly, and metal products.85 Hence there is support for the idea that the Japanese invested in industries in which Indonesia was developing a comparative advantage. On the other hand, Japan has also invested in highly capital intensive projects such as the Asahan aluminum and hydroelectric project.86

In reconciliation of these two points, one may argue that “the experience of these early Japanese investors was an intermediate stage in the development of Japanese industry . . . . [T]he giants of Japan are now becoming multinational in very much the same way as the U.S. MNCs.”87 Thus, although Japan exhibits the characteristics of a DC-MNC, perhaps it established an initial foothold in Indonesia by acting more like an LDC investor. Indeed, the investment pattern of the LDC-

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81. This theory is referred to herein as the Kojima hypothesis. For a description of the Kojima hypothesis, see Thee, Japanese Direct Investment in Indonesian Manufacturing, supra note 77, at 97.

82. See id.

83. See H. Hill, supra note 13, at 63-68; Thee, Japanese Direct Investment in Indonesian Manufacturing, supra note 77, at 97-105.

84. Now that Indonesia has reformed its trade regime to encourage nonpetroleum exports, however, Japan is seen as a promising export-oriented investor. See supra text accompanying note 68.

85. Thee, Japanese Direct Investment in Indonesian Manufacturing, supra note 77, at 99.

86. The Asahan project, in fact, accounts for much of Japan's capital-intensive investment. H. Hill, supra note 13, at 68.

87. Lall, supra note 46, at 3 n.1.
MNCs, particularly that of Hong Kong, somewhat resembles the early pattern of Japanese investment.88

An analysis of the impact of early Japanese investment in the textile industry (between 1968 and 1978) on Indonesia's traditional weaving sector demonstrates that the investment greatly benefited consumers, but damaged the traditional sector.89 The conflict between these interests may be described as being as old as technological progress itself. The Indonesian government should increase its assistance to ease structural adjustment (labor displacement) rather than discourage technological development by limiting FDI.90

In summary, one potential problem associated with both Japanese and other Asian investment in manufacturing is that it displaces less efficient, domestic manufacturers. This effect of FDI is in fact the source of political opposition to LDC-MNCs in Indonesia. Other problems associated with Japanese investment in Indonesia are discussed below. These problems are typical of the tensions which arise between DC-MNC investors and LDC host countries.

Problems Associated with Japanese Investment

In 1974, the visit to Indonesia by Japanese Prime Minister Tanaka triggered anti-Japanese riots in the streets of Jakarta. A U.S. journalist who witnessed the riots described the scene:

Mobs of students and young toughs systematically smashed Japanese cars, storefronts of Japanese-related businesses and any other visible signs of the swiftly growing economic inroads of the Rising Sun. I was startled when a group of youths, on learning I was an American journalist, shouted, "America Okay—Japan No Good."91

The rioters were reacting in part to the government's policy of increasing FDI in Indonesia; however, they objected in particular to Japanese economic domination.92

88. H. HILL, supra note 13, at 68, 72.
89. McCawley, supra note 28, at 85-87.
90. Id. at 86-87. As to structural adjustment, McCawley also attributes the problems associated with Japanese competition to Indonesia's traditionally inward-looking manufacturing sector, which until the late 1960s had never faced international competition. Id.
92. H. HILL, supra note 13, at 150.
Public political resistance to the Japanese has faded since 1974, as Indonesia resigns itself to the permanence of Japanese investment. As a political activist later remarked, "We realize now it's too late to diversify, . . . Indonesians and Japanese are 'stuck with each other.'" The suspicious attitude of Indonesian officials toward the Japanese, however, has not faded, but actually may have intensified. Relations between Indonesia and Japan were reported as being more tense in 1989 than they have been since the Japanese military occupation of Indonesia in the 1940s.

There are two aspects to the Japanese problem. The first is the cultural arrogance of the Japanese vis-à-vis the rest of Asia. The second aspect involves typical DC-MNC versus LDC host country conflicts of interest. In discussing the role of Japan in Indonesian development, an important official in the Indonesian government referred to the high potential for mutually beneficial economic relations between the two countries. On the other hand, he cited the Japanese "ruthless, competitive way of life" and its "siege mentality" as impeding Indonesian relations with Japan. He noted in particular a need for attitude adjustment in the Japanese private sector.

In addition, the Japanese, obsessed with everything Western, are notoriously ignorant of their Asian neighbors. This ignorance is deliberate. The Japanese in their quest for modernization have chosen not to focus on Asian traditions which might hinder Western-style modernization. A Japanese linguistics professor, Suzuki Takao, notes how the Japanese educational system has implemented a national policy he refers to as: "Quit Asia, look to the West." For example, there are almost no opportunities to learn an Asian language at the junior or senior high school level in Japan. At the university level, only a few languages are offered at a few institutions.

Indonesian resentment of the Japanese, therefore, might be attributed either to Japan's perceived role as economic aggressor in Asia or to Japa-
inese insensitivity to Indonesian culture. In addition to these factors, Japanese investment carries with it some of the problems inherent in DC-MNC investment. As already noted, Japanese investment in many respects resembles U.S. investment in terms of its capital intensity. Japanese investments in raw material sectors have depleted Indonesia's natural resources and incurred environmental damage. The Japanese also use their superior bargaining power vis-à-vis the Indonesians to structure deals which further Japanese interests at the expense of Indonesia's development objectives. The Japanese, for example, are prone to engage in tariff bargaining.

Another example of how the Japanese exploit their bargaining advantage over the Indonesians is through "tied loan arrangements." Japanese-Indonesian ventures are typically package deals: the Japanese lend money for the venture, provided that raw materials, components, equipment and other inputs for which the loans are needed are purchased from Japan. Hence, even if Indonesian partners could obtain cheaper inputs elsewhere (e.g., machine parts from Taiwan), they would not have the bargaining power to negotiate for such inputs because of the terms of the loan contract.

99. See supra Table 2. Another problem of Japanese investment is that it tends to locate in Java so that the benefits of industrialization do not extend far in a geographic sense. Of 140 Japanese manufacturing projects located in Indonesia in 1981, only 20 of these were located outside of Java. See Thee, *Japanese Direct Investment in Indonesian Manufacturing*, supra note 77, at 100.

One of Indonesia's most pressing developmental objectives is to promote industrialization of the country's outlying areas. From 1981 to 1986, the Indonesian government implemented a massive transmigration program to relocate over two million people from densely populated regions around Java to outlying areas. See generally *The World Bank, Indonesia: The Transmigration Program in Perspective* (1988).

Note, however, that Japanese, or even LDC, firms are not unique in their preferences of locations. Both DC and LDC investors seek to locate where there are infrastructural and urban amenities. See, e.g., *Thee, Indonesia as a Host Country to Indian Joint Ventures*, supra note 77, at 142 (citing the tendency of Indian investors to locate in Java).

100. See Utrecht, *supra* note 24, at 94-95. Utrecht describes the depletion of Indonesia's natural resources and its harmful effects on the indigenous people. In Kalimantan, Japanese MNCs (as well as other MNCs) have expanded tree cutting operations with little outside supervision or provision for reforestation. In the Moluccas islands, the Japanese fishing industry has deprived the local population of its tuna fish, and thus degraded the people's traditional diet. *Id.*

101. See *supra* notes 70-71 and accompanying text.


103. See *id*.
Even when Japan gives aid to Indonesia, it attaches conditions on that aid which run counter to Indonesia's interests. In 1968, the Inter-Governmental Group Indonesia (IGGI) granted to Indonesia a series of loans intended to stabilize the economy and rehabilitate the country's infrastructure. Japan required that seventy percent of its loan be used for the import of Japanese consumer goods as specified by the Japanese government. The Japanese also have a reputation for financing environmentally and developmentally unsound projects that further Japan's economic interests. The World Bank staff at times threatens to withdraw from projects and let the Japanese step in. The Japanese reputation in funding development projects is so bad that the threats work. "[N]o one wants to see a project with Japan as the sole lender."

Recently, the Japanese share of FDI in Indonesia dropped behind that of West Germany, the United States, the Netherlands, Hong Kong and Taiwan. Although there are a number of reasons for the drop in investment, part of the problem is that relations between the Indonesians and the Japanese are strained due to the problems mentioned above. An increased role for other Asian LDC investors would allow Indonesia to diversify and thus mitigate Japanese influence.

**Asian LDC-MNC Investment**

This article has already discussed the ways in which Asian LDC-MNCs may benefit Indonesia: innovate by adapting technology to Indonesia's needs; produce cheaper and more appropriate consumer goods; counterbalance Japanese economic power; link Indonesia to overseas (especially Chinese) marketing networks; and conserve foreign exchange by utilizing less expensive and/or local inputs. These benefits, however, should be weighed against the potential problems associated with Asian LDC-MNC investment.

Academics have questioned whether LDC-MNCs can survive in a competitive market and thus alter the host countries' dependence on DC investors. Some argue that LDC-MNCs will not change the fundamental

104. The Japanese government has provided Indonesia with massive amounts of foreign assistance. In 1989, Indonesia had over $11 billion of outstanding aid credits from Japan. Brown, supra note 94, at 34. This aid is motivated in part by Indonesia's importance to Japan, both strategically (as a trade link to the Middle East) and economically (as a source of raw materials). See id.

105. Utrecht, supra note 24, at 84-85.


107. Brown, supra note 94, at 34.

108. Causes include saturation of the Indonesian market for Japanese goods and calls from the Indonesian government to the Japanese for debt relief. See id. at 34.
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dependence of the South on the North because LDC-MNCs cannot compete against DC-MNCs:

[T]he postulated competitiveness of the LDC multinationals is based on the fact that they produce in market niches or markets ceded to them by the IC [(industrialized country)] multinationals . . . . The management of the small multinationals of the LDC will find that its special knowledge of the conditions of the developing countries will not be appropriate to deal with the more complicated situation of growing and diversifying markets nowadays.109

This argument assumes first, that LDC-MNCs' competitive advantages are easily matched and bettered by DC-MNCs; and second, that LDC-MNCs are incapable of competing in complex markets. As this article has demonstrated, LDC-MNC innovations are not easily copied by DC-MNCs because of the nature of technological change.110 Indeed, LDC-MNCs produce a range of sophisticated products.111 As to competing in complex markets, the passage cited at the beginning of this article illustrates the remarkable success of Asian LDC-MNCs in competing with, and even surpassing, U.S. and European MNCs. The value of shares traded on Taiwan's stock exchange, for example, now surpasses that of shares on the London exchange.112

Even the less-developed ASEAN countries are advancing rapidly. In 1989, the ASEAN countries grew at a rate of 7.4 percent, over twice as rapidly as the Organization for Economic Cooperation and Development (OECD) countries, which grew at only 3.4 percent.113 Asia's success in export-led development, however, has depended on the existence of Western markets for Asian exports. Today, as Western markets become more protectionist, economists fear that export-led growth will be less feasible. A basic criticism of an export-led development strategy is that it increases LDC dependence on Western markets. Therefore, it is questionable whether LDC-MNCs will succeed in the future in pursuing export-led

110. Supra text accompanying notes 44-47.
111. Lall, supra note 46, at 16-17.
113. Id.
growth. Historical growth rates may not necessarily continue in the future.114

A more difficult question regarding the Asian LDC-MNCs' ability to alter Indonesia's dependence on DC-MNCs is whether Asia is capable of developing a complementary trade market to mitigate its dependence on Western markets. The Asian countries have not been as successful as Europe in forming a regional trade market. Although ASEAN was originally formed as a trade organization, its main successes to date have been political rather than economic.115

This failure may be attributed to the competitive (rather than complementary) relationship between ASEAN economies.116 Due to the past colonial relationships between ASEAN and the West, ASEAN economies have been more closely integrated with those of the DCs than with each other's. In order to achieve economic cooperation, therefore, ASEAN first needs to disintegrate its traditional ties with DC economies and then to reintegrate by redirecting economic activities toward the region.117

Although ASEAN does indeed depend heavily on DC export markets, OECD protectionism is not in itself an argument to abandon an export-led strategy.118 ASEAN economies may find future export markets in the NICs when the NICs become net importers of ASEAN-manufactured goods.119 FDI by the NICs will facilitate economic integration by relocating mature industries from the NICs to ASEAN, thus easing competition.120

114. Wohlmuth, supra note 4, at 214.

115. The Prime Minister of Malaysia, Datuk Seri Dr. Mahathir Mohamad, admitted in 1985 that "while ASEAN . . . made significant achievements in the fields of political, cultural and social cooperation, in the field of economic and trade cooperation, the achievement has been mediocre or worse." Straits Times (Singapore), Feb. 8, 1985, cited in Wong, ASEAN's Experience in Regional Economic Cooperation, 3 ASIAN DEV. REV. 79, 95 n.19.

116. Id. at 88-89.

117. Id. at 96.

118. M. ARIFF & H. HILL, supra note 27, at 58. They point to the fundamental fact that in spite of DC protectionism, penetration of LDC exports into DC markets continues to increase. In fact, from 1970 to 1980, DC consumption of LDC exports of manufactured goods doubled from 1.7% to 3.4%. Id.

119. Id. at 59-60.

120. See id. at 59. Ariff and Hill also make note of the China factor, i.e., the People's Republic of China as a tough competitor for ASEAN in the area of exports. Id. at 60-61. In fact, before the crackdown in June, 1989, Indonesia viewed China simultaneously as a competitor for FDI, a market for Indonesian exports, and a potential recipient of Indonesian investment. The two countries had engaged in negotiations to set up joint ventures in medicine, machine tools, and steel. See What ASEAN Members are Poised to Gain in the Wake of June 4, BUS. ASIA, Jul. 17, 1989, at 234, 235.
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The chief economist at the Asian Development Bank, HakChung Choo, predicts that Asia’s development path will follow a flying goose pattern. Unlike Latin America with its enclave economies, Asian industries will shift to LDC economies as DC economies mature.\textsuperscript{121} Asia has already begun to move in this direction. In recent years, investment by the NICs in ASEAN has rivaled that of Japan. For example, in 1988, Taiwan invested two billion dollars in ASEAN (Thailand, Malaysia, Indonesia and the Philippines) and now competes with Japan as the largest investor in the region.\textsuperscript{122} Although this investment surge may slow somewhat as Western countries become more protectionist, recent investment patterns reflect fundamental changes in the structure of the Asian economic market:

Japanese production of simple electrical goods . . . has been shifted almost entirely to the NICs and ASEAN, while lower-level industries, such as textiles and clothing, are moving from the NICs to ASEAN. . . . Products will become increasingly categorized in terms of their value-added and technological sophistication, and then assigned to the best-fitting export platform in Asia.\textsuperscript{123}

As Japan and the NICs open their economies to ASEAN exports, Asia may depend less on Western markets. Intra-Asian trade has been increasing at a rate of thirty percent per year, and is predicted to surpass Asian-U.S. trade by 1991.\textsuperscript{124} This development was encouraged in part by U.S. pressure on Japan to open its market to Asian exports. Now, ironically, the United States finds itself being shut out of the Asian market.\textsuperscript{125} In short, it appears that the economic dilemma earlier described has changed: ASEAN is beginning to naturally disintegrate its economic ties to the West as it moves toward regional economic cooperation.

A second problem related to Asian LDC-MNC investment is that it displaces traditional manufacturing. Local resistance to Chinese investment may in some ways be more intense than resistance to FDI in general because its short-term effects are direct and obvious. Because LDC-MNCs have a comparative advantage in smaller scale, labor-intensive

\begin{itemize}
  \item \textsuperscript{121} Lowenstein, *The Yen Propels Asia’s Own Rising Sun*, \textit{Euromoney}, Special Supp., May 1989, at 2, 19.
  \item \textsuperscript{122} Tanzer, \textit{supra} note 73, at 49.
  \item \textsuperscript{124} Yang & Gross, \textit{supra} note 12, at 44.
  \item \textsuperscript{125} \textit{See id.} at 43.
\end{itemize}
production, they compete more directly with local manufacturers than do other MNCs. This article has already noted, for example, the labor-displacing effect of Japanese investment in the textile industry. Labor displacement, however, should not be a reason for protecting less efficient manufacturers at the expense of discouraging LDC-MNC investment.

The ongoing conflict between Indonesia’s *pribumi* class and the country’s ethnic Chinese minority further illustrates this problem. Although *pribumi* hostility toward the ethnic Chinese may be rooted in political factors, it is undoubtedly rooted in economic factors as well. Although the ethnic Chinese make up only 2.1 percent of Indonesia’s population, they control seventy-five percent of Indonesia’s domestic capital. *Pribumi* entrepreneurs in Indonesia believe that the Chinese dominate the country through a “tight and allegedly impenetrable network of credit and personal ties” which places the *pribumi* at an economic disadvantage.

Ever since Indonesia achieved independence, the government has responded to *pribumi* nationalist pressures to equalize the gains of economic development by granting concessions to the *pribumi* class. In many cases, these concessions discriminated against foreign investors, particularly overseas Chinese investors, in an effort to promote *pribumi* enterprise. Some examples:

- In 1951, the government required each foreign importer to pay deposits of five million rupiah, forcing over one thousand Chinese importers to close down.

- In 1977, Indonesia’s trade minister announced that sixteen thousand alien Chinese would be forced to sell their businesses to *pribumi* by the end of the year.

126. *Supra* text accompanying notes 89-90.


131. *Id.* at 174.
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- In the early 1970s, a number of Hong Kong MNCs proposed to manufacture and export a range of goods, including electronics, clocks, toys and plastics. The Indonesian government turned down these proposals, hoping that pribumi entrepreneurs would take up these ventures themselves. The ventures, however, never materialized.

In adopting these policies, the Indonesian government is addressing a strongly held belief among pribumi that the Chinese minority and foreign investors control a disproportionate amount of the country’s wealth. There are a number of reasons, however, why these nationalist policies may set back Indonesia’s economic growth without meeting the government’s objective of equalizing the gains of development. First, some of the measures are easily circumvented by foreign investors. For example, MNCs often get around the majority ownership requirement by resorting to dummy shareholding: the foreign investor lends the Indonesian partner the amount needed to purchase the shares, and the local partner repays the foreign loan with the dividend stream. Sometimes the foreign investor even bribes local pribumi for the use of their names as shareholders. These bribes consist of land, old factories, or even under-the-table money.

Second, nationalistic policies actively discourage the very investment which may be most beneficial to Indonesia’s development. One possible reason for Indonesia’s relatively indifferent economic performance vis-à-vis the NICs and Singapore has been the Indonesian government’s failure to utilize ethnic Chinese material, financial, and human resources. “Failure to use [these resources] at a time when foreign capital and technology are being eagerly sought is irrational, if not perverse.”

The most recent example of Indonesian economic nationalism is the share distribution initiative that the government announced this year. The directive, which applies to all foreign and local companies, requires these companies to lend money to rural credit cooperatives so that the cooperatives can purchase company shares. (Ironically, the directive works like the dummy shareholding scheme described above; the cooperative is supposed to repay the loan with the dividend stream.) Of the six thousand

133. See Wells & Warren, supra note 35, at 83-84.
134. See Thee, Japanese Direct Investment in Indonesian Manufacturing, supra note 77, at 101-02.
135. Y. Wu & C. Wu, supra note 130, at 108.
cooperatives established in Indonesia, however, approximately one-half are either insolvent or are bordering on insolvency.  

The nationalist policies that the government proposes do not directly address the problem of income distribution. Those who need the wealth the most are the forty-seven percent of Indonesians who are underemployed or unemployed.  

The most direct means of redistributing wealth would be to focus on labor-intensive social development programs to create irrigation, schools, and other infrastructure in rural areas. Moreover, there are effective ways of subsidizing pribumi entrepreneurs without discouraging foreign (particularly Chinese) investment. For example, the government might purchase an interest in a shopping center, and turn space over to pribumi at discounted rents. However, in the long run, subsidizing inefficient enterprise is a relatively ineffective means of achieving economic growth.  

A final criticism of LDC-MNC investment is that it incurs the same environmental and social costs as does other foreign investment. In the Indonesian timber processing industry, for example, concerns about resource depletion apply equally to Japanese and other Asian investors. In addition, labor-intensive, export-led investment, particularly that in the export processing zones (EPZs), has been characterized as exploitative of labor.  

Overall, the gains of FDI have been spread unevenly among Indonesians, regardless of the source of investment. Indonesia's recent push for export-oriented investment has resulted in increased FDI. However, critics claim that the benefits have accrued to Indonesia's ethnic Chinese minority. In fact, the recent share distribution initiative was motivated by

137. Id.  
138. See Soehoed, supra note 95, at 56.  
139. See McCawley, supra note 28, at 91-92 (recommends against pribumi subsidies).  
140. See supra note 100 and accompanying text.  
141. Utrecht describes how in the 1970s, employers in EPZs exploited their workers:  

There were extremely low wages, ... very long working hours, ... inadequate medical care and often no payment of wages during sickness of longer than one week, ... no pensions, no right to strike, ... a large number of industrial accidents, and inadequate protection against pollution and industrial diseases.  

Utrecht, Gains and Losses in 25 Years of Export-Oriented Industrialization in South and South East Asia, in 7 TRANSNATIONAL CORPORATIONS IN SOUTH EAST ASIA AND THE PACIFIC 154 (E. Utrecht ed. 1985). Labor conditions improved only after a number of international organizations pressed for change. See id.  
142. See supra note 136 and accompanying text.
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such claims. In short, problems of Asian LDC-MNC investment (environmental damage, harsh labor conditions, unequal gains) are essentially the problems of pursuing a purely export-led development strategy. Some commentators have suggested adopting an agricultural demand-led strategy to address these problems.

If Indonesia developed agriculture-related industries, the country could increase its productivity in agricultural production, develop linkages between agriculture and consumer goods sectors, increase labor-intensive production and decentralize economic development geographically. Indonesia could pursue this strategy by increasing public investment projects. Note that a key difference between this approach and Indonesia’s past import-substitution strategy is the absence of export disincentives (i.e., there would be no trade protection to shield domestic industry from foreign imports). This approach would be particularly suitable for Indonesia’s agricultural economy.

To date, FDI in the agricultural sector has been negligible. LDC-MNCs, with their comparative advantage in innovative, labor-intensive production methods and flexibility to local conditions, would be well-suited to play a role in an agricultural, demand-led development strategy.

REASSESSING DIFFERENCES BETWEEN LDC-MNCs AND DC-MNCs

The preceding discussion of problems related to LDC-MNC investment highlights the similarities between LDC and DC investors. Academics have questioned whether LDC-MNCs differ in any significant way from DC-MNCs in terms of the toll they exact from host countries. The evidence presented in this article demonstrates, however, that Asian MNCs pose some but not all of the problems that traditional DC-MNCs

143. In discussing the motive behind the share distribution initiative, a journalist observed how the recent government reforms that “kick-started Indonesia’s now booming economy” have helped the haves much more rapidly than the have-nots. Pisani, supra note 136. She singled out ethnic Chinese business conglomerates as comprising the haves. Id.

144. Wohlmuth, supra note 4, at 214-15.

145. Id.

146. See Soehoed, supra note 95, at 49 (contrasting Indonesia’s economy with those of the NICs and concluding that Indonesia should not copy the NICs’ pure export-led development model).

147. From 1967 to 1977, the agriculture, forestry, and fisheries sectors accounted for only five percent of realized FDI. The figure for the 24-year period (from 1967 to 1985) was even smaller (one percent). This figure includes both DC and LDC investors. H. Hill, supra note 13, at 81, table 5.1.

148. Chishti concludes that “in the final analysis all the MNCs of the Third World cast themselves in the mould of the MNCs of the North. . . Therefore, to expect a very different behavioural pattern of the Third World MNCs is unrealistic.” Chishti, supra note 13, at 110; see also Green, supra note 73, at 50-53.

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pose. The gains of LDC investment may accrue disproportionately to a minority. LDC-MNCs may not be inherently inclined to act in Indonesia's best interests. LDC-MNCs do tend, however, to invest in ways which complement Indonesia's factor endowments. Moreover, LDC-MNC investment lessens Indonesia's traditional dependence on Western and Japanese investors.

The LDC-MNCs of today may become the DC-MNCs of the future. Ethnic Chinese investors from Singapore, Hong Kong and Taiwan are becoming more like Japanese investors.\textsuperscript{149} In the long run, some predict that LDC- and DC-MNCs will dominate in specific areas as a division of labor between them develops.\textsuperscript{150} Asia's flying goose development pattern illustrates this idea. To the extent that Asia's investment resembles the flying goose pattern (assigning production to the proper Asian export platform), the line between DC and LDC investor blur.

\textbf{CONCLUSION}

The questions this article raises could be summarized as follows: (1) Does FDI promote economic development? (2) Is investment from the NICs and ASEAN a better alternative or a necessary complement to Japanese and Western investment? (3) If the answer to (2) is affirmative, should the Indonesian government take measures which favor investment from the NICs and ASEAN over other forms of investment? (4) How can Indonesia effectively equalize the gains of FDI?

This article has attempted to demonstrate that increased intra-Asian investment is net beneficial to Indonesia: it draws on a network of commercial ties among ethnic Chinese in Asia and counterbalances Japanese economic domination. To the extent that Asian LDC-MNCs begin to invest in export-oriented manufacturing projects, such investment will be trade-creating under Kojima's hypothesis. To the extent that Asian LDC-MNCs' comparative advantages are based on innovations of mature technologies, such investment develops areas in which Indonesia is gaining, and LDC-MNCs are losing, a competitive advantage. Perhaps Indonesia's underlying trade and investment policy (as it affects all foreign investors) is more important than directly encouraging the investment of LDC investors over other investors.\textsuperscript{151}

\textsuperscript{149} A journalist describes how the Taiwanese are becoming more receptive to Japanese influence: "From 1895 to 1945, Japan occupied Taiwan by force. It does so now with commerce and culture." Tanzer, supra note 73, at 52.

\textsuperscript{150} See Wohlmuth, supra note 4, at 236.

\textsuperscript{151} This is the conclusion Hill reaches. H. Hill, supra note 13, at 53.
On the other hand, the differences among foreign investors are significant. The government should recognize the value of balancing Japanese investment with Asian LDC-MNC investment. To this end, the government should not actively discourage this investment in an effort to appease political demands for economic equality. There are more effective ways to distribute wealth, for example, than through Indonesia's share distribution initiative.

The Indonesian government should not discourage ethnic economic ties, but rather should ease economic adjustment of harmed groups. To equalize distribution of economic gains, rather than subsidizing on the basis of racial origin, the government might: encourage rural investment to promote development in outlying areas and shift labor out of the unproductive traditional sector; create jobs via state infrastructure projects; or increase social welfare programs. Indeed, the government might adopt policies to promote LDC-MNC investment in rural areas, since LDC investment is typically targeted at smaller, less industrialized markets.

Regardless of whether a foreign investor is from a DC or an LDC, many of the problems of FDI are the same: destruction of the environment, uneven development, and freezing out of *priyumi* manufacturing. These problems can only be addressed with uniform government policies. There are other problems associated with DC-MNC investment, however, which LDC-MNCs do not pose (e.g., overuse of foreign technology and inputs; unequal bargaining power). It is in these areas where increased LDC-MNC investment can make a difference.

The foreign investment activities of Japan, the NICs and ASEAN have shifted the economic balance between North and South. To the extent that this has changed the traditional core-periphery relationship between the United States/Europe and Indonesia, this investment activity is good for Indonesia; but to the extent that Japan and even the NICs exhibit the traits of a DC investor, we are no longer talking about South-South investment.

Will the Asian experience be repeated in other developing regions such as Africa or Latin America? Maybe not: LDC-MNCs are not homogeneous, but reflect cultural, economic, and other differences of the LDC home country. The learning environment of LDCs differ; therefore, different LDC countries will produce different types of MNCs.\(^2\) In spite of its problems (environmental damage, unequal gains), the overall success of Asian LDC-MNC investment, in the face of a general decrease in FDI from the industrialized world, may nonetheless serve as an inspiration to other developing regions.

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