ACCUMULATION AND REPRODUCTION IN INDONESIA:

A CASE STUDY OF AUSTRALIAN INVESTMENT.

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SUMMARY OF THESIS

The main objective of this thesis is an analysis of the effect of state policy and direct Australian investment on the content and rate of economic change in Indonesia. "Radical" literature of underdevelopment has tended to adopt a framework of analysis less rigourously Marxist than that preferred by the author: the more traditional Marxist categories far better serve the needs of analysis of underdevelopment, and of consequence have been used extensively throughout the thesis.

Since the coup of 1965 and the installation of the New Order government, the growth of the foreign-owned, capitalist sectors of the Indonesian economy has been occurring at a far greater rate than that of the traditional sectors. The policies of the post-colonial state have been directed toward facilitating the growth of the capitalist sectors, at considerable expense to the traditional; yet the implementation of these policies designed to assist foreign capital penetration of the economy results in the generation of contradictions within society.

Within the light manufacturing sector of the economy, a number of direct investments have been implemented through joint-venture arrangements, by Australian companies. A major part of the thesis is devoted to an analysis of the reasons for this movement of capital from Australia to Indonesia and as well of the effects generated by the investments. These latter involve consideration of the foreign exchange costs of investment, the generation of employment, the transfer of technology, the production of commodities, the market served, the character of the joint-venture partners and other related issues. Material for the thesis was collected during field work conducted in Jakarta from May to September 1975.

Finally the thesis seeks to comment on the industrialisation process, in Indonesia, to determine the nature of economic change and the type of capitalist growth that is occurring there.

AUTHOR'S STATEMENT

The conclusions of this thesis are my own, and to the best of my knowledge the thesis contains no material previously published or written by any other person except where indicated in the text.

ACKNOWLEDGMENT

My thanks go especially to Professor Bruce McFarlane. Of the many who assisted and encouraged me in this endeavour I can mention only a few: Dr. R. Catley, Professor H.W. Arndt, Professor E. Utrecht, and the managers of the Australian parent firms and their subsidiaries in Indonesia without whose cooperation the thesis could not have been written.

ABBREVIATIONS

ADB	The Asian Development Bank
ADC	Agricultural Development Council (formerly Council on Economic and Cultural Affairs)
AFR	Australian Financial Review
AIBCC	Australian-Indonesian Business Cooperation Committee
BCAS	Bulletin of Concerned Asian Scholars
BIES-SRD	Bulletin of Indonesian Economic Studies (ANU) Survey of Recent Developments
CAB	Current Affairs Bulletin (Australian Department of Foreign Affairs)
CEDA	Committee for the Economic Development of Australia
CJWB	Columbia Journal of World Business
CKD	Completely Knocked Down
DKI	Municipality of Jakarta
EIU	Quarterly Economic Review: Indonesia (The Economist Intelligence Unit)
EKI	Ekonomi dan Keuangan Indonesia
FAO	Food and Agricultural Organisation (of the United Nations)
FEER	Far Eastern Economic Review
IBRD	International Bank for Reconstruction and Development (World Bank)
ICP	Industry Cooperative Program
IGGI	Inter Governmental Group on Indonesia
ILO	International Labor Organisation
IMF	International Monetary Fund
JCA	Journal of Contemporary Asia
NLR	New Left Review
PRWET	Pacific Research and World Empire Telegram
RIMA	Review of Indonesian and Malaysian Affairs
SEADAG	Southeast Asia Development Advisory Group (The Asia Foundation)
UN	United Nations
US	United States of America

NOTES

Indigenous capitalist classes:

This term is used extensively throughout the thesis and refers to all members of the bourgeoisie; it thus includes both Indonesians of Chinese and ethnic Indonesian origin.

Capital-intensive technology:

Throughout the thesis it will become clear to the reader that the author is not well disposed towards the use of capital-intensive technology in Indonesia, except in those cases where it is absolutely unavoidable. The problems that beset policy makers in Indonesia are immense, and one of the greatest, now and in years to come, is that related to the size of the work force and its growth rate, coupled with the demonstrated incapacity of investments to generate employment at a sufficient rate to absorb the ever-increasing number of entrants into the work force. Consequently, the author is perhaps prone to stress rather too much her aversion to the widespread use of capital-intensive technology; but the extremely serious nature of Indonesia's unemployment and underemployment problem have generated this response.

On reading the thesis:

In keeping with accepted practice, the chapter dealing with the relevant literature on economic growth has been placed at the beginning of the thesis. However, it is suggested that the readers concern themselves initially with Chapters Two, Three and Four, which deal with the activities of the state and private foreign capital as they exist in Indonesia at present. The relevance of the material presented in Chapter One will then become clearer.

CHAPTER ONE

INTRODUCTION

The objectives of this chapter are twofold. Firstly it seeks to establish the decline in popularity of state planning as the crucial element in development strategy, and to establish that this decline has been accompanied by the growing acceptance of the capacity of the private sector to engender economic development in poor countries. To accomplish this it is pertinent to offer some historical background to the evolution of Indonesian economic policy since 1949. Particular reference will be made to the changing perspectives on the roles of state and private capital in the process of economic change, and as well to those theories of economic development that have emphasised respectively the crucial role of planning and of private sector investment in economic development. Furthermore a brief examination of New Order economic policy will reveal a significant degree of acceptance of this renewed emphasis on the crucial role of private foreign investment in development.

The second objective of Chapter One is to establish the nature of the effects of direct private foreign investment in poor countries as proposed by cost-benefit analysis and the theory of the multiplier as adapted by economist Puthucheary.

CONTENTS

PART ONE:

At its most general level, this thesis is concerned with the nature of the industrialisation process in Indonesia. The two major areas of enquiry are the economic policies of the New Order government and the nature and effects of direct Australian investment in the economy. As a consequence, the focus of the following discussion of "development" theory is one which directly complements these two areas of enquiry. The thrust of this chapter then, involves consideration of the nature and function of state planning and the role of private sector investment in economic development. A further objective is to highlight the various interpretations that surround the themes of state planning and foreign investment. The suitability of confining the discussion within these parameters is further reinforced by consideration of the history of Indonesian economic policy. Yet a detailed review of the post-colonial period is not warranted here, since the major consideration is not the economy as such, but the ideological changes reflected in the various policies pursued since independence was won in 1949. Consequently the following section offers only a brief synopsis of the major areas of conflict between the two dominant political groupings of the period, the focus of that conflict being the debate over the nature and function of state planning and the role of foreign investment in economic development.

POST-REVOLUTIONARY INDONESIA: IDEOLOGY AND ECONOMIC POLICY

During the period 1950-1957, a major concern of all political groups within Indonesia was the debate over the respective roles of the state and private capital (especially foreign capital) in the development of the economy. Those early years of the republic were marked by "the dispute between those who saw the private sector as the key to a new Indonesia, and those who preferred an economy in which the state played the predominant role."[1] The situation is put precisely by Kahin who argued that

> ...the beginning of the post-revolutionary period found the leaders of all important political groups, except the Communists, dedicated to the achievement of roughly the same sort of socio-economic system, namely a mixed economy — cooperative, socialist, and capitalist — with primary emphasis on the cooperative sector. Secondary emphasis was ultimately to be placed on the socialist portions. However, it was generally agreed that the importance of the capitalist sector of the economy would remain substantial for some time to come, both because of the desirability of temporarily maintaining, if not augmenting, foreign capital investment and, as a result, the inability of the state to move directly much farther into the economic sphere because of the small number of Indonesians sufficiently trained for staffing socialistic enterprises. <u>A somewhat greater difference of opinion existed regarding long-term aims, especially as to how much emphasis was to be put on increasing the socialist at the expense of the capitalist sector of the economy.</u> (Emphasis added.)[2]

The progress and complexity of subsequent changes in economic policy is well documented in a comprehensive article by Glassburner where a review of the literature concerned with the nature of the differences between the major contending groups is undertaken.[3] The period is

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[1]<u>CEDA</u> P Series II, Panglakim, Y. and Thomas, K.: "Indonesia — The Effects of Past Policies and President Suharto's Plans for the Future", Melbourne, November 1973. See especially Chapter Two, "Government Policy and the Search for an Economic System, 1950-57". [Hereafter cited Panglaykim and Thomas (CEDA P Series II).] See also Douglas Paauw's chapter "From Colonial to Guided Economy" in McVey, R.T. (ed.): <u>Indonesia</u>, Southeast Asia Studies, Yale University, HRAF Press, New Haven, 1967, pp. 206-207. Paauw discusses the situation in some detail and concludes that "(p)ublic argument revolved about the central issue...for more than one decade after the Indonesian declaration of independence in 1945." See also Paauw's Footnote 129.

[2]Kahin, G.M.: <u>Nationalism and Revolution in Indonesia, 1950-1957</u>, Cornell Paperback, Cornell University Press, Ithaca and London, 1970 (first published 1952), p. 476.

[3]Glassburner, B.: "Economic Policy Making in Indonesia, 1950-1957" in Glassburner, B. (ed.): <u>The Economy of Indonesia</u>, Cornell University Press, Ithaca and London, 1971.

analysed in terms of the formation and implementation of economic policy, and divided into two sections. The first was marked by the ascendancy of the pragmatic, conservative or development-minded policy makers, the second by those identified as ultra-nationalists, history-minded and socialist, including Sukarno[4]: "The former turned out to be essentially Western-oriented, and the latter to be 'a mixture of communists and a large number who are nationalist, conservative (in Western terms), and isolationist.'"[5] As Glassburner makes clear, there have been numerous theses offered which seek to crystallise the major differences between these two contending groups. John Sutter identified the two periods as the "Masjumi" and the "PNI", the first ending with the fall of the Wilopo Cabinet in June 1953, and followed by the ascendancy of the "less tolerant ultra-nationalist and socialist politicians."[6] The former were concerned to implement an economic policy that sought to live with, rather than radically change, the established economic structure. According to Panglaykim and Thomas, the three important figures of this period were Hatta, Sjafruddin and Sumitro, all of whom tried to introduce an economic policy that preserved the status quo, and rendered private foreign investment indispensable to Indonesia's economic development. However, it is clear that even within this group there existed a variety of opinions as to the respective roles of the state and private capital.[7]

"Sjafruddin wanted to minimise the role of the state as the leader of development"[8] and relied heavily on private enterprise,

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[4]Glassburner adopts the terminology of Benjamin Higgins, developed in his publication Indonesia's Economic Stabilisation and Development, Institute of Pacific Relations, New York, 1957.

[5]Higgins quoted in Glassburner, op. cit., p. 73.

[6]ibid., p. 72. Glassburner quotes Sutter, J.O.: "Indonesianisasi, Politics in a Changing Economy, 1940-1955", Data Paper No. 36, Department of Far Eastern Studies, Southeast Asia Program, Cornell University, Ithaca, New York, 1959, p. 1190.

[7]Panglaykim and Thomas (CEDA P Series II), op. cit..

[8]ibid., p. 45.

particularly foreign investment as a solution. Sumitro, however, whilst in agreement with the necessity of accommodation within existing economic reality, was to the left of Sjafruddin in that he urged the implementation of strict controls on the content and direction of private foreign investment.[9] It was the existence of a wide variety of opinions within the two major political groupings that makes Sutter's analysis of the period, based on party lines, unacceptable. As Glassburner observed, "socialism was basic to the political ideology of virtually all shades of the Indonesian spectrum."[10] Similarly, Vlekke, writing in 1957, observed that although the distinction between the two groups was between the pragmatic realists, the development-minded economists, and the political nationalists, they were not of distinctly right and leftwing ideology respectively. Leading figures from the socialist party belonged to the pragmatic or "accommodationist" group, whilst in the second were many conservative muslims.[11] However, it must be remembered that central to the dispute between the two were the overriding questions concerning the future direction of the economy, particularly in regard to the issue of continuing Dutch ownership and control of key sectors, and as well the problems posed by the unequal position of the indigenous and non-indigenous capitalist classes. There was little dispute over the necessity of state involvement in economic activity (with a few noticeable exceptions like Sjafruddin); the crucial issue related to the extent

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[9]For an example of Sumitro's attitude to foreign investment see _Ekonomi dan Keuangan Indonesia_, April 1953. See also Glassburner, _op. cit._, p. 81, for a comparison of the ideas of Sjafruddin and Sumitro.

[10]Glassburner, _op. cit._, p. 72.

[11]Vlekke, B.H.M.: _Indonesia in 1956: Political and Economic Aspects_, report prepared for The Netherlands Institute of International Affairs, The Hague, 1957. Ben Anderson identified the division as being between the "autonomists" (the Ali Cabinets) and the cooperationists (Sukiman and Harahap Cabinets). Anderson, B.: _American Values and Research on Indonesia_, paper delivered to American Association of Asian Studies Conference, March 1971.

and the nature of this involvement. There was agreement at a very general level, of the necessity of reducing the foreign influence in the economy, and promoting socialism, but dispute over the speed of this process, and the character of the economic institutions that were to be developed, were central to the differences between the two groups.[12]

The importance of the dispute is highlighted by its contribution to the chronic instability that characterised Indonesian politics in the post-revolutionary years. Glassburner summarises the situation by asserting that, "from the point of view of economic policy, the years 1950-1957 in Indonesia are best understood as years of a hopeless losing battle on the part of a very small group of pragmatically-conservative political leaders against an increasingly powerful political opposition of generally radical orientation."[13] This latter group which included the "mass leaders"[14], based their power of opposition to the early cabinets on the fact of the "continued existence of entrenched Dutch economic interests, and in the economic impotency of the Indonesian elite in general."[15] In Glassburner's words again, their "position of strength...was eroded by a continued discrepancy between expectations and performances, a discrepancy which was, in large measure, the result of the efforts of the so-called mass leaders themselves, who were able to make ready use of the anti-Dutch, anti-liberal sentiments that were so deeply rooted in the community."[16]

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[12]Paauw, op. cit..

[13]Glassburner, op. cit., p. 71.

[14]ibid., p. 77. Glassburner adopts Herb Feith's terminology developed in "The Wilopo Cabinet, 1952-53: Turning Point in Post-Revolutionary Indonesia", Cornell Modern Indonesia Project (monograph series), Cornell University, Ithaca, New York, 1958.

[15]ibid., p. 76.

[16]ibid., p. 77. Glassburner relies again on Feith's analysis. For a comprehensive study of the decline of the "conservatives" and the rise of the "radicals" see Feith, H.: The Decline of Constitutional Democracy in Indonesia, Modern Indonesia Project, Southeast Asia Program, Cornell University, Cornell University Press, Ithaca, New York, 1962.

To 1958 then, a major political and economic issue involved consideration and debate over the respective roles of the state and foreign capital in Indonesian development. Greater detail will be offered later since it suffices here both to make clear its existence and to stress its importance during the post-revolutionary period. By 1958 confusion and inconsistency continued to be a characteristic of economic policy. As Leon Mears observed:

> Up to the end of 1958, no government has defined goals except in broadest terms. There had been a failure to resolve ideological and social conflicts sufficiently to provide a direction for development activities....the economy was to be organised along cooperative lines with a recognition that private enterprise would play a certain part; and while the need for private foreign investment was recognised at times, it was still not clear that it was acceptable — in spite of the law establishing a framework within which foreign investment could be made.[17]

The lack of a decisive policy was evident in the content and directions of government policies from the first days of independence[18], but the nationalisations of 1957 "brought the issue of the relative role of the sectors,...into the realm of reality."[19]

Those who succeeded the "development-minded" economists of the period to 1957 are remembered for their apparent gross mismanagement of the economy. The era of Guided Democracy was marked by international

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[17]Mears, L.A.: "Economic Development in Indonesia through 1958" in Ekonomi dan Keuangan Indonesia, January-February 1961, p. 20.

[18]Yet one must be careful to avoid the impression that the problems facing policy makers were due only to the continual clash of conflicting political viewpoints. The depressed state of the economy due to the disruptions of war, the legacy of Dutch colonialism, and most important its continuing dominant position in key sectors, must be recognised as crucial factors.

[19]CEDA, M Series No. 20. Panglaykim, Y. and Thomas, K.: "Indonesia's New Development Administration", Melbourne, February 1968, p. 18. [Hereafter cited Panglaykim and Thomas (CEDA M Series 20).]

indebtedness, under-investment and hyperinflation. Supporters of the present Indonesian government continually refer to the failure of the 'socialist experiment' when seeking to legitimise the economic policies of the New Order government. However, the ideological content of the economic policies of the former period rarely attract serious debate since Sukarno's socialism is usually perceived in terms of its rhetorical and political function, rather than as a serious, well-conceived or realistic body of economic thought. Whilst there is clearly evidence to support this view, it does confuse and diminish the importance of other issues; namely that Sukarno's rhetorical socialism co-existed with a genuine ideological commitment to socialism by the Indonesian Communist Party, and the development of a peasant-based mass movement in the countryside affiliated but not controlled by that party. Furthermore, vital issues concerning the role and nature of foreign capital and Indonesian independence were vehemently publicised.[20] It is fallacious to dismiss or diminish the importance of such events because ideological preferences were not substantially consolidated into economic and social reality. Their importance may be judged more aptly in retrospect, since the installation of the New Order government heralded a fierce and total rejection of the previous ideology and its accompanying economic policies. Since that time the new government has been substantially if not critically supported, both financially and ideologically, by the capitalist nations and the international institutions of the capitalist world. The violent rejection of the socialist road to economic development was followed by the rapid adoption of economic policies that specifically encouraged the renewed and vigorous penetration of the economy by foreign capital. The desire of the early "pragmatic conservative" policy makers

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[20]See for example in Legge, J.D.: Sukarno: A Political Biography, Pelican, 1972, especially Chapters 11, 12 and 13.

of the early 1950's to both accommodate and control foreign capital and promote its greater participation in the nation's economic growth would now appear to be both the public task and the private desire of Indonesia's policy makers. As Panglaykim and Thomas commented of the Suharto era: "We are in fact witnessing a revival of the outlook of those who advocated the necessity of the foreign investment law of 1958"[21]; and again: "To some extent, we are witnessing the return of the pragmatic outlook which was characteristic of the PSI-Masjumi coalition of the early fifties when Sumitro and Sjafruddin dominated the scene."[22]

The ideological commitment to the weakening of control over investment decisions by the state, and the increased reliance on initiatives taken by the private sector, at least in theory, are two central cornerstones of New Order economic policy. They find an interesting parallel within the currently dominant school of development theory, which has now gained ascendance over the prior dominant "planning-oriented" theories so popular in the 1950's and 1960's. The former emphasis of development economics[23] on comprehensive planning by the state has diminished in favour of a strategy that qualitatively and quantitatively changes the role of the state, and allocates the more decisive and initiatory role to private capital, notably to private foreign capital. The logical outcome of this has been to allocate to "direct" private foreign investment the crucial role in the economic development of poor countries, and a supportive but nonetheless essential role to the post-colonial state.

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[21] Panglaykim and Thomas, (CEDA M Series 20) op. cit., p. 14.

[22] ibid., p. 27.

[23] Whilst the author maintains that this was the dominant school of thought in the 1950's, early and mid1960's, she does not omit recognition of opposing schools of thought, which emphasised the capacity of private capital rather than the state, as the key instrument in economic development. infra.

The bulk of the remainder of this chapter seeks to outline the content of those "development" theories whose ideological and practical content are of particular relevance to the Indonesian experience of the last three decades. Prior to this however, it is relevant to summarise as well the history of Indonesian economic policy to the Guided Democracy period since it reveals so clearly the importance of the older state/ private sector debate to an understanding of the present period.

POST-REVOLUTIONARY INDONESIA: THE ROLE OF THE STATE AND THE PRIVATE SECTOR

During the period 1949 to 1965, all political parties agreed that economic development in Indonesia required the participation of the state. However, the nature and extent of this involvement and the related questions of the volume and type of private sector investment were never decisively resolved. Brief consideration of the content of Indonesia's first three development plans and other aspects of economic policy during the Guided Democracy period will assist to demonstrate the point further, and as well serve to illustrate the relevance of such historical considerations to a comprehension of the origins and ideological basis of New Order policies.

Initially policy makers of the fledgling republic sought no structural changes in the pattern of foreign ownership and control of the economy, but planned through the Economic Urgency Program of 1951 to foster alongside it an indigenous capitalist class of producers and importers. As described by Glassburner it "was a highly nationalistic attempt to diminish the nation's dependence on foreign economic interests in several ways: by developing small national (i.e., indigenous) industry to produce import substitutes in the hope of reducing dependence on foreign trade; by means of capital assistance to indigenous enterprise; and by restricting certain markets to indigenous sellers. The latter aspect of the program is often referred to as the "benteng program".[24] Aware of the grave economic and political implications of the acute shortage of indigenous entrepreneurs, the government tried consciously to assist this growth and as well promote the development of industrial capacity at all levels, through the method of import-substitution. However, although guided by the idea that the government must give the lead in economic life, the dominant position of foreign capital could not have been significantly disturbed without the implementation of policies far too radical in nature to be considered by those in the cabinet at the time. In short: "The program was adapted to operate within the confines of an economy dominated by foreign interests."[25] The fact remains however, that the Economic Urgency Program in theory involved "quite extensive economic intervention in an attempt to establish indigenous industries."[26] Yet its impact was slight since many difficulties made its implementation slow and weak.[27] As W.F. Wertheim observed, although

> ...in theory, industrial planning [played] a certain part in the government's policy, the practical results [were],...meager, in consequence of various factors. As during the colonial period, many vested interests [were] opposed to an all-out industrialisation program. The obligation accepted by the Republican Government in signing the Torquay

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[24]Glassburner, _op. cit._, p. 85.

[25]Panglaykim and Thomas, (CEDA P Series 11) _op. cit._, p. 51. For details of the Economic Urgency Program see _Indonesian Review_, Vol. 1, No. 3, April-June 1951 (Jakarta).

[26]Glassburner, _op. cit._, p. 82.

[27]Implementation of the plan was slow and the many difficulties encountered have been documented by L. Mears, "Economic Development in Indonesia through 1958" in _op. cit._. Mears cites the following: (1) lack of experience and poor management resulted in wasted time and materials; (2) cumbersome government administration involving delays and conflict with government authority; (3) a shortage of technical experts; (4) political priorities which impeded project preparations or implementation. p. 36.

> treaties, not to raise its import duties above a fixed minimum, [made] it difficult for Indonesian industries to compete with foreign industries.[28]

The role of the state was not at this stage, widely perceived to involve its extensive direct participation in economic activity through investment in either provision of infrastructure or the production of commodities. Instead its activities involved assistance to the indigenous capitalist class of Indonesian origin, to counter and compete with the foreigners. And yet no clear-cut policy toward Dutch and other foreign capital was readily discernible during this early period; the political instability of cabinet government contributed greatly to this situation, as well as the enormous practical problems involved. As Glassburner observed:

> The orientation...was at least nominally socialist and essentially pragmatic — toward making the system work. No cabinet undertook a major program of economic reordering. And it was Sumitro, whose inclinations were radical, who turned out to be the most ingenious at "tinkering around the edges" of the economic system.[29]

Yet it must not be forgotten that the question of nationalisation was cautiously advanced during this early period. By the end of 1950, most

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[28]Wertheim, W.F.: Indonesian Society in Transition, W. van Hoeve Ltd., The Hague, Bandung, 1956, p. 126. He continues: "New capital investment from abroad [was] lacking, and if it comes, it will probably not be directed primarily to industrial projects but to enterprises in the traditional fields of raw materials extraction. Only by a strict policy of discouraging investment in enterprises working only for export and of encouraging investment in industries and other projects essential to a well balanced economy could the general trend be reversed. The powerful position of foreign concerns has, for the time being, prevented such a departure from the traditional line. The new Republican Government has thus inherited many of the weaknesses of colonial rule." pp. 126-127.

[29]Glassburner, op. cit., p. 82.

of Java's railway system had been appropriated from its Dutch owners and placed under the control of the government, and in the same year the party of the conservative Sjafruddin was responsible for the nationalisation of the Java Bank.[30] Furthermore it was that same party, the Masjumi, that advanced a cautious but comprehensive program for the nationalisation of vital enterprises. However this was paralleled by the acceptance of aid from the U.S.A., the signing of the Mutual Security Agreement and the implementation of harsh strike and anti-squatter legislation, the latter implemented to protect the estates, which were largely foreign-owned and operated.

During this early period then, state activity involved the attempt to develop an indigenous private sector to compete with the foreigners, yet simultaneously allowed to continue and in certain ways assisted to enhance the position of privilege within the economy enjoyed by Dutch capital.

The first Five-Year Plan (1956-1961) was notable for its increased emphasis on the importance of state activity; the failure of the Benteng program discredited the notion of creating a middle class of industrialists — the private sector was henceforth to be left to fend for itself. The new emphasis was on the development of public enterprise and involved a detailed program of government investment which was to account for forty-five per cent of the total invested funds proposed. These planned investments were not only directed at the production of commodities for the market but as well the improvement of social and economic overheads — infrastructural development. Power and irrigation, industry and mining, transport and communication were each to receive twenty-five per cent of state investment funds, with the balance shared between

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[30] ibid., p. 82.

agricultural education and welfare. Thus the state's perceived role in economic development involved the creation and improvement of overhead capital, but not widespread direct participation of government in the economy.

> The plan's main rationale was to build up within the public sector the essential basic industries, utilities, and services which would sustain and stimulate further investment in the private sector....A few broad guidelines for future investment were laid down....But there was little attempt to draw these lines sharply or to indicate priorities for the few private capitalists wondering where they should invest....This laissez-faire quality of the plan became a ground for later criticisms that it was merely a coordination of departmental programmes, without any positive objectives.[31]

Despite the existence of the ambivalent attitude to foreign investment it was considered by some planners that externally-sourced revenue was essential to the success of the plan. With a feeble level of domestic investment, declining productivity, a foreign exchange crisis in 1956 and the subsequent securing of a US$55 million loan from the IMF, this position clearly had its attractions. A foreign investment bill was submitted to Parliament in 1956, but not without a lively debate concerning the risks of dependency associated with widespread direct foreign investment. It was finally passed with minor alterations in 1959. Other actions by the state designed to either protect or promote foreign interests included anti-strike and anti-squatter legialation, and yet it may not be concluded that the thrust of economic policy of the period to 1957 was either conclusively in favour of large-scale capital inflow, or its total elimination. The position was formally made clearer during the Guided Democracy period, but even then was still characterised by a

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[31]Mackie, J.A.C.: "Indonesian Economy, 1950-63" in Glassburner (ed.), op. cit., p. 49.

considerable degree of ambivalence. As Glassburner observed: "There is no clear-cut consistent march toward the elimination of the Dutch economic interests. There are several moves in this direction....None of these made major inroads. Also there is no striding forward into socialism."[32]

With the announcement of the Eight-Year Plan during the Guided Democracy period (1961-1969) however, the desire for a dominant position of the state in economic life was made abundantly clear. This period saw the attempted expansion of state influence and control over the economy through both direct and indirect activity. The former involved the nationalisation of Dutch interests and the creation of the state enterprises, the latter the promulgation of regulations designed to control the activities of the private sector. Overall an attempt was made to shift the balance of economic power from the private to the public sector.

The major themes of the Guided Economy Program included overall planned construction, land reform, increased government support for cooperatives coupled with a reduced role for private business and a concentration of a great deal of economic power in the state-owned sector.[33] After 1960 the government involved itself deeply in production, marketing and pricing policy. The law of state enterprises (Law 19, 1960) reflected the view of a powerful group of policy makers "which saw in (them) ...the instrument for direct state participation in the economy. The idea was to give a 'leading and commanding role' to the state enterprises."[34] The role of the private sector, both domestic and foreign was

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[32]Glassburner, op. cit., p. 93.

[33]Castles, L., Chapter 7 in Sukarno's Guided Indonesia, Tan, T.K. (ed.), Jacaranda Press, Brisbane, 1967, p. 75.

[34]Panglaykim and Thomas, (CEDA P Series 11) op. cit., p. 67.

severely restricted by government regulations which resulted in a highly unsatisfactory level of investment. The "(old) patterns of incentives, to save, invest and produce (were)...weakened by government policies vis-a-vis the private sector and as well as within firms which (operated) ...as government enterprises, and...these changes lie at the heart of stagnation in the market sectors of the economy."[35]

Yet despite this increased interference in private sector activity and the greatly increased direct economic activity by the state, the private sector continued to function. Panglaykim and Thomas argue that "official ideology notwithstanding there was increased reliance on the private sector."[36] Government attempts to eliminate the alien Chinese traders from the countryside and as well to increase indigenous control of the import trade were not marked by conspicuous success since in 1965 the Chinese still played an important role in both urban and rural areas; this included their important role as the suppliers of finance capital.[37] Castles argues that from early 1963 onwards, government attitude to the private sector actively improved, due to the disappointing performance of the state enterprises and the cooperatives.[38]

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[35]Paauw in McVey, op. cit., p. 188. See also Panglaykim and Thomas, (CEDA P Series 11) op. cit., who argue: "The private businessman...was not encouraged to operate efficiently by the multitude of regulations often contradictory and subject to change. Managers of state enterprises who tried to function in a businesslike manner were also affected by the same unfavorable economic environment. In the search for an economic system suited to Indonesian conditions both state and private enterprise were therefore obliged to operate in an environment conducive to the success of neither." pp. 60-61.

[36]ibid., p. 68. In the last years of the Sukarno regime attempts were made by government to encourage private enterprise to diversify its activities. But conditions remained favorable to the speculator, whilst the private sector was not keen to move into unknown areas of export and industry.

[37]ibid., p. 71.

[38]Castles, op. cit., p. 82. See also Castles, L.: "Socialism and Private Business: The Latest Phase" in BIES, June 1965.

Furthermore, it was during this period that foreign oil companies not only continued the operation of existing production facilities but as well signed new contracts with the Indonesian government.

Clearly then, despite the rhetorical commitment to socialism, the period of Guided Economy was not marked by clarity on the contentious issue of the role of private capital. Whilst state sector participation was greatly extended and government control had a powerful effect on the rate and direction of certain areas of economic activity, the position of the foreign private sector remained ambivalent until the nationalisations of 1964. Rejection of liberalism in favour of an interventionist role for the state was evident, but still, in all other respects, there was ample room for interpretation.[39] The situation was put concisely by Panglaykim and Thomas:

> Considerable uncertainty still surrounded the concept of Indonesian Socialism and most of the issues raised....were unresolved as the new government began to emerge. The Sukarno regime was still in the process of determining the most effective organisational form for the state enterprises, while the respective roles of the state and private enterprises were still being debated.[40]

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[39] Mortimer, R.: Indonesian Communism under Sukarno: Ideology and Politics, Cornell University Press, Ithaca, New York, 1974, Chapter 6, "The Politics of Economic Mismanagement", pp. 254ff.

[40] Panglaykim and Thomas, (CEDA P Series 11) op. cit., p. 74. The lack of decisive policy on foreign investment was an anathema to the Indonesian Communist Party (PKI). On 17 August 1958, the Political Manifesto of the Republic of Indonesia outlined the guidelines for economic development, but the vagueness of the expressed attitude to the role of the private sector was sharply criticised by the PKI who sought the emphatic rejection of dependence on foreign capital, a more radical agrarian reform program, and a greater strengthening of the state sector. PKI leader Aidit argued that foreign economic domination was the major barrier to development, followed closely by the existence of bureaucratic capitalists whom he regarded as constituting a new class that was enriching itself from its position within the state apparatus. The utilisation of aid funds was also a source of conflict between the PKI and the government, especially between 1959 and 1962, the former arguing that aid if

Despite this, it is arguable that the policies of Sukarno favoured the state as the key initiator of economic growth, with private enterprise functioning in a supplementary role. During both periods of time (before and after nationalisation) the domestic private sector was suffered to continue although it faced many obstacles to its lively and expanded reproduction. In sum, the economic policies purused by successive governments from independence to Guided Economy were based on a broad spectrum of ideological views concerning the role of the state and the private sector in economic growth. From the cautious and essentially pragmatic policies of the early years, to the more radical period of the 1960's, this issue was central to the debate over the content and direction of economic policy. Clearly, the relevance of this debate concerning the respective roles of the state and the private sector in economic growth is substantial to a comprehensive analysis of present policy.

With this in mind, it is now pertinent to examine in some detail the theoretical arguments supporting the pursual of development through state-initiated economic activity. In these analyses comprehensive state planning become the crucial stimulants of economic growth.

THE PLANNING VARIANT IN DEVELOPMENT ECONOMICS

In poor countries the necessity of state planning for the stimulation and promotion of economic growth was widely but not universally accepted by economists during the two decades following the second world war. However this acceptance did not mean agreement between them on the issue of the type and extent of state sector activity in economic development; basically their views may be divided into two major

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[40] (cont.) necessary, should take the form of government to government loans from communist and other friendly nations. The possibility of "stabilisation" of the economy through US/IMF aid caused further rifts as Aidit continued to urge greater self-sufficiency. He even rejected joint-ventures as a devious form of "penetration." Mortimer, op. cit., pp. 255-258.

categories: those that recommend a judicious mixture of private and public investment, including foreign investment; and those which maintain that the state must be the main investor in the economy, with private foreign capital allowed little access to the economy and a limited role allocated to the indigenous private sector.

The basis of the argument in favour of state control and long-term planning rests on the view that the factors contributing to the industrial growth of the West in the nineteenth century are not present in the poor countries of the twentieth. The assumption was that to leave economic development to private enterprise, as occurred in the West, was either insufficient or non-beneficial to the poor country. The latter distinction corresponds with the prior division stemming from the degree of public-private mix recommended.

Comprehensive State Planning: The Socialist Case

That private capital cannot by its very nature be the main agent for development in poor countries is the contention of socialists like Maurice Dobb and Marxists Puthucheary and Bagchi, all of whom were concerned with the development of India and Malaya.

Bagchi argued "that the concentrated processes that led to the rapid industrialisation of advanced capitalist countries led to the stagnation or worse of the underdeveloped countries. The parasitic mode of growth in the nineteenth century [made] capitalist growth non-applicable in underdeveloped countries...."[41] The early plunder (and, later, organised exploitation) through imperialism in poor countries, he maintained, was a fundamental prerequisite for the growth of mature capitalism in the West, and consequently of no relevance to poor

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[41]Bagchi, A.K.: "Notes Towards a Theory of Underdevelopment", Economic and Political Weekly, Annual Number, January 1971.

countries in their struggle to develop in the twentieth century. A similar case was argued by A.G. Frank when he claimed that today's developed capitalist societies were never underdeveloped in the way that poor countries are today, although there was a time when they were undeveloped.[42] Underdevelopment in his view was not the result of the factor endowments of a country, but in a large part the historical product of an unequal and exploitative relationship between underdeveloped satellite and developed metropole countries. Thus the development of subordinate metropoles was limited by their satellite status. This argument, continued by Magdoff, is summarised clearly in the following passage where he writes:

> The commonly held notion that the theory of imperialism should be concerned largely with investment in underdeveloped countries just isn't correct. The fact is that profitable investment opportunities in such countries are limited by the very conditions imposed by the operations of imperialism. Restricted market demand and industrial backwardness are products of the transformation of these countries into suppliers of raw materials and food for the metropolitan centres.[43]

Maurice Dobb argued similarly that the existence of the frontier in America, and of the empire in Britain, were conditions that strongly favored the privileged emergence of the industrial West. Britain and America, he maintained, should be treated not as models for others to emulate, but as "special cases"[44], whereas the conditions in poor countries were characterised by three features which made attempts to

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[42]Frank, A.G.: Capitalism and Underdevelopment in Latin America, Monthly Review Press, New York, 1967.

[43]Magdoff, H.: The Age of Imperialism, Monthly Review Press, New York, 1969, p. 38.

[44]Dobb, M.: "Some Aspects of Economic Development", three lectures presented to Delhi School of Economics in Dobb, M.: Capitalism, Development and Planning, Routledge and Kegan Paul, London, 1967. [Hereafter cited Dobb (1951).] For example, p. 84.

telescope the experience of the West onto them unrealistic and potentially very harmful.[45] Firstly he argued, poor countries were characterised by a very limited market for industrial goods, in other words an external diseconomy that deterred foreign investment because of the perceived high risk taken by the individual entrepreneur. Despite the individual perception of risk and isolation "...most economic decisions are interconnected — in the sense that an expansion of production in one direction may set in train a multiplier effect of increased demand for expansion in other directions."[46] This situation led Dobb to conclude that on the whole, central planning of investment decisions was the best way to achieve coordinated complementary growth in the economy.[47] He continued:

> One conclusion which the notion of external economies has made familiar to economists is that in a capitalist economy the decision to invest will be governed by calculations of the profits accruing to each firm, and hence by a calculation that excludes a considerable part of the effects of that investment. Such results (beneficial or otherwise) as accrue elsewhere in the economic system — outside the boundaries of that firm — will be ignored in the decision. When we put the problem in a dynamic setting, the fact that investment at one point on the economic front dependent on simultaneous acts of investment at other points may prevent that investment from being made at all, however economically justified it might prove to be *if the whole series of related moves could be made in unison*.[48]

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[45]See his "Economic Development and its Momentum under Capitalism", *ibid.*.

[46]*ibid.*, p. 85.

[47]Private investment by national entrepreneurs in the petty-commodity sector would be allowed; however major investments in strategic sectors would be planned and executed by the state.

[48]Dobb (1951), *op. cit.*, p. 86 (emphasis added).

The argument concluded that "the quintessential superiority of economic planning...[was] to be found as a mechanism of economic development, especially at those crucial and revolutionary turning-points in development where this kind of interdependence [was] a dominant element in the situation."[49]

The second characteristic of poor countries identified by Dobb was that of foreign investment which disallowed the possibility of any substantial generation of linkages to other sectors of the economy. In this way "enclave" foreign investment prevented industrial growth and thus perpetuated a stagnant economy.[50]

His third characteristic related to the inability of indigenous capitalists to act as the agents of growth as they did in the nineteenth century West. The indigenous bourgeoisie, he argued, were commercially minded due to the high risk nature of investment and the consequent preference for quick returns by trade in luxuries, by land speculation and usury. These entrepreneurs were unsuitable because of their lack of frugality, their "merchant" mentality and penchant for conspicuous consumption: this consumption orientation led to a direction of production in their own countries geared to the Western middle class tastes of the privileged few. Economic surplus was diverted to luxury consumer goods rather than to mass consumer goods or to productive reinvestment. "In underdeveloped countries...indigenous capitalism is incapable of creating these potentialities (for growth) unaided; and such countries remain a

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[49]ibid., p. 86. Dobb concludes the passage: "By enlarging the unit of economic decision regarding investment from the single autonomous entrepreneur to the planned community treated as a whole, it enables these relationships of interdependence to be taken into account; and it makes possible for the first time a coordination *ex ante* of the various constituent decisions in a complex strategy of development, instead of a tardy (and as experience has taught us, highly imperfect) coordination *ex post*, which the traditional market system provides." (Original emphasis.)

[50]This point will be discussed later in the chapter.

stagnant prey to the 'vicious circles' of backwardness and poverty.... [S]ocialist planning (is) the only effective answer to the economic problem...."[51] Indicating the necessity of a minimal reliance on foreign aid as an axiom of political independence, Dobb concluded that an independent economic policy shouldered by the people of the poor country, was the strategy more likely to succeed in promoting development for all rather than the adoption of one that encouraged unrestricted access by foreign capital into the economy.[52]

In sympathy, Marxist Puthucheary argued that the logic of unrestrained private enterprise development and reliance on the market mechanism functioned to enrich those who already possessed capital; "...the sort of development that will take place will be lopsided and communal – with political consequences that will be dangerous."[53] Although the discussion referred to is primarily about Malaya in the 1950's, it raises points generally applicable to the problems faced by

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[51]Dobb, M.: Economic Growth and Underdeveloped Countries, Lawrence and Wishart, London, 1963, p. 59. [Hereafter cited Dobb (1963).]

[52]"...I want to allude to that complementary relationship, or interconnection between different sectors of development which (are)... of special importance at crucial stages of transition. I...[suggest] that this relationship might be an influence *sustaining* the momentum of the investment process in a capitalist economy. But let it be noted that I said "sustaining", thus implying that the momentum was already there...if the momentum is not there in the first place, or is weak, this complementary relationship may actually become a retarding influence in a capitalist economy. Where other conditions are not sufficiently mature to supply independently a strong impetus towards investment, this may well be the major reason why the process of industrialisation is held back. In such circumstances, it may well be an illusion to suppose that 'private enterprise' is particularly enterprising. I would even go so far as to suggest that it is a reason *par excellence* why a private enterprise economy is incapable of effecting major industrial transitions unless some exceptional combination of favorable circumstances gives it a quite unusual impetus towards expansion." Dobb (1951), *op. cit.*, p. 84 (original emphasis).

[53]Puthucheary, J.J.: Ownership and Control in the Malayan Economy, published by D. Moore for Eastern Universities Press, Singapore, 1960, p. 181.

Indonesia since independence. Puthucheary's argument rests on the notion of "the homogeneity of capital", which when taken to apply to nineteenth century colonialism, as opposed to twentieth century neo-colonialism, is a useful concept. It cannot, however, be used successfully as a tool of analysis for the partly industrialised country that was once a colony, but which is now experiencing a particular type of capitalist growth. For a variety of reasons that may not be discussed here, Puthucheary's explanation of underdevelopment is no longer applicable to Southeast Asia in the seventies since that region is experiencing rapid capitalist growth.[54] It does, however, crystallise some problems that beset poor countries. "Natural resources," he argued, "set the limits of certain types of industrial development, but it is doubtful whether industrial development as a whole is a function of natural resources. All that is certain is that the types and the extent of natural resources are limiting factors."[55] Rather it is with the nature of foreign capital itself that the problem arises since "[t]hese characteristics [of capital homogeneity] make it difficult if not impossible, for profits to flow from industry to industry, and develop the economy to the limits set by natural resources and the state of technology"[56]: "the rate of expansion (of the economy) is determined mainly by the development that has already taken place."[57] Puthucheary maintained that the facilities allowing transfer of capital from one area of production to another were present in capitalist economies to a far greater degree than in poor colonial ones; functioning in the former situation capital was more heterogeneous,

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[54]For further discussion see Rhodes, R., Petras, J., and McMichael, P: "Industry in the Third World", New Left Review, No. 85, May-June 1974, and Warren, B.: "Imperialism and Capitalist Industrialisation", New Left Review, No. 81, September-October 1973.

[55]Puthucheary, op. cit., p. 142.

[56]ibid., p. 155.

[57]ibid., p. 143.

more liquid, more mobile, due to the existence of financial institutions, the capital market, and the technical and managerial capacities of entrepreneurs, the main mechanisms for giving mobility to capital. In poor countries, by contrast, the mechanisms were not available to impart these qualities to the foreign capital accumulations that derived from the exploitation of the natural resources. The characteristics of foreign capital in poor countries, argued Puthucheary, was thus its "homogeneity" and consequent homing tendency, which dictated that foreign investment must maintain the economy in its stagnant, depressed non-dynamic state. It was the process of prior investment that limited the potential for future investments. To distribute and expand the capital originating in poor countries, it had to be exported and since most of the shareholders lived outside underdeveloped countries they operated through the financial institutions and the capital market in the home country; only very rarely would the capital return in a new form to the countries from which it was extracted.[58]

Puthucheary also argued that the historical lack of complementary factors of production in the poor semi-feudal pre-capitalist society themselves would reinforce the "homogeneity of capital". Small markets, little social overhead capital or suitable infrastructure, combined with

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[58] ibid., p. 156. See also Amin, S.: Accumulation on a World Scale, translated by B. Pearce, Monthly Review Press, New York and London, 1974, Vol. 1. He argues that "the primary investment has no multiplier effect...unless profits drawn from this investment are reinvested on the spot. But this does not happen in the underdeveloped countries -- these profits are exported. This is the single cause that by itself cancels out in the end the real multiplier effect of all productive investment." p. 232 (original emphasis). Baran was also aware of the effects created by the export of economic surplus generated within poor countries. "The removal of a large share of the affected countries' previously accumulated and currently generated surplus could not but cause a serious setback to their primary accumulation of capital." Baran, P.: The Political Economy of Growth, Pelican, Penguin, Harmondsworth, U.K., 1973 (first published 1953), p. 276. Baran's chapter "On the Roots of Backwardness" discusses this point in detail.

profitable but limited growth potential in the plantation or mining sectors, would reinforce and assist to produce the conditions for under-development.[59]

The views of both Dobb and Puthucheary reserve a highly restricted place for prφvate or public foreign capital in the process of economic development and regard it as essentially non-beneficial. In Indonesia, although socialist ideas were important elements in the political and economic ideologies of the post-independence years, it was not until the Guided Democracy period beginning in 1959 that a firm if unformulated commitment of Sukarno and the government to a socialist economy was made clear to the international community. Yet at the Afro-Asian Conference in Bandung in 1955, Sukarno indicated his own awareness of the nature of the relationship between poor and rich nations:

> I beg you not to think of colonialism only in its classic form which we of Indonesia, and our brothers in different parts of Asia and Africa, knew. Colonialism has also its modern dress, in the form of economic control, intellectual control, and actual physical control, by a small but alien community within a nation. It is a skilful and determined

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[59]The same phenomenon was also observed by Mandel who wrote: "In the period of classical imperialism this substantial difference in the average rate of profit between the colonies and the metropolitan countries resulted not in the acceleration, but the de-acceleration of capital accumulation in the colonies, for a substantial part of the surplus value capitalistically produced in these countries...was siphoned out of them back to the metropolitan countries, where it was either used to boost accumulation or distributed as surplus revenue." Mandel, E.: Late Capitalism, translated from the German by Joris De Bres, New Left Books, London, 1975, p. 345. He continued: "...it was the specific structure of the capitalist economy, especially in the age of imperialism but also partly prior to it, which ensured that the accumulation of industrial capital in the metropolitan countries put a decisive brake on the accumulation of industrial capital in the so-called Third World." p. 365. Mandel claims that the existing social structure imposed limits on 'internal' capital accumulation. The "disadvantageous conditions for the accumulation of capital in these countries must be ascribed to social causes which were hardened by the effects of imperialism." ibid., p. 365. See also pp. 353ff. and Chapters 2 and 3.

> enemy, and it appears in many guises. It does not give up its loot easily. Wherever, whenever, and however it appears, colonialism is an evil thing and one which must be eradicated from the earth.[60]

During the Guided Democracy period, a strong public commitment to anti-imperialism was evident. In his address to the United Nations in September 1960, Sukarno referred to the distinction between emergent and old established nations, and argued "that the real conflict in the world was not the cold war...but between imperialism in its new forms on the one hand, and justice, equality and freedom for the long exploited peoples of the world on the other."[61] In yet another speech he spoke of the dependence and continuing poverty of Indonesia attributable to her neo-colonial status with the Western powers:

> Colonialism and imperialism are living realities in our world...at every move we make for economic reconstruction and upbuilding, we find that they exploit their technological superiority to manipulate conditions in order that our nation can be kept eternally subservient to their selfish interests.[62]

Although Sukarno has been widely criticised for his rhetorical rather than rational comprehension of economic issues, actions from 1957 onwards, involving nationalisation first of Dutch, and later all other foreign-owned enterprises in Indonesia, illustrated his comprehension, albeit for narrowly political reasons, of the importance of self-reliant economic development, the role of the state in that process and the

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[60]Sukarno addressing the Afro-Asian Conference, April 1955, quoted in Kahin, G.M.: The Asian-African Conference, Bandung, Indonesia, April 1955, Ithaca, New York, Cornell University Press, 1956, p. 44.

[61]Sukarno quoted in Legge, J.D.: Sukarno, A Political Biography, Pelican/Penguin, 1972, p. 343.

[62]ibid., p. 344.

inherent dangers in exclusive reliance on private foreign capital. Yet although socialist ideas have been a continuing thread in the fabric of post-independence thought, its former prominence has declined rapidly and violently since the installation of the New Order government. The achievement of socialism remains formally the eventual aim of the present government but in practice it would appear to receive no more than lip-service. Further discussion of this will be offered later in the chapter since at present it is necessary to return to the analysis of various theories of economic development as they apply particularly to Indonesia. The following section discusses the second group of 'planners', those for whom foreign capital is a necessary but not sufficient condition for economic development.

The Case for State Control in the Mixed Economy

There exists within this group a similar belief that the lack of comparability between nineteenth century industrial growth to conditions of poor countries in the twentieth century, necessitates development through comprehensive state planning. The essential difference is the insistence that a decisive role be played by private foreign capital. It is appropriate to begin with the now famous articles of Paul Rosenstein-Rodan who write: "There is no analogy to the process of industrialisation in the early nineteenth century for a number of reasons which may be mentioned briefly."[63] He outlined five basic points.

> (a) International investment in the nineteenth century was largely self-liquidating, based on the exchange of agrarian and industrial products. Nowadays liquidation can no longer be assumed to be 'automatic'

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[63] Rosenstein-Rodan, P.: "Problems of Industrialisation of Eastern and Southeastern Europe", Economic Journal, Vol. LIII, June-September 1943, p. 204. [Hereafter cited Rodan (1943).]

> although the problem can be solved if it is properly planned. (b) Existing institutions of international investment (floating of shares and loans) are inappropriate to the task of industrialisation of a whole unit. They deal with two small units, and do not take advantage of external economies. Capital mostly goes to individual enterprises and there has never been a scheme of planned industrialisation comprising a simultaneous planning of several complementary industries...
> (c) Technical progress was the main driving force in the nineteenth century. Industrialisation in international depressed areas, on the other hand implies the application of given technical knowledge. (d) The increase in overhead costs and fixed capital since the nineteenth century has raised the risk of loss of capital and lowered the mobility of resources and the flexibility of the economic system. It has vastly increased the average size of the firm. (e) Political risks of international investment are very much greater today than in the nineteenth century, when it was assumed that certain things were "not done". State supervision and guarantees can therefore, substantially lower risks, and for that reason constitute the conditio sine quo non of international investment on a large scale. Active participation of the state in economic life is a new factor which must be taken into account as new datum.[64]

Basic to his argument is the assumption that the otherwise efficient system of market forces cannot be applied in poor countries because of market imperfection; "additional signalling devices apart from market prices are required."[65] Rodan recommends a mixed economy, with the state planners directing the willing servant, capital.[66] The crux of his

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[64] ibid., p. 204.

[65] Rosenstein-Rodan, P.: "Notes on the Theory of the Big Push" in Economic Development of Latin America, Wallisch, H. and Ellis, H. (eds.), Macmillan and Co. Ltd., London, 1961, p. 58. [Hereafter cited Rodan (1961).]

[66] The argument is a familiar one. Hollis Chenery wrote in 1953 that unlike developed countries where perfect competition provided a standard for judging a distribution of resources, poor countries were

analysis lies in the discussion of indivisibilities and the consequent need for a big push to stimulate the underdeveloped economy. In this we see common ground with Dobbs' discussion of determinant conditions in poor country economies, and as well with Puthucheary's concept of capital homogeneity.

Rodan claimed that "the price mechanism in such imperfect markets does not provide the signals which guide a perfectly competitive economy towards an optimum position."[67] The big push and state planning are necessitated by these factors and by the indivisibilities that, he claimed, always characterise industrial growth.

Three main indivisibilities and one minor one were identified: they give rise to external economies but either implied great cost in

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[66](cont.) characterised by a situation where private value and private cost could deviate far from social value and social cost. This required government intervention to achieve an efficient distribution of investment resources. See Chenery, H.B.: "The Application of Investment Criteria", in Quarterly Journal of Economics, March 1953.

[67]ibid., p. 58. The necessity of state intervention due to the "weakness" of market forces is a common theme in the literature. See for example Das-Gupta, A.K.: Planning and Economic Growth, George Allen and Unwin Ltd., London, 1965; Bijli, S.M.: Industrialisation in the Third World, National Council of Applied Economic Research, International Book Traders, Aligarh, 1973. Bijli cites the high rate of consumption and the inappropriate use of existing capital (hoarding and speculation), the lack of technical skills, small domestic markets and traditional factors (pp. 11-12). He also argues that the government must invest to supplement the low level of private sector investment which is due not only to capital shortage but as well to the fact that the long gestation period of many investments will render certain necessary investment unattractive to the private sector. In this way the objective of state intervention is to make up for the shortcomings of the private sector. Nitisastro argued that the development theories of economists following the Harrod Domar growth model were inapplicable to the needs of poor countries since their assumptions disallowed their application on rational grounds. Institutional arrangements, the level and distribution of national income, the degree of managerial and technical skills, the state of technical knowledge and the supply of natural resources were vastly different in poor countries. Moreover, development theories of the Harrod Domar type were culturally bound by the Western framework of institutions and values. Nitisastro, W.: "The Relevance of Western Growth Models for Less Developed Countries", in Ekonomi dan Keuangan Indonesia, November-December 1960.

financial terms, or were difficult to overcome by an ad hoc approach. As a consequence their existence was an important factor contributing to the low level of investment in the underdeveloped economy. Because increased investment meant growth, and growth in his schema meant development, it was essential to recognise and counter the problem of indivisibility through state planning.

Indivisibility of production function, or lumpiness of capital, meant that only at a certain level of investment will vital sectors of the economy realise economies of scale and give rise to external economies.[68] Social overhead capital "is the most important instance of indivisibility and hence of external economies on the supply side."[69] Rodan argued that it is indivisible in four ways.

> First it is indivisible (irreversible) in time. It must precede other directly productive investments. Second, its equipment has high minimum durability. Lesser durability is either technically impossible or less efficient. For this and other reasons it is very lumpy. Third, it has long gestation periods. Fourth, an irreducible minimum social overhead capital industry mix is a condition for getting off the dead end.[70]

These indivisibilities of production function necessitated the need for planning since "...normal market mechanisms...[would] not provide an optimum supply." The provision of social overhead capital was vital in the yielding of external economies to stimulate further investment by the

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[68]External economies are due to the fact that the investor is unable to appropriate for himself the whole of the yield of the investment, except in the case of vertically integrated companies where economies of scale accrue entirely as internal economies.

[69]Social overhead capital includes basic industries like power, communications, transport, communications — the infrastructure and overhead costs of the economy as a whole.

[70]Rodan (1961), op. cit., p. 61.

private as well as the public sector. This would automatically increase the marginal productivity of capital and hence promote development.[71]

The second indivisibility, that of demand, related the low rate of investment (and therefore of growth) to market size and risk. Rodan reasoned that because decisions to invest were taken by individual isolated entrepreneurs in an uncertain market, the consequent risk was high and therefore a deterrent to investment in productive areas. As Dobb and Puthucheary also recognised, the indigenous bourgeoisie in poor countries are commercial in nature, and unwilling to invest in long-term projects. However, if the risk element could be reduced by the coordination of investment decisions by a central planning body, the consequent stimulant to investment would promote growth. Whereas the market system determined that investment be made haltingly and slowly, the implementation of comprehensive state planning could ensure their coordination simultaneously and profitably at a certain minimum level of demand, which had been created by government through complementary investment. Rodan explained:

> Complementarity of demand will reduce the marginal risk of growing and diversified investments but there will be a minimum sensible for small doses of investment — there is therefore a minimum threshold at which the complementarity of demand manifests itself. The discontinuity in the complementarity of demand may therefore be called indivisibility of demand.[72]

Because "a minimum quantum of investment [was] required to produce the bulk of additional wage-goods on which additionally employed

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[71]The importance of social overhead capital to the process of industrial growth is discussed by H.W. Arndt in an article which clearly distinguished the differing notions of external economies and examined their applicability to development theory. Arndt, H.W.: "External Economies in Economic Growth" in The Economic Record, November 1955.

[72]Rodan (1961), op. cit., p. 63.

workers [would] spend their additional income"[73], state planners and a big push were necessary to provide the initial stimulus; the external economy of increased market size would thus encourage further investment outside the state sector. Although Rosenstein-Rodan did argue that increased markets through world trade could reduce the size of the big push, he maintained that it could not eliminate the need for it.

The third indivisibility was that of savings. The vicious circle of low income, low savings level and consequent lack of the means to accumulate capital and increase investment, could be broken by the development of a situation where the marginal rate of savings was much higher than the average rate of saving. "Adam Smith's dictum that frugality is a virtue and prodigality a vice has to be adapted to a situation of growing income."[74] A certain minimum level of savings was required, hence the term indivisibility. Government planning should supply the mechanism whereby increased saving was encouraged, and a consequent increase in investment thus occurring.

Rodan also suggested that, in addition to those three indivisibilities, there may be a "psychological indivisibility of the development drive", a certain minimum quantum of vigour necessary before a successful development policy could be implemented. It is clear that in his schema, the state played a vital role as the initiator of changes designed to stimulate and increase the rate and volume of investment and thereby promote economic development. Yet although the role of the state did include public sector investment, it was finally the private sector which was to dominate. On this basic issue Rosenstein-Rodan is at odds with economists like Dobb or Puthucheary. Yet there does remain important

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[73] ibid., p. 64.

[74] ibid., p. 65.

areas of agreement as to the nature of the problem, if not to its solution. The four indivisibilities identified by Rodan evolve from the same problems of market size and lumpiness of capital that were discussed by Dobb and Puthucheary. Whilst Puthucheary argued in opposition to Rodan, that foreign capital was incapable of promoting development because it is homogeneous in nature, he did acknowledge the importance of the historical lack of complementary factors of production, the lack of internal mechanisms for mobilising capital[75], and the problem of capital shortage that necessitated development of key large-scale units of production by foreign capital.[76] He also recognised the limiting characteristics of the small markets, and that, as an industrialisation process gathered momentum, it increased external economies and deepened and widened investment opportunities.

The necessity of stimulating complementary investment by government action and a big push, was also argued by Hirschman in his book The Strategy of Economic Development.[77] Stressing that the market mechanism could not guarantee growth, he pointed to the fact that the complementary supply of workers, machines, industries and managers as well as consumption habits, that exist in developed countries, did not exist in poor countries. Anxious to establish that the theory of balanced growth, as presented by Rodan and others, contained a fundamental flaw, he argued that it "[required] huge amounts of precisely those abilities which we have identified as likely to be very limited in supply in underdeveloped countries."[78] Whilst the big push was still needed, investment

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[75]"The marginal propensity to save is an increasing function of the size of profits." Puthucheary, op. cit., p. 155.

[76]Large amounts of capital were needed to develop certain industries "and this more than anything else determined that large-scale units of industry could only be developed by Western capital." ibid., p. 42.

[77]Hirschman, A.O.: The Strategy of Economic Development, Yale Paperbound Edition, Yale University Press, New Haven, 1961.

[78]ibid., p. 53.

decisions should be undertaken in strategic sectors of the economy, in those projects which involved the greatest positive total linkages both backward and forward, and which both created and utilised external economies.[79] Again, foreign capital became a necessary but not sufficient condition for development due to imperfect market forces.

It is the concern of H.W. Singer to establish this point in an article in Social Research, where he identified three main differences between the nineteenth century industrial experience and the conditions of twentieth century poor countries.[80] Specifically, Singer was concerned to establish the lack of comparability between Schumpeter's theory of growth and the needs of poor countries. In Schumpeter's schema the agents for economic development were 'innovating and pioneering entrepreneurs' but today Singer argued "the agency is much more likely to be the government. Innovating private entrepreneurs are either conspicuously absent or are unable to operate within a framework in which the public prerequisite — ranging from law and order to essential public activities — are lacking."[81] Schumpeter also claimed a vital role for new technology

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[79]ibid., Chapter 6, "Interdependence and Industrialisation". Amin argues that the disarticulation of the underdeveloped economy is in part characterised by the absence of "leading effects" (spread effects) from investments made by foreign capital within the periphery and their transfer abroad instead. "Contemporary analysis has stressed the 'leading effects' of an increase in primary demand: leading effects that are both direct — downstream...and upstream,...and indirect...and also 'secondary' leading effects (through incomes distributed), which are likewise both direct and indirect....If the economy is extraverted, all these effects are limited, being largely transferred abroad." Amin, op. cit., pp. 288-289. "An industry will have backward linkage effects when every non-primary economic activity will induce attempts to supply through domestic production the inputs needed in that activity. Similarly, an industry will have forward linkage effects when every activity that does not by its nature cater exclusively to final demand, will induce new attempts to utilise its output as inputs in some new activity." Bijli, op. cit., p. 112. Bijli adopts Hirschman's terminology.

[80]Singer, H.W.: "Obstacles to Economic Development" in Social Research, No. 1, 1953.

[81]ibid., p. 19. The point was also made by Bijli who argued that "the individual, irrational, visionary entrepreneur whom Schumpeter saw

in nineteenth century industrial growth, in that it was able to change production functions through the introduction of new techniques. By contrast, Singer pointed out that in poor countries "economic development proceeds not by way of new technology, but through the introduction and adaption of old established technologies to the production of old established products."[82] Finally, for Schumpeter the generating force of economic development lay in the field of supply — "in the supply of new goods...and the consequent opening up of profits for the pioneering private entrepreneurs."[83] Yet in poor countries Singer argued that the generating force lay much more in the sphere of demand and in the desire for increased consumption. Having established these important differences, he urged a judicious combination of public and private enterprise. The latter would gradually increase its share of the investment decisions, to avoid over-reliance on the public sector which would stultify the growth of the economy. The state in poor countries was characterised by poor administration, a bureaucratic mentality, lack of suitable personnel with too much responsibility, and finally there was the very real possibility that economic decisions could be governed increasingly by political considerations — for example, nationalism. Such considerations, he

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[81] (cont.) as the main carrier of economic progress has been largely replaced by a private or public business leader whose action may be based on known and predictable principles whose risk has been greatly reduced, and whose activities are supported by a large corporation or governmental agency." In an underdeveloped country the entrepreneur can hardly be called innovating in the Schumpeterian sense "because they deal with borrowed technology from abroad, the marketing practices are adaptions from more economically advanced countries, and the commodities produced are imitations of consumer goods of advanced countries." Bijli, op. cit., pp. 68-69.

[82]"Modern technology...is both deliberately and innately determined by the requirements and factor endowment of industrialised countries. In particular it is shaped by the underlying assumption that capital is abundant, that labour is relatively scarce, and that wage rates are correspondingly high." Singer, op. cit., p. 24; and "...technology has reached a point...far remote from those countries' natural factor endowments and requirements." p. 26.

[83]ibid., p. 20.

argued, were irrational, and could only damage the country that was trying to develop. Like Hirschman, Singer recognised the necessity of initiatory state action but saw its direct role in the economy diminishing over time, replaced by private enterprise.

These attempts to establish a judicious balance between the private and the public sector are a central issue of the development theory so far examined. Essentially, it reduces to a discussion about the respective roles of the state and of private capital, notably private foreign capital. But the concern with planning economic development cannot be explained only by its possible rational basis nor by its success, or lack of it. Political considerations are also relevant. The post-war independent status of the former colonies meant considerable distrust of foreign capital working freely within the economy. For example, India, Malaya and Indonesia all attempted in these post-war years to give to the state a decisive and central role in the economic development. Foreign capital, notably in the form of loans and aid, and direct private foreign investment, was seen as a necessary part of development strategy, with the state firmly committed to the policy of direction and control of both domestic and foreign capital. Essentially, a two-pronged policy was followed. The import-substitution approach dominated the manufacturing sector, and in the extractive sectors like mining and forestry, an effort was made to increase output by increasing exports. Both policies were designed to increase or save foreign exchange, and were seen as essential preludes to "take-off" of the economy to self-sustained industrialisation. The import-substitution policy has, since the late sixties been under considerable criticism for inefficiency, over-protection and its inability to foster dynamic growth. The extractive sectors have also been criticised for remaining essentially as enclaves of prosperity, owned often by foreign companies, in an otherwise desperately poor economy. This topic shall be dealt with in a later section of the chapter since at this point the content and thrust of the planning concept must be further considered; some interesting observations have been made by two economists who were involved in the actual planning process itself, one in India and the other in Malaysia.

Reddaway's book, The Development of the Indian Economy, was concerned with the practical problems that faced economists attempting to implement development policies.[84] Whilst accepting that economic growth was primarily a process of capital accumulation, he argued strongly for the efficient use of existing capital; "...to secure the effective spread of improved methods, rather than the supply of capital"[85] was identified as the major problem. Reddaway's concern with the efficient use of capital relates of course to the more general problem of non-productive or idle capital — that which has been accumulated but used for consumption or hoarded rather than for reinvestment and increased accumulation as required by industrial growth.[86] In other words the capital is there but not the capitalists. A second important point is addressed by Reddaway, namely the problems posed by the difficulties in achieving correct scheduling on investment decisions. This problem of "phasing" in the investment process was identified as one crucial to the success of development plans. Reddaway stressed that unless proper phasing was practiced and planners recognised the importance of time-lags between the initial

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[84]Reddaway, W.B.: The Development of the Indian Economy, George Allen and Unwin, Ruskin House, London, 1962.

[85]ibid., p. 34. The importance of the efficient utilisation of available goods and labor was also stressed by Donkers, K.H.: "The Utilisation of Domestic Capital for the Promotion of Economic Development" in Ekonomi dan Keuangan Indonesia, May 1953.

[86]Widjojo Nitisastro also identified "hoarding" as a major problem facing planners in poor countries. The inefficient channelling of capital into capital formation was partly the result of hoarding. Nitisastro, W.: "The Relevance of Growth Models for Less Developed Economies", op. cit..

investment and on-stream production (the gestation period), then plans could seriously flounder.[87] The investment decision must therefore be considered not only in terms of its eventual effectiveness, but the "opportunity cost" of "freezing" capital in big projects in an economy where capital is relatively scarce: output does not depend on invested capital per se but on the amount of capital equipment in operation in that year.[88] Reddaway stressed furthermore that the government was obliged to stimulate expansion in all sectors of the economy simultaneously. Clearly in this schema the state assumed the central role, with foreign capital a necessary component of the plan. Reddaway's position on this question is well illustrated in the following passage. "During the early years of the development process...an inflow of capital from abroad is a logical part of policy, but the structure of production must be so fashioned as to be capable of functioning reasonably well without such inflow by (a specific date)."[89] He maintained that loans were essential to finance the import of capital goods for the manufacturing industry, since if in their place, finance was sought from export proceeds, the drop in the import of materials would result in a loss of production.[90] He then concludes that "...there is no reason of general theory why this should have a decisive influence on the pattern of development" precisely because he views capital as the agent of development, and the tool of the state, which itself will both invest in key complementary sectors and attempt to control private investment decisions in others.

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[87]Reddaway, op. cit., pp. 54ff., pp. 61ff., and Appendix 1.

[88]ibid., Appendix 1.

[89]ibid., p. 48.

[90]ibid., p. 108.

In a comparable text, Wheelwright argued that the objectives of the state should be to create conditions favourable to the emergence of industrial enterprises, in the hope that entrepreneurs would come forward and take advantage of these conditions in such numbers as to carry through industrialisation.[91] The state should, in this analysis, exert considerably less control over investment decisions than in Reddaway's schema. The government's role should be an intensive effort to build up a "synthetic capitalism", by developing the infrastructure and social overhead capital, by investing in public enterprises, creating "pioneer" or infant industries, and by inducing foreign capital to make direct investments in the country. Yet Wheelwright considered that the major impediment to the flow of domestic capital into industry was the lack of industrial knowhow by its owners. "The experiences of successful traders and merchants are not generally suitable for industrial decision-making for merchant capital is used for short period risks and quick profit."[92] Thus the problem of the desirable balance between the public and the private sector remained, as Wheelwright acknowledged when he included the following United Nations statement in his own text. "It is exceedingly difficult to estimate to what extent and in what direction private investment will respond to the stimulus provided by public investment and government policies. This is perhaps one of the weakest points in the plans of many countries of the region."[93] The essence of Wheelwright's view was to rely on increased government controls, protection and

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[91] Wheelwright, E.L.: Industrialisation in Malaysia, Melbourne University Press, 1965.

[92] *ibid.*, p. 25. The same point is stressed by Harbison; "organisational building ability is probably the most critical skill needed for industrial development on large scale." Harbison, F.: "Entrepreneurial Organisation as a Factor in Economic Development" in Quarterly Journal of Economics, August 1956.

[93] Wheelwright, *op. cit.*, p. 123, quoting "Economic Development and Planning in Asia and the Far East", UN Economic Bulletin for Asia and the Far East, Vol. XII, No. 3, December 1961, p. 7, Footnote 12.

investment, _to counter and at the same time to complement foreign capital_ — whether such a combination is possible to achieve is the most urgent economic and political problem that poor countries face.

The literature concerned with the role of planning in economic development is extensive and of necessity the preceding section covered only a fraction. It sought not a comprehensive review of the literature as such, but involved a conscious selection of those works whose ideological content and practical preferences correlated to that experienced by Indonesian policy makers of the last three decades. Their awareness of such ideological considerations and practical problems is evidenced by the existence of that long and fierce debate (referred to in prior pages) which was central to the formulation and direction of economic policy during the post-revolutionary period. An important figure in those times was Sumitro, creator of the Economic Urgency Plan and a key policy maker during early years.[94] His awareness of key theoretical questions pertaining to the concept of state planning was demonstrated in a piece published in 1953.[95] There he argued that both Keynesian and neo-Keynesian economics were inapplicable to the problems of poor countries, referring to the now familiar "factor endowment", and "different conditions" arguments that were advanced by Dobb and other economists whose work has been considered above. Sumitro reasoned that the development of the Keynesian concepts of accelerator and multiplier were achieved

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[94]Sumitro's colourful career is traced by David Ransom. As Minister of Trade and Industry, and later of Finance, Sumitro was an important figure in early years. His connection with the 1957 Rebellion resulted in his exile to Singapore, where the liaison between him and the American Ford Foundation and Berkeley University was strengthened. He remained there until his return to Jakarta after the coup, and was appointed chairman of the National Planning Board. See Ransom, D.: "Building an Elite for Indonesia" in _The Trojan Horse: The Strange Politics of Foreign Aid_, Weissman, S. (ed.), Ramparts Press, 1973.

[95]Sumitro, D.: "Macro-economics and Public Policy in Economically Underdeveloped Areas" in _Ekonomi dan Keuangan Indonesia_, April 1953.

> ...within a social framework whereby certain structural factors are taken as given data. Basic aspects of the social organisation, such as the stage of technological progress, availability of capital, the existence of modern economic and financial institutions, the effect of customs and social behavior, group conflicts and the like are regarded as given.[96]

Unlike Western industrial countries, where major economic problems related to the maintenance of full employment and effective demand, poor countries were faced with problems of a vastly different nature, namely low levels of productivity, output and income per capita. As a consequence, the role of the government could not be merely to act as a balancing agent engaged in counter-cyclical (compensatory) policies but must involve "efforts which will bring about a change in structural conditions, which by neo-Keynesians are usually regarded as given data of the social setting."[97] The structural conditions identified by Sumitro are familiar; undiversified agrarian-based economy, reliance on the export of raw materials to industrialised countries, lack of industrial capacity, population pressures, low income per capita, large-scale rural underemployment, instability of export earnings and deteriorating terms of trade. Furthermore, socio-economic aspects, especially the lack of technological, organisational and managerial skills, and the concentration of economic power in powerful monopolies were also identified as serious obstacles to development. Existing as structural aspects of the economy they functioned to thwart the normal operation of the multiplier and accelerator mechanisms. In poor countries, the "working of the accelerator...

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[96] ibid., p. 172.

[97] ibid., p. 173 (emphasis original). Sumitro emphasised this point. "Unlike the case in an industrially developed economy, government in underdeveloped countries cannot limit itself to be a mere balancing agent trying to stabilize investment or effective demand through budgetary programs, countered to business swings." p. 175.

(occurred) in a very specific form, viz. as a result of the dependence on effective demand abroad."[98]

The undesirable effects of these structural factors necessitated the acceptance of the planning mechanism; "(a) near solution...must... involve efforts directed at effectuating structural changes, based on an integral approach towards economic development and social progress."[99] Not surprisingly, Sumitro identified the state as the sole agent capable of effecting the changes necessary, urging its active intervention in the economy to determine the direction of production and investment. Such intervention could be of a both direct and indirect nature. Controls on foreign trade and exchange were necessary due to the powerful position of commercial interests in urban centres and the importance of foreign trade to the economy. In addition direct investment by the state was necessary "to make up for the lack of 'autonomous investments'"[100], and as well to create a minimum amount of social overhead capital necessary to stimulate the private sector. Indeed it was the "government's primary task in the economic process...to create the conditions to enable public investment."[101] Clearly widespread and active intervention by the public sector does not preclude the possibility of considerable private sector participation. Indeed Sumitro argued that the low level of capital accumulation in poor countries necessitated foreign capital investment.[102] The role of the

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[98]ibid., p. 174.

[99]ibid., p. 175.

[100]ibid., p. 176. He continues: "Large-scale private activities in the industrial sector...will only take place, if and when a certain minimum amount of social overhead capital is already available....In other words large-scale private industrial activities presuppose the existence of such kind of capital investment. Otherwise while they may count on cheap labour cost, they will be at a great disadvantage in terms of external economies by the lack of social overhead capital."

[101]ibid..

[102]Leon Mears also argued that the low level of surplus available from domestic sources justified the encouragement of foreign investment. "Given the relatively low per-capita income and the fact that relatively

state was to encourage such investments and to ensure adequate controls to regulate both its direction and content.[103] In short the state must function simultaneously to both encourage and control foreign capital investment.[104] It is this belief that state sector activity can both complement (through the provision of social overhead capital and direct investment) and control (through the mechanisms of planning) the activities of the private sector that distinguishes the liberal economists from the socialist. There are many similarities in their respective analyses of the type of problems facing poor economies, and as well a mutual recognition of the inapplicability of Western growth models. But they are opposed on a fundamental question, namely the ability or inability of the state, through comprehensive planning, to control the direction and rate of private sector investments, particularly those originating from abroad. It is on the respective roles of the state and the private sector that they are at issue.

The objective of the preceding pages has been to outline the theoretical assumptions that underlie major policy prescriptions of state planning, and as well to focus on the type of economic problems that beset Indonesian policy makers in the post-independence period. The following section demonstrates that this former dominance of the "planning"-oriented approach to economic development has been replaced by one which

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[102] (cont.) few people have surpluses much above subsistence requirements, the process of capital accumulation will be less onerous and more rapid to the extent outside sources can be tapped." Mears, op. cit., p. 54.

[103] "...[at] all times, [the state must regulate] the size and direction of economic activity of private enterprise." ibid., p. 178. Dronkers argued that the ownership of capital and the pattern of its distribution was a consideration of "political and social importance only" (p. 266) and should not be considered together with economic questions. It was the control of capital by the state that was the important issue. "What is...of importance is whether the country concerned has the supervision, respectively control of the capital." Dronkers, op. cit..

[104] "...[p]rivate foreign investment should be entirely geared to the plans and programmes as formulated by the governments of the areas involved." ibid., p. 183.

puts far greater emphasis on the initiatory role of the private sector and recommends a reduced role for the state in terms of the control and regulation of investment decisions. Three aspects of investment planning, all necessary to the prosecution of a successful development strategy may be identified: the rate of investment, or the percentage of production put aside annually to make machinery, plus foreign investment; the allocation of investments between sectors and the consequent decision on priorities; and finally whether investment be labor or capital saving.

THE ROLE OF MARKET FORCES: AN EMPHASIS RENEWED

The extensive attempts to promote economic development through comprehensive state planning were often made with the assistance of the various international capitalist institutions; the United Nations, the World Bank and the Asian Development Bank have all at certain times exercised a powerful influence on the direction of economic policy in many poor countries, including Indonesia. For approximately two decades the efficacy of the planning method was not, in principle, questioned, although of course there existed differences of opinion as to the accordance of priorities. Yet whilst the dominant concern of development economists in the first two post-war decades were with state planning and assistance to national industries, there did exist simultaneously a body of opinion which considered state planning and ownership of key growth sectors to be harmful impediments to the maximisation of economic growth. In 1963, Dobb showed that he was aware of the existence of both positions. Whilst the majority of economists at the time favoured planning, Dobb maintained that there existed as well a powerful minority, especially in the United States of America, who were hostile to the encroachments on the free market that was implied by the "planning school".[105] This group

[105]"In the first place, there has been the issue as to whether to leave development to the initiative of private capitalists, in the traditional manner...; or whether planning in some degree by the state and by

argued that the only way for poor nations to break out of the "vicious circle of poverty" was for them to attract large volumes of foreign aid and investment, and at the same time to create a political and economic environment that encouraged the growth of the private sector. To maintain a growth rate of say five per cent per annum, a very large amount of investment (a high rate of investment) was required, say fifteen per cent of the national income. The logical outcome of this analysis of developmental problems was to recommend massive injections of foreign capital.[106] The position is well illustrated by the following statement made on behalf of the United Nations.

> Many of the studies made on this subject (economic development) have been devoted to the problem of financing economic development....One of the broad conclusions emerging from most of these studies is that to bring about a significant rise in the rate of economic growth, of the underdeveloped countries it is essential to provide them with a substantial volume of additional capital resources for some years to come.[107]

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[105] (cont.) government organs is necessary. I think one can say that the majority of economists who have joined in the debate adopt the latter of these two positions. But there remains a powerful minority (especially in the U.S.A., and to a lesser extent among 'Western-trained' economists in underdeveloped countries) who are hostile to any encroachment on a 'free market' economy and to any considerable enlargement of the scope of state expenditure and investment." Dobb (1963), op. cit., p. 36.

[106] ibid., pp. 40-41.

[107] United Nations, "The Capital Needs of the Less Developed Countries", New York, United Nations, 1962. A further illustration of this strategy is also evident in the following quotation: "The capitalist solution is workable only in those situations where the society is willing to accept income inequalities over a long period of time without exploding or where extremely high growth rates (ten to fifteen per cent) can be financed with a generous inflow of resources from Western friends. Otherwise the only alternative solution is a genuinely socialist system." The Crisis of Development Strategies, International Development Conference, April 12-19, 1972: comment by World Bank Advisor Mahbut Ul Haqi, published by Development Assistance Division, OECD, Paris, September 1972.

It is demonstrable that this type of approach has in the last ten years gained far greater popularity than it ever enjoyed previously. This can in part be explained in terms of the acknowledged failure of the first "development decade", and the visibly widening gap between the rich and the poor nations. The lack of adequate development, the failure of the take-off into industrialisation is now in large part attributed to the inability of the state to promote growth and to the inadequacy of the mechanism of planning to ascertain and implement the correct investment decisions.[108] The conditions of increasing poverty in poor countries, and in many cases their lack of industrial growth and low rate of investment is coupled with strong criticism of the inability of government policies to substantially increase employment opportunities, or to correct the long-standing bias toward industry and against agriculture. These conditions, complemented by the investment needs of the rich industrialised countries have prompted various international bodies and individual economists to critically review the economic policies of poor countries in an attempt to isolate the main errors and to design a more realistic approach to the problems of economic development. The following pages

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[108]See for example in:

(a) Report of the Asian Development Bank, "Southeast Asia's Economy in the 1970's", Longman, London, 1971. [Hereafter cited ADB Report.]

(b) The Ecosen Reports: (1) Charles Draper (ed.), "Essays in Southeast Asian Trade and Investment", No. 04, July 1973; (2) Marcia Brewster, "Expansion of Exports from Developing Pacific Asian Countries", No. 06, October 1973; (3) T.W. Allen, "Direct Investment of Japanese Enterprise in Southeast Asia; A Study of Motivations, Characteristics and Attitudes", No. 01, February 1973; (4) T.W. Allen, "Direct Investment of U.S. Enterprises in Southeast Asia; A Study of Motivations, Characteristics and Attitudes", No. 02, March 1973; (5) Charles Draper, "Private Foreign Investment in ASEAN", No. 07, February 1974. Published by Ecosen, Bangkok. [Hereafter cited as Ecosen (1) Draper, (2) Brewster ...(5) Draper.]

(c) The SEADAG. Publication by T.W. Allen, "Policies of Asian Countries Towards Direct Foreign Investment", The Asia Society-SEADAG, New York, 1974. [Hereafter cited SEADAG (Allen).]

(d) United Nations, "Report of the Second Asian Conference on Industrialisation", held Tokyo 8-21 September 1970, United Nations, New York, 1971. [Hereafter cited UN Report.]

thus review the work of a number of individuals and institutions that strongly favour a reduction of the planning stimulus and greater reliance on market forces.

Benjamin Higgins has consistently argued against the prominent position given the state in the pursuance of economic development. In 1959 he was critical of the preoccupation with planning,[109] and as an economist with considerable experience in this field, his work is particularly relevant. Moreover, it includes not only general studies of development but as well extensive studies of the Indonesian economy.[110]

Higgins viewed the problems of industrialisation as essentially financial; although he is in no way an exponent of laissez-faire, he does maintain strongly that poor countries have been too severe in their efforts to control private enterprise. They "still rely heavily on private investment in their development planning, while imposing severe limitations on its profitability and (introduce)...measures which reduce the safety and liquidity of assets."[111] Rather than constrain the dynamic of private enterprise, Higgins proposed that the role of the state should be to create a climate conducive to a large and growing supply of entrepreneurs, and to encourage increased investment from whatever source. He reasoned that because the central problem of poor countries is capital shortage, the aim of development policies should be to foster capital accumulation by increasing the supply of foreign exchange to finance the big import bill of the industrialising country.

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[109]Higgins, B.: Economic Development, Constable, London, 1959. [Hereafter cited Higgins (1959).]

[110]For example, Higgins for SEADAG, A Development Strategy for Indonesia: The Implications of Foreign Aid, The Asia Society, SEADAG, New York, 1968. See also numerous articles in Ekonomi dan Keuangan.

[111]Higgins (1959), op. cit., p. 205.

In Chapter 25 of his book Economic Development, Higgins presents four different methods of obtaining the foreign exchange necessary for development. Firstly, by restricting imports; yet he argues that this will be inflationary as well as meaning unnecessary sacrifices in the consumption needs of the people. Secondly, expanding exports; such a policy must be pursued, but because of world market price fluctuations, Higgins states that this can only be a partial solution. The fact that this policy would also mean a sacrifice in the consumption goods available to people and be inflationary also necessitated its use only as a partial solution. Limiting imports and expanding exports Higgins argued were limited ways to solve the foreign exchange problem -- they had merit but could not be relied on as key weapons in the struggle to develop. The third possibility was the nationalisation of industry. Higgins' treatment of this was curious; he dubbed it one of the "primrose paths" for financing development, in short an unrealistic solution because it was isolationist, and thereby evaluated as unable to supply the capital skills and technology that must accompany the effort to develop. Higgins dismissed the socialist alternative and argued that "from many points of view, an approach involving elements of partnership between the under-developed countries and the advanced ones is more attractive; it seems better designed to produce an integrated international economy.[112]

The final method for financing economic development lay in greater inflows of foreign aid or private foreign investment. The balance between public and private enterprise must be so as to enable private enterprise to function as private enterprise, to make profits and be free of excessive government regulations and requirements: the role of the state was to create a suitable investment climate for private foreign enterprise. Higgins adopted the recommendations of the UN Economic Commission for Asia

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[112]ibid., p. 473.

and the Far East (ECAFE) in suggesting that the government ensure the following:

> political stability, security of life and property, opportunities for profits, facilities for remittance of profits, and dividends, facilities for immigration and employment of foreign technical and academic personnel, a system of taxation, absence of vexious controls, non-discriminatory treatment of foreigners, absence of competition of state-owned enterprises with private capital, and a general spirit of friendliness for foreign investors.[113]

It is clear that Higgins proposed a public-private mix that gave the initiative to private enterprise, and a supportive or back-up role to the state.[114] Development plans should be made, and foreign investment encouraged "within a framework of national development." The position is abundantly clear in the following quotation:

> Far from being a matter of 'permitting' foreign capital to enter under restrictive conditions, it is a matter of competing for capital against other countries in both the highly developed and the less developed categories.
>
> In countries recently emerged from colonial status, the general public must learn the difference between 'colonialism' and foreign investment. Foreign investment in a sovereign country with its own corporations, tax, and monetary legislation, foreign exchange controls, etc., is a totally different thing from investment in colonies by

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[113]ibid., p. 572. From UNECAFE, Committee on Industry and Trade, Second Session, "Foreign Investment Laws and Regulations in the ECAFE Region", Bangkok, March 1950.

[114]Higgins continues: "Moreover, it is questionable whether any country...can really hope to achieve a take-off in the next decade or two without increased foreign aid or investment....foreign aid and investment may prove to be the catalyst without which the best endeavours of underdeveloped countries will be in vain." ibid., p. 572.

> citizens of a colonial power. Certainly, big business tends to exert an influence on government policy in any country where it exists; but this fact is no less true when the big business is owned by nationals than when it is owned by foreigners, and the foreigners with less influence on the electorate, than nationals would be.[115]

The argument is continued by Kindleberger who, writing in 1958 maintained that the advantages of private enterprise related to increased capital formation and the dispersal of decisions, risk and incentives for innovation. The role of the government was not to make investment decisions, but to provide social overhead capital and a suitable investment climate. Again the stress is on the need for private capital and the state to cooperate and complement each other in order to increase productivity.[116] The underlying assumptions of these analyses is particularly relevant when compared with those of previous writers which were concerned to point out the lack of applicability of increased reliance on the market system. The role assigned here to the public and private sectors are in contrast to those suggested by the planners; the position is reversed.

This desire to place increased reliance on the market system, to correct the "distortions" to market forces, and change the role of the state is also the theme of more recent literature. The position is

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[115] ibid..

[116] Kindleberger, C.P.: Economic Development, McGraw-Hill, New York, 1958. His position is made clear in the following statement: "Capital is regarded not only as central to the process of development but also strategic. The process of capital formation is interacting and cumulative: capital formation increases income which makes possible more capital formation. At the low stage of development, poverty precludes the saving necessary to the formation of capital. Once the process is started, however, it feeds on itself. 'The rich get richer and the poor get children.'" (p. 35.) Kindleberger was of the opinion that international institutions, like the World Bank, were too concerned about the lack of entrepreneurs rather than about the lack of capital and consequently adopted an inappropriate development strategy for poor countries.

crystallised by Healy who wrote: "It is time we learned to strengthen and to make use of market forces instead of tilting ineffectively and disastrously against them."[117] Similarly Clapham referred to the "dirigsme" that in the past had been allowed too great a degree of influence in economic decisions and rejected the "special conditions" argument of the planners, maintaining that government action has repressed the dynamic force of private enterprise. His recommendations involve the dismantling of government-imposed price regulations so that "price relations evolving in the market will more and more approximate the social scarcity relations."[118] Furthermore he aimed to free the market mechanism from excess controls and allow competition to function unhindered since "[it]...is instrumental in rapidly spreading technological and organisational innovations, in improving the allocation of factors, and in compelling entrepreneurs to remain steadily on the run in adapting to changing structures of demand."[119] He argued that if poor countries chose to rely on the market economy, then the private sector must be allowed unhindered movement in order to function healthily. Government policy must be supportive and complementary, not obstructive and over-directive.

A comparable position is expressed by H.G. Johnson in an article entitled "The Crisis of Aid and the Pearson Report".[120] Johnson argued that the massive financial support from the Western aid institutions to the governments of poor countries had led to inefficiency in the alloca-

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[117] Healy, D.T.: "Development Policy: New Thinking About an Interpretation" in Journal of Economic Literature, Vol. X, No. 3, September 1972, p. 794.

[118] Clapham, R.: "A Design for a Market Economy", Intereconomics, August 1974.

[119] ibid..

[120] Pearson, H.G.: The Crisis of Aid and the Pearson Report, University Press, Edinburgh, 1970.

tion of resources, too much government control at the expense of the "unduly discountered powers of free competition."[121]

The solution to the "crisis of aid" was in Pearson's schema an increased reliance "on the private market mechanisms of economic development as contrasted with governmental planning and control of the development process."[122] The stress was placed on the naturalness of the former process and the rigidity and inadequacy of the latter.

These arguments amount to a rejection of the state planned economy as one incapable either of efficiently allocating resources or promoting economic development. This revived trend in development theory is arguably a keystone of New Order economic policy and its existence is further illustrated by reference to the recent reports of several key international institutions involved in the Southeast Asian region; these offer detailed plans and methods of execution for increasing the rate of productivity by fostering the growth of capitalist economic relations in poor countries.

INSTITUTIONAL REPORTS

Until recently, capitalist planners paid little attention to Southeast Asia, a region which is recognised to contain vast mineral wealth, large potential for agricultural products and a cheap labor force. Indonesia, the most populous and geographically the largest nation of the region, contains all three elements in abundance and they remain relatively unexploited.

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[121] *ibid.*, p. 23.

[122] "In the longer run, a more tolerable system might evolve into leaving questions involving external economies and diseconomies to governmental decisions and gradually turning other investment decisions over to the decentralized action of the increasingly effective private sector." *ibid.*, p. 148.

With this in mind, the recommendations of three organisations will be examined briefly: their analyses are focused on the industrialisation of the Southeast Asian region and on the role of foreign capital and state planning in that process. The Asian Development Bank, the Economic Cooperation Centre for the Asian and Pacific Region and the United Nations have all published extensive reports focusing on the need for new development strategies.[123] Their analyses and subsequent policy

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[123]UN Report, op. cit.; ADB Report, op. cit.; Ecosen (I)...(5), op. cit.. See also Keizai Doyukai CEDA (Japan), CEDA (Australia) and CED (US), "Southeast Asia Development Assistance", CEDA/CED, P Series, No. 10, Melbourne, 1970, [hereafter cited CEDA (P Series 10)]; Cooper, R.: Industrialisation in Indonesia, unpublished paper, Jakarta, December 1970; Little, I., Scott, M. and Scitovsky, T.: Industry and Trade in Some Developing Countries, for the OECD, Oxford University Press, 1970; Bela Belassa and Associates: The Structure of Protection in Developing Countries, The World Bank and the Inter-American Development Bank, Johns Hopkins Press, Baltimore and London, 1971; Prebisch, R.: Towards a New Policy for Development, UN, New York, 1964; Berstein, H. (ed.): Underdevelopment and Development, Penguin, London, 1973; Das-Gupta, op. cit., concluded that

> if...the shelter of import restriction is permitted to create industries within the economy producing those goods whose imports are restricted, then the objective of growth is frustrated; the economy surrenders through the back door what it secures by the front door....It is one thing to conserve foreign exchange for the import of plant and machinery designed to help economic growth; it is an entirely different thing to use import-restriction as a device for stimulating domestic manufacture of "protected" goods. Industrialisation is not synonymous with economic growth. Whilst a judicious process of industrialisation helps economic growth, a wrong process of industrialisation retards it. The goods whose import is restricted with a view to the saving of foreign exchange in the context of growth are not necessarily goods in whose production the economy has a potential advantage. The so-called 'infant industry' argument may not apply in these cases. And insofar as it does not, to use resources for the production of such goods is waste which a developing economy cannot surely afford. (p. 140)

See also IBRD Bank Staff Working Paper, No. 148, "The Employment Problem and the World Bank Activities", prepared by J.D. Turnham and E.K. Hawkins, guidelines cannot be dismissed lightly, but may be seen as the vanguard of capitalist planning for the region. The Asian Development Bank Report has as its central theme; "given the rapid economic growth of her major trading partners, notably Japan, the demand conditions for Southeast Asia's exports are likely to remain favorable during the 1970's."[124] The emphasis of the report "is on the national or the domestic economic policies which the Southeast Asian countries can pursue on their own to improve their 'absorptive capacity' for the available economic aid and trade opportunities"[125]; the objective is to redirect development priorities from import-substitution or inward-looking policies, with strong government elements to a more outward-looking strategy based on expanded trade and stimulated by private foreign capital.[126] The latter is adjudged in essence to more effectively utilise the factor endowments of the region and thus allow fuller incorporation into the world capitalist structure.[127] The new strategy, export-substitution, involves a shift from the export of unprocessed raw materials, both agricultural and mineral, to the export of semi-processed and processed materials.[128]

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[123](cont.) March 1973. Within this paper the same theme is reiterated. "Industrial and agricultural expansion reflecting comparative advantage, supported by a vigorous program of infrastructural and institutional development and a system of market determined prices with respect of labor, capital and foreign exchange, became the dominant theme in the literature of the late 1960's and the advice tendered by aid donors. Numerous countries have become more receptive to this theme and are currently pursuing or attempting to pursue more open and market-oriented policies than was the case a few years ago." p. 15. [Hereafter cited IBRD (No. 148).]

[124]ADB Report, _op. cit._, p. 18. See also pp. 254-266.

[125]_ibid._, p. 4.

[126]_ibid._, Parts 4 and 5.

[127]"In most countries, industrial development had failed to make a substantial contribution to employment, and manufacturing industries were still a mere enclave in predominantly agricultural economies." _ibid._, p. 186.

[128]_ibid._, pp. 18-22.

Trade assumes a most important role in restructuring the economy because it is argued foreign exchange earnings will increase, economies of scale be created through the application of the principle of industrial complementarity, and abundant labor utilized at a low cost. The strategy is viewed both as a more rational and efficient path to industrialisation, in that it seeks to avoid the distorted nature of production that characterised industrial growth through import-substitution[129], and as well is seen to bring more benefits to the host country in political as well as economic terms. It does however rely on the green revolution to "encourage the growth of processing industries by increasing the supply of agricultural raw materials and by releasing land for other uses, notably forestry"[130]; it is projected that demand for agricultural imports will increase, output will increase and rural income will rise. The absorptive capacity of the rural masses will become greater and create more favorable conditions for the expansion of production of manufactured consumer goods.[131]

The type of exports recommended fall into three broad categories. Firstly, the processed and semi-processed agricultural and mineral products; edible oils, processed food, including marine products, fodder processing, timber milling, veneer and plywood manufacture. They involve relatively simple technology and are labor-intensive. Secondly, manufacture, involving complex technology coupled with a skilled labor force

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[129]"In order to carry out the new pattern of industrialisation effectively, we need a wide range of economic policies to correct the distortion in the allocation of resources introduced by the import-substitution policies and to change the direction of industrial development." ibid., p. 23. Little, Scott and Scitovsky observed that import-substitution "tends to shift distribution of income in favour of urban sector and higher income groups, whose expenditure pattern typically has the highest component of imports." Little, Scott and Scitovsky, op. cit., p. 63.

[130]ADB Report, op. cit., p. 22.

[131]ibid., p. 22.

assembling intermediate goods for embodiment in sophisticated final products completed overseas. Until recently this latter group tended to be located in advanced industrial countries, but rising labor costs have forced the migration of capital to labor with consequent "benefits" for the poor countries: "these industries can serve as the basis for new export oriented industrialisation through location in less developed countries."[132]

Thirdly, manufacture of consumer products like toiletries, simple electrical equipment, match production, textiles and clothing. These products will serve the domestic as well as the export market.

The dynamic for this planned growth is to be private foreign capital investment; the desired liberalisation of trade and capital flows and the growth of the multinational corporation will allow "easier migration of complementary managerial resources and capital to the source of cheaper labor supplies."[133]

Four major areas of mutual interest between foreign capital and the post-colonial state may be identified: transfer of technological and entrepreneurial skills, direct investment, investment in the infrastructure, and investment in the service sector.[134] Benefits accruing to

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[132]ibid., p. 295.

[133]ibid.. The growing identity of interest between foreign corporations and the governments of poor countries has been similarly noted in reputable Western business and trade journals, particularly in connection with the supply of agricultural commodities and techniques, e.g., (a) Turner, Louis: "Multinationals, the UN and Development", in Columbia Journal of World Business, September/October 1972 [hereafter cited CJWB]; (b) Philip, N.W.: "Southeast Asia: Investment and Development", CJWB, November/December 1970.

[134]This latter includes, for example, the marketing of agricultural inputs necessary for expanding capitalist production. Profits accruing to agri-industry consultants alone in 1969 was over $1.7 billion. "It is a significant business for consultants, managers and construction contractors." Philip, N.W., op. cit., p. 63. "Given an acceptable political accommodation, work in Southeast Asia could dominate their (agri-business) market in the coming decade." p. 65. Philip cites one FAO projection which suggested that $185 billion will be spent on agri-imports

foreign companies include securing, maintaining, or developing overseas markets or raw material supplies, access to lower cost production base for export to either the home country or other countries, plus the political advantage of being more readily able to identify their growth with the development of the agricultural and manufacturing sectors of the economy, thus avoiding criticisms of exploitation by nationalistic elements. For the individual countries, long-term benefits are seen to include increased productivity and income resulting from the ability to concentrate more labor in higher technology export-oriented industries. Added to this are the indirect political benefits accruing to the host country government resulting from increased employment opportunities, and some redistribution of wealth coupled with valuable foreign exchange earnings vital to finance the import of production as well as consumption goods. Writing in Fortune magazine, Richard Rose supported the recommendations of the ADB Report, concluding that agri-allied industries could assist to redress the present trade imbalance of the poor countries by promoting "specifically export creating" agri-industries which utilised abundant labor resources.[135] Benefits claimed on behalf of the host country included employment creation, development of the rural sector and increased foreign exchange earnings. Rose proposed that multinationals mediate between the governments of rich and poor countries, to effect lowering of tariff barriers and increased and diversified trade; they could become in his words, friends of the developing nations.[136]

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[134] (cont.) alone in the third world during the 1970's. This huge market however can only be successfully tapped with the acquiescence of the official aid establishment.

[135] Rose, R.: "The Poor Countries Turn from Buy-Less to Sell-More" in Fortune, April 1970. He summised that "(i)f the developed countries let in more labour-intensive agricultural and industrial products from the underdeveloped world, then they will be able to shift part of their work-force into higher-technology industries. Such a shift can only lead to a higher average productivity and augmented income levels in the developed countries." p. 93.

[136] See also Simon Williams who argues that investment in world

Awareness of economic nationalism in poor countries has prompted a large number of agri-allied industries to formally link themselves with the United Nations, through the Food and Agricultural Organisation (FAO). The Industry Cooperative Program (ICP) has been named as the most successful link between the UN, the multinationals, and the governments of poor countries.[137] Indeed, one of the major activities of the ICP is the reduction of mutual distrust between governments of such countries and member companies.[138] Interested exclusively in the exploitation of Third World agriculture, the group has a wide range of activities, including a series of special committees engaged in research work on agricultural and related topics.[139] Many of the member companies are agri-businesses, supplying imports required by the green revolution; others are engaged in the production and processing of raw materials for export. Their long-term interest is to promote "integrated global development" rather than to concentrate in industries that create pockets of prosperity with little "spread" effect. By seeking to identify with agricultural development in poor countries, the ICP are in the forefront of capitalist planning as laid down by the ADB Report. Their strategy is an attempt to avoid the economic nationalism of the poor countries and possible political instability that could result. Implicitly it advocates

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[136] (cont.) agriculture is primarily for "a sound financial return" — "for profit in areas of hunger." "Private Investment in World Agriculture", Harvard Business Review, November/December 1965, p. 96.

[137] Turner, Louis, op. cit..

[138] Annual Report, ICP 1973/74, p. 1.

[139] Some better known companies associated with the ICP are Alfa-Laval (Sweden), Ceba-Geigey (Switzerland), Deere & Co. (USA), ICI (UK), Shell International Chemical Co. (UK), Phillips (Holland), Fiat (Italy), Massey Ferguson (Canada), Mitsubishi (Japan), Yates Seeds (Australia) and Automated Building Components (Australia). Research committees are engaged on many topics including farm mechanisation, forest and fisheries industries, protein food development, pesticides, integrated meat development.

a far more subtle and potentially secure foothold in the economies of these nations than does extractive, enclave-type of investments like mining, and oil exploration.

A similar concern for change in industrialisation strategy for the Southeast Asian region is evident in two reports published by Ecosen.[140] These studies are concerned with the region's potential for increased and diversified trade, by a shift from import to export-substitution[141], whilst at the same time increasing the export of unprocessed raw materials.[142] A shift towards the restructuring of production to serve the export market similar to that practised in Taiwan and Korea is recommended "so that...exports could become an engine of growth."[143] Not surprisingly the role of direct foreign investment is vital to this process; it

> is expected to serve developing countries through finding promising export markets and furnishing them with their output as well as through transplanting technology, managerial skills and capital, which are the most scarce factors of production into developing countries.[144]

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[140] Ecosen (1) Draper and (2) Brewster, op. cit..

[141] "A reorientation of the economic structures in these countries will enable them to move away from the often self-defeating 'import-substitution' era into an export-substitution era — the substitution of exports of processed primary goods or manufactures for raw material production." Ecosen (1) Draper, op. cit., p. 15.

[142] This is similar to the ADB recommendation of "export-substitution which is hitched on to a policy of expanding primary exports." ADB Report, op. cit., p. 21.

[143] Ecosen (2) Brewster, op. cit., p. 3; and "The East Asian nations can serve as a model to the countries of Southeast Asia, demonstrating export-substitution of labor-based for land-based commodities." p. 3.

[144] Ecosen (1) Draper, op. cit., p. 7; also "...it is strongly recommended for developing countries to promote direct investment provided that it is willing to undertake the important role in expanding exports from Southeast Asian countries." p. 8.

However obstacles to achieving increases in the range and volume of exported goods are considerable; government policies, production difficulties, finance, transportation and marketing were all identified as problem areas.[145] Recommendations for a more suitable export policy are very similar to those proposed by the ADB Report. They include regional cooperation to achieve economies of scale and complementarity; government promotion of, and assistance with export drives; foreign investment in export-oriented production, and its cooperation with the indigenous entrepreneurs; and the removal of legal and infrastructural difficulties.[146]

The third report with which this section is concerned reiterates these basic considerations. The UN Conference on Industrialisation aimed to review industrial problems and policies of its first development decade (1961-1970), to identify the root causes of difficulties encountered, and to suggest an appropriate strategy for industrialisation in the second development decade.[147]

The problems of foreign exchange shortages, aggravated by the high import content of industrialisation, and combined with a number of protected inefficient industries, many of them state-owned, emerged as key issues. The conference recommended a development pattern that reduced the import content of industrialisation and made greater use of local resources; in short a more balanced growth between agriculture and industry, reflected in planned development at national and regional level, greater mobilisation of foreign and domestic finance, efficient

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[145] ibid., p. 23. Table 2.2 gives details of these difficulties.

[146] For example, "nationalisation or removal of government controls on exports; elimination of excessive red tape...assistance with freight costs and improved port facilities...and the adoption of regional and 'efficient scale' approaches to cost reduction." ibid., p. 27.

[147] UN Report, op. cit..

manning of industries, increased management and technical training, and increased trade, both globally and within the region.

Within the scope of these recommendations, two interrelated issues can be identified: the concern with the choice of technology and the question of potential regional complementarity of certain key industries. The former illustrates the difficulties of capitalist planners in reconciling the conflicting goals of technological suitability and of maintaining profit in the competitive world market. Poor countries are characterised by cheap abundant labor, scarcity of capital and of the knowledge to reproduce and expand that capital. Production that is highly capital-intensive may produce quality goods competitive on world markets, but by itself cannot create employment for the millions of unemployed or under-employed workers of the Southeast Asian region.[148] The UN Report recommended that attention to modern techniques and adequate scale be given high priority; new plants must be efficient in the economic sense vis-a-vis plants in other parts of the world otherwise they cannot contribute to higher productivity. Yet this concern with higher productivity conflicts with the need for increased employment. Whilst large-scale industries should concentrate in relatively few favourable areas, it was considered that the satellite industries resulting from these

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[148]Estimated for Indonesia to be in the region of twelve to fifteen million. FEER reported an unemployment rate of six per cent, but hastened to add that the Minister for Manpower, Sadli, put disguised unemployment at thirty per cent. FEER, 24/6/72. For further information see EIU, Annual Supplements, "Economic Review of Indonesia", 1965, 1972 and 1973; EIU, No. 2, 1973, No. 4, 1972; Indonesia Letter, October 1971, "Manpower Trends in East Java"; Alex Hunter, "Notes on the Indonesian Population" in Glassburner, B. (ed.), op. cit., p. 188; UN Report, op. cit., p. 7; Healy, D.T.: "Development and Unemployment: Some Asian Experiences", paper delivered to the Third Conference of Economists, Economic Society of Australia and New Zealand, Adelaide, May 1973. Turnham and Jaeger estimated that almost one-third of the labor force in Indonesia was affected by unemployment or underemployment. Turnham, D. and Jaeger, I.: "The Employment Problems in Less Developed Countries", OECD, Paris, 1971. The ILO considered that the failure to create employment and the capital-intensive bias in economic development was due to the "distortions" introduced by import-substitution. "Towards Full Employment", ILO, Geneva, 1970.

would create employment: the concepts of backward and forward linkages and the generation of external economies is important here. For a report that is ostensibly greatly concerned with the problem of employment in the region this position seems surprisingly trite. It stresses the adoption of an industrialisation strategy that favours modern techniques utilised in plants of adequate size to ensure that significant technological or managerial benefits accrue to the economy as a whole.[149] It is clear that these recommendations are designed primarily to allow capital invested in the region to produce goods competitive on the international market whilst considerations of employment creation remain secondary. The recommended stimulus to Southeast Asian economies becomes increased trade, brought about by greatly increased foreign investment; exports are viewed as the major engine of growth. Jobs which are created will remain, for most workers, at a low technological level, by design not by accident.[150] Thus a major contradiction between the objective

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[149]The UN Conference recommends a technology transfer "at levels and rates which would ensure evolution of internationally competitive industries within the shortest possible time." UN Report, op. cit., p. 23.

[150]Australian economist, H.W. Arndt, well known for his work on the Indonesian economy, has this to say on the problem of capital and labor in Indonesia: "...it is increasingly recognised that many of the big manufacturing investments, particularly by foreign companies, do not create all that many jobs." To satisfy the needs of business for efficiency and profitability, and at the same time create employment, Arndt concludes that whilst you cannot change the actual manufacturing process "where modern capital-intensive techniques are probably essential for quality control and for efficient operation", it is possible to create ancillary activities, "packing and that sort of thing", to establish employment. Paper read to the Australia-Indonesia Business Cooperation Committee (AIBCC) Seminar, "Investment in Indonesia — 1973 and Beyond", September 13-14, 1973, Sydney. [Hereafter cited AIBCC(1973).] It must be recognised as well that the required liberalisation of trade implicit in the various reports also present problems to the developed countries in terms of their own domestic economies especially with respect the manufacturing sectors. This is well demonstrated by reference to Australia's manufacturing sector and the tariff structure that protects it. A confidential ASEAN memorandum delivered to the federal government in July 1976 charged that: "For a developed country, Australia has one of the highest tariff rates, especially on labor-intensive, light industrial goods exported by developing countries." The much vaunted Australian system of tariff preferences (ASTP) was vigorously criticised for contributing so little to any substantial increase in export of ASEAN member countries to

needs of poor countries and those of international capitalism is evident. In an important sense the above cited reports reflect a serious attempt to assist in the solution of the problems of unemployment, underemployment, and serious income inequality. Yet the recommended expansion of capitalist production methods and relations of production into the economies of poor countries is incapable in the final analysis of offering any solution to these and other related problems. This question is of course a fundamental one and will be discussed more fully in later chapters, since one final aspect to the present discussion remains for consideration; this is the issue of regional industrial complementarity.

The UN Report argued that because of the smallness of domestic markets and lack of capital within each country, production in key areas could not remain confined to the national scale, but must be based on regional cooperation. The reader will remember that this was central to the arguments of Rosenstein-Rodan in his discussion of indivisibility of demand. Whereas he argued that world trade would reduce, but not eliminate the need for the big push, all three reports see regional and world trade as central to the solution they propose. Technological sophistication embodied in large-scale heavy industries make production for the local market economically inefficient. Each country is recommended to follow a policy of selective industrialisation and regional cooperation with the long-term aim being the establishment of a common market.[151] Such cooperation is viewed not merely as desirable, "but would become imperative necessity if the accelerated pace of industrialisation...was

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[150] (cont.) Australia. The memorandum argued that "[more] than any other single factor, the developing countries need adequate access for their products to the markets of developed countries which [it]...believed would come to be reflected in more appropriate terms of trade." Reported in AFR, 27/7/76.

[151] "Neither self-sufficiency within countries nor within the region as a whole is an appropriate end in itself. The overall aim is to promote an efficient and growing industrial sector." UN Report, op. cit.,

to take place."[152] Increased trade within the region depends "to a large extent on the differences in degree of industrialisation and stages of growth within the region."[153] The factor endowments of Indonesia then, may mean that the country will be maintained at a relatively low level of technological development, except in selected areas that complement activities in other countries.

Survey findings by Ecosen bear this out. It has been found that for Japanese, and to a lesser extent, American direct investment in the Southeast Asian region, technology-transfer from both product and process technology have not been very significant. Even the complex-product type of industry (e.g., car manufacturing, radios, television, air conditioners) involved only assembly technology. The products manufactured were generally of a type which did not lend themselves to further adaption

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[151] (cont.) p. 7. The potentialities of regional cooperation are well recognised by ASEAN nations, who together are looking to neighbouring countries, especially Japan and Australia for assistance in establishing major industrial projects in the region. "Each project selected is supposed to be built on a scale large enough to supply requirements throughout the five-nation community." ASEAN members are attempting "to rationalise and harmonise their industrial development...and [Ministers]... consult with one another on national programs for development of integrated steel and petrochemical industries with a view to coordinating these programs, avoiding unnecessary duplication and competition, so as to achieve maximum benefit for the ASEAN region as a whole." AFR, 8/3/77. See also AFR, 28/2/77, "ASEAN Move for Free Trade Area", which reported that "[t]he five members of the Association of South-East Asian Nations (ASEAN) have formally committed themselves to a program of economic cooperation and integration....The foreign ministers of Indonesia, Malaysia, Singapore, Thailand and the Philippines signed an agreement in Manila last week providing a framework for preferential trading arrangements within ASEAN. The ultimate goal is an ASEAN free trade area — a target Singapore's Prime Minister, Mr. Lee Kuan Yew, foresees as 'a distinct possibility' within six to nine years....The preferential trading umbrella is one aspect of an ASEAN strategy for making the region more attractive to foreign, as well as domestic investors including a growing number of offshore manufacturers from Australia." See also AFR, 18/3/77, "Fraser Faces Difficult Decision on ASEAN Leaders' Meeting".

[152] UN Report, op. cit., p. 21.

[153] ibid., p. 22.

or growth (e.g., cement, some textiles, shoes, plywood)[154]; foreign investments thus generated limited or negligible external economies.

In summary, the various planning bodies recommend a specific industrialisation strategy that allows the development of a more mature industrial base, owned, controlled and developed predominantly by foreign corporations; they exclude the possibility of a genuinely national base for industrialisation. Labor-intensive industries involving simple technology may be fostered in Indonesia, whilst more complex production processes may be introduced elsewhere. The ADB Report recommends resource-based industrial growth for Indonesia with the "take-off" to demand-oriented manufacturing export coming later than elsewhere in Southeast Asia. Similarly the Ecosen Reports conclude:

> Whilst Korea, Taiwan and Singapore are beginning to switch to the production of higher priced and higher quality manufactures, Southeast Asia is gaining an increasing share of the market for the lowest priced categories. With careful economic and social planning, and cooperation where appropriate, the Southeast Asians may supplant East Asia as the suppliers for this type of product. While their industrial structures will become more sophisticated in the future, they will continue to rely on exports of such low priced industrial and semi-industrial goods for many years to come.[155]

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[154]See Ecosen (3) Allen, op. cit., pp. 32-37, and Ecosen (4) Allen, op. cit., pp. 31-55.

[155]Ecosen (1) Draper, op. cit., p. 21. Mandel observed the same tendency: "The increasing accumulation of capital which is visible in the semi-colonies today is accumulation of a specific kind. It is the accumulation of industrial capital moving from the sphere of raw materials into that of manufacturing industry, but on average remaining one or two stages behind the technology or type of industrialisation predominating in the Western countries....this is the corollary of the narrow domestic market, the enormous industrial reserve army, and the trend towards industrialisation with obsolescent machinery....the international division of labour is slowly moving towards the exchange of light industrial goods for machines, equipment and vehicles, in addition to the 'classical' unequal exchange of foodstuffs and raw materials for industrial consumer goods." Mandel, op. cit., p. 368. See also the Australian Senate

For foreign capital, the realisation of such plans would ensure high rates of profit and satisfactory realisation of investment over a fairly short time horizon, but the political climate of nations in the region could well be a serious obstacle to their implementation.[156] Political harmony will not be easy to achieve nor to maintain; indeed the Indonesian government voiced its concern that regional industrialisation through cooperation would be a difficult problem.[157] The initial reactions of the nations concerned indicated little interest in the recommendations of the UN Report concerning cooperation to achieve complementarity and economies of scale, except where national interests could be positively advanced. Regional disparities are great, as is the fear of domination by Chinese capital; it is arguable that Singapore would achieve more net gain from an integrated regional market than other nations where "by contrast Indonesia has been the most reticent, having both the most backward economy and the largest potential market in the group."[158]

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[155] (cont.) Standing Committee on Industry and Trade Report, Prospects for Trade Between Indonesia and Australia, Parliament of the Commonwealth of Australia, Canberra, 1975. [Hereafter cited Senate Standing Committee Report (1975).] The report noted: "In the longer term it is possible that an export surplus may be produced which would enable Indonesia to enter the low cost manufacturing field at present occupied by Singapore, Hong Kong and Japan." p. 23.

[156]Amongst the many areas of political conflict between Southeast Asian nations are the following: the Malaysia-Thailand border dispute; the Sabah-Sarawak and Kalimantan guerilla activity; long-standing rivalry between Singapore and Indonesia; the issue of sovereignty and the Straits of Malacca; the assistance given to the southern Filipino rebels of Mindanao by Indonesian Muslims.

[157]EIU, No. 3, 1973. Moves to increase the possibility of regional cooperation are, however, afoot. The text of the agreement of the Meeting of ASEAN Ministers for Economic Affairs and Planning, held in Kuala Lumpur, March 1976, discussed the issue in detail. The aim was to coordinate large projects like steel and petrochemical plants in order to avoid duplication and unnecessary competition. See Current Affairs Translation, Issue No. 0046-9165, Antara National News Agency, Jakarta, March 1976, Bulletin. See also Bulletin, February 1976, which reported on the declaration of ASEAN concord; this document involves attempts to strengthen the existing apparatus for economic cooperation.

[158]EIU, No. 3, 1973, p. 4. A recently completed survey by the UN of the potential for industrial cooperation among the five ASEAN countries has identified a number of manufacturing projects which appear likely to

More likely is the possibility that Indonesia would use the UN Report as a guideline for its own industrial development, independent of any regional cooperation.

The preceding pages have sought to demonstrate that the former dominant emphasis of development economics on comprehensive state planning and control to achieve economic development has declined, and been replaced by another strategy of development that emphasises the crucial necessity of private sector activity. Private foreign capital investment and international trade are recommended as capable of engendering the much needed stimulus to poor country economies. The role of the state has altered correspondingly to accommodate this greater and more decisive role to be played by private foreign capital and international trade. Clearly the role of the state remains an essential aspect of development strategy, but its initiatory role at crucial levels of planning have noticeably diminished, whilst its supportive functions — the organisation of the political, social and economic environment — have become more important. On the one hand then government controls are considered to be essential to the development process; on the other hand they "are eroding the contribution by private foreign entrepreneurs to economic development in many countries."[159] The favoured policy for the seventies is to let private foreign capital "assume its inevitable role" since it is in "the strengthening of the private sector against the background of cooperation and responsible government (that) the best prospects for sound and rapid economic development in Southeast Asia lies."[160]

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[158] (cont.) be viable either now or in the near future. They will be based on the five national markets combined rather than the individual ones. The thirteen projects recommended include nitrogenous fertilisers, phosphatic fertilisers, soda ash, caprolactan (the raw material for nylon), DMT (the raw material for polyester synthetic fibre), ethylene glycol, newsprint, sheet glass and steel billets.

[159] ADB Report, op. cit., p. 424.

[160] ibid., p. 429.

THE UNITED NATIONS RECOMMENDATIONS AND NEW ORDER POLICY: A LIMITED CONVERGENCE

The renewed faith in the capacity of "market forces" to promote economic growth in poor countries is one that has been embraced decisively by the New Order government. It is not coincidental that the Indonesian policy makers, the "technocrats", are firm believers of this most recent trend in development economics. Trained mainly in the United States and returning to Indonesia as the ideological vanguard of the military government, the "technocrats" are strong exponents of an economic policy which encourages, indeed urges the necessity of, extensive private foreign capital participation in the domestic economy.[161] In the following chapter the organisational and preparatory functions of the state in the promotion of the capitalist mode of production will be detailed, but at this point it remains to look briefly at the economic policies of the New Order government in the light of the recommendations of the United Nations Report.

The first of the United Nations recommendations emphasised that continuing priority be given the social implications of industrial development. This included greater concern with raising living standards,

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[161] See for example: Ransom, D.: "The Berkeley Mafia and the Indonesian Massacre" in Ramparts, Vol. 9, No. 4, 1970; Mortimer, R.: Indonesia, Growth or Development, paper to be published in "Indonesia — The Myth of Development", Mortimer, R. (ed.). Mortimer argued: "the only significant group that can be said to have any discernible effect on economic policy making besides the compradores is the 'Berkeley Mafia', a group of technocratic ministers and advisers in the Presidential palace circle." p. 7. Bruce Glassburner pointed to the fact that prior to 1965 intellectuals, especially economists were excluded from centres of power. Since that time however their position has altered and he mentions the presence of predominantly US-trained economists in the key areas of economic policy. Amongst this group is Sumitro, former minister in several cabinets of the 1950's. Glassburner, B.: "Indonesian Economic Policy After Sukarno" in Glassburner, B. (ed.): "The Economy of Indonesia", op. cit., p. 13. Ben Anderson observed that the direction of economic research in America concerned with Indonesia "was with few important exceptions consistently oriented towards the discrediting of autonomist policies always within a framework of capitalist axioms and always in the name of modernisation and development." Anderson, op. cit., p. 7.

increasing employment and ensuring a satisfactory state of labor-management relations.[162] It appears likely that the present regime will continue its repression of non-government-approved unions and the maintenance of the low and stable wage rate to retain Indonesia's advantage in this area. Moreover whilst the social priorities of the second five-year plan include adequate supply of food and clothing for the mass of the people, sufficient supply of basic household commodities and higher and more evenly distributed social welfare, how this can be achieved given objective economic conditions remains unclear. The consistently poor living standards of the mass of rural-dwelling Indonesians will remain for many years as will the problems of vastly overcrowded cities and high rates of underemployment and unemployment in both urban and rural areas.[163] In fact, the Indonesian government has little power, or arguably inclination, to accord genuine priority to the social implications of industrial development. The task of securing rapid industrial growth through the encouragement of direct private foreign investment remains the major preoccupation of government and it is one that conflicts strongly with the requirements of a socially responsible industrial policy.

The second recommendation of the UN Report stressed the need for planning the direction of investment in the private sector without stifling the initiative of the latter. In this respect the state's function is to promote a suitable environment for desired investment without exercising excessive controls. Under the first five-year plan, the government's desire for foreign capital inflow resulted in the almost uncontrolled flow of private investment funds into certain sectors of the economy, namely resource extraction (oil and timber products, minerals) and to a lesser extent manufacturing. Overall the volume of employment

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[162]UN Report, op. cit., Part One, V.

[163]Chapter Two, passim..

created for the capital invested was low, and the nature of the technological processes used ensured a very limited transfer of technological skills.[164] The early willingness on the part of the Indonesian government to accommodate foreign investors had by the final years of Pelita One been tempered to a degree, with a discernible shift toward an increased emphasis on the employment and training of Indonesians, and on the necessity of encouraging labor-intensive and foreign exchange-creating (or saving) industries. The closure of certain industries to further investment in 1970 was followed by the issuance of a list of priority industries.[165] These included agricultural estates, cattle breeding, the manufacture of commodities for use in the agricultural sector, the development of forestry and fisheries, textiles and export-oriented manufacture, including the processing of raw materials. According to the Department of Light Industry, industrial activity was to be directed at the promotion of raw material processing and of industries that created or saved foreign exchange.[166] Related to these priorities was the government's desire to decentralise industrialisation and thus encourage regional development. Areas of priority included Southern Sumatra, East and South Central Java. Industrial estates for Surabaya, Lampung, Cilacap, Batam Island as well as Jakarta were planned and some have begun operation. The development of industrial estates in the provinces are planned with the view to correct the current concentration of investment in the West Java-Jakarta region and as well to encourage the growth of medium and small-scale industries.

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[164]Chapters Three and Four, passim.

[165]Chapter Two, pp

[166]Address prepared by the Department of Light Industry, "The Prospects of Industrial Development in the Second Five-Year Development Plan (Repelita II)", AIBCC (1974), op. cit., p. 5.

The planned development of Batam Island was to have facilitated "offshore" export-oriented production. An indepth survey of the island's potential proposed to establish a free trade zone with industrial estates involving one to three large export refineries, a port, agricultural projects and tourist facilities on the island.[167] Further plans included Batam as the major collection centre for Indonesia's exports and imports, and the establishment of bonded warehouses within the proposed complex was to give teeth to plans to increase the island's export role in the processing of raw materials.[168] The question of bonded warehouses became more important as plans for increasing exports evolved. By June 1974 the government-incorporated P.T. Bonded Warehouses Indonesia was to have taken charge of operations. About 30,000 square metres of land was made available to accommodate twenty factories engaged in processing for export. However it now appears that, because of the Pertamina crisis, the Batam Island project has been indefinitely shelved.[169] Nevertheless, the existence of this type of long-term project, although only partially completed, does indicate an acute awareness amongst policy makers of the necessity of developing a broader and more diversified industrial base in the economy, an awareness of the need to encourage certain types of capitalist investment, namely those that involve the increased penetration of industrial and finance capital. The following chapter describes

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[167]The survey was conducted for Pertamina, the state-owned oil company, by the Japanese and American firms, Nissho-Iwai and Bechtel. See also "The Island of Batam. A Blueprint for Development", EIU, No. 1, 1973; see also Foreign Economic Trends, US Department of Commerce, 28/11/73. Products proposed include a wide variety of industrial chemicals, with production beginning in 1978. See also Australian Trade Mission, for Department of Overseas Trade, Mining and Oil Search Consultancy, Canberra, November 1973. "This is a particularly exciting project and will ultimately supplant Singapore as the commercial and industrial centre at the crossroads of the Eastern Hemisphere's seaways." p. 2.

[168]Department of Overseas Trade, Market Review -- Indonesia, Canberra, 1974.

[169]See Chapter Two, Footnote 38, for detail on the extent of the Pertamina debt.

those activities of the state designed to encourage this process of foreign capital penetration, and thereafter to regulate its activities. There the dominance of the former objective over the latter is demonstrated, but at this point it suffices to stress that the current direction of state policy toward private foreign investment ocrresponds closely with the recommendations of the UN Report; the formal objectives of both bodies is to allow private enterprise to function as private enterprise — to minimise where possible state interference in its activities.

The third recommendation of the UN Report concerned the importance of developing agricultural and mineral-based industries to increase employment opportunities and foreign exchange earnings. Pelita II focused on the need to increase the processing of raw materials into basic and intermediate industrial products and as well to diversify exports to include non-traditional as well as traditional commodities.[170] Chairman of the BKPM, Mohammad Sadli, has in various addresses reiterated his government's desire to partially restructure the economy towards export-substitution, indicating his sympathy for foreign investors in Indonesia; "At the moment Indonesia can only offer low wage rates, plus government willingness to extend custom area facilities on the site to any plant processing for export."[171] Since 1972, when this statement was made,

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[170]"In line with these basic principles [of long-term economic development goals], the goal of the long-term development plan is among other things to fundamentally change the Indonesian economic structure in such a way that the contribution to the national product of non-agricultural sectors may occupy a more and more important part and that industries may become the backbone of the economy....[in] regard to the export of commodities Indinesia will be exporting more and more processed materials and manufactured goods rather than only basic raw materials as was the case in the past." Address prepared by the Department of Industry, AIBCC (1974), op. cit., p. 1.

[171]Sadli, Mohammad, in Drysdale, P. (ed.): Direct Foreign Investment in Asia and the Pacific, ANU Press, Canberra, 1972; see also Sadli's comments in address to the Seminar "Indonesia: Trading Partner", ANU Centre for Continuing Education, Canberra, August 13-15, 1971. See also Ecosen (1) Draper, op. cit.. "Indonesia is anxious to attract labor-intensive export-oriented industries, but the Minister (Sadli) acknowledged the lack of good policies and specific incentives to achieve this aim." p. 62. See also Ecosen (5) Draper, op. cit., p. 125.

further steps by government have substantially improved the prospects for export-oriented foreign investment. Foreign companies have already carried out studies into the profitability of these proposals and the official aid establishments have conducted a wide variety of research into argi-based industries.[172] At the present time, investment in resource-based agri-industries is mainly concentrated in fisheries and forestry, yet the trend toward more broadly based agricultural investment is definitely there.[173] In the poor region of East Java, Japanese companies have been engaged in the export of cassava chips for cattle feed — cassava is increasingly the diet of the poorest sections of the peasantry who cannot afford rice. Exports of palm kernel and oil, maize and cattle show a healthy growth, and are expected to rise in the next few years.[174] Encouragement of foreign investment in the development of the agricultural sector is now a central plank in government policy and the fate of landless peasants may well be to serve capitalist agriculture in the role of a rural proletariat.[175]

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[172]See for example press releases of the International Development Association (IDA), Washington, 1973.

[173]By 1970 the value of fish exports had risen significantly to three times the value of the previous year. By mid-1972 prawning rights were given to four Japanese-Indonesian joint-ventures, one wholly owned Japanese enterprise and several domestic companies. Large-scale modern sector was reportedly doing well, whilst the small-scale local industry was in a depressed condition. BIES, March 1973. Pertamina had made extensive plans to develop new capital-intensive rice estates in the south Sumatran province of Lampung, in collaboration with Japanese capital. For further detail see BIES, July 1972; BIES, March 1973; BIES, July 1973; EIU, No. 1, 1974.

[174]BIES, July 1972: Whilst exports are still dominated by oil and timber, four other commodities [tin, palm oil and kernel, other foodstuffs (including maize, fish and cattle) and "other" (new minerals and manufactures)] have increased their combined share of the export market from thirteen to sixteen per cent.

[175]"...the processing of certain foodstuffs is to be intensified and prepared for exportation such as is the case of marine products, fruit, vegetables and seed preserves, and the production of cattle foods. Together with the development of these agri-industries, activities in the field of agriculture may be intensified which would in turn encourage the production of agricultural machinery." AIBCC (1974), address by Department of Light Industry, *op. cit.*, pp. 6-7.

A similar concern to promote an increased and diversified industrial base is reflected in government policy on mineral exports. By 1973 the aim was to maximise the amount of processing of mineral exports; priority was given to investments that included integrated operations through processing and refining and tax differentials have been established to encourage this.[176]

Besides promoting the export of processed raw materials, the Indonesian government is also keen to increase and diversify exports of manufactured and semi-manufactured goods. To this end, export taxes on over sixty finished goods, including wood products, textiles, products of the assembly industry, chemicals and a large number of food products have been lifted.[177] Low technology level and labor-intensive assembly line operations are generally dominant in these sectors of production and it is considered by the government that export manufacture may in future years have a high growth rate.

Furthermore, the government is aware that reduction in the tariffs of industrialised countries on certain types of imports could act as a stimulus to further direct investment; the Australian tariff reductions are no exception. As reported by W.B. Reid, for chairman of the AIBCC:

> [C]osts and labor problems in Australia, as well as a reduction in tariffs on imported goods have resulted in a change to using imported components rather than Australian components in industry. What better stimulus to further Australian investment in Indonesia?[178]

Although the value of export of light manufactured goods is small in comparison with that of other commodities, its growth has been quite

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[176]Department of Overseas Trade, Mission of Mining and Oil Search Consultants, op. cit..

[177]See Overseas Business Reports, US Department of Commerce, January 1973.

[178]AIBCC (1974), op. cit., remarks by W.B. Reid.

rapid and is expected to increase.[179] Current items exported include glass pipes and electric bulbs exported by Philipps-Ralin, and air conditioners and radios by Japanese joint-ventures.

It is now appropriate to consider the fourth and fifth recommendations of the UN Conference: the need for a "well designed human resources development plan", described as "indispensable to the process of industrialisation", and the need to mobilise indigenous financial resources for industrial development. A most obvious problem that surfaced during the Pelita I period was the shortage of skilled managerial and technical expertise in Indonesia, with the exception of the non-indigenous population of Chinese origin. Foreign capital was considered to bring with it the skills and technology that domestic capital did not possess and the advantages accruing to the domestic economy were seen to be great. Initially foreign investors were under little pressure to employ and train indigenous manpower[180], but social unrest and growing complaints from the indigenous business sector led the government to implement policies designed to help these "economically weak" sectors of the community; this included favouring joint-ventures and those enterprises which guaranteed the training of local manpower: one of the main targets of Pelita II was promotion of policies specifically designed for this purpose. For example, in April 1973 a series of financial measures to stimulate small and middle sized industries were introduced, including

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[179] BIES, July 1972, Survey of Recent Developments, pp. 2-3.

[180] Article 4 of the Foreign Investment Law of 1961 provided that the owner of foreign capital had full authority to appoint his own management; his enterprise was obliged to use local manpower "except in cases which cannot yet be filled by eligible Indonesian applicants, when it is allowed to assign foreign managerial and technical employees"..."All foreign capital enterprises were required to organise and provide regular and systematic training and educational facilities." Investment in Indonesia Today: A Revised Guide to Laws and Procedures for Foreign Investors, Economic Section, Indonesian Embassy, Australia, January 1972.

the lowering of interest rates in many categories of loans.[181] Further detail on these and other related policy moves are offered in Chapter Two.

The fifth recommendation related to the mobilisation of indigenous financial resources. The UN Report urged that local capital be more effectively utilised, for investment rather than for consumption, and that a major task of government would be the creation of appropriate fiscal and monetary policies to ensure that government and private consumption be increased at a slower rate than total gross product, and that private savings be mobilised through the appropriate financial institutions. The government has made moves in this direction and policy has included the creation of money and capital markets. They will also be detailed in the following chapter.[182]

The sixth and final recommendation related to the restructuring of multi-lateral and bilateral foreign aid. The projected industrialisation required that both types of foreign aid be redirected more in favour of the recipient countries — to help raise living standards, accelerate the technology transfer, the growth of the infrastructure, and of research and development.[183] Since previously the flow of aid to the developing

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[181]These measures included the stipulation that sixty-five per cent of all new investment credits from state banks must go to small and medium enterprises; these concerns can also obtain finance from P.T. Bahana and a new development bank set up to assist them with equity, technical assistance and management advice. Foreign Economic Trends, 28/11/73. P.T. Bahana was created in 1973 to channel government-owned capital into new enterprises. EIU, No. 2, 1973.

[182]"...most encouraging is the fact that domestic capital investment since 1970 has surpassed the projected volume of foreign capital investment." Suharto's August 16, 1973, Address of State. Domestic capital investment during the fourth year of Pelita I was reported at Rupiah 353 billion, an increase of almost eighty-five per cent on the previous year, spread over a total of 385 projects. It must be remembered however that most of this is investment by Indonesian-Chinese, many of whom act as front men for foreign investors based in Hong Kong, Singapore and other Asian cities.

[183]For discussion on the question of aid restructuring see CEDA (P Series 10), op. cit..

countries has emphasised prevailing patterns of trade discrimination[184] it is reasonable to expect that in an attempt to effect restructuring of those trade patterns, aid priorities would change. Indeed this is the view of the ADB Report which states:

> Aid and investment should be more heavily concentrated in directly productive export-oriented industries. Aid for agricultural investment and the provision of agricultural inputs such as chemical fertiliser, deserves attention in view of the promise of the Green Revolution.[185]

Within Indonesia itself, there has been quiet but growing criticism of the various aid-sponsored projects, and moves to liberalise aid contracts will undoubtedly be welcomed by the military leaders who are very much aware of social and political tensions resulting from their economic policies. In the words of an Indonesian delegate to the UN Conference:

> ...there is a need not only for the liberal-isation in terms and conditions of aid, but also in the expenses for the realisation of the projects. We all know that, by being always tied to the donor country, foreign aid results in unfavorable high prices for most of the projects.[186]

Pressure is being exerted by both the Indonesian government and international bodies to restructure aid in an effort to maximise the growth pattern now desired by Western and Japanese capital: "the essential problem is to gear financial aid to the development of export opportunity of developing countries."[187]

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[184]ADB Report, op. cit., pp. 324-330.

[185]ibid., p. 332.

[186]UN Report, op. cit., p. 55.

[187]Ecosen (1) Draper, op. cit., p. 7. The Australian Senate Standing Committee observed: "It has been argued that the best kind of

At present, much of Indonesia's aid is directed through a consortium of creditor countries, the Inter Governmental Group on Indonesia (IGGI). Originally, the loans were conditional on the return of foreign properties after the coup and on the eventual repayment with interest, which was by optimistic estimates, expected to keep Indonesia dependent on aid for at least ten years.[188] Because most of the actual work on aid projects is executed by Western and Japanese contractors much of the aid funds do not actually enter the country, but are transferred directly from donor to contractor.[189]

Whilst much of the IGGI aid does remain tied, this share of the total is falling, allowing purchases to be made in the cheaper markets of neighbouring countries. In 1973/74, the IGGI package included a higher proportion of grants, interest-free loans and untied aid than previously. During that year all non-food aid from Australia ($24 million) and part of Dutch and New Zealand contributions were in the form of non-repayable grants whilst loans from Canada, the UK and the World Bank were interest free. However, project aid in 1973 became 45.3 per cent of all aid, showing an increase of about forty per cent between 1971/72 and 1972/73[190]; the problem of debt repayments may well offset the contribution of programme aid to the balance of payments and the budget. The ADB Report admitted that servicing new loans may well absorb thirty per cent of

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[187] (cont.) aid that can be offerred to developing countries is the provision of markets." op. cit., p. 67.

[188] Higgins, B., BIES, March 1972.

[189] "The actual implementation of aid projects, involving financing, purchasing of material, the direction at the construction sites, is entirely done by the donor country, until the projects are completely finished for transfer to the local authorities....No actual transfer of the bulk amount of money to the recipient country takes place." Aid and Development in Indonesia, Information Service of the Indonesian Embassy, Canberra, 21 September 1972.

[190] BIES, March 1973. Project aid has the disadvantage of itself selling priorities and objectives for development by the actual choice and management of projects.

export earnings[191] and the enormous size of Pertamina's debt incurred during the oil price boom can only serve to aggravate the situation.

Clearly it will not be easy to completely restructure aid to accord with new economic priorities, but increased concern with technological transfer is evident. World Bank and UN-sponsored aid has recently been directed to the building of technical schools to help produce the much needed middle order management and technicians. USAID technical assistance is being offered in the case of fertilisers and high yielding varieties of rice, and a recent report indicates a reorientation of aid in the direction recommended by the planners[192]; other multi-lateral aid groups are also implementing a redirection of aid.[193] Recent FAO/UNDP plans for Indonesia checklist against the priorities of Pelita II, and stressed research and development projects related to expanded agricultural production.[194] Loans from the ADB and the International Development

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[191] ADB Reports, op. cit., p. 320.

[192] USAID/Indonesia 1974, "Indonesia and US Assistance". "...AID's legislation...is a major departure from previous years, specifically directs US assistance efforts towards improving the quality of life of the poorest people in developing countries through new programs, i.e., the functional sections of agriculture and rural development, health and population, education and manpower training. For the AID program in Indonesia which has been previously focussed on the problems of stabilisation and rehabilitation of infrastructure, this means a very sharp change in direction." USAID projects include cement and fertiliser plant expansion, power rehabilitation, roads, assistance to the modern agricultural sector, agricultural research.

[193] See for example Higgins, B., "A Development Strategy for Indonesia: The Implications of Foreign Aid", op. cit.. "Thus...every opportunity for effective capital assistance should be seized, the major goal of foreign aid policy in the next few years should be to raise both absorptive capacity and the maximum domestic effort." p. 10. Higgins is also aware of the need to diversify trade in processed natural resources; "What is the outlook for vegetable oils, vegetable fibres, tea, coffee, forest products and even natural rubber in the light of the prospective development of countries in Asia and other parts of the world." ibid., p.10.

[194] These include research into such products as rubber, palm oil and kernel, coconuts, fish and other seafood products, irrigation, land capability, forestry and forest products, livestock planning. See FAO/UNDP Country Program Digest, 1/2/74 (used extensively by the ICP); FAO/UNDP Country Program Management Plan Digest, August 1974; ICP newsletters, various issues, FAO, Rome.

Association have been approved to upgrade sugar estates, and restore and replant rubber and oil palm estates.[195] These shifts in the priorities for aid do not preclude further development on infrastructure, but do reflect the fact that for industrialisation to proceed at a deeper, more effective level, the rural sector cannot be neglected.

It has been argued above that the recommendations of the ADB, UN and Ecosen Reports have to a degree been implemented by the Indonesian government, yet the choice of strategy cannot be taken exclusively in favour of either export-orientation or import-substitution. Certainly the government has moved to encourage the increase of exports of processed, semi-processed materials and manufactured goods, complementary to the need of foreign capital to find low cost export bases in poor countries. In important respects then, the objective needs of foreign cqpital and the government of Indonesia do coincide on this issue. Yet for Indonesia the decision cannot be clear-cut. Although in the long run formal policy decisions already taken favour the growth of export-oriented investment, significant problems remain and the government plans to continue import-substitution in important fields. However this will not include areas that "would unduly penalize domestic consumers or impose continuing burdens for the rest of the industrial sector."[196] Official government criterion for the continuation of import-substitution industries are stated in terms of employment creation and technology transfer. Yet the continual implementation of the import-substitution strategy poses a dilemma. Inward-looking policies must eventually confront the situation of market saturation, and the problem is to decide which shall be continued and which discouraged.[197]

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[195] EIU, "Quarterly Economic Survey — Indonesia", No. 1, 1974.

[196] Nitisastro, W., AIBCC (1974), op. cit., p. 8.

[197] Import-substitution policies "in the longer run...will face services problems when the domestic market becomes saturated. This may

In summary, it is clear that the New Order government's policy of industrialisation involves great reliance on the capacity of private foreign capital (in the form of both aid and direct investment) to develop the Indonesian economy. Although planning by government bodies remains important, particularly with regard to the provision of social overhead capital, it is on the activities of the private sector, especially its foreign component, that heavy reliance is being placed. As Panglaykim and Thomas observed: "On the face of it, the planners are being asked to formulate a plan which will provide adequate opportunities for expansion of the private sector."[198]

The New Order government embraces an ideology which assumes that the development of the Indonesian economy can only proceed by increased reliance on private foreign investment. In contrast to the stated ideals of the earlier Guided Democracy period, "private enterprise is...to be encouraged to play a more active role in the economy."[199]

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[197](cont.) not come until ten or fifteen years later, but once we have set up high cost industries behind protective walls, it will be extremely difficult to change the orientation of those industries from the domestic market towards markets abroad." Mangkusuwondo, S.: "Dilemma of Indonesian Economic Development", BIES, July 1973, pp. 34-35. "In terms of overall development strategy, the Indonesian government feels that support for the export sector is more urgent than protecting import-substitution industries. While most exports are subject to a ten per cent tax, exports of petroleum, some minerals produced under mining contracts, batiks and other handicrafts and over sixty finished items including wood products, textiles, products of the assembly industry, machinery, electric and electronic goods, chemicals and a large number of food products are exempted from it in order to encourage exports of locally produced finished goods." Overseas Business Report, US Department of Commerce, January 1973, p. 4.

[198]Panglaykim and Thomas (CEDA P Series 11), op. cit., p. 19.

[199]ibid., p. 107.

PART TWO:

THE EFFECTS OF FOREIGN INVESTMENT IN POOR COUNTRIES

Once it is assumed that an acceptable rate of economic development can only occur by increased reliance on direct private foreign investment the argument is generally continued within the framework of cost-benefit analysis. In more academic terms, the notions of external economies, linkage and multiplier effects are used to assess the effects of private foreign investment. The second section of this chapter involves brief consideration of both approaches in order to introduce and establish the relevance of concepts that will assist the later evaluation of empirical data.

THE COST-BENEFIT APPROACH

The present popularity of this approach to evaluation of the effects of foreign investment may be explained in terms of the necessity to rationalise a process that is already well advanced, viz. the increasing penetration by foreign capital through direct investment into the economies of poor countries.[200] The cost-benefit approach[201] involves implicit assumptions about the capacity of direct private foreign investment to function in a manner finally beneficial to poor economies; it evaluates the effectiveness of its contribution in terms of the respective strengths of the bargaining positions of the state and foreign capital, and as well the appropriateness of the strategy of industrialisation

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[200]For information concerning the growth of "cost-benefit" analysis literature see Bos, H.C., Sanders, M. and Secchi, C. (for OECD): Private Foreign Investment in Developing Countries, D. Reidel Publishing Company, Dordrecht and Boston, 1974: "...crude practical applications of cost-benefit analysis were made in advance of the availability of a thorough theoretical framework. It is only in the late fifties and especially in the nineteen sixties that cost-benefit analysis attracted the attention of economic theory...."

[201]Bos, et. al., described the cost-benefit analysis "as a method aiming at providing criteria for ensuring the most economic use of scarce resources in selecting investment projects." ibid., p. 345.

pursued by the state.[202] The "costs" to the poor country are similarly evaluated. The usefulness of this approach lies not in its capacity to offer an acceptable method of analysis of the effects of foreign investment; its structural limitations in this regard will be discussed later. Rather the usefulness of the cost-benefit approach pertain to the fact that it presents clearly the type of effects to be expected from foreign capital penetration.

A representative example of cost-benefit analysis may be found in one of the Ecosen reports which listed the following as "benefits which foreign investors particularly multinational corporations, may bring to developing countries, perhaps more efficiently than other less comprehensive vehicles."

- Financial capital (especially foreign exchange)
- Entrepreneurship and managerial know-how
- Technology and training facilities
- Export market-access and experience
- Stimulation of the local business/industrial environment (and consequent more efficient use of domestic capital due to competition)
- Bias towards industrial rationalisation
- Tax paying orientation[203]

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[202] ibid., Chapter Seven, "Social Cost-Benefit Analysis as a Tool in Negotiating with Foreign Firms". The successful maximisation of benefit to the host country involves a process "in which the foreign firm tries to maximise the number of concessions granted and in which the host country tries to maximise national economic benefits....As was mentioned before, the outcome of the negotiations depends primarily on the bargaining strength of the parties concerned." p. 396. "The host country should, by means of project appraisal, determine which of the alternatives proposed is most profitable from a national economic point." p. 398.

[203] Ecosen (5) Draper, op. cit., p. 7.

The costs of foreign investment, which "are often alleged to erode or offset such benefits of foreign investment" include:

- Excessive importing of raw materials, etc.
- Insufficient orientation towards export
- Uneconomic transfer pricing in dealing with overseas affiliates
- Failure to share equity with local entrepreneurs
- Inadequate employment and training of local personnel
- Lack of local research or adoption of technology to local needs
- Absence of local philanthropic activities and identity[204]

The World Bank offers a similar cost-benefit balance sheet. Benefits included:

- Package deal of techniques and management skills
- Foreign investment may better be able to mobilise local capital, which otherwise may not be used productively through joint-ventures
- Saving of foreign exchange
- Access to export markets
- Tax paying orientation
- Increased employment and earnings "to the extent to which they are additional rather than alternative to local investment"

This may lead to ancillary local investment as well. Costs included:

- A tendency to capital intensity, reliance on parent term prototypes and lack of technical suitability
- Redistribution of revenues from subsidiary to parent
- Sale of raw materials or components at prices higher than in world market

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[204] ibid..

- Research and development in parent firm's country
- Lack of response to government monetary policies
- Fragmentation of production through government allowing large numbers of investments into each production field
- Backward linkages are difficult to establish
- Import-substitution nature of foreign investment means too few exports — foreign investment places restriction on ability to export[205]

Both reports recommended that to decrease cost and increase benefit, governments must devise appropriate strategies to achieve this.

> The extent to which the benefits of foreign investment are gained and costs minimised thus depends on the appropriateness of the industrialisation policy mix. It is true that the purpose of foreign, as of local entrepreneurs is to make profits, but with well designed policies the economic benefits of foreign investment...exceeds the costs; the flow of foreign investment in manufactures among developed countries which greatly exceeds foreign investment in developing countries is convincing evidence in support of this conclusion.[206]

The Ecosen Report similarly placed the responsibility for maximising benefits onto the government of the poor country: "...governments may develop policies and measures to maximise the net contribution of foreign investment to the achievement of their national objectives, while

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[205]International Bank for Reconstruction and Development, Bank Staff Working Paper, No. 149, "Private Foreign Investment in Developing Countries", prepared by Economics of Industry Division and International Economy Division, Development Economics and Economic Analyses and Projections Department, April 1973, pp. 4-7. [Hereafter cited IBRD (No. 149).]

[206]IBRD (Hughes), op. cit., p. 54 (emphasis added). See also IBRD (No. 149), op. cit., which states that governments of poor countries "are more conscious of their ability to shape events and negotiate from strength and investors are more pragmatic and flexible in their approach to investment in the developing world." p. 3.

foreign investors pursue corporate interests which do not conflict, with the hosts' objectives."[207] The lynch pin of a successful development policy lies in the mutual accommodation of interests of the two parties. A crucial question flowing from this is the relative bargaining strength of each.

The position of the host country in this process of bargaining will not depend only on internal factors pertaining to the needs of the domestic economy and the exigencies of the political situation. It is as well a function of external factors. For example, the condition of the world market in terms of the necessity to export commodities, and the extent of competition between foreign corporations for investment permits within the "host" country are both important factors in determining the bargaining capacity of the state.[208]

Besides these factors, the type of arrangements made between foreign capital and the "host" country are assumed to be of critical importance to the maximisation of benefit. In recent years stress has been placed on the capacity of the joint-venture company to ensure the maximisation of benefit, a view shared by both the Indonesian government and Australian investors in that country, as well as by the international institutions of the capitalist world.[209] It is widely assumed that the

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[207] Ecosen (5) Draper, op. cit., p. 7.

[208] As Sadli and Arndt have argued: "Indonesia relies for defense of her national interest vis-a-vis the large foreign corporation on competition between the foreign companies, between major companies and independents, and between companies of different countries. How effective this defense will prove remains to be seen." Sadli, M. and Arndt, H.W.: "Foreign Investment in Indonesia", Third Pacific Trade and Development Conference, op. cit., pp. 5-6. See also AFR, 12/11/73, 24/12/73, 18/6/73.

[209] On the advantages to the foreign investor to be derived from joint-venture arrangements see comments by J.B. Reid, AIBCC (1974), op. cit.; Ecosen (4) Allen, op. cit., pp. 10, 24; SEADAG (Allen), op. cit., pp. 34-35. Allen lists seven reasons why Japanese executives prefer joint-venture arrangements to one hundred per cent foreign control: (1) lack of familiarity with local conditions; (2) the risk is spread; (3) prior trading partner suggests that direct investment be made through the medium of the joint-venture; (4) increased host country acceptance;

mere existence of joint-venture arrangements will automatically bring benefits to the host country[210]; private foreign capital brings with it resources necessary for industrial growth in the form of money, machinery, managerial skills and technical knowledge. Furthermore the transfer of skills is assumed to be most readily facilitated through joint-venture ✓ arrangements.

Joint-ventures are also considered one of the better ways of mobilising possibly idle or non-productive local capital, because they involve domestic equity participation. As a consequence, it is argued that a greater percentage of profits from joint-venture enterprises will accrue to the poor country. Furthermore, it is claimed that backward and forward linkages will be better developed and external economies more effectively utilised through joint-venture, due to the presence of some local control in the enterprise.

These are benefits that are claimed to accrue to the host country, but it is recognised that the foreign investor will also gain advantage in several ways. Joint-ventures will reduce the possibility of challenges ✓ of foreign domination, by introducing local equity. "To skirt this psychological barrier, many suggestions for new investment policies have been made. Joint-ventures, in which private foreign investors share their ownership and control with local investors in the host country, are one of these."[211] They may then give the foreign partner a competitive edge on wholly-owned foreign enterprises producing in the same sector

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[209](cont.) (5) the motive for investment may not require complete ownership; (6) control of distribution held by local investor; (7) local partner skills that supplement those of the foreign investor. For attitude of the international capitalist institutions toward joint-ventures see ADB Report, op. cit., Part Three, pp. 224ff., and Part Five, pp. 420ff. See also comments made by Soehoed, Vice Chairman of BKPM, AIBCC (1974), op. cit., and AIBCC (1973), op. cit..

[210]Bijli, op. cit., pp. 73ff.

[211]ADB Report, op. cit., Part Five, p. 424.

by reducing costs and as well serving diplomacy.[212]

The joint-venture partner is a guide to the foreigner through the maze of proceedings that pre-empt any actual investment and "he can and does bring about a reduction both in the capital cost of the project and in the limitation of the downside political risk."[213] The local partner may also serve an important function in distribution, especially in Indonesia where government regulation forbids foreigners the right to distribute their goods, except in special circumstances. "The major problem in penetrating the consumer and capital equipment market lies with the means of distribution, and successful marketing and investment therefore depends largely upon engaging a suitable agent or partner with a network of outlets and contacts."[214] Thus the choice of partner for the foreign investor is important in his overall desire to reduce both financial and "psychological" costs of foreign investment. Joint-ventures are also seen as a means to satisfy more adequately than previously, the need to "transfer" technical, managerial and professional skills from the foreign-owned to domestically-owned sectors of the economy. Overall the institution of the joint-venture is viewed to function to the mutual benefit of both foreign capital and the poor country economy.

The cost-benefit approach to evaluation of the effects of private foreign investment involves consideration of real phenomena of the type

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[212]The point was recognised by the National Industrial Conference Board who argued that "(w)ith the continuing increase in nationalism and the growing demand for private capital around the world, many believe that the international joint business venture will become the most important vehicle of private foreign investment." Quoted in Bijli, *op. cit.*, p. 75.

[213]Patterson, J.: "Some Aspects of the Personnel Problem in Foreign Investment", address to seminar "Indonesia — Trading Partner", *op. cit.*.

[214]*Department of Overseas Trade*, "Indonesian Market Review" (1974), *op. cit.*, p. 3.

discussed at a later stage in the thesis. However, the nature of its limitations preclude its adoption as a framework for the analysis of such effects. In the first place, it is an approach which assumes the validity of the "benefits" it describes and furthermore places heavy reliance on the effectiveness of the bargaining process and upon the appropriateness of domestic economic policy for the maximisation of "benefit". In Chapters Four and Five of the thesis the "benefit" assumptions will be demonstrated to be either false or misleading; in Chapter Two, an analysis of the economic functions of the post-colonial state will suggest both the highly limited effectiveness of the bargaining position of the state, and as well demonstrate that the character of the New Order industrialisation policy precludes any significant state-directed activity to counter the "costs" of direct private foreign investment.

Moreover the cost-benefit analysis suffers from fundamental flaws in general approach. It fails to recognise, for example, that some "costs" to poor countries are such that their effects within the economy become structural to it — that is, they result in certain built-in features which mature over time, or assist the maturation of existing features. For this reason they may not be considered in isolation, on face value alone, but must be recognised as creating or augmenting structural features of the economy. Comprehension of the latter is crucial to an understanding of the reasons for the dominant trend in the content, rate and direction of economic activity. In short, the cost-benefit approach is both a-structural and a-temporal; it fails to examine and account for effects within a framework that allows the wider ramifications of foreign investment to be assessed. Furthermore such an assessment requires the recognition of the crucial role played by political factors in economic growth, a phenomenon which is precluded in the cost-benefit approach. Its parameters deny the possibility of genuine consideration of political factors in shaping the direction of economic change.

Despite these flaws, the cost-benefit approach does identify important phenomena that result from direct private foreign investment. One point of emphasis is the stress on the necessity of increasing the "multiplier" and "spread" effects of private foreign investment, particularly in relation to the transfer of technological and managerial skills. Thus the ADB Report argued for example that "frequently a foreign enterprise may fail to generate any educational benefits precisely because the technology it employs is too advanced to be absorbed by a country with its existing educational facilities and level of skills."[215] In sympathy the UN Report conceded that at present the costs of foreign investment outweighed the benefits and recommended that governments of supplier countries adopt measures "in order to induce a freer flow of technical know-how at a reasonable cost."[216]

The importance of the operation of the spread and multiplier effects, and the resultant external economies created, to the growth of an industrial economy may not be underemphasised. Economists like Dobb and Puthucheary were well aware of the failure of colonial investments to engender economic growth because of their "enclave" nature and consequent lack of linkage to the rest of the economy.[217] Consequently it is relevant now to examine the more academic arguments pertaining to the effects of private foreign investment.

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[215] ADB Report, op. cit., p. 25. See also Part Three.

[216] UN Report, op. cit., p. 28. The remarks of Suwoto Sukendar, Air Chief, Vice Marshal and President of the Indonesian Chamber of Commerce and Industry are relevant here. He argued that "it is not enough for a foreign company just to invest but,...(there must be) a climate of encouragement for Indonesian business so that we will have the incentive and the initiative and the ingenuity to seek opportunities for successful future business in Indonesia." AIBCC (1974), op. cit., p. 3.

[217] See this chapter, section entitled "Comprehensive State Planning: The Socialist Case".

INDUSTRIAL GROWTH AND THE PRINCIPLES OF THE MULTIPLIER

Subsequent to the colonial period, investment by industrialised nations in "underdeveloped" economies has been widely criticised for its failure to facilitate sustained industrial growth. The focus of criticism has been its effect on maintaining the poor country at a low level of industrial capacity and technological knowledge, and its inability to engender significant employment opportunities; in short its "enclave" characteristics have been identified as structurally harmful to the industrialisation of poor country economies. In the post-colonial period, the necessity of decreasing (but not necessarily eliminating) the "enclave" character of foreign investment is shared by the international capitalist institutions, poor country governments and foreign capital itself. Significant growth of the industrial sector is recognised as a crucial factor in the process of economic growth, and it is one that may only occur if certain types of investment are made; specifically those which are capable of facilitating the "spread" and "multiplier" effects to the traditional and generally indigenously-owned sectors of the economy. If such effects can be generated by foreign investment then it is possible to argue that such investments are beneficial in that they assist the growth and diversification of the industrial sector. The final section of this chapter is thus concerned to examine the concepts of the multiplier and external economies and make clear their relation to the process of industrial growth. Subsequent chapters will seek to demonstrate their specific and essentially limited character by reference to the effects of Australian private investment in the light manufacturing sector of the Indonesian economy.

Foreign investments are assumed to involve the creation of external economies or diseconomies that accrue to the economy as a whole, and not only to the individual investment. Scitovsky discusses the term and argues that

> (d)efinitions of external economies are few and unsatisfactory. It is agreed that they mean services (and disservices) rendered free (without compensation) by one producer to another....It is also agreed that external economies are the causes for divergence between private profit and social benefits and thus for the failure of perfect competition to lead to an optimum situation.[218]

Backward and forward linkages are created from any given investment by the encouragement of other related investments; consequently any one given investment results in increased investment, employment, "technological transfer" and greater productivity than is immediately evident to the individual investor.[219] Closely related to the concepts of external economies and linkages is that of the multiplier. It is not possible here to discuss this complex concept more than briefly; its major application has been with the problems posed by investment, employment and economic growth in industrialised nations and was popularised in Keynes' "General Theory of Employment Interest and Money". Central to this is the concept of the investment multiplier, defined by Dillard in the following way: "The investment multiplier means that when investment increases, national income will increase not only by the amount of investment but by some multiple of it."[220] V.K.R.V. Rao argued that the application of the investment multiplier concept to the economies of poor countries is inappropriate; he concluded "that the multiplier principle

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[218] Scitovsky, T.: "Two Concepts of External Economies" in <u>Journal of Political Economy</u>, April 1954, p. 143.

[219] See Footnote 79 this chapter for Hirschman's succinct explanation of the linkage effect.

[220] Dillard, D.: <u>The Economics of John Maynard Keynes</u>, chapter entitled "The Propensity to Consume and the Investment Multiplier", Crosby, Lockwood and Sons Ltd., London, 1948, p. 76.

as enunciated by Keynes does not operate in regard to the problem of diminishing unemployment and increasing output in an underdeveloped economy."[221] Rao maintained that whilst the investment multiplier remained a key concept within the theory of industrialisation for wealthy nations, the factor endowments of poor countries excluded its rational application there. The limited capital equipment, the low level of Western technological knowledge, comparatively low wages and small numbers of wage earners combined with production geared mainly for self-consumption, rendered the application of the investment multiplier and indeed the whole theory of industrialisation based on the Western model totally irrelevant to the needs of poor country economies. He commented:

> In the case of an underdeveloped economy... household enterprises dominate and production is more for self-consumption than for the market with the result that when there is an increase in income the marginal propensity to consume leads to an increase in the demand for self-consumption rather than for purchase in the market....The extra self-consumption induced by their increased consumption is less than what it would have been if their increased consumption had been purchased in the market. Such a conclusion would appear to undermine the theory of the (investment) multiplier, the whole basis of which is the marginal propensity to consume; and yet that seems inevitable in an underdeveloped economy dominated by household enterprises and production for self-consumption.[222]

Rao's rejection of the income multiplier appears well founded and his conclusions are supported in essence by fellow Indian economist A.K. Das Gupta. He reasoned that Keynes' notion of involuntary unemployment had limited relevance to the situation of poor economies, where

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[221] Rao, V.K.R.V.: "Investment, Income and the Multiplier in an Under-Developed Economy" in Keynesian Economics: A Symposium, Singh, V.B. (ed.), Peoples Publishing House, Delhi, 1956, p. 175.

[222] ibid., pp. 174-175.

disguised unemployment and subsistence production in the agricultural sector were the dominant economic facts.[223] Das Gupta argued that the Keynesian multiplier effects were present to a limited degree in poor economies — in the modern foreign-owned sectors only. These effects however were "negligible in the context of the volume of investment needed to fully absorb the reserve of unemployed...."[224] Thus whilst "(the) possibility of involuntary unemployment is not denied...its magnitude is not likely to be appreciable, if only because the marginal propensity to consume in a low level economy...tends to be relatively high."[225]

Central to his argument was the distinction between Keynes' concept of involuntary unemployment and disguised unemployment, which in poor countries takes on a distinct property derived from the dominance of subsistence agriculture[226] — the sector that "does not come under money transactions at all."[227] Like Rao, Das Gupta concluded that the Keynesian investment multiplier is insufficiently operative in poor economies to function as a useful tool of analysis.

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[223] Das Gupta, op. cit..

[224] ibid., p. 46. "...(the) place that this sector occupies in the national economy from the point of view of its contribution to employment...is surely insignificant." p. 33.

[225] ibid., p. 34.

[226] Disguised unemployment "(as it) applied there, is to be explained not in terms of a 'decline in effective demand' but in terms of a shortage of capital relative to the current size of population. In the rural sector, there is surplus labor pressing on a limited stock of land. And since the mode of production is family-oriented and pre-capitalistic, the laborer enjoys a living which is set by average productivity, even though the marginal productivity may be zero. On the other hand, there is not enough outlet for this surplus labor in the urban sector where shortage of capital is already depressing the real wage rate down to the subsistence level of workers...the situation calls for an accelerated rate of investment towards capital formation." ibid., pp. 41-42.

[227] ibid., p. 34.

The additional multipliers identified by Puthucheary however are better suited to an analysis of the effects of direct foreign investment in poor country economies, since they are concerned with the indirect rather than the direct effects of investment, in manufacturing and resource extraction respectively.[228] Operating in any economy, either industrialised or semi-industrialised, are both the Keynesian income multiplier and what Puthucheary chose to call the secondary multipliers; the important point to grasp is the manner and intensity of their operation, and a recognition that the differing material, political and ideological conditions of industrialised and semi-industrialised societies render the operation of the multipliers vastly different in each case.

Although Puthucheary's analysis derived from a study of the objective conditions of the Malaysian economy, its thrust is applicable more generally — to the economies of poor countries which are characterised by the dominance of foreign capital, its concentration in the resource extractive sector, and as well by an underdeveloped industrial sector. The objective of Puthucheary's analysis was to explain the limitations to poor country industrial development in terms of the effects generated by the prevailing pattern of foreign investment, viz. the dominance of investment in the resource extractive sector. He argued that both the investment multiplier and the secondary multipliers do not operate effectively to stimulate the growth of the industrial sector because of the characteristics of foreign capital when employed exclusively or predominantly in the extractive sector. Its "heterogeneity", its "homing tendency" and the consequent inability to generate the effective operation of the secondary multipliers, militate against the

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[228]Puthucheary, op. cit., p. 146. Puthucheary argued that "(t)he income multiplier is probably quite small in Malaya because of the large export of profits, import of most of our consumption goods and also the export of a part of the wages." p. 146.

development of industrial capacity and the mobilisation of domestic capital.[229] Like Das Gupta, Puthucheary admitted to the limited operation of the investment multiplier within the wage-labor resource extractive sector of the economy, but was emphatic in stressing that the combination of very low wages and high profits, and their tendency to be sent abroad, restricted its effective operation.[230]

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[229]The concepts of "heterogeneity of capital" and its "homing" tendency have been discussed in this chapter, pages . To repeat: "...as well as being unable to generate secondary multiplier effects in underdeveloped territories, foreign capital has certain characteristics that make capital accumulation in sectors controlled by it incapable of flowing into other sectors." ibid., p. 155. Amin describes the same situation in terms of the disarticulation of the economic system. "This lack of communication between the different sectors of the underdeveloped economy is due to this disarticulation of the economy in question. An advanced economy forms a coherent whole, made up of sectors that carry out substantial changes between themselves, what may be called 'inter-industrial' or 'intersectoral' exchanges. Thus, these sectors appear complementary, solid with each other, so to speak:....An underdeveloped economy, however, is made up of sectors that carry out only marginal exchanges among themselves, their exchanges being made essentially with the outside world....The disarticulation of the economy prevents the development of any one sector from having a mobilising effect upon the rest. Any such effect is transferred abroad, to the supplying countries: the sectors of the underdeveloped economy appear as extensions of the dominating advanced economy. In turn, this disarticulation and its corollary, the unevenness in productivity, are reflected in the distribution of the gross internal product and of investment, which is very different from that which is typical of the advanced countries." Amin, op. cit., pp. 16-17. See also p. 28: "Development choices have to be guided so as to ensure for the new economy the overall cohesion missing from underdeveloped economies by deliberately creating...integrated industrial groups made up of complementary activities."

[230]"The outflow of private funds is not all due to foreign investors not reinvesting. A significant proportion of the outflow is the result of unassimilated immigrants remitting their savings to India and China." ibid., p. 160. Amin similarly dismisses the application of the multiplier principle to poor economies. "Actually if the Keynesian analysis is not valid in the underdeveloped countries, this is because these economies do not suffer from inadequacy of demand, as do the economies Keynes studied. One ought therefore not to say that the analysis of the Keynesian multiplier is always valid, but that benefit of the multiplier effects of investment has not accrued to the underdeveloped economies owing to their propensity to import and to hoard.... The Keynesian analysis is not valid in the setting of underdevelopment, because hoarding is not, in these economies, a leak which reduces demand below the level of supply, but is comparable to luxury consumption.... It is indeed the export of profits, and this alone,...that cancels out the multiplier effect of foreign investment." Amin, op. cit., pp. 234-235. See also his whole section on this point, "Export of Profits and the Cancellation of the Multiplier Effects of Investment in the Periphery", pp. 231-235.

As well as stressing the inapplicability of the investment multiplier, Puthucheary also demonstrated the highly restricted operation of the secondary multipliers. Two such multipliers were identified, the main and the subsidiary. The former accounts for the indirect effects of investment in the manufacturing sector, the other in the extractive sector. In the process of investment, production and distribution, they generate the transfer of skills, both technical and managerial, assist improved communications and services, social and psychological changes and other major external economies. The extent of their effectiveness, the degree of intensity of the "industrial development radiating impulses," are a function of the type of investments made; viz. the nature of the technical processes adopted, the demand for local labor and materials, the capacity to induce additional investments (i.e., the extent of the backward and forward linkages created), and the capacity to mobilise local capital in the direction of investment in industrial capacity. Puthucheary argued that both the main and the subsidiary secondary multipliers operated very feebly within a poor country economy, and thus fail to stimulate the growth of an industrial sector. He reasoned that investments in the extractive sector by foreign capital did not allow the operation of "industrial development radiating impulses" since the "quick growth which takes the form of added impetus to growth and expansion of existing major skills, industrial and managerial know-how, public works and other major external economies, goes to countries using the raw materials in industrial processes."[231] The producer country on the other

[231] ibid., p. 148 (emphasis added). Similarly, Paauw observes that the technical dualism of the Indonesian economy resulted in little spread effect in terms of income or technology from the modern to the traditional sectors. Potential linkages were also inhibited by foreign and minority group assumption of intersectoral distributive roles, which prevented the evolution of a demonstration effect goward the modernisation of techniques in the traditional sector. Dualism also meant limited transmission of attitudes which may have induced capital formation and lowered the birth rate. Paauw in McVey, op. cit., pp. 171ff.. See also

hand did not benefit greatly from these external economies although the development of physical and financial infrastructure, whilst originally geared to the needs of the foreign-controlled sector, did offer some reward to the host country. Moreover, the existence of the extractive sector produced the conditions for the development of some subsidiary industries. In sum then, the benefits of foreign capital investment in the extractive sector "are not of the kind that are capable of the dynamic radiation which has revolutionised society in industrialised countries"[232]; "they are a by-product and are much less beneficial than the main secondary multiplier effects which come from investment in an industry whose products (are) processed or manufactured locally and where profits are locally reinvested — not exported for investment in other countries."[233]

Thus it is in the character of the main secondary multiplier that Puthucheary sees the potential for industrial development since it pro-

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[231](cont.) Singer, H.W.: "The Distribution of Gains Between Investing and Borrowing Countries" in American Economic Review, Vol. 40, May 1950. Singer points to the lack of spread effects and the weakness of linkages between sectors due to the concentration of foreign investment in the extractive sectors of poor country economies.

[232]Puthucheary, op. cit., p. 149. A comparable case is put forward by Bos, et. al.: "The existence of forward and backward linkages is not always an important consideration. Especially in the older literature one finds many examples of 'enclave' type of foreign investments, which operate almost without links with the economy of the host country. This type of investment...was predominant in mining and plantation agriculture, but is by no means limited to these sectors. Also in manufacturing and in service industries 'enclave' type of industries may occur." Bos, op. cit., p. 40. Paauw argued that the characteristic differences in productive techniques between the modern foreign-dominated extractive sector and the labor-intensive traditional sector were so great as to render impossible any significant transfer of techniques or income to the traditional sector. "Modern techniques of production...were not designed to absorb labor from the traditional economy, nor was the sector as a whole operated to raise Indonesian income. Spread effects in terms of introduction of new methods beyond the sector and raising incomes of some Indonesians were incidental...." Paauw in McVey, op. cit., pp. 171ff..

[233]Puthucheary, op. cit., p. 151.

motes the radiation of industrial development impulses which in turn create the "conditions capable of engendering considerable industrial development...conditions that would make large-scale capital investment profitable and attractive."[234] If such investments are made, the further generation of external economies could encourage industrial activity by the indigenous capitalist classes and reduce their propensity to hold capital in sterile forms. Yet the process is not an easy one. The economies of poor countries are dominated by trade, not by direct investment in manufacturing; "trade does not lead to (industrial production)... it tends rather to have backward effects and to strengthen the forces maintaining stagnation or repression."[235] Furthermore, the lack of industrial development can be explained in terms of the "heterogeneity of capital", a characteristic that makes it difficult for profits to flow from industry to industry, and thus develop the economy to the limits set by natural resources and the state of technology.[236] It is the lack of machinery and skill to make possible the movement of capital between different sectors of industry that determines this; fixed capital

> is heterogenous; it can only be transferred from industry to industry by stages, especially where the industries are radically different. The fixed capital has to be turned into liquid capital and then turned into the required fixed capital. But can liquid capital be freely transformed into different forms of capital?...The limitations of knowledge and entrepreneur capacity of owners of capital make liquid capital — to most intents and purposes — illiquid....The limitations of individuals or groups can be

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[234] ibid., p. 147.

[235] ibid., p. 144. Puthucheary quotes Gunnar Myrdal's "Eocnomic Theories and Underdeveloped Regions". In this he is close to Baran's analysis of the effects of trade on capital formation.

[236] ibid., p. 155.

> transcended and very often are. For this there must be the machinery to make the transfer. This may not be lacking in industrial countries, but in underdeveloped countries such transfers are faced with many problems.[237]

It is this heterogeneity of capital and the dominance of the trading sector, that render the operation of the main secondary multiplier very weak; no significant radiating impulses are generated. To put it another way, whilst the conditions for the accumulation of capital are quite high, the opportunities for investment in industrial capacity are low. In Puthucheary's terms:

> The high rate of saving is not turned into a high rate of capital formation. The reason is quite simple. Much of what is saved is exported; very little of it is reinvested.
>
> It is not enough to say that profits are not reinvested because...(the poor country) lacks attractive investment opportunities. Lack of attractive investment opportunities is largely due to development by foreign capital which is incapable of engendering the conditions for growth of other industries and thus _providing_ opportunities for reinvestment of profits. Much of the secondary multiplier effects depend on how much of the profits are reinvested. But the lack of initial secondary multiplier effects discourages reinvestment of profits and the upward circular causation is broken at a very early stage.[238]

If, as Puthucheary claims, this does occur, and foreign investment in the resource-extractive sector prevents the development of industrial capacity, what then is the point of considering his analysis? As later chapters will demonstrate, the Indonesian economy is experiencing a degree of industrialisation, and is no longer characterised by key investments made solely in the resource-extractive sector. Moreover, it is

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[237] _ibid._, pp. 156-157.

[238] _ibid._, p. 154 (original emphasis).

formal objective of the Indonesian government to promote the growth of the industrial sector, and as well the thrust of recommendations made by the international capitalist institutions and arguably the desire of many foreign firms. As earlier sections of this chapter demonstrated, the processing of raw materials and the growth of the industrial sector are beginning to occur. In later years it is arguable that much of Indonesia's industrial capacity will be directed at the export market; thus the contention that trade hampers industrial development is only true insofar as it involves solely the export of unprocessed raw materials. At this stage merchant capital is dominant. But as Kay observed, conditions have changed and

> (t)o survive as capital it (is) forced out of trade directly into the sphere of production; that is, it (is) forced to act as productive capital openly. At the same time productive capital which (has) previously restricted its activities to the developed world...(is) obliged to intervene directly. The result (is) a new phase in the history of underdevelopment: the inception of a capitalist mode of production proper in the underdeveloped world.[239]

In Indonesia it is demonstrable that this process is now occurring; since the early 1970's the economy has experienced a quite respectable growth within the industrial sector. It is true that the bulk of activity has been directed at the production of consumer goods for the domestic market with less activity in the production goods sector; but the actual and proposed investments in the production of intermediate and basic goods are an important new development, not merely in terms of production per se but because of the implications that their existence has for longer-term and more diversified industrial production. Thus the type of

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[239]Kay, G.: Development and Underdevelopment: A Marxist Analysis, Macmillan Press, London, 1975, p. 124.

investments made, in terms of the commodity produced and the techniques employed, render the adoption of Puthucheary's concepts of secondary multiplier and radiating impulses quite suitable. Moreover, much of this latest wave of foreign investment has taken the form of joint-ventures with local capitalists, an arrangement that would appear to stimulate and mobilise domestically-owned or controlled capital, a condition that Puthucheary identified as important to the development of the industrial sectors.

The precise nature of the current process of industrialisation will be more fully dealt with in Chapter Four; what is important here is to establish that the present and proposed volume and type of industrial activity in Indonesia warrants the adoption of a conceptual framework of the type developed by Puthucheary and others. Their stress on the importance of external economies and on the necessity of intense and steady radiating impulses to the growth of a healthy and diversified industrial sector are well placed. They are clearly suited for use in the later analysis of the effects of direct private foreign investment in Indonesia's manufacturing sector, and as well are appropriate in a more general evaluation of the type of industrial development at present occurring in that country.

CHAPTER TWO

INTRODUCTION

> Accumulation — expanded reproduction — is an essential inner law of the capitalist mode of production...but it is not an inner law of the functioning of pre-capitalist modes of production.
>
> Samir Amin (p. 2)

This thesis is concerned at a theoretical level with an examination of the interaction of foreign capital, domestic capital and the post-colonial state. In particular, it attempts to establish the characteristics of their respective roles within the process of economic change. The objectives of this chapter are therefore to outline the structural relations that are continually being created and modified between foreign capital, domestic capital and the post-colonial state, by focussing on the "indirect" economic functions performed by the state. This involves an examination of the physical, legal and financial infrastructure at present being developed in Indonesia by the New Order government to facilitate the spread of the capitalist mode of production and relations of production into the domestic economy. Furthermore this chapter examines some of the factors that hinder this process, and looks as well at some policy measures either taken or proposed by the government to eradicate these impediments to capital accumulation. In the course of such examinations it becomes clear that the spread of the capitalist mode of production to Indonesia engenders the development of contradictions within society, contradictions which may only be partially or temporarily resolved by state action.

CONTENTS

PART ONE:

THE STATE IN POST-COLONIAL SOCIETY: ITS FORM AND FUNCTION

The importance of outlining the form and function of the post-colonial state derives not only from consideration of method, but also from an obvious but hitherto neglected political question, viz. the relationship between formal political independence and the functioning of twentieth century imperialism. Radical scholarship, in its well founded intention to demonstrate the dependence of the poor nations on the rich capitalist ones, has tended to concentrate its efforts on explaining the essentially dependent and unequal nature of the relationship between the periphery and the metropole.[1] As Kay correctly observed, the focus of this "structuralist" school was to define the problem of underdevelopment in terms of trade relations; it located its analysis within the sphere of circulation rather than production and emphasised the distortion of the structure of production and consumption in the underdeveloped country as a result of its integration into the world economy. "Economic dependence" was the result; the concept is criticised by Kay whose Marxist framework directs him to an analysis of underdevelopment in terms of the law of value.[2] He writes:

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[1]For example the works of A.G. Frank, and of Paul A. Baran: (1) The Political Economy of Growth, Penguin, Harmondsworth, 1973 (first published 1957) and (2) "On the Political Economy of Backwardness" in Rhodes, R.I. (ed.): Imperialism and Underdevelopment, Monthly Review Press, New York, 1970. Baran views imperialism as the barrier to development in poor countries. He states: "the principal impact of foreign enterprises on the development of underdeveloped countries lies in the hardening and strengthening of the sway of merchant capitalism and slowing down and indeed preventing its transformation into industrial capitalism." Baran (2), ibid., p. 194. For a more comprehensive list see Kay, op. cit., p. 9, Footnote 10.

[2]"...the law of value provides the only satisfactory basis for such a theory which is not only adequate to its object, but which is also the definitive critique both scientifically and politically of conventional development theory and its radical offshoots." Kay, op. cit., p. 12.

> But this concept [of dependence] fails to grasp the real nature of the process of underdevelopment. The immediate explanation for this is the theoretical framework employed. This does not recognise the law of value but is an electric combination of orthodox economic theory and revolutionary phraseology, seasoned with supposedly self-explanatory facts, such as data concerning the pattern of trade and capital movements ....The conclusions reached are not wrong insofar as they go, only they cannot get beyond the level of general ideological critique.[3]

As a consequence, structuralist analysis of underdevelopment has neglected to consider the importance of _internal relations_ in the periphery, and has thus also omitted to consider the political and economic ramifications of those from its explanation of the imperialist nexus. One possible reason for the misplaced emphasis was the failure to appreciate fully the crucial differences between imperialism in the nineteenth and early twentieth centures and imperialism of the post-war period, when formal political independence and the changing nature of international capitalism resulted in a qualitatively different emphasis on both the level and character of the exploitation and dependence of poor countries. The "old" imperialism _did not to any significant degree introduce new relations of production into the colonies_, but extracted surplus value through export and the expansion of the "enclave" type of investment. In sum, it did not result in the spread of capitalist relations of production to the periphery, although it did tie the periphery to the world market. This situation led writers like Gunder Frank to concentrate their analyses on the questions of external surplus extraction, the drainage of wealth from the colonies and their resulting stagnation.[4]

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[3] _ibid._, p. 104.

[4] See James O'Connor's article, "The Meaning of Economic Imperialism" in Rhodes, _op. cit._, for a lucid explanation of the differences between old and new imperialism. See also Hamza Alavi's article, "Imperialism, Old and New" in _The Socialist Register 1964_, Miliband, R.

The situation clearly changes however, if "colonialism is seen as merely one form of imperialist domination...."[5]

Whilst writers like Frank and Baran were correct in their concern to demonstrate the dependence of poor countries on rich capitalist ones, their failure to employ a dialectical analysis led to what may be termed a "metropole-centric" view of imperialism. In employing such a framework of analysis, their appreciation of the potential or actual political forces that developed in the periphery was curtailed. Such forces function to either mediate the terms of dependence and exploitation (the post-colonial state) or to break away from these conditions completely (revolutionary classes). As Petras argued:

> The issue in debate has been over 'under-development' and the focus has been on which social system is more conducive to growth and 'development' to overcome underdevelopment. While of late some attention has been paid to income distribution and inequalities — the sources of these inequalities, their roots in social relations and state control, have been passed over. The issue of exploitation, rooted in capitalist social relation or in bureaucratic forms of statism, has hardly been analysed; even less so have class relations served as a point of departure within which to locate the problem of capital accumulation and expansion.[6]

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[4](cont.) and Saville, J. (eds.), Merlin Press, London, 1964. See also Resnick, S.A.: "The Second Path to Capitalism: A Model of International Development", Journal of Contemporary Asia, Vol. 3, No. 2, 1973. Resnick is aware of two possibilities. He acknowledges Baran's contention (see Footnote 1 above) but maintains that "(at) some point, often determined by the weakness in the Centre, this class must free itself from this coalition with foreign capital and use the state to direct the agricultural surplus to industrial growth. Thus the second path becomes a viable route when merchant capital is transformed into industrial capital via state action." p. 135 (emphasis added). See also Stenzel, K. and Heinz, W.: "The Capitalist State and Underdevelopment in Latin America: The Case of Venezuela", Kapitalistate, 2/73.

[5]O'Connor, J., op. cit., p. 116.

[6]Petras, J.: "New Perspectives on Imperialism and Social Classes in the Periphery", Journal of Contemporary Asia, Vol. 5, No. 3, 1975,

Whilst there is agreement amongst the critics of the metropole-centric school concerning the necessity of considering internal class relations within the periphery, there are fundamental differences between those who see formal political independence leading to autonomous capitalist growth and others who maintain their analysis within the imperialist framework. Although it is foolish to argue that formal political independence in poor countries is merely a sham, a facade or that the state is necessarily the thinly-disguised puppet of imperialist powers, it is equally foolish to argue as Warren did, that autonomous capitalist growth has occurred in poor countries, facilitated by the emergence of formally independent nation states from the prior colonial status.[7] In seeking to demonstrate the spread of capitalism from metropole to periphery, Warren invoked both the capacity of the post-colonial state to exploit inter-imperialist rivalries and the loosening ties of dependence between metropole and periphery. He wrote that:

> ...even if inequality persists unabated (which is not the case) the character of the inequality must have been significantly and not merely marginally altered, by the industrialisation achieved since the war. The term "neo-colonialism" although possessing certain merits

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[6] (cont.) p. 292. Petras argued that "a discussion of imperialism which focusses on its expansionary/stagnationist tendencies overlooks the essential character of it as the international expression of capitalism's historic mission to develop the forces of production in accordance with the logic of capital accumulation, a process that is by its nature, uneven, exploitative and contradictory." p. 293. He continued: "In this way, we demystify the notion of dependence, which as it has commonly been discussed fails to take account of the different social formations within the periphery, and the real sources of surplus appropriation located in the advanced sectors, i.e., enclaves. The initial formulation of the problem for the periphery is not 'external dependency' but imperial exploitation located in the class structure of the periphery." p. 306 (emphasis added).

[7] See Warren, B.: "Imperialism and Capitalist Industrialisation", New Left Review, September-October 1973, and Arghiri Emmanuel's reply, "Current Myths of Development", New Left Review, May-June 1974.

> stressing the continuance of imperialist domination and exploitation, is thus misleading insofar as it obscures the new and dynamic elements in the situation both as to causes (concerning the role played by formal sovereignty itself) and as to effects.[8]

Warren asserted that formal political independence could allow the state to exploit inter-imperialist rivalries[9] and as well he identified the development of central banks, export-import and currency controls as instrumental in permitting the institutional control of the domestic economy. However, he committed the same error as those whose analyses he criticised. Because he had no clear understanding of the dialectical nature of imperialist relations he also failed to comprehend the nature of modern imperialism. As McMichael, et. al., observed:

> ...we find no adequate theoretical formulation of the phenomenon of imperialism and its relation to capitalism. The concepts employed by Warren such as "independent capitalist industrialisation", "national capitalism", "distribution of power", "independence", and "dependence" constitute a disparate collection of terms, unrelated to a theoretical framework that would inform his particular argument....[T]he problem is the <u>character</u> of...industrial growth, and what it expresses about international capitalist development, and the structural contradictions inherent in the process of (worldwide) capital accumulation ....[I]mperialism [is]...the international expression of <u>capitalism's</u> historical mission to develop the forces of production, in accordance with the logic of capital accumulation, a process that is by its nature uneven and contradictory.[10]

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[8]Warren, <u>op. cit.</u>, p. 11.

[9]"Formal political independence gives underdeveloped countries a degree of manoevre and initiative which, over time, must inevitably come into play, and which is conducive to their economic advance." <u>ibid.</u>, p. 12.

[10]McMichael, P., Petras, J. and Rhodes, R.: "Imperialism and the Contradictions of Development", <u>New Left Review</u>, No. 85, May-June 1974, pp. 84, 85 (original emphasis).

Warren's confusion is evident since it is one particular aspect of post-war imperialism, industrialisation in the periphery, which he identifies as that which denies it: this leads him to the spurious conclusion that "imperialism declines as capitalism grows."[11] The criticism of McMichael, et. al., is again instructive.

> Warren's treatment of imperialism implies that it is a temporary historical phase of capitalist expansion, which is now in decline due to "a major upsurge of national capitalisms." We learn that the "historical mission" of imperialism was to "spread the capitalist system and advance the productive forces throughout the world," and once this process is completed, imperialism is destroyed by its progeny: "national capitalisms"....Warren misconceives the forces of destruction inherent in the imperialist system, choosing to identify the "gravedigger" of imperialism as "nationalism", rather than revolutionary struggle.[12]

Assuming that capitalism is spreading to the periphery, Warren's analysis is misdirected since it fails to acknowledge or explain the changing social relations of production that result from this development. Whilst the metropole-centric analysis led to an overdeterministic "economic" approach, Warren's argument relied upon the observation of the political in isolation from the economic. Clearly the more appropriate analysis of imperialist relations lies in the consideration of both internal and external political and economic relations within the dialectical framework.

The more recent focus by socialist scholars on the growth of capitalist relations of production, and the subsequent growth of new classes within the periphery has encouraged the consideration of their

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[11]Warren, op. cit., p. 41.

[12]McMichael, et. al., op. cit., p. 85.

significance within the political configuration, and as well, of the form and function of the post-colonial state.[13] Alavi argues that

> this historical specificity of post-colonial societies a specificity which arises from structural changes brought about by the colonial experience and alignments of classes and by the superstructures of political and administrative institutions which were established in that context, and secondly from radical re-alignments of class forces which have been brought about in the post-colonial situation.[14]

He has identified the composition of the post-colonial state as comprising the indigenous bourgeoisie, the metropolitan bourgeoisie and the landed classes.[15] All three classes, the propertied and exploiting classes, operate under metropolitan patronage, and whilst their interests are overall not identical, they are clearly complementary in important respects, and identical in others. The function of the state is to mediate these interests, and it may not, therefore, be the tool of any one class. So Alavi contended:

> ...a new convergence of interests of the three competing propertied classes under metropolitan patronage allows a bureaucratic-military oligarchy to mediate their competing but no longer contradictory interests and demands. By that token it acquires a relatively autonomous role and is not simply the instrument of any one of the three classes.[16]

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[13]As Petras argued, "...the focus on conditions of accumulation and its impact on class relations allows us to focus more concretely on the nature of the state ultimately involved in both accumulation and class formation, as well as internal class relationships as they emerge from, as well as shape, capitalist development." Petras, J., op. cit., p. 293. See also Saul, J.S.: "The State in Post-Colonial Societies: Tanzania", The Socialist Register, 1974, op. cit.; Amin, op. cit.; Kay, op. cit..

[14]Alavi, H.: "The State in Post-Colonial Societies: Pakistan and Bangladesh", New Left Review, No. 74, July-August 1972, p. 59. [Hereafter cited Alavi (1972).]

[15]ibid..

[16]ibid., p. 60. Alavi's point is crystallised in the following statement: "The central point which I wish to emphasise is that the state

The relative strength of the different classes must be evaluated to determine not only the degree of autonomy enjoyed by the state, but as well, the context, direction and rate of industrialisation promoted by it.[17] Arguably form and function are closely interrelated. Considering this it is possible to premise two major objectives for the post-colonial state: (1) to facilitate the spread of capitalist relations of production as the dominant mode of production; (2) to mediate the conditions of exploitation and dependence, to manage the contradictions that arise from (1).[18] Clearly, there are alternative types of classification of state objectives[19], and one which posits an economic, political, ideo-

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[16](cont.) in the post-colonial society is not the instrument of a single class. It is relatively autonomous and it mediates between the competing interests of the three propertied classes...while at the same time acting on behalf of all of them to preserve the social order in which their interests are embedded, namely the institution of private property and the capitalist mode as the dominant mode of production." ibid., p. 62.

[17]This latter point is also, according to Alavi, an important factor to consider in the assessment of the "autonomy" of the state. He writes: "...the role of the bureaucratic-military oligarchy is relatively autonomous because, once the controlling hand of the metropolitan bourgeoisie is lifted at the moment of independence no single class has exclusive command over it. This relative autonomy is not predicated on that negative condition alone. It derives also from the positive conditions which stem from the far reaching interventions by the state in the economies of post-colonial countries, both by way of a network of controls, in which the vested interests of the bureaucracy are embedded, and a direct appropriation and disposition of a substantial proportion of the economic surplus. These constitute independent material bases of the autonomy of the bureaucratic-military oligarchy." ibid., p. 72.

[18]See Hamilton, N.: "Dependent Capitalism and the State: The Case of Mexico", Kapitalistate, No. 3, 1975. Hamilton argued that the management of contradictions arising from the process of capitalist production operated at all levels; the level of production and the market, the level of international and national trade, and at the political level.

[19]See for example, Petras, J.F. and LaPorte, R.: Cultivating Revolution, Random House, New York, 1971, Chapter 6 — "The Peruvian Military as Revolutionary Moderniser". The authors identify seven major functions of the state in Peru. p. 285. James O'Connor posits "...two basic and often mutually contradictory functions — accumulation and legitimations" (original emphasis) which must be fulfilled by the capitalist state. He argues that "...the state must try to maintain or create the conditions in which profitable capital accumulation is possible. However the state must also try to maintain or create conditions of social harmony. A capitalist state that openly uses its coercive forces to help one class accumulate capital at the expense of other classes loses its legitimacy and hence undermines the basis of its

logical and coercive function rests comfortably alongside the former, at a different level of abstraction but calling forth a similar analysis. Both acknowledge the necessity of recognising the post-colonial state as a definable and separate entity capable of the "autonomy" identified by Alavi. For although capitalist accumulation does not derive its initial stimulus from within the periphery, once the process is in operation, it causes the growth of class forces there[20]; it assists to shape the particular form of the post-colonial state. Clearly the state does not function to serve foreign capital only; it represents a combination of class interests, and from the specific nature of those, and the condition of neo-imperialist ties it derives its function in society. This point is well illustrated by consideration of those aspects of state activity designed to propel its members into the economic arena, in contradistinction to other forms of state activity directed at regulation or control of the economy, or at the accumulation of non-productive surplus. As Palmer has observed of Indonesia:

> ...the bureaucracy and military had spawned a new socio-economic class which was accumulating wealth through its protracted fraternisation with the foreign aid and investment apparatus. When corruption of aid flows reaches thirty per cent there is bound to be a saturation point in the purchasing by a

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[19](cont.) loyalty and support. But a state that ignores the necessity of assisting the process of capital accumulation risks drying up the source of its own power, the economy's surplus production capacity and the taxes drawn from this surplus (and other forms of capital)...the state must involve itself in the accumulation process, but it must either mystify its policies by calling them something that they are not, or it must try to conceal them (e.g., by making them into administrative, not political issues)." James O'Connor, The Fiscal Crisis of the State, St. Martins Press, New York, 1973, p. 6.

[20]"(The) incomplete nature of industrialisation in the periphery should not obscure the nature of the process of change within the periphery: the emergence of new class forces and alliances that further circumscribe the areas of metropolitan dominance." Petras, op. cit., p. 306.

> minority of cars, cameras and the usual expensive toys. The "surplus" then turns to other outlets.[21]

Clearly, the economic impetus for state activities of this kind also derive from the necessity of state investment to supplement the low or inadequate level of private investment in order to achieve economic growth. McFarlane has identified the "deficiency in productive capacity rather than the anomaly of its underemployment"[22] as the pivotal issue for the post-colonial state, which must seek ways to expand the productive potential of the economy. In this sense the state, as well as creating or maintaining the conditions necessary for the accumulation and reproduction of capital, may also engage in that process itself. Alavi's argument crystallises the point. The state's prominent place in post-colonial society is rooted not in the colonial legacy, but also in the contemporary production process.

> ...(The) apparatus of the state, furthermore assumes also a new and relatively autonomous economic role, which is not paralleled in the classical bourgeois state. The state in the post-colonial society directly appropri-

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[21]Palmer, I.: "The Economy, 1965-1975" in Ten Years' Military Terror in Indonesia, M. Caldwell (ed.), Spokesman Books, Nottingham, 1975, p. 148. Utrecht claims that "the military are involved in eighty per cent of all the country's economic activities. As directors of state enterprises, ministers, secretary-generals and director-generals of ministerial departments and owners of so-called 'military (trade or industrial) enterprises' they are the country's real decision makers." Utrecht, E.: "The Military Elite" in ibid., p. 46. Whilst Stephen Resnick's notion of the second path to capitalism is not in its total sense applicable to the Indonesian case, nevertheless his concern with the role of strong state action in the development of capitalism in the periphery is useful here. He writes: "The second path to capitalism is characterised by strong state action. For this path to be a viable route to capitalism, the landed and merchant class in whose hands the ownership of wealth has been historically concentrated must be willing to transfer their non-industrial assets into means of production, or industrial claims on wealth." Resnick, op. cit., p. 142.

[22]McFarlane, B.: "The Contemporary Post-Colonial State", unpublished paper given to postgraduate seminar at the Department of Politics, Adelaide University, 15/11/74, p. 5.

> ates a very large part of the economic surplus and deploys it in bureaucratically directed economic activity in the name of promoting economic development.[23]

A strong native capitalist class may thus grow up around the state apparatus.[24] In this case, the interests of foreign capital as represented through the post-colonial state will be competing with those of domestic capital. Both sets of interests will be mediated by the post-colonial state, acting in a relatively autonomous role.[25] The degree of that autonomy and the degree to which the interests of the various "capitals" are represented by the post-colonial state are functions of four interrelated factors and as well functions of time. These former include the strengths (or weaknesses) of neo-imperialist ties, the degree of inter-imperialist rivalry, the nature of the interplay of other classes in post-colonial society, and the political strength and economic power of the post-colonial state. The inclusion of these two latter factors are equally important overall as the two former ones, underlines the necessity of examining the post-colonial state as an entity capable of independent action, and post-colonial society as capable of generating political forces at times independent of metropolitan dominance. Yet it

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[23]Alavi (1972), op. cit., p. 62.

[24]Alavi's contention concerning the state's deployment of economic surplus in the name of economic development is extended by Saul who "suggest[s] that the strategic position which the state occupies vis-a-vis the economy, including the privileged access to surplus which is thus available to the oligarchy, defines the latter's interest as being that of a class." p. 354. The instruments of economic power and political control available to the state allow "the crystallisation of a fully-formed class around the apparatus of the state — a class with an interest quite distinct and antagonistic to the interests of the mass of the population." p. 355. Saul, op. cit.. Saul discusses ideas put forward by Poulantzas, Debray, Schivji and Meillassoux.

[25]The question of autonomy is problematical. Saul recognises this when he argues that "(the) nature and extent of this autonomy — of the state and those who staff it — from the determinations of other classes more directly rooted in the production processes...is more controversial. And it must be admitted that Alavi's answer to the question is not entirely clear." Saul, op. cit., p. 352.

must be stressed that this capacity changes over time, due in part to the continuing stresses deriving from its ties with international capitalism, and as well to those deriving from struggle within the periphery.[26]

By acknowledging the importance of class relations in the periphery and their relationship to the political process, the errors of the "dependence/stagnation" metropole-centric analysis can be avoided and the correct role of the state in post-colonial society established. The following two sections of this chapter focus on those crucial elements of state policy which derive from its role in the promotion of capitalism as the dominant mode of production. Furthermore as these are outlined, the attempted mediation by the state of the conditions of exploitation and dependence — the management of the contradictions that arise from the spread of the capitalist mode of production in Indonesia is demonstrated.

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[26] The Pertamina/technocrat-IMF struggle is a good example of this. See Utrecht, E., "The Military Elite", op. cit., pp. 47-53. See also Patnaik, P.: "Imperialism and the Growth of Indian Capitalism" in Owen, R. and Sutcliffe, B. (eds.): Studies in the Theory of Imperialism, Longman, London, 1972, especially p. 228. Whilst these identified sources of relative autonomy are also mentioned by Warren, this does not imply agreement with the thrust of his analysis. Although the conclusions of his argument are incorrect, he has nevertheless discussed some crucial factors hitherto neglected by both Marxist and mainstream economists alike. As Emmanuel points out, his attack on the ambiguities of current left analyses of the notion of dependence, his recognition of the importance of formal political independence and the improved bargaining position of the poor nations vis-a-vis foreign companies are well founded. Emmanuel, op. cit., pp. 61-63.

PART TWO:
THE DEVELOPMENT OF THE FINANCIAL INFRASTRUCTURE

> ...the essential ingredient of colonialism is...privileged investment, namely investment in projects which carry with them some differential advantage, preference, or actual monopoly in the form of concession rights or some grant of privileged status....
>
> Maurice Dobb
> Political Economy and Capitalism

The Indonesian economy has experienced under the New Order government an unprecedented inflow of foreign capital, in the form of both direct private investment and aid funds.[27] The majority of these investments originate from Japan, the USA, and from Chinese domiciled in Hong Kong, Singapore and the Philippines. Favoured sectors for the investment of this capital are mining, oil exploration and extractive, and forestry; they are all highly capital-intensive in nature, involving heavy reliance on foreign technical and managerial personnel, and therefore have little innate capacity to generate significant employment opportunities. A lesser but still significant amount of foreign capital has been invested in the manufacturing sector, which is dominated by Chinese and Japanese interests, although American, Australian and German enterprises have significant investments in certain subsectors.[28] Capital inflow in the form of project and program aid is mainly channelled through the consortium of creditor countries that was formed in 1966. The Intergovernmental Group on Indonesia (IGGI) together with the World Bank and the International Monetary Fund (IMF), form an extremely powerful group whose influence on the content and direction of New Order economic policy has been decisive.

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[27]For detailed breakdown of the volume and origin of foreign capital inflow see Appendix A, Sections 1,2. The impact of direct investment on the demand for skilled labor and modern technology is greater than that made by portfolio investments (including aid) which is more often directed at infrastructure and banking.

[28]See Appendix B.

Growth of the banking sector has also been stimulated by inflows of foreign capital, and more recently eight merchant banks have been established in Jakarta with view to increasing medium-term credit to indigenous investors. The availability of credit to different economic groups and the actions taken by the New Order government to speed up their "pribumisation"[29] or "Indonesianisation" policy emerge as key issues in an analysis of economic policy. At one level the following section reveals, through the examination of the financial infrastructure, the contradictory roles that the state is obliged to fulfil. On the one hand there are concerted efforts to modify the infrastructure towards an increasingly sophisticated and Western-oriented model and on the other hand there looms the political necessity of the "pribumisation" policy, which officially seeks to increase the involvement of native Indonesians in the process of economic development. The contradictory nature of those two courses of action will bring light to bear on theoretical concerns. One of these is the possibility of "a relative and distinct autonomy"[30] which the post-colonial state must enjoy in order to ensure its own survival and as well perform its necessary functions. These latter involve (1) the maintenance and reproduction of those social relations of production necessary for the accumulation of capital, and (2) the government acting as the organiser of the hegemony of capital over labor and thereby mediating the conditions of exploitation and dependence. Further discussion of these issues will be undertaken in Part Six of this chapter.

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[29]"Pribumi" means literally "son of the soil", and refers to native Indonesians as distinct from both Chinese who are legally Indonesian citizens, and those who maintain their Chinese identity in tact. "In Indonesia, a person of Chinese ancestry is Chinese when he functions as a member of and identifies with Chinese society." Tan, T.S.: The Role of the Chinese Indonesians, Docterandus Oeconomicorum, Research School of Pacific Studies, Australian National University, Canberra, p. 2.

[30]Alavi (1972), op. cit..

With the takeover of power by the military in 1965-66, a radical turnabout in economic policy occurred. Distinguishing features of the new policies were not only their content and ideological preference, but as well the manner in which they were decided. The two-year stabilisation policy and the subsequent two five-year plans were designed by a group of Western-trained Indonesian economists and representatives from the IMF, the IGGI and the World Bank. The ideological preferences of the technocrats, those Indonesian economists trained mainly in the USA,[31] combined with the influence of their advisers, resulted in the implementation of economic policies which sought to reincorporate thoroughly the Indonesian economy into the international capitalist economy.[32] As Cheryl Payer and David Ransom have established, the survival of pro-capitalist forces as the ruling classes in Indonesia depended on their acceptance of economic policies designed by, or acceptable to the IMF, the IBRD, the IGGI and the technocrats. Payer has convincingly shown how this process occurred in Indonesia from 1966 onwards by examining the activities of the IMF mission to that country after the coup. She argues that they played a decisive role in the formulation of New Order economic policy which included the stabilisation program and subsequent fiscal and monetary policies adopted after 1969.[33] In that year, the IBRD, after receiving a formal request from the Indonesian government, established a

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[31]Ransom, D., "The Berkeley Mafia and the Indonesian Massacre", op. cit..

[32]The original terms of reincorporation however do not fully reflect the World Bank's more recent attitude which indicates a distinct awareness of the political problems arising from the increasingly visible lack of more equitable income distribution. In a recent volume, Growth with Redistribution, Chenery argued that whilst existing income distribution may not be changed, the increments in growth could be distributed in a more egalitarian manner. Chenery, H.B.: Growth with Redistribution, Oxford University Press, 1974, for the World Bank and the Institute of Development Studies, Sussex.

[33]Payer, C.: The Debt Trap, Penguin, Harmondsworth, UK, 1974, Chapters 2, 4 and 10.

resident mission in Jakarta, the first of its type to be set up in a poor country.[34] Cooperation between the IBRD, the IMF and the government was close from the inception of the mission, and the two international institutions worked together in what was formally an advisory capacity.[35] Their role was to assist the government to devise economic plans and programs for the stabilisation and rehabilitation of the economy and as well to advise on the utilisation of aid funds that were soon forthcoming from the IGGI.[36] The character of the financial infrastructure developed

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[34]A press statement by Robert S. MacNamara, President of the World Bank, indicates the significance of the resident mission. "...I ought to add that this is the first time that the World Bank has established this sort of a resident mission in a developing area, and our decision to do so is a sign that we believe that (the)...problem of Indonesia demands a unique solution and a greater concentration of effort than we have applied anywhere else in the world." Press statement, Jakarta, June 15, 1968. The special function of the resident mission apparently remains. Manning and Thompson noted: "The resident staff in Indonesia remains unique among the Bank's overseas missions, in terms of size, range of expertise and depth of involvement in the national development effort." Thompson, G. and Manning, R.C.: "The World Bank in Indonesia", BIES, July 1974, p. 82.

[35]Letter to the Sultan of Jogjakarta from R.S. MacNamara, June 15, 1968, stated: "Our resident staff will be prepared to advise and assist you in all phases of the effort which you have launched to achieve financial stabilisation, to rehabilitate your production and infrastructure facilities and to begin the process of expansion of these facilities and of the output and income of the Indonesian economy. To this end it will be prepared to assist and advise first in the formulation of overall economic plans and programs, second in the planning of specific development programs and projects, third in the implementation of technical and financial assistance which is available to you from various sources. We will cooperate in this endeavor with the IMF...." Library of the Research School of Pacific Studies, Economics Department, Australian National University, Canberra.

[36]For further information regarding the nature of the IBRD and the IMF see Bruce Missen: "The World Bank as a Political Institution", Pacific Research and World Empire Telegram, September-October 1971. Missen explains the growth of the twin institutions in historical terms, establishing how they grew out of post-war American plans for a "free-enterprise imperial system". The Bank's charter instructs it to "promote private investment in the Third World, and the pattern of IBRD loans suggests that this has been a strong priority of the Bank throughout its history." pp. 18-19. A similar case is argued by Magdoff who states: "By its structure and administrative procedures, the IMF acts only to enforce the rules of the game that govern the existing power relations among countries — rules that evolve in the very process by which some nations became the rich nations and other nations became the poor nations." Magdoff, op. cit., p. 146.

in Indonesia under the guidance of the IMF and the World Bank is detailed in the following pages but first it is pertinent to offer some further background to the nature of economic policy pursued during the Sukarno era.

Some Aspects of Policy Prior to 1965

Before the coup of 1965, the Indonesian economy was marked by hyperinflation, loss of confidence by foreign capital in the economic policies of Sukarno, marked under-utilisation of existing capital resources, a severe balance of payments problem, a huge international debt of US$2400 million,[37] and widespread corruption and inefficiency; all foreign enterprises had been nationalised and the state banking sector abused and weakened by excessive government spending and financial malpractice. The decision by Sukarno to attempt the restructuring of the economy by the strengthening of the public sector at the expense of the private, not only affected levels of productivity, output and employment, but as well affected adversely the psychological disposition of the indigenous capitalist classes to make productive investments. Douglas Paauw described well the psychological effect that government policy toward the private sector had engendered.[38] He examined the restrictions placed on their activity which resulted in the weakening of the incentives to save, invest and produce; companies which could survive the harsh economic climate, did so by resorting to speculation, commerce and illegal business activities. Similarly Corden and Mackie observed that the

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[37]Legge, J.D.: Sukarno, A Political Biography, Penguin, Harmondsworth, UK, 1972, p. 385.

[38]Paauw in McVey, op. cit., pp. 186-189. "The profit motive has been discredited throughout the system, and official controls have seriously weakened the relationship between the assumption of risk, the supply of effort, and legally obtained economic rewards." p. 188. See also Feith, H.: "The Dynamics of Guided Democracy" in McVey, op. cit.. Feith offers some detail as to the connection between the over-regulation of economic activity and the growth of corruption during the period of high inflation. pp. 389ff.

foreign exchange licensing system adopted during the Guided Democracy Period distorted the pattern of investment by creating a climate ill-suited to the encouragement of productive investment.[39] The staggering inflation rate of that period similarly acted to discourage productive investment by making rational business decisions impossible.[40]

It is habitual for most observers of Indonesia and its governments to attribute almost the entire blame for these circumstances to Sukarno and the economic policies pursued during the Guided Economy period.[41] However Glassburner argued that during the post-independence period to 1957, the economic power of successive governments was severely circumscribed by the colonial pattern of ownership and control of key sectors of the economy: early governments were attempting to build an Indonesian commercial and industrial economy alongside the foreign one.[42] In sympathy Schmitt commented:

> For a stagnant society to be transformed into a dynamic one, these groups (the industrial proletariat, the traditional aristocracy and the vestigial business groups of pre-colonial origin) would have had to acquire a vested interest in capital accumulation. It was precisely

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[39]Corden, W.A. and Mackie, J.A.C.: "The Development of the Indonesian Exchange Rate System" in The Malayan Economic Review, April 1962. See also Panglaykim and Thomas (CEDA P Series 11), op. cit.. They observed that during the Guided Economy period conditions remained favourable to the speculator and the private sector was not keen to move into unknown areas of export and industry. For further detail on the insecurity of business during the Guided Economy period see Tan, T.K. (ed.): Sukarno's Guided Indonesia, Jacaranda Press, Brisbane, 1967, Chapter Four, "Sukarnian Economics".

[40]Panglaykim and Thomas (CEDA P Series 11), op. cit., Chapter Four.

[41]For example see an assessment of the work of H.W. Arndt in "From Ball to Arndt: The Liberal Impasse in Australian Scholarship on Southeast Asia" in Showcase State, Mortimer, R. (ed.), Angus and Robertson, Sydney, 1973, pp. 114ff.

[42]Glassburner, "The Economy of Indonesia", op. cit..

> this development that foreign dominance in the non-agricultural sector effectively blocked.[43]

Schmitt claimed then that a certain rationality underlay government policy; "the course of events looks very much like a simple cumulative process away from an unstable equilibrium."[44] Thus whilst the shortcomings of Sukarno must be acknowledged as more often related to rhetoric than realism, it is essential to recognise that crucial determinants of economic circumstances were beyond his control. As Payer has noted:

> During its first decade of independence, Indonesia laboured under the necessity of repaying huge debts to the Netherlands — an obligation which it had been forced to accept as the price of independence; and its major businesses which were mostly export-oriented remained under Dutch ownership and thus outside the effective control of the Indonesian government.[45]

Despite the repudiation of Dutch debt in 1956 and the nationalisation of their firms in 1958 the nation, as an exporter of a limited number of raw materials remained vulnerable to world economic conditions. The seriousness of this position is well illustrated by the thirty-three per cent fall in the value of natural rubber exports, the major foreign exchange earner, during 1958.[46]

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[43] Schmitt, H.O.: Foreign Capital and Social Conflict in Indonesia 1950-58" in Rhodes, R.I. (ed.), "Imperialism and Underdevelopment", op. cit., p. 270 (emphasis added).

[44] ibid., p. 275.

[45] Payer, op. cit., p. 75. Similarly Schmitt argued that the exodus of Dutch technicians engaged in the production sector, and foreign exchange losses resulting from the severe recession in export markets combined dramatically with the rebellions in Sumatra and Sulawesi to seriously effect the financial capacity of the government. "Their combined impact reduced foreign exchange receipts by thirty-four per cent below their 1957 levels." Schmitt, op. cit., p. 274.

[46] Corden and Mackie, op. cit., p. 53.

Under colonial rule, the banking system was dominated by Dutch and English banks, mainly engaged in financing the Dutch "Big Ten" trading firms. These firms virtually controlled the modern sector of the economy, and whilst a small number of Chinese-owned national banks did exist, their activities were on a limited scale.[47] Indigenous Indonesians had virtually no access to bank credit, with the consequence that nationals and Chinese businessmen acted mainly as middlemen. Partly for this reason, there was a singular lack of development of a dynamic national business class. Furthermore although the economic control of the country was, in most significant ways, in European hands, the Chinese Indonesians were successfully used by the Dutch, and became very strong, controlling important areas of economic activity. Their position of strength in the economy grew after independence. The situation is described by Panglaykim and Palmer: "The Chinese middlemen became the links between the unorganised sector consisting of millions of farmers, and the organised sector of import and export firms. This is essentially the same distributive system as today....The Dutch firms were at the vortex of this structure and were able to exercise ultimate control through the credit system."[48]

With the nationalisation of the banking and trading firms in 1958 banks became controlled by the government. But the problem of lack of management skills and adequate sources of finance, combined with high overheads, meant that the very banks designed to extend credit facilities to the national business class were most often incapable of doing so.

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[47] Panglaykim, Y.: "Financial Institutions in Indonesia: Some Notes" in The Indonesia Quarterly, Vol. 3, No. 1, October 1974. Much of the following information in the text is derived from this article.

[48] Panglaykim, Y. and Palmer, I.: State Trading Corporations in Developing Countries; With Special Reference to Indonesia, Rotterdam University Press, 1969, p.4.

Thus a potentially strategic means of augmenting the accumulation of capital by indigenous Indonesians was not exploited. On the other hand, the position of the Chinese was constantly strengthened, as they moved into the trading avenues vacated by the Dutch. Prior to 1965, the distribution of credit was determined by semi-legal processes, and resulted in many cases of the arbitrary exercise of official authority by political influence. Government responses to try and redress the growing imbalance in credit allocation and turn it more in favour of nationals meant that public enterprises and trading corporations were favoured over the private ones.[49] Excessive subsidies in the form of liberal credit to state enterprises are known to have aggravated the hyperinflation that characterised the economy in the mid-sixties: some national firms existed in name only, organised solely for the exploitation of government funds by various political parties.

After 1949, efforts to increase the economic power of the pribumi included the Benteng policy, which sought to allocate a significant proportion of the import trade to this group. Yet the implementation of the policy proved in the long run, contrary to the aim of developing a strong national business class, since the corruption and the strengthening of "paper traders" resulted.[50] Credit allocation was directed toward trade rather than productive investment which would increase the industrial potential of the economy. Thus the colonial nature of Indonesia's inherited banking system geared credit priorities to foreign trade in particular, and preference for short-term credit by foreign exchange banks, wedded to the principle of commercial credit, meant that there was a deep-seated resistance to financing indigenous

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[49] ibid..

[50] Benteng became totally discredited as a means of displacing foreign enterprise after it became known that the issuance of licenses had become primarily a means of financial support for the Nationalist Party.

enterprises of an industrial (as opposed to a commercial) nature.[51] In sum the allocation of scarce foreign exchange to importers under fixed exchange rates severely hampered efforts to promote the accumulation of capital necessary to industrial growth.[52] The hyperinflation of the mid-sixties enhanced this tendency: the Central Bank of Indonesia noted a movement towards the institutionalisation of a way of thinking that was inflation-oriented, an attitude that preferred consumption to production. It argued that:

> Many investments were inflation-oriented, meaning that enterprises or activities chosen for investment and development were not chosen because they were more efficient but because the investor could make a living in that field in spite of inflation, or because of inflation.[53]

Other sections of the indigenous population also suffered under government policy; farmers, small industrialists, petty traders and self-employed persons were not adequately served by existing financial institutions, and their main source of finance continued to be the unorganised credit market, characterised by extremely high interest rates.[54]

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[51] See Krueger, A.O. and McDougall, I.A.: *The Indonesian Economy; Recent Developments, Problems and Prospects*, Seminar Paper No. 22, Department of Economics, Monash University, 1973.

[52] Corden and Mackie, *op. cit.*. See also Panglaykim and Thomas (CEDA P Series 11), *op. cit.*. The shortage of foreign exchange for the import of essential production inputs (raw materials, components, spares and the like) seriously frustrated the development of the manufacturing sector. pp. 26ff. See also Paauw in McVey, *op. cit.*, for detail on the problems that beset the manufacturing sector.

[53] Central Bank of Indonesia: *Economic Data for Investors*, Jakarta, May 1968, p. 16.

[54] Panglaykim and Palmer were emphatic on this point. "All our analysis in this monograph demonstrates the need for costly credit assistance to an emerging indigenous entrepreneurial class." Panglaykim and Palmer, *op. cit.*, Section 4, p. 209.

The commercially-oriented banking system then was historically ill-equipped to handle the allocation of funds to investment projects, the bias being toward short-term loans that matured rapidly and made for a high rate of capital turnover. This coupled with the much abused priorities system of government credit allocation, meant that for the most part, the Indonesian banking system functioned to serve predominantly the needs of foreign and Chinese capital. During the Sukarno period, intervention by the state was of a qualitatively different kind to that now undertaken by the New Order government. The former period was characterised by the inability of the government of the time to successfully ensure the allocation of capital into productive rather than non-productive sectors. Despite the successful growth of some state-owned enterprises, the overall pattern of economic activity revealed the incapacity of the government to foster a healthy indigenous capitalist class and a lively process of capital accumulation.

Indonesia Receives Its Future

Since the advent of the pro-Western New Order government, there have been changes in the banking sector in Indonesia, significantly marking an attempt to foster an investment-oriented sector capable of serving the interests of both foreign and domestic investors. Before outlining the key aspects of these reforms, it is necessary to establish both the content and intent of the stabilisation program of 1966 to 1969, which was devised by consultation between Bappenas and the IMF.

Central to these economic policies was the intention of firmly establishing the New Order government in power. Without a suitable state apparatus both willing and capable of facilitating the spread of capitalist relations of production, its achievement would not merely have been restricted, but impossible; the functions of the post-colonial state involving economic, political, ideological and coercive roles, are essential for the spread of capitalism to Indonesia. Clearly it was thus vital to convince the Western creditor nations, who were potential aid-givers and investors, that the former policies of Sukarno and the drift towards "etatism" would be replaced by a policy of "decontrol" of the economy: "It wants to wash away the impression of irresponsible and irrational belligerence and truculence...to demonstrate that rationality, responsibility and freedom and democracy and the rule of law are now back in Indonesia."[55] The ideological essence of the program may be found in the MPRS Decision, 23 July, 1966. Entitled "The Reform of the Basic Economic, Financial and Developmental Policy", the decision reversed all prior presidential policies and stressed the exclusion of the following: "(a) free fight liberalism of the period 1950-57; (b) etatism, where the state and its economic apparatus fully dominate the economy and tend to push out and stifle the potential and creative powers of those economic units which operate outside the government sector; (c) monopolies which are harmful to the people."[56] Article 38 of this Decision declared that "in performing its functions in the economic sector, the government must place more emphasis on controlling the direction of economic activity rather than performing all the activities itself." Whilst socialism remained the official long-term objective..."a pragmatic approach...justifies a policy of giving private enterprise an opportunity to develop and regulate itself in an attempt to rehabilitate and stabilise...(the) economy according to the direction indicated by the government."[57] It is clear that the role of the state was to be changed; rather than the

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[55]Lubis, M.: CAB, January 1, 1968.

[56]Panglaykim, Y. and Thomas, K.D.: The New Order and the Economy, Research School of Pacific Studies, Canberra, 1966. Using a translation from the text of the decision published in Business News, July 8, 1966. [Hereafter cited Panglaykim and Thomas (1966).]

[57]Sultan of Jogjakarta: Speech of April 12, 1966, Library of the Research School of Pacific Studies, Economics Department, Australian National University, Canberra.

government seeking to involve itself in the economy directly through further investment, the newly-favoured policy required government involvement at a qualitatively different level. The state was, with advice and recommendations from the various international institutions, to implement an economic policy which allocated a dynamic and vital role to foreign capital, both public and private. The complementary role of the military-bureaucratic regime was to concentrate on "social infrastructure" development in three key areas — physical, legal and financial, in order to create a suitable investment climate for new inflows of direct foreign investment which would be directed into government-determined priority areas.[58] In the words of a key government official:

> The government is to concentrate on providing the infrastructure and to leave the key capital-intensive areas to foreign capital and to local industry....So you will see that there is a division of labor with the government providing the infrastructure — the stage for private investors.[59]

To establish correctly the nature of the stabilisation policy of 1966-1969, it is necessary to stress again not only its contents, but the manner in which these were determined. As previously mentioned, Cheryl Payer outlined this when she emphasised the great power exercised by the International Monetary Fund, especially in its relationship with poor countries.[60] Enormous financial resources support its function as a credit agency, which enables it to exert leverage in the internal affairs of poor countries. As Payer remarked:

> All of the major sources of credit in the developed capitalist world, whether private

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[58] ibid..

[59] Indonesian Newsletter, 29/11/74, statement by Salim.

[60] Payer, op. cit., Chapter 4.

> lenders, governments, or multilateral institutions such as the World Bank Group, will refuse to lend to a country which persists in defying IMF 'advice'. The real importance of the IMF lies in the authority delegated to it by the governments and capital markets of the entire capitalist world.[61]

For the IMF, stabilisation involved a slowing down of inflation, the securing of a moratorium on Indonesia's massive foreign debt, and emergency aid to cover the balance of payments deficit.[62] A similar package had been offered to Sukarno by the IMF in March 1963, but later that year was emphatically rejected by him.[63] However Indonesia's new rulers were obliged to accept the formula recommended by the IMF in order to secure the aid and the debt moratorium which they so desperately required. Foreign exchange policy was one area where the influence of the IMF was apparent, involving the shift "of most foreign exchange transactions from the control of the Central Bank to the open market on 3 October 1966, the first major step in the decontrol of foreign exchange ....A weak economy could not afford to take such a step without a massive new injection of foreign aid, but this was the promised quid pro quo for the decontrol measures."[64] Anti-inflationary measures were taken to complement the decontrol of foreign exchange. These included a balanced budget, limitation of government expenditure, improvement in the tax collection system, a realistic exchange rate, an end to subsidies, severe limitation of bank credit, and reductions in the number of government employees. These tough IMF-recommended fiscal and monetary measures,

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[61] _ibid._, p. x. The following information on the IMF and the stabilisation policy is adapted from Payer, Chapter 4.

[62] For details on these measures see G. Tomasson: "Indonesia; Economic Stabilisation 1966-69", _Development Digest_, January 1975. See also Panglaykim and Thomas (1966), _op. cit._.

[63] Payer, _op. cit._, pp. 77, 78.

[64] _ibid._, p. 80.

implemented to reduce inflation, were severely applied with consequent harmful effects on employment, especially in public sector, and in domestic private business activity.[65] The latter suffered not only from the contraction of bank credit, but also from competition from the flood of imports made available under aid and the liberalised foreign exchange system. During 1967 the large increase in the inflow of imported goods assisted the middle class urban Indonesian consumer at the expense of the Indonesian domestic producer. A BIES report states that 9517 Indonesian firms collapsed between 1964-1970,[66] and more evidence of this trend will be examined later in the chapter.

In December 1966 in Paris, the Western creditor nations[67] agreed to a moratorium on those Indonesian debts incurred prior to June 1966 so payments did not have to be made for five years: after 1971, the debts were to be repaid in eight installations to 1978. This rescheduling of debts was agreed to only after Indonesia accepted an exchange reform and devaluation which left her with one of the 'freest' exchange systems in the world. However, as Payer pointed out, the rescheduling of debts incurred prior to 1966 did not solve the problem of Indonesia's continuing need for further loans implied by the IMF/IGGI plans. She wrote:

> The most significant irony, however, is that the much-maligned "Sukarno debts" are rapidly paling into insignificance relative to the debts that the Suharto government is blithely incurring with IMF support and approval. Sukarno left a legacy

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[65]As a result of the IMF austerity programme, mass dismissal of government workers resulted, to add to the already serious unemployment problem.

[66]BIES, SRD, March 1972, p. 19. Quoted in Payer, op. cit., p. 86.

[67]The creditor nations were the USA, Japan, Australia, France, West Germany, Italy, The Netherlands. The World Bank, the OECD and the IMF also attended the Paris meeting.

> of over two billion dollars in debts; but the new debts of the Suharto regime, plus projected foreign financing of the remainder of the five-year plan to 1974, add up to more than four billion dollars. The annual rate of new credits has expanded from $175 million in 1966 to $876.6 million in the fiscal year to 1973-74.[68]*

The third and most enduring of the stabilisation policies was the securing of Western aid. Initially, some emergency aid was given to cover the balance of payments and internal deficits gaps, by supply in

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[68]Payer, op. cit., p. 89. Payer is taking her figures from BIES, Vol. 6, No. 2, July 1970, p. 17 and a table prepared by the Arbeitshollecktiv Köln-Bonn in Sudostasion Korrespondenz. Apart from these directly economic considerations, there is the additional fact that early debt rescheduling gave the New Order government time to consolidate and expand first its political and then its economic power. As well as being an indirect but powerful political weapon for the denationalisation of the economy, and its increased control by foreign capital, the rescheduling simultaneously allowed a degree of political and economic power to be drawn together and consolidated by the state. It took pressure off the government by permitting additional food imports, allowed the improvement in the services of public sector agencies and allowed the massive cost of the army to be met out of the government's own budget in a less inflationary way.

The recent financial crisis experienced by the state-owned oil company Pertamina, highlights the increasing gravity of Indonesia's external debt problem. Whilst no final figure of known accuracy may be offered, estimates range from US$3 billion (Sunday Times, 9/11/75, article by J. Bell, and the Indonesia Letter, December 1975, No. 74) to US$10 billion (AFR, 7/7/76, taken from The New York Times). The implications of this large debt on Indonesia's future foreign exchange situation were noted by the AFR, 28/6/76, which stated: "Indonesian loan repayments will curtail imports." The article spoke of Indonesia's dwindling ability to purchase goods overseas because of the need to cover the debts and commitments of Pertamina. It estimated that towards the end of the decade Indonesia's external borrowings would almost be matched by repayments of earlier public debts. By 1979, the country's debt-service ratio would stand at 19.5 per cent. This implies a restraint on government borrowing for development and an increased reliance on private investment. World Bank estimates the debt-service ratio in 1979 at 19.6 per cent, a figure arrived at without counting tanker commitment payments. AFR, 2/2/77, "Indonesia softens line on likely tanker commitment settlement", p. 14. See also AFR, 22/3/77, p. 17.

* The Indonesian governments heavy reliance on foreign finance for its development program was noted in the Quarterly Economic Review. The review noted not only the overall increase in the total volume agreed upon by the IGGI for the fiscal year 1973/74. (A figure of $877 million is given). As well, it noted the increase in foreign exchange credits and project aid over previous years. Of the $877 million, $160 million was food aid, $242 million was foreign exchange credits ($32 million increase) and $475 project aid. ($85 million increase). The Review noted "the overall liberalisation of the aid terms being offered." E.I.U, "Quarterly Economic Review - Indonesia". Vol 3, 1973, p.3.

the import of necessary consumer and producer goods.[69] The effect of this on domestic production and employment has already been noted.

In early 1967, the consortium of creditor countries formed the IGGI to mobilise the much-needed new credits for Indonesia, in the forms of loans to support the budget and the balance of payments. According to Payer, the IMF officials insisted that aid credits be sold on the free market "without any specification as to use of the money"[70]; the rupiahs thus acquired (counterpart funds) were to be used as budget revenue. Hence the government relinquished its right to determine the end use of government-to-government aid.

The actual volume of aid in 1967 totalled $120 million and was to rise to $899.913 million in 1974/75.[71] So far, the IGGI has provided all the aid that Indonesia with IMF backing, has requested, and since this is substantial, the prior mentioned problem of debt payment and debt servicing remains significant.[72] As well as increasing the dependence of the economy on huge injections of market penetrating aid, the IGGI programme made resource extraction and private foreign investment necessary counterparts to it. Continued IGGI support rested on the willingness of the New Order government to create a suitable financial, legal and physical climate for foreign investors. Both the government and the IMF/IBRD group recognised its necessity not only for foreign exchange earning resource-extractive investment but also for encouraging long-term direct private foreign investment in industrial formation. Put concisely, there

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[69] For detail on IGGI aid commitments, by country and by type, see Porthumus, G.A.: "The Intergovernmental Group on Indonesia", BIES, July 1972.

[70] Payer, op. cit., p. 84 (original emphasis).

[71] BIES, March 1975 (in US dollars).

[72] BIES, March 1973, observed that the increase in aid and debt repayments would increasingly offset the contribution of programme aid to the balance of payments and the budget.

existed a genuine desire on the part of the international capitalist institutions and the Indonesian government to promote the growth of the nation's industrial capacity, to encourage a type of capitalist economic growth. An essential role of the state in this process is the development of social overhead capital, which assumes both material and non-material forms, and is essential for the unhindered growth of this desired mode of production. The stabilisation policy promoted this, as did the subsequent five-year plan, Pelita I.

The Five-Year Plans

The continuing economic problems that beset Indonesia were reflected in the priorities adopted for Pelita I. The country remained a subsistence rural-based economy, with a large number of underemployed and unemployed[73] who still continue to find it difficult to secure permanent employment in either the country's small, import-substitution-focussed manufacturing sector, or the highly capital-intensive resource-extractive sector. The industrial policy of Pelita I placed emphasis on stimulating those industries which manufactured agricultural products, helped in saving foreign exchange, processed domestic raw materials for export, or were labor-intensive. Officially, top priority was given to agricultural development through government-promoted programmes like Bimas and Inmas, and private-sponsored investment by agri-business; aid funds were also made available through World Bank/IDA credits, which were directed mainly at estate, agricultural and infrastructural development.[74] Other sectors were given a complementary and supporting role; key commodi-

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[73]One estimate of unemployment was from between ten to fifteen per cent of the total labor force of 40.1 million (1971 census). EIU: "Annual Survey — Indonesia", 1975, p. 4. FEER, 24/6/72, estimated open unemployment at six per cent, and disguised unemployment or underemployment at thirty per cent.

[74]See International Development Association (IDA) press releases, 1969 onwards. IDA, Washington.

ties here were fertiliser, textiles, cement and machinery. Whilst heavy reliance for the supply of capital was placed on foreign sources, both public and private, there was also an attempt to begin the mobilisation of domestic capital for industrial investment. Import policy formally supported the general strategy, with duties deferred on foodstuffs, textiles, capital equipment for agriculture, and building materials.

During the Pelita I period it became obvious that increased employment on any significant scale, and the growth of the indigenous business class, were not forthcoming. Indeed, it appeared that the latter were continuing to suffer decline, due not only to their partial lack of business acumen, but as well because government policy discriminated in favour of foreign capital, so that it enjoyed far more privileges and benefits than the indigenous counterpart. Furthermore, the Domestic Investment Law of 1968 was designed to encourage the Indonesian-Chinese to invest in the economy, to encourage the large amounts of capital owned by that group and often hidden abroad, into productive investment. On both counts, the indigenous producer suffered severe discrimination, the best example of this being the case of the textile industry, where hundreds of thousands of people lost their livelihood to Japanese machines, and thousands of domestic producers were forced out of business.[75] In addition, the emphasis on building up certain sectors of the economy tended to concentrate investment in certain areas where returns seemed most promising, thus enlarging regional disparities.[76] The major consequence of centralising manufacturing in one or a few urban centres is that it prevents the regional spread of capitalism and further aggravates the historically determined regional differences that exist between

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[75]Palmer, I. and Castles, L.: "The Textile Industry" in Glassburner, op. cit., pp. 333-334.

[76]EIU, No. 3, 1972.

Jakarta and the other regions. In addition, the location of manufacturing in one or two cities invites the proliferation of a bureaucracy unresponsive to, and unconcerned with the needs of small producers.

Much of the investment in manufacturing is concentrated in Jakarta, and its share of total investment appears to be increasing.[77] Despite the provision of government incentives for producers manufacturing outside West Java, it appears that the serious lack of physical and financial infrastructure makes the possibility of regionally diversified investment unattractive to the majority of investors.[78] Furthermore, most manufacturing is of the import-substitution type, a method that requires extensive import of production inputs and expertise in order to manufacture goods domestically rather than import them. It involves a continuing high foreign exchange cost, and affords substantial protection to the domestic manufacturing industry through a wide variety of concessions and incentives.

To compound the difficulties posed by this method of industrialisation, the employment-generation effects in the manufacturing sector are of a low volume, due to the highly capital-intensive nature of the investments. Although (according to national income estimates) the contribution of the manufacturing sector to Gross Domestic Product was

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[77]By 1971 nearly one-half of all implemented foreign investments were concentrated in Jakarta. "Harian Kami", 30/9/71, quoted in Mortimer, R.: "Indonesia: Growth or Development?" in Mortimer, R., _op. cit._, p. 55, Footnote 15. Palmer claims that Java's share of foreign investment has increased from thirty-four per cent of the total approved investment in December 1971 to fifty-three per cent in May 1974. In comparison Kalimantan's share fell from twenty-two per cent to twelve per cent over the same period of time. Within Java itself, the Jakarta-West Java region takes the lion's share: in May 1974, fifty-three per cent of foreign investment was in Java and of that forty-four per cent was in the Jakarta-West Java region. Domestic investment was even more concentrated in the Java region (sixty-seven per cent). Palmer, I.: "The Economy, 1965-1975" in _Ten Years Military Terror in Indonesia_, _op. cit._, p. 151.

[78]The many difficulties faced by the foreign investor are outlined by Clapham, M.: "Some Difficulties of Foreign Investors in Indonesia", _BIES_, March 1970.

fifty-four per cent higher in 1971 than in 1961 it still constitutes a relatively small part of GDP when compared with other sectors.[79]

It was clear that the majority of pre-seventies' investment by foreign firms had been implemented in the "enclave" or extractive sectors, mainly in oil exploration and production, mining and forestry; American and to a lesser extent Japanese capital dominated these sectors but since the early 1970's there has been a decisive shift from investment in resource-extractive projects towards manufacturing and real estate, and from the American to the Japanese, Hong Kong, Singapore, European and Australian sources of capital.[80] The effect of these direct investments is to increase demand by foreign firms for skilled labor.

During the Pelita I period, some foreign investment in the agricultural sector did occur notably through the participation of agribusiness, the World Bank and the Indonesian government. A variety of schemes were introduced, the better known being the Bimas and Inmas schemes.[81] The controlling idea was to apply Green Revolution technology to increase agricultural productivity and raise rural income, but the objective of self-sufficiency in rice production was not reached under

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[79] Sundrum, R.M.: "Manufacturing Employment, 1961-71" in BIES, March 1975, p. 58. EIU, "Annual Supplement Indonesia", 1975, reported that the contribution of manufacturing to GDP went from 8.3 per cent in 1965 to 8.9 per cent in 1973 (p. 6). See also BIES, SRD, July 1975. Table 8 indicates a shift by foreign investment to manufacturing from forestry and mining. Table 12 shows large increases in industrial output by industry. The article noted the changing composition of imports which "continues to improve — i.e., to move in the direction of a more rapid increase in essential commodities as opposed to non-essentials."

[80] BIES, SRD, July 1975, p. 25.

[81] Agri-business involvement in Indonesian agriculture is as yet on a limited scale. See Hickson, J.: "Rural Development and Class Contradiction on Java", Journal of Contemporary Asia, Vol. 5, No. 3, 1975, pp. 333ff. World Bank involvement in agriculture (including fisheries) involves rehabilitation of irrigation systems and plantations, strengthening of administrative capacity and diversifying agricultural production. See Thompson, G. and Manning, R.C., op. cit..

Pelita I and the likelihood of success under Pelita II appears remote.[82] Foreign investment in agriculture resulted, according to the available if rather scant evidence, in the familiar pattern of class transformation that has been observed in India, the Philippines, West Pakistan and Mexico.[83] Increased productivity through the application of Green Revolution technology meant increased expenditure for the farmer; since relatively few could afford this increased expenditure due to the subsistence nature of most farming in Indonesia, the new technology tended to benefit those who could afford the cost of the new agricultural inputs of seed, fertiliser and insecticide. As a result where Green Revolution technology has been applied, it appears that the rich farmers have become richer and the formation of a Kulak class begun, whilst the poor farmers, the majority, became poorer. Some lost their land to join the vast pool of unemployed and underemployed labor in the cities, while others became agricultural laborers. Whilst the Bimas and Inmas schemes have not penetrated the whole of the agricultural economy, where they have done so,

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[82]For example see Collier, W.L. and Gunawan, R.S.: "Recent Changes in Rice Harvesting Methods"; Utami, W. and Ihalauw, J.: "Some Consequences of Small Farm Size"; Timmer, C.P.T.: "Choice of Technique in Rice Milling on Java"; these articles in BIES, July 1973. Timmer, C.T.P.: "Estimating Rice Consumption", BIES, July 1971. Franke, R.: "The Green Revolution in a Javanese Village", unpublished Ph.D. thesis, Harvard, 1972. Hickson, J., op. cit..

[83]See for example, Ladejinsky, W.: "Green Revolution in Bihar" in Economic and Political Weekly, September 27, 1969; Staub, W.S. and Blase, M.G.: "Genetic Technology and Agricultural Development" in Science, Vol. 173, July 9, 1971; Harris, M.: "The Withering Green Revolution" in Natural History, March 1973. For effects of capitalist technology on class structure see: Monthly Review, June 1972, articles by Cleaver, Meeropol and Fatemi; Lele, V.J. and Mellor, J.W.: "Jobs, Poverty and the 'Green Revolution'", A/D/C Reprint, New York, August 1972; Jacoby, E.H.: "The Effect of the 'Green Revolution' in South and South-east Asia" in Modern Asian Studies, 6, 1, 1972; Sharma, K.L.: "Modernisation and Rural Stratification" in Economic and Political Weekly, September 12, 1970. For the ecological implications of capitalist technology see: Janzen, D.H.: "Tropical Agroecosystems" in Science, Vol. 182, December 21, 1973; Paddock, W.C.: "How Green is the Green Revolution" in BioScience, Vol. 20, No. 16; Allaby, M.: "Miracle Rice and Miracle Locusts" in Ecologist, Vol. 3, No. 5, May 1973.

undesirable social consequences have been observed. In addition, the new schemes were directed towards areas where an ample water supply was available, since the miracle rice needs a steady and large volume of water. This resulted in certain areas (already better off generally than others) being services by Bimas and Inmas, while the poorer and more needy areas received little government help of any consequence. Regional disparities, already a serious political and economic problem therefore increased.

Advances made under Pelita I were advances for foreign capital and non-pribumi capital, as well as for the government, who privately sought to increase and strengthen their ties with both groups, whilst publicly maintaining their support for Indonesian development. After it became apparent that the employment goals and the development of the pribumi were largely unattained, it became necessary for the government to publicly announce its concern for these unsolved problems. In January 1974, serious riots, especially in Jakarta and Bandung occurred, in which strong anti-Japanese and later anti-Chinese sentiments were expressed. On January 22 of that year, Suharto announced that certain principles be applied to all future foreign investment. These were: (1) all foreign investments should be in the form of joint enterprises with Indonesian nationals; (2) the share of Indonesian nationals in foreign enterprises should be increased gradually so that within a certain period it would reach fifty-one per cent; (3) the list of industries closed to foreign investors should be extended; (4) the tax incentive given to foreign investors should be reduced; (5) the number of foreigners employed in foreign enterprises should be kept to a minimum by instituting training programmes.[84]

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[84]IMF: "Indonesia; Recent Economic Developments", prepared by H. Neiss, S. Thayanithy, G.G. Johnson and N. Kirmani, April 19, 1974.

In April 1974, the second five-year plan was announced, and reflected the government's awareness for the politically necessary development of the pribumi, the economically weak sector of society, and for the pressing need to ensure that future investments increased employment markedly.[85] To achieve these goals and to maintain the same level of foreign investment would prove a difficult task, as later chapters will establish, yet officially the objectives of Pelita II could be achieved only through the coordination of public and private sectors. Foreign capital was still officially to be directed towards agricultural-supportive industries, and generally obliged to accept more government control as to the direction of investment by sector.[86] To finance an increase in the growth rate from 7.5 per cent to 9 per cent per annum the projected increase in the rate of domestic savings went from twenty-one per cent in 1975 to twenty-eight per cent in 1980.[87] Despite the improbability of this occurring there have been increased attempts through monetary and fiscal policy to increase the level of public savings and thus the mobilisation of domestic capital for productive investment. This will be discussed later in the chapter since what emerges as important here is the policy of pribumisation implicit in the second five-year plan. As one official put it, pribumisation is to be achieved "within the limits of managerial and technical skills available, and without disruption to the development of the economy."[88]

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[85]Public criticism of the government's policy toward the pribumi found expression in a seminar concerned with development strategy, held by the CSIS in Jakarta, May 29-31, 1975. Similar sentiments have been expressed by the chairman of KADIN, the Indonesian Chamber of Commerce. See the Indonesian Observer, 3/6/75, Warta Cafi, 3/6/75, and Merdeka, 16/5/75.

[86]As the chairman of Bappenas remarked during an address to Australian and Indonesian businessmen: "Government policy toward the private sector is to stimulate private participation to the maximum extent possible and to give direction to its activities." Nitisastro, W., AIBCC (1974), op. cit., p. 2.

[87]BIES, SRD, Arndt, H.W., July 1975, p. 10

[88]Suhud, AIBCC (1974), op. cit.. The official guidelines laid

Following the 1974 riots, the Indonesian government announced a policy of requiring fifty-one per cent indigenous pribumi ownerships, but not necessarily management control, within ten years. In addition state banks were instructed that only pribumi firms or joint-ventures with pribumi were to be extended investment credit. An overall tightening of regulations concerning pribumi equity was announced, since prior to the riots these had been very loosely adhered to. Furthermore, in accordance with the overall plan of using foreign capital as a means to transfer managerial and technical skills, the guidelines for the training programmes were tightened and administrative steps taken to encourage the training of Indonesians in technical and executive skills.[89] For example, the EIU reported that a levy of US$100 per month was to be paid by employers for every foreigner they employ, the proceeds of this levy going to train Indonesians to take over the more senior expatriate positions; it was also thought such a stipulation would encourage foreign firms to make use of local labor and do more themselves to train Indonesians to replace foreigners. However, as observed by the EIU, such a regulation, under present social and economic conditions is likely to benefit the Chinese; since they are economically stronger and as well disproportionately well-educated in academic, scientific and administrative skills. Moreover the implementation of such regulations has proved difficult in the past and there is no reason to expect that things can improve under present conditions.[90]

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[88](cont.) down by the government stated that all foreign capital enterprises were required to organise and provide regular and systematic training and educational facilities. Investment in Indonesia Today: A Revised Guide to Laws and Procedures, Economics Section, Indonesian Embassy, Canberra.

[89]EIU Quarterly Economic Review: "Indonesia", No. 2, 1974, p. 7. See also EIU: "Indonesia", No. 1, 1974, p. 6.

[90] With respect the new criteria placed on foreign investment "[the] view has been expressed...that through the determination to avoid the deleterious effects of foreign capital, coupled with limited experience and understanding of the effects to be expected, some of the

Clearly, such modifications to stated economic policy took their immediate impetus from the pressing political need to assist the pribumi. Yet the World Bank, and arguably, the Indonesian government recognised the political and economic advantages to be derived from a policy that does effect some redistribution of annual increments to national income to the disadvantaged groups in societies like Indonesia. In harmony with the earlier preoccupation of international institutions for greater, more rapid and visible economic development, the World Bank in a recent publication urged the necessity of a reformist "poverty-focussed strategy".[91] This aimed to directing resources towards assisting the poor gain access to land, credit, employment, education and public facilities. By this means it was hoped that well-timed intervention by government would prevent the outbreak of unmanageable social unrest or revolution,[92] by the mobilisation of the poor within an institutional framework. Although the World Bank publication was concerned primarily with the poorest groups within society, namely the landless laborers, poor farmers and urban unemployed, nevertheless the force of their argument is also applied to the indigenous producers, whose depressed economic condition is also related to the domination of the economy by foreign capital and the imbalanced growth between foreign and domestic-controlled sectors.[93] Clearly some redistribution of the annual increment

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[90](cont.) restrictions to be imposed are unnecessarily rigid. In consequence future relaxations in certain areas may be possible." <u>Report from Senate Standing Committee on Industry and Trade</u>, Parliament of the Commonwealth of Australia, Australian Government Publishing Service, Canberra, 1975, p. 57. [Hereafter cited Senate Standing Committee Report 1975.]

[91]Chenery, <u>op. cit.</u>, Introduction, pp. xiii-xx.

[92]<u>ibid.</u>, pp. 65ff.

[93]"The urban poor require a more diversified strategy...(than the rural poor). In the first place, it is desirable to restructure the modern sector to make it more responsive to the opportunity costs of labor and capital, which implies a shift toward more labor-intensive products and processes. However, even with optimal policies, the modern sector cannot provide employment for the bulk of the rapidly growing

to national income in favour of the pribumi is possible, along the lines suggested by the World Bank, and it is arguable furthermore, that the various international institutions would seek to pressure the Indonesian government into some degree of conformity with this policy. Yet the difficulty remains essentially of a political nature since at present these increments are accruing as profits to foreign capital, and as well are appropriated by the ruling elite groups in Indonesia.

At present, then it appears that the majority of the plans for pribumisation have very little chance of succeeding in their stated aim, and tend in fact to lend themselves to utilisation by other interests to enhance their already dominant economic power. The example of the training programme indicates the bureaucratic problem of impartial and regular implementation of policy. Further obstacles to their success lie in the present weak condition of the pribumi as opposed to the strength of both foreign and non-pribumi capital and the limited possibility of meaningful government action. For example, the regulations stipulating fifty-one per cent pribumi ownership within ten years become particularly unconvincing when several other factors are taken into account. It seems doubtful that there will be enough pribumi capital available to secure this percentage, and even in cases where it is secured, the company may still be effectively controlled by minority interests due to different sorts of shares and the nature of the voting rights attached to them. Priority shares can be brought into a company structure to "protect or give a certain class of shareholders a benefit"..."the other way they use these priority shares...is to maintain control of the Board of Directors."[94]

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[93](cont.) urban labor force. A second range of policies designed to reach the self-employed and to make small-scale producers more efficient is therefore necessary. This direct approach focusses on improved access to inputs, the redirection of public investment, and the removal of discrimination against small producers." ibid., p. xviii.

[94]Pearce, A.: "Legal Aspects of Establishing a Joint-Venture in Indonesia", AIBCC (1973), op. cit..

The chronic shortage of suitable managerial and executive personnel of pribumi status would also appear to enhance this tendency. As the EIU observed, the stated intention is probably denied a high probability of implementation by existing reality.

> It is too early to write this attempt off as an inevitable failure, though the government must be aware that it lends itself to relatively easy by-passing, if only because many of the Indonesian shareholders are likely to be Chinese, many of whom may anyway be effectively, nominees for foreign interests....However it seems doubtful whether the culture of Western equity capitalism can readily be imposed on the indigenous population (as opposed to allowing the adoption of its practice to emerge spontaneously) so that economic power is certain to remain concentrated in very few (even if genuinely Indonesian) hands.[95]

In an American Embassy document a similar view is expressed.[96] The airgram notes the scarcity of information from government sources concerning the implementation of the policy, and "attempts to identify the most practical and adaptable approaches to compliance". (p. 1) Six methods to increase pribumi ownership are detailed and evaluated; four offer very limited results whilst two are considered rather more promising. The proposed stock market, the report claimed, cannot come about in less than three years, and then may only play a nominal role in meeting the fifty-one per cent pribumi shareholding goal because of its probable limited activity. Partnership arrangements, through joint-venture, excluding major projects of US$100 million or more, are similarly evaluated as unable to substantially increase pribumi ownership due to the

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[95]EIU Quarterly Economic Review: "Indonesia", No. 2, 1974, p. 7.

[96]American Embassy Airgram, American Embassy, Jakarta, April 8, 1975, "Nationalising — Indonesian Style", airgram to the Department of State.

scarcity of pribumi with capital and the dilution of management control. Transferring of shares to nominees, to a nominal pribumi stockholder, who holds the shares for the beneficial interest of the controlling investor is also discussed. This Ali Baba formula has been frequently used since it creates an appearance of pribumi ownership without the substance, but the report dismissed this method of transfer as politically unwise. The fourth method evaluated was stock funded employees pension, profit sharing and bonus plans; similarly it was adjudged as unacceptable since "...in an economy where most employees live near subsistence, stock with no fixed return or ready market value has dubious attraction." (p. 6)

However, two means of compliance to the fifty-one per cent stipulation are commended in the document. Firstly trustee arrangements, involving a transfer of share title to individuals or institutions to hold in trust on behalf of future pribumi purchasers. Non-bank financial institutions are the main institution to be used, and to effect the smooth implementation of such arrangements, eight merchant banks with majority foreign ownership, have been granted pribumi status and may hold the shares for five years, after which time they must sell them to pribumi. Whilst it was claimed that this was one of the more realistic options open to the foreign investor, the reluctance of the merchant banks to purchase such shares "because they offer no assured investment return" was also admitted. (p. 8) Furthermore the five-year trustee period is a flexible time and the government will reportedly grant one or more extensions. The report concluded however that "for the great majority of medium and small investors the most practical means of compliance is the use of trusteeship arrangements". (p. 1) These and other problems relating to the operations of the eight merchant banks will be discussed later in the chapter; their relevance at this particular stage of the argument, rests in the role accorded them by the Indonesian and American governments in relation to the pribumisation policy.

The final proposal to effect this is through government ownership, either through cash purchase of shares by the development bank Bapindo (for eventual sale to the public), through joint-ventures by state enterprises, or government participation in major projects. The feasibility of this proposal is evaluated as sound, but its present practicaltiy due to the tight foreign exchange position and heavy foreign borrowing would, the report claimed, probably limit this possibility more than was desirable.

Pribumisation, then presents the government with a difficult task, one best pursued slowly and with maximum flexibility. With regard the requirement of fifty-one per cent pribumi ownership <u>within ten years</u>, the US Embassy concluded that such a time limit was only a politically expedient statement and reassured investors that each individual case would be decided on merit. "The government will make allowances for the size and nature of the investment, future expansion commitments and other relevant factors." (p. 2) Research in Jakarta by the writer supports the widespread existence of this attitude amongst the bigger and more sophisticated enterprises. Government compliance rests on a realistic evaluation of their own particular political and economic needs; an interview[97] with a high-ranking government official indicated the political motivation of the ten-year stipulation period, and confirmed the government's willingness that such stipulations be open to negotiation. Indeed, the same official has publicaly stated that "due attention will be given to arrangements already agreed upon" and that "there have already been instances where the obligation to operate under a joint-venture have been waived."[98]

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[97] <u>Interview</u> with Suhud, Jakarta, 9 September 1975.

[98] Suhud, address to AIBCC (1974), <u>op. cit.</u>.

Another consideration necessary to the evaluation of "pribumisation" policy is the question of state bank credit and its formal restriction to pribumi firms. The problem of interpretation of policy arises due to the ambivalence of the definition of pribumi. As Panglaykim observed, for a venture to be defined as pribumi at least fifty per cent of shares should be in pribumi hands provided that the majority management is pribumi, or seventy-five per cent of the shares should be pribumi in which case the management can still be in non-pribumi hands.[99] In an interview, he maintained that this policy was not practical; firstly the pribumi generally suffered a capital shortage, and those who did not and were capable, usually preferred to go into business on their own rather than with Chinese. Furthermore the required conditions pertaining to management and ownership were not realistic and consequently "since oil and water do not mix" he maintained that the arrangements on paper would rarely correspond to the practical ones.[100]

It is not premature at this stage to stress the political motivation of the pribumisation policy, and to suggest that so far it appears to have met with little success due not only to lack of implementation by design, but more importantly to the configuration of social and economic conditions that preclude its effective implementation. In short, the policy is a political response to a developing economic situation, and its formal objectives seem unlikely to succeed. In attempting to develop a more sophisticated financial infrastructure, the government inevitably harms the pribumi; the reforms to the banking sector is an important factor in this process.

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[99] Panglaykim, op. cit., p. 70.

[100] Interview with Panglaykim, Jakarta, 3 September 1975.

Banking Policy Under the New Order Government

Reforms to the banking sector centred on the need to regulate and bring to order both state and foreign banking, particularly in Jakarta, and to stimulate competition and specialisation[101]: Central Bank policy was to promote efficiency in the domestically-owned sector by encouraging merger, which resulted in discrimination against the Chinese-owned private banks in favour of state banks, which were placed in a privileged position as far as access to credit was concerned; they were permitted to lean heavily on the Central Bank to finance their own credit operations. This was criticised by those who believed that private banks performed an important function in the economy, and contributed to the competitive and dynamic condition of the domestic banking sector.[102] State banks enjoyed privileges but at the same time, were not operating as independent units since the main sources of funds came from the Central Bank and autonomy of that institution from the government did not prevail. The statute relating to Central Bank autonomy "was weaker than one might have hoped "[103] since the ceiling on funds able to be borrowed from the bank by the government was decided upon by the government itself. In effect, the Cabinet resolution to make itself the highest monetary authority meant that the Central Bank could act like a government agency.

The desire to protect state banks and guarantee them a reasonable market was clearly related to the position of strength enjoyed by the foreign banking sector. All foreign banks permitted to establish branch offices in Jakarta did so without the necessity of organising themselves

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[101] Annual report of the Bank Indonesia, Jakarta: various issues.

[102] Gurley, J.: Notes on the Indonesian Financial System, Jakarta, September 1969. "Private bankers perform such essential functions that any further deterioration in their situation may have unfortunate consequences for Indonesian development."

[103] Arndt, H.W. in Glassburner, B., op. cit., p. 338.

into a corporation under Indonesian law. Officially they were not permitted to operate outside the capital, the ostensible reason being to reduce competition with the regional branches of state banks; however many of them, by various means, do engage in this.[104] By the end of 1969, eleven foreign banks were operating[105] and offered "significant competition to the Indonesian state banks in foreign trade, finance,...(and) also (served) as intermediaries for the inflow of foreign capital."[106] Government attempts to protect the state banks were also evident in a more recent move whereby the newly licensed merchant banks were restricted on the money market. Although officially their existence is justified by the contribution they are expected to make in this area, restrictions have been imposed to prevent them conducting current accounts, savings accounts or time deposits. It is thus difficult for them to acquire Rupiah funds, so they deal mainly in dollars, and their designated function of supplying medium-term credit to pribumi is thus severely circumscribed; it is logical to attribute this situation to a protectionist policy.[107] Clearly, the post-colonial state does have leverage to protect indigenous enterprises, in this case the state banking sector; and since the public service comprises a significant part of its political support, there is clearly an incentive for it to do so. The conflicts between the objective economic requirements of promoting capitalist relations of production and the political needs of the state are in evidence here.

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[104]Informal discussion with senior executive from one of the largest foreign banks operating in Jakarta.

[105]These included four US banks, one Japanese, one German, one Dutch, one Thai, and one Hong Kong bank.

[106]Arndt, H.W. in Glassburner, B., op. cit., p. 390.

[107]Interview with senior executive of one of P.T. Mutual International Finance Corporation, one of the eight newly established merchant banks. Jakarta, 8 September 1975.

Foreign banks have, overall, experienced high profit margins and secured a large share, if not the largest share of the market for foreign exchange transactions, short-term and long-term credit. It is difficult to establish these statements with figures, because the accuracy of government statistics especially in such a crucial area as finance, remain highly dubious or non-available. However, the fact that nearly all of the internationally known banks have established representative offices in Jakarta, if not actual branches, attests to the profitability and competitiveness of the foreign banking sector.[108] By 1971, the dominant position of that sector was evident, and it was obvious that the domestic banks were unable to observe efficient, detailed or future-oriented policies; they were severely limited by their smaller capital resources as well as lacking the range and volume of managerial expertise available to foreign banks.[109] Competition was conducted not only in foreign exchange transactions, but in the mobilisation of domestic savings and in their processing for loans. In purely "economic" terms, such efficient operations are to be encouraged since they lower domestic interest rates, minimise inefficient banking which tends to drain on development funds, and increase the level of public confidence in banks, thus reducing the propensity for hoarding and consumption.[110] Its implications for independent development of Indonesia's economy are however questionable.

The big increase in the lending activities of foreign banks which occurred in 1972 "still (gave) foreign financial interests a big leverage

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[108]For a list of foreign banks operating in Jakarta see Indonesia: Guide to the Market, Department of Overseas Trade, 1975, p. 36.

[109]The Indonesia Letter, May 1972.

[110]FEER: "Banking in Asia", special report, April 9, 1973.

in the development of indigenous enterprises"[111]; furthermore, they drew business away from local banks which were unable to fund the large interest payment on the growing deposits which they were obliged to absorb. Thus whilst deposits with state banks rose five-fold in three years and are still rising, the amount of loans outstanding from these banks were reported as virtually stagnant in the first half of 1972.[112] The strength of the foreign banking sector in the area of loan transactions is further supported by the claim that sixty per cent of its profits result from loans, the remainder from foreign exchange transactions.[113]

Moreover, because of the shortage of domestic capital, indicated by the overall low level of public savings, foreign banks were encouraged to increase capital flow through loans from the parent bank, thus increasing foreign control in this decisive area of the economy. They were similarly encouraged to give credits to importers and industrialists in foreign exchange, as well as in Rupiah, which they mobilised far more successfully than the state banks, due to the ability to offer lower interest rates to the borrower. Thus although the government has formally endorsed the necessity of assisting the state-owned banking sector, it is evident that foreign domination prevents or severely circumscribes the effectiveness of any measures to achieve this. The role of the post-colonial state is in the short term mediatory, but its overall role to assist the process of expanded capitalist reproduction will, in the banking sector, mean the decline of power of the domestic and the strengthening of the foreign sector.

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[111]EIU: "Quarterly Economic Review — Indonesia", No. 1, 1973.

[112]ibid..

[113]Interview with senior executive of the Chase Manhattan Bank, Jakarta, 11 September 1975.

Since the position of the foreign banking sector is strong, so too is their ability to supply credit. Historically, its supply to the pribumi has been poor and the increased activities of the foreign sector since 1967 cannot improve this situation. With the introduction of the second five-year plan, the government announced several policies designed to improve the supply of credit to the pribumi: this was part of the Indonesianisation programme. These policies amounted to an attempted increased protection of indigenous industries and since this is by no means a new theme in post-independence economic policy it is appropriate to refer to its historical roots.

Indigenous Economic Activity and State Policy

Protectionist policies have been the princip~~le~~al and most powerful incentive to industrialisation in Indonesia, but since independence the organisation of credit to the pribumi has been a difficult and poorly performed task. The Benteng Program of 1951, part of the Urgency Industrialisation Plan, was an early effort, but it was plagued by excessive bureaucratic control, partiality, poor foreign exchange policies and increasing price instability. Other aspects of the Urgency Industrialisation Plan were launched to assist pribumi in the industrial field, but they also met with disappointing results due in part to the lack of managerial skills and consequent inability to provide funds for the expansion and reproduction of capital. Protectionist policies like these encouraged the emergence of the Ali Baba enterprise, as it was impossible to prevent the Chinese from taking advantage of a situation left wide open to their exploitation.[114] Similarly they encouraged the existence of "paper" traders and import/export companies of dubious reputation. The highly partial allocation of the various permits and licenses by

[114]An "Ali Baba" firm is that "in which a Chinese entrepreneur has a sleeping partner, frequently a military officer or a government official on his back." IBRD (Hughes), *op. cit.*, p. 45.

officials was common, as was the use of political influence in gaining favours. As Thomas has pointed out "political pay-offs played a major role in creating a large group of economically weak companies."[115]

Nationalisation of Dutch enterprises in 1957 resulted in the emergence of a large state-owned sector of the economy which enjoyed protection and privilege through extensive credits and near monopoly rights in certain fields of activity. The Chinese business community was also able to strengthen its position in the economy after nationalisation by expanding their activities in the wholesale/retail trade as well as penetrating other fields, notably import/export. As a consequence, the position of the Chinese in domestic distribution of most goods became dominant. As Tan observed, "the retrenchment of Dutch business interests in the 1950's left the overseas Chinese and Chinese-Indonesians in a position to dominate or control major sectors of the non-agricultural economy...."[116]

Thus prior to 1965 the pribumi had in almost every field of economic activity, failed to compete successfully with the Chinese. Notable exceptions are state-owned enterprises like Pertamina, which under production-sharing contracts skillfully negotiated by its outstanding executive, Ibnu Sutowo, managed to operate successfully, to build up a large and diversified corporation and eventually to become the most powerful single domestic economic enterprise in Indonesia. Yet Pertamina is an exception, and the full implications of its present economic situation are yet to be established. To explain why the pribumi have been unable to become a dynamic business class, reference to historical and cultural as well as immediate economic factors, must be made.

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[115] Thomas, K.D.: "Observations on the Draft of Indonesia's Second Five-Year Plan" in Growth, 28, December 1974, p. 42.

[116] Tan, T.S., op. cit., p. 4.

Former economist with the IMF Siregar established that the economic leadership of the pribumi was predominantly non-Javanese, namely Sumatran and Minandanese.[117] He noted that the cultural bias against any entrepreneurial occupation was highest amongst the Javanese from whom the majority of civil servants and military were recruited, and non-existent amongst the Chinese, to whom frugality and hard work were important virtues. In contrast, the consumption/accumulation priorities of the pribumi meant that surplus was not available for reinvestment:

> The accumulation of domestic capital for investment purposes [was] made more difficult in Indonesia because of the consumption pattern interest in the indigenous entrepreneurial group...the tendency to consume profits by purchasing relatively unproductive items is a conspicuous characteristic of the Indonesian entrepreneur. This tendency is aggravated by the rapid acculturation to Western standards of consumption, especially in urban society.[118]

This coupled with preference for quick and easy profits and unwillingness to engage in long-term industrial enterprises established the typical pribumi as a pre-industrial entrepreneur, both unwilling and unable to take long-term risks and reliant for his survival on protection from the state. Considering their historical experience, the low risk taking propensity cannot be seen as irrational. The current problems faced by the pribumi were outlined in a recent seminar by H.W. Arndt; it appears that little has changed. High rates of duty on imported machinery, low rates or smuggled imports of finished goods, complex and excessive taxes,

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[117]Siregar, A.F.: "Indonesian Entrepreneurs", Asian Survey, Vol. XI, No. 5, May 1969. Siregar noted that the Batak, Minankabau and Atjehnese, noticeably Christian and Muslim communities, predominated amongst the Sumatrans.

[118]ibid., p. 355. Siregar is quoting van der Kroef, "Indonesia in the Modern World". See also BIES, SRD, March 1972.

costly and inadequate credit, obsolete equipment, deficient physical infrastructure, hampering manpower regulations, and inadequate training facilities were still serious impediments.[119] Further difficulties involve poor management, low utilisation of capacity and excessive overheads. In addition there was a marked contrast between the kind of ethos which prevails among (non-Chinese) Indonesian businessmen and executives of state firms and that which prevails in the leading strata of business and government in countries like Taiwan, Hong Kong and Singapore. "What gets you prestige in elite Indonesia is not working hard to build up a firm or an organisation. It is finding quick smooth and gentlemanly routes to being rich."[120] However, whilst the position of the pribumi is in many ways hampered and stunted by state action, their position simultaneously depends upon support by the state; "it must be understood that the Indonesian entrepreneur cannot prosper independently of the government; he must have friends in high places to protect him against arbitrary action. In this respect the foreign investor is much more free to work out his obligations."[121]

The relative importance of historical, cultural, economic and political factors in determining the present economic position of the

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[119] Arndt, H.W., comments made in address during seminar organised by the Centre for Continuing Education, "Indonesia — Trading Partner", op. cit.. The effect on the domestic capitalist classes of direct and indirect taxes has been noted by Hughes. Direct taxes in Indonesia embrace "the heritage of a variety of legal and stamp payments from colonial times when these formed an important source of revenue and a deterrent to local business formation." IBRD (Hughes), op. cit., p. 21. "Indirect taxes...are in general quite high in comparison with developed countries....The lack of coordination of such taxes with import duties is frequently a cause of difficulty for domestic manufacturers, offsetting the protection which tariffs seek to give; where local production taxes are higher than tariffs, effective protection becomes negative." pp. 20-21.

[120] Feith, H.: "The Political Economy Question Marks. Bureaucratic Power and the Slowing of Reform", Monash Seminar Paper, Melbourne, 18/6/73.

[121] Sri Edi Swasono: "Some Notes on Indonesian Entrepreneurship", SEADAG Reports, Indonesia Panel Seminar, Medan, June 14-16, 1975.

pribumi is difficult to evaluate, but it is argued with Swasono, that state policy and its implementation are at present one of the greatest obstacles facing the pribumi. Swasono stated that "the matter of developing indigenous businessmen and managers able to compete with foreign entrepreneurs and managers is more dependent upon the attitudes and policies of the government than upon the economic situation and cultural conditions of the Indonesian private sector.[122]

Similarly Myrdal points to the undesirable effects of the system of "administrative discretionary controls (which)...must tend to favour those who are already active in a field where permission of some sort is needed to continue or expand production."[123] Ties between established enterprises and government strengthen over time, the administration prefers to deal with a few large concerns rather than with a number of small firms, all of which tend "to restrict competition, favour monopoly and oligopoly, and pamper vested interests."[124] For Myrdal then, state intervention also functions to the detriment of small businesses and of newcomers. With many controls regulating their activities but with little power to effect the type or frequency of regulation, the growth of the small business sector is severely hampered, whilst that of the large is encouraged. The position of the state in this matter is initially both curious and contradictory. On the one hand it is in large part responsible for the continued existence of the pribumi, on the other hand partly responsible for its present depressed economic condition. From this situation contradictions of political consequence must eventually emerge.[125]

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[122] ibid..

[123] Myrdal, G.: Asian Drama: An Enquiry into the Poverty of Nations, Twentieth Century Fund, New York, 1968, Vol. III, Chapter 19, p. 929.

[124] ibid., p. 930.

[125] For a detailed account of Indonesian government policy toward the pribumi see Glassburner, B.: "The Attempt to Foster Private Entrepreneurship in Indonesia", Indonesian Economic Review, August 1962.

In contrast, the position of the Chinese is strengthened by state policy. During Pelita I they availed themselves of opportunities placed before them by the government, through the Domestic Investment Law, and are the most important national private sector group in manufacturing (either as independent producers, or domestic "front men" for foreign capital), in the unorganised money market, and in the distribution and collection trades. This latter activity is conducted not only to acquire cash through distribution fees, but more importantly as a means to secure, for sixty days, large amounts of cash from the sale of goods. These are commonly sold immediately at cost price and during the remaining fifty-nine days the merchant will "turn over" the money several times, on the private money market where interest rates are extremely high. Similar practices exist with respect the use of state bank credits, obtained and taken to Singapore to acquire even more funds.[126]

Prior to the New Order government, Chinese capital on the whole remained atomised and linked to small-scale production. It was basically entrepreneurial in character, in that its owners sought to employ it in industries they either owned or controlled, and was not extensively employed in long-term investment projects. Yet with the event of the present limited degree of industrialisation, it appears that some Chinese have been able to adopt a more modern attitude toward investment. Whereas credit availability in Singapore, Hong Kong and other "offshore" sources was previously determined through clan and family ties, there are indications that much of this business is now being conducted on more modern capitalist lines.[127] Moreover, whereas many Chinese still remain tied to

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[126] Interview with employee of Bank of America, Kota Branch, Jakarta, 6/9/75,

[127] Hartono, S.: Transnational Problems of Foreign Investment in Indonesia, English summary of doctoral thesis, Padjadjaran University, Bandung, 1972.

the traditional family business, and resist pressure to form public companies, it appears that a proportion of this group, aided by the state and cooperating with foreign capital have made definite moves in the direction of investment in industrial formation of a long-term nature.[128] These may be identified as compradores as opposed to others of the same racial group whose specific type of economic activity excludes them from this category. A compradore of Chinese descent is he whose economic interests lie not with the promotion of indigenous capitalist development but with the continuation of the present military regime, with whom he is aligned for political protection and economic gain, and with foreign capital which financially and ideologically assists to support that regime. Members of the state on the other hand, ally themselves with this group for reasons of personal aggrandisement as well as using it as a lever against the growing power of the economically dominant capitalist class, represented by foreign capital.[129] The position is further complicated by the fact that much of these so-called domestic investments by Chinese are made possible by extensive "offshore" loans, and is not really of domestic origin; nor is it domestically controlled, since the Indonesian-Chinese may function as "front men" for investors offshore, who are both Japanese and Chinese-based in the major financial centres of Southeast Asia. With these complications plus the scarcity of reliable statistics on the subject, it is difficult to establish the actual

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[128]Whilst it is not possible to establish this more fully, the gist of the argument has been agreed upon by two prominent Indonesian-Chinese citizens, one of whom is Panglaykim, the other Lim Bian Key, secretary of the Centre for International and Strategic Studies (CSIS), the Ali Moertopo-backed think tank in Jakarta. Furthermore interview with a government official of the Agency for Money and Capital Market also suggested this to be the case. Interview, Jakarta, 3/9/75.

[129]The economic strength of the Chinese is illustrated by the claim that in 1972 domestic capital investment surpassed the volume of foreign investment. Most of this was implemented within the manufacturing sector. US Department of Commerce: Foreign Economic Trends, 28/11/73.

positions of the various groups of Chinese-Indonesian in the economy.

Attempts to identify economic classes by reference to race runs foul due to the complexity and volume of economic activity engaged in by the Indonesian-Chinese. Whilst many of the most powerful financiers, merchants and manufacturers in Indonesia are of Chinese origin, there exist as well many more whose small-scale economic activity clearly separates them in importance from the former group. The situation may further be clarified by establishing the distinction between two differing sub-fractions of the domestic or interior bourgeoisie, and also by insisting on the limited but constant changes to the pattern of membership of each. The 'old' trading bourgeoisie, representing merchant capital and in Indonesia mainly of Chinese origin, included as the majority of its members, compradors. The newer subfraction, the manufacturing bourgeoisie including both indigenous and Chinese-Indonesians may be distinguished from the latter by their role as productive capitalists, as investors in industrial capacity, but not by the assence of the comprador. The economic interests of the manufacturing bourgeoisie may lie with foreign capital, for example in the case of industrial joint-ventures, but as distinct from the 'old' trading bourgeoisie, <u>this does not necessarily prevent him</u> from pursuing the economic activity of a productive capitalist; indeed it may enable him to do so more effectively than would be possible without the relationship to foreign industrial capital. Thus it is the relationship of the domestic manufacturer to foreign capital that determines his comprador status, not his racial origin, although historical conditions have favoured comprador economic activity by the Indonesian-Chinese.

Credit Policy Under the New Order Government

It is now convenient to return to the discussion of present credit facilities available to the different groups. As already established, credit facilities to the pribumi have always been extremely poor, and the extravagant privileges enjoyed by the state enterprises resulted in heavily subsidised production which for the most part was inefficient.[130]

Present credit facilities available to the pribumi have been officially upgraded by the government since their deteriorating economic situation became politically unacceptable. Efforts to equalise the cost of capital to the indigenous investor have taken several paths, one of which has been the establishment of the state developments banks[131] and the Investasi Program, another the establishment of eight non-bank financial institutions, called merchant banks.

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[130]Since 1967, there have been significant attempts to reorder the activities of the latter; this occurred because the IMF insisted that assistance be given them subject to their reorganisation on more competitive lines. Already some state enterprises are receiving financial assistance from the World Bank and the Asian Development Bank and all will be placed under the control of a special branch of the Ministry of Finance; this branch becomes a shareholder on behalf of the Indonesian government, appoints directions and aims to develop policy guidelines and to train officials in performance evaluation. Once the enterprise is running efficiently, it will be sold by share issue to private owners on the future stock market, or made available for foreign ownership through joint-venture contract. Considering the limited probability of the functioning stock exchange, it may result that government moves to increase efficiency will again mean gains to the foreigners. In short the state will consciously encourage a healthy and efficient public sector in order at a later stage to sell it to the private and probably foreign-owned sector. An essentially stimulatory but not central position for the state in the production process is evident here. Hughes claimed that the rationalisation of the sector was necessary to increase efficiency and productivity. Such rationalisation however was <u>prevented</u> by state ownership, and to improve overall performance and effect reorganisation the minimisation of direct political interference was necessary. In short efficiency was eroded through the exercise of political patronage. IBRD (Hughes), <u>op. cit.</u>, pp. 47ff. <u>Overseas Business Reports</u>, February 1975, stated: "The policy intent (of consolidation and organisation)... is to make them into profitable enterprises so that their shares can eventually be sold to private (including foreign) investors, thus reducing public sector involvement. Some loans from donor countries have been conditional on the reorganisation of the enterprises." p. 8.

[131]The three development banks are (1) Bank Pembangunan Indonesia (Bapindo); (2) the Private Development and Finance Company of Indonesia (PDFCI), the shareholders of which include Bank Indonesia, Pan Indonesia Bank (private Chinese bank). These two banks jointly own sixty per cent of PDFCI. The remainder is held by IFC (a World Bank subsidiary) — eight per cent, the Nippon Fudesan — eight per cent, Irving International Finance — eight per cent, Bank Nova Scotia — four per cent, Darling

The development banks are those institutions primarily operating as the suppliers of medium-term credits to the pribumi. Their importance lies in the fact that through them the state may create new capitalist relations of production, instead of just protecting old ones; through them, it may cause funds to be channelled into efficient, profitable and well-managed enterprises which, with access to credit could expand and grow large. However it appears that of the three development banks only one is operational, and consequently they are unable to cope with the thousands of requests they receive. Thus their effectiveness in assisting the pribumi with medium-term credits is doubtful as the following remarks make clear. "Even if we assume that these institutions have access.to sufficient capital to satisfy the demand they still lack the manpower, expertise and other resources required by the task of tailoring credit to suit thousands of financial requests...."[132] The bulk of medium-term credits, directed predominantly to the manufacturing sector, have been provided by the Bank Indonesia under the Investasi Program begun in April 1969; credits are channelled through the five state commercial banks and Bapindo. Whilst foreign companies were officially excluded from this scheme, joint-ventures had access to term loans to a maximum of twenty per cent of their investment needs. Prior to April 1973 most Investasi loans went to medium and large enterprises but since that date sixty-five per cent of the available credit has been officially reserved for small loans. After January 1974, Investasi credits became

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[131](cont.) Holdings — four per cent, Credit Lyonais — two per cent, Banco Roma — 2 per cent, Llyods International — two per cent, West Deutsche Landesbank Giro-Zentrale — two per cent. (3) The Indonesian Development Finance Corporation. Fifty per cent held by Bank Indonesia, fifty per cent by Nederlands Financierings Maatschappij. Panglaykim, op. cit., pp. 64-65.

[132]ibid., p. 75. Much of the following information is derived from this article.

exclusively available to pribumi businessmen, but the necessity of providing both feasibility reports and twenty-five per cent collateral to obtain investment credit appears to have prevented many pribumi from enjoying those facilities. To redress this situation, P.T. Askindo was strengthened to insure credits extended to the pribumi without the required collateral, and P.T. Bahana provided collateral on behalf of the prospective pribumi entrepreneur.[133]

But since joint-venture companies could use P.T. Bahana as a source of credit and the definition of pribumi was vague, it is not surprising that most of the investment credits continue to be obtained by non-pribumi. In the words of Suhud, Vice Chairman of the Foreign Investment Board: "It is evident...from studies of past programmes that the majority of new enterprises receiving benefits from the investment incentive programmes are confined to a relatively narrow circle of people, and of these, a high proportion of the Indonesian beneficiaries, are of non-indigenous origin."[134] The problem of definition of pribumi allows a convenient loophole through which non-pribumi may pass. At present a pribumi firm is defined as one where fifty per cent of the shares are pribumi with majority pribumi management, or seventy-five per cent of the shares are pribumi with non-pribumi management. To most businessmen such arrangements between ownership and management are unacceptable, and not surprisingly the Ali Baba enterprises have been able to use regulations designed to assist pribumi, to their own advantage.

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[133]"A firm intention to strengthen the pribumi is expressed in the [second five-year] plan and...[the planners] mention the roles of P.T. Askrindo and P.T. Bahana in assisting this group." Thomas in Growth, op. cit., p. 42 (original emphasis). The difficulty of ensuring adequate credit facilities to the pribumi still remains a great problem. As observed by the BIES: "How far the new rule limiting medium-term investment credit to the pribumi could be enforced was an open question — there is a long tradition in Indonesia by which such rules are evaded through the use of the names of indigenous partners by non-indigenous firms." BIES, SRD, July 1974, p. 19.

[134]Suhud, AIBCC (1974), op. cit..

The difficulties of ensuring equal credit opportunities to the pribumi within the state banking sector are serious not only in terms of the supply of adequate credit, but as well its frequency and geographical availability. In late 1973 the government eased the requirements for credits of Rp. five million (US$17,000) or less, but although there were many applicants for these funds, both central and state banks were very cautious in granting loans.[135] Of the 57,753 applications for credit by small entrepreneurs between January and August 1974, only 18,000 were approved, 24,371 rejected and the rest remained under consideration. In addition the value of credits approved averaged Rp. 1.36 million whereas that of rejected applications was Rp. 2.52 million, suggesting greater wariness on the part of the banks for larger requests. Furthermore credit facilities are concentrated in Jakarta, leaving regional centres and the rural areas poorly served; those who did receive credit are subject to its immediate cutback since the system of priorities allows the channelling of funds into other areas should the need arise. State banks have been obliged to assist the Central Bank in the payment of the Pertamina debt, resulting in the contraction of credit flows to the indigenous producers.

It is again evident that attempts by the state to assist the process of expanded reproduction and the growth of the indigenous pribumi entrepreneur are fraught with contradiction. Development banks are key institutions in the creation of <u>new</u> capitalist relations of production; it is not their task to protect old ones, represented by indigenous small-scale manufacturing which wastes cheap labor, has poor management skills and a low rate of profit. However, in the absence of other more suitable institutions, financial or otherwise, designed to assist the

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[135]<u>Indonesian Newsletter</u>, November 1974. The information given on this page is adapted from this publication.

the raising of productivity in this subsector, it seems that the development banks must continue to operate in this area. Where opportunities existed for them to assist the process of expanded reproduction by indigenes, the government was unable to give adequate support in the creation of further credit facilities because of the monetary policy imposed upon it by the World Bank, the IMF and the IGGI.

The position of the state banks further deteriorates when it is compared to the foreign sector, in overall ability and in the supply of competitive credits. All businessmen seek the cheapest credit, and in Indonesia this may be obtained from offshore loans where borrowing is ten to fifteen per cent cheaper. Foreign, joint-venture and Chinese companies have access to such credit, and also to the package deal credit extended by the Japanese Big Ten, the Zaikais.[136] The increasing number of credits of this variety means that a fast growing area of credit allocation is beyond government control and knowledge.

Because of the chronic shortage of domestic capital, the government initially was obliged to allow foreign banks to give credit, in both rupiah and foreign exchange. The latter is offered at a competitive rate because foreign loans at lower interest rates from the parent bank can readily be obtained. In addition, the foreign banks have been more successful than the state banks in the mobilisation of domestic capital,[137] borne out by the recent trend in public deposits towards foreign banks. Certainly the government was aware of the need to mobilise domestic capital by increasing the level of public savings. To do this it was necessary to influence the propensity to save, and to do so in Indonesia not Singapore, by offering attractive interest rates. Savings certificate schemes with lottery features were introduced and followed in August

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[136]Panglaykim, op. cit..

[137]Suhud, AIBCC (1974), op. cit., pp. 15-16.

1971 by Tabanas (National Development Savings Scheme) and Taska (Insured Savings Scheme). Both schemes were expected to play a significant role in the mobilisation of domestic savings and the elimination of domestic capital outflow. By May 1972 however it was clear that whilst high interest rates encouraged saving, it restricted investment.[138] Following IMF recommendations a new monetary policy featured a cut in interest rates, which however still remained high in comparison to rates obtainable in other countries.[139] Another series of financial measures with special features to help the pribumi were introduced in April 1973 and included further lowering of interest rates on many categories of loans, and as well the stipulation that sixty-five per cent of all new investment credits from state banks were to go to the pribumi. These efforts were not only very limited in their effect because of factors already mentioned, but the added problem of increasing inflation from 1972 onwards meant moves were necessary to <u>restrict</u> credit given by state banks and raise interest rates.[140] As one source indicated: "...in view of the inflationary crisis (the government) has been compelled to reverse this policy (of increased credits)...and raise interest rates on one-year time deposits and on National Development Savings Fund deposits from fifteen to eighteen per cent and to offer much higher rates on longer-term deposits."[141] The need to restrict credit by local banks, the

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[138]<u>FEER</u>, 30/4/73, stated that the increase in state bank time deposits went from US$26 million to US$70 million between 1972 and 1973. p. 58. [139]<u>FEER</u>, 17/6/72. Export merchants credits cut from twenty-seven to twenty-four per cent per annum, exporting producers from twenty-four to twenty-one per cent, producers and distributors of essential commodities from twenty-seven to twenty-four per cent. Trading credits fell from between thirty and four per cent to between twenty-four and thirty per cent.

[140]For example, by March 1974 prices had risen forty-seven per cent over the previous thirteen months. By the first quarter of 1975 however, the inflation rate had been reduced to 20.5 per cent. <u>EIU Annual Supplement</u>, <u>Indonesia</u>, 1975, p. 18.

[141]<u>EIU</u>: "Quarterly Economic Review — Indonesia", No. 2, 1974, p. 6.

report continues, "is clearly creating the danger of returning the capital investment market to a state of complete domination by foreign banks, even though greater restrictions are now being applied to foreign investment capital, which has always been much more cheaply obtainable."[142]

So far, it appears that the financial infrastructure militates against the significant accumulation of capital through industrial investment by the pribumi, and strengthens the immediate and strategic position of the foreign and non-pribumi sector. As Hughes observed: "The monetary framework within which industrial entrepreneurs invest, both in terms of domestic conditions and with regard to the relationship with the rest of the world, strongly influence their expectations of future production conditions, and it is therefore a fundamental factor in investment."[143] The development of a money and capital market also heightens this trend. Two aspects of this policy will be examined, namely the development of the stock market, and the creation of eight merchant banks through consortiums of foreign and state banks.

Money and Capital Markets: More Development and Contradiction

The existence of financial institutions and the capital market "is the main mechanism for giving mobility to capital."[144] It facilitates its transfer from non-productive economic activity (non-productive investment, savings and consumption) to productive economic activity. Officially the proposed stock exchange in Indonesia was presented as a means of enabling citizens with limited funds to participate, by share purchase in economic growth, whilst simultaneously mobilising idle capital toward productive investment.[145] In June 1968, the government authorised the

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[142] ibid., p. 6.

[143] IBRD (Hughes), op. cit., p. 23.

[144] Puthucheary, op. cit., p. 157.

[145] Announcement by Bank Indonesia, 29/6/72. The importance of the proposed stock exchange has been recognised by the Australian govern-

establishment by the Bank Indonesia of a Preparatory Money and Capital Markets Team to investigate such a possibility and to then make recommendations to the government. In 1969 it was replaced by the Money and Capital Market Team, whose job it was to make the necessary preparations for the actual development of the market, to reactivate the stock exchange and advise on its condition. This was also dissolved, and in January 1972, the Agency for Money and Capital Market Development was established which was to effect the gradual development of the market, to supervise the activities of the stock exchange, and in cooperation with the Ministry of Finance discuss the establishment of financial institutions.[146] Other activities included the organisation of aid-financed training courses, overseas study trips, and the "think tank" functions aimed at improved accounting methods and stimulating public interest in, and understanding of, money and capital markets. Political motives may also be detected in the government's desire to establish a stock exchange since its existence would pre-empt the possibility of Indonesian shares being traded on the Singapore stock exchange and thus avoid increased dependence on that nation.[147] Furthermore, Suharto's recent renewed directives that a basic share market be established by January 1977 has been criticised as motivated purely by consideration of the impending elections in May 1977.[148] It appears that the government

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[145](cont.) ment, who admit nevertheless that its actual establishment will be a slow and lengthy process. One report recommended that "[if] requested by Indonesia, Australia should give consideration to providing assistance in the establishment of a stock market." Senate Standing Committee Report, 1975, op. cit., Recommendation No. 2, p. 6.

[146]Steps Taken for the Development of Money and Capital Markets, Jakarta, Decision of Ministry of Finance, No. Rep25/H.K./IV/1/1972 and No. 38/M.K./IV/1/1972 respectively.

[147]According to informal but reliable sources, Singapore and Hong Kong are used at present by persons in Indonesia "to wash dirty money," obtained from unorthodox practices.

[148]See AFR, 23/12/76; AFR, 17/12/76.

is using the reactivation of the stock market as a symbol of increased pribumisation, even though warnings of the many dangers of premature activity seem to be firmly based.

Despite government enthusiasm for the potentialities of the stock exchange with respect "pribumisation" of economic growth, it appears that such a development will be difficult if not impossible to achieve. For a functioning stock exchange to exist on a sophisticated level, many prior conditions must be satisfied. Accountants in abundance with appropriate skills, and an impartial and operational tax department are obviously necessary, but neither of these are present in Indonesia, nor are likely to be developed within the foreseeable future.[149] Furthermore the current interest rates offered by state banks are so high as to preclude the effective functioning of a stock exchange. At present, state banks offer twenty-four per cent per annum on a two-year term.[150] In order to compete with the banks, dividends that matched these high interest rates would need to be offered. Yet this is out of the question since profit margins of public companies would need to be in the vicinity of sixty per cent, which would preclude many companies from competitive production.[151] Another related problem is the need to reinvest profits rather than to distribute them. The stock exchange would seek to encourage the public sale of family (Chinese) companies, and as well to trade

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[149]Until companies keep one balance sheet only, instead of two, three or even four, each for a different purpose, the public cannot be expected to buy shares in public companies. The partiality of the Taxation Department is well known in both private and public circles in Jakarta. Taxation levels it appears are usually determined by private negotiation between the company and individual members of the taxation department, who in return for assessing an acceptable taxation level, receive payment from the companies. See also AFR, 17/12/76.

[150]AFR, 23/12/76.

[151]By this it is meant that the profit margin has to be exceptionally high so as to yield rates of return on capital invested competitive with the money rate of interest available to the bank depositor. See also AFR, 17/12/76. The problem of competing forms of investment remains a serious problem.

shares from enterprises whose reputations are considerably tarnished due to the political patronage necessarily involved in their operations; it would not be surprising to find that people were reluctant to invest their meagre funds in such enterprises.[152] Indeed, the eight merchant banks in Jakarta, whose job it is to act as the principal underwriters of share issue, recently warned that the "chaotic and secretive" nature of the private sector would be unlikely to attract investors.[153] Furthermore direct warnings about market manipulation and abuse by directors were voiced, and a very limited nature of share trading for the first stages of stock exchange activity was recommended to protect investors. Finally, there is a psychological problem of educating the pribumi as to what a stock exchange involves, of developing a petty-capitalist mentality in the consumption-oriented middle classes who have many reasons to remain skeptical of the "pribumisation" policy.[154] What has emerged most recently on this issue is a decision to limit the sale of securities to government financial institutions, banks, insurance companies and pension funds rather than to promote sale to private individuals. A government-owned share-trading firm has been created to

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[152]Interview with senior official of the Agency for Money and Capital Market Development, op. cit.. The resistance of the family company to such proposals has been noted by the World Bank. Such companies, with a small capital base and a traditional outlook toward capital structure, management and labor, are reluctant to relinquish personal control and the financial fringe benefits of sole ownership. This is one factor that slows down the formation of public companies; "in general, the consolidation and rationalisation of industries is impeded by the family structure of firms." IBRD (Hughes), op. cit., pp. 42-43.

[153]AFR, 17/12/76.

[154]An interesting parallel to an earlier period is evident here. K.H. Dronkers, writing in 1953 observed that "[the] mere opening of an opportunity for domestic capital to participate in a foreign enterprise operating in the country conferred through an issue of bonds or shares or the purchasing of the same on the stock exchange is often insufficient to arouse the interest of the citizens, especially...where these citizens suffer from a lack of technical knowledge and experience in the field of modern industrial enterprises." Dronkers, H.K., op. cit., p. 268.

select sound companies, and purchase their stock for later resale to the public. Yet arguably, the incidence of, or potential for manipulation and abuse within this institution is high.

These and other problems face the Agency, and enquiries conducted during the course of fieldwork noted an attitude of skepticism and pessimism prevailing over the stock exchange question. The spacious but little used offices of the Agency symbolised this attitude, and a senior executive expressed the view that they feel themselves to be performing a token function since they are unable to influence any of the factors that act as obstacles to the development of the stock exchange. It is clear that the stated policy intentions of the government on this issue must not be confused with reality.

Thus whilst the objective function of the stock exchange is to mobilise domestic capital through the creation of a market for that capital, it is evident that the prevailing domestic conditions render this process extremely difficult. Unlike Western nations, Japan, and to an increasing extent Singapore, Indonesia will continue to experience difficulties in the growth of a modern and diversified industrial sector. The proposed stock exchange is not under present conditions able to operate as it should, but its highly limited area of activity will instead assist the penetration of foreign capital into the key growth sectors of the economy. Clearly consideration must be given not only to the type of obstacles which prevent the orderly, rapid and healthy growth of a stock exchange, but as well to the other effects engendered through its establishment, which assist the development of contradictions. A similar situation exists when the scope of merchant bank activity is examined.

The establishment of the eight merchant banks was begun in 1973 when licenses were given to eight approved consortiums of foreign and local banks to establish non-bank financial institutions with view to their use as vehicles for the development of a viable money and capital market, and as a means for promoting the pribumisation policy. To help accomplish these two objectives, the eight institutions were given pribumi status which allowed them to purchase up to twenty-five per cent of shares in industrial ventures, to hold them in trusteeship and within five years to sell them on the public stock exchange. In addition, if further funds were required by the enterprise, then another merchant bank may similarly hold up to twenty-five per cent. The idea was to increase public ownership whilst maintaining completely professional management. This meant that up to fifty per cent of (say) a joint-venture may be held by two merchant banks in their capacity as pribumi, and pribumi status is then automatically attributed to the joint-venture company.[155] The position is at the least curious considering formal policy objectives since they are clearly not pribumi, but represent by consortium, many of the capitalist world's biggest and most powerful banking institutions.[156]

However, when considering the objective needs of capitalist growth, the situation clearly indicates the recognition by the government and the international capitalist institutions, of the key position played by money-capital in this process, even if at the bureaucratic level, officials are unsure as to its detailed workings. The situation was recognised by Rosa Luxembourg, who identified imperialism as the industrialisation of the hinterland. George Lee explained her thesis thus:

> At the level of the international economy this is effected by means of loans. It is immaterial whether these take the form of share capital in new independent enterprises

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[155] The Australian, Friday Notebook, "The Indonesia Connection", 8/4/75.

[156] See Appendix C for a complete list of the participants in these ventures.

> overseas or government loans to a foreign state. Money capital is allocated at a rate of interest to a satellite country. It is then transformed into productive capital as the loan is spent on the import from lending metropoles of machinery and materials. In this way accumulated capital is diverted from old capitalist countries to the young ones....the capitalisation of realised surplus value is mediated by the hinterland.[157]

Clearly this process is beginning in Indonesia, signified by the appearance of merchant banks, development banks and later the growth of the stock exchange and capital market. The particular lending-borrowing relations at present militate against capital accumulation by all but the very big firms, and to overcome this a market for financial assets is objectively necessary for the development of an indigenous capitalism, and as well to assist the spread of capitalism through the penetration of foreign capital. However it would appear that the accomplishment of both is incompatible, given objective economic conditions described previously.

The present condition of the merchant banks clearly reveals the contradictory roles performed by the post-colonial state. Present policy does not permit the formation of industrial groups around banking institutions. As Panglaykim has explained, state banks have at present capacity to generate not only short-term, but medium and long-term loans as well.[158] However, they are not permitted to engage in medium-term

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[157] Lee, G.: "Rosa Luxembourg and the Impact of Imperialism" in Economic Journal (London), December 1971, p. 851.

[158] "The state banks receive seventy-five per cent of credits (for credits allocated under the Domestic Investment Law)...from the Central Bank with operating capital generally being supplied from their own funds generated from Asia Dollar Loans abroad, certificates of dollar deposits from non-bank institutions and from domestic depositors.... These banks having increased their borrowing capacity overseas are thus in a position to make substantial dollar loans and while at present it may be true that such borrowing is of a short-term nature, it appears that they are now also in a position to generate funds from the medium and long-term money market." Panglaykim, op. cit., p. 67.

finance as this area has been allocated to the development banks. Yet it appears that it could be appropriate for these banks to take up options on shares of those industries which, from bank assessment could be expected to yield profits. Panglaykim concluded however that this was not possible since

> the government does not currently permit the formation of industrial groups around banking institutions. The main reason for this prohibition on equity participation appears to be the prevention of conflicts of interest and empire building which would distract the attention of bank management. This ruling appears to be the result of a government policy of not allowing excessive direct state participation in industry.[159]

Despite this, the government has specifically encouraged the merchant banks to do what it has forbidden state banks.

One of the stipulations of the licenses ruled that no foreign bank or its subsidiary currently operating in Indonesia be allowed to partake through equity in the merchant banks, specifically to prevent domination of this aspect of the monetary structure by foreign banks.[160] However it appears that this requirement has been flagrantly ignored, since foreign banks in Jakarta do, through their subsidiaries and the "transfer to nominee" method, hold equity in these institutions.[161]

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[159] ibid., p. 69. Thomas also recognised the potential of increased cooperation between banks and industrialists, as occurs already in Germany, Japan and Singapore, especially in regard to the strengthening of the pribumi. "Both the government and private banks could create industrial groups in Indonesia which could act not only to strengthen the weaker groups, but also as centres of countervailing power vis-a-vis the multinational corporations." Thomas in Growth, op. cit., p. 44.

[160] FEER, 10/12/73.

[161] It is not possible to offer further detail of this but casual glance at Appendix C indicates the possibility of this practice. Interview with an executive of the Bank of America, Jakarta, 11/9/75, indicated that at least two major banks in Jakarta, the Bank of America and the First National City Bank, used the "transfer to nominees" or Ali Baba method of equity participation.

Clearly, the possibility of increased control by a few large financial institutions, is not impossible if such public defiance of regulations is acceptable to the government.

Yet since their inception, the merchant banks have been subject to what they consider is excessive bureaucratic controls which lack consistency and understanding of their role in the economy. To begin with they are formally directed to supply medium-term finance (a maximum of forty per cent of all business may be of less than one-year duration) yet they are not allowed to give medium-term credits, but to purchase negotiable commercial papers. This means in practice that the merchant bank buys from the client a promisory role or bill of exchange, which is technically not a loan, but will serve to assist in the government's view, the creation of a money market by the encouragement of the use of commercial papers. Partly as a result of this, pribumi businessmen constitute a small percentage of business transactions conducted by merchant banks. It could be expected that their continuing capital shortage and lack of Western commercial and business skills means that they are obliged to obtain medium-term loans of the "package-deal" variety from the Japanese Big Ten, the Zaikais.[162] A possible reason for this medium-term credit policy may well be to pre-empt increased competition with the large number of state and foreign banks engaged in short-term loans, in an effort to stimulate complementary rather than competitive banking activity, by increasing the availability of medium-term finance. In the words of the director of the Bank Indonesia:

> in defining the scope of activities of these financial institutions our government has always observed that existing other financial institutions such as banks, should not in any

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[162] Panglaykim, <u>op. cit.</u>, p. 75.

> way whatsoever be unnecessarily impeded in their operations, so that all finance institutions will be able to operate complementarily and as harmoniously as possible.[163]

It is obvious that the government sought to direct the activities of an important area of financing, but a wish is not a deed, and the possibility of doing so in such a highly competitive and strategically important subsector of banking, becomes more remote each day.

Yet the government has apparently tried to do this by imposing a series of frustrating and restricting regulations on the merchant banks.[164] Their uncoordinated and _ad hoc_ nature allows relaxation or tightening of different aspects of their activities, depending on how these activities are perceived by officials at the time. The specific reasons for this are not clear, but one possible explanation is that most merchant bank activities are unknown and completely new to Indonesia, meaning that there is little comprehension within the Ministry of Finance as to how and why they function. In consequence, attempts have been made to prevent their too rapid growth and acquisition of economic power. This is further supported by information detailed above, and also by the fact that under license stipulations, a minimum of three foreign banks of differing nationality was required in any one consortium. However, whilst the ad hocery of government policy is arguably a function of its limited experience in this area of economic policy, the original stimulus arose out of a clear understanding of its economic and political significance. Arguably policy towards merchant banks is at once a function of the political necessity (of protecting or assisting the pribumi) which conflicts with the economic function of the state to encourage a lively and

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[163] Serah, J.E., Director of the Bank Indonesia, AIBCC (1974), _op. cit._.

[164] _Interview_ with executive of P.T. Mutual International Finance Corporation, 8/9/75.

sustained process of capitalist growth.

Further restrictions on the activities of merchant banks in the money market prevented them from conducting current accounts, savings accounts or time deposits; this made the acquisition of rupiah funds difficult so they deal mainly in dollars. To further confuse the issue, the government issued a regulation on April 9, 1974, to restrict the merchant banks in the foreign borrowing; As an anti-inflationary measure aimed at some temporary control of capital inflows, its effect on the merchant banks was negligible. Yet considering the cumulative effect of these restrictions, it is difficult to conceive how the merchant banks are to fulfill their allotted task of mobilising domestic capital sources. Another obstacle is the obligatory nature of the gearing ratio, whereby total liabilities (borrowing) may not exceed fifteen times the paid-up capital and accumulated reserves (or minus accumulated losses) plus subordinated loans (a loan that is subordinate to all other debts of the company). Whilst such a ratio is accepted practice in Western countries and was decided upon after consultation between the Central Bank and the IMF, it becomes restricting to the merchant banks in Indonesia because, for tax reasons, all are under-capitalised, due to the five per cent stamp duty on issued capital levied by the government.[165] Thus despite the large potential volume of business available to the merchant banks, the current level is much lower than it need be. Present business involves not the financing of pribumi, but of the state banks (with whom they may be partners through consortium) and various government enterprises, including Pertamina. As noted by the <u>Far Eastern Economic Review</u>, the official aim of increased opportunities for locals conflicts with the more likely event that the development of money and capital markets will help the big companies and strengthen

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[165]All merchant banks are capitalised at time of writing at the minimum possible level of Rp. 300 million. <u>ibid.</u>.

them in contrast to the small entrepreneurs.[166]

Once again the desire to protect the small and medium-size pribumi conflicts with the objective needs of expanded capitalist production. Clearly the bureaucratic controls exercised over the merchant banks by the government are objectively a barrier to the development of their proposed money-capital role. Moreover, their role in assisting the pribumi appears to be extremely limited. Once again, contradictions that are generated from the incompatibility of the necessary functions of the post-colonial state are in evidence.

The Distribution Laws and the Negative List: A Political Exercise

As previously established, since 1974, the government has sought, at least publicly to redress imbalanced economic growth through its pribumisation policy. Earlier concern for the situation prompted the Minister of Trade, Sumitro, to reserve all domestic distribution for the pribumi with the exception of joint-venture companies operating in supermarkets, department stores and motor vehicle servicing.[167] The regulation states that "the field of trade activities involving imports, exports and domestic distribution is exclusively reserved for national enterprises...." Clearly the government recognised the importance of trade as a source of financing development: "In the process of economic development the chance to accumulate funds from these commercial activities represents a basis of capital strength to be channelled towards investment in the manufacturing and service industries."[168] Advantages accruing from this decision included increased revenue, and job opportunities, the stimula-

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[166]FEER, 9/4/73.

[167]Decree 314/K.P./XII/70, December 4, 1970, Indonesian Department of Trade, Jakarta.

[168]Statement by the Ministry of Trade, November 1970, reproduced in "Invest in Indonesia", Jakarta, 1972, Appendix "On the Rationale of the Present Policy on the Import and Distribution of Heavy Equipment" (unofficial translation).

tion of business skills, and opened the way to bypass middle men in Singapore. The decision was directed as much against domestic Chinese as foreign capital, but the impossibility of implementing such a regulation, led to loopholes being found and utilised. Initially, the announcement was ill-received by the foreign business community, but their fears were short-lived since "its not the regulation that (counted)...but the method of implementation."[169] That the government is not doctrinaire in its approach to the implementation of the policy is further supported by remarks of a leading official of BKPM, who expressed his concern that some foreign companies had over-reacted to the event. Furthermore he emphasised that patience and confidence in the eventual outcome of the policy decision would pay off, as it obviously had done for large established companies, like Unilever who continue to distribute their own products themselves, with no interference from officials that cannot be dealt with by bribery.[170] Foreign companies, with the sanctioned exceptions mentioned are not permitted to engage in export/import except for the purpose of their own production, when they are exempt from duties on specified categories of goods. Once the commodity has been manufactured, its distribution must be by an Indonesian company. Foreign companies were however allowed to open up trade representative offices and their ties with the Indonesian distributor or importer became close, often so close as to render the independence of the latter inconsequential.[171] Legally, the foreigners who liaised with their distributor and acted in purely an advisory capacity were within the law, but the effec-

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[169]FEER, 7/7/71, p. 62.

[170]Interview with Suhud, 9 September 1975.

[171]As noted by the Australian Department of Overseas Trade: "Many representative offices of foreign merchant companies have now established close connections with Indonesian national importers so that the two companies can virtually operate as one." Indonesia: Guide to the Market, Department of Overseas Trade, Trade Publicity Branch, Canberra, 1973, p. 34.

tiveness of that law in promoting an independent group of national businessmen was severely weakened. Further qualifications may be detected in Minister of Trade's announcement that he would allow a gradual and therefore slow build-up of real traders, since prior government efforts to do so, like the Benteng Policy, had resulted in the proliferation of "paper" traders: government policy could not involve the elimination of the Chinese in their capacity as distributors.[172] The contradictory position of the state is again evident; the original purpose of the policy was to reserve the area of import/export and distribution for the pribumi; to do this, the Chinese would have to be removed from their present strong position in both fields, a highly unlikely possibility. It clearly required far more than a government decree to alter the existing ownership of the means of distribution in Indonesia. The distribution law itself thus reflected the political necessity of pribumisation whilst its method of implementation the objective necessity of maintaining the <u>effective</u> distribution of commodities.

Protection and special privileges for the pribumi were again the official rationale behind the closure of certain areas of manufacturing to further foreign investment. The first list of so-called "closed" industries (the negative list) appeared in 1968, and by December 1970 the Ministry of Industry had some forty-one industries listed. A predictable outburst of dissatisfaction from the foreign business community was followed by an acceptance of the decision, once it became clear that the list could be made to work to their advantage. Officially, the government was seeking to protect existing producers, both domestic and foreign from further foreign competition, and to enable decisions as to market saturation levels in specific areas of production to be used as a guide

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[172] <u>FEER</u>, 7/11/70.

to planning and directing future investment; this was to avoid over-production and underutilisation of capacity and promote economies of scale. The reader is referred back to the discussion of complementarity in Chapter One for the theoretical rationale of this attitude.

Not surprisingly, the reality belied the intention. The first list of 1968 included many areas of production where foreign investors were early entrants; these included cigarettes, dairy products, shoe polish, beverages, tyres, drycell batteries and galvanised sheeting. It may not be fully substantiated at present that the compilation of the original list was not an independent government action; however more recent information concerning present compilation policy indicate this as a distinct possibility. The list as it exists today is not final, but subject to annual review; it is informal and foreign companies, with adequate capital and political backing, may be granted approval to invest in an area that had been previously designated as closed.[173] Discussion with the BKPM executive supported this view. The list thus acts not as a regulatory instrument to help the amount and direction of investment in any one particular sector; instead it allows the purchase of oligopoly rights to some foreign investors whose dominance in their particular area of production is thus guaranteed. The list compilation is not however merely the result of foreign influence, since it is officially compiled

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[173] FEER, 30/4/73. Business International/Asia Pacific/Hong Kong reported that the Metal Box Company Ltd. of the UK obtained a special dispensation to invest in a closed area of production because their joint-venture partner was a subsidiary company of one owned by the DKI. op. cit., p. 67. Similarly at least one Australian company surveyed during fieldwork "bought" their way into a closed section of production. CEDA noted that the Department of Light Industry is prepared to receive information tending to show that the market is not adequately served, and stated that the original list had been criticised by the international financing agencies; presumably this referred to the World Bank and the IMF. CEDA: "Foreign Investment in Indonesia — A Discussion of Problems", M.B. Hardaker, Supplementary Paper No. 37, Memorandum for Trustees, September 1971. [Hereafter cited CEDA S.P. 37.]

after negotiations between the various government departments, each of which wishes to augment its bureaucratic power by promoting associated industries. At present, the various departments, after debate and consultation, have introduced a four-category investment area: (1) high priority and special incentives; (2) normal incentives; (3) no incentives; (4) closed to foreign investment.[174] Differences arise as to the criteria of "priority" and it is emphasised once again, that political considerations determine this, not rational economic criteria. Whilst consultation with the Foreign Investment Board is desired in order to coordinate the differing priorities of each department, it is not apparently forthcoming to any meaningful degree. The rationale to coordinate investments and thus maximise both social and economic returns becomes lost in the power struggles that occur between various sections of the bureaucracy.[175] Coordination and competition on this level do not mix.

Clearly, these policy moves directed ostensibly at selected protection and investment coordination, have met with little success, since their overall effect has been to assist the strengthening of foreign and non-pribumi capital at the expense of the pribumi.

To summarise, the New Order government, through its financial policies has achieved, with a measure of success, the development of a financial infrastructure of the type necessary for the growth of the modern capitalist sector of the economy. It is one that enables the foreign firms almost unhindered access to the new growth industries, whilst the majority of pribumi-owned firms are suffered to continue

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[174] "The new scale of priorities lists in book form about 830 areas of investment....We hope that by setting out this book that each investor might know what are the possibilities." AFR, 1/3/77. Another report similarly noted that "[in] the above (closed) industries especially good proposals may be considered, particularly in a joint-venture with existing plant." "Establishing a Business in Indonesia", OBR, February 1973.

[175] Interview with Suhud, 9 September 1975.

without substantial assistance from the state. Indigenous capitalist activity for the most part can operate within the existing pattern of production and distribution, whilst foreign and to a limited degree state and non-pribumi capital, are free to exploit and develop the new areas where the former may not enter, let alone compete. As Thomas observed; "...The pribumi are found largely in the unorganised and traditional sector of the economy in contrast to the state and foreign companies in the modern organised sector located for the most part in the large cities. The national firms, even those few to be found in the modern sector, are atomistic."[176] The uneven nature of capitalist growth and its restriction to specific economic groups and sectors within the Indonesian economy results in the development of contradictions within society. In the final analysis the problem is a political one, a function of the contradiction between the objective requirements of capitalist production and the political requirements that arise from the particular class formation of Indonesia.[177]

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[176] Thomas in "Growth", op. cit., p. 42.

[177] "Chronic political instability is a function of the contradictions between the realities of a colonial economy and the political requirements of legal sovereignty." Kling, M.: "Towards a Theory of Power and Political Instability in Latin America" in Latin America. Reform or Revolution? A Reader, Petras, J. and Zeitlin, M. (eds.), Fawcett Premier Books, Fawcett Publications, New York, 1968, p. 92.

PART THREE:
THE DEVELOPMENT OF THE LEGAL INFRASTRUCTURE

"Don't eat the soup as hot as it is served."

As the prior pages were devoted to an analysis of one aspect of the economic functions of the state, so this third section examines another aspect of the same. An analysis of the legal framework within which the Indonesian government seeks to regulate and control the direction and rate of capital investment reveals not only its "weakness" but as well its tendency to assist the growth of foreign and non-pribumi capital at the expense of pribumi capital. Moreover this legal infrastructure, functioning as it does to assist the penetration of foreign capital in a privileged capacity, as well assists the development of contradictions within Indonesian society.

The Laws on Foreign Investment

It is appropriate to begin with Law No. 1, 1967, the Foreign Investment Law, enacted in haste by a government eager to create a favourable impression with their international creditors, and to demonstrate the sincerity with which they would implement the new economic policies. The political purpose of the law was to assure the outside world of Indonesia's new outward-looking pro-Western attitude, and to emphasise the contrast between this and the 'socialist' policies of Sukarno. Its economic function was to facilitate the quick and easy entry of foreign capital into the economy, which theoretically, would serve to accelerate industrial development by the 'multiplier' or 'spread' effects that would result from its presence, and also to develop the natural resources of the archipeligo, then in majority untapped due to the shortage of capital, technological and managerial skills. Foreign capital was seen to be complementary rather than competitive with domestic capital, a situation to be formally ensured by legislation enacted to regulate its activities and to direct it into government priority areas. The result was a foreign investment law ambiguous in meaning and unspecific in definition. The Australian Trade Commission in Jakarta noted these qualities and commented thus:

> The Law itself cannot be considered more than a clear expression of the "good intentions" on the part of the Indonesian Government. In particular, a number of clauses are worded, at least in translation, in a way that leaves them open to wide interpretation. Therefore, many of the criteria applying to foreign investment are open to negotiation.[178]

Yet this ambiguity was not merely a result of errors of omission performed unknowingly and in haste. That this was a deliberate act with a specific purpose is supported by the following passages:

> The law, is in effect, an enabling act leaving wide discretionary powers to the administration on many important issues. It is purposely vague and even ambiguous to permit increasingly liberal attitudes to be given full administrative effect on the basis of practical experience with specific projects. Government officials here repeatedly emphasised that they are ready to negotiate and interpret the law liberally whenever approached with specific development projects.[179]

Continuing on this vein, the Minister for Economic and Financial Affairs explained:

> ...that the government will do its utmost to give the widest possible facilities within the framework of...(the)...foreign investment law. I know that this law is still far from

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[178] Australian Department of Overseas Trade: Investment Climate Study: Indonesia, Canberra, 1973, p. 7.

[179] Stanford Research Institute (SRI): Indonesia, 1967, p. 8. [Hereafter cited SRI Publication (a).]

> perfect. We will be happy to listen to suggestions, if such may help to improve the investment climate of this country.[180]

Thus, even before the law was implemented, the government was hastening to assure potential investors of its flexibility. Requirements relating to employment of professional and unskilled Indonesian workers were included only to be weakened substantially as indicated by later government statements like the following: "...the spirit of the law is that foreign enterprises should do all these things over a reasonable period of time and not overnight."[181] As to who decided what constituted a 'reasonable period of time' it was a matter, like other such stipulations that was decided upon, after negotiation.

That this and other important issues were decided upon not by a formal legal process but by negotiation between the military-bureaucratic state and foreign capital establishes the necessity of examining the development of the legal infrastructure not in isolation, but as part of the much wider process of the penetration of foreign capital into Indonesia's economy and the growing alliance between it and the post-colonial state. To regard the law as impartial is as unrealistic as to regard the state as the neutral arbiter of conflict between competing groups.

The more important aspects of the foreign investment law related mainly to the incentives it offered, particularly the fiscal incentives

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[180]SRI: The Jakarta Report, No. 3, 1967, p. 6, statement by Sultan Buowono IX. [Hereafter cited SRI Publication (b).] Note also the comment made by Professor Mohammad Sadli, Chairman of the Technical Team of the Foreign Investment Board, who stated: "[in] the first phase of implementation of the law...the accent is on negotiations rather than setting rules or treating customers on a take-it-or-leave-it basis...we must learn with an open mind." _ibid._, chapter entitled "New Investment Law: The Philosophy Behind the Law". Further comments of this nature may be found in various government statements, as well as in many publications by private foreign and international institutions, e.g., First National City Bank, the Crocker Bank, the Asian Development Bank, SEADAG, CEDA, Business and Industrial Advisory Council of the OECD (BIAC) and Keidranen (Japan), report of meetings held in Jakarta during second half of 1968.

[181]SRI Publication (b), _op. cit._, p. 2 of Sadli's article.

in the form of generous taxation concessions and tax holidays. Capital eligible for the benefits of the law was required officially, to be equity capital, since it was assumed to bring with it technical skills and as well place less strain on the balance of payments.[182] However, later loan capital also became eligible provided certain provisions were adhered to.[183] Ostensibly the incentives aimed to encourage investment by private capital by offsetting the effects of the limited markets and low technological efficiency that characterised the economy. By allowing the government a degree of selectivity they were also seen to offset the sacrifice of reduced government revenue resulting from the privileged status afforded foreign capital.[184] A two-year tax holiday applied to all foreign investments, and subsequent payment of the corporation tax could be further postponed for up to six years, providing certain conditions were fulfilled. These included proof of saving or earning foreign exchange, investment outside of the island of Java, investment that increased employment, or investment that coincided with special priority objectives of the government.[185] As one CEDA report noted, it would not be difficult to obtain further tax holidays under such a broad set of conditions; "there is...a very broad discretion for the government to grant further incentives of this type to investments which are urgently

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[182]"We regard foreign equity as a better guarantee for productivity and efficiency than foreign credit or aid capital." Statement by Sadli, SRI Publication (b), op. cit., p. 2 of Sadli's article.

[183]The amount, source and terms of the loan and the debt-servicing schedule must all be approved by the government.

[184]"...[The] hope is that the sacrifice [in revenue] will be offset by increases in economic activities that would promise bigger revenue in the future." From address by DRS. Salamun, Secretary General, Department of Finance, Jakarta, AIBCC (1973), op. cit., p. 8.

[185]Priority sectors under the two five-year plans include agriculture, use of domestic raw materials, production for export, tourism, transport, infrastructural development, fully integrated textile mills, basic industries, chemical industries and those producing chemical fibres and basic consumption goods.

needed for the development of the economy."[186] Since the government allowed that almost every type of direct foreign investment was desirable, it appears that extremely generous tax concessions are available for negotiable lengths of time. In the words of the government, "there is an overall limitation of five years for accumulated tax holidays available to a single investment. Additional years of reduced tax burden may be granted, as a matter of discretion for up to five more years."[187]

Indonesia is not the only country in the region to adopt a policy of generous tax concessions, and their limited, sometimes negative role has been noted by the World Bank, Ecosen and SEADAG groups. The latter concluded that the taxation incentives "appear to have been made an important factor by the developing countries themselves. If taxation incentives did not exist, it is unlikely that the volume of investment in the ASEAN countries would be reduced significantly."[188] The thrust of the various Ecosen papers supported this and emphasised that it was the host countries, not the foreign corporations who placed great importance on the value of fiscal incentives.[189] Another study concluded that they were too generous and non-selective, and should be dropped "because they contain a high degree of redundance and as far as foreign investment is

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[186] CEDA: Supplementary Paper No. 40, "Foreign Investment in Indonesia, Laws and Procedures; A Revised Guide", M.B. Hardaker, November 1971, p. 11. [Hereafter cited CEDA, SP 40.]

[187] Embassy of Indonesia: "Foreign Investment in Indonesia", Washington, 1969, p. 9.

[188] SEADAG: "Policies of ASEAN Countries Toward Direct Foreign Investment", T.W. Allen, op. cit., p. 60.

[189] Ecosen papers, various op. cit.. See also IBRD (Hughes), op. cit.. She argues that tax concessions "are most attractive to enterprises with low fixed investments which expect to make a quick profit, and least attractive to enterprises with large-scale, long-term investments which do not expect to make profits for the first few years-...[it is] doubtful whether they attract sound investment which would not otherwise take place." pp. 21-22. See also IBRD (No. 148), op. cit.. Turnham and Hawkins argue that "[c]apital intensity is directly stimulated by low or duty free concessions in respect of the importation of machinery and equipment...[and] tax concessions in respect of investment in new equipment...." p. 12.

concerned simply result in a transfer of revenue from Indonesia to the lending countries."[190]

It appeared that there was acceptance of this argument by the Indonesian government, since by 1970 amendments to the Foreign Investment Law were characterised by increased concessions to foreign capital, except in respect of taxation incentives, which at least formally, were to be more stringently applied.[191]

Apart from the tax holiday, a large number of further incentives were made available through the law and its amendments, including exemption from stamp duties, import duties and sales tax on certain items (the so-called "starting-up" imports, those goods directly related to the production process, e.g., machinery and raw materials). Companies were permitted a four-year period for carry forward of losses, and those which were incurred during the first six years of existence could be carried forward indefinitely; the repatriation of capital by remittance of dividends, interest and royalties, advisory management and license fees, and plant rental was unrestricted; companies were permitted unrestrained access to local finance; a special investment allowance for new investment above and beyond what was originally planned, permitted a deduction of twenty per cent of the amount of additional investment spread equally over four years; companies were guaranteed against nationalisation except by act of Parliament, and guaranteed compensation as decided by international law; investment guarantee agreements were signed

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[190] Donges, J.B., Stecher, B. and Wolter, F.: "Industrialisation in Indonesia: Recent Developments and Prospective Policies", a paper drawn on monograph "Industrial Development. Policies for Indonesia", Institute fur Welwirtschaft, Kiel, 1973, p. 35. Information offered in this report was based on fieldwork in Jakarta from January to May 1971. [Hereafter cited Donges.]

[191] "After a few years, the Indonesian government has reassessed her bargaining position and as a result carried out some reduction of fiscal incentives." CEDA, SP 37, op. cit.. For details on the amendments see CEDA, SP 40, op. cit..

between Indonesia and major investing nations, and were characterised by their marked lack of reciprocity, and Indonesian part consisting almost entirely of obligations and the other part, by rights.[192] Clearly these conditions facilitated virtually unrestricted entry of foreign capital into the economy, and combined with other factors gave to that capital significant advantage over elements of domestically-owned capital.

One of the more important amendments to the Foreign Investment Law was that concerning voting rights. Article 54 of the Law, following the commercial code originally established by the Dutch, stipulated that no shareholder regardless of the number of shares held, could register more than six votes.[193] Whilst the problem of power within the company could be sidestepped by the creation of different classes of shares, or by management agreements, nevertheless foreign companies pressed for change. Furthermore the limitation on voting rights was depicted by the government as inhibiting the growth of public companies and the creation of an active capital market. The amendment by Presidential Act No. 4, 1970, changed the voting rights to one share one vote. The probability

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[192]Hartono, op. cit.. On February 16, 1968, the government ratified the IBRD Convention on the Settlement of Investment Disputes. Hartono has argued that the convention "has been especially designed for the protection of the investments made by capital-exporting countries in the underdeveloped countries. Therefore the main object is to get these less developed nations to ratify this convention, so that the interests of capital-exporting countries would be sufficiently protected by international means....The close nexus between the International Centre and the World Bank provided not only the assurance to comply with an arbitral award of its tribunal but assured the ratification itself of the convention by these underdeveloped countries." p. 24. She continued and argued that the ratification by Indonesia undermined the sovereignty of the country, by introducing an outside arbiter and reducing the power of the national court. Furthermore, because Indonesia relies for aid on industrailised countries and international institutions, the ratification was in essence obligatory. On the one hand, the Convention meant a further decrease in autonomy for the government, and on the other, the introduction of a powerful yet respectable weapon to the armoury of foreign capital.

[193]The former maximum of six votes per shareholder existed "in order to prevent large capital owners (generally foreign capital owners) from gaining too much control on Indonesian limited corporations, and also to protect the small capital owners (generally the national capital owners)." Government of Indonesia: Invest in Indonesia; Guide to Laws and Procedures for Foreign Investors, January 1972, p. 58.

of foreign domination however was deemed no greater "providing that the large shareholders recognise their moral obligations to the public in general and to the company in particular."[194]

The amendments denoted not just a more generous attitude to foreign investment per se, but were the expression of the resolution of difficulties experienced by foreign capital in the first few years of the New Order government. Under Pelita II, despite the inflationary increases of 1973/74, the government moved to reduce the tax rate in an effort to encourage savings and promote investment. In addition former restrictions on the freedom of foreigners outside of Indonesia to hold shares in public limited companies, was revoked by mutual consent between the Ministries of Justice and Finance, and now there exists no restraint on the sale of shares arising from company law.

Section Two of this chapter has already mentioned the advantageous access to cheap credit enjoyed by foreign investors; add to this the availability of DICS rupiahs, especially in the late sixties, and a formidable list of privileges presents itself. DICS rupiahs were initially created to help Indonesia meet her international debt obligations.[195] The Debt Investment Conversion Scheme (DICS) allowed for the gradual repayment of debts incurred by the Sukarno government through the creation of rupiah funds in the name of those creditors whose losses were not guaranteed by the home governments: the amount of conversion of debts to DICS rupiahs was limited by agreement with the IMF. The scheme allowed foreign exchange debts to be repayed whilst conserving foreign exchange, since they were to be used for local expenditure only, except under special circumstances when they could be used to finance imports for

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[194]ibid., p. 59.

[195]Cabinet Presidium Instruction, No. 28/EK/IN/5/1967 in Bank Indonesia: Economic Data for Investors in Indonesia, Jakarta, 1968, pp. 195, 206.

investment. This latter could only occur when DICS rupiahs were used by the original claimant or affiliate (DICS A Rupiahs); either of these persons could also sell their claim to another person who could use them for local expenses only (DICS B Rupiahs). The instructions as to the precise use of these rupiahs are clear, yet it appears that especially during the early years of the New Order government, the system was abused. Quantities of DICS rupiahs were used to import goods, when strictly their use was limited to domestic purposes; furthermore investments using DICS rupiahs qualified for the special privileges normally reserved for foreign capital. Their distribution and allocation also suffered abuse; although the DICS rupiahs were officially obtainable through the Bank Indonesia, and more recently, the First National City Bank, the situation developed whereby the purchase of these cheap rupiahs was conditional upon personal contacts within the banks or through private contacts. Investors would await the announcement of further release of DICS rupiahs, only to discover on enquiry that their sale had been previously arranged.[196] Some foreign investors had access to cheap rupiah funds (in September 1973, sold at fifteen per cent discount) and although pribumi businessmen were in law guaranteed equal right to purchase, their depressed economic condition ensured that generally this did not occur. Once again, the abuse of regulations resulted in advantage to foreign businessmen over local. Regulations designed to save foreign exchange were able to be abused and a supply of cheap domestic finance made available to foreign investors.

[196] Information about DICS rupiahs was difficult to obtain during fieldwork; some investors had no knowledge of their existence, whilst others were decidedly reticent to discuss the issue. Yet information gleaned from numerous discussions left little doubt that unorthodox practices have occurred with respect the allocation of DICS rupiahs.

The Domestic Investment Law

The pattern of privilege inherent in the content and application of the Foreign Investment Law and amendments is paralleled closely in the Domestic Investment Law (Law No. 6, 1968) which ensured privileges to the Indonesian-Chinese as surely as the Law of 1967 ensured it to the foreigners. Theoretically, it was promulgated to encourage both pribumi and non-pribumi investment, but clearly its intention was "to cover investments by non-Indonesian citizens who have resided in Indonesia for many years, in some cases for generations."[197] The tax clearance provision declared that the original investment capital was not subject to investigation and was therefore exempt from former tax due. Clearly this was to encourage the Chinese to repatriate their hidden capital and to use the funds for productive investment. About seventy-five per cent of investment under this law is, theoretically Chinese and concentrated in manufacture (fifty-five per cent) and forestry (thirteen per cent).[198] The law required that all capital and management be Indonesian, and gave concessions similar to those enjoyed by foreign investors, except that the domestic investor had no legally guaranteed right to transfer dividends because the investment capital was in rupiahs. Yet it is a relatively simple task under the present foreign exchange policy to make an overseas transfer of profits derived from 'domestic' ventures. Not surprisingly the restrictions regulating domestic investment have been widely abused and exploited by various groups. To begin with the terminology of both laws, Hartono claimed, is such that conflict and ambiguity arose as to the definition of 'foreign corporation'. Under Article 3 of the Foreign Investment Law a corporation may be regarded as foreign but that same corporation under Article 2 of the Domestic Investment Law is regarded

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[197] Department of Overseas Trade, Investment Climate Study, op. cit., p. 14.

[198] US Department of Commerce: Foreign Economic Trends, 28/11/73.

as domestic.[199] She concluded that the different approaches taken by both laws "help to facilitate the joining of capital and skill of foreign and domestic Chinese capital,"[200] very often the foreign and domestic investors being members of the same family, but of different nationality. The Bank Indonesia's definition was similarly ambiguous, stating that a domestic company is one "settled in Indonesia and established on the basis of Indonesian law."[201]

Whilst the government made much of the fact that by 1970 domestic capital investment had surpassed the volume of foreign capital investment,[202] it later became known that many foreigners, especially the Japanese were able to set up factories under the Domestic Investment Law.[203] Much of the so-called domestic investment was the result of "soft" foreign loans by overseas Chinese who used their Indonesian contacts to act as front men behind whom they set up a 'domestic' enter-

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[199]Hartono, op. cit., p. 7. Article 2 of the Domestic Investment Law defines a domestic enterprise as any economic activity which directly or indirectly involves the use or exploitation of Indonesia's natural resources.

[200]ibid., p. 17.

[201]Bank Indonesia, op. cit., p. 83.

[202]Suharto's Address of State, August 16, 1973. The fourth year of Pelita I saw an eighty-five per cent increase in domestic investment over the previous year.

[203]"Indigenous manufacturers and importers are approached by Japanese trading companies to purchase machinery, know-how and materials so that they can commence various operations for themselves before or at the same time that similar manufacturing subsidiaries commence their operations. The intensive competition among leading trading companies of Japan often causes some firms to lose out to others in establishing manufacturing subsidiaries in Indonesia. And the Indonesian government is reluctant to grant more than a few fixed numbers of investment permits in each product and industry category. Rather than giving up the active roles in establishing Japanese subsidiaries, the losers then identify indigenous entrepreneurs and persuade them to begin manufacturing operations under the Domestic Investment Law." In "Japanese Direct Investment in Indonesia", Yoshihiro Tsurumi, Visiting Associate Professor, Harvard Business School, unpublished paper, p. 42. [Hereafter cited Tsurumi.] It is now claimed by some sources that "the opening by which foreign capital could enter the country by way of the domestic investment laws was closed by legislation early in 1975." Senate Standing Committee Report on Foreign Trade, op. cit., p. 56.

prise.[204] The effect of the law then was to allow a strengthening of non-pribumi capital, and offered further opportunity for foreign capital to penetrate the economy. Indeed both the Foreign and the Domestic Investment Laws must be viewed as part of a concerted effort by the state to encourage the spread of the capitalist mode of production to the Indonesian economy. This spread however, is always uneven, a phenomenon well illustrated by the unbalanced industrial growth at present occurring there. It occurs at the geographical and the sectoral levels, and as well is manifest in the retardation or incorporation of the indigenous capitalist classes by foreign capital. These phenomena clearly have both historical roots and contemporary stimuli, one of these latter being the effects of a legal infrastructure which encourages the entry of private foreign capital and often functions to ensure its continuingly privileged status. However despite the clear intention of the post-colonial state to promote capitalist growth through foreign capital penetration, many restrictions arise from the existence of bureaucratic, physical and attitudinal factors. The relationship between these objective conditions engenders the development of contradictions. The cultural and political superstructure of Indonesia is one that derives from pre-capitalist and merchant capitalist economic formations yet the economic base of society is also characterised by the simultaneous existence of the capitalist mode of production. Between base and superstructure the spark of contradiction must fly.

The following section thus outlines some of the more important factors which hinder the process of capital accumulation in Indonesia. They spring from both the nature and function of the state itself and as well from physical and attitudinal conditions that derive their origin from the heritage of Dutch colonialism.

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[204] "It is obvious that such so-called domestic enterprises or joint-ventures are not much more than a form of import of the same product assembled in an 'Indonesian' factory." Hartono, op. cit., p. 3.

PART FOUR:
OBSTACLES TO ACCUMULATION

Corruption and Administration: The Contradictions of the Indonesian Bureaucracy

The incidence and effects of corruption within the Indonesian economy are both fascinating in themselves and as well a factor influencing the content and rate of economic change. A comprehensive analysis of the nature of economic activity in Indonesia may not preclude an understanding of the nature of the graft mechanism, and its effects on the functioning of both the public and private sectors. And yet the subject is conscicuously absent from the majority of texts dealing with the 'problems' of economic development, a fact which contributes to the general inadequacy of orthodox "development economics" to account for the persistently low level of economic growth in Indonesia. Although corruption has been endemic to the economic process since the formation of the Republic, its implications have been either ignored completely or regarded as peripheral to the dynamics of economic change.[205] Yet the widespread incidence of corruption, the sheer volume of funds involved and its demonstrably structural effects on the economic process dictate the necessity of its inclusion in serious analysis.

The essential point to appreciate about the phenomenon of corruption in Indonesia is that it represents a portion of economic surplus, appropriated by individuals or groups within the public sector, from the private sector, and used by them in the pursuance of personal interests: all societies produce a surplus,[206] and in poor countries _the manner in_

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[205]Myrdal's work is the only systematic attempt known to the author that seeks to evaluate the effects of corruption on the economic process. Myrdal, G.: _Asian Drama_, The Twentieth Centure Fund, New York, 1968, Vol. 2, Chapter 20, "Corruption — Its Causes and Effects".

[206]"Actual economic surplus has been generated in all socio-economic formations, and while its size and structure have markedly differed from one phase of development to another, its existence has charac-

which that surplus is utilised is crucial to the rate and content of economic growth. As Baran explains:

> The principal obstacle to rapid economic growth in the backward countries is the way in which their potential economic surplus is utilised. It is absorbed by various forms of excess consumption of the upper class, by increments to hoards at home and abroad, by the maintenance of vast unproductive bureaucracies and of even more expensive and no less redundant military establishment. A very large share of it ...is withdrawn by foreign capital.[207]

The export of a proportion of economic surplus is a crucial factor in the explanation of persistent poverty and lack of industrial growth in poor countries.[208] However the manner in which the remaining surplus is utilised within poor countries is also relevant to an understanding of their present underdevelopment; it is in part the nature of existing social and economic formations of the poor country which determine this, distinct from those to be found in the industrialised nations. Kay's argument is instructive on this point. He argues that whilst all societies produce a surplus of material production over necessary consumption, in a capitalist society the surplus is appropriated by capital and assumes the social form of profit.[209] In his words: "...capitalism differs from other class societies in one vital respect: the surplus takes the form of surplus value, is appropriated by capital as profit and systematically

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[206](cont.) terised nearly all recorded history." Baran, P.A.: The Political Economy of Growth, Pelican, Penguin, Harmondsworth, UK, 1973, p. 133.

[207]ibid., pp. 376-377. See also Amin, Vol. 2, op. cit., pp. 9-11. Amin is in agreement with Baran and argues that what is typical of poor countries "is not lack of surplus but a distinctive way of using surplus: unproductive, wasteful, exported." p. 9. And again; "...the forms taken by the surplus and the ways it is used depend on the nature of the social and economic formations in the countries of the periphery, and the mechanisms whereby they are integrated into the world capitalist system." pp. 9-10.

[208]See Chapter One, section entitled "Comprehensive State Planning: The Socialist Case".

[209]Kay, op. cit., p. 30.

ploughed back into production, for it is the nature of capital to expand."[210] On the other hand, barriers to accumulation which are significant in poor countries, derive in part from social formations which affect the manner in which surplus may be utilised. It is not always or consistently used to increase the accumulation of capital, and therefore assist industrial growth, but rather a substantial proportion of it is appropriated by the upper classes for personal consumption.

In feudal and semi-feudal societies, "excess consumption" by the ruling classes was, of course accepted as essential, productive and rational; it "was compatible with and conducive to the continuity and stability of the feudal system. Non-essential, non-productive and wasteful was all that interfered with or was unnecessary for the preservation and the normal functioning of the prevailing social order."[211] However when the feudal social and economic order experiences vigourous assault from a new and historically more progressive mode of production — capitalism, the manner in which economic surplus is utilised comes under criticism, and the upper classes castigated for the wastefulness of the older socio-economic formation.[212]

It is within this type of historical framework that the phenomenon of "corruption" must be assessed; as one deriving from the continued existence of feudal and merchant capitalist attitudes to wealth, it may not therefore be viewed and adjudged in isolation from a social and historical perspective. The ideas of W.F. Wertheim are instructive in this respect. In his discussion of pre-colonial Indonesian society, he noted that where high agricultural productivity allowed, generated

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[210] ibid., p. 36.

[211] Baran, op. cit., p. 134.

[212] ibid., pp. 132-137.

economic surplus did support a superstructure of aristocracy.[213] Within these highly stratified societies, authority and power rested on the traditional power of the aristocracy, who appropriated economic surplus and used it for their own consumption; the society was essentially a static one, which suffered a gradual but irreversible decline under the assault of Dutch colonialism. The traditionally based power of the aristocracy, the pryayis, was at first replaced by that of the colonial masters, but the economic activities and administrative tasks of the foreign rulers was instrumental in the formation of a petit-bourgeoisie of Muslim traders and Western-educated Indonesian bureaucrats. With occupation of the Dutch East Indies by the Japanese during the second world war, the latter group enjoyed a measure of political freedom never experienced by them before, and as well held positions of power "comparable to those formerly occupied by the pre-war upper classes...on the other hand, trends during the occupation enabled this new middle class to compete with great success with the aristocracy."[214] However, although this new middle class of "Javanese 'new style' pryayis"[215] successfully challenged the traditional authority of the old aristocracy, and eventually became the political leaders of the Indonesian republic, old cultural attitudes to wealth, patronage and the functions of political power remained. As Wertheim observed, "(t)he new ruling class is... a mainly urban class, like the white rulers whom it replaced, and is taking on many of the luxurious habits of the former ruling class."[216] Furthermore, in their capacity as administrators within the burgeoning bureaucracy, the habits and attitudes of this petit-bourgeoisie seriously

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[213] Wertheim, W.F.: Indonesian Society in Trasition, W. van Hoeve Ltd., The Hague, Bandung, 1956, p. 89.

[214] ibid., p. 155.

[215] ibid., p. 316.

[216] ibid., p. 127.

affected the success of economic planning.[217] The increasing regulation of economic life allowed this new ruling class extremely powerful positions within the administration, and "their social supremacy was unimpaired."[218] The essentially intellectual and semi-intellectual character of this rising petit-bourgeoisie, their high social aspirations and concern with the symbols of status and power, determined that they would use their political positions within the bureaucracy for their own, or their parties' advantage. The pressing necessity of directing economic surplus into increases in productive capacity, rather than using it for immediate consumption was a real problem, but the new ruling group were content to reap for themselves the profits deriving from the sphere of circulation[219]: they did not understand that economic growth required the conscious and successful allocation of economic surplus into the spheres of production, nor that the further surplus generated from this process should also be consistently ploughed back into production. What attempts were made (through state intervention) to increase capital accumulation by the indigenous capitalist classes, foundered in part on abuses within the administrative apparatus, and particularly on the widespread existence of "paper traders" and the partial application of regulations pertaining to import licensing.[220] The effect of these and other practices was so great as to seriously affect the attitude of later policy makers to the private sector and its capacity to engender economic development; policies of the Guided Economy period were marked

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[217]For example: "Government restrictions on the import of luxuries are difficult to put into effect as many higher officials are easily tempted to indulge in these habits." ibid., p. 127.

[218]ibid., p. 161.

[219]ibid., p. 129.

[220]Mochtar Lubis' novel, Twilight in Jakarta, Hutchinson of London, for the Congress for Cultural Freedom, 1963, deals with this aspect of corruption in Indonesia during the late fifties and early sixties.

by a rejection of growth through private sector activity partly because of the excesses of the early period.

However, although attempts to foster economic development through state intervention were not marked by conspicuous success, the efforts to consolidate political power by the new ruling group were. During the post-revolutionary period there occurred the growth of a class of powerful bureaucratic capitalists

> composed of military and civilian officials who, because of their key positions in the politico-bureaucratic apparatus, were able to obtain a purchase on the modern sector of the economy,...and, through the manipulation of state corporations, government funds and private business activity, amass great wealth and power. In accordance both with traditional elite values and the economic realities of the time, they aspired to found, not flourishing entrepreneurial empires, but appanages, strategic bases for the exaction of tribute from society and the enhancement of their own status.[221]

In short, the higher ranking military and civilian personnel within the apparatus of the state have been able to appropriate for themselves a portion of economic surplus generated both in the public and private sectors. Their social background, predominantly petit-bourgeois, and their essentially pre-capitalist mentality meant that in the main the surplus appropriated by them was not reinvested in productive capacity — not used to assist the necessary process of capital accumulation, but rather was used to finance the expansion of the armed forces and the bureaucracy, and as well allow this elite to pursue a life style of extravagant consumption[222]: a similar pattern is observable in contem-

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[221]Mortimer, R.: "Indonesia: Growth or Development" in Mortimer, op. cit., p. 57. See also his Footnote 22.

[222]After 1958, the power of the military was greatly enhanced by the quashing of the 1958 rebellions in Sumatra and Sulawesi, and by the nationalisation of Dutch enterprises. The political position of the

porary Indonesia. It is in this sense then that the phenomenon of corruption must be viewed — as the political appropriation of surplus by members of the state apparatus and its subsequent direction into areas of activity not conducive to the growth of industrial capacity, not favourable to the accumulation of capital which is the process essential to the spread of the capitalist mode of production.

Clearly it is not sufficient merely to recognise the nature of corruption; its relevance must be evaluated in terms of the effects rendered by it on the actual process of industrial development. And in this sense it is arguable that corruption can either hinder the process of capital accumulation, and in other ways assist that process; when it is carried out by the owners of foreign capital or by members of the state apparatus, corruption can function to ensure or reinforce their privilege, just as surely as it can, in other circumstances create serious difficulties, especially for the foreign investor. It is with these considerations that the following pages are concerned.

At all levels, the existence of corrupt practices adversely affects the formally designated role of the administrative apparatus. In Indonesia where economic planning has been allocated a supportive but crucial role in the promotion of economic growth, the condition of that administration, entrusted to implement policies designed to achieve that end, is clearly an essential point to consider. The authoritative and widely known report of Little, Scott and Scitovsky concluded that

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[222] (cont.) armed forces increased as did their economic activity and power within the administrative apparatus. Although the participation of the military in economic activity had existed prior to this period, new conditions made the possibilities far greater than before. It was accepted that shortfalls in funds for the armed forces were made up by military participation in business and commerce and their privileged position within the administrative apparatus ensured an increasingly privileged position in the economic arena as well. In short, the armed forces, in their capacity as entrepreneurs, became one of the major beneficiaries of the mechanism of corruption.

industrialisation policies of poor countries, relying as they did on a plethora of administrative controls could "pull 'industrialisation' in the wrong direction; and...be inefficient, oppressive, or cause excessive delays."[223] They noted that the combination of massive incentives and the resulting necessity of extensive controls on the private sector, encouragec corruption and curbed private initiative.[224] The result was often a disincentive to invest by foreign capital and the diversion of domestic investment into speculative activities. Thus excessive state controls in the economy adversely affected the direction of the allocation of a proportion of the economic surplus, and hindered the process of capital accumulation and industrial development. Gunnar Myrdal came to the same conclusion[225]; in an attempt to isolate and identify the major factors inhibiting economic growth he postulated that attitudinal and institutional factors, widely neglected by the major schools of development economics, were the major obstacle to economic development.[226] They functioned to make weak or absent the spread effects resulting from increasing output and rising levels of income, from the changing

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[223]Little, Scott and Scitovsky, op. cit., p. 4.

[224]ibid., p. 216.

[225]Myrdal, G.: Asian Drama: An Enquiry into the Poverty of Nations, The Twentieth Century Fund, New York, 1968, Vol. 2, Chapter 18, Sections 13 and 14, Chapter 20; Vol. 3, Appendices 2 and 3.

[226]Attitudinal factors refer to prevailing attitudes and patterns of individual performance, and included low levels of work discipline, punctuality and orderliness, superstitious beliefs and irrational outlooks, lack of alertness, adaptability and ambition and general readiness to change and experiment, contempt for manual work, submissiveness to authority and exploitation, low aptitude for cooperation, low standards of personal hygiene and unreadiness for deliberate and sustained birth control. ibid., p. 1862. Institutional conditions unfavourable for economic development included "a land tenure system detrimental to agricultural advance; undeveloped institutions for enterprise, employment, trade and credit; deficiencies of national consolidation; imperfections in the authority of government agencies; instability and low effectiveness national politics; low standards of efficiency and integrity in public administration; ineffective organs for provincial and local self-government; and a weak infrastructure of voluntary organisations — the institutional conditions which together constitute those national communities as 'soft states' in our terminology." ibid., Appendix 2, p. 1863.

conditions of material production.[227] In other words, the inertia of the social system of attitudes and institutions constituted the most serious check to development impulses. In particular "(c)orruption introduce(d) an element of irrationality in plan fulfillment by influencing the actual course of development in a way contrary to the plan, or if such influence is foreseen by limiting the horizon of the plan."[228] In short corruption "is a force slowing down development."[229]

That the phenomenon of corruption can hinder the process of capital accumulation in Indonesia is demonstrable by an examination of the condition of the bureaucratic apparatus. The New Order government has placed with this large and complex administration the task of implementing an economic policy, which because of its capitalist nature is a force for change in society. At the same time, that apparatus functions as a power base for the ruling military group, whose concern above all also is to preserve and consolidate their political power. The two functions, economic and political, are in essential respects contradictory. As one observer noted:

> ...the evidence from other countries (and from Indonesia) indicate that the highly centralised governmental structure established to serve the primary goal of containing change, usually encounters great

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[227]ibid., p. 1874. Myrdal argued that the soft state does little to remove, in fact helps to create almost unsurmountable obstacles and inhibitions to planning. "By preventing vigorous attacks on all those conditions that lie outside the narrowly defined economic sphere it impedes development." ibid., p. 1909.

[228]ibid., p. 952.

[229]ibid., p. 932. Similarly Little, Scott and Scitovsky noted that "corruption often rendered it difficult or impossible for discriminatory measures to achieve their aim." op. cit., p. 214. The Asian Development Bank observed the following of the Indonesian administrative system: "Low pay, the redundance of personnel, the remnants of old feudal systems, bureaucratic jealousy and the lack of training and discipline have all contributed to the deterioration in efficiency and morale of public servants." ADB Report, op. cit., p. 380.

> difficulty in attempting to generate change. At the present time Indonesia's government is probably far more capable of containing change than of generating it.[230]

The Indonesian bureaucracy is not monolithic in organisation or purpose, but consists of a large and unwieldy number of departments, headed by high ranking military officers, and staffed predominantly by Javanese, who make up a large percentage of the small but relatively privileged middle class, living mainly in Jakarta. Whilst the bureaucracy is formally centralised, separate areas of power exist within and between various departments, often in competition with each other for influence at higher levels; there is little opportunity for initiative from the lower echelons.[231] Decisions are delayed for little apparent reason, red tape multiplies the complexity of already complex processes,

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[230] Smith, J.M.: A Tentative Report Concerning Indonesia's Administrative System: Its Capacity and Problems in Connection with Economic Development, Jakarta, 1970, p. 3. A similar evaluation was made by Sopiie who argued that to facilitate the creation and successful adaption of foreign technology "...a well-coordinated effort encompassing a broad field of government bureaucracy [was required]....and most developing countries are not prepared to successfully carry out such an undertaking. Indeed administration is in many ways the constraint in the implementation of a well-intentioned government policy." Soedjana Sopiie: "The Transfer of Technology — A Proposed Solution", Indonesia Quarterly, Vol, III, No. 1, October 1974. An Australian Senate Standing Committee argued that "[to] what extent Indonesia's administrative structure has the capacity to fully implement the social aspects of the Repelita II program remains to be seen. The social structure and administrative weaknesses, characteristic of large traditionalistic societies, presents formidable obstacles to the progress of development and the speed of social justice in Indonesia." Report of Senate Standing Committee, op. cit., p. 10.

[231] Herb Feith noted the existence of this situation within the bureaucracy in the 1950's. Policy implementation was difficult then as now, due to rival cliques and empires that developed, especially after 1956. He argued that "to a large extent the bureaucracy has lost its instrumental character and become a law unto itself." To achieve an economic programme civil servants were of necessity drawn into political conflict. To obtain resources, support in high places was needed and thus they concentrated their energies on building and maintaining their political positions and those of their agencies and to make appointments with view to this rather than to rewarding efficient performance of tasks. It is this which forced them to be tolerant of corruption. Feith, H., "Dynamics of Guided Democracy" in McVey, op. cit., pp. 394-397.

communications between departments are poor and consequently the coordination of policy difficult to achieve. This can mean that a project approved by one department may be delayed for months or even years by other departments. Similarly there is an absence of strong administrative consistency between Jakarta and the outer provinces, and the lower echelons of the ministries.[232] Furthermore cultural factors regarding time ("rubber time") and the allocation of priorities contribute in Western terms, to inefficiency and slowness. Although salaries have been increasing in recent years, the problem of low wages persists, and combined with the demonstration effect of Western life styles and consumption habits, means that employees may have two jobs, or supplement their incomes by accepting bribes from the private sector.[233] The actual volume of economic surplus accountable for in this way is of course indeterminate, but evidence suggests that it is quite high. The substantial inflow of foreign capital since 1969, in the form of aid funds and private capital investment render the opportunities for a large misappropriation of economic surplus. Several Australian firms indicated their

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[232] CEDA, SP 37, op. cit., pp. 10ff. See also article by H. MacDonald, FEER, 13/8/76. As one observer noted low salaries mean that "...most provincial officials all participate in business, whether officially or unofficially. These officials are often in a position to retard or facilitate an investment project regardless of arrangements made and approvals granted in the capital....Despite national exemption laws local governors may assess local taxes of which the foreign investor is not aware when the permit to invest is granted." Hong Lan Oei of the UN ECAFE Secretariat: "Implications of Indonesia's New Foreign Investment Policy for Economic Development", Conference of Business International, New York, p. 47.

[233] "On the pretext that they don't have sufficient salaries and supported by the spirit of materialism that sweeps society, most government officials no longer think how to discharge their duties as best as possible but use their power to get the greatest possible amount of money and profit. The government system obstructs the prevention and eradication of rotten things....The reason is that for the sake of political stability and the security of the state, many things which according to the people out of government are in conflict with the interests of the people and state, and in violation of the law are not discussed and talked about publicaly nor in the so-called House of Representatives." The Indonesia Letter, November 1975, No. 73, statement by Masjumi leader Syafruddin Prawiranegara. See also Oey Hong Lee "Power struggles in South East Asia," InterDocumentation Co, AG Zug, Switzerland, 1974. Esp. p 258.

dissatisfaction with the size of this 'hidden' cost, but readily agreed that it was an unavoidable aspect to investment in Indonesia.[234] Firms which do not engage in corruption are highly unlikely to succeed. The essential point is not one evaluating the morality of the situation, but which stresses that these funds are "lost" to the economy as a whole, and are appropriated by individuals or groups for their private benefit. Furthermore it is important to consider the use made of these misappropriated funds — to assess whether or not any instances of socially or economically beneficial effects are in evidence.

Clearly, much of these funds are spent directly by the recipients on consumption, much of it on conspicuous consumption. Some of it is sent abroad for investment in the established money markets, a process graphically described as "washing dirty money".[235] Some of it would no doubt be used in speculative activity and in the purchase of land[236] and it is possible that some would be used for productive investment, but, for reasons already established the proportion of funds used in this manner would most likely be small. Finally, a significant proportion of these funds is used for financing military expenditure. As explained previously this phenomenon is not new to Indonesia, but the volume of misappropriated funds available for military use is much greater now than in the past. It is an established but empirically unproven fact that a

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[234]Myrdal observed: "...in private conversation (the foreign investors) are frank to admit that it is necessary to bribe high officials and politicians to get a business deal through and to bribe officials both high and low in order to run their business without too many obstacles.... These bribes they say, constitute a not inconsiderable part of their total cost of doing business in South Asian countries." Myrdal, op. cit., Vol. 2, p. 946.

[235]One argument put forward in defence of the establishment of the Jakarta Stock Exchange was that it would encourage the domestic circulation of "hot" or "dirty" money.

[236]Utrecht claims that the incidence of absentee landlordism in parts of Java is increasing, due to the purchasing of land by medium and high-level military personnel who are the recipients of not unsubstantial funds from the private sector. Personal correspondence.

large proportion of Pertamina's economic surplus was spent on financing sectors of the armed forces.

Whilst it is not possible to either accurately gauge the amount of economic surplus misappropriated through the mechanism of corruption, or to specify with accuracy the uses to which it is put, the sheer volume of funds extracted from the private sector are of such quantities as to warrant serious consideration of the consequences for Indonesian economic growth. In short, corruption implies the misallocation of a proportion of economic surplus and its use in non-productive activity; it is also a phenomenon structural to the rate and content of private sector activity, not one that may be dismissed as an unpleasant but peripheral aspect of the process of economic change.

As well as assisting the misallocation of economic surplus domestically, the mechanism of corruption operates to encourage the repatriation of capital by foreign firms, by raising the risk nature of direct investment. In an economy where a continuing and serious problem is the lack of incentive to invest, reinvest and expand industrial capacity, it is an important task of the state to reduce outward capital flows and create a stable climate for long-term investment. Yet in Indonesia it is the state itself which is one of the major contributors to the unstable elements of the investment climate.[237]

The inability of the bureaucracy to successfully administer economic policy and its demonstrated capacity for irregular practices, together greatly assisted in the creation of a perceived high-risk situation for the Australian investors, all of whom had experienced the frustrations and delays normally associated with conducting business in

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[237]As Little, Scott and Scitovsky observed: "Excessive government intervention creates uncertainty, as policies change with new governments, and tends to dampen initiative." op. cit., p. 5.

Indonesia. These included delay or failure of the import of goods, difficulty in the acquisition of licenses and permits, unanticipated costs arising from graft, as well as the usual problems of reliable, efficient and honest communications. Guarantees made by one section of the bureaucracy and essential for the implementation of the investment had been broken, causing market fragmentation; this had been serious enough to ruin one company, and substantially lower profitability for another. Besides broken promises, irregular activities, inefficiency and the everpresent problem of the bureaucratic mentality, the problem of smuggling also affected several firms. Since much illegal import is conducted with the consent and often large-scale involvement of, the Department of Customs and Immigration, the government is incapable of effectively preventing the widespread smuggling of goods. Thus, despite the wide range of incentives offered private foreign capital by the government, it appeared that many disincentives also existed, not only attributable to poor infrastructure, small market size and low technological level, but in important respects, deriving from the activities of the military-bureaucratic state. The relative importance of all these factors contributing to the high perceived risk nature of investment was difficult to ascertain. However, the author suggests that the latter are perhaps the greatest single contributing item, not only because they were unknown quantities at all points of time (except when arrangements were concluded to regularise relations between individual firms and the bureaucracy) but also because the possibility of improvement to many other problems hinged upon government activity, or more commonly its lack.

Furthermore, the existence of high-risk nature of investment is a crucial factor in deterring the small and medium-size capitalists, of both foreign and domestic origin, from investing in industrial capacity, since they are less likely to absorb the hidden costs of investment than the larger and often more experienced firms.[238] In this way, the existence of corrupt practices increases the likelihood of investments from large foreign firms, a phenomenon which is further augmented by the preference of the administrative apparatus for dealing with large firms. This results not merely in additions to their status but as well opens the possibility for extracting much greater amounts of payment for their services than would be possible with the smaller firms.[239] Corruption, then, is instrumental in deciding the choice of project and thus a factor contributing to the propensity for the adoption of capital-intensive techniques of production. Furthermore, it serves to aggravate the regional bias of investment, since the centralisation of government administration in Jakarta makes investment physically close to the source of extra-legal privilege a distinct advantage.[240] Moreover, the ability of the larger firm to more easily regularise and control their relationship with the bureaucracy means the forging of stronger links between

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[238]"...[I]t is mainly the beginning and small businessman who gets discouraged, those without contacts, without knowledge of the government's ways and by-ways, and without money to engage professionals to deal with these matters." ibid., p. 214.

[239]Once again this is not confined to Indonesia alone. "The bureaucratic process tends to favour larger projects over groups of small ones because they are easily handled and show more tangible results. The net effect...is often to lead developing countries to follow the line of development of older industrial areas rather than seeking a pattern more suited to their own resources." Chenery, H.B.: "The Application of Investment Criteria" in Quarterly Journal of Economics, March 1953, p. 96. Similarly the World Bank noted: "Large firms tend to be favoured over small ones with respect of access to government and to credit on concessional terms and in respect of duty concessions for import of capital goods." IBRD (No. 148), op. cit., p. 14. Similarly in the same report: "Bias and distortion in the operation of incentive programs and policies favouring capital intensity and larger enterprises...." p. 16. See also AFR, 3/3/77: "Affecting every investor, but particularly the smaller companies, are the constant bureaucratic delays and demand for payment associated with such things as customs clearance and work permits for expatriates." p. 7.

[240]"Other costs are the diversion of skilled manpower, and the tendency of industry to be concentrated near administrative centres, so that protracted negotiations with the government's administrative services can take place; corruption has been encouraged, and more productive initiative discouraged." Little, Scott and Scitovsky, op. cit., p. 5.

them; the process is continually self-reinforcing and from it the growth of the comprador classes and of foreign capital domination continually evolve. In sum, the larger foreign firm can operate more successfully in Indonesia than the small, and the partners with whom they contract are highly likely to be the most successful sections of the local capitalist classes; both are privileged by legal and extra-legal devices and both continue to reinforce the privilege of the other. In this way the joint-venture arrangement allows the institutionalisation of corruption and its operation to the benefit of the foreign firm.

The mechanism of corruption also assisted to create or maintain the dominant market position held within the economy by the Australian firms; this position derived not only from legally attributed advantage but as well from the extra-legal advantages gained from their ability to influence bureaucratic decisions in their favour.

The conditions under which the restricted entry of investors into formerly government-determined areas testifies to this fact.

Of the fifteen joint-venture firms, four enjoyed a monopoly or near-monopoly situation, eight contributed part of an oligopoly whilst three experienced fierce competition. The overall favourable market conditions so gained were the direct result of privilege, that derived from their ability to either influence or bribe officials at either high military of bureaucratic levels. It reflected also the ability to exploit the government's fear of monopoly practices, and its official desire to rationalise the allocation of investments.[241] Economists

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[241]This situation is not exclusive to Indonesia. As Hughes observed: "Fearing both monopoly and 'excessive' competition, most countries have tended to restrict incentives to a small group of entrants in each industry." IBRD (Hughes), op. cit., p. 27. Overseas Business Reports, February 1973, listed those industries closed to further foreign investment. Six of these are industries in which Australian firms have made investments through joint-venture (boot polish, galvanised iron sheeting, bricks and tiles, dairy products, pharmaceuticals and printing inks). Five other closed industries are among those which are supplied by Australian firms (batteries, ice cubes, printing, soft drink and beverages).

arguing for the beneficial nature of direct foreign investment refer to the external economies deriving from the effects of competition, concerning care, service and quality considerations and the stimulation of further investments. Yet the combination of import-substitution and direct foreign investment in the majority of the cases which were considered, led to a situation of monopolistic or oligopolistic control by the firms, market fixing agreements between some and the elimination or diminution of many major competitive sources. The unduly large market share enjoyed by the foreign firms was more attributable to their influence on government bodies than to the operation of efficient, modern production and management techniques; the situation was also assisted by the desire of the government to be seen as a modernising force in the economy which resulted in their desire for, and acceptance of capital-intensive techniques of production.[242] However, the activities of the government are not consistent; privilege, that led to a monopoly or oligopoly situation was the experience of the majority of firms, but three companies did experience fierce competition as a result of the failure of the government to fulfill its obligation. Severe fragmentation of the market had occurred, and in two cases production of increasingly sophisticated and specialised products was intensified to retain or increase market shares. In these cases, the allocation of investments had been made not on the basis of rational economic factors, but for reasons of personal financial gain on the part of administrators. Market fragmentation had led firms to request further protection from the state, especially from imports; clearly the privileges enjoyed by the firms were not only extensive, but also precursors of a variety of other similarly

[242]One aspect of this is the regulation that forbids the import of secondhand plant and equipment for production purposes. However, with suitable negotiation and the payment of bribes, several Australian firms still managed the import of secondhand plant, which consisted of plant now technically obsolete in Australia.

exploitable situations — the situation was to a degree self-sustaining.

Thus privileges within the sphere of circulation for the foreign investor derive not only from the exploitation of concessions and incentives, but as well from the series of informal links developed between the investor and the administrative organs of the state. This discrepancy between the formally designated tasks of the state apparatus and its day-to-day slow partial and often inefficient or irrelevant administration is clearly illustrated by reference to the activities of two particular departments, customs and taxation. These two departments have been selected because it is with them that all foreign investors must always at some stage deal.

Fiscal incentives, which include the reduction or temporary cancellation of duties on 'starting up' imports, have been introduced by the government as an encouragement to the import-substitution manufacturing process. Yet their implementation may only be fulfilled if the administration operates both efficiently, honestly and impartially.

In Indonesia, it appears that this does often not occur. The notoriety of the Department of Customs and Immigration is widespread, and it operates to a large degree, as a law unto itself. An anti-smuggling campaign was begun in February 1976, but as Rice and Lim have noted, its effects "must be tempered... by the fact that the smugglers convicted so far have been of little national significance.*

Illegal practices, payment of bribes, stealing of goods awaiting clearance, and a variety of rackets for the mutual benefit of customs officials and import/export agents are common, indeed expected.[243] In polite terms, the situation could be explained by

[243]Whilst it is not possible to prove formally the existence of these practices by extensive reference to literature, nevertheless as research in Jakarta has shown they do exist in large enough quantities to have a noticeable effect on business attitudes and activities. As Tsurumi observed: "A nursery investigation of customs clearance and

* BIES, SRD, Rice, R.C. and Lim, D., July 1976.

insisting that the tariff structure is full of anomalies. Since these are obstacles which the foreign investor must overcome with little or no help from other sectors of government, this means that bribery is often the quickest, cheapest and safest way to ensure the delivery of imported goods, intact and in working condition. If negotiations with the customs department takes too long it may mean a loss of competitive advantage to the investor, or the creation of ill-feeling between himself (or his company) and the customs official. These and other circumstances combine to produce a particularly corrupt department, whose formal duty it is to regulate the imports and exports of the country by the levying of duties.[244] For a nation that is inducing growth in the manufacturing sector by the method of import-sbustitution, the condition of the department should be cause for more than public concern since import tax policies within the system of import-substitution, in theory aim to support industrial and other productive sectors, as well as limiting the import of non-essential goods. The smuggling of goods into Indonesia is conducted in an organised manner[245] often by arrangements made with individual customs officials,

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[243](cont.) warehouse practices of Indonesian ports uncovered numerous hidden 'tariffs' and 'special charges' and endless delays in getting finished products out of the warehouses. When all hidden charges are taken into consideration, actual tariffs paid often amount to fifty to sixty per cent over and above the nominal rate." Tsurumi, op. cit., p. 11. Similarly the Australian Senate Standing Committee Report noted both the physical problems encountered at Tandjung Priok, and as well the difficulties with customs clearance. By mid-1974, 250,000 tons of accumulated uncleared goods choked the godowns of Jakarta. Senate Standard Committee Report, op. cit., p. 83.

[244]"The administration of customs collections is in many countries as important a part of the protective system as quotas and duties. In some Southeast Asian countries customs officials are grossly underpaid and 'tea-money' is considered a normal and indeed a 'necessary' part of their income. Such 'taxation' is an unsavoury as its incidence is erratic and it is a serious impediment to the deve-opment of manufacturing." ADB Report, op. cit., p. 198.

[245]Smuggling is widespread in Indonesia, and includes unrecorded intra-regional trade. A large volume of goods are smuggled and according to semi-official sources in 1972 illegal imports into Indonesia (textiles) amounted to fifty-two million metres whilst legal imports were measured at 259.8 million metres. FEER, Asia Yearbook, 1974, p. 174.

by underinvoicing of goods, and forged CKD documents (especially in automobile and electronic industries). Apart from the effect on domestic industry, smuggling results in large losses in revenue to the central government.[246] For the foreign investor these practices are both a real and a psychological deterrent, and the government at least officially recognises the need to alleviate such irregularities which detract from the investment climate and are overall detrimental to their economic plans to promote investment in manufacture, for both domestic and foreign markets.[247] Furthermore it could be argued that the political and social consequences of smuggling are as important as the economic effects. As one observer argued: "...smuggling undermines political and legal processes. It corrupts and demoralises...(as well as) evades national fiscal resources that perforce are often heavily dependent on import levies."[248] Yet despite government awareness of widespread smuggling, it appears that the Department of Customs and Immigration continues with a plethora of illegal and semi-legal practices which are an anathema to its stated purpose. Feith's observation of bureaucratic power fits the

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[246]The Indonesia Letter, August 1973, claimed a fifteen per cent customs revenue loss due to smuggling. In June 1971 duties on two hundred imported items were lowered to reduce the incentives to smuggle. See also IBRD (Hughes), op. cit.. Hughes wrote: "Smuggling of goods — both of exports to evade export taxes and particularly of imports to avoid tariffs — takes place on a sufficiently large scale in Southeast Asia to affect the protection system....Indonesia has the highest proportion of local imports and exports smuggled." p. 18.

[247]See address by H.W. Arndt and Nitisastro, Australian-Indonesian Business Cooperation Committee Conference, Jakarta, April 1974. The report of the Senate Standing Committee concluded: "Unorthodox practices, some of which may be of doubtful probity, are likely to be encountered. The Indonesian government is making a serious effort to combat this problem but the structure and traditional attitudes of society are such that sometimes it is extremely difficult to determine what practices may or may not be legitimate." Senate Report, op. cit., p. 5. See also Bulletin of Indonesian Economic Studies, Nov. 1970, "Report of the Commission of Four on Corruption", James Mackie.

[248]Gray, H.P. and Walker, I.: "A Theoretical Analysis of Smuggling: Comment", Quarterly Journal of Economics, November 1975, p. 643.

case well; he wrote: "(to) a large extent the bureaucracy has lost its instrumental character and become a law unto itself."[249]

To this aspect of internal contradiction may be added another which results from the activities of the Department of Taxation. This department may not be regarded as that impartial body that implements taxation regulations and collects revenue for the state. Officially, corporation tax as amended by Law No. 8, 1970, is assessed on the first Rp. 5,000,000 of taxable profits, with an additional twenty-five per cent tax on all amounts in excess of this; the effective rate of tax on profits of all kinds is forty-five per cent (formerly sixty per cent). The impetus for these amendments was a desire to encourage savings in the private sector and thereby stimulate further investment and production. However, corporation tax will often be decided upon negotiation between individual taxation officer and the firm, which will keep at least two, if not more, sets of books. Whilst this may ultimately benefit the foreign investor, to the new firm both taxation and customs departments are dark and unchartered waters where corporate skills and Western business techniques may not always be applicable; they can represent an unknown quantity that must be considered when deciding corporation strategy.[250]

In both cases, an important function designated to a government department is continuously and seriously undermined by illegal processes

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[249] Feith, H., in McVey, R.T.: Indonesia, Modern Indonesia Project, Cornell University Press, 1967, p. 397.

[250] Tsurumi observed that tax collectors have no appreciation of modern business. As a result final tax settlements have to be negotiated between tax collectors and firms. This negotiability of the tax payment like the negotiability of other regulations, not only feeds graft and unfair practices, but also hampers any reasonable planning and forecasting on the part of business, because they will not know how much they will make before their negotiations with taxation authorities. Tsurumi, *op. cit.*, p. 56.

which involve not only the misappropriation of economic surplus for private use, but as well the generation of unquantifiable but nevertheless important social, political and psychological effects.

The situation is contradictory. Corruption as practised within the two departments examined, increases the high-risk nature of investments, encourages the rapid repatriation of capital and limited reinvestment (if at all). And yet it is one of the clearly stated objectives of government policy to encourage the reinvestment of capital in order to assist the growth of a more mature and diversified industrial sector. Similarly, revenue collected by both departments should clearly contribute significantly to the financing of government budgets, yet unquantifiable sums are siphoned off for the use of private individuals. As civil servants, this latter group would have negligible experience in industrial or commercial fields. This means that surplus accumulated in this way is more likely to be spent on consumption rather than invested in production. Such a possibility is further reinforced when the strong "demonstration" effects of foreign investment on middle class consumption patterns is considered together with the traditional elite Javanese distaste for manual work or activities associated with commerce or industry.

Acceptance of corruption means that privilege can be purchased for money, not allocated according to the rational set of criteria developed by the planners in the economy. Furthermore the effect of corruption on the psychological state of the nation must not be neglected; where indulgence in grant is essential to both business profitability and an acceptable standard of living for the administrators, the incentives to conduct one's economic activities in an "honest" manner are slight indeed, and the spirit of the administrators to act as public servants severely cramped.[251]

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[251]The dialogue between the wives of two Indonesian officials,

A final but necessarily brief remark on this question of the nature and effects of corruption relates to the penetration of various sections of the military-bureaucratic apparatus by different factions of foreign capital. Although this situation is not one at present demonstrable by reference to empirical data, it is clear that this does probably occur.* The propensity for the most powerful of the foreign firms in Indonesia to obtain privileges in part rests upon the special relationship they foster within various government departments and with individual high-ranking members of the military elite. During the 1950's it was the political parties that obtained privilege in this way; during the early 1960's it was the increasingly powerful armed forces, and in the 1970's it appears to be the foreign capitalists and elite sections of the military who can adapt most profitably to the mechanism of corruption.

To summarise, the incidence and affects of corruption in Indonesia are not peripheral to the pattern of economic activity; they do in fact influence the process of accumulation at present occurring there. Its incidence represents a portion of economic surplus misappropriated by individuals or groups within the state apparatus and its affects within the economy simultaneously hinder and assist capital formation. Other factors such as the problems engendered by the state of labor relations and of the physical infrastructure are also important. It is to these that the argument now turns.

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[251](cont.) recounted in Lubis' novel crystallises the situation: "Aduh, your husband's very smart at making money. Not like my husband, Hasnah. He keeps telling me that a government official must be honest. And no matter how many examples I show him of honest officials living in misery nowadays, he still wants to stay honest. He says the time will come when righteousness will come to our country and those who stay honest will have their reward. Isn't he stupid, though?" Lubis, op. cit., pp. 187-188.

* Not surprisingly, little evidence is available to support this fact, but E. Utrecht has made some progress in this regard. See Utrecht, E. "Corporate Compradors in South East Asia" in Arena, vol 47/48, 1977; See also "Indonesia and the Pentagon" in Arena [illegible]

Some Further Difficulties

The problem of labor. Although the Indonesian economy is characterised by a low and predominantly stable daily wage rate and an extremely weak union movement, it is nevertheless true that the foreign investor does experience difficulties with respect the application of various aspects of the labor law and the continued existence of a wage system, features of which pose problems for the foreign investor.

Traditionally, the Indonesian employee receives both a cash wage and fringe benefits in return for his or her labor, the latter comprising up to eighty per cent of the cash wage. This latter phenomenon has its roots both in pre-capitalist social relations of production and in immediate post-revolutionary labor relations. In pre-capitalist Indonesian society the employer was regarded as the patron, from whom workers or "clients" expected both protection and assistance when needed. As W.F. Wertheim observed: "Paid labor as a means of subsistence, that typical institution of the modern age according a man freedom, yet forcing him to hire himself in the service of others, does not fit in at all with the pattern of early Indonesian social relationships."[252] Paid coolie labor began in the Netherlands East Indies in 1849; it was more efficient than former compulsory labor and its introduction was necessary to the plantation-based colonial economy. Wertheim's comments are again instructive; the abolition of bondage and its replacement by new forms was, he claimed, "undoubtedly due to new capitalistic forms replacing traditional 'human bondage' by a wage slavery sometimes still harder to endure."[253] Yet within the traditional sectors of agriculture, pre-capitalist methods of payment remained. During the immediate post-

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[252]Wertheim, op. cit., p. 230.

[253]ibid., p. 239.

revolutionary period, the method of payment of labor changed again, in both the plantation sector and the infant industrial sector. Arguably there was some reversal to more traditional methods of payment, which resulted from militant trade union activity and employee self-interest.[254] The extremely low level of wages became supplemented by payment in kind, particularly of foodstuffs. Thus the wage system had important social policy functions and it continues in Indonesia to the present day. However, under the impact of the most recently introduced modern capitalist mode of production, it is suffering decline. Its lack of suitability to the changing material base of society was recognised by the ILO which criticised it as a needs-based system characterised by the inefficient use of labor, and a restriction to the free flow of "market forces".[255]

> Indonesia is now at a stage of economic and social development when it becomes increasingly desirable and feasible to relieve the wage system of most, if not all its social policy functions. Such a reassignment is becoming more desirable because of the extreme urgency of economic development, in the sense of sustained increase in productive capacity, in a country faced with a Malthusian crisis of population pressure.[256]

In short, the growth and expansion of the capitalist sector make unsuitable the old system of payment: this sector requires a free and available labor force, unfettered by what is essentially a pre-capitalist wage system. Yet the two systems, and combinations of both remain in Indonesia.

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[254] *ibid.*, pp. 252ff.

[255] ILO, Asian Regional Team for Employment Promotion, panel discussion, Jakarta, May 29-31, 1974: "Wages, Salaries and Incentives", prepared by Arndt and Sundrum. See section entitled "Functions of Wage Policy".

[256] *ibid.*, p. 31.

Furthermore, the labor law itself, which formally governs relations between employer and employee poses problems for the foreign investor. Formally the law offers substantial protection to the worker with regard dismissal, although there is no guaranteed minimum wage at present and strikes are not permitted. As Ali Moertopo, Deputy Chief of the State Intelligence, put it: "(W)hat the workers are doing is to increase production for the welfare of the people — and therefore if they stage a strike it means an obstacle for the increase of production and can therefore be considered as an act of subversion."[257] With regard the question of the dismissal of labor, some foreign investors have experienced difficulties. Although pressure has been brought to bear upon the government and government-controlled or factory-based unions, the bureaucratic processes involved in dismissal remain for many employers a time-consuming and frustrating task. Yet moves are at hand to redress the problem. As noted by one foreign bank investment climate study:

> It is realised that the factor labor reflected by the current labor law does not tend to promote investment. Although labor is easily obtainable, the dismissal of labor is quite difficult. The current labor law is under review and it may be changed to stimulate foreign investment although this should go hand-in-hand with the still existing <u>political</u> problem to provide employment for millions still unemployed at present.[258]

Investors are advised to apply the spirit if not the exact letter of the law and the government does not always enforce its provisions. An interview with Suhud of the BKPM revealed that "in good political time" the implementation of policies would result in the watering down of the

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[257]<u>The Indonesia Letter</u>, April 1975, No. 66. "...[Labor] is quite inexpensive and strikes virtually non-existent as it requires authorisation of a formal arbitration committee on which the government is represented." <u>Bank Impor-Ekspor</u>, "Window on Indonesia", p. 19.

[258]Bank Impor-Ekspor, <u>op. cit.</u>, p. 19 (emphasis added).

thrust of the original labor law; "even Indonesians know how to appreciate their own regulations."[259] In 1971 The Indonesia Letter reported the high regard in which the Minister of Manpower, Sadli, was held by foreign businessmen due to his sympathetic attitude to their complaints regarding the implementation of the labor laws.[260] Furthermore it appears that the problem of discipline within the work force may be avoided by the employment of a low-ranking military officer in the capacity of "personnel officer", thus leaving the distasteful task of labor dismissal to a member of the indigenous ruling group. The direct or indirect presence of military personnel within all unions thus enables almost complete control to be exercised over the labor force on behalf of the foreign investor. However,the importance of the military arm of government to the control of labor is not new. As Everet Hawkins has shown, its position of control within the labor force became increasingly important with the Declaration of the State of War and Seige in 1957.[261] Furthermore the government as an employer of a large number of workers in both direct production and administration, obliged the adoption by its employees of its own preferred methods of organisation.

Thus whilst difficulties remain as to the conditions of dismissal and engagement of workers, in future years it is not unreasonable to

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[259]Interview with Suhud, Jakarta, 9 September 1975.

[260]The Indonesia Letter, October 1971.

[261]Hawkins, E.D.: "Indonesia" in Galenson, W. (ed.): Labor in Developing Economies, University of California Press, Berkeley and Los Angeles, 1963, pp. 122ff. See also Hawkins, E.D.: "Labor in Transition" in McVey, op. cit.. Hawkins reasoned that the replacement of foreign management by Indonesian public control made the government more sympathetic to the problems of management, resulting in weakening of union strength. Most strikes were made illegal through a series of emergency measures aimed at maintaining production and the government held down the cost of labor to reduce deficits and limit inflation. The fact is that the military entered the field of labor relations through the assumption of a role in management and through its subsequent establishment of supervision over labor unions. pp. 268ff.

expect that these problems will lessen substantially, whilst at the same time the level of wages paid to Indonesian workers will remain extremely low.[262] The requirements of the modern capitalist sector of the economy will oblige these changes whilst that sector will continue to benefit from the low level of wages payable to their employees.

The problems experienced by the foreign investor do not only pertain to the employment of direct labor but as well to that of executive and managerial personnel. Although the Foreign Investment Law guarantees the right of firms to appoint the managerial staff of their choice, the more recent political question of pribumisation has meant a tightening up by the administration of regulations relating to the issue of training.[263] As a consequence the renewal of work permits has become at worst impossible, and at best (and probably more frequently) more time-consuming and expensive. It appears that the bureaucracy can enforce regulations as rigidly as it can at other times ignore them.

The condition of the physical infrastructure. In addition to the many legal and bureaucratic restrictions experienced by the foreign investor, serious problems arise due to the depressed state of the physical infrastructure.[264] Communications are poor, transport facilities often uncoordinated and run-down causing serious bottlenecks in the process of distribution. Electricity and water supplies are sporadic, and suitable industrial land difficult to obtain. It must be acknowledged

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[262]Sadli, M., in The Times (London), 17/8/71: "The level of wages in Indonesia is the lowest in East Asia and will stay so for a long time."

[263]This policy is not new. In 1957, with the nationalisation of Dutch-owned enterprises the cry for "Indonesianisation" was strong and well publicised. It called for foreign firms to undertake the training of Indonesians for more senior positions. Hawkins (1963), op. cit..

[264]For a precise and comprehensive outline of these infrastructural problems see Senate Standing Committee Report, op. cit., pp. 82ff.

that the task of rejuvenating the infrastructure would be a formidable one for any government, yet the large but indeterminate amount of budget funds allocated by the government to military expenditure must be a significant factor in determining the limited scale of infrastructural development. Furthermore, the colonial orientation of existing infrastructure for land transport, especially, means that the distribution of infrastructural facilities is not even, but Java-centric with approximately sixty to seventy per cent located on that island, an area comprising only 6.9 per cent of the entire land area of the archipeligo. Seventy-five per cent of the railway network is on Java, which also has the lion's share of communication facilities.[265] Yet through the development budget and international aid funds the government is actively engaged in the provision of improved physical infrastructure. The necessity of such provisions to the growth of the modern industrial and the agricultural sectors is well recognised by the international aid institutions which accord high priority to the development of infrastructural facilities. Thus the aforementioned developments within the legal and financial infrastructure are paralleled by the development of the physical; significant changes to all three are necessary to allow an unhindered process of accumulation to proceed.

It is not possible here to detail all aspects of changes to the physical infrastructure, so emphasis will be placed on some improvements which relate most directly to the growth of the manufacturing sector. Communications is a major problem for the foreign investor in Indonesia at both domestic and international levels. To redress the situation is an enormous task since the condition of communications infrastructure is very depressed, due in part to the large land area of the archipeligo and

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[265] Central Bank of Indonesia, "Economic Data for Investors", op. cit., pp. 109ff.

the lack of an equal geographical dispersion of communications facilities resulting from the needs of Dutch colonialism. At present there are two major communications projects under way, financed by both aid and state funds. A series of microwave radio stations are currently being installed in Sumatra under the direction of TeleCom Australia, and more recently the nation has acquired a domestic satellite system, which according to some sources has rendered large parts of the former land-based project redundant.[266] Other major projects include the construction of the Sumatran highway and the multi-lane highway from Jakarta to Bogor.

Apart from poor communication facilities the foreign investor finds great difficulty in the acquisition of land for industrial sites. Traditional (adat) law maintains that foreigners may not own land, although they may obtain the right of exploitation and building. Add to this the red tape that inevitably surrounds such a transaction and it emerges that the difficulties in obtaining land is more a function of price than of law, and most importantly government red tape. Efforts to improve the supply of suitable land sites have been an achievement for the New Order government, assisted by the international aid institutions. Industrial estates in Jakarta and Surabaya are either planned or now in operation, and are an important factor in reducing many of the physical

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[266]See PRWET, Vol. VII, No. 4 (1976): "Satellite Communications: Indonesia's Bitter Fruit", R. Jones. This article explains that Indonesia is the fourth nation in the world to have a domestic satellite system (after USA, Canada and USSR). It argues that the reasons for its adoption were a mixture of pressure from foreign investors, Pertamina and, as well the needs of the forthcoming general elections scheduled for May 1977. The government needed the mechanism for greater internal control, and the foreign firms required for more efficient internal communications. The decision as to the *type* of system adopted was a result not of the application of "rational" economic priorities, but of the mechanism of corruption, since the bigger, more sophisticated the system that the foreign firms could sell to the government, the bigger the "rake-off" by Indonesian officials with the Department of Post and Telecommunications. *The New York Times* reported a "kick-back" to officials of twenty per cent of total cost of project (A$303 million). *The Advertiser*, 27/1/77.

problems faced by investors since they offer to the user a far more controlled and controllable physical environment.[267] As Hughes recognised, the development of physically separate facilities for the foreigner bypasses the problems posed by bureaucratic factors as well as providing them with modern and efficient infrastructural facilities.

> If the degree of change required in the legal and administrative structure is very great and generally reasonable business conditions are hence too far off in the future, islands of efficiency can at least be created in industrial estates to allow manufacturers, both local and foreign, to escape the corrosive effects of bureaucratic malfunctioning and corruption.[268]

The development of the industrial estates has been paralleled by that of a complex of bonded warehouses and duty free processing zones. In an effort to induce the growth of export-oriented labor-intensive light manufacturing and assembly plants,[269] the government is offering cheap rents and a high degree of efficiency; the management of these complexes is to be given to an international warehousing company. It is reasoned that such arrangements will induce further foreign investments for those reasons, and as well because they will allow negligible contact with the Department of Customs and Immigration. The Batam Island Project was to have been a major element of this new type of physically removed infrastructural development.[270] At present the project appears to have

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[267]There are now three industrial estates in operation in Jakarta; one of the major shareholders is the DKI who operate their major venture in cooperation with the World Bank and private enterprise. The Westinghouse Corporation, for example, has the management contract for the Pulo Gadung Industrial Estate. For detail on industrial estate development see Indonesian Newsletter, 30/7/73; The Indonesia Letter, No. 30; Business International, op. cit., pp. 66ff.; Restricted Reproduction, Surabaya Investment Information Office, prepared by W.D. Scott and Co., October 1969.

[268]IBRD (Hughes), op. cit., p. 74.

[269]For detail on bonded warehousing development see The Indonesia Letter, March 1972.

[270]For detail on the Batam Island Project see FEER, 25/12/71, 24/12/73.

been shelved indefinitely due to the financial position of Pertamina, the major investor,[271] but originally the nature of the long-range plans themselves revealed an awareness of the gains to be made by large-scale and integrated infrastructural development. The island, in the Riau group off Singapore, was to have acted as a logistics and operational base for the exploration and exploitation of oil and gas. It also included a complex of downstream petro-chemical plants, as well as facilities for light industry, agricultural development and tourism. Warehousing storage facilities and housing were to have been provided to ensure adequate support for the proposed manufacturing sector on the island.

These examples of improved infrastructural development demonstrate again that the development of modern facilities by the state and the aid consortiums necessarily assists the foreign and wealthier indigenous producer who can afford to make full use of them. In the attempt to foster a lively and sustained process of capital accumulation, the Indonesian government assists the development of those conditions that favour the most rapid growth of modern predominantly foreign-owned capitalist sectors; infrastructural development has not been primarily directed at those areas most likely to assist the small and medium-size producer; on the contrary, it involves predominantly development of Western capital-intensive technologically sophisticated infrastructure which is both initially expensive and requires constant servicing from abroad.

Yet the implementation of infrastructural development projects does not occur easily or unhindered. Funds designated for that purpose are often appropriated by individuals within the administrative apparatus, bottlenecks to the establishment of facilities are numerous and further-

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[271] AFR, 12/12/75.

more the allocation of a substantial but indeterminate amount of budget funds for military expenditure reduce their availability for infrastructural development. Finally the concentration of infrastructural development in Java exacerbates regional differences and hinders the development of industrial capacity in the outer islands.

PART FIVE:

The major concern of Parts Two, Three and Four of this chapter has been to outline some crucial factors that either contribute to or hinder the process of capital accumulation in Indonesia. The development of an increasingly complex and Westernised legal and financial infrastructure, and modernised physical infrastructure are crucial in this process which is both geographically and sectorally uneven. In contrast, the expansion of the capitalist mode of production into Indonesia is restricted by a number of "obstacles" to accumulation, some of which have been briefly outlined above. The point to stress is that the pre-capitalist economic and social formations that remain in Indonesia are at present under assault from the penetration of a more advanced mode of production, but they nevertheless present significant structural "obstacles" to capital accumulation: the industrialisation of Indonesia does not involve a total transformation of the economic and social structure, but its partial transformation, and the simultaneous existence of different modes of production within and between different sectors, and different social relations of production between individuals within these numerous modes.[272] As Amin concludes: "Aggression by the capitalist mode of production, from the outside against these formations, constitutes the essence of the problem of their transition to formations of peripheral capitalism."[273]

Yet despite these "disincentives" to invest posed by such historically determined bureaucratic and infrastructural factors, the official

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[272]Kay's comments are instructive here. He argues that the new phase of underdevelopment, characterised by the growth of industrial production, does not involve a total transformation in the economic structure of poor nations. "They remain dependent upon the export of primary commodities, non-capitalist production persists and merchant capital continues in its quasi-independent form." Kay, op. cit., p. 125.

[273]Amin, op. cit., p. 142.

volume of direct private foreign investment in Indonesia since the New Order government seized state power has been substantial. The following section offers some detail as to the nature and extent of this investment, as regulated by the Foreign Investment Board under the framework of the Foreign Investment Law.

FOREIGN INVESTMENT: APPROVAL AND IMPLEMENTATION

The volume of approved foreign investment in Indonesia has been large, and directed mainly toward enclave type resource-extraction projects, which are capital-intensive and employing complex technological processes. Yet it is important to note that whilst the official amount of foreign investment 1967-1974 excluding oil is in the order of US$3.278 billion,[274] only a small proportion of that has been implemented. Due to the nature of much investment, the gestation period is long, and the time-lag between investment and on-stream production is great. The above figure indicates merely the amount of investment that has been approved, not the actual amount now invested. The time-lag factor plus the many procedural and legal difficulties, and a number of fictitious applications designed to allow access to state bank credits, resulted in a large proportion of delayed implementation of investment. The manufacturing sector has the highest rate of implementation (44.3 per cent)[275] due partly to the smaller average size of individual projects (less than US$1 million).[276]

[274]Report from the Senate Standing Committee on Trade, op. cit., p. 59. Figures taken from "Indonesia Handbook 1974", Indonesian Department of Information. Figures given by BIES, Survey of Recent Development, July 1975, estimate approved direct foreign investment to total US$3.879 billion.

[275]The figure of 44.3 per cent was given for March 1973 by Foreign Economic Trends, 28/11/73. Possibly this implementation figure is too high. BIES gave a rate for manufacturing at 25.4 per cent, with an overall rate of 14.9 per cent. Both figures given for the period 1967-71. BIES, November 1971, p. 20, Table 9. Dönges, op. cit., Table 6 offers a variety of reasons for delayed implementation.

[276]The figure of $1 million is given as average expenditure per project. Dönges, op. cit., section entitled "The Role of Domestic and Foreign Investment".

Mining shows a twenty-five per cent implementation rate, and forestry twenty-seven per cent.[277] Although statistics indicate an increase in the annual rate of implementation, one must continually keep in mind the lack of reliability on such matters, for political as well as bureaucratic reasons. One report indicated an overall implementation rate for 1967-1970 (inclusive) at twenty-seven per cent.[278] By 1972-73 the overall rate was higher, at 22.4 per cent of approvals and by March 1973 a figure of 36.5 per cent was reported,[279] but the author is not aware of more recent information.[280]

Partly because of this question of implementation, the government decided in 1973 to alter the structures of the Foreign and Domestic Investment Boards, by replacing them with one body, the Capital Investment Coordinating Body (BKPM).[281] The original Foreign Investment Board had been too weak and possessed a limited capacity to assist the investor beyond verbal encouragement and basic information, leaving him to make his own way through the bureaucratic morass. The new board was designed to serve a more decisive function, to coordinate and bypass government departments and enable investors to file all documents direct to the board.[282] Interdepartmental negotiations and arrangements would in future be handled by the BKPM staff, not the investor. This rationalisa-

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[277] FEER, 28/8/71.

[278] ibid..

[279] The US Department of Commerce reported an increase in intended investments accompanied by an acceleration of implementation during this period. Foreign Economic Trends, 28/11/73.

[280] For further detail on implementation rates see Dönges, op. cit., pp. 23ff. BIES, No. 3, 1972, claimed that approvals from mid-1967 to mid-1972 exceeded US$2 billion but only $300 million of this (fifteen per cent) was implemented, mainly in the oil industry. Tsurumi claimed that the Japanese have the highest level of implementation (ninety per cent) compared with seventeen per cent for all other foreign investments. Tsurumi, op. cit., p. 5.

[281] Presidential Decrees, Nos. 20, 21, June 1, 1973.

[282] Embassy of Indonesia, Economic Section: "Capital Investment Coordinating Body (BKPM)", Canberra, 1973.

tion to increase efficiency, save time and streamline investment procedures was initially greeted with enthusiasm by the foreign business community. Yet recent interview with the vice president of the BKPM indicates that old problems cannot be solved by the addition of another bureaucratic body.[283]

The BKPM is divided into five sections with separate functions. But still, intersectional coordination is very poor, and the weekly board meeting of section heads allows little opportunity for the expression of views concerning improvements to the organisation. Whilst the quality of staff is reported as good, a bureaucratic and unflexible attitude still pervades negotiations with investors, and the gap between bureaucracy and business remains. Further frustration with the performance of the BKPM was expressed in another interview, when it was argued that the board was still weak, lacking in initiative and unable to act as a mediator between rival departments whose squabbling and pursual of self interest meant not only time wasted but a tendency toward ad hoc and uncoordinated policies.[284] It appeared that government attempts to streamline investment procedures and achieve competitiveness with respect to other countries of the region, suffered serious difficulties because of the nature of the bureaucracy. An initially curious situation. But as has been previously argued, such a contradictory situation is not surprising when one views the post-colonial state as one that, by definition, is fraught with internal contradictions. Efforts to reduce political tensions arising from the depressed condition of national capital and the mass of the people who live and work in the agricultural sector, conflict with the desire to build a secure power base by encouraging the development of capitalism. Efforts to improve the physical, legal and financial

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[283]Interview with Suhud, Jakarta, 9 September 1975.

[284]Interview with Lim Bian Key, Jakarta, 2 September 1975.

infrastructure are continually frustrated by the existence of bottlenecks, red tape and the sheer immensity of the problem. Yet although restrictions exist in irritating and sometimes deterring quantities, the incentives offered do much to augment the already existing strength of foreign capital which stems from its lively and sustained capacity to reproduce itself and to contribute therefore to the uneven expansion of capitalist relations of production to predominantly non-capitalist nations. From this condition many highly competitive capacities result.

FOREIGN CAPITAL: SOME CHARACTERISTICS AND STRENGTHS

Much of this chapter has been devoted in large part to outlining the mechanisms by which foreign capital, upon entering the Indonesian economy, receives extensive privileges which far outweigh those enjoyed by its domestic counterpart. Yet some mention must be made of privileges and advantages enjoyed by foreign capital *prior* to such entry, since the exploitation of the former set of privileges is even more intense *because of* this fact; the topic may be touched upon only briefly. For example, marketing and distribution skills evolve from long experience in the commercial practices of the industrialised world. Subsidiary companies in Indonesia, whether joint-venture or wholly-owned subsidiaries enjoy the benefits of this experience, and are clearly advantaged over their pribumi competitors. Similarly in the area of technological innovation, research and development foreign capital is in a dominant position. Whilst the financial strength of foreign capital clearly supports and sustains these characteristics, the abundance of skilled professional and technical expertise must be considered not merely as the product of wealthy firms, *but of societies* with highly developed technological and educational infrastructure.

Another distinct advantage enjoyed by foreign firms is their ability to attract the best workers, technicians and management personnel away from local firms purely because of their superior financial capacity. Furthermore, the Western orientation of business administration teaching methods results in the proliferation of graduates well trained in skills suitable to the needs of foreign companies rather than to those of the small to medium-scale indigenous producer.[285] With an acute shortage of skills for industrialisation this drain of human resources from the indigenous to the foreign sector represents a serious problem. In addition, again because of their superior financial capacity, foreign firms are able to hire managerial consultants to assist with their problems, especially those deriving from the condition of the Indonesian bureaucracy.

In sum then, foreign capital, with its extensive financial, technical and managerial resources, its knowledge of markets and its often highly favourable bargaining position within government circles is capital which is highly privileged (in comparison with domestic capital) prior to its entry into the domestic economy. Once there, as preceding sections have demonstrated, another process begins. The effect is cumulative; privileged investment is undertaken by foreign capital in key growth and highly protected areas of the economy; the residue is left for the indigenous private producer who is unable to make partnership with foreign capital; those elements of the indigenous capitalist classes who are able to do this are the military entrepreneurs, the wealthiest Chinese and a tiny number of successful pribumi. It is not difficult to account for the poor performance of the pribumi, and their historically determined weak position within the economy is fiercely accentuated by the pattern of privileged investment, led by foreign capital and encouraged by the state. Nor it is difficult to understand the type of contradictions that spring from the class of functions necessarily

[285] ibid..

performed by the post-colonial state. The final section of this chapter offers some detail on this important question.

PART SIX:

THE CONTRADICTIONS OF THE POST-COLONIAL STATE: THE CASE OF INDONESIA

The preceding pages have sought to outline a major aspect of the "economic" function of the post-colonial state; viz. the development of an infrastructure conducive to the spread of the capitalist mode of production as the dominant mode of production. That process necessarily demonstrated the existence of contradictions that have developed and are maturing within Indonesian society since the seizure of power by the New Order government in 1965. Two major sources of contradiction may be identified; those that spring from the nature of the post-colonial state itself, and those intimately related to the latter, that spring from the conflicting functions that the state must fulfill. These latter involve consideration at the most general level of the relationship between domestic and foreign capital and the state, whereas the former concerns discussion of those bureaucratic and military factors that so closely determine the nature of the activities of the post-colonial state.

Before the discussion of the particular source and nature of the contradiction proceeds, it is pertinent for the sake of clarity to reiterate the framework of analysis that was suggested in Part One of this chapter. There it was argued that an analysis of the post-colonial state could be most usefully begun by an initial statement of its objectives. They are as follows: (1) to facilitate the spread of the capitalist mode of production as the dominant mode of production; (2) to mediate the conditions of exploitation and dependence — in other words, to manage the contradictions that arise from the first objective. The achievement of these two objectives is dependent upon the successful implementation of certain functions which are best categorised under four major headings: economic, political, ideological, coercive. Whilst a degree of overlap of functions exists, for the purpose of analysis some basic categorisation is necessary. The specific nature of the overlap should become evident as the discussion of the character and strength of the contradictions generated by the form and function of the post-colonial state proceeds. As each "function" is outlined, so the contradictions become evident.

Because the bulk of this chapter is concerned to analyse vital aspects of the economic function of the post-colonial state, it is suitable to deal with these first and in the most detail. A distinction must be made between <u>support-related</u> and <u>direct</u> economic activity, since it is with the former that this chapter deals. The "support-related" activities involve the development of the physical, financial and legal infrastructure suitable to the spread of the capitalist mode of production as the dominant mode of production. They are activities designed to increase the historically low surplus absorption capacity of the economy in the direction of the capitalist mode of production. This low absorption capacity is due to a variety of historically determined factors, viz. small domestic markets, low per capita income, low technological level, cultural and religious attitudes, poorly developed infrastructure, and broadly speaking, a colonial legacy which served to inhibit the spread of the capitalist mode of production to the colony. Although the Indonesian economy was shaped to suit the needs of the Dutch this did <u>not</u> involve generally speaking, the spread of capitalist mode of production or relations of production to the colony. Instead it tied large, profitable, technically and managerially efficient sectors of the East Indies economy, the "enclaves", to the needs of Dutch capitalism; it made very little impact on large sections of the Indonesian economy, particularly in the countryside which remained in Western terms, technically backward, oriented to domestic markets, and produced very little <u>surplus</u> which could be productively reinvested. The situation in Indonesia in the modern period is substantially different, since it is a conscious and deliberate policy of Suharto's New Order government to assist the spread of the capitalist mode of production and relations of production, and to allow that mode to become dominant. This is being achieved in part by government activity designed to increase the low absorption capacity of the economy. Parts Two and Three of this chapter have indicated the variety of methods presently being employed to achieve this objective; Part Four has demonstrated the existence of contradictions that have arisen due to the bureaucratic-military nature of the Indonesian post-colonial state and the problems posed by the wage system and physical infrastructure. These contradictions arise when the requirements of historically progressive capitalism are frustrated by the enormous force of bureaucratic inertia and the continuing drain caused by the financial and human resources required by the armed forces. The simultaneous existence of pre-capitalist economic and political formations offer resistance to the penetration and growing dominance of the more progressive mode of production, as does the appropriation of economic surplus by the military-bureaucratic state — an appropriation crucial to its continued existence. Yet as Amin has repeatedly stressed,

> [t]he capitalist mode of production tends to become exclusive, that is to destroy other modes of production. This feature, which is distinctive of the capitalist mode of production alone, operates where the latter is based on the creation and expansion of an internal market that is formed through the break-up of previously existing modes of production.[286]

The <u>dominant</u> effect of the bureaucracy is to hold back, slow down or distort the development of capitalism in Indonesia, although formally it

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[286]Amin, <u>op. cit.</u>, p. 139.

has been entrusted with exactly the opposite task. This same bureaucracy constitutes an important base of political power for the New Order government as well as forming an important part of the post-colonial state whose objective functions require an efficient, modern, specialised and honest bureaucratic structure. Clearly it is a difficult task for the New Order government to make any thoroughgoing alteration to the dominant structure of power within the bureaucracy. It may however create new bodies to bypass the old,[287] oblige individuals within established institutions to accept its control[288] or attempt to reduce or eliminate the most public examples of "corruption" within the bureaucracy.[289] Yet these moves can have only a limited effect. This is not merely because of the size of the bureaucracy, its inertia, or its historical legacy but as well because sections of the New Order government comprise part of that bureaucracy; most senior and many middle-ranking positions are held by the military, and politically it is just not possible to "rationalise" a bureaucracy if this involves an erosion of important elements of one's political power. Furthermore the commercial activities of some aspects of the governmental apparatus have become in recent years of growing importance to that apparatus in terms of the nuturance of an

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[287]For example the BKPM, which is expected to make the implementation of investment by foreign companies easier than it would be if direct negotiation took place between government departments and investor. See for example, AFR, 1/3/77. Numerous complaints against increasing backlog of investment applications, long delays and difficulties negotiating with the various government departments, and the problems of acquiring suitable sites apparently facilitated the creation of the BKPM.

[288]For example: prior to its abolition in 1974, ABRI played a critical role in the formulation of Pelita I, and as well introduced tight controls on the bureaucracy. Civil ranks were purged and all officials obliged to join Golkar for the 1971 elections. Apparently a good deal of suspicion of the civilian bureaucracy by ABRI was founded on the former's past affiliations with radical political parties. See Rudner, M.: "The Military in Indonesian Development Planning 1969-1974", A Symposium on the Military and the State in Modern Asia, Hebrew University, Department of East Asian Studies, H.S. Truman Research Institute, Jerusalem, July 1974.

[289]For details see H. Crouch: "Generals and Business in Indonesia", Pacific Affairs, Vol. 48, No. 4, Winter 1975-76.

indigenous capitalist class: this point will be dealt with at a later stage. To conclude, contradictions arise from the fact that a major section of the apparatus of the post-colonial state is incapable of fully promoting the objectives of that state both because of its historically determined characteristics and the requirements of its political position with respect the configuration of class forces in Indonesia.

A similar situation arises with respect the dominant element of the Indonesian state, namely the military. Whilst it is important to consider, as will be done, the direct participation of the state in commercial and industrial activity, it is also vital to recognise that an unknown quality of economic surplus generated domestically is deployed by the military state in the maintenance of the armed forces.[290] In an important sense this represents a drain from the total volume of deployable surplus available for investment,[291] but it must also be seen as necessary in terms of the maintenance of internal political and social control throughout that vast archipeligo that forms the Republic of Indonesia. In this sense the coercive function of the post-colonial state both conflicts with and is necessary to its support-related economic functions.[292]

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[290]Crouch argues that this process began in the early 1950's on a relatively small scale because of the shortage of budget funds necessary to support both the military and personal requirements of the armed forces. By the 1960's he states that "the most important aim was to utilise many of the new state corporations, as well as military-connected business concerns, as a source of funds for the army. Officers involved in economic management were entrusted with the task of siphoning off funds which were transferred directly to the army, rather than to the government, so that the army's dependence on allocations from the central government budget was reduced." ibid., p. 521.

[291]Crouch estimates that from one-half to two-thirds of actual expenditure on the armed forces came from these "unconventional sources". The major donor was Pertamina, and as well Bulog was involved. ibid., pp. 524ff.

[292]Crouch maintains that failure to provide for the economic well-being of military personnel in the 1950's "had led to discontent and contributed to rebellion." ibid., p. 523. He stressed the importance of expanding opportunities for fund raising to keep the peace, especially in

Of equal importance to those support-related economic activities is the direct economic activity of the state and its agencies. As argued in Part One of this chapter, the strength of the military-bureaucratic state — its relative autonomy, derives in part from this type of activity. As Alavi argues:

> this relative autonomy...derives...from the positive conditions which stem from the far-reaching intervention by the state in the economies of post-colonial countries, both by way of a network of controls, in which the vested interests of the bureaucracy are embedded, and a direct appropriation and disposition of a substantial proportion of economic surplus. These constitute independent material bases of the autonomy of the bureaucratic-military oligarchy.[293]

Coincidentally, it is clear that a distinction must be made between two segments of the Indonesian capitalist class: those who benefit from state activity and those who are either harmed or not helped sufficiently by it. This former group include the state or military enterprises including "The Military P.T.".[294] Many enjoy an important (in terms of volume

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[292](cont.) the regions. ibid., p. 524. See also Feith, H., and Lev, D.S.: "The End of the Indonesian Rebellion" in Pacific Affairs, Spring 1963.

[293]Alavi (1972), op. cit., p. 72. Alavi states again in another passage that "(t)he state in the post-colonial society directly appropriates a very large part of the economic surplus and deploys it in bureaucratically directed economic activity in the name of promoting economic development. These are conditions which differentiate the post-colonial state fundamentally from the state as analysed in classical Marxist theory." ibid., p. 62. See also Resnick, op. cit., "The Second Path to Capitalism: A Model of International Development". "For...[some] selected countries, colonialism acts then as the midwife for the emergence of a powerful native elite who are able to concentrate landed and merchant wealth into their hands, and who endeavour to use state action at some latter period of time to facilitate the transfer of this concentrated wealth into industrial assets." p. 133. "...[t]he second path becomes a viable route when merchant capital is transformed into industrial capital via state action." p. 135. See also Warren, op. cit..

[294]A "military PT" refers to those enterprises run by the military in their capacity as individual officers. They produce a wide range of goods available to the domestic market. Increasingly they have taken the form of joint-ventures with foreign companies. For further details

and type of activity) and strategic (in terms of their relations with other capitalist groupings) position within the domestically-owned capitalist sector of the economy. This position is made possible because of the power and privilege afforded them by virtue of their special relationship to the state.[295] Sections of the military group that came to power after the coup have been able to carve out for themselves, to allocate for themselves, profitable areas of economic activity[296] and to enhance the existing position of the most dynamic of the previously established state enterprises. As well they have been able to call upon the experience and business acumen of the Indonesian-Chinese, that other powerful fraction of the domestic capitalist class. The power of the latter is to important degrees limited by its politically subordinate position to the military.[297] As Rudner has argued the industrialisation

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[294] (cont.) on the various types of military enterprises see A. Rieffel and A.S. Wirjasuputra: "Military Enterprises" in BIES, Vol. VIII, No. 2, July 1972.

[295] "...military PT probably have significant advantages over civilian PT by virtue of their access to political/military power." ibid., p. 107.

[296] The position of state enterprises was formally strengthened after the nationalisation of Dutch enterprises in 1957. Privileges extended to liberal credit facilities, import licenses with high quotes attached and near-monopoly rights in certain fields of economic activity. Siregar argued that from 1950-57 government policy favoured the creation of an indigenous entrepreneurial class, but during the period of Guided Democracy the private businessman enjoyed low social standing in comparison to state-employed businessmen who were often chosen for reasons other than technical or managerial competence. Siregar, A.F.: "Indonesian Enterpreneurs", Asian Survey, May 1969. For detailed analysis of the emergence of the public sector, especially the state trading corporations see J. Panglaykim and I. Palmer, "State Trading Corporations in Developing Countries: With Special Reference to Indonesia", op. cit.. Utrecht claims "that the military are involved in eighty per cent of all the country's economic activities. As directors of state enterprises, ministers, secretary-generals and director-generals of ministerial departments and owners of so-called 'military (trade or industrial) enterprises' they are the country's real decision-makers in the economic field as well as the political." E. Utrecht: "The Military Elite" in M. Caldwell (ed.), Ten Years Military Terror in Indonesia, op. cit., p. 46.

[297] Rudner argues that after 1967, the New Order government reversed previously discriminatory legislation against domiciled Chinese with respect personal and property rights. Trade Minister Sumitro tendered security to the Chinese in return for accelerated economic performance.

policy pursued by the Indonesian government fostered the emergency of the military as prime local participants in and beneficiaries of industrialisation.[298] Military-run enterprises have been accorded favoured treatment which has included an often intimate and profitable relationship with foreign capital, not usually available to non-military domestic enterprises or those not in some unofficial way, connected with the military. This relationship involves not only direct investment by private foreign capital, but includes as well the flows of aid money mainly forthcoming from the IGGI, the World Bank, the IMF and the ADB, as well as the volumes of bilateral aid.

State or military enterprises are favoured choices as joint-venture partners in direct investment activity by foreign firms, this stemming in part from recognition of the advantages to be gained by the foreign company that cultivates and utilises high level government/military connections. Not only can this facilitate smoother implementation of investment, the reduction of bureaucratic bottlenecks and greater access to government and aid contracts, but as well may offer to the foreign partner an established distribution and marketing network.

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[297](cont.) As Chinese involvement grew, a special relationship with the military arose, and an alliance between military entrepreneurs, politicians and Chinese businessmen developed. This involved exchanging protection for financial return, and contributed to the mobilisation of domestic capital. A negative reaction from officers-in-the-field, Muslims and indigenous entrepreneurs resulted, but their effective power was extremely limited. Rudner, op. cit.. Crouch identifies the situation in essentially the same way. "Increasingly officers become involved in a private capacity as partners in business concerns usually run by Chinese. While the Chinese provide the business acumen, officers were able to ensure that bureaucratic obstacles to profit-making were overcome.". Crouch, op. cit., p. 523.

[298]Rudner, op. cit.. The economic activities of the military include large holding companies, industrial and commercial conglomerates, trading syndicates, manufacturing, banking, timber, transport, mining and oil exploration. Rudner claims that these businesses operate in the manner of autonomous economic fiefdoms.

The Indonesian and US governments and as well the international aid institutions have stated their preference for state enterprises as joint-venture partners. For the Indonesian government this stems in part from the very limited success of prior policies designed to assist the pribumi businessman and as well from the genuinely felt responsibility to resist domination of both Chinese and foreign capital in the economy.[299] For the World Bank, the desirability of encouraging the growth of the state-owned sector of the economy springs from both political and economic considerations. Clearly there is growing recognition of the problems that manifest themselves with the increasingly obvious growth of economic power of foreign capital within the domestic economy.[300] Cooperation with the post-colonial state and the strengthening of ties between state-owned enterprises and foreign capital is seen to be an important way of reducing foreign dominance. This is also recognised by the US government which has indicated that one of the most likely ways to assist the "pribumisation" policy involved the encouragement of government ownership through the direct cash purchase of shares through Bapindo and as well through the establishment of joint-ventures with state enterprises.[301] It is arguable that the historical weakness of the indigenous

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[299] Panglaykim and Palmer have argued for the necessity of allowing the state sector to develop as far as it can, otherwise the government must carry the responsibility for permitting the Chinese to control the economy. Y. Panglaykim and I. Palmer, op. cit.. By 1973 state-owned enterprises were under the formal control of the Ministry of Finance which has been delegated power to "shake up" the management, set profit targets and assist their overall rationalisation and insist on their operation in accordance with price mechanisms and competition. In this way state enterprises will become more attractive as joint-venture partners. On the basis of these actions, financial, technical and managerial assistance is now being made available by the World Bank and the Asian Development Bank. The Indonesia Letter, No. 43, May 1973.

[300] See ADB Report, op. cit., Part 4, pp. 290ff; Part 5, pp. 420ff.

[301] American Embassy Airgram: "Nationalising — Indonesian Style", airgram to the Department of State, American Embassy, Jakarta, April 8, 1975.

capitalist classes has been to a degree reduced by the alliance of its most powerful fraction, the military, with foreign capital through the mechanisms of aid and the joint-ventures. On the other hand, the weakest fraction, represented by the pribumi, is unable to either compete or join with foreign capital. It may only engage in those economic activities not taken up by the more dynamic capitalist groupings. Thus although penetration by foreign capital may speed up the formation of native capital, it does so unevenly. The most privileged fractions become stronger by virtue of their alliance with foreign capital, whereas the weakest are severely restricted by it.[302] This process, of course, began in the 1950's, with the takeover of Dutch enterprises, and an observation made by the PKI Politburo remains convincing some twenty years later. It concluded:

> The influential elements of these groups (military) formed amongst themselves a group of bourgeoisie which controlled and make use of the state apparatus to serve their economic interests; they also created amongst themselves bureaucratic capitalists who oppressed both the working class and the national bourgeoisie and proved themselves to be a medium which was creating conditions for the imperialists to continue their policy of exploitation and distortion.[303]

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[302] "Penetration by foreign capital speeds up the formation of native capital. The latter cannot find investment parallel with the penetration of foreign capital, and that local capital, weak because newly formed (and therefore small in amount) is incapable of competing with the advanced industry of the centre....[Y]oung local capital cannot compete with the enterprise set up by this stronger foreign capital....it will move towards certain sectors that have been left to it. This orientation will in turn influence the pace of subsequent accumulation of capital, and will determine the peripheral character of the capitalism that arises." Amin, op. cit., p. 162.

[303] PKI Politburo statement quoted in Pauker, G.J.: "The Role of the Military in Indonesia" in Johnson, J.J.: The Role of the Military in Underdeveloped Countries, Princeton University Press, Princeton, New Jersey, 1962, p. 228. See also Tan, T.K., Sukarno's Guided Indonesia, op. cit., Chapter 7 by Castles. Castles considers PKI leader Aidit's analyses of state enterprises. He quotes Aidit: "Too much authority has

Yet as well it must be recognised that the relationship between foreign capital and the local capitalist classes is also marked by a dependence of the latter on the former.[304] The involvement of local and particularly of state capital in joint-ventures implies a rising local capitalist class both antagonistic to metropolitan capital and dependent on it.[305] The strong sections of the domestic capitalist class are often obliged to align themselves with foreign capital in order to grow in strength or maintain their present level of economic activity. However at the same time, by virtue of that alignment in the capacity of junior partners, they become subordinate to the needs of foreign capital. The position is fraught with contradiction. Furthermore, the state enterprises are part of the apparatus of the post-colonial state, the objective function of which is to assist the spread of the capitalist mode of production as the dominant mode and to mediate the contradictions that are generated from this process. To mediate the sometimes conflicting interests of foreign and domestic capital, whilst simultaneously acting as a junior partner to the former and the most powerful fraction of the latter, is a difficult but necessary task for the post-colonial state.

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[303](cont.) been given to the state trading enterprises and it can be said that such enterprises are now outside the control of the government, let alone the Parliament. Their task of taking part in the leadership of the economy, in line with state policy and centrallised planning may be said to have been entirely liquidated. In fact...we cannot avoid the impression that these enterprises have been handed over to their managers to order as they please." Aidit: "Dekon Dalam Udjian", Jakarta, 1963, in Castles, p. 79. See also Mortimer, R.: Indonesian Communism under Sukarno, Cornell University Press, Ithaca and London, 1974, pp. 257ff.

[304]O'Connor argues that "joint-ventures are an up-to-date version of the colonial policy of creating a dependent and passive local bourgeoisie....the alliance between foreign and local capital inhibits potential economic competition and paves the way for the diversification of the foreign operations of the international monopolies and extends their control over related product fields in the local economy." J. O'Connor: "The Meaning of Economic Imperialism" in Imperialism: A Reader, R. Rhodes (ed.), op. cit., p. 130.

[305]"Thus the position of the bourgeoisie is paradoxical — it wishes to introduce independent national development yet it cannot do so without relying on metropolitan countries. It is nationalist yet it must collaborate with imperialism." Patnaik, P.: "Imperialism and the Growth of Indian Capitalism" in Owen, R. and Sutcliffe, B.: Studies in the Theory of Imperialism, Longman, London, 1972, p. 227.

The most powerful fraction of the domestic capitalist class, the military or state enterprises enjoy great advantages over other segments. The economic growth of the small and medium-scale producers is usually restricted and thwarted by the policies pursued by the state. In order to facilitate the spread of the capitalist mode of production preference in economic matters is given to military enterprises, the Chinese capitalist class and foreign capital. These dominate the growth areas of the economy leaving the traditional and subsistence sectors largely untouched. Politically the government must be seen to be assisting the "pribumi", but the demands of the growing capitalist sector makes mockery of its well publicised "pribumisation" policy. The contradiction between economic necessity and political desirability is clear.

The situation is further complicated by the strategically dominant position of various foreign capitals within the economy. To the extent that inter-imperialist rivalries are played out within the Indonesian economy over time, they will operate on the one hand to contribute to divisions within the armed forces and the ruling elite from which they are drawn, and on the other hand allow some measure of "autonomy" on the part of the post-colonial state in its dealings with foreign capital.[306] The two processes are contradictory, they operate simultaneously and the relative strength of the one over the other depends not only upon class formation and the degree of unity within the state, but as well on the complex external events of the advanced capitalist world.

One further aspect of contradiction within the structure of the post-colonial state lies with the apparent division within the armed forces between the officers in the field and those in industry. The

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[306]For an exposition of this thesis, see Warren, W., "Imperialism and Capitalist Industrialisation", op. cit..

latter are able to apportion for themselves some of the surplus that derives from the commercial and industrial activities of the various state enterprises, but the former are to a large degree, denied this opportunity.[307] The possible political implications of this are identified by Crouch as highly pertinent to any discussion of the stability of the New Order government which he sees as resting to a large degree on the distribution (albeit unequal) of the economic surplus between sections of the armed forces. The New Order government "was aware that the failure of earlier governments in the 1950's to provide for the economic well-being of military personnel has led to discontent and contributed to open rebellion."[308]

Corresponding to this unequal distribution of surplus within the military is that distinguishable in the type, volume and rate of capital investment in the various regions of the Indonesian archipeligo. Capitalist relations of production expand unevenly into the economy and that unevenness manifests itself in the unequal allocation of funds between various sectors of the economy, between various fractions of the domestic capitalist class, and as well, in a geographical sense. The historically determined and potentially politically explosive regional differences that have occurred are aggravated by the process of capitalist expansion. As one observer remarked: "Capital tends to be regionally concentrated — it creates its own environment which draws other capital

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[307]Utrecht, E.: "United States of Indonesia? The Pentagon and the Generals", Arena 42, 1976.

[308]Crouch, op. cit., p. 523. Crouch continues: "The stability of the Suharto regime has been achieved in large part through its success in limiting dissent within the officer corps. Lacking both inspiring leadership and a compelling ideology, the regime has consolidated itself through the distribution of patronage. The rapid growth of foreign investment and oil funds has provided constantly expanding resources with which to reward supporters and buy off potential dissidents. The encouragement given to military officers to engage in business activities has thus been a key element in maintaining Suharto's base of support in the armed forces." Crouch, op. cit., pp. 539-540.

to it and this process is cumulative."[309] Despite the official acknowledgement of the necessity of promoting regional development, the New Order government has shown itself incapable of promoting any significant activity in this direction. The penetration of foreign capital into the Indonesian economy precludes the possibility of planned and coordinated regional development, and yet the predominantly Javanese-controlled government must recognise the grave political implications that could arise if the present concentration of investment in the West Java-Jakarta region continues at the present rate.

The preceding pages have sought not only to outline in general terms the major elements of the "economic function" of the post-colonial state, but as well have demonstrated the existence of contradictions that have inevitably arisen as the state attempted to fulfill its objectives. It is clear that contradiction arises within the parameters of one function, and as well because of conflict between two or more. It is the purpose of the following pages to outline very briefly some of the major sources of contradiction that derive from the execution of the prior-mentioned political, ideological and coercive functions of the post-colonial state.

Politically, the Indonesian government is faced with a problem that has beset all policy makers since the establishment of formal political independence. As has been demonstrated in this chapter, the wide variety of action taken by the government to assist the development of the pribumi group have not had significant effect in the economic sense, yet politically they serve a vital function in that they present the government as one willing and to a lesser degree capable of promoting the interests of this group. The objective needs of an exapnding modern

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[309]Patnaik, op. cit., p. 213.

capitalist sector conflict, it appears irreconcilably with the political necessity of promoting a dynamic capitalist class of pribumi origin.

At other levels as well, the state is faced with perpetual conflicts of interest between itself and its ally, foreign capital and other groups within Indonesian society. The relationship between the armed forces and the once-powerful Islamic groups further demonstrates the point. The Indonesian military, with its traditional Javanese and secular Western values has little interest in furthering the interests of Islam as a political force, and it is arguable that their policy has been one of decided opposition toward a strong and independent Islamic political movement.[310] Participation of santri within the army is extremely limited and the growing economic power of the military at the expense of other sections of the pribumi, including the once powerful Muslim business community has meant an increasing gap between the interests of Islam and the military since 1965.[311]

Similarly, the present sad condition of Indonesia's political parties indicates yet another area where the present government has pursued a deliberate policy designed to circumscribe their autonomy by manipulation and obstruction. The heavy-handed encouragement of fusion of the many political parties into two basic parties (Nationalist-Christian and Islamic) was designed to permit far greater control and surveillance of the remaining legal opposition within the present political system.[312]

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[310] Samson, A.: "The Army and Islam in Indonesia", Pacific Affairs, Winter 1971-72. Samson argues that "(the) Indonesian military, considered from a historical and sociological viewpoint, has been most influenced by traditional Javanese and secular Western values; it views a politicised Islam as an alien force....In these contradictory perceptions is reflected the depth of the religio-cultural division that has beset much of Indonesian society for generations." p. 561.

[311] "The effort of the military and secular groups to limit Islam's political power has been effective, but at the price of increasing bitterness." ibid., p. 564.

[312] Samson, A.: "Indonesia 1972: The Solidification of Military Control", Asian Survey, February 1973. See also Mackie, J.A.C.: "Civil-

The area of tolerated political activity by parties has been severely reduced, as has that allowed the mass of the people through demonstration and press criticism. Samson argues that "(limited) criticisms of policies was allowable (during 1972) so long as it was not sustained and did not focus on prominent ABRI or governmental figures."[313]

Possibly the greatest limitation of political freedom has occurred within the trade union movement, and it is here that a large degree of overlap between 'political' and 'coercive' functions is evident. Severe coercion of unions began with the installation of the New Order government and the violent attacks on SOBSI, the PKI-affiliated federation of unions — the largest in Indonesia. Under military rule, the labor laws have been mainly concerned with transforming the nature of trade unions, from organisations concerned with what were called narrow sectional interests of social classes, to their incorporation into the "national aim" of development and unity. Under this ideology the unions transform "from organisations of workers into organisations of 'functionaries within the economy' whose relationship to owners and managers of capital is one of 'partnership' in a 'family life' to achieve the same goal — economic 'development'. Conflicting interests are subordinated or, more often, dismissed as non-existent."[314] This reorganisation of trade unions has occurred concurrently with the fusion and simplification not only of political parties, but of peasant organisations as well. The political process is arguably one of the deliberate political disorganisation of the dominated classes in order to consolidate and extend political power.

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[312](cont.) Military Relations in the 1971 Elections in Indonesia" in Australian Outlook, December 1970, Vol. 24, No. 3.

[313]ibid., pp. 128-129.

[314]Capuzzi, E.: "Trade Unions under the New Order" in Taylor, J., et. al., Repression and Exploitation in Indonesia, Spokesman Books, London, 1974, p. 35.

The maintenance of that power not only depends on the control of opponents within the political arena, but as well relies upon the maintenance of territorial unity and legitimacy.[315] The necessity of sustaining a large army may well put high costs on the economy,[316] but the exigencies of the economic and political situation demand that regional unrest be kept at a minimum. The coercive function of the state may be correctly identified as an extension of the political since it is the major role of the armed forces to maintain domestic order and control social unrest.[317] The tragic case of Timor, invaded by Indonesian troops on December 7, 1975, is the most recent example of the necessity for territorial unity and legitimacy; the presence of 4000 Indonesian troops in West Irian also demonstrates the point. Furthermore the state's monopoly on coercion serves to control social unrest through the repression of union activity and peasant organisations, the continued existence of large numbers of untried political prisoners, the ostentatious displays of military power in key cities and the little-documented activities of the Kopkamtib and the other security organisations. It should not be forgotten that the establishment of the New Order government was preceded by a massacre of immense proportions, the purge lasting

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[315]Feith and Lev argued that by 1963 "...the army [was]...far stronger and more united than it was in 1958, and with major increases in the size of the navy and air force, it seems that Indonesia's territorial integrity is far more firmly established than in pre-rebellion days." Feith, H. and Lev, D.S.: "The End of the Indonesian Rebellion" in Pacific Affairs, op. cit., p. 46.

[316]Because a proportion of funds for the army is raised by 'unconventional' or non-budget-allocated means, it is difficult to arrive at any figures that accurately depict the cost of the armed forces. Yet Crouch maintains that the government allocation for defence and security covered only about one-third to one-half of actual expenditure. The true amount has never been publicly revealed. Crouch, op. cit., p. 524.

[317]This is borne out by the claim in Tempo that "there is the explicit condition that Australian and American military aid may be used only to maintain domestic order and may not be used against foreign countries." Tempo, October 25, 1975, quoted by L. Siegel, "Arming Indonesia", Pacific Research and World Empire Telegram, Vol. VII, No. 1, 1975.

from October 1965 to April 1966. Political control began with the physical elimination of large numbers of opponents, and has been continued through what appears to be a reasonably efficient policy designed to reduce and contain all opposition to the regime through whatever means necessary.

The final function performed by the post-colonial state is an ideological one. Capuzzi argues for a corporate ideology that asserts the primacy of 'national unity' for the 'national aim' of economic development through foreign capital investment.[318] The role of the armed forces in this is paramount; it has two functions (dwi fungsi), military and civilian, and through the execution of those presents itself as the legitimate sole force in Indonesian society capable of leading a sustained movement toward "economic development". Opposition to this goal is portrayed as divisive, sometimes treasonous and popular demonstration, trade union, Islamic and party activity has been severely contained within the corporate ideology. To reduce at least publicly, the heavy military overtone of the New Order government, the establishment of the Western-trained technocrats within the state apparatus has been important. The plethora of public statements decrying corruption and luxury consumption and the establishment of the Committee of Four on Corruption have served it appears, not their proposed objectives but instead have operated in an ideological sense to give the impression of government concern and accountability to the people. Yet such official concern is one aspect of an ideological commitment to the spread of the capitalist mode of production as the dominant mode of production; this of course requires the continuing reinvestment of economic surplus and an honest, efficient and modern bureaucratic apparatus. It appears that the government is in important ways restricted in its capacity to effect the type of changes

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[318] Capuzzi, _op. cit._.

necessary for the spread of capitalism to Indonesia. In this sense it is a progressive force that is restricted and demonstrably one that may well be generating contradictions that it eventually will not be able, as it has done in the past, to successfully control.

CHAPTER THREE

INTRODUCTION

The objectives of this third chapter are twofold. The first task is to examine both the general and specific reasons for the growth of direct private investment in the Indonesian economy by Australian firms. To achieve this, some examination of the present condition of the Australian manufacturing sector is warranted and as well the presentation of the results of field work which covered this area. To complete this first section of the chapter a brief outline of corporate strategy and Australian government policy on investment abroad is offered; the latter indicates clearly the importance of the state in the promotion of this recent and increasingly important phenomenon.

The second part of the chapter presents in detail the activities of the Australian companies in Indonesia's light manufacturing sector. For convenience they are divided into four separate sections, all of which deal with issues central to the problems of poor country development, as identified in Chapter One. It is not the objective of this chapter, however, to make comment on the implications of the facts thus presented...only to offer them in detail. It is the task of the final chapter to evaluate critically the effects that the set of Australian investments examined had on the Indonesian economy.

CONTENTS

PREFACE

The purpose of the survey was to compile data concerning various aspects of fifteen Australian direct investments through joint-venture arrangements in Jakarta, Indonesia, and as well to seek more general information on the economy by interview with government and semi-government bodies. All investments were undertaken in the light manufacturing sector and include the total population of Australian companies investing in the manufacturing sector in Jakarta to September 1975. To the author's most recent knowledge, there is only one other implemented investment outside the Jakarta area, undertaken by Wormalds International in Surabaya.

The material acquired has been used in the following chapters to describe the various activities of the companies, and to make comment on the prevailing presumption made by mainstream economists that foreign capital invested in poor countries assists, indeed is vital too, their economic development and sustained industrial growth. This issue has been discussed at length in Chapter One. All enquiries sought to obtain information which would demonstrate not only the dependence on Australian products and technology that was engendered by the investments, but as well which would illustrate the specific type of capitalist growth that is at present occurring in Indonesia. To achieve this four major areas were examined: the import-substitution nature of the investments; the character and function of divisions within the labor force; the origin and nature of the technology employed and its effect on the type and volume of employment generated by the investments; the character and role of the local joint-venture partners. Although each of the four areas has been dealt with separately for convenience, it must be emphasised that together they do imply a conception of economic analysis in opposition to that adopted by mainstream economists. Overall the research was directed towards enquiries that sought to demonstrate not only the lack of suitability of private foreign investment as an agent for development in Indonesia, but as well its inherent incapacity to assist the growth of autonomous, self-sustaining industrial growth in that country.

Before survey methods are presented some definition of terminology is required.

Notes on the Usage of Terminology

Direct investment refers to investment that is followed by the actual setting up of (e.g.) a factory in order to produce commodities.

Joint-venture: A company that has formed as a result of equity participation from foreign and indigenous capitalists. In Indonesia a joint-venture is formed when two or more parties, one of whom must be an Indonesian corporate entity, the other(s) a foreign corporate entity, agree to form a company under Indonesian law, in which each partner contributes a share of the equity.

Capital to labor ratio: Given a certain technology there is a certain quantity of labor that a piece of capital good may accommodate if worked to full capacity.

Total cost to production includes the following items: Direct costs (direct labor, raw materials and components, fuel, direct factory overheads); Indirect costs (fixed manufacturing costs, administrative expenditure, distribution costs, debt servicing, depreciation, technical and managerial fees).

Return on invested capital or "pay-back" time refers to the time needed for the cumulative expenditure to be exactly balanced by cumulative income. It is a rough, crude and ready index, measured in time. It is also referred to as the "break even" point. A more accurate measure is "return on investment",

$$\left(\frac{\text{net income in specified years} \cdot 100}{\text{total cumulative investment}} \right),$$

but unfortunately since the numerator was not always made available on interview, such precise calculations were not possible. See Allen, D.H., The Economic Evaluation of Projects, The Institute of Chemical Engineers, London, 1972, for detailed information on various methods of economic evaluation.

Unless otherwise indicated dollars indicate Australian dollars.

Notes on the Method

The survey was concerned with some fifteen direct investments by Australian and Australian-based companies; twelve of these were licensed to manufacture with the Department of Basic and Light Industry, two with the Department of Chemical Industries and one with the Department of Health. Of these fifteen, fourteen were operational, and one at a pre-operational stage, when the survey was conducted. The latter was due to commence commercial production by January 1976.

There are a large number of other Australian-based investments in light manufacturing as well as several other planned direct Australian investments, but they have been excluded for the following reasons. The current economic climate in Australia has deterred several Australian-owned companies from pursuing their investment intentions at this stage; others are marking time, neither wishing to withdraw completely nor to press on with negotiations. These companies represented possible intended investments only, and for this reason are excluded from the survey, except where interviews with them lead to useful information regarding reasons for their possible withdrawal or indefinite postponement of plans. Other Australian-owned companies have been almost totally excluded because they are still at the pre-investment, or "Form B" stage[1]; negotiations over particulars of Form B may take from between six months to two years to complete satisfactorily. Interviews with several of these companies were undertaken to obtain information about current investment difficulties, but the primary concern was with implemented investments. A large group of Australian-based foreign-owned companies have also invested in Indonesia; they include companies like Philip Morris, Amatil, Comalco, Coca-Cola, Ford and Philips; some are one hundred per cent foreign-owned, others offer ten per cent (not often) of their share issue to the Australian public. They therefore remain subsidiaries of the foreign parent company. For this reason they were excluded from the survey.

Of the fifteen companies considered, some have a substantial proportion of foreign ownership. One only has majority overseas ownership, but was included because forty per cent of the company is Australian-owned, the company retains totally Australian management and the Indonesian investment was promoted and achieved totally by the Australian subsidiary. Six other companies had a significant but not majority foreign ownership, by British and American interests. The remainder were wholly owned Australian firms, all but one being a public-listed company. Table A indicates implemented investments in Indonesia by the fifteen firms.

The Jakarta area was the predetermined location because all but one implemented Australian investment in manufacturing is situated there; the author was also interested in other areas of Australian investment,

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[1]Form B is the second form which potential foreign investors must submit to the Indonesian government. The form is more like a small book, and may take many months to prepare, after which forty copies must be made. The completed form must be written in English.

but their geographical location would have made the task extremely time consuming and difficult to undertake. Furthermore, travel to any area outside Jakarta to undertake the research would have required extensive administrative procedure, and the issuance of formal permits by the Department of the Interior.

The manufacturing sector was chosen for several reasons: the difficulties of pursuing research into other areas, like mining or oil exploration, have been noted above. Not the least important is the fact that whilst total Australian investment is small in comparison with Japanese, American or Hong Kong/Singapore-based investments, in the manufacturing sector it is disproportionately well represented in relation to Australia's total investment in Indonesia, and in relation to the national composition of investments in the manufacturing sector. In addition, the strategy of industrialisation at present employed in Indonesia, is import-substitution. As discussed in Chapter One, various reports by leading international institutions have indicated the serious problems that emerge from such a strategy. This research is aimed, in part, to examine the particular effects that the combination of foreign investment and import-substitution produced. A further incentive to concentrate on this sector of industry resulted from the consideration that whilst the leading sectors for foreign investment are resource-extractive, investment in manufacturing has nevertheless been significant, especially since 1971. Manufacturing projects have a high rate of implementation, and a much lower gestation period than larger, more capital-intensive investments. Government policy allocates an increasingly important role in future years to manufacturing, which already increased its contribution to G.D.P. from 8.3 per cent in 1965 to 9.2 per cent in 1969.[2] Its importance is seen to lie in its ability to create

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[2]E.I.U. Annual Supplement 1970, quoting from UN Statistical Year Book of Asia and the Far East, 1970.

more employment than investments in the resource-extraction sectors have been able to do, to eventually increase Indonesia's domestic production of manufactured and semi-manufactured goods, with view to eventual export, to reduce the foreign exchange cost of industrialisation and lay the foundations for sustained industrial growth.

The procedure followed in the research was conducted in two stages. Firstly a printed questionnaire was sent, with a letter of introduction, to the various parent companies in Australia. Interviews were subsequently made with all but one company, whose main office was located in Brisbane. Interviews were conducted with either the general manager of the firm, the senior executive in charge of overseas investments, or the export manager. In this way, basic information was gathered, and introductions to the parent firm's expatriate general manager of the joint-venture company were obtained. Letters were sent to Jakarta informing companies of the direction of research and supplying them with an outline of a second questionnaire; after arrival, the firms were contacted and appointments made. Interviews were conducted on factory site or at the city office of the firm, and sufficient data was compiled of their various activities. Other interviews with bank and government officials were also conducted and invaluable information was obtained in informal discussions with a variety of members from the foreign business community. This field work was conducted in Jakarta from 25 May to 14 September 1975.

The response to the questionnaire was not uniform. Both in Australia and Indonesia all companies cooperated by granting interviews, but the amount of information acquired varied from firm to firm. Most parent companies offered the minimum requested information and many offered more, but in Indonesia there was a much greater reticence on the part of several firms to answer certain questions specifically. These delicate areas were usually concerned with structure of costs, the financial structure of the company, and the identity and role of the local joint-venture partner. Generally, however, the amount of information forthcoming was in sufficient quantity for evaluations of every aspect of enquiry to be made.

The two questionnaires used are printed below. The first was that directed to the parent company, the second to the joint-venture company. The survey covered a range of manufacturing activities which may be divided into production goods and consumer goods manufacture. Production goods are those not directly usable by the consumer but form part of a finished product, or assist in its manufacture. Consumption goods on the other hand are directly available for purchase by the consumer. The table below shows the product division.

<u>Consumption Goods</u> (5)	<u>Production Goods</u> (10)
Inks	Pails and drums
Shoepolish, household disinfectant and insecticides	Asbestos cement building materials
Collapsible aluminium tube	Refined lead ingots and lead alloys
Sweetened condensed milk and other reconstituted dairy products	Cast iron pipe fittings
Pharmaceuticals	*Bright wire and reinforcing mesh *Wall and roof cladding
	Industrial gases
	Concrete tiles, blocks and pipes
	Readymix concrete
	Steel louvres
	Glass bottles

* Produced by the one company

I. QUESTIONNAIRE SENT TO THE PARENT COMPANY IN ADVANCE OF INTERVIEW

Questions to be directed to the company in relation to research conducted for a Ph.D. thesis in politics, Adelaide University. All written work to respect the anonymity of individual companies cooperating in this research. Companies researched include Australian-owned and partly Australian-owned concerns.

1. Ownership of Company
   a. Foreign company (%)
   b. Australian company (%)
   c. Public-listed shares (%)

2. Overseas Operations of the Company
   a. Countries involved
   b. Duration of investment and/or trade
   c. Wholly owned subsidiaries or joint-ventures (please give relevant detail for individual countries)
   d. Products manufactured, assembled, or exported

3. The Decision to Invest in Indonesia

   Reasons:
   a. Company-related factors (e.g., to protect or expand markets, to foster growth by expansion)
   b. External-related factors:
      i) Conditions within the Australian economy; state specific factors (e.g., labor costs, saturated markets)
      ii) Policy of the Indonesian government on foreign investment
      iii) Existence of adequate insurance through EPIC
      iv) Other (specify)
   c. Why choose the joint-venture as the vehicle of investment?

4. a. Australian government policy on overseas investment; company attitude
   b. Indonesian government policy toward foreign investment; company attitude

5. a. Expected return on capital, within how many years?
   b. Policy on repatriation of capital or its reinvestment

6. Parent company's role in the choice of technology to be employed by the joint-venture

II. QUESTIONNAIRE USED DURING INTERVIEW IN JAKARTA

A. THE INVESTMENT

1. Prior to the investment did the parent company engage in trade with Indonesia?
2. When were initial enquiries concerning investment possibilities begun?
3. When were Form A, Form B submitted for approval?
4. When was official permission to invest given?
5. Time taken from date of approval to commencement of production
6. Amount of capital approved and additional capital approved (with allowance)
7. Ratio of foreign to local equity approved?
8. Amount of capital invested to March 1975 and plans for additional capital expenditure
9. How much of the original approved capital was in the form of imports of capital equipment
10. Under what Indonesian government department is the joint-venture operating?

B. THE PRODUCTION UNIT

1. Prior to Present Ownership
   a. Was the joint-venture undertaken by buying into a previously existing company?
   b. If so, what did this company produce and who owned it?
2. The Product
   a. Nature of the products manufactured
   b. Who constitute the market?
   c. Who undertakes marketing and distribution for the joint-venture company?
3. Production Inputs
   a. Source of raw materials and conditions of entry
   b. Source of component parts and conditions of entry
   c. Is there a supply agreement with the parent company in Australia?
4. Capital Structure
   a. Give approximate breakdown between fixed and working capital
   b. Give ratio of equity to loan capital
   c. Indicate source of working capital (i.e., loans from banks, and funds, issued shares, DICS)
   d. Value of capital equipment initially imported to commence production
   e. Value of capital equipment subsequently imported

5. Structure of Production Costs

Value of output

Value of wages

Costs of raw materials

Overheads

Technical fees and royalties

What share of profits is repatriated, how much is reinvested?

Relative attractiveness of the special investment allowance (deduction from gross income of twenty per cent of the amount of additional capital invested, spread evenly, over four years)

C. STRUCTURE OF THE COMPANY

1. Equity

a. Present ratio of local to foreign equity

b. Company policy and government regulations pertaining to the equity structure

2. Formal Decision-making Structure

a. The Board of Supervisors; who constitute this Board and what is its function?

b. The Board of Directors; who constitute this Board, what is its function and how is its composition changed?

3. Management

a. What are the arrangements in the management contract for the Australian partners?

D. LAND

1. From whom were the leasehold rights to the land acquired?

2. Why was this particular site chosen?

3. Who negotiated the purchase for the company?

E. COMPETITION

1. Companies producing the same or similar goods in Indonesia

2. Indicate whether these companies are local or foreign

3. Competition from imports, legal or illegal

4. Is the joint-venture producing in areas of industry now closed to further foreign investment as decreed by the Department of Basic and Light Industries?

5. Did the company ask for protection from the Indonesian government?

F. TECHNOLOGY

1. What factors affected the parent company's decision to install the equipment now in use?
Cost of alternative technology considered? Feasibility study done? Quality control? Familiarity with equipment.
Importance of the following:

Technical regulations – duty free import with favourable exchange rate, use of DO, DK of funds, accelerated depreciation on all depreciable property but not intangible assets, investment allowances

2. What is the Nature of the Technology?

   a. Basic, intermediate or final

   b. Single or multiple product operation

   c. Simple or complex product

   d. Simple or complex process (single or multiple process)

   e. Capital costs of maintaining the equipment

G. LABOR

1. Labor employed with breakdown of unskilled to professional
2. What is the number of expatriates, their position in the company? When are they to be repatriated?
3. Number of Indonesians employed at executive or professional level
4. On what contractual basis are skilled, semi and unskilled hired?
5. Is there a company-based union formed or in the process of formation?
6. Does the company find the labor laws restrictive in any way?
7. Does the company pay higher wages to its workers than local companies?
8. How important are stipulated wage rates penalty rates, a burden to the company?

H. TRAINING

1. Present facilities for training professional and skilled staff
2. Future plans for training

I. INDONESIAN GOVERNMENT POLICY

1. Any particular legislation or regulation that have been noticeably restricting
2. Does the Indonesian government respect the investment contract provisions?

J. FUTURE PLANS OF THE PARENT COMPANY IN INDONESIA

K. JOINT-VENTURE PARTNER

1. Prior occupation and status of the partner
2. Business interests of the partner
3. Racial origin of the partner
4. Function of the partner in the joint-venture company
5. Equity contribution of the partner

Table A

IMPLEMENTED AUSTRALIAN INVESTMENTS IN INDONESIA IN MANUFACTURING IN JAKARTA

CONSUMPTION-GOODS INDUSTRIES (5)

Parent Company	Ownership of Parent Company	Joint-Venture Company and Equity Participation	Goods Produced Currently†	Licensed under Department of
Australian Dairy Corp./ Asia Dairies (Hong Kong) Ltd. (holding company and subsidiary of the former) (ADC/AD)	ADC: statutory body (semi-governmental) AD 100% ADC	P.T.* Indomilk ADC/AD . . 60% P.T. Marisons . . 40%	sweetened condensed milk, recombined butter, pasteurised liquid milk ice cream mix	Light Industries
Impact International Pty. Ltd. (Impact International)	80% privately-owned in Australia. 20% Alcoa (US)	P.T. Impact International. Impact International . 60% Private Indonesian citizen . . 40%	collapsible tube, zinc battery cans	Light Industries
Kiwi International Pty. Ltd. [Kiwi (Aust.)]	100% public listed in Australia	P.T. Kiwi Indonesia Kiwi (Aust.) . . 80% P.T. "999" . . 20%	shoe polish floor polish insecticides general household cleaning products	Light Industries
Nicholas Pty. Ltd. (Nicholas)	100% public listed in Australia	P.T. Nicholas Laboratories Indonesia. Nicholas . 90% Private Indonesian citizen . . 10%	pharmaceuticals	Light Industries
Sydney Cooke Chemicals (Sydney Cooke)	38% Inmont (US). 62% public listed in Australia	P.T. Sydney Cooke Indonesia. Sydney Cooke . . 75% Indra Chemicals . . 25%	printing inks	Light Industries

† Many of the companies have licenses to manufacture a variety of products in the future, but these were not included since we are concerned with current operations only.

* P.T. refers to Perosuan Terban, or "public limited company".

Table A cont.

PRODUCTION-GOODS INDUSTRIES (10)

Parent Company	Ownership of Parent Company	Joint-Venture Company and Equity Participation	Goods Produced Currently†	Licensed under Department of
Blue Metal Industries (CSR/BMI)/ Resource Industries Asia (holding company for CSR/BMI group) (BMI/RIA)	BMI: 15% CSR, rest public listed in Australia. (CSR 100% public listed in Australia)/ RIA: 60% BMI, 40% CSR	P.T. Jaya Ready Mix. BMI/RIA . 75% P.T. Pembangunan Ibu Kota Jakarta Raya . . 25%	ready-mixed concrete	Light Industries
Commonwealth Industrial Gases (CIG)	60% British Oxygen (UK) 40% public listed in Australia	P.T. Industrial Gases Indonesia (P.T. IGI) CIG . . . 65% P.T. Ineka Gas Industry . 35%	industrial gases	Chemical Industries
Concrete Industries (Monier) Australia Ltd. (Monier)	49.99% Redland Ltd. (UK) 50.01% public listed in Australia	P.T. Monier Indonesia Monier . . 60% P.T. Lima Satu . . 40%	concrete blocks and tiles	Light Industries
Australian Consolidated Industries (ACI)	100% public listed 98% held within Australia	P.T. Kangar Consolidated PICA . . 14.5% ACI . . 35.5% Owen(US) 20.0% Singapore Glass Manufacturers . . 15.0% Private Indonesian citizen . . 15.0%	glass bottles and containers	Chemical Industries
Guthrie Aust./ Chris, Turner & Scott (Guthrie/CTS)	Guthrie: 100% Guthrie (UK) CTS: 26% Guthrie Aust.: rest privately owned in Australia	P.T. Stormline Indonesia Guthrie . 20% CTS . . . 40% P.T. Sumber Selatan . 40%	metal fabricated building material (louvres)	Light Industries

Table A cont.

PRODUCTION-GOODS INDUSTRIES cont.

Parent Company	Ownership of Parent Company	Joint-Venture Company and Equity Participation	Goods Produced Currently*	Licensed under Department of
James Hardie	100% public listed in Australia (with large family shareholding)	P.T. Harflex Indonesia James Hardies . . 75% P.T. Karyra Jasa . . . 25%	asbestos cement building materials	Light Industries
John Lysaghts/ Australian Reinforced Concrete Ltd. (JL/ARC)	John Lysaghts: 50% Guest, Keen and Nettlefold (UK), 50% BHP ARC: 31.3% BHP, rest public listed in Australia	P.T. BRC Lysaght Indonesia JL/ARC . . 90% P.T.Freysinnet . . 10%	bright wire and wire mesh, steel roofing wall and cladding	Light Industries
Rheem Australia Pty. Ltd. (Rheem)	67% BHP, rest public listed in Australia	P.T. Rheem Indonesia RHEEM . . 70% DKI . . . 30%	drums and pails (steel)	Light Industries
Simsmetal Pty. Ltd. (Simsmetal)	100% public listed in Australia	P.T. Jaya Lead Products Simsmetal 60% P.T. Pembangunan Ibu Kota Jakarta Raya . . 40%	refined lead and lead alloy	Basic Industries
Tubemakers of Australia (TMA)	43.75% BHP, British Steel Corp. and Tube Investments (UK), 43.75% BHP, 12.5% public listed shares in Australia	P.T. Bakrie Tubemakers TMA . . . 75% Bakrie Bros. . . 25%	malleable cast iron pipe-fittings	Basic Industries

These ownership figures taken from the Sydney Stock Exchange Statistical Service, and some also obtained during interview.

PART ONE:

THE DIALECTICS OF EXPANSION

One of the major objectives of the thesis is an attempt to place direct Australian investment in the light manufacturing sector of the Indonesian economy within a framework broader in analysis than a purely empirical study could affect. Empirical data may not stand in isolation and simultaneously purport to establish any meaningful analysis of modern imperialism since that phenomenon involves the continuing and reciprocal interaction between foreign capital, domestic capital and the post-colonial state. To develop the analysis it is necessary to consider not only the effects of the Australian investments but also from whence and why they occurred. To ignore this is to omit a key element of the whole argument, since capital is not used for direct overseas investment due to whim, nor is it employed for such purposes by decisions peculiar to the individual firm and isolated from the rest of the domestic economy within which it operates. The individual firm may perceive the rationale for direct investment in terms of market expansion, protection or consolidation; it may consider investment behind tariff walls necessary to pre-empt potentially ruinous competition; other firms may perceive such investment in terms of securing or conserving raw material supplies. Whilst such explanations remain valid for companies in terms of their individual perceived needs, they may not be extrapolated to the economy at large or sectors therein and remain satisfactory explanations for the overall growth of direct investment by Australian companies in Indonesia. It is not sufficient to attribute to such explanations any fundamental significance; rather they should be seen as consequent phenomena of more basic economic causes derived from the particular type of capitalism that has developed in Australia. However, to ignore the individual explanations of the Australian companies themselves as irrelevant, is as misguided as attributing to them any fundamental status. They must be located within a broader framework, not accepted as either self-explanatory or sufficient cuase. Isolation and identification of specific explanations for direct foreign investment must be achieved within the framework of the contemporary condition of the Australian manufacturing sector. This will better serve the purpose of structural analysis than would a purely empirical account relying solely on the responses of individual firms.

The Australian Manufacturing Sector: A Maturation of Contradictions

The manufacturing sector of the Australian economy has, since its inception, been moving toward the maturation of basic structural problems which have resulted in part from industrial policies pursued since the second world war by the Liberal-Country Party coalition government. The ~~recently published~~ Jackson Report isolated and identified many major problems faced by the manufacturing sector and established their historical roots.[3] This report is a significant document since it clearly indicates the need within the manufacturing sector for an extensive and long-term restructuring, away from highly protected, domestically-oriented production and uneconomic usage of resources that characterises the manufacturing sector at present, to a more internationally competitive, export-oriented, skill-intensive production process, aimed at wider markets, and more effectively utilising the high degree of skill and advanced technology that characterise the Australian economy. In other words, the Jackson Report urges more effective exploitation of factor endowments of the economy and less reliance on protection of the manufacturing sector. Much of the ensuing discussion is derived from the

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[3]Report to the Prime Minister by the Committee to Advise on Policies for Manufacturing Industry, Policies for the Development of Manufacturing Industry, a Green Paper, Volume 1, Australian Government Publishing Service, Canberra, 1975. [Hereafter cited Jackson Report.]

report, which has as its basic premise the following statement:

> Australian manufacturing industry is in an acute financial crisis. Unemployment is high, factories are running below capacity. Many firms have borrowed to the hilt...their profit record and prospects make it hard to raise equity. But their need for cash increases, to finance stocks that are slow to sell and that cost more because of inflation. Some firms are in serious financial trouble; some are closing....In part, manufacturing problems are manifestations of the world economic crisis in which all countries, including Australia, are enmeshed. But in Australian manufacturing there is a deep-seated and long-standing malaise. That malaise has been sharpened by the impact on industry of the current economic crisis. _When it passes the malaise of manufacturing will still be there_. (Jackson Report, page 1. Emphasis added.)

The historical causes of the malaise are identified as the import-substitution policies implemented to promote industrialisation, with the consequent high level of protection ensured by tariff and non-tariff barriers. This industrialisation strategy involved "deliberate policies of import-substitution, immigration, fixed exchange rates and capital inflow." (_ibid_.) As the main instrument of strategy the tariff structure was complicated and comprised various components; its growth was characterised by an ad hoc approach, with tariff rates "made-to-measure" for individual firms rather than being determined by reference to an overall plan of import control and regulation. The result was an enormous range of protection, with large segments of industry unreviewed for decades and enjoying protection of highly inefficient production. Import replacement sought to reduce the foreign exchange content of industrialisation at a time of chronic shortage, fostered a huge demand for semi- and unskilled labor at a time of large-scale immigration and looked to the small and fragmented domestic market which would eventually reach saturation or near-saturation point. Clearly objective economic conditions within Australia have changed since then. Furthermore, import replacement resulted in the development and promotion of industries that became increasingly inefficient and unable to compete successfully on world markets. A CEDA forum in 1968 noted that the structure of domestic industry presented problems which hampered export efforts.[4] It stressed that the geographically dispersed nature and small size of industries with excess capacity had resulted in a limited industrial maturity — a limited potential for growth due to innate structural problems and lack of coordinated government policy. Furthermore, the forum contended that the allocation of protection was more a function of political influence in Canberra than of any concerted industrial plan to foster long-term healthy growth of the economy. An Ecosen study supported these views with findings from a more-recent survey of the economy, when it contended that a

> ...large proportion of the traditional manufacturing sector in Australia...is using scarce financial, entrepreneurial and human resources to pursue activities which are probably inappropriate for advanced economies with small labor forces, high labor costs and limited home markets...in the presence of other pressures for increasing efficiency, the investment argument must help rather than hinder the political forces favouring economic rationality over protected production.[5]

An important study by the OECD in 1972 involved a detailed and highly critical examination of the Australian economy which was clearly echoed in the Jackson Report[6], and their more recent report of May 1975 commented that the tariff protection "...(combined) with factors such as

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[4]CEDA: Australian Trade Prospects in South East Asia, Forum, Supplementary Paper 14, Melbourne, July 1968.

[5]Ecosen (5) Draper, op. cit., Private Foreign Investment in Asean, Chapter 7, "Australians Approach to South East Asia".

[6]OECD, "Economic Survey of Australia", Paris, December 1972.

Australia's size, small population, geographical isolation, relatively large foreign investment, and market sensitive exports,...(has) contributed to creating an industrial structure in which existing resources are used with less than optimal efficiency, thus reducing industry's contribution to national wealth."[7] This report suggested the "development of industries based on the exploitation, and above all, the further processing of the natural resources which Australia possesses, encouragement of export-oriented industries, and the promotion of industries based on skill, innovation or design."[8]

In Australia more recently, the elements of this debate are emerging in the financial press. As argued by the "modest member of Parliament" in January 1977, the structural problems of the economy demand solutions painful to some sectors. The effects of the large increase in mineral exports on the competitive position of import competing industries result from the former's effect on the exchange rate.[9] To mitigate the effects of this large mineral expansion on the rest of the economy, especially the manufacturing sector, and to build up Australia's long-term economic strength, a countervailing expansion of overseas aid and investment is proposed. In this way, export receipts may be used to build up Australian assets abroad whilst the return on profits from such investments are viewed in time as able to reduce the mitigating effects of investment abroad.

Common to all the above mentioned reports is a highly critical attitude to the import-substitution policies pursued by the coalition

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[7] AFR, 26/11/75, "Australian Tariff Reliance seen as Damper on Resources — OECD". This article summarises the May 1975 OECD Report which involved an evaluation of Australia's industrial policy.

[8] ibid..

[9] "The Alternative is to Give Money Away", a modest Member of Parliament, AFR, 21/1/77. See also, "The Dilemma of Mineral Exports", a modest Member of Parliament, AFR, 14/1/77.

governments since the early 1950's. To varying degrees they all reiterate the ideas put forward by Little, Scott and Scitovsky in an authoritative report published by the OECD in 1970.[10] This report analyses the inbuilt limitations of the import-substitution approach to industrialisation and argues for the inevitable maturation of structural problems for economies based on this approach. Their diagnosis is based on the factors of limited domestic markets, critical thresholds, high production costs, bias against domestic agriculture, unemployment in urban centres, over-valued exchange rates, discouragement of exports, underutilised industrial capacity and ponderous administrative controls.

Clearly the Australian manufacturing sector is currently undergoing a fundamental crisis. The Jackson Report is itself a result of this crisis. Review of the tariff structure began under the Liberal government in 1971 but it was the Labor government which took office in 1972 that undertook an extensive and searching review not only of the tariff structure but of the manufacturing sector as a whole. The following passage from the Jackson Report outlines the main features of Labor government policy.

> There has been a shift in emphasis to more selective economic growth based on industries where Australia is best suited, and to considerations of quality of life and sovereignty in the control of Australian resources and activities. Evidence of the change is seen in reduced assisted migration, the screening of foreign investments and take-overs; the more selective approach to tariff assistance for high-cost activities and the related moves to provide adjustment assistance to those adversely affected...."[11]

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[10]Little, I., Scitovsky, T. and Scott, M.: Industry and Trade in Some Developing Countries, published by the Development Centre of the OECD by Oxford University Press, London, 1970.

[11]Jackson Report, op. cit., p. 34.

Furthermore the report recommends a more selective and less exclusive reliance on fiscal and monetary policies and a gradual shift toward an industrial strategy that will promote long-term growth of the economy. In January 1974 the Industries Assistance Commission (IAC) replaced the Tariff Board, and the former emphasis on inward-looking protection policies is gradually being replaced by a move toward freer trade, more selective use of the tariff, official encouragement of Australian investment overseas, all underpinned by recognition of the need to begin the restructuring of the economy. Certainly, decisions toward freer trade, like the July 1973 across-the-board tariff cut of twenty-five per cent and the revaluation of the Australian dollar have been subject to widespread criticism and substantially modified.[12] Yet the point remains that any future government must be aware of the necessity of increasing efficiency within the Australian manufacturing sector and this may not avoid substantial alteration to previous protectionist policies.[13] When an economy based on continual expansion, growth and consumption stalls, the state must intervene and attempt to redress the situation, not just with palliatives but with fundamental, often painful changes that may invoke criticism from both the representatives of capital and labor.

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[12] Recent moves by the Australian Liberal-Country Party government have included the dismemberment of the IAC for "cost-saving" reasons. AFR, 9/7/76.

[13] The present Liberal-Country Party government policy on the manufacturing sector has been recently revealed in the White Paper tabled in federal Parliament on May 24, 1977, by the Ministers for Industry and Commerce, and Business and Consumer Affairs. As reported in the press: "The federal Government has committed the manufacturing industry to gradually lower and simplified tariffs in its long awaited White Paper....But it has opted for strong reliance on temporary assistance to see needy industries through their difficulties, particularly where employment is threatened." The Australian, "Fraser to Slice Tariffs — Slowly", 25/5/77. Despite government efforts to develop a more appropriate policy on the manufacturing sector, criticism from important elements within it quickly followed the publication of the White Paper. See The Australian, 30/5/77; AFR, 30/5/77.

The existing specific conditions in the manufacturing sector have contributed greatly to the decline in the overall rate of profit within it.[14] These conditions combined with other factors, produced a situation favourable to the export of Australian capital, and the necessity of seeking new markets for the export of goods. Nicholas International, a firm long established in trade and investment overseas, clearly recognised the need for Australian manufacturers to invest abroad to protect existing markets threatened by competitive production behind tariff walls, and as well urged manufacturers to develop new markets when faced with the impending saturation of the old.[15] Nicholas International has a factory established in Jakarta as well as others throughout the southeast Asian region and the rest of the world. The company's management

> ...feels that other Australian companies will soon be forced to invest directly in Asia in order to secure growth and protect their existing markets. Australia's geographic location and good image in the area plus the rising living standards in a number of Asian countries should also stimulate increased domestic investment in Asia by Australian firms.[16]

The point to emphasise here is that internal economic conditions favour overseas investment in manufacturing by specific subsectors, in order to

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[14] Catley, R.: "Vulgar Marxism", in ARENA, No. 40, 1975. "It has now become clear that profits and investment in Australian secondary industry are declining, a process somewhat disguised by inflation and only accelerated not caused by the present very severe business cycle." p. 15. See also his Footnotes 4 and 5.

[15] As Arrighi observed: "Expansion in the periphery is usually undertaken by a foreign concern in response to protectionist policies on the part of national governments in order either to protect its own export interests, or to establish itself anew in the area. In other words, the existence of a local market for the production of the foreign concern, though a necessary condition, is not sufficient for the actual establishment of a plant." Arrighi, G.: "International Corporation, Labour Aristocracies, and Economic Development in Tropical Africa", in Rhodes, R. (ed.), "Imperialism and Underdevelopment", op. cit., p. 230.

[16] Business International/Business Asia/Hong Kong, Volume 1, p. 10. [Hereafter cited Business International.]

sustain an adequate growth rate and, of course, an acceptable rate of profit.

The point is further reinforced by the findings of a recent report on Australian corporate activities abroad.[17] The dominant factor in the decision to invest abroad was found to be a defensive one, viz. the limited size of the Australian market which was no longer capable of absorbing the productive capacity "which was itself necessary to obtain economies of scale or maintain profitability."[18] Wider markets meant increased stability and profits with potential for earnings to grow. Furthermore overseas experience abroad placed the firms "in an advantageous position compared to its competitors in meeting a difficult and uncertain future in Australia."[19] Other factors identified by the report as contributing to overseas expansion were changing Australian government policy, diversification of risk and host country policies.

Another factor that led to the necessity of increased overseas expansion was the decline of traditional foreign markets. Britain's entry into the Common Market reduced considerably the size of Australia's foreign market and assisted to dictate the necessity of market diversification and increased foreign exchange receipts, in order to offset the decline in profits that the British market had previously ensured.[20] Furthermore, Australia in the late sixties experienced a boom situation, which combined with the existence of saturated or near-saturated markets meant that many large Australian and foreign firms generated huge cash

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[17] Australian Enterprise Overseas: A Study of Australian Experience in Corporate Foreign Investment, report compiled by students in the Masters of Business Administration Course, School of Economic and Financial Studies, Macquarie University, July 1976. [Hereafter cited Macquarie Report.]

[18] ibid., p. 33.

[19] ibid., p. 1.

[20] OECD (1972), op. cit., pp. 12, 13, Table 3.

flows and possessed markedly under-utilised human, technical and financial resources. In addition, the surplus on the national capital account has been cited in the Jackson Report as a substantial reason to encourage overseas investment. It argues "...[i]f the future tendency is to external surpluses other policies should be considered as alternatives to revaluation....If strong capital inflow is contributing to the surplus it should be reduced to the extent necessary. Possible uses for the remaining surpluses include 'buying back the factory' and the selective encouragement of Australian investment abroad."[21] In stronger terms, Business International puts the same argument: "Australia's embarrassment over its bloated international reserves has strengthened the argument for easing government restrictions on export of capital. At present official approval is restricted to direct investments that use Australian management and technical skills and preferably promote Australian export."[22]

For some companies, one factor contributing to the overseas investment decision is the existence within the domestic economy of strong competition from foreign firms operating in Australia. Neil McInnes suggested two methods that Australian companies might use to

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[21]Jackson Report, op. cit., p. 181 (original emphasis).

[22]Business International, op. cit., p. 9. See also National Times, 30/7/73, "Guarantees for Australian Investors in Indonesia Break New Ground", F. Brenchley. Brenchley argues that J.F. Cairns was a keen supporter of Labor government measures designed to stimulate overseas investment "which he saw as a positive utilisation of Australia's large balance of payments surplus." See also OECD (1972), op. cit., p. 55. The report noted the large scale capital inflow of 1970-1972, and as well the announcement by the Liberal-Country Party government in September 1972 of measures designed to restrain capital inflow. These included greater freedom for portfolio investment abroad by local residents. In conclusion the report stated: "Thus, a country in a strong a balance of payments position as Australia, even while remaining a net importer of capital, might well consider being more liberal in its treatment of overseas lending and investment by its own residents", p. 60. See also The Bulletin, March 20, 1976, "Banking 1976". This article refers to the then Prime Minister McMahon's actions of September 1972.

counter the dominance in industry by foreign capital.[23] He argued that mergers should be encouraged since "[it] is their bargaining power, their pool of managerial talent and capital that have enabled us to deal with such redoubtable partners as Esso."[24] To complement this type of action, he also urged increases in direct investment abroad by Australian companies in Southeast Asia in anticipation of the arrival of foreign investment in Australia.[25] McInnes recognised the significance of the internationalisation of production for the Australian company, recommending the export of technology through investment in Asian countries. The import of such proposals was great since it

> ...is not just something to do because it is nice to have our foreign ventures or because it is good business; it is what you *have* to do because in the age of the internationalisation of production the only thing to do with a technological advantage is export it — fast. Your neighbour is going to build such an industry sooner or later, so better get in now and help him, incidentally thereby winning future investment income and orders for capital goods, components, etc....[26]

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[23]McInnes, N.: "The Challenge to Australia of the Multinational Corporation" in AIPS, *Big Business in Australia*, Angus and Robertson, Sydney, 1970. Proceedings of the 36th Summer School.

[24]*ibid.*, p. 81. He continues: "Similarly the Japanese government is encouraging mergers in its auto industry before admitting G.M., Ford, and Chrysler. It is mainly because countries like Indonesia and Peru don't have such conglomerates that they cannot accept the big foreign investors without imagining that they are being robbed (and maybe they are). In short, you cannot efficiently deal with the international company if you hamstring your own business with mistaken imitations of the U.S. anti-trust laws", pp. 81-82.

[25]*ibid.*, p. 82. "The formation of one's own international companies is not just a sop to national pride needed to deal with the giants from abroad *but an essential part of international corporate strategy*." (Emphasis added.)

[26]*ibid.*, p. 85. Harold Bell similarly argued that "the main source of competition among large corporations is the arrival of overseas firms, though this may involve surplus capacity, especially if there is a limited export franchise." "The Large Corporation in Australia" in AIPS, *op. cit.*, p. 44.

Thus to maintain their rate of profit, or pre-empt its possible decline, companies can move to diversify both horizontally and vertically, and also to broaden their markets by overseas investment and/or trade. The latter situation is well described by Business International: "At a time when many Australian companies are targets for foreign take-over interests, an old established firm down under has remembered that the best defense is an offense."[27] David McClean has also observed that the larger Australian firms which, with their foreign counterparts, dominate strategic areas of the economy, are able partly by overseas expansion to counteract the diminution of control over the domestic market.[28]

Other factors, like increased labor costs are also major determinants of overseas investment by Australian companies, especially in a period of high inflation. The position is summarised in the following passage from one Ecosen report.

> Continual cost inflation is making the need to rationalise industry in the search for higher productivity more urgent, and thus improving some Australian...businessmen's perception and acceptance of the case for relocation of some industries in lower-cost areas by making it applicable to more industries.[29]

The Jackson Report makes only passing mention of such a possibility being applicable to Australian industry by brief reference to a report by the Economic Council of Canada[30], but by 1975 the efficacy of such a move had clearly been appreciated by other government bodies. The Senate Standing Committee on Trade observed the following:

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[27] Business International, op. cit., p. 19.

[28] McClean, D.: "Australia and the Expansion of Capitalism to Indonesia" in Review of Indonesian and Malaysian Affairs, Volume 6, July-December 1972.

[29] Ecosen (5) Draper, op. cit., p. 172.

[30] Jackson Report, op. cit., p. 150.

> It has been argued that the best kind of aid that can be offered to developing countries is the provision of markets for the products of their labour-intensive manufacturing industries. This of course, implies, for Australia, a progressive shift of labour-intensive manufacturing industries to countries like Indonesia on a joint-venture basis. This would have the object of a concurrent resolution of Indonesia's problem of widespread unemployment, and difficulties caused in Australia by rising labour costs.[31]

The growing relevance of these ideas has not been lost on some Australian businessmen and private institutions. When President of the Australian-Indonesian Business Cooperation Committee (AIBCC), John Reid, of the James Hardie group of companies, made clear his awareness of this in his opening remarks to a seminar; he argued that

> ...with rising costs and a shortage of labor in Australia, there is merit in the establishment of labor-intensive industries, assembling components for export to Australia and incorporation in Australian-made products. The first advantage is that Indonesia is able to buy raw materials competitively because of its geographical location; second the components themselves be exported to other countries as well as to Australia.[32]

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[31] _Report from the Senate Standing Committee on Industry and Trade_, Parliament of the Commonwealth of Australia, Australian Government Publishing Service, Canberra, 1975, p. 67. [Hereafter cited Senate Standing Committee Report.] The report continues: "Other developed countries, among them Japan and the U.S.A., have already embarked upon courses leading to this pattern of development. These however tend to favour low wage structure countries with a more advanced infrastructure and skilled work-force such as Singapore and Malaysia rather than Indonesia....In the long run, unless positive policies are formulated and implemented covering the problem of Australian labor-intensive industries, overseas competition is likely to enforce its own solution. There is already some evidence of Australian industry exporting high wage content operations, despite inconvenience and high transport costs." _ibid._, p. 68.

[32] AIBCC (1973), address by John Reid, p. 5.

One year later at another seminar, he reiterated this theme and urged both governments to encourage Australian companies to use Indonesia as a low-cost export base.[33] J.A. Patterson of ACI, the Australian-owned glass monopoly, also indicated his awareness of the potentials of such a strategy when he asked

> ...what will doing business in Asia be like in the future?...some signs are already clear — such as the further development of the international assembly line. This of course started when Japanese and other labor became too expensive for mere repetitive assembly work and manufacturers moved part or all of their operations to Hong Kong, Taiwan, Singapore. These places are now getting more expensive...and other countries such as Indonesia...are more favourable.[34]

Both the James Hardie group and ACI have established manufacturing plants in Indonesia.

An article by Brian Scott of W.D. Scott and Co. Pty., Ltd., identified several reasons for foreign investment, and labor costs are included. Scott argued: "Wage rates are increasing in Australia by at least eight per cent per annum: for say, a machinist this means an increase of eight dollars per week — an increase which is more than many Indonesian workers earn in a month."[35]

More recently, the financial press has printed leading articles which discuss the reasons for the growing "off-shore exodus".[36] These

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[33]AIBCC (1974), op. cit., address by John Reid.

[34]Patterson, J.A.: Doing Business in Asia, ACI Ltd. Publication, p. 2.

[35]Scott, B.: "Investment Opportunities in Indonesia", The Australian Director, May 1973, p. 37.

[36]AFR, 23/11/76, "The Off-Shore Exodus". See also AFR, 24/11/76 and 25/11/76. The Macquarie Report, op. cit., offers figures that show the increasing volume of Australian investment abroad: from 1961 to 1975, an annual growth rate of ten per cent (from $225 to $844 million) was experienced. "Since 1969, annual flows have increased in importance

articles reveal that since the late 1960's, numerous Australian firms have been obliged by the high cost of labor to establish their manufacturing plants in Southeast Asian countries. Moreover the metal trades industries expect to face within the next twelve to eighteen months a dilemma involving a choice between remaining at home and accepting a low rate of return on investment, or establishing plants with low unit cost overseas. The present estimate of between five to ten thousand jobs already exported, further reinforces the point that labor costs are an increasingly important factor in the decisions of manufacturers to invest overseas. The Macquarie Report described Australia as

> ...poised for more rapid growth in the next two decades. Indeed this may be essential for the survival of manufacturing industries, which appear to be being priced out of both domestic and world markets by rapidly increasing labour costs at home. This has resulted in some companies establishing their own manufacturing facilities overseas, while others now rely on increasing projections of imported components.[37]

It is not only the low wage rate, but the strong likelihood of a stable daily wage and the absence of industrial disputes, which Scott argued makes Indonesia an attractive place for investment.[38] Clearly

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[36](cont.) from around five to ten per cent of the total flow to forty-four per cent" (p. 26). The report noted the strong growth rate in Pacific Basin and "other" countries (which includes Hong Kong, Malaysia, Singapore and Indonesia). It also observed that Australian investment was moving away from traditional areas like the U.K., Papua-New Guinea and New Zealand, and being channelled into Pacific Basin countries (p. 26).

[37]*ibid.*, p. 19.

[38]The cost of labor in Indonesia according to the Australian Department of Overseas Trade is listed below.

Wages	Unskilled	\$0.60 - \$0.80	per day
	Skilled	\$1.00 - \$1.20	per day
	Supervisor	\$1.00 - \$1.50	per day
	Mechanic	\$1.80	per day
	Engineer	\$200 - \$300	per month

Figures given in *Some Legal Restrictions on Trade and Investment in Indonesia*, Department of Overseas Trade, Canberra, 1974.

rising labor costs in Australia are an important but not dominant factor in the decision to invest overseas. However, the concern of this chapter is to locate specific factors within a wider analysis, having as its foundation the specific type of capitalism that has developed in Australia. At present the economy is marked by high inflation, rising labor costs, increased indebtedness of many firms, all leading to a decline in the rate of profit, especially in the vulnerable manufacturing sector: as the Jackson Report noted, "the long-term adverse trends in profitability, liquidity and debt structure...."[39]

In addition to these above mentioned economic factors that determine investment decisions, less specific but nevertheless important political considerations should not be neglected. In the early years following the second world war, Australia's political and economic involvement in the Southeast Asian region was minimal, but as Mortimer has argued, grew under the influence of United States' government pressure. He proposed that

> (the) U.S. was anxious to involve its trusted Pacific allies in the execution of its imperial duties through agencies such as SEATO, an approach which called for some closer acquaintance with South East Asian affairs on Australia's part. At the same time senior Australian ministers and administrators recognised that beneath the American umbrella a small but industrialised country might hope to play some role of its own in shaping flimsy South East Asian political structures and establishing a degree of economic influence in the area.[40]

In recent years growing trading links with Southeast Asia, but more particularly with Japan, have increased the realisation among

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[39] Jackson Report, op. cit., p. 78.

[40] Mortimer, R.: Australia's Liberal Impasse: Bastard Offspring of Racially Pure Unions, unpublished paper, Melbourne, p. 3.

Australians that geographically their country is part of Asia. As one of the strongest and most advanced nations of the region, it is inevitable that, in respect of economic and political considerations, Australia's future is bound with Asia's. In military matters also, the region remains an essential ingredient in any calculations concerning Australia's future. Indonesia has become important as a strong "anti-communist" ally since the recent victory of the Indo-Chinese people over foreign occupation and invasion led to the establishment of an independent Indo-China. Moreover as Catley and McFarlane have argued, the decline of U.S. imperialism in the Southeast Asian region has opened up some further opportunities for Australian penetration.[41]

Conditions external to the Australian economy have enhanced the desirability of direct foreign investment; any notion of economic independence rather than interdependence must be abandoned, since Australia's economic future is determined in ways that successive governments are often unable to foresee or control. Australia is not the only industrialised country to experience such domestic and external pressures promoting direct investment, and increased trade abroad. These pressures reflect a qualitative shift in the nature of the production processes in industrialised and semi-industrialised nations. Discussion in Chapter One argued for the existence of such a change, and it is clear that the findings of the Jackson and other cited reports, justify the location of Australian investment overseas within a framework of analysis that includes such considerations.

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[41]Catley, R. and McFarlane, B.: "Australia, Multinational Corporations and the Pacific Rim Strategy" in Kapitalistate 3/75, pp. 99-100. The authors argue that successive governments, in particular the Australian Labor Party government of 1972-75, have sought to promote Australia as a regional base, for investments in Southeast Asia, a 'springboard' from which both Australian and multinational companies based in Australia, could increase their penetration of the markets of the region.

The Specifics of Expansion

Whereas the preceding pages were concerned with the generalities of expansion, it is necessary at this point of the analysis to examine specific and individual reasons for investment and to see how each company involved in the survey explained their investment decision. In keeping with the concern to locate specific phenomena within an analytical framework however, some mention must be made of the specifics of the Australian manufacturing industry. The Jackson Report noted the clear division within the sector between the top two hundred companies which dominated strategic capital-intensive industries (steel, non-ferrous metals, chemicals, petroleum refining, automobile manufacture) and the remaining 30,189 companies, the majority of which were small and engaged in the production of non-strategic items (clothing, footwear, wood and wood products, fabricated metal products).[42] Of these largest two hundred companies, eighty-seven are foreign controlled, and sixty-eight have more than fifty per cent of shares held by foreign shareholders. The eighty-seven foreign controlled firms account for forty-five per cent of total value added by the top two hundred firms, and have invested in strategically important capital-intensive industries, and in the highly protected manufacturing sector maintain a dominant position. These top two hundred firms account for some fifty per cent of total manufacturing value added (1972-1973 figures), employ forty-four per cent of the workforce and account for sixty-one per cent of fixed capital expenditure (1971-1972 figures). The report noted that the relative size of these two hundred firms brought them significant competitive advantages, and enabled them to exert considerable indirect influence on smaller firms in

[42]"Of 32,291 firms engaged in manufacturing in 1968-69, 30,399 of them employed fewer than 100 people." Jackson Report, op. cit., p. 93. The additional figures given in the following section are taken from this section of the Jackson Report.

the same industries and over suppliers through their pricing and investment decisions their general competitive capability.[43]

The parent firms of the Australian-Indonesian joint-venture companies comprised many well known and established companies engaged in a wide area of activity, from resource-extraction and processing, to sophisticated manufacture. Many operated in a virtually monopolistic or oligopolistic market situation within Australia, and included firms like BHP, ACI, CIG, Sims, Tubemakers of Australia, Concrete Industries (Monier) Ltd., the James Hardie group of companies and the Australian Dairy Corporation (formerly Australian Dairy Board). Nine of the fifteen parent firms were listed amongst the one hundred largest public companies in Australia.[44] In addition some have numerous joint-venture agreements with foreign (mainly U.S., U.K. and Japanese) firms, for resource extraction and processing or manufacture; as well a number of technical licensing agreements have been concluded by the firms with large foreign companies for either the purchase or sale of specific industrial processes or products. Several of the companies were engaged in long-established and extensive foreign trade, whilst others were at the initial stages of creating international divisions within the firm. Thirteen of the fifteen parent companies had implemented direct investments in other countries,

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[43] ibid., p. 92. See also Harold Bell in AIPS, op. cit.

[44] These are as follows: BHP (no. 1); CSR (no. 4); James Hardie (no. 25); CIG (no. 32); ACI (no. 36); Tubemakers of Australia (no. 38); Concrete Industries (Monier) Ltd. (no. 60); Sims Consolidated (no. 80); Rheem (no. 91). In addition many other firms who have also invested in Indonesia, are amongst these top one hundred public companies. They include the Bank of N.S.W. (no. 7), the A.N.Z. Bank Group (no. 11), Comalco (no. 14), Philip Morris (no. 18), AMATIL (no. 29), CBC (no. 40), Hooker (no. 55), Wormald International (no. 77). The latter company is the only Australian-owned company to implement its investment in manufacturing outside the West Java area as of September 1975. Figures given in The National Times, "100 Biggest Companies Based on Market Capitalisation and Compiled in Cooperation with the Sydney Stock Exchange Statex Service", 9-24 January 1976, p. 43.

both poor and industrialised, and of these thirteen, nine had over five such investments. Two had extensive investments throughout the world and several more the same in the Southeast Asian region. The maintenance of a key market position is assisted not only by trade and investment abroad, but by the large-scale horizontal or vertical diversification pursued by the companies, and at least five of the parent firms have undertaken a substantial diversification of their enterprises in recent years.

Preliminary field work involved enquiries (directed at the Australian parent companies) concerning their reasons for direct investment in Indonesia. Several factors emerged recurrently as important for many companies. The limited size of the domestic market had obliged at least ten of the companies to consider the investment. Several firms were quite specific on this point, indicating that an actual or potential decline in the rate of profit had obliged them to seek new markets through investment behind tariff walls. Whereas it was recognised that the market for their products in Indonesia comprised only a very small percentage of the population, it was emphasised that in Indonesia the possible rate of growth of profit was higher and the market potentially huge, compared to the limited or saturated market in Australia. In some subsectors of Australian industry a decline in the rate of profit was reflected in unused resources, underutilisation of capacity; this meant very limited potential for long-term expansion within Australia. Furthermore, within this limited market in recent years there had entered other large companies — foreign companies whose activities had significantly reduced the individual market shares of the original participants. Their competitive presence had obliged indigenous firms to expand within the domestic economy, through diversification, and to invest overseas as well; such moves increased company flexibility and assisted long-term growth.[45] The alternative to many investments was export of goods from Australia, but in many cases protective tariffs, high freight costs and the non-suitability of products for export due to size and volume, meant that it was not always a feasible alternative. Where trade preceded investment, erection of protective tariffs had obliged direct investment.

Rising labor costs featured prominently in the investment decision for three firms. Although it was not in any case the most important factor, those for whom it was a consideration clearly indicated their expectation of its growing importance in future investment decisions. One company, clear on this point, added that the firm's intention was to invest in a low cost export base and re-export to Australia as well as to third countries. This investment for re-export facilitated the achievement of economies of scale and ensured the long-term growth of the firm.

Protection of existing markets by manufacture behind tariff walls was a key factor for other firms. Companies reasoned that the market in Indonesia could not be adequately serviced or fully exploited by costly imports: direct investment both protected and serviced the market properly and opened the way for future larger investments. They considered their investment to be the best way in which to promote export of goods and sale of expertise from Australia. In one case, the Indonesian investment was but one of a series of similar investments specifically

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[45]The chairman of Petersville, Australia, described the firm's investment and licensing arrangements in the Southeast Asian region as defense by attack, since the area allowed that wider markets be found. This possibility was correctly seen as protecting the firm from the vagaries of the small, highly competitive local market. He argued that expansion overseas was a way of rejuvenating the firm, which had been regarded as a potential take-over target by large foreign (predominantly U.S.) food groups wishing to establish a foothold in the Australian market. Statement by Sir Charles McGrath, AFR, 11/2/72, p. 14.

undertaken to further the export of dairy products from Australia.[46] The dairy products industry is highly protected and subsidised and recognised as highly inefficient in most cases.[47] For seven other companies, direct investment facilitated export of components, spare parts, semi-finished goods and raw materials. A cursory glance at figures pertaining to the value of Australian exports to Indonesia reveals a market increase in the export of goods necessary to production rather than consumption activities. Especially noticeable in terms of the rate of increase as well as absolute size of increase are those commodities classified under metals, machinery, transport equipment, metal manufactures, chemical

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[46]As Tony Webster, Chairman of the Australian Dairy Corporation observed: "We are an industry historically geared to export." AFR, 2/2/76. This article clearly outlines the prime importance of exports to the Australian dairy industry. AFR, 5/4/76, noted that fifty thousand tonnes of skimmed milk powder for human consumption was exported to subsidiary or joint-venture companies of the Australian Dairy Corporation in Southeast Asia. A further twenty thousand tonnes is exported to Japan and ten thousand to Mexico. The rest, about half the total powder exports, is supplied for stock feed purposes. AFR, 23/3/77, "Joint Ventures Boost Dairy Sales in Asia":

> ADI (Asia Dairies Industries) had its nemesis in the early 1960's after the Australian processed milk industry had failed over the years to gain other than a very minor share of the processed milk market in South-East Asia.
>
> The basic purpose of forming ADI was to secure market for Australian dairy products in South-East Asia with the closing of the European Economic Community market.
>
> In order to stimulate supply to countries which had hitherto imported sweet condensed milk, joint-venture recombining (or processing) plants were established to utilise Australian raw materials in the local production of sweetened condensed milk. (p. 26)

[47]AFR, 24/6/76, reported Mr. D. Anthony, the then Acting Prime Minister, as saying that there "...is a pressing need for the industry to begin to operate as a cohesive industry in which all sectors of the market and the industry are integrated." See also AFR, 12/5/76, for details of federal government scheme to underwrite the equalisation value of skimmed milk powder and thus offer short-term support for the ailing industry. See also AFR, 27/4/76, "Chanticleer" column for further detail of federal government support of the dairy industry.

elements and compounds and chemical materials and products.[48] These trade figures not only indicate the importance of increasing trade in non-consumption commodities, but when considered together with the above information, concerning the links between investment and trade, serve as well to illustrate the growing importance of trade-oriented investments. In three further cases the sale of expertise, either management or technical, was considered important. Seven firms had, prior to their Indonesian investment, an established network of investments in the Southeast Asian region, and considered their most recent addition a logical step in the expansion of overseas activities.

Clearly a variety of reasons for investment, in differing combinations and with differing importance, existed for these fifteen companies. The combination peculiar to each company was a result of prior experience, present status, and economic conditions, both internationally and domestically. In only a few cases did the firm pinpoint specifically the reason for the investment decision. In most cases, a mixture of reasons were offered because they had all been considered before the final decision had been made. However, evidence suggests that the limited size of the domestic market and the desire to promote the export of goods and services, are more important than other factors; the

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[48]Senate Standing Committee Report, op. cit., Table 3C. For example, the value of metalliferous ores and metal scrap rose from $4000 in 1968-69 to $337,000 in 1973-74; the value of chemical elements and compounds from $14,000 in 1966-67 through to $384,000 in 1968-69 to $1,382,000 in 1973-74; the value of iron and steel exports rose from $28,000 in 1966-67 through to $4,136,000 in 1973-74 and finished at $8,369,000 in 1974-75. For Australia's major scrap metal dealer, Sims (one of the firms investigated), the export market is the most profitable, but if all scrap steel is sold abroad a shortage in Australia would result. According to one source, Sims was forced to sell scrap to its main domestic customer, BHP, at fixed prices well below the ruling export parity price. As well as being the company's major customer for scrap metal, BHP and associate companies were the main source of supply for that company. AFR, 6/7/76.

cost of labor is identified as potentially of great importance in the near future.

The examples offered by two Australian companies who failed to pursue their direct investment in Indonesia supports this. Siddons Industries Ltd., a leading toolmaker to Australia, in recent years has suffered heavily from the competition offered by cheaper Japanese imports. The rising cost of labor in the industry had been a major factor in this. In an effort to regain their former dominance in the domestic market, the company planned an investment in Bandung, Java. From the low-cost base, products were to be re-imported back to Australia and to other Southeast Asian countries.[49] Similarly Repco, a major supplier to the Australian automobile industry, had plans to supply the Indonesian industry with parts, through investment rather than trade. High labor costs were considered a major determinant in this decision.[50] Whilst these results are limited in that they do not accord proven priority to the various determinants of direct foreign investment, they do bear directly upon the previous discussion concerning the present condition of Australia's

[49]However the plan was abandoned because an agreement concerning foreign equity and control requirements could not be reached between the company and the Indonesian government. The company had since then decided on Hong Kong as the more suitable low-cost export base, but had found the project to be more expensive than the abandoned Indonesian venture. The decision has been deferred "until the position of the home market is clarified." The Australian, Friday Notebook, 4/4/75.

[50]As a major supplier to the automobile industry the company has been adversely affected by industrial disputes and was recently obliged to lay off thousands of employees. Despite initial enthusiasm about the investment, the firm had been forced to postpone its implementation indefinitely. Interview with the export manager of Repco Australia Ltd., Melbourne, April 1975. According to the former most senior employee of the company in Indonesia, the firm experienced serious problems in Australia and recognising the serious nature of production and administrative problems in Indonesia had firmly decided not to proceed any further with the investment. Interview with Gordon Perry, former general manager of P.T. Repco Engine Parts Indonesia, and Repco's "man-in-the-field", Jakarta, 25/6/75.

manufacturing sector. In short, the peculiar structure of the domestic economy has been the major determinant in the character of these overseas investments. In other words, the major stimulus for expansion was generated, originally, from within. External factors, such as an attractive investment climate in Indonesia or declining trade with other regions must help swing the balance in favor of investment, but they will not be its primary determinants.

The peculiarities of the investment climate in the host country will, however, influence the propensity to invest in one sector in preference to another. The degree of protection offered to the foreign investor by the Indonesian government in the manufacturing sector has attracted a large amount of capital with a high implementation rate.[51] Australian companies are well represented in this sector, despite the small overall size of direct Australian investment compared to the biggest investors, Japan, America, Hong Kong and Singapore, which dominate the modern sector of the economy. As CEDA observed, "Australian investment is small by comparison with that of the U.S.A., or Japan and even below that of Singapore and Hong Kong. Yet in light industry it compares favorably with other countries even though...(its) entry was late."[52] Other favored areas of investment by Australian capital are mining (with BHP and CSR well represented), oil exploration, construction, and various types of consulting work.

Perfect accuracy concerning the amount of total Australian investment authorised but not necessarily implemented, and the number of intended projects under consideration, is not possible. Figures conflict. For example, the BKPM estimated total Australian investment from 1967-74

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[51]See Chapter Two, Section Five for details on the implementation rates of foreign investment by sector and country of origin.

[52]CEDA (S.P. 37), op. cit., p. 11.

to total $174.1 million, for forty-two projects[53]; Suhud, of the BKPM estimated at a seminar the total authorised investment at $132 million for thirty-three projects[54], whilst the Indonesian Newsletter of May 1974 notes a total investment of $50 million, but fails to specify whether this is referring to actual or intended investment.[55] If it can be accepted that the figures given by the BKPM are likely to be the most accurate, then total authorised investment in all sectors amounts to approximately $180 million.[56] This figure has been arrived at by the author after additions to the $174.1 million total have been made, based on known approvals made during 1975. Yet the reader must be reminded that this amount indicates authorised investment only, and does not assess actual or implemented investments. Implementation rates are not readily available from any known government source. However, it is known that the implementation rate is highest in the manufacturing sector and is due to the smaller average size of individual projects compared to those undertaken in other sectors, the greater short-term profitability of import-substitution manufacture and the comparatively short gestation period involved in light manufacture. Authorised direct investment by the Australian companies in the light manufacturing sector in the Jakarta area total $34,617,500 to September 1975. This figure includes three companies who received approval for investment but decided against the project. Because they received approval they must be included in the

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[53]BIES, SRD, July 1975, p. 25. See also Senate Standing Committee Report, op. cit. Table 5C, p. 54, gives a figure for 1967-75 of $175.3 million or 4.9 per cent of total foreign investment, involving some forty-three projects.

[54]Statement by Suhud, AIBCC (1974), op. cit.

[55]Indonesian Newsletter, 30/5/74.

[56]A figure of US$176.8 million was given to indicate the total number of Australian joint-ventures approved by the Indonesian government to 1976. From 1971 to 1976, the number of joint-ventures increased from eighteen to forty-five. Figures announced by Ambassador Woolcot, reported in the Indonesian Newsletter, 24/5/76.

overall figure. The implementation figure stands at $31,817,500 or ninety per cent of intended investment and represents an extremely high average when compared with other sectors.

Investment through Joint-Venture: Corporate Strategy and its Lack

In the preceding section it was established that the fifteen companies involved in the field work comprise a mixture of large Australian-owned or partially Australian-owned companies together with a number of much smaller firms. Some, like ACI, CIG, James Hardie, Sims, CSR and Monier enjoy a strong position in the domestic economy and have undergone large-scale horizontal and vertical integration in recent years. ACI is Australia's largest glass and packaging group, Sims the largest scrap metal company, CSR is effectively a sugar monopoly whilst CIG and James Hardie at present control eighty-five per cent and sixty per cent of the market for industrial gases (and related equipment) and asbestos building products respectively.[57] Monier also commands leading market share. The BHP-associated companies, John Lysaght, ARC, TMA and Rheem similarly operate from position of strength in their own right, and are assisted by the fact that their parent, or one of their parents, company is Australia's largest firm, with all the associated benefits that monopoly and oligopoly within the strategically placed steel and resource-extractive industry must inevitably bring. The remaining companies are generally smaller and engaged in production in "non-strategic" areas of the economy, food production, and consumer goods. Whilst some (like Nicholas and Kiwi) are well established firms with large foreign markets, they are not involved in areas of production of the size or

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[57]CIG dominates the market at present with only one other company (French) which operates with fifteen per cent of the market. Yet the company was aware of a potential decline in their market share due to the impending investment by a German group in association with BHP. This latter company is CIG's largest customer. AFR, 26/11/75. Data on James Hardie, in Age, 31/5/77, p. 21.

importance of the former group. To establish the identities of these companies requires not only empirical data informing the reader of their ownership, and a knowledge of their activities both domestic and foreign; it also requires the location of such data within a framework of analysis that is concerned with the structural relationship between the individual activities of firms and the condition and movement of the economy as a whole. To develop this further, and to identify the different approaches taken by firms in the substantially altered business environment of Jakarta, the corporate business strategies of the firms may now be considered.[58]

The business and investment climate of Jakarta differs vastly from that of Australia; clearly the strategy adopted by a firm to enable it to cope with unforeseen and unexpected events becomes an essential factor in determining a company's overall performance, as well as its potential for long-term profitability. Business practices that in Australia would be, or are illegal, continue in Jakarta without official interference. This does not imply that individuals within the government or the private sector are not concerned about the widespread existence of "corruption" and unorthodox practices; it merely points to the degree of independence from government interference enjoyed by different public and private groups. Such activities may be impossible to prevent or else they are suffered to continue for reasons of practicality. Indeed, it is argued that some of these practices fulfill a useful role in the economy by, for example, speeding up investment procedures or keeping the price of imported goods at a realistic level. Clearly, this situation is

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[58]Corporate business strategy refers to the general approach taken by a firm to the foreign investment, its relevance to other activities of the firm and includes an evaluation of company adaptability to a different business environment other than that experienced in Australia.

vastly different from the Australian business environment, and the reader is referred to Chapter Two for a more detailed account of business practices common in Jakarta. The appropriation of a proportion of the economic surplus generated by private foreign capital investment by individuals or groups within the apparatus of the post-colonial state is a phenomenon usually referred to as "corruption". But as explained in the previous chapter such an appropriation is one that has its roots in the predominantly pre-capitalist social formation of Indonesia. Corruption arises when the requirements of the individuals operating within this formation impinge on those of the progressive and more vigorous capitalist mode. Put simply, different modes of production appropriate surplus for different purposes.

Few foreign investors can successfully commence production without the payment of bribes or "additional fees"; nor can they continue production unless payment is made to a variety of public and private groups.[59] The latter may include gangs or the local police who demand "protection money" in return for a peaceful existence.[60]

The difficulty of proving the existence of these and other practices by reference to literature has been acknowledged previously, but again it is emphasised that this in itself ought not lead to their omission from the text, since they are important determinants of the

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[59]Gunnar Myrdal is specific on this point when he refers to his private conversations with businessmen operating in the Southeast Asian region. He writes "...they are frank to admit that it is necessary to bribe high officials and politicians in order to get a business deal through and to bribe officials both high and low in order to run their businesses without too many obstacles....These bribes, they say, constitute a not inconsiderable part of their total costs of doing business in South Asian countries." Myrdal, G.: Asian Drama, op. cit., p. 946.

[60]It is not our purpose to infer that the entire police force operates in this way, but the fact remains that a proportion of it does.

business environment.[61] Those companies that fail to accept bribery as an inescapable fact, will tend to find themselves in difficulty. An observation made by Mohammad Hatta in 1957, that "all business men who remain faithful to economic morality are constantly pushed backward" applies with as much force today as it did two decades ago.[62]

This was the actual experience of one of the Australian companies: during an interview it was learned that the parent company in Melbourne had sought to restrain and regulate the activities of the joint-venture company to such a degree that necessary flexibility was denied to it. The payment of bribes had been excluded as a course of action; consequently the subsidiary failed to obtain the cooperation of that section of the government bureaucracy with which they mainly dealt. The expatriate general manager of the company argued during the interview that the failure of the joint-venture was to a large degree a result of over-direction from a parent unable to accept the necessary if unpleasant activity of bribery. During a number of other initial interviews with parent companies in Australia, it was found that at least one company, originally included in the survey, had decided to withdraw from the investment. When questioned as to why this decision had been taken, it was explained that the country was "too corrupt". The company had decided not to become involved in unorthodox practices and an impossible situation had resulted.[63] All other companies however had a realistic

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[61]Myrdal points out the importance of considering the factor of "corruption", and comments on its almost total non-consideration by economists. He writes: "It is almost taboo as a research topic and is rarely mentioned in scholarly discussion of the problems of government and planning." Myrdal, loc. cit..

[62]Hatta, Mohammad: "The Cooperative Movement in Indonesia", quoted in ibid..

[63]This company, having completed the building of a factory, imported plant from Australia, but their refusal to pay bribes at Tandjung Priok resulted in the refusal of customs authorities to give clearance. The plant was left to rust on the wharves, and the company

attitude to unorthodox practices. Most stated that they regretted the necessity of conforming but argued that failure to do so would seriously damage the competitiveness of the firm with other producers and reduce their profitability. Understandably, most companies were not anxious to discuss the point further. Whilst none denied the necessity of involvement, all lamented its existence. Some firms were able however to regulate and regularise their involvement in unorthodox practices by calling on the assistance of their local partner. Several firms revealed that the choice of partner had been largely determined by his promised capability in dealing with the bureaucracy. Three companies, all having the same corporation as partner, commented that they had experienced very little problem with "corruption" and attributed this directly to the political power enjoyed by their partner, the DKI (municipal government of Jakarta).

A company then, must not only be aware of unorthodox practices, but had also to be prepared to become involved in them if the investment was to proceed on schedule. Similarly, a company could not balk at the collusion between the private and the public sector, but was obliged to accept "that smooth running of their business [was] facilitated by cultivating a network of high level connections."[64] During interviews this, or similar suggestions, were put to the expatriate managers. (It was not formally incorporated into the questionnaire because its asking was dependent on factors that could only be determined during the process of the interview.) Of the fifteen managers interviewed, only two did not admit to the existence of privilege, deriving from the high-level

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[63](cont.) waited until their only appreciable assets, the factory and land, could be sold at such a price as to enable recoupment of the large losses incurred.

[64]AFR, 3/2/72, "Investment Guidelines in Indonesia", p. 25. See also statement by leading Indonesian official reported by John McIlwraith, "Investment in Indonesia — The Time is Now", AFR, 5/7/71, p. 6.

political connections cultivated by the firm or assured by the position of the local partner. The degree of advantage derived from such connections varied from company to company, but existed to some degree in all. Further information on this subject is offered in Part Two of this chapter, where the functions of the joint-venture partners are discussed. It suffices here to insist on the necessity of collusion with officials, and to stress again that bribery is not considered with the same degree of condemnation as it is in Australia. Rather it is accepted as an unfortunate element vital to the continuation of administration by the bureaucratic apparatus.

Possibly one reason why firms were able to adapt to the business environment was that they learned from prior experience in other counries in the region, where similar practices are common.[65] Eight companies had other direct investments in the region, and the remainder, bar the one failed company, had investments in other areas. Whilst no definite conclusion can be drawn from this information, it does suggest that the fourteen successful joint-venture companies would be more able to draw on the prior experience and expertise of the parent than a company that had no such opportunity. Several of the parent companies described their subsidiary general managers as "old Asia hands" or "old Indonesia hands", this referring to an individual who knows the region or the country, knows what to expect and how to most effectively or profitably deal with any given situation that arose there. In Australia,

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[65]See Business International, op. cit., three volumes. These volumes include advice for the foreign investor. One example draws on the following experience of an Australian firm. "About one year ago, ACI decided to sell part of its Thai branch to the public. The decision was not in any way connected to the Alien Business Law, but rather in keeping with the firm's policy to forestall anti-Australian feelings abroad by promoting local participation in its foreign ventures. Previously the company had taken similar steps in Indonesia and Malaysia." Chapter entitled "The Problem: How to Ease the Pressure of Conforming to Thailand's Alien Business Law", p. 57.

however, the cautious approach of potential investors has been noted and lamented from several sources. The low risk-taking propensity is seen as an undesirable and often unnecessary aspect of the general approach taken by Australian firms toward foreign investment. A more informed, sophisticated and less "provincial" approach must be acquired if firms are to compete successfully as investors in other countries. Former Liberal government Treasurer, William McMahon, observed that many Australian businessmen were unaccustomed to evaluating and accepting political instability in the host country, and noted that EPIC had been extended to cover non-commercial risk in an effort to encourage more direct foreign investment by Australian companies.[66] A recent Trade Mission report similarly noted the reluctance to invest because of non-commercial risks and pointed to the necessity of increased risk-taking if "these organisations wish to establish their products in the market and to take advantage of the anticipated rising purchasing power, resulting from Indonesia's economic development."[67] A cautious attitude was similarly noted to apply to Australian banks and their attitude to investment in Indonesia.[68] A few, however, have set up branches in Jakarta. Although the overall contribution of Australian capital to total direct investment in Indonesia is small in comparison with the three largest groups of investors, the combined size of all Australian investments was sufficient to warrant the establishment of branches by several Australian banks and

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[66]Department of Foreign Affairs, Current Notes, April 1969. Non-commercial risks include expropriation, exchange transfer blockages, war damages and nationalisation. See also Macquarie Report, op. cit., pp. 15ff.

[67]Statement by F.R. Lavis, leader of the Trade Mission of the Building Materials Industry to Indonesia in June 1973. Documented in Market Prospects in Indonesia, Department of Overseas Trade, Canberra, 1973.

[68]It was reported that leading trading banks had ignored overtures from Indonesia's administration inviting their investment. The banks however claimed that Reserve Bank regulations had prevented this. In reply the Reserve Bank argued for its keen interest in foreign investment by Australian banks, to complement trade and investment. "Australian Banks Ignore Indonesia", AFR, 1/2/72, p. 1.

their participation in two of the eight recently-established merchant banks in Jakarta.[69]

Whilst most of the firms in this survey regarded Indonesia's political situation as a factor increasing the risk nature of their investment, several companies considered the situation to be more stable than that existing in Australia under the Labor government. All companies considered that the risk involved necessitated a quick return on invested capital, but this did not, apparently, imply an exclusion of a commitment to future long-term investment, provided the political situation remained relatively stable. The riots of January 1974 certainly added to their awareness of potential domestic upheaval, but most were confident that the government was sufficiently in control to handle any future situation. Added to this was the insurance for non-commercial risk offered by EFIC (formerly EPIC) but surprisingly not all firms ensured against risk with this institution. Those who did however, were more than pleased with the terms of the agreement. An one executive put it, "With EFIC you cannot lose."

Whilst Australian businessmen at home are often berated for their extreme caution, there are those who appear to have adopted a quite sophisticated long-term approach to risk and investment. Large corporations, in particular, are familiar with the problems of foreign investment and take a realistic view. Ford executive G. Miller notes: "The Sukarnoist socialism of the early sixties is gone. It has been replaced by a pragmatic military regime committed to a policy of encouraging

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[69]The National Bank of Australasia (the "BHP" Bank) and the Bank of New South Wales have branch offices in Jakarta. The former also holds equity in the merchant bank, P.T. Indovest, and the Commercial Bank of Australia similarly owns equity in another merchant bank, P.T. Mutual International Finance Corporation. FEER, 10/12/73.

capitalism."[70] Former chairman of the AIBCC, and then director of the James Hardie group of companies (he is now president), and of the BHP, John Reid, noted that "the competition for the hearts and minds of Indonesia, as well as for a share of its economic development is growing fiercer and more sophisticated each month. It will be our national tragedy if...we allow opportunities to slip from us."[71] More recently, he stressed again this view and lamented the fact that too many Australian businessmen do not avail themselves of the growing number of both public and private facilities available to them to assist with the necessary "educational background and technical skills to conduct business."[72] He continued, "It seems to be a national characteristic that we buy a piece of equipment, try all ways to make it work, and then if unsuccessful we read the manufacturer's instructions."[73] Australian investors, he argued, can more successfully weather the storm of political discontent by increasing liaison with both the Indonesian and Australian governments. Furthermore, he urged the relocation of labor-intensive industries in Indonesia.[74]

Questions were directed to the joint-venture companies concerning attempts to establish (if any) liaison with the Australian government through the Department of Overseas Trade and the Trade Commission in

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[70]Miller, G., of Ford Asia-Pacific, address to the seminar Indonesia — Trading Partner, Centre for Continuing Education, Canberra, August 13-15, 1971. [Hereafter cited Indonesia — Trading Partner.]

[71]Reid, J., address to seminar, *ibid.*, p. 6.

[72]Reid, J., AIBCC (1973), *op. cit.*, p. 4.

[73]*ibid.*

[74]"One area which is timely is the specific encouragement of Australian business to produce finished or semi-finished components not only for the Indonesian and Far East markets, but for the Australian market. Costs and labor problems in Australia, as well as a reduction in tariffs on imported goods have resulted in a change to using imported components rather than Australian components in industry. What better stimulus to further Australian investment in Indonesia?" Reid, J., AIBCC (1974), *op. cit.*, p. 4.

Jakarta. Attitudes were mixed. Some felt the Commission's role to be useful only at initial stages of investment, and thereafter limited. Others described their activities as very helpful; only one company (the failed company) did not use the services of the Commission at all. Because of the small size of the Australian business community in Jakarta, it was possible to detect animosity on the part of a considerable number toward the Trade Commission. Fifty percent of the companies interviewed felt that much more could be done for the Australian investor. Complaints focussed on the bureaucratic attitudes of many staff, the lack of up-to-date information, in comparison with that available to American or Japanese investors, and the widespread lack of understanding of the realities of the business environment.

Further questions sought to identify firms as members of the AIBCC and to enquire as to that body's level of effectiveness as a lobby for Australian business interests in Jakarta and Canberra. Seven companies declared themselves members, two in name only: the remaining five used its services extensively. Most of the remaining firms had not heard of the group, and two gave a very positive "no" when asked about membership. Further enquiry revealed that the institution was effectively organised and administered for and on behalf of several leading Australian companies who had large investments in Indonesia. Certainly, the James Hardie group of companies have very strong links with the AIBCC, since one of its directors was instrumental in forming the group and promoting its growth.

One further measure of overall corporate strategy is the degree of awareness by companies of the possibilities of utilising government and private agencies to their benefit. Another is the degree of awareness of the potential profits to be made through pursuance of aid contracts, and some firms felt that a share of the aid market could be captured by consultants, contractors and suppliers in Indonesia.[75] They were clearly aware of the advantages to be gained from familiarisation with the plans of the international aid agencies and the Indonesian government policies which complemented them. Two firms positively stated their interest in this area, whilst four more were well aware of the desirability of familiarisation with government plans. These were the larger companies in the production goods sector, making basic and intermediate goods suitable for use in development projects which involved building and construction. In addition some of the larger companies were advantaged by their association with the Business Asia/Business International group, based in Hong Kong, which recently published three volumes containing extensive information on investment in the Southeast Asian region.[76] These publications included evaluations of investment sites, the development of regional investment strategies, the acquisition of suitable joint-venture partners, analyses of economic and monetary factors, and information on political, legal, administrative, geographic, financial and social conditions considered to be of interest to a potential investor. Australian firms associated with the group are BHP, ACI, CSR, Nicholas and Rheem (a BHP subsidiary).

Company attitudes to training policies were also considered as indicators of a corporate approach. The increasing awareness by the

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[75]This was particularly the case within the building and construction industry where major capitalisation for construction work in the 1960's resulted in the need to seek economies of scale overseas to avoid profit loss through operating below capacity. See The Building Industry in Papua-New Guinea and Indonesia, Department of Overseas Trade, Canberra, 1971. This is the published report of the Construction Industry Survey Mission to Southeast Asia and Papua-New Guinea. See also the report of the Australian Mining and Oil Consultants Mission to Indonesia: Mining and Oil Consultancy: Opportunities in Indonesia, Department of Overseas Trade, Canberra, 1973. See also AFR, 11/12/75, "Construction Slump", pp. 1, 10.

[76]Business International, op. cit.

Indonesian government of the political desirability of increasing the "transfer of skills" through formal training programs has been discussed in Chapter Two, and the recognition of its potential importance by firms may be considered as an indication of their attitude toward this aspect of the investment climate. All of the companies (save the failed company and one of the smaller firms) formally endorsed the necessity of comprehensive training programs as part of a realistic approach to government relations. ACI executive Patterson indicated his understanding of the benefits accruing to a company that genuinely promoted "Indonesianisation". He recommended the sending to the subsidiary of only the best personnel available, so that thorough training and transfer of skills would result in local people able to take responsibility for key areas of production and management. Patterson noted the political desirability of genuine training programs as well as the financial resources that would be saved.[77] Overall, however, endorsement of the training program was found to be more often a matter of public relations than any long-term commitment to a genuine widespread "transfer of skills".

The various pre-investment activities of the firms were also scrutinised to determine company attitude to the use of specialist consultants. A company that attempts to evaluate the feasibility of a proposed investment by engaging the services of a consultant demonstrates an awareness that the investment may involve problems that an individual firm is unable to isolate precisely and quickly. A specialist in the field is in a position to evaluate problems and suggest suitable strategies because of his concentration of knowledge in the area; he is concerned daily with many problems that the individual firm may only face rarely. Investigation revealed that four companies used outside

[77]Patterson, J.A., op. cit..

consultants whilst nine relied on in-company reports. Two companies declined to comment. Further enquiries related to the use of technological feasibility studies. Nine companies conducted such studies in Australia, four made no study and two again declined to comment. Most companies then, recognised the need for pre-investment research of one type of another. Those firms that engaged a consultant did so because they judged their own knowledge on the subject to be too limited; in order to pre-empt possible problems, especially with the Indonesian administration, it was reckoned that the high consultants' fees were a worthwhile pre-investment expenditure.

Company policies toward the character of the investment were similarly examined. All but two companies indicated the existence of plans for further investments and although recoupment of the original invested capital was generally expected within a maximum of five years, plans for significant expansion were evident. Horizontal diversification and market extension were the predominant areas of planned expansion, but two companies referred to definite plans for the export of their products to a third country and back to Australia, whilst a third mentioned the possibility of this. Their evaluation of long-term increasing costs and declining profitability in Australia were the major factors in this decision. Both firms with definite export plans of this nature were BHP-associated companies, and one was in the process of forming an international division to develop this aspect of its activities. Other long-term plans had included a joint-venture between an Australian firm and a Japanese consortium. However the plan to build an integrated steel mill had been abandoned because of the failure of the Japanese group to continue with their investment due to the effects of the economic recession in Japan. The Australian firm indicated their intention nevertheless was to continue with the present small investment, which was to be followed by a related series of complementary investments at later stages. The profitability of this venture, and of those undertaken by other firms, was expected to be low (or even non-existent) initially. The parent companies had taken such a possibility into account and reasoned that before undertaking major investments, a small "tester" type of investment was necessary if the firm was to undertake long-term large-scale investment. Most companies were aware of the benefits to be gained by long-term investments in Indonesia. As one Trade Mission leader remarked, "For those who persevere the future rewards could be great."[78]

The possible strategic advantage that could be enjoyed by Australian capital has not been lost on either the Indonesian government or the private sector. Questions were not directed to the joint-venture or parent companies on this matter, but its potential significance is such that its consideration at this point is in order. It is possible that Australian capital could gain a strategically advantageous foothold in the Indonesian economy out of proportion to its actual size. The following statement from an Ecosen report summarises the situation. It remarks that "the discreet desire of some Southeast Asian policy makers to create a countervailing influence to the dominant positions maintained by the economic giants, Japan and the U.S., could be an important factor in raising the level of Australian and New Zealand (as well as EEC and 'other Asian') investment in the area."[79] Australian capital could perceivably be seen as less of a threat to the economic independence of Indonesia since the majority of even the largest Australian firms are small and domestically-oriented by American, Japanese or European standards. Suhud, of the BKPM, indicated official acquiescence with this view

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[78] The Building Industry in Papua-New Guinea and Indonesia, op. cit..

[79] Ecosen (5) Draper, op. cit., p. 173.

when he stated: "The Indonesians are also becoming increasingly concerned about economic domination by Japan and want to encourage investment from countries such as Australia which poses no such threat."[80] In 1971 an Indonesian government official exhorted Australian firms to invest and berated them for their slow response to the opportunities made available. He argued:

> I know that Australians are going to reply that they are hungry for capital themselves ....But Australian companies do not need to invest many millions of dollars to gain a foothold here. What we need, and what Australians can provide, are industries that cost perhaps only $100,000 to establish here, making simple products for what is a growing local demand.[81]

The preceding pages have sought to establish some facts about the corporate approach of the fifteen firms to their Indonesian investments. It appears that in certain respects they show a high degree of adaptability to the new environment. Overall, attitudes to unorthodox practices, training programs and the pursuance of privilege by the cultivation of high level connections were realistic and practical. Whilst unorthodox practices were deplored publically, in practice they could not be ignored. Company attitude to risk was similarly realistic, the major factor in

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[80]Suhud reported in AFR, 4/2/72, in Brenchley's article, "Business as Unusual: Soeharto Seeks Commercial Hotline". "Australian investment is seen as a balance to heavy foreign investment from a few major countries such as Japan and the U.S., and from a source which has no desire at all to dominate the economy." National Times, 30/7/73, op. cit., p. 45. A similar comment was made by Sadli and Arndt in 1970. They stated: "Indonesia relies for defense of her national interest vis-a-vis large foreign corporations on competition between the foreign companies, between major companies and independents, and between companies of different countries. How effective this defense will prove remains to be seen." Address by Mohammad Sadli and H.W. Arndt at the Third Pacific Trade and Development Conference, Sydney, August 1970, pp. 5, 6. See also Tsurumi, op. cit., pp. 45ff, and FEER, 12/11/73, 24/12/73 and 18/6/73.

[81]AFR, 5/7/71.

this being the potential political instability of Indonesia. Expected period of recoupment of capital ranged from a five-year maximum to a one-year minimum. Clearly the investments were classified as "high-risk", with the result that a quick return on capital was deemed essential.[82] Yet many companies indicated their interest in a long-term approach to investment — a desire to invest larger amounts of capital over a longer period of time. The feasibility of this depended in part on overall political stability and control of economic nationalism. Fewer companies were aware, however, of the specific benefits and advantages to be derived from increased contact with other public and private bodies involved in business and commerce. The several larger companies that did utilise these resources were aware of their immediate and future signifinance, but they were in the minority of firms.

A mixed picture emerges from the above information. In some areas of activity, corporate strategy seemed well enough developed, but in the more sohpisticated and specialised areas, appreciation of new factors with long-term significance, was lacking for all but a few.[83] These latter constituted a small core of companies, whose activities and attitudes show a high degree of sophistication and specialisation which

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[82]The findings of the Macquarie Report confirm this point. They concluded that "...[most] companies feel that, in a potentially volatile political climate, investors should attempt to recoup their invested capital within five years. It also follows that the greater the political risks involved, the greater the return sought on investment." Quoted from Department of Overseas Trade Document (uncited) in Macquarie Report, op. cit., pp. 29-30.

[83]This conclusion is also confirmed by the Macquarie Report. Conclusion 3 of the study stated: "Most Australian firms lack a sophisticated international organisation. Aside from a few important instances, domestic organisations have not evolved very much to cope with the overseas activity, nor have people's skills been developed very adequately. Nevertheless, this deficiency is offset largely by the imposition of tight formal and informal control systems. This situation is a function of corporate size and management style." ibid., p. 21. (Original emphasis.)

should give them in future non-domestic activities, a genuine degree of competitiveness with other large foreign corporations, and a great advantage over their less sophisticated Australian rivals.

Supply of Auxilliary Resources and Conjuncture by the Australian Government

In Chapter Two the role of the Indonesian government in the promotion of foreign investment was observed to be of great importance to its increased penetration of and consolidation within the domestic economy. The post-colonial state played a vital role in the maintenance and development of the physical, legal and financial infrastructure within which foreign investment functioned. In keeping with the stated aim of locating Australian foreign investment within a suitable framework of analysis, it is relevant at this point to examine briefly the attitude of successive Australian governments toward the export of Australian capital, and to establish their particular role in that process.

The late 1960's marked the beginning of a qualitatively different period in Australian-Indonesian economic relations. During that time the Liberal-Country Party coalition government increased its recognition of the political and economic importance of the Southeast Asian region and it was not only Australia's involvement in the Vietnam war which hastened this development.[84] The urgency of increasing the nation's economic involvement in the area through increased and diversified trade as well as investment and aid grew alongside and complementary to, the increased military and strategic commitment.

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[84] "In recent years Australians have become increasingly aware of the need to display a more independent and self-reliant stance in world affairs. This awareness has gone hand in hand with a desire to adopt positive and responsible long term policies with respect to neighbours in the Asian and Pacific regions." Senate Standing Committee Report, op. cit., p. 1.

Prior to the period in question, Australian-Indonesian trade was characterised by the exchange of a few major commodities, the most important being flour and oil.[85] This simple trade pattern originally operated with a trade imbalance in favour of Indonesia, but the decline in Australia's imports of crude oil due to the growth of domestic production has meant a continually growing trade imbalance in Australia's favour.[86] As well as the increase in value terms, there has also been a change in the type of commodities traded, from a large proportion of aid-financed exports of consumption goods (mainly food), to a growing proportion of goods traded independent of such non-commercial factors. These include a large and growing proportion of production goods and related inputs. By 1973-74, metals, machinery, transport equipment and other metal manufactures accounted for 57.9 per cent of all exports to Indonesia and it is expected that this will be a major growth area in trade between the two nations.[87] This increase in the import of production goods and the decline of the import of consumption goods by Indonesia is common to her changing trade pattern with all nations and indicates the growing needs of the small but expanding industrial sector of the economy. It is a change that is also linked to the increasing number of direct invest-

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[85]From 1950 to 1962 flour constituted between seventy to eighty-five per cent of total Australian exports to Indonesia. In 1968-69 petroleum products comprised 92.8 per cent of imports from Indonesia, but fell by 1973-74 to 3.6 per cent. Other major imports from Indonesia were timber, rubber, tea and coffee. ibid., pp. 12, 27ff.

[86]ibid., pp. 12ff. As a portion of total Australian imports, those from Indonesia have declined in money terms from a peak of $64,034,000 in 1964-65 to $18,800,000 in 1974-75 (provisional approximation for last figure). A decline in percentage terms has also occurred from a peak of four per cent of total imports in 1958-59 to 0.3 per cent in 1973-74. Conversely, as a percentage of total Australian exports, those to Indonesia have shown a rapid increase from 1968-69 onwards. In 1968-69 they constituted 0.6 per cent of total exports; 1969-70 (0.9 per cent); 1971-72 (1.2 per cent); 1973-74 (1.5 per cent).

[87]ibid., pp. 19, 24. Conclusion 6 of the report noted that "the greatest potential for growth...probably lies in capital goods, including machinery, transport equipment and other metal manufactures."

ments made by Australian and Australian-based companies in Indonesia. The majority of these investments require a constant supply of raw materials and/or component parts for the production process and some are implemented specifically to facilitate such a flow of inputs from the parent firm. In these cases investments are made for the purpose of expanding the market for goods produced in Australia.

The third indicator of the changing pattern of economic relations between Indonesia and Australia is the 'aid' component. The Liberal-Country Party coalition government clearly recognised the growing importance of Indonesia to Australia's economic and political future when in 1972, the Department of Foreign Affairs stated that "Indonesia (occupied) a special position and (received) the largest share of Australian bilateral aid disbursements outside that provided to Papua-New Guinea."[88] Indonesia receives 8.2 per cent of the total, Papua-New Guinea 60.6 per cent.[89] The growing importance of Indonesia to the government's perception of the national interest is further evidenced by the fact that since 1970 there have been huge increases in the volume of aid directed to that country; from 1946 to 1970 total bilateral Official Development Assistance aid flows totalled $48,264,000, but by 1975 had risen to $149,340,000.[90] From 1971 onwards annual increments to aid flows have steadily increased, from $15,607,000 in that year to $22,866,000 in 1975.[91]

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[88] Department of Foreign Affairs: Australian Aid to Indonesia, Canberra, 1972.

[89] Australian Official Development Assistance: Financial Statistics, 1945/46-1974/75, Development Assistance Agency, Central Statistical Service, Canberra, August 1975, from Introduction.

[90] "Functional Distribution of Australian Official Assistance to Less Developed Countries 1945/46-1974/75", Statistics and Research Section, Australian Development Assistance Agency, Canberra, December 1975, Table, p. 72.

[91] ibid..

As well as this increase in the volume of aid funds, there has occurred as well a significant change in the composition of the aid "package". As noted previously, aid-financed exports, the main form of balance of payments supports to Indonesia from Australia, are being phased out and increasing priority given to capital and technical assistance projects.[92] This new emphasis involves some thirty development assistance projects which give ample opportunity for the "export" of expertise (through consultancy) and of capital goods from Australia.[93] The projects, similar to those undertaken by other donor countries, will assist the development of a financial infrastructure more suited to the needs of the modern capitalist sector of the Indonesian economy than that which exists at present. This changing composition of bilateral aid flows is indicated by figures which show the decline in aid-financed imports, from $12,572,000 in 1972 to $9,233,000 in 1975 and $5,181,000 in 1976; conversely the substantial increase in funds available for infrastructural development is indicated by the figures of $2,286,000 in 1971 to $8,101,000 in 1972 and $10,730,000 in 1976.[94]

The changing composition of Australia's aid disbursements is not unique. In the first five years of the New Order government all IGGI aid mainly took the form of balance of payments support, in line with the policy prescriptions laid down by the IMF. By 1971 however, a substantial proportion of this aid was redirected towards the rehabilitation of the infrastructure. Furthermore with the changing emphasis of economic policy from stabilisation to development, aid was used more and more to

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[92]Senate Standing Committee Report, op. cit., p. 64 and Table 5F.

[93]See various Australian Trade Mission reports cited this chapter, Footnote 108. The thirty projects cover telecommunications, roads, railways, port rehabilitation, irrigation schemes, plant quarantine, animal husbandry, water supplies and public health.

[94]"Functional Distribution of Australian Official Assistance", op. cit., p. 72, and Statistical Summary, Australian Development Assistance Agency, 1975-76, Canberra, Table 2.

finance the import of capital goods needed for industrial projects.[95] Australian aid has in the past had beneficial consequences for her trade[96], but with changing trade patterns, the growth of direct Australian investments in Indonesia and of industrial activity in that country, alteration to the prevailing pattern of aid disbursements was necessary if they were to remain in an important supportive role with respect those trade and investment patterns. The necessity of initiating aid projects that would more directly complement the activities of the private sector has been voiced by many members of the business community. In 1971 John Reid of the AIBCC criticised the lack of direction of export activity to Indonesia, which he argued was fostered by the supply of credit certificates under the BE system. He urged instead the exclusive use of at least a proportion of aid funds for the benefit of Australian firms interested in direct investments which would promote the export of capital goods.[97]

Clearly, the patterns of aid, trade and investment are interrelated. As important indicators of the nature of the economic relationship between two nations, they must be monitored to assess how changes to them indicate more general changes in this relationship. The above is a brief synopsis and may only suggest the type of changing economic relationship between Indonesia and Australia; they involve not only the strengthening of economic ties but as well signify the increased structural connection between the two economies. This is in turn a

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[95] Posthumus, G.A: The Intergovernmental Group on Indonesia, University of Rotterdam Press, 1971, pp. 27ff.

[96] "Australian Aid has had a very Significant Influence on the Trade Relations Between the Two Countries", Department of Trade and Industry, Background Paper, Australian-Indonesian Trade, Canberra, July 1971.

[97] Reid, J., "Indonesia — Trading Partner", op. cit..

result of the expanding nature of Indonesia's industrial sector and the changing basis of the Australian economy.

At this point it is necessary to return to the major concern of this section, and the following pages detail the alterations to Australian government policy which have been designed to assist the maturation of these new economic relationships. It is appropriate to begin by considering the findings of a recent report detailing the activities of Australian companies abroad. The Macquarie Report observed a discernible shift in the emphasis of Australian government policy toward the encouragement of private investment abroad[98]; as well as a less restrictive policy on the outflow of capital, successive governments have become more specific in their positive attitude to such outflows. Statements by Snedden (Treasurer, February 1972), McMahon (Prime Minister, September 1972) and Whitlam (Prime Minister, February 1974) are, the report argues, milestones in government policy. The following passage from a much earlier statement by McMahon further demonstrates the new awareness in government circles of the economic significance of the Southeast Asian region. The former treasurer noted:

> As industrialisation proceeds in the developing countries the pattern of their import demand is likely to change; finished goods are likely to become relatively less important and components and raw materials become more important. Those Australian manufacturers who recognise and accept this changing pattern by establishing production facilities in developing countries will be well placed to preserve existing markets for the products and develop new markets for components and materials.[99]

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[98] Macquarie Report, op. cit..

[99] Department of Foreign Affairs, Current Notes, April 19, 1969. These comments were made by W. McMahon in his capacity as federal Treasurer of the Liberal-Country Party government.

Under the McMahon government of 1971-72, policy directives indicated the need to increase military and economic ties with Indonesia; this was reflected in substantially increased aid[100], a policy which was continued by all successive governments.[101]

When President Suharto visited Australia in February 1972 the press noted that the increased coincidence of business interests was reflected in the president's long consultations held with Australian business leaders as well as with government officials.[102] In 1974, legislation transformed the former EPIC into EFIC which now operates to cover the non-commercial as well as the commercial risks of foreign investment; originally created in 1957 to encourage and increase trade, its newly expanded role reflected the more recent needs of exporters of capital as well as of goods. The creation of the new body was "to give effect to the Government's desire...to encourage Australian businessmen to make the kinds of investments in overseas countries, particularly the developing countries which can contribute to the economic and social progress of the host country and be in Australia's national interest."[103] The administrators of EFIC are not unaware of the long-term potential of the Southeast Asian region and remarked in one publication "that as industrialisation proceeds in the developing countries, the pattern of their import demand is likely to change, with finished goods becoming

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[100]Department of Foreign Affairs, Current Notes, June 1972.

[101]Over the six-year period 1967/68-1974/75 there was an increase over fourfold in total Australian aid disbursements to Indonesia, from $5,970,000 in 1967-68 to $22,300,000 in 1974-75. The importance of these figures is highlighted by comparing them with aid disbursements to Indonesia for the period 1952-53 to 1969-70 which totalled $47,910,000. Figures taken from Tables 5E and 5H of the Senate Standing Committee Report, op. cit., pp. 65, 67.

[102]AFR, 4/2/72.

[103]EFIC pamphlet quoted in the Macquarie Report, op. cit., p. 32.

relatively less important and components and materials more important."[104] Both EFIC and Prime Minister McMahon clearly recognised the value to the Australian economy of setting up production facilities behind tariff walls.

The Department of Overseas Trade, formerly the Department of Trade and Industry (under the Liberal-Country Party coalition governments) similarly has increased the encouragement of the export of capital as distinct from the export of goods and services. In November 1972 a new trade agreement was promulgated between the two nations, replacing the former agreement of 1959 which had become insufficient in scope to meet the new and growing needs of trade and investment.[105] This agreement provided preferential access to Australian grains and cotton in return for similar treatment of Indonesian exports of tea, timber and rubber and was to serve "to promote and expand mutually beneficial trade relations...in respect of both traditional and potential exports."[106] In addition it sought to promote direct investment of Australian capital. Article 8 of the agreement stated:

> ...the Government of the Commonwealth of Australia will facilitate the flow of such [direct] investment. Furthermore...[it] will use its best endeavours to encourage Australian enterprises to enter into joint-ventures with Indonesia enterprises and in doing so will have regard to the desire of the (Indonesian) Government to develop industries using domestic raw materials.

The new agreement is supplemented by upgraded facilities[107] and an extensive information service to investors which includes publications like

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[104]EPIC: Overseas Investment, Department of Overseas Trade, Canberra, 1973, Forward.

[105]Trade Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Indonesia (1972 Agreement).

[106]ibid., from text of the agreement, Introduction and Article 1.

[107]AFR, 17/1/77. The upgrading of Department of Overseas Trade

"Guide to the Market", "Notes on the Market for Australian Exporters" as well as numerous Trade Mission reports dealing with various aspects of investment possibilities. It is useful to observe the content of the many recommendations made to government in several such reports between 1971 and 1973, the period of greatest Australian investment in Indonesia. Missions urged greatly increased spending on aid programs that would more directly benefit Australian investors and exporters[108]; an increase in long-term loans from the Australian Export Bank to finance Australian investments in mining was also recommended. Mission leaders noted the extensive range of information available to investors of other nationalities, and recommended the upgrading of the information services provided by the Department of Overseas Trade, to ensure a more detailed flow of information on aid projects and to ensure that this information became available more quickly than at present. Overall, recommendations sought to increase government assistance to exporters and investors by way of increased incentives. It was argued that such moves were necessary if Australian exports and investments were to become more competitive overseas; this could be effected by increased government-private sector liaison and cooperation, and a more realistic appreciation of the problems faced by investors in poor nations.

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[107](cont.) includes the use of microfiche recording methods, which are used for storing huge amounts of information about company activities in and outside of Australia. It was reported that this up-to-date method would assist to promote the sale of Australian goods and services abroad.

[108]For example see report of the Australian Earthmoving, Road-making and Heavy Transport Equipment Trade Mission to Indonesia, _The Construction Equipment Market -- Indonesia_, Department of Overseas Trade, Canberra, November 1972, Recommendation (to government) No. 2; The Building Industry in Papua-New Guinea and Indonesia, _op. cit._, Recommendation (to government) No. 9; Mining and Oil Consultancy Opportunities — Indonesia, _op. cit._, Recommendation (to government) No. 9; Report of the Australian Electrical, Electronic and Telecommunications Trade Mission to Indonesia, _Communications and Power, Indonesia_, Department of Overseas Trade, Canberra, 1972, Recommendation (to government) Nos. 2, 3.

Under the Labor government, it appeared that attempts were made to implement some of the recommendations made by the private sector through Trade Mission reports. A prime ministerial statement of 22 January 1974[109] announced measures to increase the flow of direct private foreign investment by means of the extension of the overseas investment insurance scheme to include all worthwhile direct investment. In addition, two separate funds were created to promote investment feasibility studies by Australian companies and investment clauses in the trade agreement were to be negotiated and where appropriate any investment guarantee agreements drawn up.[110] An official of the Department of Overseas Trade stressed his increased commitment to the promotion of Australian foreign investment at the AIBCC conference in 1974. He spoke of "the important interrelationship between trade and investment, and... (the adoption) of a cooperative and positive policy (by the Department) in encouraging Australian investment overseas, particularly in Southeast Asia."[111]

Furthermore the Australian Labor Party government showed itself to be well aware of the delicate political problems posed by foreign investment in Indonesia, particularly in view of the anti-Japanese riots of early 1974. Prime Minister Whitlam's statement of January 22nd stated it was

> ...the intention of the Australian Government to do all it can to ensure that Australian

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[109]Statement by the prime minister, E.G. Whitlam, 22 January 1974 (Press Release). See also Australian-Indonesian Joint Communique, 23/2/73, reported in Australian Government Digest, 5/12/72 to 31/3/73.

[110]The Investment Feasibility Fund allowed up to $250,000/annum to assist Australian companies meet the cost of pre-investment feasibility studies. To 31/7/75 applications for eligibility were received from fifty-five firms including eleven in Indonesia. Senate Standing Committee Report, *op. cit.*, p. 58.

[111]AIBCC (1974), *op. cit.*, remarks made by P.J. Dixon, First Assistant Secretary, Department of Overseas Trade.

> investment in overseas countries will benefit the people in those countries. The intention is that that investment will be favourable to ownership and control of enterprises by people in the countries in which it is made and will have advanced labour relations and environmental policies.[112]

Finally, the more recent Senate Standing Committee Report on trade concluded that "[c]onsiderable opportunities exist for Australian participation in joint-venture enterprises in Indonesia. Establishment of a joint-venture is rarely easy and considerable patience is required. Many have already found the effort well worthwhile."[113]

Clearly, recent years have witnessed an increased recognition of the need to promote the export of Australian capital as well as goods and services by successive governments, and as well to facilitate the establishment of new measures designed to facilitate that export. Although the Australian business community in Jakarta is not wholly enthusiastic about the services provided by the Trade Commission or the federal government, there has been an improvement of investment services as well as a more positive recognition of the growing importance for the Australian economy of investment in Indonesia.[114]

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[112]AFR, 28/3/74, "Australia — the Ugly Investor Image", p. 3. The statement continued: "The Government will amend the Export Payments Insurance Corporation Act to broaden the eligibility criteria to provide that all new worthwhile direct investments which can assist in the economic and social development of an overseas country will be eligible for insurance cover."

[113]Senate Standing Committee Report, op. cit., p. 4. See also p. 57.

[114]Australian investors initially faced the following problems: (1) lack of financial incentives; (2) lack of assistance with high-cost pre-operational expenses; (3) lack of double taxation avoidance agreements; (4) maintenance of export incentives which permit the export of goods when in fact the export of technology and capital would be more consistent with economic costs; (5) lack of suppliers' credits to enable a switch in emphasis from finished exports to machinery supplies related to investment; (6) inadequacies of government information; (7) lack of government to government arrangements to provide sufficient guarantee of repatriation to permit EFIC to offer insurance cover on extended finance;

One role of the state in capitalist society is to ensure the reproduction and accumulation of capital. When new circumstances arise deriving from a combination of internal and external conditions threaten or slow down that process, the state must make positive moves to redress the situation. It must devise new policies, design new agreements, promote attitudes and activities more likely than former ones to foster the process of reproduction and accumulation of capital. It would appear from the above that the state has attempted with reasonable success to fulfill this task but it appears in a manner by no means sufficient to the degree desired by private capital.

The purpose of these prior pages has been to identify the origin and character of the capital invested through joint-venture by fifteen Australian companies, and to locate it within a suitable framework of analysis. The second part of the chapter continues this process by examining their numerous activities in detail.

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[114](cont.) (8) failure of Trade Commission to provide support and back-up expertise in the absence of clear government policy. Many of these difficulties have now been overcome. For detail of Australian government services available to promote trade and investment see Chapter 8 of Senate Standing Committee Report, _op. cit._.

PART TWO:

THE MANUFACTURING SECTOR IN INDONESIA: FOREIGN DOMINATION AND IMBALANCE

Since the installation of the "New Order" government in 1965, Indonesian economic policy has been directed toward industrialisation through import-substitution in the manufacturing sector, together with resource extraction and processing in the primary sector. The former involves a variety of protective devices operating to ensure the continuation of domestic production, and as a method of industrialisation it has to serve several important functions: to reduce the foreign exchange cost of industrialisation; to increase employment at a greater rate than was possible in the capital-intensive resource-extractive sector where foreign investment was formerly concentrated; to raise domestic output and thereby provide a basis for further large-scale industrialisation. However, the configuration of the manufacturing sector is currently characterised by imbalance at many levels: for example, in the development of different subsectors. In the consumer goods sector, especially in clothing, textiles, footwear, food processing, chemicals (mainly pharmaceuticals) and transport equipment (mainly passenger vehicles assembled in Indonesia), there is overdevelopment, whilst virtually all intermediate and capital goods industries are poorly developed. Further manifestations of imbalance within the manufacturing sector is evidenced by the regional concentration of investment, with urban centres, particularly Jakarta, being favoured.[115] Finally, the dominance of non-pribumi and more importantly, of foreign capital within the capital-intensive, high-productivity modern subsectors of the manufacturing industry stand in contrast to those owned by pribumi capital, characterised by labor-intensive technology and low levels of output and productivity per worker.[116]

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[115] See Chapter Two, Part Two, "The Five-Year Plans".

[116] See Chapter Two. See also IBRD (Hughes), *op. cit.*, p. 40.

This imbalance in the development of different subsectors within the industrial sector as a whole has its roots in the import-substitution policies pursued during the 1950's and early 1960's, and as well in the colonial heritage which encouraged the development of light manufacturing only. Prior to the gaining of formal political independence, the dynamic sector of the economy was of course the export-oriented resource-extractive sector. The effect of the operations of this sector did not significantly encourage changes within the traditional sectors towards the usage of modern techniques of production and distribution.[117] Thus all significant additions to capital formation and level of skills were concentrated within the modern foreign-owned sector. Following independence government policy sought to foster the growth of the domestically-owned industrial sector through a variety of programs[118], but the concentration of effort was focussed on the manufacture of consumer durables, involving a low technological level and relying heavily on imported inputs. The possibility of encouraging growth within other subsectors was discouraged in part by the low level of technical skills and inadequate infrastructure; also important was government policy which functioned to depress incentives for long-term investments in industrial capacity; merchant capital continued to dominate in the domestically-owned sectors of the economy, whilst in the most dynamic and high profit areas of economic activity, foreign capital retained its unrivalled position of strength; also important of course was the overvalued exchange rate and the inflation of the 1960's. As Paauw explained, "the economic impact of [government] policies (was)...to foster the rapid

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[116](cont.) Hughes argues that the principle causes of low productivity in Southeast Asian industries is the small scale of production.

[117]Paauw, in McVey, op. cit., pp. 170ff.

[118]See Chapter One, Sections One and Two.

expansion of aggregate demand while deterring the growth of capital formation and output."[119]

Thus prior to 1965, the manufacturing sector was characterised by a serious imbalance in the development of subsectors, with consumer durables dominant, and basic and intermediate industries on the whole very poorly developed. This legacy has of course influenced the current direction of industrial investment, although it is clear that the New Order government and its technocratic planners are well aware of the necessity of diversifying the industrial base and encouraging the growth of basic and intermediate industries. Yet despite this awareness and the implementation of policies designed to diversify industrial investment, the pattern of investment within the manufacturing sector remains characterised by the domination of the consumer goods sector and under-development in the production goods sector. The problem of over-saturation of existing domestic markets for certain products has already occurred, obliging the government to issue the so-called "restricted" or "negative" list, citing areas of production closed to further foreign investment. (In Chapter Two it was observed that government regulations are often difficult to enforce, and that the "negative" list appeared to be open to widespread and recurrent abuse from both administrators and investors.[120]) Within the overdeveloped areas of production, an overall high profit rate for investors is ensured because of the high rates of protection which accrue, along with generous taxation concessions and unfettered repatriation of capital. As Glassburner noted: "Because duty rates on imports are half or less than those on final products, protection to value added in final goods production will often be more than

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[119]Paauw, in McVey, op. cit., p. 203.

[120]See Chapter Two, Part Two.

twice the nominal rate."[121] He pointed out the average duty rates for samples of three classes of goods: consumption goods 52.3 per cent, intermediate goods 22.5 per cent, and capital goods 18.9 per cent. These classifications have been instrumental in the compositional shift in the import bill from 1969 onwards, towards a rising proportion of lower dutied items, reflecting an increase in domestic production.[122] The Bulletin of Indonesian Economic Studies [ANU] similarly noted that between 1973 and 1975 there was an eighty per cent increase in imports in dollar terms (about sixty-nine per cent with price inflation accounted for), with a move towards preference for essential over non-essential items.[123] The Dönges study calculated the foreign exchange component of manufacturing investment to be a high seventy-six per cent[124] and with the high levels of inflation worldwide, this meant a degree of imported cost inflation to Indonesia.[125]

In the 1967-73 period, the New Order government foreign investments were concentrated in forestry, mining and oil exploration and dominated by American capital, but, after a while, the emphasis shifted increasingly towards investments in manufacture (and real estate) with huge investments by Japanese and Chinese (of both domestic and foreign origin) capital, and smaller but substantial involvement by European and Australian capital.[126] The Dönges report noted the impressive projects

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[121]Glassburner, B.: "The January 1973 Tariff Revision", BIES, November 1973, p. 107.

[122]ibid., p. 106.

[123]BIES, SRD, Booth, A. and Glassburner, B., March 1975, p. 6.

[124]Dönges, op. cit. Data taken from Table 5.

[125]H.W. Arndt noted that Indonesia was importing inflation directly through rising import and booming export prices, and indirectly "through the effect on domestic liquidity of capital inflow attracted by high interest rates." BIES, SRD, July 1974, pp. 7-9.

[126]BIES, SRD, Arndt, H.W., July 1975, pp. 24, 25. See also Tsurumi, op. cit., pp. 1ff.

list of "intended" foreign investment, starting with twelve approved projects involving expenditure of US$34.1 million by the end of 1967. By December 1972, three hundred fourteen investments totalled expenditure of US$654.2 million, or 28.9 per cent of total intended investment.[127] To June 1975 (from 1967) total approved foreign investment was estimated at US$3944.2 million and involved some seven hundred ninety-nine projects.[128] In Chapter Two it was observed that the implementation rate is highest in the manufacturing sector (forty-five per cent), which would suggest that in terms of the implemented investments of foreign firms, the figure would be higher than the total average of 28.9 per cent. No precise figures were available to the author on this matter.

Clearly the manufacturing sector has experienced an increase in capital accumulation yet the difficulties in obtaining correct or sufficient data remains a problem.[129] According to one source, from 1965 to 1971 the contribution of manufacturing to Gross Domestic Product rose from 8.3 to 9.6 per cent, and by 1974 stood at 10·4 per cent.[130]

Another source claimed that it contributed approximately

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[127]Dönges, op. cit., Table 6.

[128]Senate Standing Committee Report, op. cit., p. 54, Footnote. There are more recently indications that this quite rapid increase in the rate of foreign investment approvals is now declining, due partly to the fact that much of the investment was in the "easy" initial stage of import-substitution. Also important in the declining rate of foreign investment approvals is the recognition of limited actual market size and of the difficulties in setting up investment in Indonesia due to high costs, corruption and lack of suitable industrial sites. See AFR, 25/9/76. See also AFR, 1/3/77. See also E.I.U., "Quarterly Economic Review Indonesia", Annual Supplement, 1976, p. 14.

[129]The difficulties involved in securing accurate statistics is noted in BIES, July 1971, and by the Bank Indonesia in its publication "Economic Data for Investors in Indonesia", Jakarta, May 1968. It appears that the problem of accurate statistical information is recurrent and has worried economists for many years. See for example Paauw, in McVey, op. cit., p. 189.

[130]Economic Intelligence Unit, "Quarterly Economic Review: Indonesia", Annual Supplement, 1973, p. 6, for the 1965 figure only. See ibid., 1976 p6 for the remaining figures including the 1971 figure adjusted from 9·6 to 8·8 per cent.

ten to eleven per cent of GDP in 1970.[131] The Bulletin of Indonesian Economic Studies put the increase between 1969 and 1970 at fifteen per cent.[132] Sundrum noted that the contribution of manufacturing to GDP was fifty-four per cent higher in 1971 than in 1961, most of this increase occurring during four years, 1969-71, when the value added in manufacturing rose at an annual rate of nearly fourteen per cent.[133] By 1973 manufacturing was the leading sector for foreign investment in terms of the rate of new approvals and almost certainly in terms of realised expenditure.[134]

Turning to another major indicator of the contribution of manufacturing to economic development, it appears that the percentage of the labor force employed in all manufacturing rose from 5.7 per cent in 1961 to 7.5 per cent in 1971.[135] Yet when figures are taken for all medium- and large-scale enterprises (which include all foreign investments in manufacture), the figure shows a decline in the total number of persons employed, from 5.7 per cent in 1961 to 3.7 per cent in 1971.[136] Combining both sets of figures, it would appear that the small-scale enterprises, which on average currently employ more than fifty per cent of the total manufacturing employment, generate employment at a faster rate than do medium- and large-scale industries. This is further

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[131] Dönges, op. cit., pp. 2ff.

[132] BIES, SRD, July 1971, p. 3, Table 1.

[133] Sundrum (1975), op. cit., p. 58.

[134] BIES, SRD, November 1973, p. 10. "...[I]n the years 1967-1970 there was a rush of interest in foreign investment as mining and forestry investors moved quickly to take advantage of the best opportunities. Much of that investment, however, has not yet eventuated or has a long gestation period. Interest in manufacturing was slower to pick up, but recently as much as half of approved investment has been in manufacturing where the gestation period is relatively short."

[135] Sundrum (1975), op. cit., p. 59.

[136] Dönges, op. cit., "Employment, Size of Plants and Productivity".

supported by the fact that in the urban areas, where the latter type of industry predominate, there was a decline in manufacturing employment from 684,000 in 1961 to 662,000 at 1971 according to 1971 census figures.[137] These figures become more significant when it is realised that urban populations, especially in Jakarta and Surabaya, have increased dramatically.[138]

It is arguable that the distortions introduced into the economy as well as the excessive "dependence" thereby fostered by a vigorous implementation of an import-substitution approach often involve disastrous effects on the indigenous economic system which limit its capacity for sustained long-term growth. The problem as it applies to Indonesia is crystallised in the following remarks made by a government official:

> ...if the choice is on industrialisation oriented toward the domestic market, then Indonesia could easily embark on protective policies which also happen to be particularly suitable for the promotion of indigenous entrepreneurs. But these policies normally create inefficient and high-cost industries with a consequent waste of resources. Besides, in the longer run those industries will face serious problems when the domestic market becomes saturated. This may not come until ten or fifteen years later, but once we have set up high-cost industries behind protective walls, it will be extremely difficult to change the orientation of those industries, from the domestic market towards markets abroad.[139]

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[137]Sundrum (1975), *op. cit.*, p. 59. Sundrum concludes that the growth in manufacturing employment that occurred between 1961 and 1971 took place entirely in the rural areas. In 1961 manufacturing employment in rural Indonesia accounted for 1,172,000 persons and in 1971 for 2,270,000 persons. (Table I)

[138]For detail on Jakarta's explosive population growth especially during the decade of the 1960's, see *The International Bank for Reconstruction and Development*, International Development Association, Economic Staff Working Paper, No. 105, "Greater Jakarta, The Capital City of Indonesia", April 1971, prepared by R.W. Oliver, pp. 9ff.

[139]Suhadi, Mangkusuwondo: "Dilemmas of Indonesian Economic Development", *BIES*, July 1973, p. 34.

In Chapter One the various recommendations of the Asian Development Bank, the United Nations and Ecosen were noted to coincidentally urge the structural change necessary in poor countries toward export-oriented investment, and away from the prior concern with developing domestically-oriented industry. Chapter Two demonstrated Indonesian government's awareness of the problem and detailed some of the policy measures designed to assist its solution. However, the majority of manufacturing in Indonesia remains domestically oriented, highly protected and generally caters for the small but growing market of Western-oriented middle class urban dwellers. By a thorough examination of the activities of the fifteen Australian companies that are involved in the import-substitution process, light may further be thrown on the nature and seriousness of the problem of Indonesian development. It is with this former that the following is finally concerned.

IMPORT-SUBSTITUTION THROUGH JOINT-VENTURE: THE FACTS ABOUT AUSTRALIAN INVESTMENT

In common with much direct private foreign investment in manufacturing in Indonesia, all Australian investment in that sector is achieved through the import-substitution method. And with it is associated the high foreign exchange cost, the technological unsuitability, the low level of employment generation and the often restricted scope to assist industrial development. Since these and other problems generally associated with the import-substitution method have been outlined in preceding chapters, it is the task at this point to present in detail the results of the survey of the set of fifteen investments that have been made by Australian companies in Indonesia's light manufacturing sector. A major concern of the enquiries directed to both parent and subsidiary company was to establish the specific nature of the situation that the combination of import-substitution and foreign (as opposed to domestic) investment produced. Eight areas of enquiry were pursued: (1) the import content of the investment; (2) the level of import duty required and paid by the manufacturer and the capital cost of maintaining the plant; (3) the source of raw materials and components necessary for manufacture, and the existence of raw material supply agreements; (4) the existence, if any, of technical or licensing fees, payable by the joint-venture company to its parent; (5) the degree of protection enjoyed by the joint-venture companies and the degree of competition to which they were subject; (6) the nature of the market to whom production was geared and the percentage of market shares currently held by the company; (7) the structure of production costs; (8) and the level of profitability of the firms overall. Each will be dealt with in turn.

The Import Factor

As indicated by the term "import-substitution", this method of industrialisation substitutes the import of finished goods for the import of capital goods and technology. It is clear then that an important aspect of research should have sought to determine the size, value and nature of the import content of the Australian investments. To achieve this each company was asked what was the value of imported capital equipment that constituted part of the original authorised investment. Individual figures showed that the import content ranged from a high ninety per cent of implemented investment to a low ten per cent, with the weighted average forty-seven per cent in the production-goods sector. The first high figure of ninety per cent is accounted for by the fact that the particular firm was engaged basically in transport activities, and the bulk of capital was spent on the purchase of transport equipment in Australia. On the other hand, the low figure of ten per cent occurred because the particular firm had bought into an established factory, so that few additions to capital goods were required. For consumption goods, the weighted average was thirty-four per cent, ranging from fifty-two per cent to eighteen per cent. This lower weighted average of expenditure on imported capital goods is explained by reference to the type of production in each area. The production-goods sector makes intermediate or basic products for incorporation into final products, and their activities involve the use of complex machinery in greater quantity than in the consumption-goods sector, which is more often concerned with packaging and other non- or semi-mechanised activities. The highest figure, the fifty-two per cent in the consumption-goods sector, is explained partly by the technical nature of the production process, glassmaking. The factory is at present operating below capacity, but the company chose to do this "because duty free import of plant constituted long-term savings." What this means in practice is that the company expected full utilisation of capacity to occur in later years and argued that economies of scale would eventually be reached. To have installed a smaller plant, they reasoned, was uneconomic. By importing a large plant duty free they saved on future expenditure for additional plant, and acted to forestall possible competition from other potential investors by possessing a large-capacity plant. Foreseeably, the company could protect its secure market position by requesting that the government limit future investments to prevent over-capacity in the sector as a whole. Further questions sought to estimate the value of subsequent imports of capital goods but this was not significant. Clearly firms were aware of the financial and possible competitive advantages to be gained from the initial duty free import of capital goods.

Besides the high direct import content of investment, there was also offsetting expenditure within the country on imported and semi-imported goods, like cars, trucks, building materials and office equipment. Data was not available to determine the value of such purchases, but superficial observation indicated that it would add not a small amount to the import bill incurred directly and indirectly by the company. For example, some earlier entrants in the field were obliged to import their factories because of the shortage of appropriate building materials required by the type of production to be undertaken: capital-intensive production encouraged high capital expenditure on infrastructure. This is further demonstrated by the fact that many companies required a constant and heavy source of electricity, which is costly, time-consuming and sometimes impossible to secure from the local authorities. Companies were often obliged to supply their own source of power, by the purchase of generators and related equipment from foreign sources: several Australian companies did this.

Besides expenditure on imported plant, building materials and other items necessary to Western-style production and management, companies incurred what they called "pre-production" expenses, which were included in the authorised capital expenditure and therefore subject to tax concessions and other benefits. Prior to committing itself to an investment, it is natural for a company to investigate the situation thoroughly prior to implementation. Expenses incurred in this way usually comprise luxury accommodation in international standard hotels, first class air fares, executive expense accounts and the purchase of ground transport.[140] Some "hidden" costs may also be incurred at the pre-production stage since few companies can avoid them. Several companies stated that significant portions of their authorised capital

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[140]The luxurious accommodation enjoyed by almost all foreigners in Indonesia is not by itself of great importance. Nevertheless it does mean that not small sums of money are spent on goods and services that are imported into Indonesia, an unnecessary and arguably excessive use of scarce foreign exchange. Considering that there are approximately 10,000 expatriates living in Jakarta, the foreign exchange cost involved in the servicing of their wants and needs would be considerable. Furthermore, the luxurious and often wasteful life style enjoyed by expatriates contributes to the "demonstration" effect created by the penetration of foreign capital.

expenditure were attributable to unforeseen and costly charges paid to individuals in different government departments. Furthermore, the time-lag experienced by some of the firms meant that additional capital had to be authorised because inflation had increased the cost of imported goods.[141] It was not possible, overall to determine the value of such pre-production expenses since most firms were reticent to discuss them in detail. One company however indicated that sixty per cent of the authorised capital investment had been spent on pre-production costs; little had been spent on imported plant because that firm had bought into an established factory. It is not contended that this was a typical case, but failure to mention the existence of pre-production expenses would constitute an omission in the overall argument which seeks to establish the specific nature of production that the combination of import-substitution and Australian investment produced.

Import Duties

The next point to be discussed is the level of import duties levied on the import of plant, components, spare parts and raw materials. One of the much vaunted incentives to foreign investors under the import-substitution method is supposedly the duty free import of raw materials, components and plant during the initial two years of operation. Yet all but three companies were obliged to pay "duty" on these imports. One of these three companies was especially well connected at high government level and it was learned that their joint-venture partner was instrumental in securing and maintaining duty free import. Another company stated that little difficulty had been experienced due to the advantage derived from the semi-governmental status of their parent company in Australia. At the end of their two-year holiday period a forty-five

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[141]See Appendix C for time-lag calculations.

per cent duty was attached to the imported raw materials, but after negotiation and President Suharto's visit to Australia, it was reduced to twenty per cent: the parent company had been successful in lobbying the government at its highest level on behalf of its subsidiary. The third company to obtain duty free import did so for a saving of $230,000 over the two-year period, and subsequent to that paid a variable duty on different imported items. Reasons as to why this occurred were not made clear, nor could they be deduced from any other evidence. Generally, payment of duties was made "without receipt", a polite term indicating that bribery was necessary to secure the goods. In some cases "duty" was actually paid, due to deliberate misinterpretation of categories of items; apparently a "miscellaneous" column enabled customs officers to make official their dishonesty. More blatant cases of bribery were involved in the long delays experienced by firms trying to clear their goods from the wharves. Attitudes judged inappropriate in bargaining the price of the bribe could mean damaged goods, or even their mysterious disappearance from the wharves. It was a commonly expressed view that it was less costly to pay the bribes than to risk total loss, damage or profits foregone because of non-utilised plant. In addition, storage costs were high and this increased the likelihood of officials refusing to free the goods. For obvious reasons, it was not possible to estimate the increase costs incurred by the firms due to these "hidden costs". Company executives were reticent to give details, although none were hesitant in their criticism of the Department of Customs and Immigration. One firm calculated the actual cost of goods to store at thirty per cent over c.i.f. price, and attributed this mainly to "hidden costs". Another firm cited hidden extra costs at between fifty and one hundred per cent more than c.i.f. price, and one even claimed that during the tax holiday period, full duty had been paid. Furthermore, some companies experienced difficulty in trying to recoup from the Customs Department revenue due to them from prior-paid (but afterwards cancelled) duties. This blockage occurred on several occasions where the company began the import of plant prior to the granting of an operating license, trying to lessen the delay between final approval and the commencement of production. Revenue due was rarely recouped and the time spent in attempting to get it seriously undermined its value to the company.

Once the imported plant was installed and functioning, the firm incurred costs on its maintenance. No accurate estimation of the average cost of maintenance can be given because most companies declined to give a specific figure; when a figure was given, methods of calculation varied from firm to firm.[142] Six companies stated that their maintenance costs on capital equipment were high, and indicated that the import of spare parts (often air freighted) or the necessity of regrinding tools because of their age, had determined this. In one case, the constant need to service vehicles used to transport the product resulted in extremely high maintenance costs (twenty-two per cent of gross profit). In other cases however, the capital cost of maintenance was low, more often in the consumer-goods rather than the production-goods sector[143], although one company in the former group estimated the cost at sixty per cent per annum of the original value of the equipment. This high cost was explained in terms of the age of the equipment and the constant necessity of regrinding.

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[142]For example, the cost in some cases was given as a percentage of gross profit, in others as a percentage of total sales, total costs or of direct costs only.

[143]Costs for the consumer-goods sector varied from 0.2 per cent to 1.9 per cent of gross sales (considered low), to thirteen per cent of total costs, or five per cent of direct costs.

Production Inputs: Their Source

The third point to be discussed is the source of raw materials and component parts. Clearly one result of foreign investment by rich into poor countries is the stimulus to rich country trade, and the increasing dependence of the poor economy on not only the capital goods and technology of rich nations, but on the supply of production inputs as well. Survey findings bore this out. Of the fifteen companies, all but two purchased their raw materials from foreign sources. Reasons for this were variable; in some cases the raw materials were not available domestically, noticeably steel, aluminium, asbestos, various chemicals and milk products. In one case, foreign purchase was made despite the availability of suitable goods locally because duty free import had made import cheaper than domestic purchase. Some firms bought imported cement on the domestic market, in preference to importing it themselves. Even with the duty and "hidden" costs at Tandjung Priok, Japanese-produced cement was sold on the Indonesian market cheaper than locally-produced cement. The three BHP-associated companies commented on the curious choice they faced in the purchase of their major raw material, steel. It appears that the parent company, in seeking new foreign markets for its major product, had allowed the investments in Indonesia partly to ensure such a market. However, the joint-venture companies all commented that BHP steel was too expensive and so Japanese steel was purchased in preference by two of the companies: a third unrelated company commented similarly. The remaining company was obliged to purchase its steel from the Australian parent under a two-year raw material supply contract. A further example of this relationship between investment and increased trade was to be found in the exclusive raw material supply agreement between one parent and its subsidiary, that ran for the life of the joint-venture. The agreement guaranteed to supply the raw materials at "equivalent world market prices" to the Indonesian subsidiary, and, as well to its numerous other manufacturing firms throughout the Southeast Asian region. The original and specific purpose of this network of investments was to facilitate the export of the parent company's major products.[144]

Another company referred to the technical requirements of production as major determinants in the choice of raw material source. In order to compete successfully in an oligopolistic market dominated by a few large foreign firms, technically sophisticated methods of production requiring costly imported raw materials were used by the firm. Companies were competing fiercely to increase their market share and this resulted in the continual upgrading of the quality and technical sophistication of their products. (Raw materials were not available for purchase in the domestic market.) Ostensibly, the rationale for foreign purchase was a technical one, but underlying this was the motive of increased market share for the firm. Another company was similarly obliged to purchase overseas due to lack of quality control and reliability of local materials. Yet the fierce state of competition within its sector of production meant that technically sophisticated products were necessary to hold one's market share.

Several firms were able to purchase their raw materials locally; it was out of the question to purchase unprocessed raw materials, sand and gravel from abroad. One firm had recently acquired its own quarry having earlier purchased its raw materials from a local company. Such backward-linkage diversification was natural and assisted by the fact that the parent company in Australia was well represented in the mining and quarrying industry. Another firm also purchased their sand and

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[144]See Footnote 46, this chapter.

gravel from a local supplier, and a component part from another Australian joint-venture company. Most components, however, were not purchased locally, due to lack of availability. Packaging was usually acquired locally, although one company was able to use DU (aid) funds to purchase tin plate for containers. That same company had been instrumental in the development of a carton factory, independently-owned and supplying all packaging cardboard for the company; its existence was a specific example of the backward linkages that occur from investment in consumer-goods industries.

In conclusion, it was clear that considerations of cost were the major immediate determinants of the source of raw materials and components. Whilst technically-determined factors were also important, in at least two cases they belied the more basic consideration of maintaining competitiveness in relation to other foreign firms. The choice of product (and therefore of technology) of course determined the nature and source of the imported goods, but that choice was not made in isolation: competition often dictated it. Similarly, decisions taken by the parent company could dictate that choice; the example of raw material supply agreements illustrates the point well.

Within the production-goods sector there were two raw material or component supply agreements between parent and subsidiary. One, a contract to supply for a two-year period, meant that the major raw material was not purchased at the cheapest possible price, but did at least ensure an outlet for the parent company's product. The second involved the supply of a chemical necessary to achieve a particular characteristic in the product that was its major competitive quality. The parent company had stated specifically that it sought to increase the sale of its technology rather than the sale of its goods, which because of size and weight, were difficult to export competitively; the investment also generated the sale of spare parts. Both had been important factors in the original investment decision. One further company was supplied by its parent company but there was no formal agreement. In the consumption-goods sector there were also two raw material and component supply agreements. One, mentioned previously, entailed the complete supply of all raw materials for the life of the joint-venture company. Originally, the investment had been made in order to supply a large section of the total market population, and not to restrict their major products to the urban middle classes; indeed the firm had prided itself on this fact. However, the cost of imported raw materials rose so dramatically after the early years of production that the product is now within the purchasing power of only the wealthier classes.[145] The firm had sought alternative raw materials to defray costs to the consumer, but such a remedial action was possible only to a limited degree, since the original intention of the investment was primarily to create a market outlet for the parent company's products: a continual purchase of expensive raw materials could not be avoided. One other company had a raw material agreement, so profitable to its parent that repatriation of profit was considered unnecessary, and its reinvestment was made to enable the subsidiary to achieve a satisfactory level of production. The parent is a proprietory company but twenty per cent of its shareholding is held by one of the world's largest producers of aluminium, the major raw material component of the joint-venture company. Two other companies were supplied with components or raw materials on a non-contract basis. Clearly in the four specific cases mentioned above, the export of capital was used to facili-

[145]Originally, the firm's largest selling product, sweetened condensed milk, sold for about Rp90 per tin. Whilst still out of the reach of many people, it did gain wide distribution at village as well as town and city level. However, the cost to the consumer is now between Rp300 and Rp400 per tin which placed it well above the financial capacities of the majority of Indonesian consumers.

tate the export of goods or technology by the owners of that capital. In conclusion, raw material or component supply agreements can contribute handsomely to the export revenue of parent companies, and are thus a way of indirectly repatriating profits to the parent, as opposed to direct repatriation by dividends.

The Function of Service Fees

The reliance of production under import-substitution on imported physical inputs is complemented by its apparent reliance on foreign technology. Yet when simple technology dominated, as in the majority of cases examined, the payment of technical service, royalty and management fees was demonstrably one further way to assist the repatriation of profits to the parent firm. This is the fourth point which serves to develop the basic argument concerning the specific nature of production that results from the combination of foreign investments and import-substitution. Of the eight surveyed firms in the production-goods sector, six were subject to the payment of some type of technical service or royalty fee to the parent company. Of these, two stated that the technical fee had adversely affected the cash flow of the company, so that renegotiation with the parent had been requested. Both companies were BHP subsidiary companies. Calculation of the fee was either based on a percentage of total sales (two to three per cent and five per cent were two given figures) or consisted of a flat sum regardless of the volume of sales. One company considered the latter method quite unreasonable and had clashed with the parent over payment, wishing to renegotiate for a fee calculated on a percentage basis. No specific information could be obtained from the remaining companies, either relating to the actual amount of capital rapatriated in this way, or concerning the method of calculation. However, enquiries directed to other members of the foreign business community indicated that the generally accepted rate was between two per cent and six per cent of gross sales.

In the consumption-goods sector, six out of seven firms had a technical assistance or royalty agreement with the parent. Rates given for three companies were five and two per cent of net sales. One other company had calculated the fee as a percentage of sales, but had later altered this in favor of a flat fee. Financial difficulties encountered by the one failed company had resulted in the waiving of the technical fee by the parent. In two other cases, both a technical fee and management fee were paid, the latter meaning that the expatriate labor in the joint-venture was paid for by the parent, which then charged its subsidiary a fee for their services. Whilst the technology employed by two firms was stated as being of a "simple" nature, a technical assistance fee was nevertheless still paid. In the opinion of one manager its existence was redundant and served only as an indirect means of profit repatriation.

In sum, twelve out of fifteen firms paid some kind of technical, royalty, or management fee; sometimes a combination of all occurred. Although actual figures were not available it was evident that many parent companies received a proportion of their profits through the payment of these fees. Whether or not such assistance is necessary to production for the life of the firm was not factually evident; however it may not be disputed that the widespread use of these and other indirect means of profit repatriation is common to many similar situations in other industries and in other countries.[146] The nature of the technology

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[146]It is important to note the increasing volume of "technological payments" to be made by the poor countries. They "have resulted in considerable strains on the balance of payments of almost all developing countries. The proportion of such payments to total efflux of repatriations varied from fifty per cent in India, to seventy-eight per cent in Brazil, and seventy-two per cent in Argentina, according to U.N. statistics for 1971." Venu, S.: "The Multinationals and Developing Societies; A Profile of the Future", Futures, April 1974, p. 137.

involved strongly suggests that these services could well be curtailed much earlier than at present seems likely.

The State of Competition

It has been observed that import-substitution in Indonesia relied heavily on protection through high tariffs, restricted import and the existence of the 'restricted' or 'negative' list. Abuses in all three areas were widely practised, and the weak or 'soft' state of the legal and administrative infrastructure did much to encourage these abuses. It is possible at this stage to turn to the fifth point and examine the state of competition experienced by the companies, and the degree of protection which they enjoy. Of the fifteen companies, four were in a position of monopoly, or near-monopoly, eight were in a position of oligopoly and the remaining three experienced fierce competition. Within the oligopolistic situation there was fierce competition amongst the few companies that dominated the market, and the one failed company had been seriously weakened by its foreign rivals.

Those four companies experiencing a monopoly or near-monopoly situation did so for several reasons. Two had been placed on the restricted list; one of these experienced very limited competition from a small Chinese firm and individual producers, and there was some competition from imports. Furthermore, quality control of the product gave them more advantage, since a guaranteed quality was required by the major purchasers of the product which thus effectively excluded local firms from offering any effective competition, which overall was so small as to be negligible to the company. One other company was in a monopoly position because prior to investment it had secured an unwritten guarantee from its politically powerful partner, the DKI (the Municipality of Jakarta), that promised to ensure that no further licenses would be issued to make the product, ready-mixed concrete. For the first three years, the company experienced no competition at all, and expanded at a rate far greater than was initially expected by the parent company. Competition from local producers was not significant, since the domestic producers aimed their product at different markets. The local product was batched on site, used simple technology; it could not be of guaranteed quality because the essential but expensive ingredient, cement, was often skimped. Although the foreign product was fifteen to seventeen per cent more expensive than the local, the company maintained its market share easily because guarantees of quality, and punctual delivery, made the product more attractive to the large-scale building projects which it serviced. The company's local partner, the DKI, was one of the largest building contractors in Jakarta and was thus able to secure much of the market for it. The DKI had sought to guarantee a large and almost exclusive market for this joint-venture company, but in November 1974, the BKPM had issued another license to a foreign (U.S.) company. For three years the DKI had managed to discourage new entrants to the field, but it appears that the BKPM nevertheless decided to issue another license. (This new company has not yet begun production, so the Australian firm was still in a monopoly position.)

The third firm to experience an effective monopoly, like the two previous companies also had the DKI or subsidiary as its joint-venture partner. The area was not closed to further foreign investment, but influence derived from the political position of the local partner had (so far) provided a monopoly situation. The company's largest competitor, Pertamina, accounted for seventy per cent of sales, was also its local partner, but their plant was old, techniques poor and production very low. According to the joint-venture company, they offer no serious competition.

A fourth firm had secured a monopoly position for itself by purchasing the right to produce in an area designated as permanently closed to foreign investment. Negotiations with the administration had guaranteed that no further exceptions would be made, so for the sohpisticated manufacture of one product, concrete tiles, the company experienced a monopoly situation. Competition consisted of domestically produced goods of lower quality to be directed at the low income and agricultural market; they were of no consequence to the firm since their market was the modern sector, whilst that of most of their competitors was within the 'traditional' sector.

Eight companies effectively experienced situations of oligopoly, and whilst three described the competition as fierce, it was observed that it existed between several large foreign companies battling for a share of the too-fragmented market. The government has attempted to direct investment into preferred sectors, precisely to avoid overcapacity of production and prevent market fragmentation in any one field by restricting the number of entrants. However, irregular practices prevented this, and other contradictory government policies severely weakened its effectiveness.

Four Australian joint-venture companies commented on government policy and market fragmentation. The first, in a strong but not dominant position, experienced competition from state and private enterprise (the latter being owned by different sections of the military in partnership with a Chinese-Indonesian firm), and from domestic enterprises with foreign financial support. A curious situation existed where the firm's local partner, a state enterprise, was also their strongest rival. Fragmentation of the market had meant difficulty in achieving economies of scale, a factor particularly relevant to profitability in this area of production, industrial gases. As a consequence, the firm asked that the area be "closed", but in response were requested by the government to draw up a "master plan" with a view to rationalising the industry. The firm did so, and effectively asked the government for a monopoly in the West Java area, and further recommended that the remaining five companies be relocated in other regions where at present no such industry existed. Understandably, the plan was rejected by the five competitors; it appeared that the Department of Chemical Industries contained some progressive administrators and entrepreneurs, including the joint-venture company's local partner and chief competitor, as well as other leading competitors. All were keen to contain the expansion of the Australian firm, which by its superior technology and experienced management maintained a superior market position.

Failure by the government to honour pre-investment agreements had been instrumental in the demise of one joint-venture company. The government had issued assurances to this company that no further licenses would be issued to foreign companies and that smuggling would be brought under control. The investment had then been made on the understanding that a secure market share was guaranteed; at that stage they were the fourth and final company to be given a license to manufacture printing inks. Subsequent to this, a British company had purchased a license, and later, yet another had been acquired by a Japanese company in partnership with the DKI. At this point market fragmentation was great and whilst the central government was disturbed, it was unable to prevent its evolution. Instead of the planned four investments, six had been made. These six, however, controlled the market for sophisticated inks since locally-produced inks were not of the appropriate quality to be used on new highly sophisticated printing machines.[147] The Australian joint-venture company explained that their failure was due in part to unexpected market fragmentation and the fierce competition practised within the

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[147]These printing machines were financed through tied aid funds according to the general manager of the joint-venture company.

oligopoly. (It will be recalled that the parent company had refused to allow its subsidiary to engage in unorthodox practices, and that this had been another reason given by the general manager, for failure.) Clearly the other foreign firms had been able to purchase a market share and eliminate their weakest competitor.

A similar situation occurred in another area of production, where an Australian joint-venture company had been the first to receive approval for the manufacture of steel castings and pipe-fittings. Subsequently, an Indian and a domestic firm had been issued with licenses. The company anticipated further fragmentation since in their opinion the government was attempting to counteract abuses that had resulted from the monopoly practices of many foreign companies. The company planned in the near future to request protection from imports and to continue pressure on the government to restrict further investments.

A fourth firm had been faced with a similar problem of unexpected market fragmentation. This firm controlled seventy per cent of the market for tinned sweetened milk and reconstituted milk despite the fact that three other large foreign firms produced the same item. The last firm to receive a license did so by purchase, had spent $10 million to date and without having reached full commercial production was experiencing difficulty due to the market fragmentation that had already occurred. Those three firms that had reached full commercial production controlled the market almost totally, the area was closed to further foreign investment and competition from smuggling, widespread in the past, was now minimal. In 1971, however, competition from imports (now banned) caused a fall in profit for the joint-venture company, and to redress the situation a reduction on duty payable on raw materials was requested and granted. The firm commented on the high profitability of the venture, and attributed this to the protection they received.

Competition from local producers was not as yet a problem, although concern was expressed at the rapid growth of a small local company, producing "filled" milk by using low fat content vegetable oils in lieu of the expensive imported alternative. The result was a cheaper but palatable product that had begun to encroach upon their market; as yet the company was undecided on the most appropriate course of action to control this new competitor, but had considered either his incorporation or an effort to restrict his sales by influencing the distribution network.

Four further companies enjoyed an oligopoly situation. One, having taken over by purchase its strongest competitor and given it the status of partner, was in a strong but not dominant position, with competition from small local and large foreign companies. By placement on the "restricted" list of its major product only, the company was assured of protection and limited market fragmentation, but it remained highly sceptical that the situation would remain stable for long. A ban on the import of building materials guaranteed another company protection within an oligopoly of four firms. Competition was keen and the company indicated that, at a later stage, they would request that the area be closed. Smuggling of cheap imports from Japan was an embarrassment as well as a problem since the goods could be landed in Indonesia cheaper than any of the four foreign companies could produce them in Indonesia.

In the area of glass container manufacture, another Australian joint-venture company was well placed within an oligopoly of three large firms and some forty-five smaller companies; these latter offer no direct competition due to quality considerations. One of the major investors, a state-owned enterprise, received technical and managerial assistance from the Australian joint-venture company, and it was explained that destructive competition between the two had been minimised by a market sharing agreement. Competition also came from a "domestic" company, which was in fact a disguised foreign venture. Smuggling of secondhand glass bottles was a problem together with recycling of non-returnable bottles. No-deposit bottles did not easily remain so when the poorest urban dwellers can eke an existence by scavenging and reselling them to small soft drink manufacturers.[148] (Legal imports had been reduced to a minimum by increased tariffs at company request.) Recycling and extensive smuggling were major irritants to the company; but for their existence it would have enjoyed a classic oligopoly situation.

A much fiercer degree of competition existed in another oligopoly encompassing three joint-venture companies and one local manufacturer. The situation at the time of enquiry was clearly very delicate, and the general manager was reticent to give any but the most vague answers to all but a few questions. The company had been promised closure of the area after two licenses had been granted, but not surprisingly the guarantee was not permanent and later negated by the issuance of other licenses, even though the area was officially closed.

Only three of the fifteen companies could be described as experiencing "fierce competition" from a large number of producers. One area where severe market fragmentation had occurred was in pharmaceutical industry. Prior to 1966 an Australian joint-venture company had been the only foreign pharmaceutical company manufacturing in Indonesia. This monopoly had been completely destroyed during the first few years of the New Order government when some twenty-seven foreign companies obtained licenses to manufacture, and as many more to import their products. In April 1974 however, on request from the industry as a whole, imports were

[148]Whilst the bottle may be specifically molded for a particular product, this does not deter the small manufacturer from re-using them by placing his own paper label over the molded one. It is considered by many Indonesians that these latter soft drinks are inferior to the "Western" product with the international brand name, although in fact they will often contain more real fruit and less chemical additives than the latter. This again indicates the "demonstration effect" at work.

banned; but extensive smuggling still persists, and competition from domestic and foreign sources is great. Another company competed with five local companies of comparable size in an area not closed to further investment: smuggling was not a problem due to technical factors. The situation could conceivably become oligopolistic since the joint-venture company was looking to supply a far greater proportion of the market, when production difficulties were overcome. It intended to seek protection when it felt capable of supplying most of the market. One other firm experienced a fierce state of competition that had been completely unexpected. Like the ink-making and building supply manufacturers, the company had been given a verbal guarantee of closure, but within the year, three more foreign and one domestic investments were licensed. Severe market fragmentation had resulted and the area still remains open, for a price. Smuggling offered some competition, as did imports, which are often purchased by the government with 'tied' aid funds and usually offer competition to domestic producers. High raw material costs meant that Singapore producers could land the goods cheaper than they could be domestically produced. In addition secondhand plant had been imported by a Chinese manufacturer who was producing the same product much more cheaply than the capital-intensive Australian investment.

The information above clearly indicates that at least twelve companies enjoyed a highly-protected position and were often able to substantially control their market environment. Three companies stated that protection would be sought in the future whilst others had successfully negotiated a desirable degree of protection. However uncertainty prevailed for five firms who were given guarantees of closure that proved not only worthless but damaging, since in several cases the investment decision hinged on these guarantees. Despite this, most companies enjoyed privileges at the expense of imports (which in at least two cases were cheaper to land than the same goods produced domestically), and as well at the expense of small indigenous producers; their main competition derived from the existence of other foreign companies. Nine companies stated their major competitor to be other foreign companies, and of those nine, two considered smuggling to offer as much competition as domestic production. Two firms experienced their major competition from domestically-owned firms, and the remaining four indicated that no serious competition existed.

The Nature of the Market

Having established the degree of privilege afforded the firms through protection and restricted competition, it is possible to move on to the sixth point of this enquiry that seeks to establish the specific situation that the combination of foreign investment and import-substitution produces. It is concerned with the nature of the market to which production is geared and the percentage of market share currently held by the company.

Six companies were legally restricted to the Jakarta or West Java region, but several use their distributors to increase market penetration outside the prescribed area. The remaining nine companies distribute domestically but because of the nature of the products, and problems of distribution, this was generally restricted to Java. Three companies, however, sold their products, non-durable consumer goods, throughout the archipeligo. Two other firms had definite plans to export their products to third countries, and more could do so, depending on the conditions of production by the parent company and economic conditions within Australia overall. Labor and raw material costs as well as industrial policy overall will affect these decisions.

The market for the fifteen companies' products was divided basically between the consuming public, the building and other industry. Six companies provided a variety of products to the modern sector of the building industry which was located mainly in Jakarta. Six firms supplied the general public with consumer goods.[149] There were nine companies manufacturing production goods and six consumer goods. Some of the latter were not sold directly to the public but have been classed as final products because, as individual items, they are complete (bottles, collapsteel tubes, steel louvres). The main point concerning the market for all goods produced by the firms was its class base, geographical concentration, limited size and in most cases its restricted potential for growth. The implications of this and other facts presented above will be discussed in the next chapter where an attempt will be made to draw them together and evaluate the effects of this resultant combination of import-substitution and foreign investment. At this stage, however, empirical data still remains to be presented: the following is concerned with discussing the structure of production costs and the profitability of the fifteen joint-venture companies.

Production Costs: A Breakdown

Two further areas of enquiry that assist to establish the type of industrialisation fostered by the combination of import-substitution and foreign investment are those concerned with the breakdown of production costs and the level of profitability for individual or groups of firms.

It was not surprising to find firms reticent to indicate the precise structure of their production costs. The high predominance of imported items in the expenditure of the initial investment and the need for continual foreign purchase has been previously noted. Further

[149]Products supplied to the building industry include asbestos cement sheet, concrete blocks and tiles, steel roof and wall cladding, bright wire and steel reinforced mesh, malleable cast iron pipe-fittings, ready-mixed concrete and aluminium louvres. Products supplied to other manufacturers included pails and drums, refined lead ingots and alloys, industrial gases, collapsible tube, glass bottles and containers. Products supplied to the consumer were reconstituted dairy products, pharmaceuticals, boot polish, household cleaners and insecticides.

enquiries sought to establish the relative importance of individual factor costs, with particular reference to the percentage accounted for by labor and raw materials respectively. Unfortunately, great variety in the quality of response to questions pertaining to cost meant that no precise breakdown of items could be calculated. Yet it was clear that direct labor costs were a very minor proportion of total cost, raw materials the highest cost, with other items varying in importance from company to company, depending on the requirements of production and distribution. In the production-goods sector, raw material costs averaged sixty-two per cent of total cost (mean average), ranging from a high seventy-six per cent to the lowest given figure of forty-five per cent. Direct labor costs on the other hand averaged 4.9 per cent of total costs, with a range from seven per cent to 1.8 per cent. In the consumption-goods sector however, labor costs were a much smaller proportion of total costs, ranging between one per cent and 2.5 per cent. Raw material costs were also less for this sector, with a weighted average of 50.15 per cent of total costs; individual costs ranged from sixty-six per cent to 28.6 per cent. The discrepancy between the two groups in relation to labor costs is due to the fact that in the production-goods sector, more skilled and semi-skilled labor is required than in the consumption-goods sector, where packaging and other simple skills are mainly required. Distribution and packaging costs are thus higher for the latter group, because of the type of products manufactured. For three companies within the consumption-goods sector, packaging costs were high: in one case fifty per cent of the total cost was accounted for by packaging, for the other two it was thirty per cent and eight per cent respectively. These two companies produced directly marketable consumer goods, and distribution and marketing costs for them were also high, in one case thirty-three per cent of total cost: advertising accounted for five per cent of total cost for the other company. (Fuel costs were not a major factor except in one case, where it constituted a high 8.2 per cent of total cost.)

Within the production-goods sector, marketing and distribution costs were not as important as overheads, which in three cases were very high (37 per cent, 22 per cent, 22 per cent of total cost). The firms were aware that overheads should be reduced as it was one of the major direct ways of increasing profits when other costs were for the most part fixed or likely to increase rather than decrease.

Within the two sectors, relative cost structures differed because of the type of product being manufactured; most important however, was the fact that raw material costs overall were the greatest individual factor cost, whilst direct labor costs were minimal.

Profitability

The profitability of the companies was also an area of enquiry; the privileges enjoyed by the Australian firms has been established in the preceding pages and was reflected in overall profitability rate. In 1972 Suhud, Vice Chairman of the BKPM, noted the profitability rate of Australian investments as between 1967 and 1970 at eighty-nine per cent realisation on initial outlay, second only to the Dutch who realised 107 per cent.[150] He attributed this to the concentration of Australian investments in the import-substitution light manufacturing sector, where investments were small in comparison to those in resource exploration and

[150] AFR, 4/2/72. Suhud claimed that this high rate of return was due to the fact that investments were made in the light manufacturing sector. See also McClean, D., "Australia and the Expansion of Capitalism into Indonesia", op. cit.. McClean estimates a return of eighty-nine per cent on invested capital by Australian firms over the 1967-70 period, in comparison to an average of thirty per cent for all foreign investment.

extraction, where gestation periods were much longer and risks greater. He further noted the contribution of government policy to the high profit rates experienced by the firms. The following passage from a CEDA publication encapsulated his inference: "The importation of plant and equipment and the outward remittance of funds in the form of interest, dividends, debt service and other expenses, have been made simpler and cheaper. In addition, the income tax levels have finally been reduced from the unrealistic level of sixty-five per cent to a maximum rate of forty-five per cent."[151] Of the fifteen companies, only one had experienced a negative profit rate. No figures were available, but the manager explained that the date of withdrawal would be dependent upon the rate of appreciation of the land and factory owned by the company. Eventual sale would allow the recouping of losses by the company which could then be dissolved. Another company, not included in this survey because it had ceased operation, was similarly awaiting the sale of its assets to make up for losses incurred during the lifetime of the investment.

For the remaining fourteen firms profitability ranged from very high to moderate. Return on invested capital was expected within five years for three companies. Although foreward estimates predicted this, the general manager of one joint-venture firm had indicated his preference for a longer pay-out period of ten years. He considered that the long-term political and economic advantages for the firm clearly indicated this to be a wise policy. Another company viewing the investment as risky, expected return on capital within five years and already appeared to be well placed to achieve this; the parent company had increased profits by 7.6 per cent, despite a fifty-seven per cent tax boost in Australia and had attributed this to its Indonesian and New Zealand

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[151] Hardaker, M.B.: Foreign Investment in Indonesia — A Discussion of Problems, CEDA, op. cit., Introduction.

operations. A third company expected capital back plus twenty per cent within the five-year period. Other expected rates of return ranged between one and four years since companies considered their investments to be of high risk nature. Eight companies declined to comment specifically but two firms did indicate the status of their profit rates. They described the investment as highly profitable; one referred to the 1974 tax payment of $2 million gross turnover on the initial investment of $0.4 million. Three companies declined to make any comment at all and were noticeable generally for their reticence to provide any detailed information. One was in a delicate state of market stabilisation and guarded its activities quite secretly, another was in the process of ridding itself of the first joint-venture partner whose business methods and demands on the firm had not been acceptable to the Australian management.

Policy on the reinvestment of profits was mixed. Six firms declared their preference for the reinvestment of profits until such time as the venture was running smoothly, or in two cases for the financing of additional investment. The remaining nine companies chose not to divulge company policy on this matter, but indicated only that a proportion of profit was to be used for reinvestment and the rest to be repatriated. On several occasions, parent and subsidiary had conflicted on the issue of repatriation — but no further details were available.

The profitability of any investment depends on many factors, but in this specific situation it is not unreasonable to conclude that the actions of the government in ensuring a protected and often captured market for the foreign investors have been instrumental to a large degree in guaranteeing an overall high profit rate to already privileged investments. This high profit rate is also indicative of the overall perceived high risk nature of the investments. Factors contributing to this include irregular business practices and infrastructural bottlenecks, both of which appear deeply rooted and persistent, despite numerous and ongoing attempts to eradicate them. They simultaneously hamper the efforts of many pribumi to expand their enterprises, and assist to justify extremely high profits for the foreigner.[152] One final aspect of their privileged position is the financial advantages enjoyed by foreign companies.

The Pattern of Privilege Continued: Finance

The indigenous business class usually experienced great difficulty in obtaining adequate, continual and low-cost capital supplies to finance their operations. This applied to both long-term finance, and short-term loans for working capital. Conversely, foreign companies were advantaged by their access to cheaper capital obtainable within the country through foreign-owned banks, or outside the country, on the international money market, from banks or from their parent company. Enquiries directed to the fifteen firms revealed a similar availability; all companies bar one indicated their source of both loan funds and working capital. Of the original loans procured for establishing production facilities, seven were provided for by the parent company, and one from a minor foreign shareholder (PICA)[153], whilst five were obtained

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[152] The question of the importance of subsidiary profits to the overall profit of the parent company is one which unfortunately was not possible to determine accurately or in any detail. However, it is true that in several cases the substantially increased profits of parent companies in Australia has been in part attributed to the operation of overseas subsidiaries. For example, AFR, 25/8/76 (Chanticleer column), reported that ARC's forty-one per cent increase in profit in 1975-76 was in large part due to the overseas investments made by the company, including that in Indonesia. The significance of this is more outstanding when it is realised that ARC in Australia operates in one of the most depressed sectors of the building industry. Similarly, Concrete Industries (Monier) attributed its massive profit increase (80.4 per cent) in part to the increased profit of its overseas subsidiaries. AFR, 20/8/76. Kiwi's big rise in profit for 1976-77 was similarly attributed to the expansion of overseas markets and not from economic activity in Australia. The News, 5/3/77, p. 60.

[153] PICA was conceived within the Pacific Basin Economic Council

from foreign banks either in Jakarta or from overseas sources. A further six loans were provided by foreign banks in Jakarta for additional capital expenditure. Working capital was also acquired by five companies from these banks, through loans, and by two companies through overdraft facilities. Four firms used internally generated funds for working capital and two a combination of loans from the international finance market and internally generated funds; one further company obtained working capital mainly through a credit arrangement made with the foreign supplier of raw materials.

The reader will remember mention of DICS rupiahs in Chapter Two. A source of cheap rupiahs for foreign firms, they were available to them _for use within Indonesia only_. Curiously a number of the joint-venture companies knew nothing whatever of their existence, whilst several indicated that they were very difficult to obtain unless 'private sources' or 'inside contacts' arranged their purchase. Only three companies had used DICS rupiahs; one had used them in an illegal fashion: in their words, "to lower the exchange rate"; one used them to finance the building of the factory, and the third company acquired a small quantity early in the investment but had been unsuccessful in attempts to secure more. A fourth company was less fortunate and despite some effort had failed to purchase any. This limited availability of DICS rupiahs to the companies corresponded with the overall scarcity that was noted in Chapter Two.

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153 (cont.) by the Japanese Committee. Formed in 1969 as a private international investment company, its aim was to make and facilitate private capital investment in Asia. One-third of the capital is Japanese, one-third American, with the balance contributed by Australian, Canadian and European countries. Over the past seven years PICA has participated in financing various industrial projects, either through equity participation or financing. To May 1976, PICA has invested $12 million in nine joint-venture projects in Indonesia, covering textiles, cement, cables, glass and steel manufacture. A further $10 million is to be spent on the production of synthetic raw materials. _Indonesian Newsletter_, 18/5/76.

Whilst DICS rupiahs were difficult to obtain, it is clear that the joint-venture companies enjoyed adequate access to credit facilities for both long- and short-term loans. This relative ease of access must clearly have advantaged them in respect of the indigenous business class, whose historically poor entrepreneurial record has been partially determined by inadequate access to finance. By contrast, the joint-venture companies, as subsidiaries of foreign companies, enjoyed the privileges that foreign status brought, not the least of these being access to cheaper, better serviced, and more reliable sources of finance, which made the maintenance or increase of profit rates a more controllable and possible task.

The preceding pages have sought to establish the specific nature of the situation that the combination of import-substitution and foreign investment produced. The remainder of the chapter will be devoted to the analysis of the three other major areas to which research was directed; namely labor, technology and the character and role of the local joint-venture partners. Each will be dealt with in turn.

THE QUESTION OF LABOR

One of the most prominent issues concerning the effect of foreign investment in Indonesia, or any poor country for that matter, are those pertaining to the creation of employment and to the type of employment and in Indonesia, since the riots of 1974, there has been increased official concern about unemployment. Investigations directed to the Australian companies were oriented to determine both the volume and character of the employment generated by the Australian investments, and concentrated on four major areas of enquiry.

The first sought to establish the nature of the functional and racial divisions within the labor force and the second focussed on wage rates, contracts of work and the current status of side benefits. The third area of enquiry covered the theoretical and practical status of the Indonesian labor laws, whilst the fourth that of training facilities. These areas of enquiry were pursued because it was clearly essential to illustrate not only the power of metropolitan capitalist classes over the indigenous capitalist classes in Indonesia, but as well to outline the characteristics of the urban working classes whose formation is stimulated by direct foreign investments.

Functional and Racial Divisions

The first area of enquiry sought to discover the functional breakdown of employment created by the investment, between administrative, professional, skilled, semi-skilled and unskilled labor[154], and to establish the existence if any between the type of employment held by the two major racial groups, indigenous Indonesians and Indonesians of Chinese origin. A total of 2390 people were employed by fifteen companies, thirty-nine of whom were expatriate Australians. Of the remaining 2351, sixty-five per cent were unskilled workers, twelve per cent were semi-skilled workers and seven per cent skilled workers. Of the unskilled workers, the majority were direct factory labor, whilst a few were employed in the administrative section or in unskilled jobs like cleaning, gardening, and security. Several factories employed all unskilled labor in the direct production process, and only one company employed more semi-skilled than unskilled labor.[155] The seven per cent skilled labor

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[154]An unskilled worker receives a few hours or days of training on site and is then classified as semi-skilled.

[155]It is doubtful whether the general manager of this latter company applied the same criterion for "unskilled" and "semi-skilled" as his fellow expatriates. Further enquiries related to technological factors revealed that a predominantly unskilled workforce was probably employed since the "skills" required to operate the machinery were basic, involving in the main, assembly and packaging.

was not spread evenly through the total population of workers, since five per cent was employed by three companies whose particular production process required proportionately more skilled workers than was usual. These workers were drivers of heavy trucks and operators of machines that required critical supervision. The unskilled work involved, in the main, process work, assembling, packing and labelling, whilst semi-skilled work involved the employee in highly regularised tasks, usually with large machines that required constant but not complex supervision.

In the administrative section, eleven per cent were classed as clerical staff, but a proportion of these were also unskilled workers, messengers, tea boys and other support staff. A further 3.5 per cent were employed in distribution, but the majority of these were accounted for by two firms who distribute their goods directly, contrary to Indonesian law. Local managers comprised one per cent of the total work-force but again the number was not evenly distributed throughout the population. Only six companies employed local managers and half were accounted for by one firm. Engineers accounted for 0.4 per cent of the workforce, and were employed by two companies only, the remaining firms relying on expatriate staff. A number of the local engineers and managers had been trained in Australia under the Columbo Plan, and another in Japan under a similar aid program. One firm had a conscious policy of employing local senior staff, with preference given to those who had been trained in Australia, knew something of the country and had a familiarity with Australian technology or business methods.

As well as these clear-cut divisions between the skilled and unskilled labor employed by the firms, there was some evidence of a further division, based on race, but precise information was not available from the six companies whose expatriate managers were reticent to give information about politically sensitive areas. However, of the remaining nine companies three employed Indonesian-Chinese in all upper echelon and administrative positions, and in the remainder a large but indeterminate proportion were similarly employed. Areas where Indonesian-Chinese were predominant were accounting, management and secretarial positions. The expatriate management indicated that circumstances of great scarcity of suitable indigenous Indonesians necessitated this. Only one firm specifically mentioned the potential political problem involved with the large-scale employment of Indonesian-Chinese in white collar and executive positions, and pointedly referred to company policy which kept the maximum level of their employment at thirty per cent of the total.

Further Division through Wage Differentials

The second major area of enquiry pertaining to the question of employment was concerned with wage rates, contract of work and current status of the side benefits aware to labor. Enquiries brought the conclusion that there was a great discrepancy in wage rates between unskilled and semi-skilled workers, skilled workers, and the white collar and executive employees. Unskilled and semi-skilled workers earned on average between $10 and $10 per month. Not all firms were willing to indicate the precise levels of their wage rates, but did comment on the very low wages of the majority of workers — between $0.50 and $1 per day. On the other hand, skilled workers received from $35 per month and upwards, depending on the skill and availability of labor.[156] One company stated that its skilled workers were paid ten times more than its unskilled

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[156]This discrepancy between the wages of skilled and unskilled workers is not new. Hawkins observed that in 1953 skilled workers received between two and four times the wages of the unskilled. At that time as well skilled workers were relatively scarce, a factor which led to the weakening of organised labor. Hawkins cites the International Labor Review, Volume 70 (1954). Hawkins in Galenson (ed.), op. cit., pp. 109ff.

workers but overall the discrepancy between wages paid to this latter group and white collar and professional employees was even greater. Accountants and engineers received $500 per month and senior administrative staff $800 per month. The salary of expatriates was between $15,000 and $30,000 per year, this figure not including "extras" like free accommodation, transport and travel.

Contracts of work similarly varied according to occupational status. Of the 1962 workers involved directly in production, twenty-five per cent were employed on a casual or daily basis; the worker could be a full-time employee of the firm but liable to dismissal at a moment's notice; or s/he could be hired on a daily basis when production required it and dismissed without notice. The figure of twenty-five per cent is probably too low since incomplete figures necessitated estimation in some cases, and as such is a conservative estimate. A further five per cent of direct labor, all employed by one company, were engaged on a weekly basis but assessed on a daily basis; they comprised the total direct labor force of that particular company. The remaining seventy per cent of total direct labor were employed on a monthly basis, beginning their term of employment on a three-month trial or probation period. Although no data was available for calculation of similar figures for administrative and other white collar staff, the shortage of such workers and their consequent high demand would strongly suggest a much greater stability in their contracts of work than those applicable to their more numerous and expendable fellow employees. Expatriate employers appeared conscious of this situation and payed administrative and clerical staff much higher rates than direct labor, and generally payed higher rates to their employees than did local companies. Eight companies indicated that this was a deliberate policy since "poaching" of workers was common in several areas of production, particularly in the pharmaceutical and metal-related industries. Two companies complained that "poaching" was a considerable problem to the firm; one explained that intense competition within the pharmaceutical industry had prevented wage-fixing agreements within it and extensive "poaching" of skilled workers had resulted. However, two other companies had successfully negotiated wage-fixing agreements with other foreign companies engaged in the same or similar area of production, had thus eliminated the problem of poaching and at the same time kept wages at a level determined by the employers.

Payment of penalty rates was varied, but information on this subject was not complete. Five companies paid overtime, two did not; three paid penalty rates, the rest did not. Only five companies worked shifts; four worked three eight-hour shifts and one, two twelve-hour shifts, the latter without payment of penalty rates. Whilst some companies did pay penalty rates for shift work, they indicated that it was of no real consequence to the overall structure of the wage bill since there was no stipulated minimum wage from which to calculate over-award payments. Employers simply took a very low base wage on to which they added their estimation of suitable penalty rates. Casual workers and day laborers employed at $0.50 per day, on average received no overtime payments or other penalty rates. But those employed on a monthly basis received a guaranteed monthly wage often supplemented with a number of side benefits.

Traditionally in Indonesia a large portion of wages are paid in kind and may include a rice, clothing and travel allowance, medical coverage and a bonus during Lebaran, the major Muslim religious period. Clearly relationships between employer and employed differ according to the mode of production; under the traditional and colonial system this relationship was not governed <u>only</u> by the payment of a money wage, but was defined within a very paternalistic framework. The employer would often concern himself with the family matters of his employees, see to their medical needs, and to those of his family, offer advice and sometimes financial assistance in times of need. These social obligations exerted far greater pressure on the employer than his Western counterpart in the modern sector would face, and contributed as well to his social status within the community as a whole. The employer, a wealthy man, was expected by society to assist his less fortunate fellows; failure to do so would mean a severely damaged reputation in a much smaller, close knit society than Jakarta. At the rural level too, the same sense of social obligation meant that the rich farmer must allow whoever wished, to harvest his crop and thus receive the traditionally decided share of the harvested grain. Because of the existence of pre-capitalist methods of payment questions were directed to the company to determine their status. Only one company retained the full system intact. Six companies retained elements of it, but had phased out certain aspects: changes had occurred within the traditional system to make it better serve the needs of the company; for example, rice and clothing allowance were substituted for benefits that more directly promoted company loyalty. One firm complained that cash payment only was preferable to the management, but had been impossible to accomplish. Yet four companies did pay in cash only, seeing it as a more rational and controllable system than the traditional method of payment, which they considered involved irregular and undesirable claims on them. One firm maintained the traditional payments as part of a rational economic system to foster company loyalty and to ensure healthy workers by supplying them with a midday meal. Most companies provided meals for workers, except those who had adopted the labor-for-cash system; many firms were obliged to provide transport because of the location of factories far from public transport.

In contrast, benefits for senior white collar and executive employees sometimes included accommodation and transport, payment of income tax and comprehensive insurance policies, as well as medical and dental coverage for the immediate family. Several firms had also taken insurance policies for their direct factory labor, covering hospitalisation and/or death. One firm showed a high level of interest in their workforce as part of a conscious public relations policy directed toward both government and their workers; this included the encouragement of sporting teams and consideration of religious matters.

The observed pattern of clear-cut wage differentials between different occupational groups is important not only for the political and social reasons indicated above, but as well for factors pertaining to company profitability. The economic significance of the large discrepancy between wages and salaries paid to different occupational groups is made clear when comparison with Australian manufacturing industries is considered. Allowing for those unskilled Indonesian workers not involved in the production process, a conservative estimate of those involved directly in production is seventy-five per cent.[157] Of the total wages and salaries paid to all employees of the companies, this group receive only a small proportion relative to their numerical size. Precise details were not available but the prior given figures clearly indicate that the total wage bill of production workers, who constitute the bulk of employees is small in comparison with that deriving from payment of administrative and professional staff. The importance of this low and stable wage bill to company profitability is difficult to assess conclusively, but when it is compared to the Australian wage bill for the same industry classes, it is clear that joint-venture firms derive advantage from the low cost of direct factory labor. Within comparable industries in Australia, direct labor costs range from between thirty-five to eighty per cent of the total

[157]Skilled labor (seven per cent), semi-skilled (twelve per cent) and unskilled (sixty-five per cent): total eighty-four per cent. Allowing for those not directly involved in production process, the estimate is seventy-five per cent.

wage bill, with a greater proportion of these costs above the fifty per cent mark. (See Table B.*) In Australia then, the cost of direct labor is far higher than it is in Indonesia, a factor which must contribute significantly to the overall high degree of profitability enjoyed by the joint-venture firms.

Unions with no Power; The Law with no Teeth

The third major area of enquiry concerned the implementation of the labor law and the status of unions. It was observed in Chapter Two that the implementation of laws was neither easy for administrators, nor desirable for persons subject to it. The labor law of the present government, inherited from the early days of independence, is a comprehensive body of legislation covering a wide area of activity, but significantly it does not stipulate a minimum wage nor incorporate provisions for its establishment. The law is administered by the Department of Manpower and formally protects the rights of workers and ensures that obligations of employers are fulfilled. To assess its effectiveness enquiries were directed to the companies concerning their experience in the application of the law; the results were markedly uniform in all but two cases. In theory, the firms regarded the law as highly restrictive to management and comprehensive in scope, but it was generally acknowledged that with the correct approach, remarkable flexibility could be achieved. In law, a company may not dismiss a worker before three letters of intent to dismiss are dispatched by the company to the worker; furthermore the Department of Manpower must given final approval for dismissal. Yet dismissal without license, especially of unskilled workers was found to be widespread.[158] If negotiation with the administration was required, unofficial payment could be made to both the government official and the

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[158]The Indonesia Letter of March 1975 stressed that nobody enforced the obligatory collective labor agreements.

* See overleaf.

Table B

AUSTRALIAN INDUSTRY: WAGES AND COMPONENT COSTS

1 Industry Class	2 Name of Australian Parent Firm	3 Total Paid to all Employees ($000)	4 Total Paid to Production and all Other Workers (except administration/office/sales and distribution) ($000)		5 Material Component Supplies ($000)
milk products	Australian Dairy Corp.	98,830	62,771	(35%)*	641,399
pharmaceutical products	Nicholas International	53,036	22,167	(40%)	76,867
industrial gases	Commonwealth Industrial Gases	← not available for publication →			
inks	Sydney Cooke	6,233	3,317	(52%)	11,187
glass products	Australian Consolidated Industries	48,495	36,395	(76%)	33,460
ready-mixed concrete	Ready Mix Concrete (CSR/BMI)	20,860	9,872	(48%)	152,850
concrete products (excluding pipes)	Concrete Industries (Monier) Ltd.	36,704	26,928	(75%)	48,435
asbestos cement products	James Hardie	20,042	14,426	(60%)	24,343
iron and steel castings and forgings	Tubemakers of Australia	56,689	45,175	(80%)	51,677
smelting and refining (silver, lead and zinc)	Sims Consolidated	26,909	18,186	(75%)	112,911

* Percentage figure indicates Column 4 as a percentage of Column 3.

Table B cont.

1 Industry Class	2 Name of Australian Parent Firm	3 Total Paid to all Employees ($000)	4 Total Paid to Production and all Other Workers (except administration/office/sales and distribution) ($000)		5 Material Component Supplies ($000)
architectural aluminium products	Guthrie Aust./ Chris, Turner & Scott	32,646	21,111	(65%)	72,756
metal containers	Rheem Impact International	35,212	26,793	(70%)	94,389
pesticides and agricultural chemicals	Kiwi	5,884	2,640	(48%)	20,498
chemical products	Kiwi	← not available for publication →			
iron and steel basic products	John Lysaghts/ Australian Reinforced Concrete	268,071	194,870	(80%)	675,193

Table derived from those in Australian Bureau of Statistics, "Manufacturing Establishments: Details of Operations by Industry Class, Australia, 1972-73". Columns 3 and 4 taken from Table 4, "Manufacturing Establishments: Wages and Salaries Paid in Each Industry Class, Australia, 1972-73". Column 5 taken from Table 8, "Manufacturing Establishments: Usage of Materials by Industry Class".

dismissed worker. In several cases, a personnel officer was employed by the company to discipline the unskilled and semi-skilled workers; in one instance he was a brigadier general and guaranteed to ensure a passive workforce in return for a suitable salary. Although only two companies stated that such a position existed within the company, numerous conversations with other expatriates including Australians, indicated that it was a not uncommon practice. Dismissal of workers was usually the duty of the plant manager, since senior foreign management reasoned dismissal by a fellow indigene was preferable to dismissal by a foreigner. One company explained that labor presented no problem because all the workers were completely dependent on it for employment. The huge pool of unemployed·labor acted as a stimulus to limited demands by labor on management. Only two companies experienced difficulty in the application of the labor laws, one of these being the failed company. In both cases, problems mainly stemmed from the difficulty each experienced in the dismissal of workers quickly and without bureaucratic entanglement.

The weakness of the labor law is compounded by the complete absence of union activity independent of government or company control; Union groups exist mainly at national level, with few regional branches, and rank and file participation in policy is either non-existent or extremely limited in scope.[159] Nine firms had no union activity whatever within their staff, and one of these attributed this directly to the power of their local partner, the DKI. In these cases any negotiation was directly between the company and the individual worker. Yet company-based unions had been set up by three firms in conjunction with the Department of Manpower, or had been encouraged by the company; another two firms intended to form unions in the future. In these cases union activity was viewed by the firms as a rational and non-disruptive element

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[159]<u>ibid.</u>.

serving the dual positive function of regularising the control of workers and promoting better relations with the Department of Manpower. Regularised control of unskilled workers was effected in one case by the existence of a "planted" government official in the union, and enquiries suggested that such a practice was common. One further union was affiliated with the government-controlled Federation of Indonesian Trade Unions, so the particular company experienced few problems with their workers, whose main concern was to negotiate for better fringe benefits rather than higher wages. Overall, the union activity that did exist was characterised by a marked lack of militancy and independence of either government or company control. Companies that anticipated the future formation of unions were not anxious about their creation, because it would regularise the control and discipline of unskilled workers, and promote better relations with the Department of Manpower. In this manner unions are successfully harnessed as a force for social stability rather than its opposite.

Training Who? Training for What?

The fourth and final area of enquiry was concerned with the existence and current status of training facilities and company policy on training. The increasingly sentitive political situation regarding the 'transfer' of technical and managerial skills was noted in Chapter Two; one of the major benefits (or multipliers) of direct foreign investment is claimed by mainstream economists to be the substantial transfer of such skills from foreign to indigenous worker, in preparedness for the eventual take-over of the joint-venture company by Indonesians. The strategic importance of this transfer must be identified as crucial to the credibility of a theory of economic development that insists upon widespread and unhindered penetration by foreign capital into a poor country's economy; clearly the status of training facilities both present and future, is an area well deserving attention.

Enquiries directed to the fifteen firms revealed a marked division between the training facilities available to direct factory labor on the one hand, and administrative and managerial staff on the other. No formal training programs existed within any company for unskilled or semi-skilled labor; what training did occur was accomplished by on site instruction and association rather than by classes. One firm did have plans for a formal technical training program but at present on site instruction was used; another planned to start apprenticeships for machine maintenance and transport driving since it expected to experience a shortage of such skilled workers as more foreign firms entered that or similar areas of production. Generally, however, the type of employment created by the investment at factory level was such that extensive training was not usually necessary. Sixty-five per cent of all labor employed by the firms was unskilled and twelve per cent semi-skilled; clearly the technology employed did not require a high proportion of trained workers.

The training that did occur was mainly directed at senior technical and managerial staff. Three companies had sent senior technical employees to Australia, Singapore or Thailand for several months' instruction by the parent company or well established subsidiary. In addition, fees for skilled workers attending night school were paid for by two of these three companies, and a further company, following accpeted parent company practice, conducted a two-week training course for senior technical staff. Those who received the most training were senior professional staff. Ten companies had sent or intended to send their senior managerial technical or financial personnel to Australia, for a two- to four-month training period. These included accountants, a foreman, a production manager and a marketing manager. Yet several expatriate managers spoke of the status value of these trips and made clear that in many cases they were as much undertaken to improve the status of the person involved as to facilitate his increased knowledge on any given subject: overseas visits were measures of high social standing and executive authority amongst the affluent middle class of Jakarta. Some firms on the other hand expressed a genuine commitment to improved training facilities. By increasing the skill of the workforce two objectives were gained; training assisted the smooth running of the firm at all levels and as well insured against possible future disapproval by a government more firmly committed to Indonesianisation than the one at present.

Attitudes toward the repatriation of Australian executives and take-over by their Indonesian counterparts were mixed. One firm indicated its genuine desire to repatriate as quickly as possible but expected difficulties because honesty and responsible management could not be guaranteed. The high cost of expatriate labor together with the existence of management agreements were the major factors in determining company repatriation policy, and several firms indicated the existence of well-defined plans for the staggered repatriation and take-over. Most companies indicated that repatriation would eventually occur but would not give further details. Clearly the rate of repatriation in these instances was to be determined by the position of the company in the market. Evidence suggested that in future years, the larger joint-venture companies would continue to place foreigners in the most senior positions, supported by an executive staff of local persons. In some cases, the existence of a management or technical agreement prevented this possibility and indicated a highly reduced possibility of repatriation. Company policy on training and repatriation was well enough defined to make its compatibility with the government Indonesianisation program a none too frequent but not non-existent event. Some firms looking to the future and long-term investments of size were clearly conscious of the political and economic necessity of the transfer of skills to certain sections of their workforce. However, the limitation of this will be partly determined by the choice of technology and it is convenient at this point to consider this question.

THE USE OF FOREIGN TECHNOLOGY

The interrelationship between employment generation and the choice of technology is one that has assumed great importance in academic discussion concerning the effects of foreign investment in poor countries, and as well has become increasingly relevant to official government policy on foreign investment. The issue of technology has assumed great importance to the Indonesian government, at least at the level of policy formulation; clearly it is well aware of the associated problems of capital-intensive foreign investments, especially with regard the generation of employment for economic and political reasons.

The problems posed by the penetration of foreign capital into the Indonesian economy are further aggravated when the impact of its form, in both the physical and organisational senses, is examined. The following pages involve an examination of five major areas pertaining to this: (1) the type of plant used; (2) the factors determining its adoption; (3) the type of process involved in production; (4) the type of product manufactured; (5) the mean (average) capital-to-labor ratio embodied in the production process.

The Plant: Its Origin and Nature

Earlier in this section, it was observed that a large percentage of the total authorised capital investment was spent on goods imported from abroad. In the main, these imports comprised plant and other equipment necessary to the production process. Fourteen companies imported all essential plant and equipment, whilst the one remaining company bought into an existing factory complete with a Dutch plant, which although old remained quite suitable for the manufacture of the products chosen by the company. Four companies purchased all plant and equipment from Australia, whilst the remainder procurred from a variety of foreign sources. Second to Australia, the U.S.A. was by far the largest supplier of plant, with other sources used by particular firms with specialised needs. Three firms had managed to import secondhand reconditioned equipment that constituted surplus obsolescent plant to the parent company.[160] Generally, the type of plant used was identical in essential aspects (if not totally similar) to that used by the parent. Fourteen firms stated that the technology used was identical in all essential aspects, changes in the process occurring where labor could readily be substituted for capital. This occurred in areas where unskilled labor could replace a machine in sorting, packaging, assembly and the manual cutting of components. Such changes were not basic to the manufacturing process but resulted from considerations of cost. Unskilled workers employed on a daily basis and easily dismissed gave firms flexibility in the volume of production required at any given time. The installation of a machine, for example a sophisticated product-handling maching with a fixed capacity corresponding to maximum output of the plant, could never be a rational alternative to using a flexible volume of low-cost labor. Clearly in these and similar situations, it was not economic to automate. One company, however, did substitute a machine for a number of unskilled workers. Originally in this case

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[160]Indonesian government regulations forbid the import of second-hand machinery, except in special circumstances. As the ILO noted: "...a possible preference for modern capital-intensive and labor-saving industries and technology on grounds of prestige, as distinct from economic argument." ILO Report, "Fiscal Measures for Employment Promotion in Developing Countries" in Employment Policies in Developing Countries, Mouly, J., and Costa, E., for the ILO, George Allen and Unwin, London, 1974, p. 24.

packaging (cardboard cartons) had been assembled by hand but irregular quality had obliged the manufacturer to replace workers with a machine. Government regulations had obliged the firm to find alternative work within the factory for the displaced men; this was one case where the labor law had been successfully implemented. Apart from these considerations, the essential production process remained the same as in Australia. Alterations toward a more labor-intensive technique were only applicable in non-essential areas.

Why Foreign Technology

The second area of consideration was concerned with the factors that had determined the choice of technology by the firm. Since all firms in Indonesia were subsidiaries of Australian companies, it was not surprising to find that the decision was made finally by the parent after consultation with its subsidiary general manager, who was in a position to indicate where capital-saving alterations could be made. A combination of factors, both internal and external to the company, were relevant to the final decision but these may only be mentioned briefly since many firms were not overgenerous with the required information. The author may only suggest that technical regulations encouraged capital-intensity in the production process; these include duty free import of capital goods at favorable exchange rates, the granting of investment allowances or accelerated depreciation on all depreciable property. Most parent companies did not indicate that these and other incentives had been decisive factors in the conscious decision, but clearly if the opposite situation had applied and regulations made the use of capital-intensive and sophisticated machinery an expensive undertaking instead of a subsidised one, then investment in technically sophisticated areas would not be so attractive. As Helen Hughes observed: "The choice between capital and labor is not (in the main) in the production processes, but in the products and industries, and the relatively low employment generated by foreign investments is due (mainly) to its concentration in capital-intensive industries encouraged by high protection." She continued: "In modern industry there is very little room for the substitution of labor for capital except in preparation and finishing and here the substitution of labor for capital is common."[161]

Technical feasibility studies were undertaken by nine companies but they did not consider the possibility of any alternative technology more suited to the factor endowment of the country; they sought only to establish the feasibility of manufacturing a particular product or products by an established process, not to ascertain the suitability of the production process or the product to the country destined to receive the investment. The desire to achieve economies of scale also affected the choice of technology for certain firms.

Other factors influencing the choice of technology were "built in" to the existing economic situation and applied to all foreign investments in manufacture. A severely competitive or oligopolistic situation dictated that companies must manufacture products competitive with others', especially those produced by their foreign rivals, with whom they may be competing in other nations as well. Since much of the market was, either directly or indirectly, the growing urban middle class, care and quality considerations became very important. The "demonstration" effect of Western presence resulting from increasing economic penetration operated to create a demand for foreign-styled and sophisticated products, made by machines, not by people. Another inbuilt factor was the poor

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[161]Hughes, H.: The Assessment of Policies Toward Foreign Investment in the Asia-Pacific Region. Paper to the Third Pacific Trade and Development Conference, op. cit.. See also IBRD (Hughes), op. cit., p. 48. "...[T]he nature of the produce and the equipment available has tended to determine the choice of manufacturing process."

condition of the physical infrastructure which obliged heavy power consuming factories to be equipped with their own pumps and generators. Much Western technology depends on a constant and large volume of power, and sometimes water. The fifteen Australian companies were no exception, since many were obliged to provide their own power supply.

Clearly, the immediate determinants of technology were many, and varied with each sector of industry. Product and market related considerations, inbuilt technical factors, company policy and infrastructural considerations were all relevant in differing degrees to the firms. What is important to note at this point is the absence of consideration deriving from the factor endowment of the host country, specifically a shortage of capital and an overabundance of labor. Having established the preference for Western technology it is appropriate to continue and discuss the third area of enquiry: the type of processes embodied in that technology.

Simple Process, Simple Product, Complex Technology

The reader is referred to Table C for a summary of results obtained. Column 4 indicated the type of plant used by each firm. Seven plants were found to incorporate an intermediate technology and eight a complex technology. The former included plants where for example, a precision machine would perform most of the vital tasks in the production process, but did not incorporate highly sophisticated electronic or electrical components. The latter group included, for example, plants where sophisticated timing mechanisms, electronic and electrical components contributed significantly to the quality of the final product. The various processes of production were characterised by their uniformity; every company indicated that the production process was simple, except in two cases involving some complex operations performed by highly skilled workers. Column 5 summarised these results. It was noted previously

Table C

AUSTRALIAN JOINT-VENTURE COMPANIES: TECHNOLOGY EMPLOYED

PRODUCTION GOODS

1 Industry	2 Product Type (basic, inter-mediate, final)	3 Product (single, multiple)	4 Plant (simple, inter-mediate, complex)	5 Process (simple, complex)*	6 Product (simple, complex)
Rheem: pails and drums	inter-mediate	multiple	inter-mediate	simple	simple
James Hardie: asbestos cement build-ing materials	inter-mediate	multiple	inter-mediate	simple	simple
Sims: refined lead ingots, lead alloys	basic	multiple	inter-mediate	simple	simple
Tubemakers of Australia: malleable cast iron pipe fittings for household use	inter-mediate	multiple	inter-mediate	simple (with some complex operations)	simple
John Lysaghts/ ARC: bright wire and rein-forced mesh, wall and roof cladding	inter-mediate	multiple	complex	simple	simple
CIG: industrial gases	basic	multiple	complex	simple (with some complex operations)	simple
Concrete Industries (Monier): tiles, blocks	inter-mediate	multiple	complex	simple	simple
Ready-Mix Concrete: ready-mixed concrete	inter-mediate	single	complex	simple	simple

* Refers to complexity of process, not of the machine.

Table C cont.

CONSUMPTION GOODS

1 Industry	2 Product Type (basic, inter-mediate, final)	3 Product (single, multiple)	4 Plant (simple, inter-mediate, complex)	5 Process (simple, complex)*	6 Product (simple, complex)
Nicholas: pharma-ceuticals	final	multiple	complex	simple (assembly)	complex
Kiwi: shoe polish, floor polish, house-hold disin-fectants	final	multiple	inter-mediate	simple (processing and packag-ing)	simple
Impact International: collapsible tube	final	multiple	inter-mediate	simple (packaging)	simple
ACI: glass bottles, containers	final	multiple	complex	simple	simple
Australian Dairy Board: sweetened con-densed milk, recombined butter, liquid milk, ice cream mix	final	multiple	complex	simple	simple
Guthrie & Co.: steel louvres	final	single	inter-mediate	simple (assembly)	simple
Sydney Cooke: inks	final	single	complex	simple	simple

For definition of 'basic', 'intermediate' and 'final' see "Statisticians Australian Standard Industrial Classification".

that changes to the production process as it existed in Australia only applied to non-essential areas of production. Four companies described the major process as either packing, processing or sorting, and the majority of processes involved the worker at either end of a large machine which dominated the essential part of manufacture – in preparation and finishing. Overall, however, more people were employed by essentially the same process as occurred in Australia because labor was substituted for capital in non-essential areas, and because productivity per person was much lower than in Australia; in addition jobs were found for people that would not exist in an Australian company of the same size; these include messengers, general office help, cooks, laundresses, gardeners, nightwatchmen and the like. There was however, a technical limit to the employment capacity of any given production process, and thirteen of the fifteen companies indicated this to be the major limitation to the employment potential of the investment. For two firms, maximum profit lay in the full utilisation of installed capacity, and the maximum employment level had actually been reached. Another company explained that since their investment had been made with view to increasing the export of technology its employment potential was limited. Quality control was also a factor affecting employment potential, since a certain degree of mechanisation was vital in the competitive urban market. The nature of the product and the market determined that the technology and hence the employment potential of the plant should remain unchanged. There was then, very little opportunity for increased employment since most companies had reached the "technical" limit to employment. As technology largely determines employment potential of any given plant, so does the product to be sold and the type of market served determine the technology.

Products Manufactured

The fourth consideration is concerned with the products manufactured by the fifteen companies. Columns 1 and 2 of Table C show that six companies produced intermediate goods; five of these directly serve the modern building industry, centred in Jakarta, and the sixth produced goods essential to many modern industries, particularly Indonesia's important oil industry. Two further companies produced basic commodities for sale to other manufacturers whilst seven companies produced final goods, five for sale direct to the consumer, and two for wholesale to other manufacturers (collapsible tube and glass bottles). Whilst these two products could be feasibly classified as intermediate goods in that they are not for sale direct to the consumer, the author has preferred to class them as final products since they are both finished items which are not altered in any further production process, except to receive labels.

The consumer goods produced were of the non-durable type and as noted previously were directed mainly to the urban consumer. Twelve companies were engaged in multiple-product and three in single-product manufacture (Column 3). Fourteen of the companies classified their products as simple, only one as complex. The latter referred to pharmaceutical products which were complex in that they comprised a variety of refined ingredients mixed in specific quantities and at specific times. Yet although the product was complex, the process of manufacture was simple, labor mainly being used for packaging and sorting.

The Degree of Capital Intensity

The final point to determine was the mean (average) capital-to-labor ratio. There were several methods available to determine this figure and in pursuance of accuracy three figures were obtained and compared. The first figure of 13,312:1 was calculated using the total implemented invested capital and the total labor involved, including expatriates. A second figure of 9.700:1 was arrived at by using the total investment in imported capital goods and the total direct labor. This figure is artificially low because figures indicating the total value of plant were not available. The final figure of 12,700 was obtained by using the mean average investment of $2.030 million and the mean average number of workers per factory (160). Clearly no precise figure can be given, but the average of these figures, 11,904:1, will suffice as a rough but useful guide to further discussion.[162]

JOINT-VENTURE PARTNERS: OF DEFINITE CHARACTER AND LIMITED ROLE

In the preceding pages, empirical data relating to three of the four major aspects of enquiry have been offered. The remainder of this chapter is concerned to establish the character and role of the joint-venture partners of the fifteen Australian companies. As with the preceding pages, the following is significant not only because it is newly gathered but as well because it assists to assess the relevance of the assumptions made by mainstream economists as to the benefits of private foreign capital investment in poor countries. One of these assumptions is that "pribumisation" of the Indonesian economy is greatly assisted by the proliferation of the joint-venture company structure.

Joint-venture arrangements between foreign and local interests are viewed by the government as well suited to facilitate the "transfer" of technical and managerial skills from foreigner to indigene and as well to increase indigenous financial participation: these processes are together thought to increase the multipliers that are said to accrue from direct foreign investment. As one Indonesian official made clear: "The

[162]McClean claims that Australian foreign investments have as high or higher capital-to-labor ratios than those pertaining to similar enterprises by the investing company in Australia. McClean (Rima, 1972), op. cit..

cardinal principle...would be to appreciate that no Indonesian government may be prepared to encourage industrial exploitation on traditional capitalistic lines."[163] Neither have the advantages deriving from joint-ventures been lost on the Australian and other foreign businessmen. Patterson, of ACI, remarked that

> ...there is no doubt that for most Australian companies, the local partner is a must. Someone who can guide the investor through the maze of local customs, regulations, procedures and negotiations can certainly reduce the headaches....A local partner of course is not only a guide – but he can and does bring about the reduction both in capital cost of the project and in the limitations of the downside political risk....[164]

The role of the local partner in distribution was noted in the Department of Overseas Trade publication, "Market Review", where it surmised that "the major problem in penetrating the consumer and capital equipment market lies with the means of distribution, and successful marketing and investment therefore depends largely upon engaging a suitable agent/partner with a network of outlets and contracts."[165] Seminars organised by the AIBCC continually emphasised the need for local partners to advise suitable actions that may be taken by the firm to deal with political, bureaucratic, land, labor and distribution problems.[166] The Vice President of the First National City Bank in Jakarta expressed the situation well: "Economic nationalism in Indonesia is not out of control by any stretch of the imagination but you can expect there will be an

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[163] Singh, M.: "Care and Quality Considerations", address to seminar, Indonesia – Trading Partner, <u>op. cit.</u>.

[164] Patterson, <u>op. cit.</u>.

[165] Department of Overseas Trade, "Indonesia: Market Review", Canberra, 1974, p. 3.

[166] AIBCC (1973), <u>op. cit.</u>, and AIBCC (1974), <u>op. cit.</u>.

increased nationalism and if you have a good solid partner it could help guide you through a lot of rough times."[167]

In Chapter Two it was observed that the United Nations, the World Bank and the Asian Development Bank are all in favor of the development of the joint-venture as a readily available and acceptable means of increasing local equity and the transfer of skills. In addition joint-venture arrangements were viewed as politically more acceptable than complete foreign ownership of any given investment and were thus perceived as more likely to protect the "national interest" and prevent disruptive xenophobic nationalism. Not only did the joint-venture arrangement benefit the foreign party by reducing the possibility of political resentment, it was viewed as of benefit to the indigenes as a group, by encouraging the development of a strong indigenous class of entrepreneurs and industrialists that could assist the independent economic development of Indonesia.

It would appear that these assumptions rest on the premise that formal participation in any given joint-venture arrangement guarantees increased Indonesian ownership and the transfer of skills; subsequently the level of those skills and the degree of indigenous control is raised and automatically contribute to the strengthening of the indigenous business class as a separate and identifiable group, capable and willing to play a leading role in the inevitable progression toward economic development. Rather than relying almost solely on state protection to foster the development of this class, as was done previously, the present government has partially abandoned this stance in favor of a mixture of both public and private support, the latter being best effected through joint-venture arrangements. Moreover for the populace at large, their

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[167]Crouse, T.C.: "Financing Investments in Indonesia", AIBCC (1973), op. cit., p. 2.

ideological function may not be ignored, since they sustain the view that Indonesians are increasingly sharing in the development of their country. Since the riots of January 1974 the government may not neglect the political as well as economic importance of joint-ventures, especially in sectors of investment clearly visible to the public; this especially refers to manufacturing. Since January 1974 it appears that Australian companies seeking to invest have experienced more difficulty than most of their predecessors in obtaining the necessary government approval for their joint-venture proposals. Several firms indicated that since the riots, bureaucratic procedure had made approvals considerably more difficult to obtain than previously.[168] In addition two firms had been obliged to alter arrangements that had previously been approved by the government, and informal discussion with Australian personnel suggested strongly that several companies had been effectively deterred from an imminent investment decision by the bureaucratic consequences of the riots. Areas of disagreement between administration and companies related mainly to the provisions for local equity.

As part of the Indonesianisation program, joint-ventures are now obligatory for any foreign company undertaking investments under US$500,000. Yet Australian investments that involved capital far in excess of that amount have taken joint-venture form and were obliged to do so. Twelve companies were obliged to take a joint-venture partner, and several clearly stated that even had this not been insisted upon, the parent company would have taken local equity for political reasons. Two other companies began as one hundred per cent Australian ventures but

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[168]Interviews with several Australian companies who were planning investments in Indonesia revealed that since January 1974, negotiations concerning equity and licensing arrangements had become more arduous and time-consuming. The reader is referred to the time-lag estimates offered in Appendix C which indicate the relative east (time-wise) of direct investment approvals in Indonesia in less recent times.

under the foreign investment law were required within a specific time period to take local equity, and had done so. One company was the first foreign company to invest in Indonesia under the New Order government through a joint-venture arrangement. However, enquiries revealed that such arrangements presented difficulties to the parent company, as well as advantages: these were often problems rarely if ever faced in Australia, undesirable to but unavoidable for both parent and subsidiary.

The following pages are concerned to describe the origin and function of the joint-venture partners of the fifteen Australian firms. To achieve this, five major points will be discussed: (1) the group or groups of people that comprise the partners; (2) the method of contact between Australian company and partner; (3) the equity contribution of each partner; (4) the regulations governing the gradual transfer of majority equity to the partner; (5) the function of the partners in the company.

The Partners

The fifteen Australian companies varied in their choice of partner, and in the reason for their choice. Three partners were large well established firms owned by indigenous Indonesians, who in addition had a variety of other business interests with other foreign as well as local firms. Two of these were consciously chosen for their well developed distribution system, as well as their well known capabilities as successful businessmen. One had, prior to partnership, been producing a similar product as the Australian firm but lacked the technology to improve its quality. Both companies were owned by Sumatrans, and one was a Batak. The third indigenous company was selected because its owner was a well established, well known and successful Javanese businessman, with commercial interests, many of them with foreigners, and well developed personal contacts within the top echelons of government.[169]

Three other companies had selected as their partner the DKI or its subsidiary, P.T. Pembangunan Ibu Kota Jakarta Raya, commonly known as Pembangunan Jaya; another chose their former trading partner, a state-owned enterprise. A further six companies chose Chinese firms as partners, and in all but one case, arrangements had been satisfactorily concluded between the foreign and local partner. In one case only, problems had arisen and the local partner divested of his interest in the company; he had been pressing for a fifty per cent equity share in the business and this had not been acceptable to the company which was currently engaged in procedures to secure another local partner of more reliable character. A former ambassador to Australia was soon to become this firm's new local partner, financed by the Australian parent. The six Chinese firms had extensive business interests with foreign companies and offered a well developed market knowledge. Their political influence and knowledge of the graft mechanism was also of value to the joint-venture companies. One Chinese company, wishing to avoid political repercussions included in their staff a well known professional Indonesian, a public figure, as a cover or "front man" who lent a non-Chinese character to the company. As a former Minister of Public Works, and by virtue of his current position as advisor to the government and supervisor of important public works programs, he was able to secure large contracts for the joint-venture company. This man had been specifically chosen because of his influence in the building industry and consequent ability to secure such contracts. Another partnership was made between an Australian company and three individuals; two of these were part-owners of a well established Chinese firm, and the other a high-ranking Indonesian employed by a large foreign auditing firm.

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[169]This partner was a personal friend of Suharto.

The two Chinese partners stayed well in the background for political reasons, and allowed the Indonesian partner to publicly represent their interests.

Further partnerships were formed between Australian companies and individuals. In one case, the joint-venture company employed as tax consultant and legal advisor a Chinese who effectively functioned as the partner, but was not legally the partner. As far as the firm was concerned the Staff Provident Fund was the partner, represented by the above mentioned individual; but under Indonesian law such a fund was not a corporate entity and thus legally unable to function as partner. So far, this peculiar and rather indecisive arrangement had sufficed company needs, but political unrest and potential government pressure had caused a change in company attitude toward the partnership arrangements. Future partners were to be of an industrial or entrepreneurial background, and serve to assist the firm avoid administrative interference. One other company had as its partners two individuals, one a chartered accountant employed by the large foreign auditing firm previously mentioned, and the other a lawyer. The origin and economic status of these joint-venture partners could be viewed as a microcosm of the overall situation, where Indonesian-Chinese, and outer-island peoples especially Sumatrans, dominate domestic business activity aided by high-ranking military or military-connected personnel of Javanese origin.

The Method of Contact

The Australian companies employed a variety of methods to select their partners. Five relied on industry and personal contacts. Prior trade with Indonesian firms, or the existence of other investments in the Southeast Asian region created a network of informal contacts from which it was possible to select a partner. In other cases, the selection was obvious, since the partner was previously established as a leading producer of the same or similar goods. In one case, the Indonesian government had approached the Australian firm and suggested the venture; in another the Australian government through the Trade Commission had recommended the partner. In two cases, the Australian company was approached by a local company or individual.

The Equity Contribution; A Mobilisation of Domestic Capital?

Once the decision to manufacture goods through joint-venture arrangements had been made, the Australian firms, in discussion with their partners, had to determine the character and value of the local partner's equity contribution. Five companies declined to comment on this issue and moreover were unwilling to indicate their reasons for this. It is not unreasonable to assume that this suggests the existence of illegal practices since it is accepted within the business community in Jakarta that many local partners are financed by their foreign partners or "pay" their equity out of the future profits of the joint-venture company. Payment in land is a common form of equity contribution, and six of the joint-venture partners made payment in this way. Whether the book value of the land corresponded to the stated equity contribution of the local partner is not known, but enquiries suggested strongly that the two values did not always correspond. One partner contributed a factory as equity payment, two were loaned money by the parent company, and one promised to pay out of profits. As far as can be deduced, few if any paid for their equity in cash money. The nature of the equity contributions indicated that the financial capability of the joint-venture partner was not a major determinant in the final choice of partner.

Equity Provisions

The fourth point to be dealt with is the nature of the regulations applicable to each joint-venture company – decrees that concern the gradual transfer of majority equity to the local partner. The joint-venture companies were subject to a variety of regulations. For the majority of eleven, changeover provisions had been written into the joint-venture contract, but for another two, the original equity provisions had been changed subsequent to their incorporation as a company. Only one company had not been subject to any stipulation to increase local equity. Six companies stated that within from five to ten years, majority equity could be held by the joint-venture partner(s). Whether this would in fact occur was not possible to ascertain, since legal rights to purchase are not the same as the actual ability or desire to do so. Within this group of firms, several were anxious about the possibility of majority local ownership whilst the remainder were sceptical about its probability, because of the financial and cultural condition of their partners. In the preceding chapter, the psychological dispropensity by the indigenous business classes to engage in long-term industrial undertakings was established, and evidence indicated that this was a factor applicable to this particular group as well. Many expatriates complained bitterly at the lack of interest by joint-venture partners in the venture and a common cause for concern was that the partners rarely if ever visited the company. It is also important to note that of this group of six companies, four had a configuration of technical service and royalty fees, as well as management contracts that operated often for the life of the company, and acted to ensure the undisturbed repatriation of profits to the Australian company in the event of financial take-over by the local partners. In these cases majority Indonesian ownership was not a sure way of keeping profits within the country for reinvestment.

For the remaining nine firms, equity provisions gave the right of local purchase to all partners. But the specific conditions varied: one company spoke of the present 75/25 ratio moving over a ten-year period to 70/30, another from 90/10 to 70/30 within five years, another from 90/10 to 51/49 over a twenty-five-year period. Other companies had at least formally, a more generous attitude toward local ownership, from 75/25 to 50/50 and 65/35 to 50/50 within ten years. Overall, the evidence suggested a very slow and ineffectual Indonesianisation program through the process of increasing local equity as it applied to these fifteen Australian investments.

The Sleeping Partner: Troubleshooter or Troublemaker

The more important functions of the local partners becomes clearer when the fifth point in the discussion is considered; this is concerned with the real function of the partners in the operations of the companies. Enquiries revealed that not one local partner had any significant management control within the company. Five companies were regulated by management contracts which effectively excluded the local partner from important decision-making and one company was indirectly controlled by the Singapore branch of the parent company's regional operations. In the nine remaining cases, it was clear that the joint-venture companies, as subsidiaries of an Australian firm, were directed in all important decisions from Australia. These companies stated that the most important function of their partner was their ability to act as "troubleshooters" or "liaison men" with the various government departments. When difficulties were experienced in matters such as labor, immigration, licenses or import, the local partner was there to smooth out problems, negotiate bribes, secure licenses or obtain permits. In a few cases, the fact that the partner could contribute land or organise its purchase meant that his function was in an even more limited area and of more limited duration. Once his initial usefulness in securing land had been exhausted, he became a silent, non-contributing partner. Apart from mediatory roles, some partners proved useful because their political influence or power enabled them to secure large contracts for the company. The example of the DKI illustrates this. As the municipal government and administrator of Jakarta, the DKI receives or has access to foreign aid and government development funds, and is thus well placed to receive and offer large contracts, especially in the building and construction industry. Three Australian companies had the DKI or its subsidiary as their partner, and two were not unwilling to explain how useful this had been in the securing of contracts, licenses and permits. In one case, the DKI was also the firm's second largest customer, and the general manager stated that this had been the most important single factor in the rapid and unexpected growth of the company. One other company however complained that the DKI had not been of much use so far in such matters, possibly because the investment was small and not expected on its own, to have a high profitability. Initially the DKI had expressed willingness to assist the company, but had done no more than collect a director's salary. Other companies however, were more fortunate: in one case the political position of the local partner had in the opinion of its director been instrumental to the smooth running of the company. Although he never visited the factory or took interest in production, his influence exerted at strategic times, had secured for the company, fairly untroubled existence. In two other cases partners took no interest in the day-to-day running of the company, but were available in their capacity as tax consultants, lawyers or accountants, to advise the company when required to do so. A few expatriate managers considered the generally "silent" status of their partners as undesirable, but generally most considered the situation inevitable. They were aware of the acute shortage of suitable partners and consequently did not view the status of their partner as anything unusual; rather it was seen as an inevitable part of the operation of the joint-venture company.

In three cases, however, the contribution of the local partner did not remain at an advisory or mediatory level. Three joint-venture partners were engaged in the distribution of the company product and had been chosen partly because of their well established distribution network. In two cases, these partners were Sumatran in origin and received most of their revenue from the sale of goods bought wholesale from the company. The reader will remember that whilst the law in Indonesia forbids distribution by foreign companies except in special circumstances but that a variety of loopholes allows its widespread abuse. Enquiries revealed that both distributors were supplied with the services of an expatriate sales manager, who assisted them to upgrade and rationalise their distribution network. Clearly both Australian companies were within the law because their sales managers were not officially sales managers; however, both companies agreed that the law was impossible to implement and that to ensure effective distribution on modern lines, they were obliged to offer the "advisory" services of an expatriate to their distributor. One further company used their local partner as sole distributor; to remain within the law, the local partner formed a distribution company of which he was the sole shareholder, and the two companies worked closely together — indeed in the same office. Five other companies used no distributor at all, and serviced the market directly from the factory. Two firms denied knowledge of the illegality of this practice, and the others were not overconcerned that it was illegal. Four firms effected distribution by a mixture of direct and indirect means. This meant that distribution was shared between a trading firm separate from the joint-venture company, the local partner, and the direct ex-factory method. Where this mixed distribution occurred, the local distributor received a small part of the total volume of sales, by far the largest share being distributed directly from factory to customer. In two cases, the joint-venture partner was distributor on paper only. A loophole in the distribution law allowed the use of invoice methods to indicate the participation of an indigenous firm whereas in fact that firm had negotiated a management contract for a percentage of the distribution rights with a large foreign trading firm based in Hong Kong. Other sales were made directly by the same company which then paid a commission to the partner based on false invoices. In another case, the joint-venture company engaged the services of a well-known Chinese trading firm, assisted by "marketing advisors" employed by the company; in addition they utilised the services of their local partner, but once again his position was controlled by the fact that he was managed and directed by staff supervised by the joint-venture company. It was explained that these arrangements were necessary to protect the firm against poor distribution.

Two further companies utilised the services of non-related companies as sole distributor and in both cases they were owned by Chinese-Indonesians. The one remaining company, finding it difficult to procure the services of a reliable distributor had set up its own distributor and supplied him with credit and advice on marketing methods. Clearly the difficulties in finding efficient indigenous distributors were so great as to oblige the companies to either contravene the law, or discover and use its many loopholes. Because such practices were widespread, they experienced little interference from the government. For example, two companies were permitted to engage in their own distribution because of technical considerations. The joint-venture partner had in one case been able to secure the license, the other however had run foul with the government and was under pressure to reduce its dominant market share. At first the firm was unable to renew its license to distribute directly, but continued despite this, to do so, not worried by the existence of the department which could not implement its own regulations. Eventually, after payment had been negotiated, a renewed license was secured and the company continued to distribute directly from the factory. Clearly, the methods of distribution employed by the joint-venture companies involved similar practices as were observed earlier to be generally employed by foreign and domestic distributors.

In the preceding pages, five major points have been detailed to illustrate the origin and function of the joint-venture partners; clearly specific racial and political characteristics were common to them as a group, and operated in general to increase the advantages already enjoyed by foreign capital in Indonesia. Expectations that these joint-venture forms of investment will more easily facilities the growth of the Indonesianisation program do not appear to be grounded in any factual evidence, and rest on the simple assumption that formal equity participation guarantees increased Indonesian ownership and control, and facilitates the transfer of skills. This and all other related matters will be discussed in the following chapter.

CHAPTER FOUR

CONTENTS

PART ONE:

The objectives of this first section are to evaluate the direct effects of production by the Australian joint-venture firms in the Indonesian economy. This involves looking at the implications of the domestic production of commodities and of the generation of employment opportunities; each will be dealt with in turn.

THE PRODUCTION OF COMMODITIES

The domestic manufacture of commodities through the method of import-substitution has been subject to widespread criticism which points to a variety of effects now observed to have been created, and to have enhanced structural problems within the economies of poor countries. The Asian Development Bank concluded in its recent report: "...the evidence suggests that all-round protection for import-substituting activity is a costly and inefficient road to industrialisation and frequently penalizes growth of the very industries which generate the highest productivity and export growth."[1] The Bank's report is but one of a number of similar reports which consistently argue that to ensure a healthy economic and political growth in the Southeast Asian region, a wide range of new economic policies are needed. Appropriate fiscal and monetary measures, new priorities in resource allocation, production methods and pricing policies were some of the more important elements of this new direction in economic policy, a policy that seeks to remove the "distortions" in economic growth caused by almost exclusive reliance on the import-substitution method and over-regulation of private sector economic activity. The Asian Development Bank concluded that the requirements of the New Industrialisation Policy would encounter great resistance, but insisted that such "painful economic choices were necessary for the

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[1]ADB Report, op. cit., pp. 294-295.

creation of a satisfactory basis to long-term industrialisation and economic development."[2]

The importance of these reports may not be underestimated since they make clear the desired objectives of the capitalist nations and international institutions with respect the future direction of economic development in the Southeast Asian region, and detail the methods available to alter the current type of capitalist development there to one that is at once more sophisticated, dynamic and mature, and thus more complementary to the needs of foreign capital originating in the industrialised countries. The focus of the criticisms of the import-substitution method relate to the high and continuing foreign exchange costs incurred, the limited markets served, the unsuitable nature of the products manufactured and the limited generation of employment opportunities. Consequently, the following section examines the effects of Australian investment within the following two subcategories: the foreign exchange cost of domestic production; the nature of the commodities manufactured and the type of market they serve.

The Foreign Exchange Costs of Domestic Production

The problem of international indebtedness is not new to Indonesia. After formal political independence was achieved, many of the difficulties faced by early governments of the new republic were compounded or created by the existence of a huge debt to their former colonial masters. The New Order government has found no means of avoiding this problem, despite initial but reserved enthusiasm by observers for the implications of Indonesia's oil wealth, heralded by the dramatic rise in oil prices that began in 1973.[3] Indeed, it appears that the problem has become

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[2] ibid., pp. 29-30. For details of the bank's and other similar reports see Chapter One, section entitled "Institutional Reports".

[3] For example see Palmer, I.: "Oil Prices and the Indonesian Economy" in Journal of Contemporary Asia, Vol. 4, No. 2, 1974; and

much greater due to the enormous magnitude of the foreign debts incurred by Pertamina during the early years of the oil boom.[4] Foreign exchange difficulties of this nature[5] are further compounded by the pursuance of an industrial policy heavily dependent on foreign inputs; and, as evidence offered in Chapter Three demonstrated, the investments made by the Australian companies proved no exception. The foreign exchange costs incurred by these firms may be divided into two categories: those that resulted from the import of capital goods and other production inputs;

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[3](cont.) Arndt, H.W.: "Survey of Recent Developments", BIES, July 1974. Arndt wrote that the increase in the price of Indonesian crude oil, from US$2.93 per barrel in April 1973 to US$11.70 in April 1974 "has transformed the country's economic prospects, certainly in the short and perhaps in the medium term. It has added to the external resources available for development on a scale undreamed of a year ago." p. 1. Yet both Palmer and Arndt were reserved in their enthusiasm for future economic prospects, due to the inflationary effects of the huge increases in revenue, the necessity of strict economic management to control the effects of this increase (Arndt) and "the political character and ethos of the government [that] would suggest further underdevelopment is more likely than new development." (Palmer, p. 185.) See also a reply to Palmer, "A Note on Ingrid Palmer's Article from Inside the Oil Industry", Journal of Contemporary Asia, Vol. 4, No. 3, 1974. The author of this article considered Palmer's figures for revenue gained should be considered to be the absolute maximum, and that the benefits of the rise in oil prices must be considered alongside other pressing problems; notably that of limited employment generation created by an expanding but highly capital-intensive oil industry.

[4]See Bell, J.: "Could a Company Sink a Nation", Sunday Times, 9/11/75, and Wren, C.: "World's Biggest Corporate Rescue", AFR, 12/12/75. The former article listed the Pertamina debts as follows: short-term debt US$1.4 billion, medium-term debt US$800 million, commercial debt US$800 and local debt US$400 million. These early estimates proved to be too low as Sadli's report, published in Sinar Harapan, 21, 22 and 23 May 1976, gave the debt to be US$10.5 billion. Reported in BIES, SRD, July 1976. For table on the nature of the debt see FEER, 2/7/76: on these calculations the peak of debt-service ratio is reached in 1979 (19.5), tailoring off to 16.4 in 1985.

[5]The extent of future foreign exchange difficulties due to the Pertamina crash is unclear. McCawley claims that by 1976 the debt-service ratio was recognised to be higher for future years than was expected in 1975, due to the impact of the Pertamina crash. McCawley, P.: "Survey of Recent Developments", BIES, March 1976. Later, it was calculated that from 1976 to 1979, between twenty-five and forty per cent of the government's external debt-service payments would be to service Pertamina's external debt, thus making public sector debt servicing obligations two-and-one-half to four times greater than they were estimated to be at the end of 1973. BIES, SRD, July 1976. Since negotiations over the oil

those incurred through the payment of monies to the parent firms or other foreign corporate bodies.

It is axiomatic to state that direct foreign investments are often made specifically to facilitate the growth of trade. Lenin noted that "[t]he export of capital abroad...becomes a means for encouraging the export of commodities"[6]; Magdoff observed that foreign trade becomes built in to the capacity and overheads of parent firms, so that investments are created to suit their needs, the priorities of the host country coming a poor second.[7] More recently the Asian Development Bank expressed concern for the serious capital servicing problems that inevitably arose from import-substitution. It argued that whilst parent company loans or supplier's credits initially would assist the balance of payments, they led ultimately to a severe capital servicing problem, as well as to the "distortion" of the direction of industrial development.[8] Joint-ventures were identified by the US Department of Commerce as most

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[5](cont.) tanker hire-purchase agreements (made between Pertamina and foreign suppliers) appear to be still in progress, the true extent of the debt remains unclear at the time of writing.

[6]Lenin, V.I.: Imperialism, the Highest Stage of Capitalism, International Publishers, New York, 1972, p. 66. (First published 1916.)

[7]Magdoff, op. cit., p. 36. See also Mandel, op. cit.. Mandel relates the debt servicing problems of poor countries to the very high repatriation of profits through indirect means, for example through joint-venture arrangements and aid. He concluded that a huge amount of foreign exchange usage was accountable for by debt servicing. p. 372.

[8]ADB Report, op. cit.. "Although the aim of industrialisation ...was largely import replacement, imports of manufactured products have grown almost as fast as domestic output....While foreign investment and suppliers' credits initially assisted the balance of payments situation, eventually a capital servicing problem is created....Industrialisation has thus tended to build up the Southeast Asian countries' import requirements." p. 225. Rosa Luxembourg also observed this relationship. As George Lee described it, "the Luxembourg Effect...is the causal relationship between the flow of money capital from the metropolis to the satellite and the flow of capital goods." Lee, G.: "Rosa Luxembourg and the Impact of Imperialism" in Economic Journal, Vol. 81, December 1971, p. 862.

appropriate vehicles for foreign investment in manufacture, but their proliferation was observed to encourage the large-scale duty free import of raw materials and semi-finished goods for incorporation into the final product: in effect they provided an excellent basis for the expansion of trade.[9] In a highly critical study of the function of joint-venture firms in Indonesia, Hartono wrote:

> All that is necessary for the foreigner is to provide the machinery and other equipment which he so very often manufactures himself — and by doing so, could be exempt from income tax and other import levies, whilst obtaining all other profits connected with doing business in the country itself.[10]

Not surprisingly, the import content of the Australian investments was high overall. The majority of raw materials, component parts, plant and spares were purchased from foreign sources, and in forty per cent of cases, the capital cost of plant maintenance was high. As a percentage of total cost to manufacture, raw material costs were by far the largest single item of expenditure, comprising sixty-two per cent in the production goods, and 50.15 per cent in consumption goods, sectors. The existence of several raw material supply agreements indicated that some investments had been expressly made for the purpose of facilitating increased trade by the parent firms. In these cases the joint-venture firm was obliged to absorb increased costs resulting from increases to the cost of production inputs, or to pass them on to the consumer. These increased costs, reflecting the changing economic conditions in Australia, were clearly outside the control of the subsidiary firm, and contributed to the unforeseen, unplanned for, increases to the foreign exchange bill of the economy as a whole; in addition they contributed to

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[9] US Department of Commerce: "Economic Trends in Indonesia", April 1968.

[10] Hartono, *op. cit.*, p. 3.

the imported cost inflation experienced by the economy in response to the inflationary situations endemic to many industrialised nations at that time. Furthermore, the Indonesian government, in promoting industrialisation through import-replacement and foreign investment in the manufacturing sector, forfeits control over significant areas of monetary policy.

It was observed in Chapter Three that in several cases, raw materials were not purchased at the cheapest possible price, due to the supply agreements between parent and subsidiary. The absurdity of such a situation for a country as poor as Indonesia may not pass unnoticed, and serves to illustrate the divergence that exists between the real objectives of foreign investment and the stated goals of Indonesia's policy makers.

Besides the direct effect on the balance of payments resulting from the import of production inputs, the high foreign exchange cost of the investments is also accounted for by monies payable by the subsidiary to the parent company or other foreign corporate bodies. The majority of firms paid some sort of technical service, royalty or management fee to their parent, and in some cases disguised such payment so as to ensure the continuance of special concessions, tax holidays and the like. In numerous cases, revenue acquired in this way had been a major consideration in the original estimate of profitability of investment, and although it was impossible to acquire accurate information as to the actual amounts involved in these payments, it was clear that in several cases they had imposed a strain on the financial resources of the joint-venture firms. Evidence from more comprehensive studies strongly suggests that these payments contribute handsomely to the total capital repatriated to the parent firm.[11] Furthermore, the equity-to-loan ratio of most firms showed a high proportion of capital held in loan form, much of it acquired from the parent firm, and some from foreign banks based in Jakarta or abroad. Clearly a capital servicing situation existed, but unfortunately most companies were reticent to give further details. However, it is likely that the scheduling of subsidiary debts could be so arranged as to assist with the maximum repatriation of profit before tax, through this indirect means. The payment of dividends to the parent company, as major shareholder also occurred, but again, further information was not available as to the actual amounts involved.

The relative importance of both direct and indirect repatriation of capital and the problems of the foreign exchange costs of industrialisation depended, in part, on company attitudes to reinvestment and expansion of production facilities. Although firms differed on their reinvestment policies, there was overwhelming evidence to suggest that the perceived high-risk nature of the investments increased the propensity for rapid repatriation of capital, reduced the probability of continued

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[11]See UN statistics quoted in Venu, S.: "The Multinationals and Developing Societies" in Futures, April 1974, p. 137. See also Mandel, op. cit.. He noted that through the joint-venture the indirect repatriation of profit was high. p. 372. Bijli, op. cit., cites OECD, "Technical Balance of Payments Estimates" for 1964 which indicated that developing countries received a tiny proportion of receipts for technology payment, whilst the US and other Western industrialised nations receive the bulk. Thus the "transfer of technology" to a developing country involves a very heavy expenditure. McDaniels, J.F., op. cit., quotes M. Krust, "Reports on June 1963 Hearings of Treasury"; the most attractive feature of foreign ventures for US firms was the non-investment returns, dividends comprising a small percentage of profit. McDaniels stressed that these non-investment returns are profitable and without capital risk. See also Alavi, H. and Khurso, A.: "The Burden of US Aid", originally published in Pakistan Today, Autumn 1961, and reprinted in New University Thought, Autumn 1962. The authors argue similarly that the profits made by local subsidiaries were not the main criterion; this was actually the profit that accrued to the parent company through the supply of raw materials, components, spare parts, royalties and the disguised payment for technological and managerial know-how. See also Rose, op. cit., p. 18, and Kidron, M.: "Foreign Investment in India" in Wheelwright, E.L.: Radical Political Economy, Australia and New Zealand Book Company, Sydney, 1974, p. 328.

reinvestment for long-term development or delayed its implementation by years.[12] This not only contributed to the overall foreign exchange costs of industrialisation but also to the "distorted" pattern of capitalist growth, aggravated by the limited capacity for reinvestment attributable to some firms and aggravated by bureaucratic and political factors. Yet despite the acclaimed high-risk nature of the investments, profitability ranged from moderate to exceedingly high, with a large number of firms in the latter category.[13]

The crucial point to be made here is not so much to emphasise the incidence of high foreign exchange cost to the economy as such, since the indebtedness that results is not in itself necessarily undesirable. The important consideration must surely be the terms of indebtedness and the uses to which the borrowed funds are put. The fact is that the type of economic activity which produces the high foreign exchange cost, does so continuously, for the life of the investment. The type of products manufactured, the technology necessary for this, the promotion of parent firm trade through the supply of production inputs, the existence of the various agreements between parent and subsidiary, and the lack of suitable facilities for the manufacture of production inputs domestically, are all factors which combine to make the future reduction of foreign exchange costs a distinctly remote possibility. In this, the Australian investments closely followed the pattern of costing observed in the reports cited previously; they result in a large and continuous foreign exchange

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[12] The slow increase in the contribution of the manufacturing sector to GDP in Indonesia between 1971 and 1972 "suggests that a very high proportion of the real substantial increase in output in these sectors is accruing as remitted profits of the foreign investors." EIU: "Indonesia", No. 1, 1973, p. 2.

[13] The Asian Development Bank noted: "In general the highest profits are to be made in highly protected industries catering to a Westernized market rather than the less protected mass consumption goods, in primary processing, or of course in exports." ADB Report, op. cit., p. 219.

cost to the Indonesian economy, <u>which may not be altered without serious disruption to the prevailing pattern of production</u>.

<u>Product Type: An Assessment of Suitability</u>

The concern of the Indonesian government to raise the volume of domestically produced commodities is well-founded, and reflects their leaders' assessment of the necessity of reducing the nation's dependence on the import of both consumer goods and producer goods. This priority in turn is an expression of the need to reduce the foreign exchange cost of industrialisation, and as well as the desire to develop the nation's industrial capacity. It is after all the government's formal policy to encourage the production of goods that will <u>complement</u> the development of the rural sector. According to the Department of Light Industry, "(t)he development of the industrial sector in Indonesia is based on efforts to develop and make profitable use of the natural bounty, namely natural resources and geographic factors as well as the traditional know-how of the production world."[14] Both five-year plans emphasised that growth in the rural sector be complemented by the development of a supportive industrial capacity, which in turn emphasised the adoption of labor-intensive techniques of production and the promotion of regional development. Despite the efficacy of these proposals, investment in the light industrial sector has not been made in a manner conducive to these objectives. The Australian investments examined proved no exception to this allocation of investment funds toward the production of commodities available only to a small and essentially restricted market, based mainly in the urban centres. The market for all goods produced by the fifteen joint-venture companies surveyed may be divided into three areas. Three firms produced directly for the consumer goods market, six for the

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[14] Address by the Indonesian Department of Industry spokesman to AIBCC (1974), <u>op. cit.</u>.

building and construction industry, and six for other manufacturers. The area served by most companies was the West Java-Jakarta region, but three firms engaged in widespread distribution throughout the archipeligo.[15] Notwithstanding these exceptions, the market was characterised by its geographical concentration, limited size, class base and in many cases, restricted capacity for growth. Because most products were not for direct consumption, but supplied other industries, many of them in their infancy, the expected market size for many of the products was to be determined by the pace and character of industrial growth overall. For the six firms supplying the construction industry the prospects of rapid expansion seem good to a point. In March 1975 this sector was identified as the fastest growing sector of the economy,[16] having already increased its contribution to GDP by sixty-five per cent between 1965 and 1970.[17] A recent trade mission of the Australian building industry noted the large and growing market for materials like glass, timber, window and door frames, connectors and plumbing equipment, and mentioned the heavy demand for modern hotel and office space.[18] One other observer noted the vast market for building material and commented on the necessity of upgrading the construction industry in Indonesia by the implementation of Western techniques.[19] He also spoke of the external economies and backward linkages that would result from the growth of this sector of industry. Yet although it is true that the building industry, especially

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[15]A CEDA report noted the heavy concentration of Australian investment in the Jakarta area. Advantages to be derived from this included access to port facilities, superior communications, closeness to the West Java market (which had the greatest purchasing power) and proximity to other industries. CEDA, No. 37, op. cit..

[16]The Indonesia Letter, S.P., Supplementary to No. 65.

[17]Overseas Business Reports, February 1973.

[18]Australian Building Materials Trade Mission Report, op. cit..

[19]Seminar "Indonesia — Trading Partner", op. cit., address by R.G. Warren.

in Jakarta, has experienced rapid growth the important question lies not in the size or pace of growth per se, but in the type of growth, and the market it serves.

The desire of the government to hasten economic growth is symbolised by the skyline of Jakarta, which is an initially impressive outline of tall modern buildings and spacious residences, and surrounding them a sea of kampongs, few of them with a fresh water supply, and even less with sewerage. Six Australian companies manufacture production goods for the modern building industry, using mainly imported raw materials. The type of products manufactured and their relatively high cost to the purchaser served a small (though growing) wealthy urban market. The construction industry which it served, produced expensive office space and hotel rooms mainly used by foreign firms and their subsidiaries, and government departments or agencies. It was doubtful that there was a shortage of hotel accommodation but rather of luxury accommodation, and even allowing for the need to increase available office space, it is not objectively necessary to use the most expensive type of construction method. However, when foreign investment becomes the major stimulant to the modern construction industry, this type of building may not be avoided. In the case of these six Australian investments, the products manufactured (apart from their cost), by their very nature could only serve a very small section of the total market, the important point being the fact that it was in the main the foreign and to a lesser extent the state-owned sectors, which constituted the bulk of their market.

A similar situation was observable with respect to the six other investments producing goods for the industrial sector generally. Both the cost of the product and its nature meant that the market served was in the main either the state or the foreign-owned sector. However the three companies producing consumer goods distributed to a much wider market spread throughout the archipeligo. Goods produced included shoe polish, household disinfectants and insecticides, reconstituted dairy products and pharmaceuticals, but the major product lines were shoe polish, tinned sweetened condensed milk and aspirin. Although these goods represent an increase in domestic output of manufactures, the more important consideration is the suitability of products and the market they serve. In Indonesia, where income differences between classes are enormous, a rough but suitable guide to consumer product suitability is cost; for these products, the cost of the major as well as the minor more expensive items, was high enough to effectively preclude purchase by the majority of poor rural-dwelling Indonesians. Besides considerations of cost, the question of product suitability to the needs and income of the majority become relevant. Shoe polish has limited relevance when the majority go bare-footed or wear rubber sandals; sweetened condensed milk, being forty-five per cent white sugar, is a doubtful contributor to dental health, while aspirin, possibly the product with the largest market, is now known to have highly detrimental effects on the kidneys. These are not trite observations but add to the discussion at a very basic level; economists also must take account of the social as well as economic consequences arising from the orientation of the prevailing pattern of investment and production. Moreover, the importance of the "demonstration effect" of foreign investment must not be underestimated. When competition within or without an oligopoly is fierce, and the market characterised by a voracious consumer mentality, the physical appearance of, for example, pharmaceutical products becomes as important, if not more so, than the medicant effect. One Australian firm manufactured a wide variety of pharmaceutical goods, and their packaging and advertising accounted for a large amount of the total cost to manufacture. At the present level of Indonesia's industrial growth such practices represented an unnecessary leakage of scarce resources, but are unavoidable when foreign capital is given almost unrestricted freedom to develop the economy. The point to emphasise here is that increases in the level of domestic output may not be adjudged only on the criterion of increase per se. It is not the increase to domestic production that is important, but the type of products manufactured and the uses to which they may be put. It is of course true that the Australian investments produced commodities of both the "basic" and the "intermediate" variety, as well as final products. Furthermore, a number of these products were those important to the development of a mature industrial base and in this sense of benefit to the growth of the industrial sector overall. Yet the problem posed by the foreign ownership of such industries remains, as does the fact that most of the growth in the industrial sector overall is attributable to investment made by foreign firms. The extent to which the Indonesian government has any control over the activities of these firms is arguable. Whilst some products surveyed were suitable in terms of the industrial objectives of the government, in the majority of cases the reverse was true. In terms of both suitability and cost, the majority were unsatisfactory when considered in the light of the most pressing economic problems that face Indonesia today: low agricultural productivity; widespread and probably increasing poverty for the poorest sections of society; an unbalanced industrial sector; widespread unemployment and underemployment; and a continuous foreign debt. The allocation of investment towards the production of such commodities represents, in the author's view, a mis-allocation of scarce resources; the production of goods for the predominantly middle class urban market, whether directly or indirectly, involves the eventual saturation of this market; furthermore production is achieved under circumstances of great, and in many cases excessive privilege; finally the production of such goods serves to increase the incidence of the demonstration effect of foreign investment — that blind desire to be seen to be modern, use Western products because somehow they are better than the local. In sum, the production of the majority of goods by Australian firms requires a specific pattern of resource-allocation and investment that Indonesia's poor and predominantly rural-based economy cannot afford if it is to develop a mature industrial base. And this does not even touch on the other essential question concerning the ownership and control of this sector.

THE GENERATION OF EMPLOYMENT

One of the most serious and consistent criticisms levelled at private foreign investment, in both the extractive and the manufacturing sectors of Indonesia, is its continuing failure to generate employment opportunities of sufficient quantity to absorb the huge reserves of labor that currently exist.[20] The problem of continuing and widespread unemployment and underemployment is of course, a political as well as an economic issue, a fact that makes its solution an urgent matter for the present government. Although investments in the manufacturing sector have been sought as a major means to employment creation, it appears from the data presented (as well as other evidence) that the capacity of foreign investment to alleviate the problem is relatively restricted for a number of reasons.[21] The fifteen joint-venture companies had a limited technical capacity for employment and the immediate determinant of this was the type of processes used in manufacture. The production processes employed were, in essential respects, inflexible from the point of view of employment-creation. Alterations in non-essential areas (such as packaging) of the production process replaced capital for labor, but to a

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[20]ADB Report, op. cit., Part Three, Section Four, "Industrial Location, Urban Growth and Employment". See also IBRD (No. 148), op. cit..

[21]See Chapter One, "Institutional Reports".

limited and specific degree. The nature of the product necessitated the use of technological processes which could sustain little alteration toward greater employment capacity. Furthermore, the majority of workers were employed as unskilled labor, performing simple tasks in an uncomplicated production process; consequently little improvement to worker skills overall could be expected since the technology required a low and basically inflexible level of expertise. The type of technology used, in general could be classified as "either end" technology, since the majority of workers were engaged in sorting, handling and packaging. Not only did the technological processes used dictate the type and volume of employment, they introduced the important question of "technological dependence" fostered through import-substitution and foreign investment.[22]

Added to this was the effect on the division of labor brought about and continually aggravated by the use of Western technology.[23] The introduction of relatively sophisticated methods of production by the Australian firms resulted in a noticeable aggravation of the most undesirable characteristics of the existing configuration of labor and the pattern of wage differentials.[24] On the one hand, vast pools of unemployed labor and decisive technological limitations to employment combined to create a very weak or non-existent bargaining position for the

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[22] Seers and Joy noted that the "slow growth in employment is in large part an example of the cost to low-income countries of being dependent on the technologies of the rich." Seers, D. and Joy, L. (eds.): Development in a Divided World, Pelican Original, Penguin, Harmondsworth, UK, 1971, p. 225.

[23] "Capital-intensive techniques will not only require less labor for each level of output, but they will also require a different composition of the labor force than labor-intensive techniques, as they make possible the division of complex operations, which would need skilled labor, into simple operations that can be performed by semi-skilled labor." Arrighi, G.: "International Corporations, Labor Aristocracies, and Economic Development in Tropical Africa" in Rhodes, op. cit., pp. 228-229.

[24] Chenery observed this trend. "(T)his large integrated firm brings in a style of employment and wage structure which often introduces or reinforces very large differentials in the local wage structure." Chenery, op. cit., p. 174.

majority of direct labor. On the other hand, the technological requirements of production required the employment of a number of skilled workers; these men, in short supply and high demand,[25] were attracted to the foreign firms because of the better wages and conditions, resulting in an internal "brain drain" from the indigenous to the foreign-owned firms.[26] With higher wages, better fringe benefits, job security and some claim to increased social status, these skilled workers enjoyed a privileged position in relation to the majority of workers. The latter were, by comparison badly paid, with little prospect for training and little guaranteed job security. The importance of this division of functions between skilled and unskilled workers has wide ramifications; effectively the serious unemployment situation, the capital bias of import regulations and the distinct and near exclusive preference of Australian firms for capital-intensive techniques of production, meant a continual aggravation of existing divisions within the industrial working class and the maintenance of an elite section within the labor force whose enviable positions were guaranteed as long as they remained cooperative, loyal to the firm, non-militant and apolitical within the union.

[25] ADB Report, op. cit., p. 219. See also IBRD (No. 148), op. cit., p. 12, and SEADAG (Allen), op. cit., p. 12.

[26] "Foreign firms tend to pay better wages and salaries than the local ones, but this attracts the best workers, technicians and managers away from the local firms." ADB Report, op. cit., p. 224. See also IBRD (No. 148), op. cit., which noted "...a dual structure of the labor market, particularly in the urban areas, tends to become established, whereby a relatively small and well-paid aristocracy of workers and managers in the modern industrial and commercial sectors co-exists with a much larger and usually ill-defined mass of urban self-employed and family workers employed in small workshops or retail establishments, in street trading, porterage and conveyance of goods and people, and in a miscellaneous category of service occupations of which domestic service is most prominent. In these sectors, regulation of work and wages is minimal or non-existent." p. 13. The ILO noted that the high wage pockets in foreign and some state enterprises in Indonesia "may...have undesirable allocation effects by causing a kind of domestic brain-drain into high wage enclaves and unfavourable longer run effects on the demand for labor by inhibiting the use of labor-intensive ones." ILO, "Wages, Salaries and Incentives", op. cit., p. 49. See also Chenery, op. cit., p. 172.

Yet the bulk of direct labor employed by the Australian firms was unskilled, enjoying far fewer benefits than their more skilled fellow workers. Despite this, they were employed, enjoyed some fringe benefits, and provided their behaviour was acceptable to the firm, could experience steady, if low paid work. Even at the low level of job security and remuneration, these workers were privileged in relation to the vast numbers of unemployed and underemployed persons within the Indonesian work force. Clearly the existence of this huge industrial reserve army functions as an indirect means of control of those fortunate enough to be employed. The impending creation or existence of labor unions was an indirect means to achieve the same ends; they were not regarded with apprehension by the majority of firms but on the contrary were considered to fulfill two important functions. Their existence promoted cordial relations between the firms and the Department of Manpower, and also served to regularise and control the activities of the workers. In these senses they fulfilled a positive rather than harmful role for the foreign firms and assisted the control of capital over labor. Furthermore, the widespread existence of negotiation between the administration and the firms on labor matters effectively precluded an active or influential role for unions; overall the labor law was thus severely restricted in its capacity to promote the interests of the industrial working class.

A comparable situation of division and control existed with respect the conditions of indirect labor, which was further heightened by the racial origin of many of its participants. Because of the acute shortage of indigenous Indonesians with administrative, technical and clerical skills, employers were often obliged to engage a disproportionate number of Chinese-Indonesians in relatively high paid, high status administrative and professional positions. These employees enjoyed more comprehensive side benefits, higher wages and better job security than the majority of direct labor, a division that was accentuated by the racial difference. In colonial days, the Dutch very effectively used the Chinese as middlemen and clerical staff, and did much to facilitate their present privileged status within the economy. More recently the foreign investors, obliged by the dictates of production methods, competition and profit, are continuing to aggravate this tendency severely.

The restricted generation of employment opportunities and the division of labor are a direct result of the introduction of capitalist managerial and technical methods, and they are in turn aggravated by the historically produced condition of indigenous and non-indigenous labor. Further evidence of the effective penetration of the capitalist mode of production is witnessed by the changing nature of the method of payment of labor, both in the countryside and in the cities. Within the industrial sector, the traditional system of payment is undergoing substantial modification and in some cases complete rejection.[27] As detailed in the preceding chapter, Australian joint-venture firms preferred purely cash payment or a judicious combination of traditional and capitalist methods. Some employers reasoned probably correctly, that the latter would encourage company loyalty and serve to demonstrate flexibility and concern on their part. They sought successfully to adapt the traditional method of payment to the needs of their industry, retained their best workers and maintained good relations with the Department of Labor. Other employers preferred the exchange of cash for labor, with no side benefits at all. Both the moderation and rejection of the traditional system of payment signified the growth of wage labor, of relations between employer and

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[27]ADB Report, op. cit., noted that whilst wages in Indonesia were low, labor costs are not correspondingly low. Low wage rates often promote ineffective utilisation of labor and high rates of absenteeism. To counter this problem of low labor productivity "a realistic attitude to fringe benefits" is required "in favor of higher direct wages." p. 239. See also Chapter Two, section entitled "Other Difficulties".

employee that were increasingly capitalist social relations of production.

In sum, the direct investments made by the Australian firms failed to generate significant employment opportunities, and as well functioned to aggravate the existing divisions, based on level of skill and racial origin: furthermore it assisted the growth of the foreign-owned sector at the expense of the domestic. These factors point both to the growth of the capitalist sector within the domestic economy and also to its "enclave" nature. The drainage of skilled labor from traditional to modern sector, and the availability of an industrial reserve army, indicate that the type of links established between the two sectors of the manufacturing industry are links that benefit the modern foreign-owned sector at the expense of the traditional. The growth of capitalist relations of production within the privileged foreign-owned sector of the economy is thus achieved <u>at the expense of the traditional, locally-owned sector</u>.

PART TWO:

THE GENERATION OF EXTERNAL ECONOMIES THROUGH FOREIGN INVESTMENT: A LIMITED AND SPECIFIC PHENOMENON

The objectives of this second section are two-fold. Firstly it seeks to assess the actual nature of the indirect effects generated by the Australian investments. The extent and character of the assumed "spread" effects and external economies generated by these investments will be evaluated. Following this, the character of the joint-ventures themselves will be discussed and an assessment offered of their effect on the process of economic change in Indonesia. Finally, some concluding observations will be offered on the role of the Indonesian post-colonial state.

The Mobilisation of Domestic Capital

Whilst it is accepted that a crucial issue for poor countries in their struggle to develop is the scarcity of capital, there exists as well the important and related fact of the existence of significant amounts of "idle" or non-productive capital of domestic origin. Clearly its effective utilisation in productive capacity is an important economic and political issue, well recognised by the international capitalist institutions as well as by individual economists and more recently the Indonesian government itself.[28]

Early years in Indonesia saw the marked tendency for locally accumulated capital to be used in either trade or speculative activity; the role of the government in the aggravation of this tendency was marked, as was the established pattern of investment by Dutch and other foreign investors, which made extremely difficult the alteration of the direction flows toward directly productive economic activity. The

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[28]See Chapter Two, section entitled "The Development of the Financial Infrastructure".

problem of domestic capital mobilisation toward productive investment remains crucial in Indonesia today, and the New Order government is well aware of the need, for, if not capable of effecting, the increased mobilisation of locally accumulated capital toward industrial rather than commercial and speculative activity. The tendency of the domestic capitalist classes to hold their capital in sterile forms, or to prefer trade and speculative activity to industrial investment are phenomena that may be significantly reduced if adequate opportunities for comparable rates of profit present themselves. Yet, as Puthucheary observed, it is in part the limitation of knowledge and entrepreneurial capacity that restrict the transfer of capital from one sector to another, and not only the lack of suitable machinery to facilitate this transfer.[29] These factors are aggravated in Indonesia by the continuing high rates of inflation, the difficulties in ensuring adequate and reliable sources of credit and the problems posed by the condition of the administrative apparatus. Furthermore, there is the fact that the foreign investor, with his modern techniques of production and distribution, and as well his special relationship with the state, occupies a highly privileged position within the domestic economy. This in turn seriously narrows down the possible areas of production that may be profitably entered into by the indigenous capitalist classes, and reinforces their propensity to engage in non-industrial economic activity, except in the cases where they can become the junior partners of foreign capital. This is significantly the case in activity undertaken in the resource-extractive sector, since the sheer volume of capital required by such investments, and equally important, the technological requirements of production and the long gestation period, make private domestic capital participation in such projects a rarity. It is the state itself which performs the role

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[29] Puthucheary, op. cit., p. 157.

of the domestic capitalist class with respect investment in the resource-extractive sector. In the manufacturing sector however, since the installation of the New Order government, there has been the appearance of considerable domestic capital mobilisation, from both the private and the public sectors, a phenomenon directly attributable to the large inflows of foreign capital and to encouragement by the state of economic activity by the non-pribumi capitalist class. The most prevalent form that this mobilisation has taken has been the joint-venture arrangement, and it is upon this type of cooperation between indigene and foreigner, that great hopes are pinned with respect the productive investment of local capital, and as well the transfer of technical and managerial skills.[30] In the following section, the extent of domestic capital mobilisation engendered by the set of Australian investments previously examined will be assessed, and at a later stage utilised in an evaluation of the character of joint-ventures themselves.

As demonstrated in the previous chapter, despite external appearances, the amount of local capital mobilisation resulting from the investments examined was low. Although it is the stated policy of the present government to effect the mobilisation of domestic capital for the purpose of industrial expansion, it is clear that economic, technical and social factors make this task extremely difficult.

The results of the survey indicated that few if any local partners paid cash for their equity share in the joint-venture company, most of it being accounted for by payment in kind, non-cash contributions of "goodwill" or future payment to be taken out of profits. Where cash was paid it was generously described as a loan from the parent company. The

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[30]See Chapter One, section entitled "The Cost-Benefit Approach".

capacity of partners to raise finance for industrial development was thus extremely limited. It is not possible to state conclusively that this situation will predominate in the future, but whilst existing economic trends prevail, there is little reason to suppose otherwise.[31] Agreements between local and foreign partners concerning the gradual increments to local equity further support this view. Few joint-venture firms were worried by the possibility of increased local equity participation, due to the existence of managerial, technical and supply contracts, as well as to the very slow change-over period that had been agreed upon, as well as the scarcity of local finance. The limited financial role of the partners paralleled their similarly limited managerial and administrative roles. Furthermore, the existing configuration of domestic economic power was enhanced by the choice of joint-venture partners. Proportionate to their numbers, non-pribumi, state and municipally-owned enterprises were over-represented, and pribumi under-represented. The acute shortage of suitable joint-venture partners was, in the cases examined, chronic, a situation which led the majority of Australian firms to choose a partner who was already involved in equity arrangements with other foreign firms.[32]

The needs of foreign capital within Indonesia resulted on the whole in the strengthening of the already economically powerful Chinese

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[31]See Chapter Two, section entitled "The Development of the Financial Infrastructure". The lack of availability of domestic capital for the purpose of industrial investment must be partially attributed to their "merchant" mentality, which prefers quick recovery of capital to slow. In an economy in which the "best lending rate" of the leading banks is 1.5 to two per cent per month, Indonesian investors' reluctance to deep-freeze any capital for a few years without any prospect of immediate return is understandable. The Indonesian partners of Japanese firms appear to be content for the time being, with the sole distribution or leading distribution rights of the product made by their joint-venture partner. Tsurumi, op. cit., pp. 20-21.

[32]Other sources have also observed this tendency. See Tsurumi, op. cit., p. 22, and SEADAG (Allen), op. cit.. Allen claims that since reliable partners are difficult to find, there is a tendency for foreign investors to use already successful local businessmen, who are joint-venture partners with many other foreign firms. The result was an increasing concentration of industrial wealth. p. 37.

and state-owned firms to the effective exclusion of the indigenous private firm.[33] In effect this means that what mobilisation or apparent mobilisation does occur, further strengthens the already existing economic ties between Chinese, state and foreign capital, and lessens the probability of indigenous producers in the private sector participating significantly in the growth sectors of the economy.[34] Whilst the Indonesian government officially views the creation and proliferation of joint-venture firms as a major element of its stated policy of "pribumisation", evidence strongly suggests that the joint-venture arrangements do not encourage "pribumisation" as such, but rather allow the strengthening of non-pribumi and state capital at the expense of pribumi capital. Clearly the lack of sufficient entrepreneurial skills hampers private pribumi capital mobilisation for industrial investment, and as well augments the process of increasing concentration of economic power in the hands of state and Chinese capital. Moreover, the volume of capital actually mobilised through the creation of joint-venture arrangements did not occur in sufficient quantities to warrant the continuance of the commonly held assumption about the capacity of such arrangements to facilitate domestic capital mobilisation. The role of the local partner rarely had any significant connection with financial contribution on his part. In sum,

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[33]Chauvel claims that sixty per cent of <u>all</u> local joint-venture partners in Indonesia are Chinese. Moreover, he asserts that the Chinese operate "behind the scenes" as well, in enterprises involving nominal pribumi partners. Chauvel, R.: "The Calm Before the Storm" in <u>RIMA</u>, July-December 1973. Utrecht claims that eighty per cent of all economic activity in Indonesia involves the military, but the extent of the active as opposed to the "sleeping" nature of this participation is of course unknown. Utrecht, E.: "The Military Elite" in <u>Ten Years Military Terror in Indonesia</u>, Caldwell, M. (ed.), Spokesman Books, Nottingham, 1975, p. 46.

[34]Mandel observed the same with respect the effect of multinational investment in poor countries which tended "to deprive the so-called 'national bourgeoisie' of its predominance in manufacturing industry, where the joint-venture combining indigenous, private and public foreign capital, becomes one of the most important features of late capitalist or neo-colonialist phase of imperialism." Mandel, <u>op. cit.</u>, p. 347; see also his p. 372.

what occurred was not only the extremely limited mobilisation of domestic capital, but as well _the tendency for it to be concentrated in the hands of already successful local capitalists_, whose position within the joint-venture nevertheless remains subordinate in all ways to that of the foreign partner.

Further efforts to facilitate local capital mobilisation are evident in the government's attempts to rejuvenate and significantly expand the money and capital markets. By the development of these mechanisms, it is hoped that currently non-productive capital will be circulated and made available to producers in the industrial field. However, as Chapter Two has demonstrated, it is most probable that the capacity of the money and capital markets to achieve this end is extremely limited, and most recent observations indicate that the sale of shares will be restricted to institutions and corporations chosen by the government, thus heightening the distinct possibility of unorthodox practices prevailing on the stock exchange. This will deter local capital mobilisation and operate to the advantage of already established firms. The probable limited role of the stock exchange is paralleled in the government-directed establishment of the money market. Although originally conceived as a means to increase the availability of funds to the small and medium-size local producers, it appears for practical and political reasons the implementation of these objectives is a remote possibility. Instead, the real functioning of the eight merchant banks, the instruments of the policy, will be the supply of credit to the foreign sector and the wealthiest sections of the local capitalist classes. It is clear that the scarcity of credit to the small producer will not be relieved by the establishment of the money market, but will _on the contrary_, make their position in relation to the more privileged sections even more disadvantageous.

In sum, it appears that the institutions of the joint-venture and the money and capital markets do not greatly assist the mobilisation of domestic capital for use by the local producers, but rather function to increase its concentration within already established and highly privileged groups, and allow the increased penetration of foreign capital into the economy on a privileged basis. Clearly, although conditions for the accumulation of capital within the domestic economy have improved since the installation of the New Order government, there are still many factors that hamper the process considerably; they are of both domestic and foreign origin. On the one hand, there remains the historically conditioned dispropensity of the local capitalist classes to invest in long-term projects of an industrial nature, a condition seriously aggravated by the vagaries of government policy, the existing commanding position of foreign capital and the less powerful but strategically important position of the Chinese and state-owned sectors of the economy. The depressed state of the infrastructure and the continuing high rates of inflation similarly reduce the propensity of accumulation for industrial investment. On the other hand, the policies of the parent firms in Australia with respect to future ownership and control of their subsidiaries does little to encourage domestic capital mobilisation except when used in junior partnership with foreign capital. The result is the extremely limited mobilisation of domestic capital and as well its use by, or on behalf of, specific economic groupings within the domestic economy.

The Nature of the "Transfer of Technology"

Arguably, a most important assumed effect resulting from direct foreign investment in poor countries is the so-called transfer of managerial and technical skills from foreigner to indigene. The capacity of the joint-venture firm to facilitate such a transfer is assumed to be significant due to the fact of equity participation by indigenous capitalists and the introduction of modern techniques of production. Criticisms of private foreign investment have, in the past, often been made on the basis of a lack of such transfer and indeed the most prevalent form of foreign investment in the years of colonial domination was resource-extractive, a form which failed to generate the spread of skills to the traditional and domestically-owned sectors of the economy. The "dual" economy that resulted prevented the linking of the modern and traditional sectors, the former remaining essentially an "enclave", characterised by the use of modern technology and the generation of high profits, which were repatriated to the imperial nation rather than reinvested in the colonised economy. In other words, the resource-extractive sector was not capable of generating external economies of the type that could accrue to the whole economy; they accrued instead to the foreign-owned sector as a whole and to the processing and manufacturing firms in the imperial nation.[35] With the advent of greatly increased direct foreign investment in the manufacturing sector of poor countries however, it is commonly argued that the opportunities for the generation and effective utilisation of external economies within the economy, are greatly enhanced. Direct investment by foreign firms in the manufacturing sector is seen as a crucial instrument in the promotion of technological and managerial "transfer", and the joint-venture its most valuable form. As demonstrated in the first and third chapters, this is the official position of the Indonesian government and the international capitalist institutions, a position which is bolstered, and to an important degree created by, the necessity of expansion abroad by Western and Japanese capital.

Direct investment by foreign capital through the medium of the joint-venture is thus assumed to generate technological and managerial

[35]See Chapter One, section entitled "The Planning Variant in Development Economics", especially the sections on comprehensive state planning.

external economies, and it is the purpose here to examine and assess their type of frequency; an evaluation of the effects of private foreign investment must necessarily include such considerations, since the reasons for the former lack of growth in poor country industrial capacity is at least partially attributable to the extremely low level of Western technical and managerial skills within the economy. It is crucial to recognise that the shortage of capital and its inefficient use in poor countries is paralleled by an equally serious shortage of technical skills; this is clearly a factor which contributes to the prevailing pattern of investment by indigenous producers, and one that is a significant obstacle to the development of industrial capacity. The necessity of enabling the redirection of economic surplus from trade and speculative activity to ones more directly productive is thus a process that is seriously but not exclusively hampered by the shortage of suitable skills, and the following section addresses itself to this issue; it involves as well, reflection on the actual function of the joint-venture arrangement in the process of "technical and managerial transfer".

The transfer of technical skills. As the preceding chapter has demonstrated, the external economies of a technical nature, involving increases in skills of the domestic population, and assumedly the subsequent improvement to local techniques of production, were neither prolific nor easily exploitable by indigenous producer or worker. The reasons for this are as important as the fact itself, since there exists a powerful body of opinion which maintains that whilst the problem of limited transfer is a pressing one, nevertheless the adoption of appropriate policies by investing countries and the Indonesian government itself, will redress the situation.[36] In other words, it is considered that the implementation

[36]See Chapter One, section entitled "The Cost-Benefit Approach". The UN report on Asian industrialisation concluded that with respect the transfer of technology, at present costs outweighed benefits. It recom-

of laws and regulations, and a recognition of a moral responsibility on the part of foreign investors themselves, will render the benefits of technology transfer to Indonesia far greater than the costs.[37]

The nature of the technological processes involved in the production of commodities was the most readily identifiable factor limiting the transfer of technical skills to indigenous workers. Whilst both the products themselves and the process used to create them were in the main simple, the plant itself was complex, and generally of the type used by the parent firms in Australia.[38] The majority of direct factory labor was involved in unskilled work, performed side-by-side with complex machinery, and of consequence there was little scope for the workers involved in production to even being to comprehend the nature of the technological processes.[39] Furthermore, since the main form of competition experienced by the firms was with other foreign firms, it was distinctly unlikely that alteration of production techniques toward more appropriate technology (in terms of its ability to render more effective the transfer of skills) could occur. The demonstration effect of foreign investment ensured that the local market favoured the more technically

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[36](cont.) mended that the governments of supplier countries adopt measures "in order to induce a freer flow of technical know-how at reasonable cost." UN Report, op. cit., p. 28.

[37]The many problems associated with the transfer of technology are detailed by Lipton, M.: "The International Diffusion of Technology" in Seers and Joy, op. cit..

[38]Tsurumi observed the same for Japanese machinery used in the manufacturing sector in Indonesia. Tsurumi, op. cit., p. 30.

[39]Similarly the ADB Report noted: "Frequently, a foreign enterprise may fail to generate any educational benefits precisely because the technology it employs is too advanced to be absorbed by a country with its existing educational facilities and level of skills." ADB Report, op. cit., p. 25. Allen came to essentially the same conclusion when he wrote: "The dominance of simple process and assembly projects implies that the development of skills of the local work force to a high grade has not been extensive overall and...that horizontal and vertical linkages have been minimal." SEADAG (Allen), op. cit., p. 12.

sophisticated and Western-style products.[40] The dominant market position held by the majority of firms was also a contributing factor to the limited or negligible transfer of skills to the indigenously-owned sectors, since their monopolistic and oligopolistic market position clearly reduced the possibility of competitive alternatives using similar technology functioning with the same areas of production. Moreover, the indigenous firm, producing a comparable but technically less sophisticated commodity, is not likely to command anywhere near the same market share as can his foreign counterpart, due once again to the demonstration effects of foreign investment, as well as their less sophisticated marketing knowledge. Thus the dominant market position held by the foreign firms, their superior (in the sense of more sophisticated) marketing techniques, and the demonstration effect of foreign investment together contribute to the extremely limited technological transfer from the foreign to the indigenously-owned sectors of the economy. The modern technology is confined to a relatively small number of foreign firms and there is no reason to anticipate that this situation will alter significantly to the increased benefit of the indigenously-owned sectors.

Another contributing factor to this situation is the motives for the original choice of production technique. Clearly, the Indonesian government preference for modern and sophisticated capital goods, their ban on the import of secondhand machinery and their officially generous subsidy to capital goods imports, are contributing factors to the adoption

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[40]Chenery, for the OECD recognised the effect of consumer preference on the choice of technology and argued that the production of goods by foreign firms, especially the multinational companies, created a distortion of consumer demand and technical choices. He noted this as a "backwash" effect of foreign technology, and concluded that it had an undesirable demonstration effect on consumer patterns. Chenery, op. cit.. See also Tsurumi, who concluded that the Japanese investors showed a preference for "high quality products (and a notch 'higher' quality than existing competitors for late-comers)." Tsurumi, op. cit., p. 33.

of capital-intensive techniques of production. When this is combined with the objective of foreign firms to increase the export of technology, goods and services, the reason for the present technological status of production methods is further clarified. The crucial point is that the objectives of the foreign firms, considered together with supportive and complementary government policy, make very difficult or impossible the introduction of those techniques of production capable of significant absorption by the traditional sectors. Capital-intensive investment and the ensuing production of Western commodities render the possibility of technological transfer very limited indeed.[41]

Yet whilst opportunities for technology transfer did not exist in significant quantities at the actual place of production, it could be argued that the existence of backward linkages resulting from the investments allowed a transfer to occur indirectly; technological external economies could be generated in this way. However, this is not likely to occur due to the extremely limited frequency of such linkages. The majority of Australian investments were made with the view to increasing either the export of goods or technology, a fact which ensured that few backward linkages of supply were created. Furthermore, the existence of technical service agreements between parent and subsidiary similarly rendered the process of transfer very weak and not likely to improve over time.[42] Finally, the conspicuous absence of training facilities for the

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[41]"The shortage of skilled labor is as relevant as the ample supply of low-priced unskilled labor to the choice of manufacturing techniques, but neither has been of overriding importance, because for both local and foreign investors, the nature of the product and the equipment available has tended to determine the choice of manufacturing process." ADB Report, op. cit., p. 220. The capacity to absorb technology is of course also limited by cultural and physical factors. See Bijli, op. cit., p. 13.

[42]As Rhodes, Petras and McMichael observed, the "proliferation of dependent services is hardly an example of spreading know-how as it is of spreading dependence. The promotion of local entrepreneurs to extend the areas of exploitation and as agents for the transmission of an imperial ethos, is hardly extending local technology, but allowing the product of

bulk of direct factory labor was further evidence of the lack of technological transfer. Although the training of workers was negligible, it did in certain instances occur, and the skilled workers, as recipients of this training, were evidence of a transfer of skills from foreign firm to indigenous worker. Now whilst it is true that a small proportion of workers did receive training, both on site and through professional instruction, it is essential to recognise that such training does not constitute an external economy to the economy as a whole. _It is one that accrues internally to the foreign-owned sector of the economy._ The internal "brain drain" mentioned in the preceding chapter operates at the expense of the domestically-owned sectors of the economy and for the benefit of the foreign. The relatively high wages paid to the skilled workers, who are in short supply and high demand, and the high status accorded to those who secure employment with the foreign firm, means that with respect the securing of the necessary skilled labor, the foreign firm has a distinct and decisive advantage over its local counterpart. In this sense it is clear that the transfer of technology operates to the advantage of the foreign firm, not to that of the host economy. The essential point is that the technological external economies that do occur are limited in that they accrue in the main, internally to the foreign-owned sectors. There is therefore a limited and specific operation of the technical multiplier, which is caused by the dictates of technological and competitive factors, and by the special relationship between the state and foreign capital. In sum, the existence of the small, highly productive and profitable foreign-owned capitalist sector within the domestic economy, renders the operation of technological external economies highly limited and specific.

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[42] (cont.) imperial-controlled technology to penetrate the local level." McMichael, et. al., _op. cit._, p. 91.

<u>The transfer of managerial skills</u>. It is true that one of the most serious problems to plague Indonesia since the gaining of formal political independence has been the lack of entrepreneurial skills within the indigenous capitalist classes, particularly amongst the pribumi. Early efforts to assist the development of the pribumi were hampered by (among other things) this dearth of managerial and executive expertise. The position of the non-indigenous capitalist classes, particularly those of Chinese descent, has always been much healthier in this regard, although their activities have, in the main been confined to trade, private banking, speculative investment and the manufacture of light durable and non-durable consumer goods. Since the inflow of private foreign capital after the coup, it has been in the main the Chinese-Indonesians and the state enterprises that have benefitted in their role as local partners to foreign capital; the position of the pribumi remains poor.

As a partial solution to this politically sensitive situation, the Indonesian government has identified the joint-venture as a highly appropriate vehicle for the transfer of managerial skills. It is considered that the fact of equity participation by indigenous capitalists will facilitate the transfer of managerial skills and as well guarantee local management participation. But in no instance was this the case in any of the investments examined. Many local partners chosen were owners of well-established firms and their knowledge of the local market and their influence at high military or administrative level rendered benefits that accrued to the joint-venture firm. The cumulative effect was in several cases to reduce competition by the incorporation of local companies into the foreign-controlled joint-venture company. In other cases the partner was considered a phenomenon to be suffered by the firm in exchange for the securing or privilege, as well as the diplomatic advantage to be gained from the appearance of local participation. In these cases, the function of the joint-venture partner was limited to the collection of directors' fees and the occasional appearance at social functions. Overall there was little opportunity or indeed desire for the training of local partners for future managerial roles[43]; the present role of all partners was non-managerial in nature, and was limited to this, not only by their own capabilities, but as well by the particular pattern of production and distribution undertaken by the joint-venture firms.[44] Within this pattern, the possibility of substantial transfer of managerial skills or the growth of significant local executive authority was precluded. The existence of managerial agreements thus severely limited the operation of managerial external economies. The effective role of the joint-venture partners was to contribute, when requested to do so, to the solution of problems <u>external to the pattern of production and administration within the firm</u>, but which arose from the peculiarities of the business environment.[45] In only one instance did the local partner actually work with the firm on a day-to-day basis, and his presence had proved a distinct problem for the firm's Australian management. Where the local partner was engaged in the distribution of goods, there was evidence of a transfer of expertise, but the existence of an

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[43] The Macquarie Report observed similarly that the majority of Australian companies did no formal training at all to fill in managerial gaps. The recruitment of local partners was in most cases examined for the purpose of overcoming cultural or language gaps. The report also noted the very tight control of overseas subsidiaries by parent firms with respect management practices and concluded that "it seems to be the nature of Australian enterprises overseas that small scale requires tight control." Macquarie Report, <u>op. cit.</u>, pp. 46-50.

[44] Tsurumi, <u>op. cit.</u>, observed that the "silent partner" status of most local partners in Japanese joint-venture firms was <u>partially</u> attributable to their commercial merchant mentality.

[45] Another aspect of this "external" function of local partners is pointed out, again by Tsurumi. He states that much so-called domestic investment is in fact disguised foreign investment, the role of the local "managers and owners" in practice being one of "front men"; in these cases their activity is clearly external to the pattern of production distribution and administration. Tsurumi, <u>op. cit.</u>, pp. 42ff.

Australian sales manager, albeit one who was acting in a formally advisory capacity, meant that a loophole in the distribution laws had been found and successfully utilised.[46]

In sum, the role of the Indonesian partners did not relate to their actual or potential capacity as industrialists, administrators or executives, for on this respect they were all sleeping partners. Rather it related to their ability as distributors, and in the main to their ability to act as lobbyists for the firm. Formal recognition of the Indonesianisation program was reflected by the fact that all local partners were either directors or president-directors of the firms, but this was a matter of form not substance. The assumption concerning the capacity of the joint-venture arrangement to facilitate the development of managerial skills of the indigenous capitalist classes are on this evidence ill-founded. Where evidence of transfer was found, it represented not an external economy that could accrue to the economy as a whole, but, as with the transfer of technical skills, one that accrued internally to the foreign-owned sector of the economy.

It is clear that the effective operation of the main secondary multiplier as it pertains to technological and managerial transfers, is severely hindered by a number of factors that are not likely to disappear or suffer reduced intensity in the foreseeable future.[47] The fact that

[46]Moreover, it appeared that generally, those managerial economies, resulting from foreign investments and supportive aid-financed training programs, accrue mainly to the foreign-owned firms, since the particular skills acquired through formal training, were tailored to suit the needs of modern Western style business practices, and were thus unsuitable to the needs of most pribumi and many non-pribumi firms. The proliferation of management courses sponsored by chambers of commerce and run by pribumi were the object of unveiled contempt by a representative of the CSIS in Jakarta, who criticised their undisguised American flavour and inapplicability to the real problems faced by the pribumi. Interview with Lim Bian Key, Secretary of the CSIS, Jakarta, 2 September 1975.

[47]For full explanation of this concept see Chapter One, section entitled "Industrial Growth and the Principle of the Multiplier".

Australian foreign investment in the manufacturing sector is predominantly of an enclave nature is the crucial determinant of this. The use of capital-intensive and sohpisticated technology for the production of commodities for a numerically small and limited Westernised market, the existence of widespread monopoly and oligopoly within the modern sector, the prevalence of technical and managerial agreements, the effective internal "brain drain" from the domestic to the foreign-owned sectors, all render the operation of technological and managerial external economies limited and specific. There are of course other factors that severely aggravate this dominant tendency; the historically conditioned aversion of the indigenous capitalist classes, particularly the pribumi, to long-term investment in industrial capacity is continually reinforced by the thrust of government policies; the low levels of productivity and technological methods within the traditional domestically-owned sectors of the economy, coupled with the poor supply of credit and small scale of activity, means that this sector is ill-equipped to absorb the technologies and managerial techniques used in the modern sectors. Finally the regional bias of foreign investment and the generally poor state of the physical infrastructure also function to reduce the degree of technical and managerial linkage between the modern and traditional sectors.

Clearly, the extent of the effectiveness of the main secondary multiplier (as identified by Puthucheary) — the type and frequency of external economies and diseconomies pertaining to managerial and technological factors, are determined by the relationship between foreign capital, domestic capital and the post-colonial state, operating as they do within the historically determined economic and social conditions. It is insufficient to merely observe and record the occurrence of external economies, or to assume that they naturally accrue to all sectors of the economy. What is crucial is to determine which sectors of the economy are able to utilise them and which are not.

The Linkage Effects of Australian Investment: An Evaluation

One of the most pressing criticisms of direct private foreign investment in the resource-extractive sector, is its inherent incapacity to generate an acceptable volume of backward and forward linkages, that operate to join together, in a complementary fashion, various sectors of the economy and thus promote a balanced and diversified growth.[48] Direct investments in the manufacturing sector, on the other hand, are assumed to have a much greater capacity to avoid this "enclave"-derived behaviour, and to assist considerably in the proliferation of linkage effects; induced additional investments to supply the necessary inputs (backward linkage) or to utilise output initially produced (forward linkage) imply not merely increases to domestic production per se, but as well complementary production and thereby diversified economic activity.[49] Yet evidence obtained in field work makes clear the highly limited generation of linkage effects, and also revealed that their occurrence resulted, in the majority of cases, in benefit to the foreign-owned sectors of the economy, not to the domestically-owned sectors. Linkage effects were thus limited and specific in both type and frequency.

To consider the generation of backward linkages first; as defined by Hirschman, these "result in the fact that the setting up of an industry brings with it the availability of new and expanding markets for its

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[48]This problem is well recognised by the World Bank, the Asian Development Bank and the United Nations, who all argue that the processing of raw materials in the poor country should be undertaken on an extensive scale in order to increase the linkage and spread effects of investment in the resource-extractive sector. See Chapter One, section entitled "Institutional Reports".

[49]Hirschman, op. cit., and Chapter One, section entitled "The Case for State Control in the Mixed Economy".

inputs, whether or not these inputs are supplied initially from abroad."[50] In the case of the Australian investments, the widespread necessity of the parent firm to increase trade in raw materials, component and spare parts and other production inputs through the export of capital, meant a highly restricted actual linkage effect, and as well of future linkage effects. Backward linkages of supply did not accrue to the domestic economy, but to the Australian economy; firms could not make use of local production inputs simply because the type of goods manufactured demanded imported inputs, and because of the relationship of the overseas subsidiary to the parent company's need to export certain goods. Because of this, there was little reason to expect the future generation of backward linkages to the domestic economy, a situation recognised by Hirschman when he wrote: "(t)he interests of the converting, finishing and mixing industries are often opposed to the establishment of domestic sources of supply for the products they convert, finish or mix."[51] Yet despite his awareness of this fact, he maintained that linkage effects "of practically infinite range and depth"[52] would occur gradually over time; the trickle-down effect and the consequent growth of domestic production could, he maintained, result from import-substitution.[53]

The generation of backward linkages of supply was also limited with respect the provision of the physical infrastructure necessary to the type of production processes introduced by the foreign firms. In the cases of early investments particularly, the actual factory was imported,

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[50] ibid., p. 99 (original emphasis).

[51] ibid., p. 118.

[52] ibid., p. 112.

[53] Hirschman writes: "Imported goods have been gradually replaced by domestic production which has been called forth by the existence of a large and stable market." ibid., p. 112. He suggests the setting up of "last" industries first, then the gradual development of the intermediate and basic materials production will develop from this.

and in general the demands of the production process necessitated the provision of Western infrastructural facilities as well, including power generation and communications equipment, modern office accommodation and the like. The point is that the growth of the foreign manufacturing sector requires not only the continuous import of direct production inputs, but as well the import of appropriate infrastructural facilities. The effect is not only the extremely limited occurrence of backward linkages *directly associated with production, but also of those indirectly associated but equally crucial to continued production by foreign firms.* Thus the nature of production by foreign capital excludes the possibility of substantial backward linkage effects to the domestic economy, but *ensures a continuous linkage effect to the economy of the country that originally exported the capital.*

The generation of forward linkages by the Australian investments was also limited, but the type of products manufactured did in some cases engender linkages to the locally-owned sector of the economy. However the type of products utilising these inputs were of a kind that necessitate consideration of another factor, that of product suitability.

As defined by Hirschman, the output utilisation or forward linkage effects refer to "every activity that does not by its nature cater exclusively to final demand...(and) will induce attempts to utilise its output as inputs in some new activities."[54] Six joint-venture companies manufactured a variety of goods for other industries. Forward linkages were in evidence here, for this group of firms manufactured a number of basic and intermediate goods, used in a fairly wide range of manufacturing processes. They included lead for batteries, gases for metallurgical industries and containers for oil and domestically produced beverages.

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[54] *ibid.*, p. 112.

But again, the type and size of the market was more important than its existence per se. Batteries at present are required for the highly competitive and fragmented automobile assembly industry, which serves the urban middle class market; glass bottles and aluminium tubes are used mainly in the packaging of beer, soft drinks and pharmaceutical products, and with prices beginning at Rp. 200 per tube or bottle, the market is clearly limited to the same class; moreover, these products, sold as non-returnable items, encourage an inappropriate attitude toward disposal and re-use, an attitude hardly commendable in an economy where maximum utilisation of existing resources should be accorded high priority. The manufacture of industrial gases and containers proved to be most useful in terms of relevancy and applicability to long-term industrial growth. Despite this, it must also be remembered that these useful forward linkages of supply serve, in the main, the foreign-owned sectors of the economy, and therefore operate to assist the health and growth of those sectors in particular. <u>What integration and complementary economic activity can result from the investments will most readily accrue to the foreign-owned sectors</u>. In sum, one can point to the generation of forward linkages of supply particularly, because the majority of Australian investments examined manufactured basic and intermediate rather than final products. However, the point to emphasise is that consideration will always need to be made of the internal character of the linkage effects, and as well of the type of products able to be made from this new range of inputs.

The Australian-Indonesian Joint-Venture: An Assessment

The institution of the joint-venture is one whose increasing proliferation and assumed capacity for facilitating the "transfer of technology" and the "pribumisation" of economic development, warrants both careful investigation and critical evaluation. The preceding chapter has presented in detail the most important facets of economic activity pursued by Australian subsidiary or joint-venture firms, and it is now possible to summarise their actual function and effect within the economy.

As a method of promoting the interests of the local capitalist classes, as interests separate and distinct from those of the foreign, they have been shown to be ineffective. However they do serve to promote the idea that "Indonesianisation" is occurring, and in this sense fulfill an ideological function. Since it is the formal objective of the present government to encourage the gradual transfer of ownership from foreign to local capitalists, to encourage the mobilisation of domestic capital for industrial investment and to increase the transfer of skills from foreign to domestic producers and investors, the joint-venture is portrayed as an ideal vehicle for the achievement of these objectives. But as the prior chapter has shown, this is far more a matter of form than substance. Contrary to what is either assumed or claimed for the joint-venture arrangement, with respect its assistance to the indigenous capitalist classes, the actual effect appears to be the reverse. Instead of assisting the development of the local capitalist classes as classes separate and distinct from the foreign capitalist classes, the joint-venture is a highly effective vehicle for the weakening of these local classes and simultaneously for the further strengthening of foreign capital, in its ability to penetrate and control key sectors of the economy.[55] With the

[55]Alavi's comments are instructive here. He writes: "Their (the national bourgeoisie) small resources and scale of operation keep out the possibility of developing their own technology, independently, out of their reach. For access to the requisite advanced industrial technology, they have to turn to collaboration therefore, to the bourgeoisie of the developed metropolitan countries, or to socialist states. This they do despite the fact that the terms on which the collaboration is offered are such that it hamstrings their own independent future development." Alavi (1972), op. cit., p. 75.

creation of joint-ventures, the local capitalist classes are faced with two alternatives. They may either attempt to compete with them or they may, if possible, join with them to increase their own economic strength or forestall its demise. Since the possibility of success of the first alternative is remote, and the latter an attractive possibility both financially and socially, it is little wonder that the most successful elements of the local capitalist classes become the junior and permanently subordinate partners of foreign capital. In short, the joint-venture is an extremely effective vehicle for the privileged and increased penetration of foreign capital into the Indonesian economy, at the expense of the growth of the local capitalist classes; as Magdoff observed: "...(T)his is not.prompted by the malice of the individual, but by the normal and proper functioning of business in the conditions confronted. The pattern of these investments should be examined in the historical context, in the light of actual situations business firms deal with...."[56] The detrimental effects of Australian investment thus may not be finally attributed to the actions of individuals: rather it is a pattern of development that cannot fail to occur.

Some Final Comments on the Role of the State

Having considered the type and frequency of external economies generated by the Australian investments themselves, it is fitting to consider briefly those directly generated by the state itself. In a poor country such as Indonesia, the state must fulfill certain functions essential to the process of expanded reproduction; it must provide the conditions for the rapid, steady and diversified reinvestment of profits and attempt to overcome or diminish the disincentives to investment and

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[56] Magdoff, *op. cit.*, p. 38.

reinvestment by the private sector.[57] The functions of the Indonesian state in this regard, make necessary their evaluation within the context of generated external economies; clearly the role of the state in the elimination of the many "bottlenecks" that impede the process of industrial development must be considered. The provision of the necessary infrastructure are not projects usually undertaken by the private sector, except in the role of contractors, where it does not take the risks and responsibility for the completed project. These expensive and low profit activities are the designated role of the state, and it is the resultant effects of these activities that demand evaluation.

As Chapter Two has shown, the Indonesian government is pursuing (with moderate success) the development of a physical, financial and legal infrastructure conducive to the development of expanded reproduction along capitalist lines <u>that clearly benefits those who have the capacity and the knowledge to exploit it most effectively</u>. For example, a number of Australian firms have established their factories and offices on industrial estates, recently developed by the DKI, private foreign capital and aid funds. Although the lease of these sites is available to all firms, the prohibitive cost of lease purchase precludes all but the larger firms from taking advantage of their existence. This means that the foreign firms are the most likely and numerous candidates. Overall the initial political and economic advantages enjoyed by the foreign firms increase their access to all benefits of improved physical infrastructure. An obvious example is the new multilane highway built from Jakarta to Bogor, financed by aid money. It has been made primarily to serve the needs of the many industries that line the original narrow and crowded road: the majority of these industries are foreign-owned.

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[57]For detail on the indirect economic functions of the post-colonial state see Chapter Two, section entitled "The Form and Function of the Post-Colonial State".

Supporters of this large and capital-intensive infrastructural development may realistically argue that benefits will accrue to the local populace as a result in increased industry, employment, and better and safer roads. Yet it is crucial to go beyond immediate observation and evaluate the longer-term side-effects that this and many similar projects have on the structure of the economy. As well as the high cost and capital-intensive nature of the project, the new transport system will bring added advantages to the already privileged foreign-owned sector and encourage further investment in regionally concentrated "enclave" type import replacement industries. The same type of effect results from the development of the financial infrastructure. Because of prior experience with, and accumulated knowledge of the workings of banking and credit institutions, foreign firms possessed a greater managerial, as well as financial capacity, to utilise the services offered by the modern banking sector. Furthermore, foreign firms and their subsidiaries are not only psychologically predisposed to use such services but are more readily welcomed as customers; the small volume of business transacted by the pribumi in the modern financial sector illustrates the point.

The resulting effects of improved infrastructure are clearly those most readily exploited by the foreign-owned sectors of the economy. It is not enough to merely acknowledge their existence; <u>they are external economies generated by the state that operate to assist the privileged penetration of foreign capital into the economy</u>. Whilst in theory, they accrue to the economy as a whole, in practice conditions determine that they <u>may only accrue in the main to the foreign-owned sector</u>. <u>It is a process that cannot fail to occur</u>. In sum, the conclusions to be drawn with respect the effects of state activity on the industrial process, are similar in thrust to those observed of direct investment itself. Policies are directed at changes to the content, pace and direction of economic activity, which assist the process of industrial growth controlled by the foreign-owned sector of the economy. The beneficial effects of state activity still accrue in the main to the foreign-owned sector, and operate to ensure and increase its position of privilege and dominance in the key areas of economic growth.

Concluding Comments

This final chapter has revealed the adverse effects of the Australian investments on the Indonesian economy, notwithstanding the immediate and tangible evidence of increased domestic production and employment opportunities. The major effects of the investments were to increase the dependence of the economy on foreign inputs and technology, and to assist the development of industrial growth of a specific type which is, in the author's view, inherently incapable of solving, or assisting to solve, the most pressing economic problems that face Indonesia today. The capitalist growth being fostered in Indonesia by the international capitalist institutions, the New Order government and foreign capital, is capitalist growth of a particular type; it is neither a continuation of the old pattern of colonial exploitation nor a progression towards integrated industrial development of the type in existence in the West or Japan. Industrialisation after colonialism is different to that which occurred in both the old world and the new; the latter involved the growth of a mature and diversified industrial structure, with well developed links between all sectors, and as well the growth of a social, political and ideological superstructure that developed to complement the requirements of mature capitalist growth. The situation in a poor country like Indonesia, once a colony of the Dutch empire, is significantly different. As demonstrated in the preceding chapters, the process of accumulation is occurring in Indonesia, but the crucial point to recognise is that it is an accumulation that is restricted to specific sectors and social classes. It is accumulation within enclaves of privilege, by foreign capital, and to a much lesser degree by state and non-pribumi capital. It is accumulation that is geographically uneven and which serves therefore to exacerbate the already uneven spread of industrial growth.

We have dealt with an accumulation of a type that does not allow the generation of linkage effects between different sectors, nor the generation of external economies than can accrue to the economy as a whole; rather the linkages and external economies created operate to the benefit of the already privileged foreign-owned sectors of the economy. Thus it is not only the process of accumulation, the introduction of the capitalist mode of production to Indonesia that is of significance; the crucial point is that its growth, externally induced by the introduction of private foreign capital, involves the continuation and aggravation of existing inequalities within the economy <u>and</u> the social order. Clearly it is not sufficient to adjudge development in terms of growth of GNP, and rates of growth in different sectors; nor is it sufficient to recognise the "problems" associated with increased private capital inflow without also recognising the structural effects that such inflow generates within the domestic economy. Clearly, foreign investments must be located within an analysis that seeks to determine the precise nature of their causal relationship to the existing economic <u>and</u> political configuration. If this is done, then foreign investment, of the type being encouraged in Indonesia emerges as incapable of creating or augmenting economic change of the type that can assist to improve the material and social conditions of the mass of the people. On the contrary, foreign investment of the type examined in preceding chapters, emerges as structurally harmful to self-reliant, integrated and sustained economic growth, and demonstrably functions to assist the continued enjoyment of political power by a repressive military regime, whose dominant interests become progressively more closely aligned to the interests of foreign capital. It is capitalist growth fostered by the needs of foreign capital, and its content and direction will subsequently be determined by those needs. It can thus, in the long term only benefit foreign capitalists and the ruling military elite in Indonesia, whilst the material needs of the mass of the people will continue to be poorly served.

APPENDIX A

FOREIGN CAPITAL INFLOWS

Section 1. Direct Foreign Investment (by sector, by country; US$) 1967-75

	1967-73		1974		1967-74		1975
	No.	Intended investment $ m	No.	Intended investment $ m	No.	Intended investment $ m	Intended investment $ m
By sector							
Agriculture	66	113	5	12.5	71	125.5	8.2
Forestry	82	495.5	4	10.9	86	506.4	—
Mining	19	860.5	—	—	19	860.5	—
Manufacturing	407	1,045.1	55	813.9	462	1,859	985.5
Textiles	(56)	(436.8)	(12)	(250.4)	(68)	(687.2)	—
Chemicals	(81)	(101.7)	(12)	(190)	(93)	(291.7)	—
Electronics, etc.	(35)	(58.7)	(4)	(11.5)	(39)	(70.2)	—
Other	(235)	(447.9)	(27)	(362)	(262)	(809.9)	3.1
Construction	44	51.9	10	10.3	54	62.2	—
Hotels, tourism	12	101.8	13	71.4	15	173.2	—
Real estate	13	94.1	11	129.3	24	223.4	28.9
Other services	43	66.4	4	3.2	47	69.6	—
Total	686	2,828.3	92	1,051.5	778	3,879.8	1,025.7
By country							
USA/Canada	118	959.6	6	14.4	124	974	
Europe	158	230.6	18	319.7	176	550.3	
Germany (FR)	(27)	(33.5)	(2)	(132.9)	(29)	(166.4)	↑
U.K.	(38)	(46.5)	(4)	(18.4)	(42)	(64.9)	
Netherlands	(40)	(72.9)	(8)	(98)	(48)	(170.9)	
Other	(53)	(77.7)	(4)	(70.4)	(57)	(148.1)	not available
Asia	374	1,486.6	61	694.3	435	2,180.9	
Japan	(149)	(633.4)	(32)	(450)	(181)	(1,083.4)	
Hong Kong	(94)	(267.4)	(18)	(178.8)	(112)	(446.2)	
Singapore	(42)	(100.0)	(3)	(25.6)	(45)	(126.1)	↓
Other	(89)	(485.3)	(8)	(39.9)	(97)		
Australia	35	151	7	23.1	42	174.1	
Africa	1	0.5	—	—	1	0.5	
Total	686	2,828.3	92	1,051.5	778	3,879.8	1,025.7

Source: 1975 Column — EIU, Annual Supplement 1976.
Other columns — Investment Coordination Board in BIES, July 1975.

APPENDIX A (cont.)

Section 2. Foreign Aid Inflows

IGGI Aid Program
(commitment in US$ million)

	1 1967	2 1968	3 1969/70	4 1970/71	5 1971/72	6 1972/73	7 1973/74	8 1974/75	9 1975/76	10 1976/77†
Japan	60.0	110.0	120.0	140.0	155.0	185.0	180.0	150.5[4]	140.0	133
United States	60.1	163.9	220.4	225.0	215.0	203.0	150.0	176.0	50.0	99
Holland	15.0	25.0	29.3	34.7	36.6	44.2	51.7	66.0	52.0	45
Australia	5.8	14.8	16.6	19.0	20.0*	24.4	23.8	33.0	34.0	38
West Germany	25.0	23.0	29.8	34.7	41.1	46.8	57.0	73.0	42.5	38
Canada		0.8	2.9	3.0	8.0*	16.7	13.0	18.0	40.0	33
France		11.2	14.2	15.0	—	20.6	26.3	37.0	—	33
England	1.4	5.1	5.2	6.7	23.3	26.1	29.8	—	25.3	10
New Zealand	—	—	—	—		1.5	3.5	5.3	7.2	5
Belgium		0.4	2.9	3.5	20.5*[3]	6.1	7.5	10.5	9.0	8
IBRD		7.0	89.0[2]	64.0*	80.0*[2]	145.0	133.0		400.0	550
ADB			13.4	25.0	25.0	—	31.0	80-90	120.0	120
Other				0.5		4.2	10.0			8[5]
Total IGGI Aid	167.3[1]	361.2	543.7	571.1	624.5	723.6	716.6	649.3-659.3	920.0	1,120

1 b.e. aid
2 IDA
3 For France, Belgium and Italy
4 Including foreign exchange credit
5 Expected to be provided by Italy, Switzerland, and Australia
† Includes credit agreements
* Actual or likely

Source: Columns 1-3 — Posthumus, A. _The Inter Governmental Group on Indonesia_; Column 4 — _BIES_, July 1970; Column 5 — _BIES_, July 1971; Column 6 — _BIES_, July 1972; Column 7 — _BIES_, July 1973; Column 8 — _BIES_, July 1974; Column 9 — _BIES_, July 1975; Column 10 — _BIES_, July 1976.

APPENDIX A (cont.)

Section 2. Foreign Aid Inflows (cont.)

AUSTRALIAN DEVELOPMENT ASSISTANCE TO INDONESIA: 1952/53 to 1974/75
($A'000)

	1952/53 to 1969/70	1970/71	1971/72	1972/73	1973/74	1974/75
Balance of payments Support (Devisa Kredit)	18,500	7,721	9,949	5,781	2,813	—
Capital and technical assistance projects	12,320	2,286	2,683	8,797	7,640	11,300
Training	9,500	1,327	911	957	908	1,006
Food aid	7,540	4,178	4,275	5,082	9,793	7,272
Emergency rice gift	—	—	—	2,453	30	—
	47,910	15,512	17,818	23,070	21,184	22,300
Percentage of Australian bilateral official development assistance	—	9.3	9.4	11.3	8.6	6.8

Source: Australian Development Assistance Agency, in Report from Senate Standing Committee on Trade, op. cit..

APPENDIX A (cont.)

Section 2. Foreign Aid Inflows (cont.)

SECTORAL APPLICATION OF AUSTRALIAN DEVELOPMENT ASSISTANCE TO INDONESIA: 1972/73 to 1974/75

Sector	1972/73 Total $A'000	1972/73 % of ODA	1973/74 Total $A'000	1973/74 % of ODA	1974/75 Total $A'000	1974/75 % of ODA
Planning and public administration	1	negl	20	0.1	244	1.0
Development of public utilities	8,101	34.9	6,830	32.2	9,704	42.4
Agriculture, fishing, forestry	398	1.7	538	2.5	2,181	9.5
Industry, mining and construction	744	3.2	46	0.2	—	—
Trade, banking, tourism and other services	20	0.1	—	—	9	—
Education	1,177	5.5	1,117	5.3	1,296	5.7
Health	223	1.0	171	0.8	182	0.8
Social infrastructure and welfare	12	negl	10	negl	27	0.1
Sub-total	10,676	46.4	8,732	41.1	13,623	59.6
Other applications —						
IWA-FAC food aid	5,082	21.9	9,793	46.2	9.196	40.2
Devisa Kredit	3,709	16.0	1,646	7.8	37	0.2
Other (including freight on food)	1,328	5.7	1,167	5.5	—	—
Emergency food aid	2,453	10.6	30	0.1	10	negl
Sub-total	12,572	54.2	12,636	59.6	9,243	40.4
Total	23,248	100.0	21,185	100.0	22,866	100.0

negl Negligible.

Source: Australian Development Assistance Agency, in Report from Senate Standing Committee on Trade, op. cit..

APPENDIX B

FOREIGN INVESTMENT BY MANUFACTURING SECTORS*
(1967 up to December 1972)

Industrial branch†	No. of projects	Amount (US$ million)	Average amount per project (US$ thousand)	Sectoral shares in total %	Share of Jakarta area %
Food manufacturing	20	44.7	2,235	6.83	79.4
Manufacture of animal feed	8	5.4	675	0.83	50.0
Beverages	9	18.4	2,044	2.81	58.6
Tobacco manufactures	11	13.8	1,255	2.11	61.4
Textiles	29	225.6	7.779	34.48	19.7
Clothing	11	17.7	1,609	2.71	92.1
Footwear	2	1.3	650	0.20	76.9
Wood products	5	2.4	480	0.37	72.7
Furniture	1	0.3	300	0.05	100.0
Paper products	5	4.7	940	0.72	89.4
Printed matter	9	6.1	678	0.93	88.1
Leather products	1	0.5	500	0.08	100.0
Rubber products	9	17.6	1,956	2.69	2.1
Industrial chemicals	10	14.4	1,440	2.20	89.6
Other chemicals	59	61.5	1,042	9.40	69.7
Plastic products	8	12.9	1,613	1.97	100.0
Manufactures of pottery, china and earthenware	1	2.8	2,800	0.43	n.a.
Glass and glass products	5	18.7	3,740	2.86	100.0
Other non-metallic mineral products	4	46.3	11,575	7.08	0
Iron and steel	8	15.7	1,963	2.40	71.4
Non-ferrous metals	2	3.1	1,550	0.47	45.2
Finished metal products	31	35.7	1,152	5.46	67.5
Non-electrical machinery	6	5.0	833	0.81	57.9
Electrical machinery	27	42.8	1,585	6.54	88.2
Transport equipment	10	17.4	1,740	2.66	100.0
Scientific equipment (including photographic and optical products)	3	2.6	867	0.40	96.2
Other manufactures	20	16.5	825	2.52	50.9
TOTAL	314	654.1	2,083	100.00	50.5

* Approvals
† According to ISIC

Source: Data provided by the Foreign Investment Board in Dönges, _op. cit._.

The limited availability of statistical data has been noted in the main text. Construction of a more up-to-date and detailed table on foreign investment in the manufacturing sector was unfortunately not possible. The author intended as well to present a table covering direct foreign investment in manufacturing _by country of origin_, but lack of access to necessary data prevented this.

APPENDIX C

LIST OF THE MERCHANT BANKS ESTABLISHED IN JAKARTA

Name	Shareholders	Equity
P.T. Asian and Euro-American Capital Corporation (P.T. Asean Indonesia)	Bank Bumi Daya	50%
	Dai-Ichi Kangyo Bank	8.3%
	Dresdner Bank A.G.	8.3%
	Goldman, Sachs and Company	8.3%
	Kleinwort, Benson Ltd.	8.3%
	Banque de Paris et des Pays Bas	8.3%
	Union Bank of Switzerland	8.3%
P.T. Financial Corporation of Indonesia (P.T. Finconesia)	Bank Negara Indonesia 1946	10%
	Nomura Securities Company Ltd.	19%
	Mitsui Bank Ltd.	17%
	Barclays Bank International Ltd.	17%
	Manufacturers Hanover International Finance Corporation	17%
	Commerzbank A.G.	10%
	Banque Francaise du Commerce Exterieur	10%
P.T. First Indonesian Finance and Investment Corporation (P.T. Ficorinvest)	P.T. Bina Usaha Indonesia	50%
	Pierson Heldring and Pierson	8.5%
	Rothschild International Bank	7.5%
	Bank of Montreal	7%
	Industrial Bank of Japan	7%
	Banque Lambert S.C.S.	5%
	First National International Corporation of Texas	5%
	AMFAS Groep N.V.	5%
	National City Cleveland International Corporation	2.5%
	Seattle First International Corporation	2.5%
P.T. Indonesian Investments International (P.T. Indovest)	Bank Dagang Negara	25%
	First Chicago Ltd.	35%
	Mitsubishi Bank Ltd.	20%
	The National Bank of Australasia Ltd.	10%
	The Nikko Securities Company Ltd.	10%
P.T. Indonesian National Investment (in formation)	Bank Central Asia	30%
	Jardine, Flemming and Company	25%
	Long Term Credit Bank of Japan	20%
	Royal Bank of Scotland	15%
	Asia Insurance of Hong Kong	10%

APPENDIX C (cont.)

Name	Shareholders	Equity
P.T. Inter Pacific Financial Corporation	Bank Rakyat Indonesia	10%
	Continental Illinois Bank and Trust Company of Chicago	45%
	The Sanwa Bank Ltd.	41%
	Credit Commercial de France	4%
P.T. Merchant Investment Corporation (P.T. Merincorp)	Bank Ekspor Impor Indonesia	10%
	Morgan Guaranty International Finance Corporation	36%
	The Sumitomo Bank Ltd.	34%
	Bank Mees and Hope N.V.	20%
P.T. Mutual International Finance Corporation (P.T. MIFC)	P.T. Mutual Promotion Corporation Ltd.	34.5%
	Fuji Bank (Schwiez)	20%
	Crocker International Development Corporation	17%
	The Commercial Bank of Australia Ltd.	15%
	P.T. Pan Indonesia Bank Ltd.	7.5%
	The Fuji Bank Ltd.	6%

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