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Table of Contents

Page

THESIS ADVISER RECOMMENDATION LETTER .............................................. i
DECLARATION OF ORIGINALITY .............................................................. ii
PANEL OF EXAMINERS APPROVAL SHEET ............................................... iii
ABSTRACT ................................................................................................. iv
ACKNOWLEDGEMENT .............................................................................. v
LIST OF TABLES ....................................................................................... viii
LIST OF FIGURES .................................................................................... ix
LIST OF ACRONYMS ................................................................................ x

CHAPTER 1 : INTRODUCTION

1.1 Background of the Study ........................................................................ 1
1.2 Problem Identification ........................................................................... 2
1.3 Statement of the Problem ...................................................................... 3
1.4 Research Objectives ............................................................................. 3
1.5 Significance of the Study ...................................................................... 3
1.6 Theoretical Framework ........................................................................ 3
1.7 Scope and Limitations of the Study ....................................................... 8
1.8 Definition of Term ............................................................................... 8
1.9 Research Method ................................................................................. 13
1.10 Research Framework .......................................................................... 14
1.11 Research Time and Place .................................................................... 15
1.12 Research Instruments ......................................................................... 15
1.13 Thesis Structure ................................................................................. 17
CHAPTER II : JAPAN FOREIGN DIRECT INVESTMENT IN INDONESIA (2015-2017)

2.1 Historical Overview Toward FDI Policies in Indonesia .................... 19
2.2 Indonesia Economy Development Towards Japan Foreign Direct Investment ................................................................. 31

CHAPTER III : JAPAN-INDONESIA STRATEGIC PARTNERSHIP

Japan- Indonesia Strategic Partnership .................................................. 33

CHAPTER IV : THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT TO INDONESIA ECONOMY

4.1 The Japan Policy in Asia ........................................................................ 41
4.2 Impact of Abe Doctrine of Japan FDI ......................................................... 42
4.3 Japan Foreign Direct Investment (FDI) Trends Toward East Asia ........... 43
4.4 Japan Foreign Direct Investment (FDI) in Indonesia ............................. 44
4.5 The Benefits of Japan Foreign Direct Investment for Indonesia .......... 58

CHAPTER V : CONCLUSION

Conclusion ............................................................................................. 58
REFERENCES ......................................................................................... 60
This thesis entitled “THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT ON INDONESIA ECONOMY DEVELOPMENT: A STUDY ON JAPAN-INDONESIAN STRATEGIC PARTNERSHIP (2015-2017)” prepared and submitted by Jodi Oktario Pahlevi in partial fulfillment of the requirements for the degree of Bachelor of Arts in International Relations in the Faculty of Humanities has been reviewed and found to have satisfied the requirements for a thesis fit to be examined. I therefore recommend this thesis for Oral Defense.

Cikarang, Indonesia, August 3, 2018

HENDRA MANURUNG, S.IP., MA
DECLARATION OF ORIGINALITY

I declare that this thesis, entitled “THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT ON INDONESIA ECONOMY DEVELOPMENT: A STUDY ON JAPAN-INDONESIAN STRATEGIC PARTNERSHIP (2015-2017)” is, to the best of my knowledge and belief, an original piece of work that has not been submitted, either in whole or in part, to another university to obtain degree.

Cikarang, Indonesia, August 3, 2018

Jodi Oktario Pahlevi
PANEL OF EXAMINERS APPROVAL SHEET

Panel of examiners stated that the thesis entitled “THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT ON INDONESIA ECONOMY DEVELOPMENT: A STUDY ON JAPAN-INDONESIAN STRATEGIC PARTNERSHIP (2015-2017)” that was submitted by Jodi Oktario Pahlevi majoring International Relations from the School of Humanities was assessed and approved to have passed the Oral Examinations on August 7, 2018.

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Examiner 2
**ABSTRACT**

This research objectives are to describe analytically and thoroughly about Japan Foreign Direct Investment (FDI) on Indonesia Economy development between 2015 until 2017 and to know the benefits between Japan and Indonesia Strategic Partnership that last from 28th November 2006 until now. As long as this Strategic Partnership, Japan and Indonesia was also made *Japan Economic Partnership Agreement (IJEPA)* on 20th August 2007. As we know there are two theories about Foreign Direct Investment (FDI). The first theory said that Foreign Direct Investment (FDI) have risk to destroy the natural resources of the destination country, unhelpful for the destination country economic and also have chance to destroy local capabilities. The second theories claim that besides the negatives effects from Foreign Direct Investment (FDI), there are many benefits in Foreign Direct Investment (FDI). This research is important to prove that Foreign Direct Investment (FDI) have many benefits for country that are investment destinations, especially developing country like Indonesia. In the other hand, this research was focused on the benefits of Japan Foreign Direct Investment (FDI) for Indonesia economy. Because Japan is one of the major country that have many Foreign Direct Investment (FDI) in Indonesia.

**Keywords**: Foreign Direct Investment, Strategic Partnership, IJEPA, Indonesia, Japan.
ABSTRAK


Kata kunci: Penanaman Modal Asing, Kemitraan Strategis, IJEPA, Indonesia, Jepang.
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Assalamu’alaikum wr wb...

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Wa’alaikumsalam wr wb...

Cikarang, August 2018

Author
LIST OF TABLE

Page

GDP Growth Indonesia from FDI 1981-2017 ....................................................... 56
## LIST OF FIGURE

<table>
<thead>
<tr>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan’s FDI Towards Asia</td>
<td>44</td>
</tr>
<tr>
<td>Japan’s FDI Towards ASEAN</td>
<td>45</td>
</tr>
<tr>
<td>FDI Inflows to Indonesia 1970-2014</td>
<td>46</td>
</tr>
<tr>
<td>Indonesia Foreign Direct Investment 2015-2017</td>
<td>47</td>
</tr>
<tr>
<td>AFTA</td>
<td>Asean Free Trade Area</td>
</tr>
<tr>
<td>------------</td>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>APEC</td>
<td>Asian Pacific Economic Cooperation</td>
</tr>
<tr>
<td>ASEAN</td>
<td>The Association of South East Asia Nation</td>
</tr>
<tr>
<td>ASEAN-5</td>
<td>Indonesia, Thailand, Malaysia, Phillipine, Vietnam</td>
</tr>
<tr>
<td>BKPM</td>
<td>Badan Koordinasi Penanaman Modal</td>
</tr>
<tr>
<td>BPS</td>
<td>Badan Pusat Statistik</td>
</tr>
<tr>
<td>DSP</td>
<td>Daftar Skala Prioritas</td>
</tr>
<tr>
<td>EPA</td>
<td>Economic Partnership Agreement</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>G20</td>
<td>Group of Twenty</td>
</tr>
<tr>
<td>G8</td>
<td>Group of Eight</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>ICSID</td>
<td>International Center for the Settlement of Investment Dispute</td>
</tr>
<tr>
<td>IJEPA</td>
<td>Indonesia Japan Economic Partnership Agreement</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IP</td>
<td>Intellectual Property</td>
</tr>
<tr>
<td>IPR</td>
<td>Intellectual Property Right</td>
</tr>
<tr>
<td>IUU</td>
<td>Illegal Unregulated Unreported</td>
</tr>
<tr>
<td>KADIN</td>
<td>Kamar Dagang Indonesia</td>
</tr>
<tr>
<td>MNC</td>
<td>Multinational Corporation</td>
</tr>
<tr>
<td>MNE</td>
<td>Multinational Enterprise</td>
</tr>
<tr>
<td>Acronym</td>
<td>Full Form</td>
</tr>
<tr>
<td>---------</td>
<td>-----------</td>
</tr>
<tr>
<td>MRA</td>
<td>Mutual Recognition Agreement</td>
</tr>
<tr>
<td>NIC</td>
<td>Newly Industrialized Country</td>
</tr>
<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
</tbody>
</table>
CHAPTER 1

INTRODUCTION

1.1 Background of the Study

Indonesia's and Japan's diplomatic and economic relations began in 1958, and since then trade relations have grown enormously, especially in the last decade. Through Japan International Cooperation Agency, Japan is the main donor of development aid to Indonesia. And Japan is also a major trading partner and the largest export partner for Indonesia. Both countries are members of the G20 and APEC.

In 2012, there were between 1,200 and 1,300 Japanese corporate operating in Indonesia, with some 12,000 Japanese nationals living in Indonesia. In the last few decades, Japan has invested in Indonesia primarily in the automotive, electronic goods, energy and mining sectors. One of the reasons that prompted Japan to advance further to the south in their military conquest during World War II was the need for natural resources, and Japan had viewed Indonesia as the most important source of natural resource. Major Japanese suppliers for natural rubber, liquefied natural gas, coal, minerals, paper pulp, seafood such as shrimp, tuna, and coffee for nowadays are Indonesia. Traditionally Japan considers Indonesia as the main market of automotive and electronic goods. For Japanese business, location for various natural resources required by low cost operations in Indonesia. Approximately 1,000 Japanese companies operate in Indonesia which employ approximately 300,000 people. East of Jakarta, Bekasi, Cikarang and Karawang, West Java is the location of major Japanese factories in Indonesia.

In a wide range areas of economy, Indonesia and Japan have established a close relationship. In the field of trade in goods, Japan is the largest trade partner

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in both export and import for Indonesia. According to the Indonesian trade statistics issued by the BPS Statistics Indonesia, its trade with Japan accounts for 19.06% of export and 13.07% of import in 2004. Japan’s trade with Indonesia accounts for 1.60% of export and 4.11% of import in 2004 according to the trade statistics issued by the Ministry of Finance, Japan. It is also observed that Indonesia is an important energy supplier to Japan.

Japan has always been one of the top investors for Indonesia. According to the Indonesian statistics, from 1967 to 2004, cumulative foreign direct investment from Japan to Indonesia accounts for 19.47% of the total foreign direct investment to the country, which makes Japan the largest investor for Indonesia. And since then, Trade Relations has developed between Indonesia and Japan. Even Indonesia passes Thailand as the recipient of foreign direct investment (FDI) in 2013, according to Kroll reporting in October 2014. One of the top four investors in Indonesia every year since 2006 is Japan.

Based on the description above, the authors are interested to make research about “THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT ON INDONESIA ECONOMY DEVELOPMENT: A STUDY ON JAPAN-INDONESIAN STRATEGIC PARTNERSHIP (2015-2017)”.

1.2 Problems Identified

There are two main opinions about Foreign Direct Investment (FDI). First, some people said that Foreign Direct Investment (FDI) used to be viewed negative, have risk to destroy the natural resources of the destination country, unhelpful for the destination country economic and also have chance to destroy local capabilities. Second, other people said beside the negative effects that Foreign Direct Investment (FDI) make their also have many benefits in it. In fact the benefits are more than the disadvantage. Indonesian government also realized about the benefits. More diverse view on Foreign Direct Investment (FDI) and

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3 www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
4 www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
development has now arise in the research community. The research elaborates the effect of Foreign Direct Investment (FDI) on country economic growth. Based on that research view, the author decide to researching about the contribution and benefits of Japan Foreign Direct Investment (FDI) for Indonesia economy.

1.3 Statement of the Problem

Topics: This research is about the contribution of Japan foreign direct investment on Indonesia economy development from 2015-2017.

Question: How did Japan foreign direct investment contribute to Indonesia economy since 2015 to 2017?

1.4 Research Objectives

This research aims to describe analytically the contribution of Japan foreign direct investment on Indonesia economy development between 2015 until 2017. We can also know the benefits between Japan and Indonesia agreements in maritime field, political field, economic field, and culture and other field.

1.5 Significance of the Study

The beneficiaries of this research are:

1. To give us knowledge about the contribution of Japan foreign direct investment on Indonesia economy development
2. To give us knowledge about Japan foreign direct investment field in Indonesia
3. To give us knowledge about Indonesia economy development after Japan foreign direct investment in Indonesia

1.6 Theoretical Framework

1.6.1 Diplomatic Relations

Diplomatic relations are used by a country in carrying out its foreign policy. Diplomatic relations between countries involve permanent contact and communication between sovereign countries. As part of diplomatic relations, the
two countries sent diplomats to work in their respective countries and formally interact.

Japan and Indonesia started their first diplomatic relation in 1958 when foreign ministers of Japan and Indonesia signed The Treaty of Peace between Japan and Indonesia on 20\textsuperscript{th} January 1958. After both of the country signed, the diplomat relation was established for the first time. Since that the cooperation and the friendship between both countries have become stronger.

Now in 2018 Japan and Indonesia have already celebrate their 60\textsuperscript{th} anniversary of their diplomatic relation. This anniversary also the right momentum for both countries to talk about the achievement that already made together and also the strategic partnership for both countries in the future.

Japan has been seen Indonesia as their vital supply chain development and vast domestic consumer base. On the other side Indonesia has been seen Japan as their investor to boost Indonesia economy, so the Indonesia economy can compete with another country. Both countries have their benefits.

1.6.2 Strategic Partnership

The relationship between two companies or organizations or country to help each other or work together, to make them achieve the things they want to achieve. Japan is the biggest investor for Indonesia also the main trade partners for Indonesia. Also Japan need Indonesia as their development chain. Because of that both countries agree to build Strategic Partnership for Peaceful and Prosperous on 28\textsuperscript{th} November 2006. Both countries also signed Japan Economic Partnership Agreement (IJEPA) on 20\textsuperscript{th} August 2007.

Japan’s investment in Indonesia in 2016 reached USD 5.4 billion, while until the 3\textsuperscript{rd} quarter 2017, Japan’s investment has reached US$ 4 billion. At the same time, the index of doing business in Indonesia jumped up from 114\textsuperscript{th} position in 2015 to 72\textsuperscript{nd} in 2017. Both countries have been cooperating not only
in the field of economy, politics and security, but also the people to people exchange.\textsuperscript{5}

Indonesia and Japan hope that the two agreement above will make a new era for Japan and Indonesia relationship, by forging closer economic relation through each other capacity, economy, liberalization, facilitation and promotion in trade and investment between the two countries.

1.6.3 Foreign Direct Investment

Long time ago, there are two arguments about the benefits of Foreign Direct Investment (FDI) for the destination country. The First argument are based on the traditional neo classical and the new economic growth theory. The second argument are based on strictly economic and philosophical or ideological economies theory.

Traditional neo classical argument said that FDI is a way of filling in gaps between the domestically available supplies of savings, foreign exchange, government revenue, and human capital skills and the desired level of these resources necessary to achieve growth, and development targets. The first contribution of FDI to national development (i.e., when the development is defined in terms of GDP growth rates) was the way to fill the resource gap between targeted or desired investment and locally mobilized savings. The second contribution is to filling in the gap those derived from net export earnings plus net public foreign aid (this is the so-called foreign-exchange or trade gap) and targeted foreign-exchange requirements. The Third contribution was the gap between targeted governmental tax revenues and locally raised taxes could be filled by foreign direct investment. The Fourth contribution was the operation of FDI in the local market presumed could fill in the gap in management, entrepreneurhip, technology, and skill.

Otherwise, another argument stated that: First, even FDI provides capital, they may be able to lower domestic savings and investment rates by inhibiting

\textsuperscript{5} 2018 : RI-Japan will celebrate the 60th Anniversary of Diplomatic Relations. An article from Ministry of Foreign Affairs Republic of Indonesia on Sunday, 17 December 2017
competition through exclusive production agreements with the FDI destination government, failing to reinvest much of other profits, generating domestic incomes for groups with lower savings propensities, inhibiting the expansion of indigenous firms that might supply them with intermediate products by instead importing these goods from overseas affiliates, and imposing high interest costs on capital borrowed by destination governments. Second, in the long run the initial MNC investment can reduce foreign exchange earnings both in current and capital accounts. Although initial MNC investment aims to improve the foreign exchange position of recipient nation. In the long run, when the company starts to proceed a profit, investors will transfer their earning to their home country. Furthermore this transfer earning will reduce foreign exchange earnings on both current and capital accounts. Third, as a result of the liberal tax concessions, the contribution of MNCs to public revenues in the form of corporate taxes, its contribution can be much less than it should be, the practice of transfer pricing, excessive investment allowances, disguised public subsidies, and tariff protection provided by the host government. Fourth, little impact may be possessed by technology, entrepreneurial skills, management, ideas, and overseas contacts provided by MNCs on the development of local resources of these scarce skills and resources and as a result of MNC dominance in the local market may inhibit their development by strangling the growth of indigenous entrepreneurship.

Indonesia has long believed that foreign private investment was economically beneficial to host country. In 1967, when president Soeharto took power from president Soekarno, he directly changed the orientation of the economy from centralized economy toward liberal economy. Despite the initial liberal action policies FDI showed significant growth only after 1986. Policies toward FDI could be broken into four periods. The first liberalization policies were 1967 to 1973, which aimed to correct the economic policies of the previous government. The second policies were 1974 to 1986, which categorized protectionist policies. These policies have implemented in response to increased nationalist reactions to FDI. The third period was marked by the second

liberalization policies, from 1986 to 1997, as an effect of the fall in oil price. The fall in oil prices forced the government to restructure the economy, away from its dependence on oil revenues. The fourth period was the third liberalization policies, after the 1997 crisis, which was the continuation of the second liberalization policies 1986 -1997.7

Since the onset of 1997 currency crisis, Indonesia has given more attention to FDI. This was because the government desires to foster economic recovery by way of attracting FDI. In the short run FDI was expected to solve lack of capital, absorb unemployment, extend the market price systems and the private sector and mitigate the external debt problem in Indonesia. When a country suffers a resource or savings gap (an internal macro imbalance between national expenditure and national saving), it would also confront a foreign exchange gap that has to be balanced with an inflow of foreign capital. In macroeconomic terms, when government expenditure plus private investment exceed government revenue and private savings (a resource gap), this internal imbalance would spill over into a current account deficit and hence create foreign exchange gap.

International financial intermediation was then required to fill in the foreign exchange gap. Moreover this gap could be covered by loans from multilateral lending agencies and commercial banks, or by foreign direct investment. For a developing country, the sources of external financing were foreign aid from government to government, cross border sovereign lending by commercial banks, loans from the World Bank, access to the country’s drawing rights in the IMF and private foreign direct investment (FDI and portfolio investment). While the four sources of foreign capital declined, FDI had strong potential.

Against such a background, this research plans to investigate the benefits of Japan foreign direct investment on Indonesia economy development from 2015

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7 This analysis based on data statistic provided by BKPM and IMF, International Financial Statistics Yearbook, 1997
until 2017. Is FDI economically beneficial to Indonesian economic since long time ago?

1.7 Scope and Limitations of the Study

The scope and limitation of the study is about the contribution of Japan foreign direct investment on Indonesia Economy development and Japan Indonesia strategic partnership from 2015 until 2017.

1.8 Definition of Terms

- **AFTA** The ASEAN Free Trade Area (AFTA) is a trade block agreement by the Association of Southeast Asian Nations supporting local manufacturing in all ASEAN countries. The AFTA agreement was signed on 28 January 1992 in Singapore. When the AFTA agreement was originally signed, ASEAN had six members Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. Vietnam joined in 1995, Laos and Myanmar in 1997 and Cambodia in 1999. AFTA now comprises the ten countries of ASEAN. All the four latecomers were required to sign the AFTA agreement to join ASEAN, but were given longer time frames in which to meet AFTA's tariff reduction obligations. The primary goals of AFTA seek to:
  
  1. Increase ASEAN's competitive edge as a production base in the world market through the elimination, within ASEAN, of tariffs and non-tariff barriers; and
  2. Attract more foreign direct investment to ASEAN.

The primary mechanism for achieving such goals is the Common Effective Preferential Tariff scheme, which established a phased schedule in 1992 with the goal to increase the region's competitive advantage as a production base geared for the world market.

- **APEC** Asia-Pacific Economic Cooperation (APEC) is a forum for 21 Pacific Rim member economies that promotes free trade throughout the Asia-Pacific region. It was established in 1989 in response to the
growing interdependence of Asia-Pacific economies and the advent of regional trade blocs in other parts of the world; to defuse fears that highly industrialized Japan (a member of G8) would come to dominate economic activity in the Asia-Pacific region; and to establish new markets for agricultural products and raw materials beyond Europe.

An annual APEC Economic Leaders' Meeting is attended by the heads of government of all APEC members except Republic of China (Taiwan) (which is represented by a ministerial-level official under the name Chinese Taipei as economic leader). The location of the meeting rotates annually among the member economies, and a famous tradition, followed for most (but not all) summits, involves the attending leaders dressing in a national costume of the host country. APEC has three official observers: the Association of Southeast Asian Nations Secretariat, the Pacific Economic Cooperation Council and the Pacific Islands Forum Secretariat. APEC’s Host Economy of the Year is considered to be invited in the first place for geographical representation to attend G20 meetings following G20 guidelines.

- **ASEAN** The Association of Southeast Asian Nations (ASEAN) was formed in 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand to promote political and economic cooperation and regional stability. Brunei joined in 1984, shortly after its independence from the United Kingdom, and Vietnam joined ASEAN as its seventh member in 1995. Laos and Burma were admitted into full membership in July 1997 as ASEAN celebrated its 30th anniversary. Cambodia became ASEAN’s tenth member in 1999.

The ASEAN Declaration in 1967, considered ASEAN’s founding document, formalized the principles of peace and cooperation to which ASEAN is dedicated. The ASEAN Charter entered into force on 15 December 2008. With the entry into force of the ASEAN Charter,
ASEAN established its legal identity as an international organization and took a major step in its community-building process.

The ASEAN Community is comprised of three pillars, the Political-Security Community, Economic Community and Socio-Cultural Community. Each pillar has its own Blueprint approved at the summit level, and, together with the Initiative for ASEAN Integration (IAI) Strategic Framework and IAI Work Plan Phase II (2009-2015), they form the Roadmap for and ASEAN Community 2009-2015.

ASEAN commands far greater influence on Asia-Pacific trade, political, and security issues than its members could achieve individually. This has driven ASEAN’s community building efforts. This work is based largely on consultation, consensus, and cooperation.

- **EPA** Japan Economic Partnership Agreement. Agreement that strengthens economic partnership with other countries and region in various fields with liberalization/facilitation of movement of people, goods, and capital, centering on FTA. Recently Japan has concluded six EPAs and a number of EPAs are under negotiation, mainly with countries in Asia. EPAs give opportunity to import products from Japan with zero or low tariff rates.

- **FDI** Foreign direct investment (FDI) is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. In the context of foreign direct investment, advantages and disadvantages are often a matter of perspective. An FDI may provide some great advantages for the MNE but not for the foreign country where the investment is made. On the other hand, sometimes the deal can work out better for the foreign country depending upon how the investment pans out. Ideally, there should be numerous advantages for both the MNE and the foreign country, which is often a developing country. We'll examine the advantages and
disadvantages from both perspectives, starting with the advantages for multinational enterprises (MNEs).

- **Access to markets**: FDI can be an effective way for you to enter into a foreign market. Some countries may extremely limit foreign company access to their domestic markets. Acquiring or starting a business in the market is a means for you to gain access.

- **Access to resources**: FDI is also an effective way for you to acquire important natural resources, such as precious metals and fossil fuels. Oil companies, for example, often make tremendous FDIs to develop oil fields.

- **Reduces cost of production**: FDI is a means for you to reduce your cost of production if the labor market is cheaper and the regulations are less restrictive in the target foreign market. For example, it's a well-known fact that the shoe and clothing industries have been able to drastically reduce their costs of production by moving operations to developing countries.

FDI also offers some advantages for foreign countries. For starters, FDI offers a source of external capital and increased revenue. It can be a tremendous source of external capital for a developing country, which can lead to economic development.

- **G20** The **G20** (or **G-20** or **Group of Twenty**) is an international forum for the governments and central bank governors from Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, the Russian Federation, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the European Union. Founded in 1999, the G20 aims to discuss policy pertaining to the promotion of international financial stability. It seeks to address issues that go beyond the responsibilities of any one organization. The G20 heads of government or heads of state have periodically conferred at summits since
their initial meeting in 2008, and the group also hosts separate meetings of finance ministers and foreign ministers due to the expansion of its agenda in recent years.

Membership of the G20 consists of 19 individual countries plus the European Union (EU). The EU is represented by the European Commission and by the European Central Bank. Collectively, the G20 economies account for around 85% of the gross world product (GWP), 80% of world trade (or, if excluding EU intra-trade, 75%), two-thirds of the world population, and approximately half of the world land area.

With the G20 growing in stature after its inaugural leaders' summit in 2008, its leaders announced on 25 September 2009 that the group would replace the G8 as the main economic council of wealthy nations. Since its inception, the G20's membership policies have been criticized by numerous intellectuals, and its summits have been a focus for major protests by left-wing groups and anarchists.

The heads of the G20 nations met semi-annually at G20 summits between 2009 and 2010. Since the November 2011 Cannes summit, all G20 summits have been held annually.

- **GDP Gross domestic product (GDP)** is a monetary measure of the market value of all final goods and services produced in a period (quarterly or yearly) of time. Nominal GDP estimates are commonly used to determine the economic performance of a whole country or region, and to make international comparisons. Nominal GDP per capita does not, however, reflect differences in the cost of living and the inflation rates of the countries; therefore using a basis of GDP per capita at purchasing power parity (PPP) is arguably more useful when comparing differences in living standards between nations.

- **JIEPA Indonesia–Japan relations** are foreign bilateral relations between Indonesia and Japan. Both are two Asian nations which share historical, economic, and political ties. Both nations went through a
difficult period in World War II when the then Dutch East Indies was occupied by the Imperial Japanese Army for three-and-a-half years. Japan is a major trading partner for Indonesia. Japan is Indonesia’s largest export partner and also a major donor of development aid to Indonesia through Japan International Cooperation Agency.

- **NICs** The category of **newly industrialized country (NIC)** is a socioeconomic classification applied to several countries around the world by political scientists and economists. NICs are countries whose economies have not yet reached a developed country's status but have, in a macroeconomic sense, outpaced their developing counterparts. Another characterization of NICs is that of countries undergoing rapid economic growth (usually export-oriented). Incipient or ongoing industrialization is an important indicator of an NIC. In many NICs, social upheaval can occur as primarily rural, or agricultural, populations migrate to the cities, where the growth of manufacturing concerns and factories can draw many thousands of laborers.

### 1.9 Research Methods

For this thesis, qualitative approach is more suitable than quantitative approach because the qualitative approach use multiple systems of inquiry for the study, including biography, case study, historical analysis, discourse analysis, ethnography, grounded theory and phenomenology. As defined by (Srivastava & Thomson, 2009), Qualitative approach is “an inquiry process of understanding based on distinct and methodological traditions of inquiry that explore a social or a human problem. The researcher builds a complex, holistic picture, analyses words, reports detailed views of informants and conducts the study in a natural setting.”

Qualitative approach focuses on the beliefs, experiences and interpretations of participants, addressing psychosocial questions. The frameworks for qualitative research questions aim at interpreting, understanding and explaining a wider phenomenon, “What” “How” and “Why” questions. Qualitative approach also allow the researcher to study selected issues in depth
and detail without being constrained by pre-determined categories of analysis. While quantitative research values control, qualitative research values openness and flexibility. The quantitative researcher maintains an objective, detached stance, but the qualitative researcher is considered to be the key instrument involved closely with the data collection and analysis.

1.10 Research Framework

Harrod (1939) – Domar (1946) model stresses the importance of capital investment in economic growth. Harrod (1939) – Domar (1946) explained that the role of the investment for economic growth has two functions. The first function of investment is able to increase income and the second is able to grow the production capacity of the economy by increasing stock of capital. Foreign direct investment adds gross capital formation and raises the capital formation rate. The FDI also raises the productivity of capital through improved competition, positive technological externalities, and accelerated spillover effects. Most theories of FDI are also developed from the point of view of multinational corporations.

There are two main points of views on the FDI study. The first is the majority of the study claims that FDI has positive impacts on the host county. FDI becomes powerful tools and indicators for economic development and global integration. The second argument is the study claims that the FDI can cause growth in the economy only in short term condition and reduce growth in the long run.

According to Moosa (2002), Foreign Direct Investment is a process where the economy actor (individual or corporate from a country (home country) gains owner assets to control production, distribution and other activities from one corporate in another country (host country).

Foreign Direct Investment is international capital flows which company from one country establish or expand its business and network cooperation in
other countries. One prominent feature of foreign direct investment is the actions involve not only the relocation of resources but involve control of ownership. It means that the branch in other countries has obligation in financial and as a whole integrity to the main company so that the branch is the extension of the parent company in the sources country (Krugman and Obstfeld, 2004).

1.11 Research Time and Place

The research was started on 1 March to 31 July 2018

This research was held at the National Library of the Republic of Indonesia, University of Indonesia Library, The Japanese Embassy Website, BPS Website, UNCTAD Website, Bank of Japan website, Trading Economics website and other website that related to this research.

1.12 Research Instruments

Instrument is the general term that researchers use for a measurement device (survey, test, questionnaire, etc.). To help distinguish between instrument and instrumentation, consider that the instrument is the device and instrumentation is the course of action (the process of developing, testing, and using the device). Instruments fall into two broad categories, researcher-completed and subject-completed, distinguished by those instruments that researchers administer versus those that are completed by participants. Researchers chose which type of instrument, or instruments, to use based on the research question.

In this research, the researcher views Qualitative approach make it easier to understand that as it is more communicative and descriptive. The following are the qualitative research methods that are frequently used: One-on-One Interview, Focus groups, Ethnographic research, Text Analysis, Case study research.

1) **One-on-One Interview:** Conducting in-depth interviews is one of the most common qualitative research methods. It is a personal interview that is carried out with one respondent at a time. This is purely a
conversational method and invites opportunities to get details in depth from the respondent. One of the advantages of this method provides great opportunity to gather precise data about what people believe and what their motivations are. If the researcher is well experienced asking the right questions can help him/her collect meaningful data. If they should need more information the researchers should ask such follow up questions that will help them collect more information. These interviews can be performed face-to-face or on phone and usually can last between half an hour to two hours or even more. When the in-depth interview is conducted face to face it gives a better opportunity to read the body language of the respondents and match the responses.

2) **Focus groups**: A focus group is also one of the commonly used qualitative research methods, used in data collection. A focus group usually includes a limited number of respondents (6-10) from within your target market. The main aim of the focus group is to find answers to the why what and how questions. One advantage of focus groups is, you don’t necessarily need to interact with the group in person. Nowadays focus groups can be sent an online survey on various devices and responses can be collected at the click of a button. Focus groups are an expensive method as compared to the other qualitative research methods. Typically they are used to explain complex processes. This method is very useful when it comes to market research of new products and testing new concepts.

3) **Ethnographic research**: Ethnographic research is the most in-depth observational method that studies people in their naturally occurring environment. This method requires the researchers to adapt to the target audiences’ environments which could be anywhere from an organization to a city or any remote location. Here geographical constraints can be an issue while collecting data. This research design aims to understand the cultures, challenges, motivations, and settings that occur. Instead of relying on interviews and discussions, you experience the natural settings first hand. This type of research method can last from a few days to a few
years, as it involves in-depth observation and collecting data on those grounds. It’s a challenging and a time-consuming method and solely depends on the expertise of the researcher to be able to analyze, observe and infer the data.

4) **Text Analysis:** Text analysis is a research method that is a bit different from other qualitative research methods as this method uses researchers to analyze the social life by decoding the words and images from a piece of the document or other similar forms like film, music etc. The researcher looks at the context in which the images are used and then tries to draw inferences from the same. In the last decade or so, content analysis through what is shared on social media and other online platforms has become more prominent. Researchers take into consideration the activities on social media and follow the pattern that relates to their related topic of study. This is how data is collected in modern times. The aim of content analysis is to identify important characteristics of the content being researched and present it in a simplified manner so that it can be easily understood.

5) **Case study research:** The case study method has evolved over the past few years and developed as into a valuable qualitative research method. As the name suggests it is used for explaining an organization or an entity. This type of research method is used within a number of areas like education, social sciences and similar. This method may look difficult to operate, however, it is one of the simplest ways of conducting research as it involves a deep dive and thorough understanding the data collection methods and inferring the data.

1.13 **Thesis Structure**

According to International Relations Study Program 2013 Thesis Guideline, as to get a clear picture of the overall content, the structure of this thesis can be divided by four chapters systematically as follows:
Chapter I : Introduction consisting of: Background of the Study, Problem Identified, Statement of the Problem, Research Objectives, Significance of the Study, Theoretical Framework, Scope and Limitations of the Study, Definition of Term, Research Methods, Research Framework, Research Time and Place, Research Instruments, Thesis Structure.

Chapter II : JAPAN FOREIGN DIRECT INVESTMENT IN INDONESIA (2015-2017) consisting of: Historical Overview Toward FDI Policies in Indonesia, The Effect of Japan Foreign Investment in Indonesia Economy.

Chapter III : This chapter describe about JAPAN – INDONESIAN STRATEGIC PARTNERSHIP.

Chapter IV : In this chapter THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT TO INDONESIAN ECONOMY consisting of: The Japan Policy in Asia, The Impact of Abe Doctrine of Japan Foreign Direct Investment, Japan’s Foreign Direct Investment Trends Toward East Asia, Japan Foreign Investment in Indonesia, The Benefits of Japan Foreign Investment for Indonesia.

Chapter V : Represents the closing chapter which is conclusion.
CHAPTER II

JAPAN FOREIGN DIRECT INVESTMENT IN INDONESIA

2.1 Historical Overview Toward FDI Policies in Indonesia

In order to investigate the role of foreign direct investment in Indonesia’s economic development, first we have to review the government’s policy on FDI. This policies could be discussed under four periods, the first liberalization policies (1967 to 1973) ; the protectionist policies (1974 to 1986) ; the second liberalization policies (1986 to 1997) ; and the third liberalization policies (after the 1997 crisis).

2.1.1 The First Liberalization Policies (1967 to 1973)

Some policies towards foreign direct investment were first taken in 1967 as follows: first the government established a new law concerning with foreign direct investment, law number 1 of 1967 on foreign direct investment. Second, government returned some nationalized enterprises to the previous owners (article 21, Law No 1/1967). Third, government created the Foreign Capital Investment Advisory Board (Badan Pertimbangan Penanaman Modal Asing, BPPMA, 1967). The Board’s main task was to give advice to the president with respect to the implementation of foreign direct investment. Fourth, government allowed 100 percent foreign ownership and no restriction anymore on foreign equity and employment of expatriates (Hadi Soesastro, p.4). Dr Sadli, a government minister, characterized Indonesia’s condition toward FDI during that period: (Dunning, 1996, p.323 quoted from Palmer, 1979, p.100).

“When we started out attracting foreign direct investment in 1967 everything and everyone was welcome. We did not dare to refuse: we did

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8 The detail of Law no 1 year 1967, see Country profile of Indonesia : Exchange Control, Foreign direct investment Legislations
not even dare to ask for bonafidity of credentials. We needed a list of names and dollars figures of intended investments to give credence top our drive” (Palmer, 1979)

The only limitation on foreign equity ownership was that foreign direct investment licenses were only given for a period of thirty years. After thirty years, the foreign investors should transfer its shares to an Indonesian investor; otherwise the company would be liquidated. The regulations also establish a minimum investment limit of $1 million for foreign direct investment projects. The rationale behind this regulation was government realizes that the primary benefit of MNEs was their access to large fund of capital that Indonesian investors did not hold. Thus, the government was willing that foreign investors should undertake bigger investment projects and domestic investors could undertake smaller investment projects⁹.

Even though Law No. 1/1967 was liberal for FDI in selected sectors, in some sectors government still restricted to foreign companies. The motivations for closing these sectors were security sectors (e.g. explosives and atomic generation plants), strategic sectors (e.g. transportation, the media, and telecommunications) and public services (e.g. electricity generation and distribution, water supply). The mining agricultural and fisheries sectors were also closed to FDI (sources BKPM). These sectors were closed because they run on Article 33 (2) of the 1945 Constitution (branches of production which are important for state and affect the welfare of the people at large will be undertaken by the state) and article 33 (3) (water and natural resources are owned by the state and should be used to benefit all the people). As a result of Law No. 1/1967, twenty-two PMA projects were approved in 1967. By 1970, 177 PMA projects had been approved, in which thirty-seven were 100 percent foreign owned projects (BKPM).

In general, based on analysis data statistic, the government decision to rehabilitate an economy by opening the domestic market for foreign direct

⁹ See article 18, law no 1 year 1967
investment was quite successful. Growth was restored, inflation was brought down, private initiatives were promoted and foreign capital plus aid were coming back. As a result, GDP was growth stable in turn 7 percent; inflation dropped to below two digits and number of foreign direct investment has increased significantly more than three times, 22 projects in 1967 to 69 projects in 1974\textsuperscript{10}.

2.1.2 The Protectionist Policies (1974 to 1986)

In January 1974, after violent demonstrations during the visit of Japanese Prime Minister Tanaka and also because of increasing nationalist reactions to foreign direct investment, the government made significant change in Indonesia’s FDI system. In addition, since the government started to implement liberal policies on FDI, Japan became the major investor in Indonesia. In January 22, 1974, the government set the standard for principles governing foreign direct investment that all new foreign direct investments should be in the form of joint ventures; Indonesian equity in these investments would be increased at least a 51 percent majority share holding within a certain period of time, in 1975 defined as ten years; the number of sector closed to foreign direct investment was increased; tax incentives were reduced; and number of foreign personnel permitted to work at each foreign owned company was reduced (Donald J. Lecraw, p. 324; Hadi Soesastro, p. 4).

At the same time where these changes were being made in the FDI system, growing controls were instituted on all private investment and the financial system, in the form of investment licensing and credit allocation. The government also used oil revenue to expand the role of state owned enterprises. Public enterprises began to take a dominant role in a number of sectors and public investments were increasingly directed into heavy industries, petrochemicals and mining. These changes in government policy both towards the private sector as a whole and towards FDI demonstrate a recurring theme in 10 government economic policy in Indonesia. After foreign exchange and capital restraints had

\textsuperscript{10}This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
been reduced, the government increased the public sector roles and decreased the role of the private sectors and FDI.

The falling of oil revenue, in 1975-1976, combined with the Pertamina Crisis, led to deteriorate Indonesia’s investment climate and exacerbated its external debt situation. To improve the investment climate, the government simplified and facilitated the foreign direct investment approval process. The government also implemented existing restrictions on foreign direct investment less forcefully. The administrative improvements introduced in 1977, including the establishment of the BKPM as a one-stop service and the introduction of a Priority Investment List (Daftar Skala Prioritas, DSP, BKPM, 1977). The government used the annual Priority Investment List as a main instrument to regulate the sectoral composition of investment for the private sector in general and MNEs in particular. The DSP list covered all economic activities except oil, gas and the financial sector. The first DSP list was very detailed; 831 sectors in one of the four categories (BKPM).

However, the DSP list still had exceptions. Foreign companies could invest in activities that were closed to foreign direct investment. Furthermore both foreign and domestic investors could also invest in sectors that were closed to all investment under certain conditions related to the development objectives of the government. The rationales underlying these exceptions were: regional distribution, located outside Java; exports, 100 percent of production exported; employment creation. These exceptions illustrate how the government relaxed regulation for MNEs if they could provide additional benefits (beyond capital) to the Indonesian economy.

The second oil price increase in 1978-1979 again relaxed Indonesian foreign exchange constraints accelerated economic growth and increased government budgeted revenues. As a direct consequence, the government again instituted additional restrictions on foreign direct investment. In 1981, the government required foreign-owned companies to transfer 51 percent of their ownership to Indonesian shareholders within ten years (BKPM). Furthermore, the
government appeared to move to implement the phase down requirements. The government stated that for foreign companies approved prior to February 1974, a minimum of 30 percent of their equity had to be transferred to Indonesian shareholders by the end of 1984. Also, at this time the government introduced a requirement that, at the time of formation, there would be a minimum 20 percent Indonesian shareholding for all foreign companies. Starting in 1980, the government closed an increasing number of sectors for foreign direct investment. The 1981 DSP list kept additional sectors for cooperatives.

Starting from 1982, Indonesia experienced external shocks in the form of falling oil and other commodity prices. Between 1982 and 1985 the government introduced 12 measures to stabilize the macro economy; introduced some structural reforms to mobilize resources (e.g. tax and financial reforms); and made improvements in customs, ports and shipping. In this case, the government’s trade and industrial policies became more inward oriented and interventionist. Against this background, the government also increased the restrictive nature of its foreign direct investment policies.

In the second stage period policies, based on data statistic, we could say that government failed to uphold friendly investment climate. The changes in government policy both towards the private sector as a whole and towards FDI demonstrated a chronic theme in government economic policy in Indonesia. The protectionist policies and government controls had adverse effect on the competitiveness of domestic market, creating a high-cost economy. As a result inflation stayed above two digits; GDP sharply fluctuated only 2.2 percent in 1982; and the number of FDI suffered a four-fold Decline in 1979\textsuperscript{11}

2.1.3 The Second Liberalization Policies (1986 to 1997)

In 1986, the economy again suffered a series of external shocks due to a sharp fall in oil prices and the appreciation of the yen (a substantial portion of Indonesia’s external debt was dominated in yen). These actions led to 34 percent

\textsuperscript{11}This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
deterioration in Indonesia’s term of trade and an increase in the debt service ratio from 26 percent in 1985 to 37 percent in 1986. In response to this condition the government again undertook macroeconomic stabilization procedures (fiscal strictness and devaluation) as well as substantial real and financial sector reforms. In the field of foreign direct investment policy, the government initiated gradual policies to liberalize all aspects of the FDI system.

The liberalization of both the economy as a whole and the foreign direct investment system in particular was connected to the government’s policies to promote non-oil exports and to encourage participation of the private sector in the economy. As in the past, under the pressure of falling economic growth, strained international credit, and the need for both investment capital and foreign exchange, the government turned once again towards the private sector and foreign investors by relaxing regulations on private and foreign investors.

In May 1986 the government reduced the 20 percent minimum requirement for Indonesian ownership to 5 percent for high risk investment: those located in remote areas (i.e. mostly in eastern Indonesia); those involved in high technology; those that were export oriented (i.e. at least 85 percent of their production); or investments requiring a large amount of capital (i.e. project costs above $10 million). The phase-down requirements for such projects were: to 20 percent Indonesian ownership within five years and to 51 per cent Indonesian ownership within ten years as under the previous regulation (In 1981, the government reiterated the requirement that foreign-owned companies were to transfer 51 per cent of their ownership to Indonesian shareholders within ten years). The government relaxed the requirement for foreign investors to phase down their equity ownership to 49 percent over a ten-year period under certain conditions. The government also confirmed that the licenses of joint ventures were suitable for thirty years and could be extended another thirty years if the firm increased its capital in order to expand or diversify their output (BKPM).12

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12 This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
In the 1986 DSP list, the number of business activities, open to foreign direct investment increased from 475 to 926. In the industrial sector government also increased activities for foreign direct investment from 253 to 596 (BKPM). The government’s opening the number of sectors investment to foreign companies reflected a major change in their policy focus: from one in which large sectors of the economy were reserved for domestic companies to one in which greater emphasis was placed to attract foreign direct investment come to these sectors.13

In December 1987, the government again relaxed foreign direct investment restrictions. The minimum Indonesian ownership was lowered to 5 percent for foreign companies, which exported 100 percent of their production without further obligation to phase down their share. The general phase down requirement to 51 per cent was also extended to fifteen years. Moreover, foreign owned companies with a minimum capital of $10 million; or located in one of the provinces in Eastern Indonesia; or exporting at least 65 percent of their production also could be formed with a 5 percent minimum Indonesian shareholding. Unlike the 100 percent export oriented foreign companies, however, there was a phase-down requirement to 20 percent within ten years and 51 percent within fifteen years for these companies.14

In May 1989 the DSP list was replaced with a Negative List. In principle, any sector not on the Negative List was open for foreign companies. By this change the government could effectively further opened additional activities to foreign direct investment. The original Negative List had sixty-four sectors closed to foreign direct investment, although some of these sectors open under certain conditions, such as for export-oriented investments. In 1989, the government introduced deregulation packages that lowered the 15 minimum capital investment required for foreign companies from $1 million to $250,000 if the project were labor intensive (i.e. employed more than fifty workers), export

13 This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.

14 This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
oriented, or supported small industries, which did not compete with existing industries.\textsuperscript{15}

In October 1989, the government also liberalized foreign ownership restrictions, although only in certain areas: 100 percent foreign ownership was allowed in the Batam Economic Zone with 5 percent divestment to Indonesian shareholders within five years. For this type of investment, there was no further requirement for divestment, if the foreign company exported 100 percent of their products.\textsuperscript{16}

In 1991, rapid growth and the resulting accelerating inflation and the increasing current account deficit led the government to establish macro-stabilization measures of tight monetary policies, as well as to impose limits on foreign borrowing by state-related entities. At that time Japan changed its major investment destiny to China. Furthermore the decline in the general investment climate in Indonesia led to a perceived decline in foreign investor interest. As a result, the government introduced two important policy reforms in 1992-1993.\textsuperscript{17}

A significant initiative came in the government’s 1992 decree, whereby the government allowed 100 percent foreign ownership for certain types of investments: investments of over $50 million, investments located in Eastern Indonesia, and investment located in a bonded zone if all production were exported. For these types of investments, phase down from a maximum 100 percent foreign ownership was required. The other changes introduced by the government where foreign direct investment in labor intensive operations (defined as those employing more than fifty persons), export oriented projects (defined as projects exporting 65 percent of production) and supplier 16 industries producing raw materials or intermediate goods, the minimum Indonesian shareholding at the time of investment was set at 5 percent with a phase down to

\textsuperscript{15} This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
\textsuperscript{16} This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
\textsuperscript{17} This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
10 percent in ten years and 51 percent in twenty from the start of commercial production. The lower minimum investment also applied to foreign direct investment in the services sector, but with 20 percent minimum Indonesian shareholding formation and phase down to 51 percent in twenty years.\textsuperscript{18}

The October 1993 package was notable for two reasons. On the one hand, that package continued the past trend towards liberalization on FDI system by allowing initial foreign ownership of 100 percent for investments with amount over $2 million in supplier industries. Conversely, the liberalization of the phase-down requirements of the 1992 package were taken back for investments with amount over $50 million, those located in Eastern Indonesia, and those in bonded zones: phase down had at least 51 percent Indonesian ownership instead of 20 percent.\textsuperscript{19}

In June 1994, the government announced a dramatic FDI liberalization package phase down regulations were removed; FDI with up to 100 percent foreign ownership was permitted in a wide range of sectors; the minimum capital requirements were eliminated; and nine public interest sectors port, production, transmission and distribution of electricity, telecommunications, shipping, air transportation, drinking water, railways, atomic generating plants, and mass media which had previously been closed to FDI were opened to majority, but not 100 percent foreign ownership.\textsuperscript{20}

Other policies which were important for improving the FDI in Indonesia were as follows. First, the Indonesian government has agreed to submit any investment disputes to the International Center for the Settlement of Investment Disputes (ICSID) in 17 Washington D.C. In 1993, a long-pending investment dispute involving a U.S investor was resolved throughout ICSID. Second, under Government Regulation No. 45 of 1996, the government has re-introduced basic

\textsuperscript{18}This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
\textsuperscript{19}This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
\textsuperscript{20}This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
tax holidays. According to Regulation 45, specific sectors, including capital goods manufacturing, agribusiness, infrastructure, sea and air transport, engineering, and professional personnel training may be qualified for tax holidays.\textsuperscript{21}

The second liberalization undertaken in response to the significant drop in oil revenue was quite successful to attract foreign direct investment. Trade liberalization package of October 1986, and 1994; a dramatic liberalization package of June 1994 to increase the attractiveness of Indonesia’s investment regulation due to increased competition for investment from China, Vietnam and other countries in the region. Out of those years, 1986 and 1994, the deregulation on FDI did not significantly increase FDI inflows\textsuperscript{22}. Iqbal (1995) described that from 1991 to about the middle of 1994 the country experienced a “reform fatigue” or a policy inertia (Hill, 1997). In addition, the increasing of FDI in Indonesia started from 1986, beside the domestic factors (government policies), also because of the external factors (globalization). According to Dunning (1993), the most sticking development that has affected government attitudes and policies toward MNEs since the 1980’s has been the globalization of the world economy. Such globalization was shown by tremendous growth of all forms of international transaction especially related to MNEs activities. In addition, the number of foreign direct investment in the second period of liberalization has increased significantly more than ten times from 1986 to 1996 and GDP was stable in the level 6-7 percent\textsuperscript{23}.

\textbf{2.1.4 Indonesian Third Liberalization Policies (after 1997 crisis)}

The Capital Investment Coordinating Board (BKPM/BKPMD) played an important role in promoting foreign direct investment and approving project applications. As an investment board, BKPM functioned as a one-stop investor service. Investors that have approval from BKPM no longer need approval from a

\begin{flushright}
\textsuperscript{21} Government Regulation No. 45 of 1996
\textsuperscript{22} FDI increase drastically after deregulation 1986 and 1994, in other years FDI was stable, detail see the FDI development, BKPM (Badan Koordinasi Penanaman Modal).
\textsuperscript{23} This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
\end{flushright}
provincial governor or regional chief. Another significant change was that master lists of capital goods and basic material imports for both foreign and domestic investments were approved by BKPM/BKPMD and no longer need clearance from the Directorate General of Customs and Excise.

In approval process, the Indonesian government also simplified the approval process. For example, approvals for foreign direct investment up to $100 million need no longer to be approved by the president of Indonesia, but only by the Chairman of BKPM. On the domestic side, approval of investments of to US$1.2 million might be issued by the Chairman of the regional BKPM office rather than by headquarters in Jakarta. A recent Ministerial decree gave authority to Indonesian embassies and consulates abroad to accept applications for foreign direct investment, which would then be forwarded to BKPM for final approval. (Indonesia: Investment climate statement 2000).

Following the deregulation above, in June 1998, the government of Indonesia eliminated many FDI restrictions in retail and wholesale markets with the condition that they enter into a cooperative agreement with a small enterprise. In addition, many foreign firms used franchising, licensing, and technical service agreements to distribute their goods. Under current regulations, foreign companies manufacturing in Indonesia might distribute their locally produced goods at the wholesale level and might apply for permits to import and distribute other products as well. However, companies engaging in wholesale distribution may not conduct retail operations directly, but should form a separate retail company. Further, the number of expatriate employees granted visas to work in any single wholesale and retail business remains limited.

The government also made some revision in some sectors restricted previously. Sectors such as harbors, electricity generation, telecommunications, shipping airlines, railways, and water supply were revised. Recently government developed policies on the private provision of infrastructure through build-own-operate and build operate-transfer schemes, particularly for electric power, telecommunications and roads. Full foreign ownership was not permitted in these
sectors. Local partners were required to own anywhere from five to 51 percent of these investments. Even the government has reduced a negative list of restricted sectors; however, there were some certain sectors remain restricted for foreign direct investment. Sectors that remain closed to foreign direct investment are among others, freshwater fishing, forestry, public transportation, broadcasting and film, and medical clinics.

In order to give more guarantees to foreign investors in January 2000, Indonesia has made bilateral investment agreements with other countries. In addition, Indonesia has signed investment agreements with 52 countries, namely the United States (Agreement on Investment Guarantees), Argentina, Australia, Bangladesh, the Netherlands, Belgium, Chile, People’s republic of China, Czech Republic, Denmark, Finland, Hungry, United Kingdom, Italy, India, Jamaica, Germany, Jordan, Cambodia, South Korea, Cuba, Kyrgyz Stan, Laos, Malaysia, Morocco, Mauritius, Mozambique, Egypt, Mongolia, Norway, Pakistan, France, Poland, Romania, Singapore, Slovak republic, Spain, Sri Lanka, Sudan, Suriname, Syria, Sweden, Switzerland, Thailand, Tunisia, Turkey, Turkmenistan, Ukraine, Uzbekistan, Vietnam, Yemen, and Zimbabwe. In the case of double taxation, Indonesia also has signed treaties for the avoidance of double taxation with 50 countries. (United Nations, Bilateral Investment Treaties, 2000)

Additionally, the economic crisis accompanying such domestic problems, political and social dispute, has fallen foreign direct investment interest in Indonesia substantially. Even though many deregulations have been created by the government, if the business environment, as well as general political and economic environment did not support the government policies, the deregulation has no meaning. So, besides being committed to deregulation the government should consider stable political environment too. Bureaucratic procedures, corruption, and legal reform are also important factors in determining foreign direct investment development. Klaus Peter Kriegsmann from Asian Development Bank, observed that investors had lost confidence in Indonesia. He emphasized the need for legal and judicial reform and strengthening of the capital markets and the banking system. He considered corporate governance reform to
be the core building renewed investors confidence to make investment in Indonesia (World Bank, Corporate Governance Workshop, February 19, 2002). In the same occasion, I Nyoman Tjager, Chairman of the National Committee for Corporate Governance, also said that invertors were concerned about transparency and disclosure concerning the use of their funds by borrowers, and the accountability of the borrower for performance and fair distribution of profits. If Indonesia and Indonesian companies want to attract international investors, there is a need to meet investors requirements such as transparency and disclosure. Unfortunately, this is not as easy as it sounds, most investors still consider doing business in Indonesia as too costly and risky (World Bank, Corporate Governance Workshop, February 19, 2002). In addition, the 1997 crisis has caused total value of investment decreased significantly, more than three times. GDP growths also decrease significantly, even in 1998 reached –13.1 percent\(^24\).

**2.2 The Effect of Japan Foreign Investment in Indonesia Economy**

The Indonesian foreign direct investment (FDI) regime has typically been rather restrictive and liberalized only in times of economic difficulties (Patunru and Rahardja, 2015). It is possible, even likely, that the restrictions on FDI have been costly in terms of forgone economic growth and development. FDI can benefit the host country in different ways, all of which work through an impact on value added.

The category investment by economic sector has nine subcategories: agriculture (including forestry and fishing), mining and quarrying, manufacturing, construction, gas, water and electricity, financing (including insurance, real estate, business services), community, social and personal services, wholesale, retail trade, restaurants and hotels, and transportation (including storage, communication). Of these nine categories, the leading categories were manufacturing; gas, water and electricity and transportation.

\(^{24}\)This analysis based on the data statistic provided by BKPM (Badan Koordinasi Penanaman Modal) and IMF, International Financial Statistic Yearbook.
More specifically, there are three main mechanisms through which such an impact on value added may arise. The first is through the capital, technology, management and other resources the foreign firms brings with them, and which will contribute to production and value added. Moreover, because of the special characteristics of multinational enterprises (MNEs), to value added, foreign firms tend to contribute more than domestic firms. As an example, most new commercial technologies are developed by MNEs. New technology with a positive effect on value added in the host country are the result of the Affiliates of the MNEs. Moreover, MNEs have superior international networks and dominate international trade. It follows that FDI will increase the host country’s exports and thereby value added and economic growth. Finally, foreign firms will have access to high-quality inputs, which again is likely to increase value added. The second mechanism is through the types of goods and services that are being produced in the host country. FDI might contribute to a structural change by expanding high value added industries such as manufacturing and high-end service sectors. Such growth will result in use of idle resources or move capital and labor from low value-added sectors to high value-added ones. The third and final way the effects of FDI on domestic firms impact on the company’s added value. This effect could be either positive, for instance through support of local linkage industries, or negative, for instance because of crowding out effects that force domestic firms to operate at a lower scale.

25 As ann illustration. MNEs account for around 10 percent of world output but 30 percent of world trade (UNCTAD,2007)
CHAPTER III

JAPAN – INDONESIA STRATEGIC PARTNERSHIP

During the APEC Summit Meeting in November 2004, President Susilo Bambang Yudhoyono of the Republic of Indonesia addressed to Prime Minister Junichiro Koizumi of Japan the importance of Economic Partnership Agreement (EPA) as a means to further promote the close economic relationship between the two countries.26

On December 16, 2004, Minister of Economy, Trade and Industry Shoichi Nakagawa of Japan and Minister of TradeMari Elka Pangestu of the Republic of Indonesia shared the view on the need to launch the Joint Study Group to explore the future of the economic partnership between the two countries.27

On January 6, 2005, Minister for Foreign Affairs Nobutaka Machimura of Japan and Vice President H. Muhammad Jusuf Kalla of the Republic of Indonesia decided to hold three rounds of meetings by April 2005 in order to produce recommendations on issues including whether to commence negotiations on a bilateral EPA.28

The first round of the meeting was held in Jakarta on January 31 and February 1, 2005. The second round was in Bali on March 4 and 5. The third round was in Tokyo on April 11 and 12.29

The meetings were conducted between the representatives of relevant ministries and agencies of both Governments, and involved representatives of academic and private sectors from the two countries. A wide range of areas was covered by the discussions throughout the meetings.

Japan and Indonesia have established a close economic relationship in a wide range of areas. In the field of trade in goods, Japan is the largest trade

26 www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
27 www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
29 www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
partner in both export and import for Indonesia. According to the Indonesian trade statistics issued by the BPS Statistics Indonesia, its trade with Japan accounts for 19.06% of export and 13.07% of import in 2004. Japan’s trade with Indonesia accounts for 1.60% of export and 4.11% of import in 2004 according to the trade statistics issued by the Ministry of Finance, Japan. It is also observed that Indonesia is an important energy supplier to Japan. In the field of investment, the private direct investment from Japan to Indonesia has been declining due to the stagnation of Indonesian economy after the crisis in Asian economies in the year of 1997. Although solid recovery has not yet been observed, Japan has always been one of the top investors for Indonesia. According to the Indonesian statistics, from 1967 to 2004, cumulative foreign direct investment from Japan to Indonesia accounts for 19.47% of the total foreign direct investment to the country, which makes Japan the largest investor for Indonesia. It is also noted that the number of Japanese enterprises operating in Indonesia is approximately 1,000 and that of Indonesian workers employed by those Japanese enterprises is over 200,000. In addition, Japan is the largest provider of Official Development Assistance (ODA) to Indonesia.\(^{30}\)

The close economic relationship mentioned above, however, will not be maintained for perpetuity without continuous efforts by the two countries. In the Joint Study Group, the researchers of both sides indicated that the bilateral EPA between the two countries could significantly benefit both sides.

The benefits are list below:

1. **Trade in Goods**

   Both sides shared the view that the Japan-Indonesia EPA should include elements of free trade agreement consistent with Article XXIV of the General Agreement on Tariffs and Trade, given that improvement of market access for trade in goods including tariff elimination and reduction is an important element to strengthen the economic partnership between the two countries. The Indonesian side expressed interests in reduction or elimination of tariffs, \(^{30}\text{www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf}\)
especially in tariff peaks or in tariff escalation as well as in non-tariff barriers, particularly of products of interests between the two countries.\textsuperscript{31}

Also both sides emphasized that the pursuit of expanding investment from Japan to Indonesia through the improvement of investment climate is one of the main goals of EPA Japan-Indonesia. The Japanese side stated that the improvement of market access should be discussed together with improvement of investment climate in Indonesia. On the basis of such understanding, and also recognizing the complementary nature of the industrial structure of Japan and Indonesia, the Japanese side expressed the view that immediate tariff elimination of substantially-all goods is the basic principle, and that both sides should aim at the tariff elimination ahead of the AFTA schedule. The Japanese side also expressed its particular interest in the elimination of tariffs on goods such as auto and auto-parts, electrical and electronics, steels, and textiles, where the Indonesian side maintains relatively high tariffs.\textsuperscript{32}

With a view to building win-win relationship between the two countries, it is important to promote Indonesian supporting industries and also to strengthen their business partnership with Japanese enterprises operating in Indonesia. The Japanese side pointed out that, in order to achieve these goals, the 7 Indonesian side should have well-coordinated industrial strategies by sectors, and suggested that it is prepared to further strengthen the existing cooperative relationship through active utilization of Joint Forum on Investment which was launched in December 2004 and the first meeting was held on March 14, 2005.\textsuperscript{33}

In the area of fisheries, both sides expressed their concern that trade liberalization could threaten sustainable utilization of fishery resources and affect negatively on the fishery resources management, and suggested that it would be more beneficial for the economic partnership of the two countries to further strengthen existing cooperative relations regarding the fishery resources management. While Japanese fishery industry groups pointed out that the fishing

\textsuperscript{31} www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
\textsuperscript{32} www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
\textsuperscript{33} www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
The industries of the two countries are competing on fishery resources including tunas and skipjack tuna, both sides recognized the importance of taking further steps towards organized fishery resources management, specially to eliminate Illegal, Unregulated and Unreported (IUU) fishing around Indonesian waters. They also suggested that it would be more desirable under the EPA to study the possibility of promotion of cooperation in a wide range of the fishery field than to incline only to trade liberalization of fishery products.34

2. Customs Procedures

The Japanese side emphasized that with regard to customs procedures, the EPA should include the followings: (a) ensuring transparency, (b) cooperation and exchange of information between the customs authorities for the purpose of facilitating trade through simplification and harmonization of their customs procedures, and ensuring effective enforcement against illicit trafficking of goods, and (c) establishment of proper follow-up mechanism. The Indonesian side provided information concerning its customs procedures that have been simplified. In addition, the Indonesian side emphasized that Indonesia was making efforts to continuously improve its customs procedures.

3. Intellectual Property

Both sides shared the view on the need to reinforce the existing cooperation in IP sector and to promote the establishment of adequate and effective system for IP protection.

4. Competition Policy

Both sides shared the view on the importance of efforts in competition policy under the Japan-Indonesia EPA.

5. Standards and Conformance/ Mutual Recognition (MRA)

Both sides confirmed that the two countries would identify the areas of concern for the mutual recognition for the verification and certification of product

34 www.mofa.go.jp/region/asia-paci/indonesia/summit0506/joint-3-2.pdf
safety, and have further examination by experts in order to specify the problems of relevant areas without prejudice to the necessity of such mutual recognition.

6. Investment/Trade in Services

The representative of the Indonesian Chamber of Commerce and Industry (KADIN) explained that national treatment in the steady process of liberalization and further liberalization is under consideration through the new upcoming Investment Law which is currently being amended; that the national treatment at the post-establishment stage is a policy in principle, but there is no discriminatory regulations even at the pre-establishment stage other than foreign capital restriction; that the new upcoming Investment Law, however, is a general law and specific law related to individual services provide for certain restrictions on foreign capitals in some cases; that the new upcoming Investment Law aims at simplification of investment-related procedures including shift from license system to registration system, and certain other arrangements including adoption of one-roof services are also planned to be prepared; and that there is no problem on the inclusion in the agreement of expropriation and compensation, freedom of transfers and the international arbitration between a Party and an investor of the other Party. The Indonesian side provided clarification regarding the existing laws and regulations of investment.

The Japanese side expressed its interests in liberalization of service sectors including manufacturing-related services, construction services, information and communications services, transportation and tourism services, distribution services, financial services, and legal services. The Japanese side explained that Japanese construction services could contribute to the improvement of infrastructure in Indonesia, and that manufacturing-related services are essential to manufacturing industries in which the Japanese investors are among the largest contributors to Indonesian economy. The Indonesian side also expressed its interest in services sector liberalization, including tourism, information and communication services, maritime transport, construction, education and health-related services.
7. Mineral Resources/ Energy

The Japanese side stated that the areas of mineral resources and energy, that are important areas for Japan, should be discussed within the Japan-Indonesia EPA, in particular the following issues: (a) deregulation of the market participation restriction on Japanese enterprises, (b) improvement of investment environment, and (c) securing stable supply of mineral resources and energy in emergency. In addition, the Japanese side referred to Indonesian efforts in the improvement of investment environment, and particularly emphasized the importance of mineral resources and energy areas in this context.

The Indonesian side pointed out that the area of energy is one of the most important pillars of the Japan-Indonesia EPA, and that it is willing to maintain constructive discussions through the negotiations of the Japan-Indonesia EPA.

8. Movement of Naturals Persons

The Indonesian side expressed its interest in mutual recognition of qualifications in tourism and hotel services, spa services, food- and beverage-related services, caregivers, seafarers and nurses. The Indonesian side requested: (a) acceptance of skilled workers or professional workers in areas such as nursing, care giving, hotel and tourism industries, and (b) recognition of certified seafarers on Japanese tuna fishing vessels and allowing Indonesian officers to be officers in Japanese tuna fishing vessels. The Japanese tuna fishing industry expressed its expectation for further employment of Indonesian seafarers on Japanese tuna fishing vessels.

The Japanese side expressed its interest in the exemption of payment by short-term visitors to the funds for the development of skills, treatment on the short-term visa equivalent to the ASEAN countries, approval for concurrently serving as directors for both a local Japanese company and a local joint venture, unification of procedures for work permits, exemption of fiscal tax (departure tax), and elimination of the nationality requirements on a manager for personnel divisions of a local Japanese company. Responding to the Japanese requests, the Indonesian side provided the following clarification: (i) the request to exempt the
so-called “fiscal tax” cannot be accommodated, since it is a method of installment of income tax for all residents going abroad and is treated as a tax credit for related persons, and (ii) the nationality requirement on a manager of personnel division is based on Law No. 13/2003.

9. Government Procurement

The Japanese side stressed that it is important to discuss transparency of procedures for government procurement as well as market access based on principle of non-discrimination between domestic and foreign suppliers under negotiations on the Japan-Indonesia EPA in accordance with the international framework regarding government procurement, recognizing that government procurement under transparent and competitive environment will benefit the two countries and their citizens by enabling fair and efficient implementation of budget as well as strengthening competitiveness of their economies.

The Indonesian side explained that in the context of reform of the government procurement system, the enactment in 2003 and steady implementation of the Presidential Decree No. 80/2003, which beyond certain threshold allows market participation of foreign companies, are currently in progress.

10. Improvement of Business Environment

The Japanese side noted that there is strong correlation between the improvement of business environment and the improvement of investment environment in Indonesia and emphasized the importance to build a stable mechanism under the Japan-Indonesia EPA to discuss relevant issues, which occur through daily business activities, such as customs clearance, taxation and labor, as well as the importance to develop investment rules and administrative procedures, for the promotion of investment to Indonesia by Japanese enterprises.

The Indonesian side emphasized that the improvement of business environment is important for the two countries, and that it is important to discuss broad spectrum of issues between public and private sectors in parallel with
preparations by the government for legislation of taxation laws and labor laws. The Indonesian side stated that in its efforts to improve business environment, Indonesia has proposed: (i) an amendment of tax law which is aimed at improving transparency, predictability, simplicity and equality; and, (ii) the issuance of implementing regulation on tax facilities.

11. Cooperation

With regard to the training and internship schemes, the Indonesian side requested: (a) improvement of working conditions, (b) expansion of covered areas, and (c) employment after internship. The Japanese side responded that the training and internship schemes are not for employment and have clear objectives of technology transfer to the developing countries. The Japanese side also indicated that ways to improve the implementation of the schemes be discussed. In this connection, a Japanese labor organization pointed out that there are problems regarding the schemes.
CHAPTER IV

THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT TO INDONESIAN ECONOMY

4.1 The Japan Policy in Asia

Japan was the first Asia country to modernized its society, government and economy. This make Japan the most powerful Asian states. Although for over two decades Japan economy suffer stagnation, it remains highly developed, and Japan economy is slowly adjusting to a post industrial era. The government under Shinzo Abe is competent and organizationally complex, while elites in both the public and private sectors are highly educated and capable. As we know Japan natural resources are limited but the others national resources are well developed.

In late 2012, a year after Shinzo Abe elected, he has pushed aggressively to realize his ambitious agenda. He instituted sweeping reforms to the national security apparatus. As the result in December 2013, Japan announced the formation of National Security Council (NSC) modeled. The council streamlines the prime minister’s decision making process while breaking down the various bureaucratic barriers that have impended effective crisis management.

Under Abe’s command, Japan’s major focus is domestic recovery, and if there was to be any radicalism and international risk posed, there were to be in the form of his three arrows economy policies. The three arrows are quantitatives easing, fiscal stimulus and economic restructuring.

Abe’s apparent restrained statesmanship won plaudits domestically and internationally: efforts to revitalize the Japan economy earned him the depiction of a Superman like figure. He gained praise at G8 summit in UK. Apparently Abe’s slogan, “Japan is back” was highly credible.
Japan needs Prime Minister Shinzo Abe’s doctrine for more regionally and internationally engaged foreign policy integrated with other Asian leaders political economy interest that offer unstinting liberal support for an open, pursuing rules based order in Asia.

Therefore Abe’s ideology are needed to make Japan expand and modernized and free itself from domestic restraints that prevent it from playing a central role with liberal allies in maintaining Japan regional stability.

4.2 The Impact of Abe Doctrine for Japan FDI

The beginning of Abe’s doctrine start on December 2012, when prime minister Shinzo Abe’s gain his election victory. After that in December 2014 he make ideologue for Japan to be more assertive, high profile, and high risk foreign and security policy. He also has intention to make Japan more radical external characterized agenda by a defense posture less fettered by past anti militaristic constraints, a more fully integrated US Japan alliance and value oriented diplomacy with East Asian and another country region.

Abe’s ideology is revisionist thus will be also impact in his doctrine. The foundation of Abe’s ideology is from pre war colonial tradition and wartime, in that time Japan want to be a first rank nation and leader for Asia, the other foundation is from post war ambition to make Japan an autonomous state, US equal partner and liberal capitalist power facing down authoritarianism.

The Abe doctrine have potential to make Japan on a new international trajectory despite by all of the protest from others political party. The Abe doctrine has been the principal driver of Japan’s foreign and securities policies. Abe’s theory make basis of expedient adaption of Japan’s national interests to the prevailing status quo in The East Asian Regional and US led international systems.

There are three general areas or three arrows on The Abe doctrine:

1. Bold monetary policy by spending and aggressive monetary easing;
2. Flexible and expository fiscal policy (short term) with fiscal consolidation (mid term)
3. Structural economic reforms such as deregulation, productivity and competitiveness

The competitor for Abe’s doctrine is The Yoshida doctrine. The Yoshida doctrine focused on Japan’s cautious navigation through the post war international system as a defeated and low profile power. On the other side The Abe doctrine is fixated on the recognition of Japan’s position as a first rank advanced industrial democracy, and hence the rightful restoration of its place amongst the great powers, even if this necessitates attempts to adjust rather than adapt to the extant international system.

As one of the main objectives in order to revive the Japanese economy is to achieve a rise in domestic investment, many people agreed that most of the money injected into the economy should stay inside the Japanese borders in order to pursue the success of The Abe doctrine thus will also have effect in Japan FDI.

Many companies being careful choosing their next FDI country because reviving the domestic economy is naturally also in the interest of Japanese companies, which will thus be complying with the government’s intentions about increasing domestic investment as long as the incentives are strong enough. Naturally, from Japan’s point of view it is essential that most of the investments have to stay in Japan. That has lead to the point that the growth of the economy has not been as good as it could have been.

4.3 Japan’s Foreign Direct Investment (FDI) Trends Toward East Asia

Japanese firms have had a long history of foreign direct investment (FDI), their substantial commitment to an outward orientation did not begin until the mid 1980s. By then Japanese firms had become successful exporters of their products and had gained enough confidence to go abroad. The sharp appreciation of the yen after the Plaza Accord in 1985 was a trigger for Japanese exporting firms to seriously consider the relocation of production plants to foreign countries. During this same period, East Asia was becoming a great attractor of FDI. The
forerunners of ASEAN (Associations of South East Asian Nations) switched development strategies in order to utilize incoming FDI more aggressively after economic slumps in the mid 1980s.

Since the second half of 2016, Japanese corporations have maintained a high level of Foreign Direct Investment (FDI) toward the ASEAN-5 (Thailand, Malaysia, Indonesia, Philippines, and Vietnam) but overall FDI toward Asia decline in the first half of 2017. On the other hand, FDI toward China has remained at a level below that of FDI toward ASEAN. Meanwhile, Japanese investment to India continues to expand where the economy continues to grow rapidly exceeding 7% (Chart 1) due to the stable FDI Japan to ASEAN.

Chart 1: Japan’s FDI toward Asia

Source: Bank of Japan, Balance of Payments

Turning to investment in the ASEAN (major 5 countries). FDI declined in Thailand in the first half of 2015 and in Indonesia in the first half of 2017 (chart 2) due to contraction in the transportation equipment sector, which had driven investment in both countries. In Thailand, phase 2 of eco car program (phase 1 starting in 2009) measures to stimulate investment in small cars, fuel economy, led by the government increased investment when it began in 2014 but appears to have reached a full circle. The slowdown in car sales in Thailand (882 thousand units in 2014, 800 thousand units in 2015, and 557 units in Jan-Sept 2017) is also
attributed to the decline. The slowdown of car sales (1028 thousand units in 2014, 1031 thousand units by 2015, and 783 units in January-September 2017) appears to have affected investment in Indonesia as well.

Meanwhile, FDI towards Vietnam grew in the first half of 2017 and FDI towards Philippines continues to grow, investment continues to grow in the "electric machinery" sector, one of the main export-oriented industries. Investments that also reflect expectations of an increase in domestic demand grew in the sectors of "food", "transportation equipment", and "wholesale and retail". In Vietnam, investment in “transportation equipment” increased, mainly with respect to motorcycle. Investment in “wholesale and retail” sectors also increased.

![Chart 2: Japan's FDI Towards ASEAN](chart2.png)

**Chart 2: Japan’s FDI Towards ASEAN**

Source: MHRI based on the Bank of Japan, *Balance of Payment*

FDI toward Malaysia declined due to a backlash to the large scale investment in the energy sector in the first half of 2015. Japanese manufacturers reexamination of their global production system, because their investment in "electric machinery", one of the major industries in Malaysia has been sluggish. Meanwhile, investment in "chemicals and pharmaceuticals" has been stable. There seem to be a renewed interest in Malaysia as an investment destination by a
capital-intensive industry driven by a relatively strong state infrastructure. As investors focus on Malaysia’s purchasing power, which stands out among ASEAN members, investment in the "wholesale and retail" sector is also growing.

4.4 : Japan Foreign Investment in Indonesia

FDI inflows played a minor role in Indonesia until the liberalizations in the early 1990s, as seen in Chart 3. The reforms, including relaxed ownership rules and changes in the trade policy contributed to strong growth in FDI. Annual inflows grew by more than 800 percent between 1989 and 1996 when it amounted to more than US$6 billion. The 1997 Asian financial crisis, and the large political and economic turmoil that followed, resulted in the collapse of FDI inflows. In fact, FDI inflows were registered as negative every year except one between 1998 and 2003.\textsuperscript{35} Inflows of FDI started to increase again in 2004, and the increase was dramatic. More precisely, FDI inflows in 2005 were higher than at the previous peak in 1996, and they further increased, by another 170 percent, from 2005 to 2014. Moreover, the strong growth continued in 2015, for which data from UNCTAD is not available: FDI increased by almost 20 percent from 2015 to 2017 (chart 4), according to the Investment Coordinating Board of the Republic of Indonesia (BKPM).\textsuperscript{36}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fdi_inflows.png}
\caption{FDI Inflows}
\end{figure}

\textsuperscript{35} Negative FDI flows are caused by disinvestment of existing foreign firm
\textsuperscript{36} http://www.tradingeconomics.com/indonesia/foreign-direct-investment
The growth of FDI in Indonesia coincides with global growth in FDI. Global FDI flows have for instance been growing more rapidly than international trade (Jungnickel, 2002; Antrás and Yeaple, 2014). However, growth in FDI to Indonesia seems even higher than the global trend. For instance, in 2014 FDI to Indonesia was higher than to any other Southeast Asian country, with the exception of Singapore. Moreover, Indonesia has been among the top 20 receivers of FDI in recent years (UNCTAD, 2013). It seems likely that high inflows of FDI will continue, at least as judged from investors’ view on Indonesia (UNTAD, 2013). More specifically, in 2012 Indonesia was ranked as the fourth most popular prospective host country for FDI. However, following historically low inflows of FDI in Indonesia, might to some extent be a catching-up effect. Chart 3 tries to answer this question by relating the stock of inward FDI to national gross domestic product (GDP) in a number of Southeast Asian countries. Singapore is not included since figures on FDI to Singapore are notoriously unreliable.
FDI as a share of GDP in Indonesia increased from 7 percent in 1990 to 15 percent in 2000 and almost 30 percent in 2014. Despite this growth, the relative amount of FDI in Indonesia is low compared with FDI in other countries in the region. More precisely, it is substantially lower than in Cambodia, Thailand, Viet Nam, and Malaysia; it is at about the same level as in Lao PDR; and it is only higher than in Myanmar and the Philippines.

To sum up the discussion on FDI above, inflows to Indonesia have increased rapidly over the last decades. Part of this increase is presumably caused by a general worldwide increase in FDI and by a catching-up from previously low inflows caused by restrictive policies. Despite the increased inflows, FDI seems to be slightly less important in Indonesia than in many of its neighboring countries.

In addition to generating foreign exchange, Indonesia governments encourage FDI for a number of reasons: creating jobs for the local unemployed; producing a diversified range of cheap consumer goods for the local market; and establishing linkages with other enterprises to promote further economic growth.

4.5 : The Benefits of Japan Foreign Direct Investment for Indonesia

Theoretically, causal relationships can run in both directions between FDI and GDP growth. There are three concerning theories on the relation between FDI and economic growth that need to be analyze of this study:

1. FDI-Led Growth
Borensztein et al. 1998) with FDI-led growth hypothesis stated that FDI inflows are able to stimulate growth for host countries with capital increase stock, new job opportunities, and ease of technology transfer.

2. Market size
Mah (2010) stated from market size hypothesis stated that rapid GDP growth create new investment opportunities in the host country and larger inflows FDI.
The existing studies suggest that there is positive impact of FDI on economic growth. However, the evidence from some studies like Aitken and Harrison (1999) found out that FDI has negative effects on economic growth with crowd out domestic investment, increase external vulnerability, and cause dependence.

3. Neutrality
The theory believes that FDI has no causal relationship to economic growth. Foreign direct investment (FDI) has contributed to the economic growth of the recipient (or host) economies in important and varied ways. Not only has FDI brought financial resources for fixed investment. It also has brought new technology and managerial know-how to the recipient economies, thus further promoting economic growth. In addition, FDI greatly improves efficiency in production and marketing as it has enabled recipient economies to utilize the sales, procurement, and information networks developed by foreign companies. Several studies confirmed the positive contribution of FDI to economic growth. Borensztein, de Gregorio, and Lee (1998) examined the economic growth of sixty-nine developing countries from 1970 to 1989. Their regression analysis showed that FDI had a marginally positive impact on economic growth, but it had a significantly positive impact when the FDI was undertaken in the countries with high educational attainment. Their findings suggest that education plays an important role in the effective use of FDI. United Nations (1999) examined the economic growth of more than sixty countries from 1971 to 1995 and obtained results similar to those of Borensztein, de Gregorio, and Lee (1998). Kawai and Urata (2003) found that FDI had significantly positive impacts on economic growth by analyzing the data for 133 countries from 1970 to 1997. Among the countries in various groups, Indonesia experienced particularly strong positive effects on economic growth from FDI.

In the early phase of Indonesia’s industrialization process and the move from import substitution to export-oriented industrialization, the removal of restrictions and deregulation of current FDI and real sector regimes were sufficient. In fact, Indonesia did not use tax incentives as a tool to attract
investment at the time, and it did away with tax incentives all together in 1984. Instead it provided more liberal policies for the type of FDI it wanted to attract namely, export-oriented FDI. Subsequent attempts to use tax incentives also have not worked. Separate policies governed the role of FDI in the financial and oil and gas sectors. However, Indonesia’s export orientation led to a dualistic structure of export-oriented industries with high import dependency and, at the time of the crisis, continued failure to develop domestic supporting industries and an indigenous technological capability. This weakness will continue to be a major problem for Indonesia in the years ahead.

In the current, post crisis situation, a country like Indonesia can no longer attract the right type of foreign direct investment simply by improving its FDI regime or giving tax incentives. It must first of all address the basic conditions of concern to foreign investors: safety, security, and law and order. Although there have been slight improvements under the Megawati government, obvious concerns about terrorism and basic security remain. These issues are not likely to go away in the short term. Indeed, they were center stage during the election process in 2004. A wait-and-see attitude prevails; the new president, Susilo Bambang Yudhoyono, was elected on September 20, 2004. The new government must make a concerted effort to address the major issues contributing to the country’s negative investment climate.

Investors, including domestic investors, know that it will take time to improve the fundamental problems Indonesia faces. Institutional, infrastructural, and human resources need to be increased. Given the competition for investments that exists, the new president and cabinet (“United Indonesia”) can spur the much-needed new investments only if there is a credible beginning to woo back investors and address their concerns. Only then will the process of restructuring and building up Indonesia’s industrial base and capability proceed successfully. Although this chapter is about foreign direct investment, the role of domestic investors in Indonesia needs to be taken into account. Interviews have revealed that foreign investors look to the return of domestic investors (who have funds
abroad to bring back to Indonesia) as an important signal of a healthier investment climate.

Beyond the short-term considerations of just improving basic conditions for investors, what should be the government’s long-term policy toward FDI? In a nutshell, Indonesia needs to have a clear and comprehensive policy. To begin, it needs consensus on the role of FDI in Indonesia’s economic development (Soesastro and Thee 2000). Otherwise, vacillations between efficiency considerations and nationalism will prevail. From an economic perspective, the traditional role of FDI (with regard to capital inflows, technology and management know-how, the development of spillovers in terms of supplier industries and human resource development, and improved market access) remains important. In addition, given technological developments and large multinational companies’ tendency to outsource goods and services, developing countries are exploring how they can fit into the production network that is evolving within big firms and within regions. Increased specialization and discovery of a market niche is the name of the game today. The focus is no longer on large-scale production to lower costs (although still relevant for some industries) or on manufacturing everything from capital and intermediate goods to final goods. Countries or companies do not have to graduate in a stepwise fashion along the value chain anymore. They can leapfrog or choose different parts of the value chain to specialize in. The emergence of China as a regional production and export center is extremely important. China has huge import demand to satisfy domestic demand as well as export production. The question is how countries and companies can be part of the regional production network of multinational companies or, independent of this, supply and be a part of China’s huge production and export needs.

As others have recommended (Thee and Pangestu 1998), we concur that Indonesia and other developing countries need to adopt a comprehensive FDI policy. In the first place, an open FDI regime and open implementation (the latter is still a weakness in the current context) are needed. There must truly be a
streamlining of licensing and administrative procedures, including by provincial governments. This requires clear and simple procedures with minimal approval processes and a clear mechanism for recourse. The Board of Investment needs to be restructured and tasked with true investment promotion. Instead of being another bureaucracy involved in the licensing process, it should be a Board that is committed to addressing investors’ concerns. The process of ratifying the investment law needs to be accelerated to increase and enhance predictability. Of course, implementation will be watched carefully, and the resulting track record evaluated.

Investors will choose to locate where there is strong supplier industries and services, where there is supporting infrastructure (both physical and human), and where there is a market. Indonesia must look beyond manufacturing. It must look at the need for efficient supporting services whether in the backbone services, such as telecommunications and transport, or in other specialized services pertaining to the industry. Developing countries like Indonesia also need to consider whether they can participate as exporters of low-cost labor services such as data processing.

How can these goals be accomplished? Physical infrastructure can be developed through a combination of fiscal spending by the government and foreign investment by the private sector. Greater openness is needed, specifically clear domestic regulatory policies including the regulation of competition and the regulation of pricing; in some cases certain industries do tend to be natural monopolies. Strategic development of human resources can be accomplished with training and education programs on a continuous and regular basis since they will take a long time to produce fruit.

This question often arises: should industrial policy target the development of certain industries, including supporting industries? Past experience would suggest that this is not easy to do and that a general policy that will improve the policy environment without biasing a particular sector is preferable. Targeted
interventions are difficult to implement in the world of imperfect information and imperfect governments. The creation of a cluster of supporting industries and services is difficult to create without the development of a dynamic final goods and services industry. For these reasons, the focus should be on providing a conducive policy environment, creating a sound financial sector as a source of financing, and ensuring an adequate physical and human resources infrastructure. Targeted interventions in R&D, training, education, specialized skills, and technology development should complement such policies but not be a substitute for them.

Finally, one must look beyond the economic objectives and address the noneconomic concerns that often arise—the forces of nationalism in particular. FDI also must be related to social objectives, such as employment creation. These noneconomic objectives of FDI must be recognized, and the most specific policy to address the concern should be pursued. For instance, in the case of privatization of so-called strategic industries, if the concern is dominance of ownership in the sector, then privatization can be designed so that there is divestment by the foreign acquirer to the capital market by a certain time period. The role of local governments and their shares of FDI also need to be addressed since current experience shows that this issue can be a real deterrent for investors. FDI is often also expected to contribute to social objectives. For example, it is expected to promote small and medium size enterprises, cooperatives, and the creation of jobs. Satisfying these expectations cannot be forced upon foreign direct investors. Rather, incentive programs are needed or programs where contributions from FDI (possibly through the fiscal system) are pooled and administered in an efficient and transparent manner to achieve the objective (say training). As for the transfer of technology and indigenous technological capability development, past studies have shown that this responsibility also cannot be imposed on the foreign investor. Progress can occur only if the industries in question are required to be competitive in the global and/or domestic market so that ensuring technological capability becomes a necessity to compete. Progress also depends on the absorptive capacity of the domestic industries and
players, whether the partner in the joint venture or the supplier industries. As noted throughout the chapter, a set of policies related to infrastructure, education, and human resources is essential. Governments can intervene, but targeted interventions, such as science parks or R&D assistance, must be seen as a complement to the other basic policies that need to be in place.

Product Life Cycle theory (Vernon 1966) described positive role of FDI in promoting exports from host countries. According to Vernon, there are four stages of product life cycle. The stages are innovation, growth, maturity and decline. Product life cycle initial stage is characterized by high prices, high profits and wide promotion of product. There is limited opportunity for international followers to imitate the product so that the chances of exports are great because the suppliers are able to export the product into follower economies. Product life cycle in the maturity phase is characterized by demand levels off and slower rate of sales volume increases. Imitations are easy in foreign markets and cause decline of export sales. Because of this situation so the original supplier reduces prices in order to maintain market share and sales support. The business still attractive but the profit margins decrease. Last is final phase which is characterized by decreases of sales volume and some products are discontinued because the follower economies are success to develop imitations as good quality as original. The follower economies are able to export the goods even to its original supplier home market. The consequence of this situation is sales and prices depress.

From all the stages, the last phase, product and technology is more mature, standardized and accessible to local imitators. It makes low labor cost and international competitors. In this stage host countries have more chances to increase in export and make reversed flow trade. The most important thing is this stage is there is relocate production into host countries and re import to the home country.

Vernon Model was applied by Kojima(1973,1985) He applied Vernon model at level industry and found out that the investment creates effect that there will be increase in the host’s country’s export if FDI is made with origin country has comparative disadvantage and comparative advantage in the host country.
New trade theory stated that the separation of different stages in different countries production or vertical FDI cause trade creation effect. According to Helpman (1993) the vertical FDI causes trade creation effect with export form on finished product from affiliated company to parent company and intra firm transfer of intangible services from parent company to affiliate company.

There are many factors determine the relationship between exports and economic growth. Exports are GDP components so that exports growth has direct contribution to the growth of GDP. According to Helpman and Krugman (1985) exports allow poor countries with narrow domestic markets to get benefit from economies of scale.

According to Balassa (1978) export leads to improve efficiency in resources allocation and capital utilization owing competition in world markets. There four views which describes the relationship between exports and economic growth:

1. **Neoclassical export-led growth**
   This theory explains the reasons of the causality direction running from export to economic growth. Helpman and Krugman (1985) stated that export expansion will increase productivity by offering greater economies of scale and export expansion bring higher cause high quality product because the pattern of consumption is international consumption patterns. This theory believes that exports will lead a firm to overinvest a new technology as a commitment to achieve larger output and increase the rate of capital formation and technological change (Rodrick 1988 and Sharma 2001)

2. **Causality run from economic growth to export**
   Economic growth affects export growth if there is increase in domestic production which is faster than domestic demand
3. **Bilateral causal relationship between export and economic growth**

The theory that agree that export and economic growth has a bilateral causal relationship

4. **No causal relationship between export and economic growth theory**

Economic growth not affects export growth if there is increase in domestic production which is faster than domestic demand.

Among the East-Asian countries after China, Hongkong and Singapore, Indonesia was ranked the top 4. Indonesia's GDP growth, GDP and FDI from 1981 to 2017 can be seen in the following table.

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP growth</th>
<th>GDP</th>
<th>FDI</th>
<th>Year</th>
<th>GDP growth</th>
<th>GDP</th>
<th>FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>8.11</td>
<td>85.518</td>
<td>133</td>
<td>1999</td>
<td>0.79</td>
<td>140.001</td>
<td>-1.866</td>
</tr>
<tr>
<td>1982</td>
<td>1.12</td>
<td>90.158</td>
<td>225</td>
<td>2000</td>
<td>4.92</td>
<td>165.021</td>
<td>-4.551</td>
</tr>
<tr>
<td>1983</td>
<td>8.41</td>
<td>81.052</td>
<td>292</td>
<td>2001</td>
<td>3.64</td>
<td>160.447</td>
<td>-2.977</td>
</tr>
<tr>
<td>1984</td>
<td>7.17</td>
<td>84.854</td>
<td>222</td>
<td>2002</td>
<td>4.51</td>
<td>195.661</td>
<td>145</td>
</tr>
<tr>
<td>1985</td>
<td>3.48</td>
<td>85.289</td>
<td>312</td>
<td>2003</td>
<td>4.78</td>
<td>234.772</td>
<td>-596</td>
</tr>
<tr>
<td>1986</td>
<td>5.96</td>
<td>79.954</td>
<td>258</td>
<td>2004</td>
<td>5.03</td>
<td>256.837</td>
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<td>1987</td>
<td>5.31</td>
<td>75.931</td>
<td>385</td>
<td>2005</td>
<td>5.69</td>
<td>285.689</td>
<td>8.336</td>
</tr>
<tr>
<td>1988</td>
<td>6.36</td>
<td>84.311</td>
<td>576</td>
<td>2006</td>
<td>5.51</td>
<td>364.571</td>
<td>4.914</td>
</tr>
<tr>
<td>1990</td>
<td>9.1</td>
<td>106.141</td>
<td>1.293</td>
<td>2008</td>
<td>6.01</td>
<td>510.229</td>
<td>9.318</td>
</tr>
<tr>
<td>1993</td>
<td>7.25</td>
<td>158.007</td>
<td>2.004</td>
<td>2011</td>
<td>6.17</td>
<td>892.969</td>
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<tr>
<td>1994</td>
<td>7.54</td>
<td>176.892</td>
<td>2.109</td>
<td>2012</td>
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</tr>
<tr>
<td>1996</td>
<td>7.64</td>
<td>227.371</td>
<td>6.194</td>
<td>2014</td>
<td>5.58</td>
<td>890.487</td>
<td>25.121</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2017</td>
<td>5.04</td>
<td>887.065</td>
<td>20.945</td>
</tr>
</tbody>
</table>

Table 1: GDP Growth, GDP and FDI from 1981-2017
In 2013, FDI Indonesia has experienced 23% growth. FDI continues to grow to 25% or approximately USD 23 billion by 2014. However in 2015, FDI growth was down to 20%.\textsuperscript{37} Foreign investment in the service industries has been allowed in Indonesia. According to world investment report- UNCTAD 2015, Indonesia has to strengthen the attractive destinations for multinational companies because Indonesia lost its place among the three most attractive destinations for multinational companies. During the period 1981-2015 to examine the co-integration and causal relationships between foreign direct investment, GDP and exports in Indonesia, studies on the relationship between FDI, exports and economic growth have been conducted.

\textsuperscript{37} bbs.binus.ac.id/international-business/2018/01/foreign-direct-investment-gdp-growth-and-export-in-indonesia/
CHAPTER V
CONCLUSION

5.1 Conclusion

This research objectives are to describe analytically and thoroughly about Japan Foreign Direct Investment (FDI) on Indonesia Economy development between 2015 until 2017 and to know the benefits between Japan and Indonesia Strategic Partnership that last from 28th November 2006 until now. As long as this Strategic Partnership, Japan and Indonesia was also made Japan Economic Partnership Agreement (IJEPA) on 20th August 2007.

At the end of this thesis, based on the results of the study “THE CONTRIBUTION OF JAPAN FOREIGN DIRECT INVESTMENT ON INDONESIA ECONOMY DEVELOPMENT: A STUDY ON JAPAN-INDONESIAN STRATEGIC PARTNERSHIP (2015-2017)” then it can be concluded several things. There are four periods of Japan FDI historical overview toward Indonesia:

1. the first liberalization policies (1967 to 1973); historical overview
2. the protectionist policies (1974 to 1986);
3. the second liberalization policies (1986 to 1997); and
4. the third liberalization policies (after the 1997 crisis).

This four history period of Japan FDI historical overview in Indonesia was the fundamental based of Japan FDI in Indonesia from 1967 until now.

Japan and Indonesia have established a close economic relationship in a wide range of areas. In the field of trade in goods, Japan is the largest trade partner in both export and import for Indonesia.

Indonesia and Japan also made an agreement called IJEPA. IJEPA (Indonesia Japan Economic Partnership Agreement) is bilateral agreement that make Indonesia equal with other competitor country in Japanese market, especially the country who also have another economy agreement with Japan. To
make IJEPA become the win win agreement for both Indonesia and Japan. Both countries must meet often to discuss the agreement. Because each day economy grow in unpredictable ways. IJEPA must stay update with the two countries economy conditions so the agreement become equal and benefits each other. Beside that, There are many benefits that Indonesia economy gain from Japan FDI:

a. Covers over 90% of goods (agriculture and industrial products) that Indonesia exports to Japan.
b. Provide greater certainty of market access for Indonesia products and puts Indonesia on equal footing with competing countries that have concluded agreements with Japan.
c. Provide an improved capacity building for Indonesian producers, particularly will help improve the quality of Indonesian products in the domestic market and in international markets.
d. Help Indonesia to move ahead with necessary reforms to improve customs, tax administration and to provide for greater legal certainty, thus enhancing the business climate in Indonesia.
e. Improved transparency of the implementation of IPR (Intellectual Property Rights), customs procedures, competition policy, and other matters in Indonesia.
REFERENCES


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Indonesian Law No. 1/1967 on Concerning FOREIGN INVESTMENT


