

# The Japan-Indonesia Economic Partnership: Agreement Between Equals?

David Adam Stott

## The Japan-Indonesia Economic Partnership: Agreement Between Equals?

David Adam Stott

### Introduction

After ratification by the Japanese parliament (Diet) one month earlier, the Japan-Indonesia Economic Partnership Agreement (JIEPA) came into force on July 1, 2008. Indonesia's first such bilateral trade agreement appropriately takes effect during the 50th anniversary of bilateral diplomatic relations. For Japan it follows similar agreements with some of its other production centres and resource suppliers in Southeast Asia.

The two countries began formal negotiations on the JIEPA in July 2005, with the intention of reaching a deal by the end of 2006. Taking longer than expected, the pact was finally sealed on August 20, 2007 when Japanese Prime Minister Abe Shinzo and President Susilo Bambang Yudhoyono signed a Memorandum of Understanding during Abe's three day visit to Indonesia. The Agreement aims to enhance economic cooperation between the two countries by boosting bilateral trade, facilitating Japanese investment and conducting industrial capacity-building programmes whereby Indonesian firms benefit from the transfer of production and management techniques.



Abe, Yudhyono and their wives, August 20, 2007

This article begins by examining Japan's similar agreements with other countries and then looks at the present state of bilateral economic relations before analysing the content of the Agreement. It then assesses perceptions in the two countries and briefly outlines some of the projects spurred by the JIEPA. Of note here is the threat by some major Japanese investors in Indonesia to pull out of the country unless electricity supply issues are addressed. Finally, some general prospects for the future are considered.

### Japan's Economic Partnership Agreements

Tokyo refers to its free trade agreements (FTAs) as economic partnership agreements (EPAs) ostensibly aimed to achieve a cohesive and holistic partnership transcending mere trade issues. Despite being conceptually more comprehensive, in practice they are actually similar to FTAs involving the United States or the European Union. In fact, they are actually somewhat shallower in scope. Both EPAs and FTAs strive to create a reciprocal free trade

area between two or more countries. Such an area exists where countries have agreed to eliminate or substantially reduce tariffs, quotas and preferences on most or all goods between them, with the result that different tariffs, quotas and customs arrangements apply to non-signatories. By reducing such barriers to trade, the theory is that all signatories will benefit from the resulting specialisation, division of labour, and comparative advantage. The theory of comparative advantage posits that trade can benefit all parties concerned (countries, regions, companies, and individuals), if they can create products with different relative costs. Therefore, in a free trade zone each producer would be advised to specialise in an economic activity where it has a comparative advantage, supposedly resulting in a win-win situation for all involved.

Until the late 1990s, Japanese administrations relied on multilateral institutions such as the World Trade Organisation (WTO), the World Bank and the International Monetary Fund (IMF) to prise open foreign markets. As a result, Japan has been somewhat slow in signing bilateral free trade agreements. In recent years however, Tokyo has become increasingly aware that it has to implement bilateral FTAs to avoid market share loss overseas. For instance, to counter balance the effects of the North American Free Trade Agreement (NAFTA), Japan concluded its own treaty with Mexico to ensure that its products enjoy similar tariff levels in that country to those from the United States and Canada. Similar concerns over any future Free Trade Area of the Americas (FTAA) and the impending pact between the European Union (EU) and Mercosur (the South American Common Market of the South) persuaded Japanese policy makers to conclude a similar EPA deal with Chile in March 2007.

With the exception of Mexico and Chile, Japan has so far concentrated on signing bilateral trade agreements with such Asian countries:

Singapore (signed January 2002); Malaysia (December 2005); Philippines (December 2006); Brunei (June 2007); Indonesia (August 2007); and Thailand (November 2007). Japan's latest EPA, with the Association of Southeast Asian Nations (ASEAN), ratified by the Diet on June 21, 2008, is the country's first multilateral free trade agreement. The terms specify that about 90% of trade between Japan and ASEAN's ten member states will be exempt from tariffs within 10 years. In the meantime, Tokyo has been conducting bilateral EPA talks with Vietnam since mid-2006, whilst agreements with India, China, Cambodia and Laos have also been mooted. Indeed, in mid-2006, Japan even proposed an East Asian FTA with ASEAN, India, China, South Korea, Australia and New Zealand, but this received a guarded response from ASEAN. Bilateral EPA talks between Japan and South Korea have also been suspended since November 2004 partly due to Tokyo's refusal to open its closed farm sector. This has long been a sticking point in Japan's various EPA negotiations, but these particular bilateral talks are set to resume later in 2008.

Of late, Japan has also placed more far flung countries on its bilateral trade agenda. In early 2005, exploratory talks with both Switzerland and Australia were initiated, and the following year discussions with Kuwait and the six Arab states of the Gulf Cooperation Council (GCC) started. This latter approach was officially codified in Japan's so-called 'New National Energy Strategy', adopted in late May 2006, which calls for stronger relations with resource-rich nations. Among other things, the strategy intends to improve relations with such countries through ODA (official development assistance) and trade agreements, such as the JIEPA. Recently, there has been talk of similar trade deals with Brazil and New Zealand.

## **Japan-Indonesia Economic Relations**

With broadly complementary economies, Japan

and Indonesia have long enjoyed close interdependent economic ties. The smaller archipelago has played a key role in its larger partner's economic development since the early 1970s through ODA, FDI (foreign direct investment), bilateral trade, and the transfer of technology and expertise. Indeed, between 1967 and 1999, Indonesia was the largest recipient of Japanese ODA loans, receiving some 3,432 billion yen (around US\$30 billion) or 18.6% of such loans, which were delivered without the hectoring of other donors with regard to human rights. [1] Indonesia was the single largest recipient of Japanese ODA in 2000-2001, and was second behind China in 2002. Whilst levels of Japanese aid to Indonesia have fluctuated somewhat since then, yen loan assistance for the country in fiscal 2007 (until March 31, 2008) amounted to \$1 billion. Japan is also Indonesia's largest creditor with loans of around Rp186.38 trillion (US\$20.3 billion).

For its part, the relationship has guaranteed Japan a stable supply of natural resources, with Japan being the destination of nearly 70% of Indonesia's fuel, metal and mineral exports in the last three decades. [2] Particularly with regard to gas, the past, present and future of this association is explored further below. In addition, Japan also accounted for the largest share of Indonesian non-oil and gas exports in January-November 2007 at 14.6%. [3] Indeed, Indonesian statistics indicate that bilateral trade rose 10.69% in 2007, up from US\$27.24 billion the previous year. At present, Japan absorbs around 20% of Indonesia's total exports, with the balance of trade in Indonesia's favour at a ratio of around 4:1. These exports are dominated by oil, gas and other resource-based items such as metals, coal, timber and seafood, in addition to small quantities of manufactured goods. Imports from Japan are mostly industrial, capital goods and machinery inputs. In this sense, it might be said that Japan benefits more from the relationship as its exports traditionally command a higher price than primary commodities as a result of

value-adding technologies not present in resource-based products.

Despite a decline in recent years, Japanese firms still have more investment in Indonesia than in any other Southeast Asian country, and presently there are around 1,000 Japanese companies operating in Indonesia employing some 280,000 local staff. Excluding oil and gas, figures for 2006 indicate that the biggest targets for Japanese investment in Indonesia were in the electricity and electronic sectors (US\$2.8 billion); automotive and transportation equipment (US\$1.6 billion); mineral and non-metal industries (US\$862 million); chemical and pharmaceutical (US\$780 million); and trade and repair (US\$661 million). [4] The Indonesian Investment Coordinating Board (BKPM) calculates that between 1967 and 2007 Japanese firms invested some US\$40 billion in Indonesia but such inflows have fallen dramatically since 1997. This reflects a relocation of existing Japanese investment from Indonesia to neighbouring countries, Sony being a high profile case, due to a diminishing comparative advantage in labour costs and concerns over the country's institutional and physical infrastructure. In 2007 Japan ranked fourth in terms of Indonesian FDI inflows.

### **The Japan-Indonesia Economic Partnership Agreement**

The JIEPA aims to redress this reverse and widen cooperation between the two countries as such agreements are essentially a strategic tool to stimulate Japanese investment and boost bilateral trade. In essence, tariff-free trade between Japan and Indonesia will reach 92% (by value) under the terms of the Agreement. Indonesia is committed to eliminating about 93% of its 11,163 tariffs on Japanese goods, with 58% of these cut immediately upon implementation. Japan, for its part, will slash more than 90% of its 9,275 tariffs on Indonesian products, with 80% of these having disappeared with implementation on July 1.

These cover all of Indonesia's main exports such as textiles, footwear, plywood, tropical fruits and fishery products, as well as the almost complete elimination of tariffs on its industrial products. It is thus anticipated that bilateral trade will increase to an estimated US\$65 billion by 2010. Trade Minister Mari Elka Pangestu stated that, "Our exports to Japan are expected to grow 4.68% a year and we hope we can compete with other countries that already have similar agreements with Japan". [5] For Indonesia, the biggest immediate beneficiaries of the Agreement will be the automotive, electronics and construction sectors. Although no FDI commitment was specified in the JIEPA, some 26 new Japanese investment undertakings in these industries have been agreed, most of which expand existing operations and are worth around US\$557.5 million.



**Japanese plant in Indonesia**

The Agreement is not limited to easing trade barriers, however, but also encompasses investment rules, intellectual property rights, government procurement and improving the business environment. Unlike Japan's bilateral EPAs with its other ASEAN production centres, the JIEPA additionally covers capacity-building to increase Indonesia's technological capabilities, in theory enabling local firms meet the requisite standards to pierce Japanese markets, whilst simultaneously raising the

capability of SMEs (Small to Medium Enterprises) and enhancing labour skills. This scheme also includes plans to extend technical assistance to various sectors including manufacturing, energy, agriculture and fisheries, the centrepiece of which is the formation of the Manufacturing Industry Development Centre. Japan will also provide training to businesses that use raw materials made in Japan and, in return, will receive special dispensation under a User Specific Duty Free Scheme enabling free access to Japanese raw materials for use by its firms in Indonesia. [6]

Japan will expect to benefit from a guaranteed supply of raw materials for its firms operating in Indonesia and improved governance in both the investment and public spheres. Whilst the enactment of new investment laws should stimulate the business environment, the competitiveness of the Indonesian manufacturing sector in many regions compared to neighbouring countries remains weak, thus stifling the investment climate in large parts of the country. Therefore, it has been argued that Japanese FDI should be invited to develop Special Economic Zones (SEZs) in order to spread economic development more evenly around the country. Such investment has already played a role in founding the Cikarang Industrial Zone (1992) and a similar venture in Indonesia's second city of Surabaya (1995). [7]

Indeed, SEZs play a crucial role in the development of SMEs which support larger industries operating in the SEZ. In order to attract investment, however, SEZs require the necessary physical infrastructure in terms of highways, ports and power supplies; transparent and business-friendly legal and taxation frameworks; and an efficient financial and telecommunication network. Given that these prerequisites are lacking throughout much of the sprawling archipelago, some analysts have expressed the view that the EPA



should also cover measures to hone Indonesia's financial structure and enhance the information & communication network. [8] The hinterlands of the larger urban centres throughout the country have been suggested as appropriate sites for the development of such SEZs. [9]

## Nurses

Whilst the JIEPA is comprehensive in scope and coverage, perhaps its most eye-catching clause is that Japan plans to receive some 400 Indonesian nurses and 600 caregivers over the next two years. The Agreement specifies that Japan will accept 200 nurses and 300 caregivers each year, with the first group to arrive in August. It has been reported that nurses will hold special visas for up to three years and caregivers for four years. Although a similar provision was included in the Japan-Philippines EPA signed in September 2006, this is the first time Japan will recruit a large group of foreign professionals in the medical and welfare field.

During their first six months, the Indonesians will undertake some 850 hours of Japanese-language tuition in which time they will study everyday conversation in addition to hiragana, katakana and about 700 kanji (Chinese characters). In February, they must sit a Japanese language exam and will be sent back to Indonesia if they fail. Thereafter, both nurses and caregivers will have to prepare for their respective national exams while working, and those who fail to obtain the licenses before their visas expire will also be required to leave the country. The workers will have to learn how to pass the demanding national exam during on-the-job training at their workplace. A test to be taken after two years of employment has also been mooted.

It seems that this particular scheme has already been beset with difficulties, however. Notice was only given three days before a competency test was held in May 2008, with

the result that only 251 nurses applied for this year's intake. Of these, only 180 fulfilled the criteria of having graduated from nursing academies in Indonesia and possessing a minimum of two years nursing experience. From this cohort of 180 participants, 174 passed the test. [10] Therefore, to achieve the quota of 200 nurses for this year, the Health Ministry invited an additional 70 nurses to take another competency test, but had trouble securing enough attendance. In the final tally, only 174 nurses and 131 caregivers successfully navigated the application process, meaning that of the 105 facilities looking to hire to the Indonesians about 40 will be unable to do so. [11] Whilst the caregivers did not need to sit any test or submit any work experience, it is stipulated that they must either be university graduates with six months relevant training or be qualified nurses in Indonesia. At least two Indonesian care workers will be employed at each institution. [12]

Indonesia presently dispatches around 200 nurses abroad annually, in particular to Brunei, Kuwait, Malaysia, the Netherlands, Saudi Arabia, the United Arab Emirates and the United States. [13] However, given that around 30,000 people graduate each year from the country's 770 nursing schools, Erman Suparno, the Manpower and Transmigration Minister, hopes that Japan will recruit a larger quota of its health care professionals in future. At present, only some 30% of these graduates work as nurses. [14]

Two further sticking points emerged during implementation negotiations between the two governments. Firstly, the Indonesian nurses will be considered nursing assistants until they pass the Japanese national nursing exam. [15] The Indonesian side is concerned that these career nurses will be dissatisfied being constrained by such an arrangement. Secondly, the Japanese government has refused to guarantee minimum wage levels, despite the

Indonesian government having determined that the monthly salary for a nurse assistant should be at least 200,000 yen and 175,000 yen for caregivers. Tokyo did agree, however, to 'request' that employers meet these figures. [16] Equivalent salaries in Indonesia usually range between about 10,000 yen and 30,000 yen a month.

Unfortunately, exploitation of foreign workers in Japan, including many Indonesians, on training programmes has been prevalent. Similar schemes have resulted in trainees being forced to work long hours with commissions deducted from salaries as low as 58,000 yen a month. Some of the approximately 6,000 Indonesian trainees employed in Japan have also been subjected to physical abuse and forced to do unpaid overtime, whilst others have been denied such basic human rights as freedom of movement. [17] To prevent such reoccurrences, the Labour Ministry has asked the Japan International Corporation of Welfare Services (JICWELS) to monitor places that employ the nurses and caregivers. Once a year JICWELS will conduct on-site checks, but since the only punishment for transgressors is a three-year ban on further employing foreign workers it is doubtful if exploitation can be prevented. Another potential difficulty is that these facilities must also display a degree of religious tolerance given that some 82% of Indonesians are Muslim, although not all are santri or devoutly practicing. Devout applicants might be wondering about the provision of halal food, for example.

Nevertheless, despite these obstacles, it would appear that such a policy is somewhat overdue. Already boasting the world's longest life expectancy along with one of its lowest birthrates, in 2005 Japan's population started falling in absolute terms and immigration is below the level required to replace the decline. As a result of this and changing family structures, demand for facilities providing long-term care for the aged has mushroomed.

Highlighting the staffing difficulties involved, local media reported in June 2008 that three such places in Fukuoka City have experienced a total of 82 accidents involving patients over the past five years, of which 29 have been fatal. The facilities say that chronic personnel shortages are a significant factor in these incidents. The central government is adamant, however, that the JIEPA is not designed to fix labour scarcities as nursing homes and hospitals are not permitted to count these workers in their mandated staffing quotas. Furthermore, hiring an Indonesian worker will cost each employer an additional 600,000 yen, when factoring in the recruiter's fee. [18] Moreover, personnel shortages also render finding the time to train foreign employees problematic, casting into doubt the practicality of the whole scheme.

It should be noted that while not renowned as an immigration destination, Japan does have a sizeable number of foreign workers. However, the central government has provided social support or an attractive path to permanent residence or citizenship, and restricts foreign workers' rights. [19] Anecdotal evidence suggests that in the bigger cities those who appear non-Japanese are subject to rampant racial profiling in the form of checking foreign registration cards or passports, which must be carried at all times. From November 2007, even permanent residents returning to Japan must submit to fingerprinting at immigration posts in airports and ports. On the subject of foreign residents in Japan, one commentator was even moved to write that, "They are frequently marginalised from the national community as both temporary sojourners and culturally alien outsiders, deemed unworthy to partake of the rights and social services reserved for citizens of the nation-state." [20] This is despite a rapidly aging and shrinking population which seemingly requires immigration to maintain a stable tax base and staffing levels in the private sector. It could be that the invitations extended to the Indonesian

health care professionals are something akin to testing the water prior to a more substantial and systematic recruitment of foreign expertise and help in sectors experiencing staffing shortages.

## Japanese Perceptions

Japan views Asia as a significant and expanding market with bright prospects for future growth. Many countries in the region have been successfully making the transition from import-substitution to export-oriented economies, including Indonesia despite the reverses of the 1997-98 monetary crisis. The archipelago is also the fourth most populous country in the world after China, India and the United States. As such, it represents a potentially lucrative foreign market if sustained economic growth can be realised. It is thus in Japan's interests to assist Indonesia on this path to prosperity, whilst in the meantime taking advantage of its low wage levels and abundant natural resources. To do this, however, Japanese business leaders have been stressing that the country needs to urgently overhaul its physical and institutional infrastructure.

A major reason for Tokyo to propose the JIEPA was to secure a continued and stable supply of energy. Since the mid-1970s Indonesia has been the biggest supplier of natural gas to Japan. Throughout this period Japan has bought between 50% and 70% of Indonesia's LNG exports and remains the world's largest LNG market. Indonesia's two major liquefied natural gas (LNG) processing facilities, Arun at Lhokseumawe in Aceh province and Badak at Bontang in East Kalimantan province, were both constructed in the mid-1970s under supply contracts to Japan, although excess production has been made available to other buyers. Indeed, it is fair to say that Japan has been the driving force behind the development of the Indonesian LNG industry, enabling her to become the world's biggest exporter of LNG until being surpassed by Qatar 2006.



**The Arun LNG facility**

Ironically, however, Jakarta has repeatedly stated that, upon expiry in 2010 and 2011, its current contracts with Japanese utilities will be renewed at just one quarter of their present volume, and for shorter terms. Hence, these supply contracts will be slashed from around 12 million tonnes (MT) at present and renewed for only ten years, with 3 MT annually in the first five years and 2 MT per annum thereafter. Such contracts typically run for 15- to 25-year periods to cover the huge capital investments required. The affected companies include Kansai Electric Power, Chubu Electric, Kyushu Electric, Osaka Gas, Toho Gas and Nippon Steel Corp, and the LNG concerned is supplied from the Badak plant, Indonesia's largest. The complacent attitude these utilities displayed to Indonesian LNG supplies half a decade ago has been replaced by an unseemly scramble for gas resources in an increasingly seller's market. In 2003 Japanese buyers were negotiating price decreases with Indonesian producers amid a glut of the resource, and then Indonesian President Megawati Sukarnoputri was seen vainly lobbying Japan to buy more Indonesian LNG during a visit to Tokyo that June. Shorter contracts will invariably provide greater flexibility to Indonesia but represent a worrying trend for Japan.

Jakarta's dramatic policy reversal is based on the desire to retain a greater share of gas

production to sustain domestic industries amid record crude prices and Indonesia's declining oil output. Official figures indicate that Indonesia became a net importer of crude oil for the first time in February 2004 whilst annual power demand is estimated to be rising by at least 10% a year. [21] Hence, increasing the availability of natural gas in areas which suffer energy shortages has prompted Jakarta to shift its LNG export focus towards domestic use as a substitute for costly oil. To this end, Indonesia is currently expanding its domestic pipeline infrastructure from Kalimantan and Sumatra to supply the main consuming areas of Java. Government forecasts indicate that if oil averaged US\$100 a barrel for 2008, oil revenues from Indonesia's exports would increase by US\$13.7 billion but the cost of maintaining fuel subsidies would rise by US\$19.7 billion, equivalent to around 3% of GDP. [22] As a result, the central government took the politically risky step of reducing fuel subsidies on May 24, 2008. The result was an average 29% price rise of subsidised petroleum products in order to restrict the impact of escalating oil prices on the budget. Analysts point out that this reduction was not only insufficient to balance the books, but note that the government was later forced to replace the subsidy with cash payments for the poor, thus barely trimming the budget while provoking a national outcry.

Jakarta's decision to reduce LNG exports remains somewhat embarrassing for Tokyo given that the JIEPA negotiations have coincided with Japan's New National Energy Strategy of May 2006. This strategy aims for stronger relations with resource-rich nations at a time of growing competition for energy. Specifically, it targets a greater share in imports of oil developed by domestic companies from the present 15% to 40% of total imports by 2030, and aims to improve relations with oil- and gas-producing countries through ODA and trade agreements. Thus, the Japanese government had long urged Jakarta to

guarantee LNG supplies as part of the JIEPA. However, despite the two countries agreeing on approximately US\$4 billion worth of energy projects on the sidelines of the JIEPA signing, the Indonesian government consistently refused to meet this request.



**Sumitomo LNG shipment from LNG terminal at Bontang, Indonesia**

Nevertheless, Japanese investment in the Indonesian LNG industry continues apace. Abe's visit to Indonesia to sign the JIEPA coincided with an agreement to accelerate LNG development in Banggai district, Central Sulawesi province, where 51% shareholder Mitsubishi Heavy Industries is constructing an LNG refinery. Land clearance was slated to finish at the US\$1.4 billion development by the end of June 2008, and the natural gas will be sourced from the Senoro and Matindok fields owned by Indonesia's PT Medco Energi International. [23] The plant had been scheduled to open in 2011 but progress has been delayed recently due to difficult pricing negotiations. [24] Survey results indicate an annual yield of 2 million tonnes (MT), all of which will be exported to Japan. Mindful of its increasing difficulties in securing a continued supply of Indonesian natural gas, Tokyo had demanded Senoro LNG supply guarantees as part of the JIEPA, whilst the Indonesian side cited a lack of infrastructure to supply it to the



domestic market as a reason why the LNG would be exported to Japan. [25]

It is also possible that gas production currently under exploration in eastern Indonesia's Timor Sea, in which the Japanese firm Inpex holds a 100% share, could be used to meet future export demand. In January 2008, Indonesia had been exerting pressure on Inpex to submit a firm proposal by May or risk losing its rights to develop the field, despite Inpex's original exploration contract of November 1998 expiring in November 2008. [26] Thus, in the final week of May, Inpex duly submitted a project proposal based on estimates of more than 10 trillion cubic feet (TCF) of natural gas reserves in the Masela Block's Abadi field. [27] If confirmed, this will be Indonesia's second-biggest new gas field after Tangguh in Papua, which has combined reserves of 14.4 TCF. After deciding not to process the gas in Australia, Inpex will build Indonesia's first floating LNG plant instead. [28] The refinery will have just one LNG train but with a capacity of 4.5 MT a year. [29] The project is slated to cost a massive US\$19.6 billion, with shipments scheduled for a 2016 start, and should provide a huge boost to both countries. [30] Given the ratification of the JIEPA by the Diet on June 1, the timing of Inpex's proposal could not have been better.



**LNG facility under construction at Tangguh**

In addition, Japanese firms are also getting involved in efforts to boost Indonesia's sagging oil production. Mitsui Oil Exploration Co. will collaborate with Indonesian state oil company Pertamina on a US\$1.9 billion project to expand the ageing Cilacap oil refinery in Central Java, increasing its daily processing capacity from 348,000 to 410,000 barrels of crude. Meanwhile, Itochu Corp. will team with Pertamina to raise the processing capacity of the oil refinery at Balikpapan in Indonesian Borneo to 280,000 barrels a day and that of the Balongan refinery in West Java to 250,000 barrels a day, at a projected combined cost of around US\$3.2 billion. [31] These projects, inked on the sidelines of the JIEPA signing, would seem to indicate that, on resource-extraction matters at least, the Agreement is getting off to a good start.

The signing of the JIEPA also coincided with the inking of an infrastructural scheme, in addition to two power projects and the Senoro LNG plant. Japanese business leaders such as Akira Okabe, a Toyota senior managing director and board member, concede that Indonesia has long since fallen behind neighbouring countries in the construction of the modern highways and port facilities vital for companies like Toyota to circumvent potential bottlenecks in their local manufacturing operations. In March 2008 Japan's foreign ministry announced new loans worth 60.7 billion yen for projects which include laying another track in Java along the country's busiest rail route.

Indonesia's power supply infrastructure also needs an urgent overhaul, in the face of decent economic growth rates of 5.5 to 6.3%, and has even become an issue in the bilateral relationship. On July 3, just two days after the JIEPA's implementation, the Japanese ambassador complained in writing to the Indonesian government on behalf of about 400 Japanese companies operating in Indonesia, many of which are threatening to shift operations to other Asian countries if the situation is not rectified. [32] Indeed, the ambassador's letter followed a week in which a major blackout hit Jakarta and elsewhere in Java because the 600 MW Cilacap plant in Central Java suspended operations due to coal shortages. PLN's reserve supply capacity is now only half the recommended minimum of 30%, prompting it in February 2008 to begin rotating blackouts to manage a 1,000 MW shortfall in the Java-Bali power grid caused by four stations operating at less than full capacity. The official reason for the outages has been that coal supplies to the power plants were interrupted by unusually high waves, raising concerns over poor management. [33] In many further outlying provinces, moreover, rolling blackouts actually began three years ago.

Whilst state-owned electricity monopoly PT Perusahaan Listrik Negara (PLN) has a reported generating capacity of 24,000 MW, actual output falls well under that due to old and inefficient power stations. PLN has ambitious plans to provide electricity to every Indonesian household by 2020 as presently about 44% of the population lives without electricity, mostly in rural areas. However, a 2006 central government scheme to increase power-generation capacity by 10,000 megawatts (MW) has been stymied by bureaucratic wrangling and political infighting over government financing guarantees.

Whilst highlighting Indonesian mismanagement of its power supplies, Tokyo has also been promoting its nuclear technology overseas to maintain the viability of Japan's own nuclear power plant makers. Officially codified in August 2006 when the Ministry of Economy, Trade and Industry (METI) released its Nuclear Power National Plan to "actively support the global development of the Japanese nuclear industry", this approach coincides with increasing domestic concerns over the industry's patchy safety record. Spurred on by Vice-President Jusuf Kalla, Jakarta has revived former President Suharto's plan to build two nuclear reactors with a production capacity of 4,000 MW by 2016 in Central Java. Having conducted an initial feasibility study into Suharto's nuclear project in 1994, Japanese specialists have more recently been advising this reborn programme through the offices of the Ministry of Education, Culture, Sports, Science and Technology (MEXT) and its Forum for Nuclear Cooperation in Asia (FCNA). However, a METI-commissioned Japan External Trade Organization (JETRO) report of March 2007 reassessing the nuclear option in Indonesia returned less than encouraging results, and pointed to a slew of issues needing to be addressed. [34] Meanwhile the jockeying for position in Indonesia among power plant-exporting nations continues, and it is not inconceivable that Japanese concern over

Indonesian power shortages will serve to encourage the nuclear option. Furthermore, with its emphasis on 'capacity-building', investment in energy projects and infrastructural improvements, the JIEPA might also implicitly strengthen the case for greater Japanese involvement in the nascent Indonesian nuclear industry in the face of strong competition from South Korea and Russia.

### Indonesian Perceptions

Reaction to the JIEPA has been mixed in Indonesia, however. Some business circles are optimistic that the JIEPA, if implemented properly, will liberalise and stimulate bilateral trade and investment. They foresee the foundation of a wide-ranging reciprocal economic partnership that will benefit both countries. Some even view it as a vehicle for solving Indonesia's various economic ills through the engine of increased foreign investment.

Specifically, the pact provides a framework to encourage Japanese investment in Indonesian energy development projects. For instance, there is a proposed scheme to build new large-scale coal-fired power stations to further move away from costly oil. No doubt Japanese investment in this massive project will be sought, as per the JIEPA, and Indonesia remains desperate to secure such foreign investment. Moreover, Jakarta hopes that the JIEPA will spur wider foreign investment as if the country is good enough for Japan, with its reputation for high quality manufacturing, it should be good enough for other investors too.

Indeed, foreign investment in infrastructure has been a priority for Jakarta in the last decade, especially since an inadequate infrastructure has often been cited as a deterrent to investing in the country. Since the Asian Financial Crisis of 1997-98, there has been under investment in infrastructure. The

financial strain of subsidising domestic energy prices has been partly responsible for precluding large-scale infrastructure investment whilst lack of coordination between government departments has resulted in funding allocations being left unused.

Nevertheless, there is a suspicion in the Indonesian media that Japan got the better deal in the JIEPA. Indeed, some Indonesian analysts contend that Japanese firms will derive more benefits from the JIEPA than their Indonesian counterparts, despite the focus on capacity-building. Utama Kajo, chairman of the public policy committee at the Indonesian Chamber of Commerce and Industry (KADIN), has argued that, "Japan is supporting industries back home while eating out on the Indonesian market. We will likely become more dependent on Japan to the detriment of local industry." [35] Industry Minister Fahmi Idris has also hinted that Japan might benefit more from the deal as its high-tech products will now command lower import taxes but Indonesia's leading exports, such as agricultural products and timber, will still face powerful non-tariff barriers in the form of strict quality standards.

Such a perception is nothing new as Indonesia has long felt at a disadvantage in its dealings with Japan. This feeling manifests itself in both imports and exports. For instance, domestically it is felt that Japanese goods are dumped in Indonesia to the detriment local industry, whilst Indonesian exporters are prevented from accessing Japanese markets due to powerful informal barriers to trade. As the JIEPA focuses largely on bilateral tariff reductions, some Indonesian business leaders are sceptical that it can be an engine for domestic growth in manufacturing and fear that it will facilitate further dumping of Japanese products on the Indonesian market. Indeed, Indonesia's inability to sell finished goods to Japan has long been a source of bilateral tensions. However, Indonesian Trade Minister Mari Elka Pangestu has argued that, "We should not worry too

much about the flooding of Japanese goods in our market because goods from Japan will be more expensive than local products.” [36]

Indonesian Employers Association chairman Sofyan Wanandi has argued that the benefits of the JIEPA will be minimal if Indonesia fails to adopt meaningful and wide-ranging reforms to improve its business climate. Whilst he contends that Indonesia could secure trade parity with other ASEAN members that have signed EPAs with Japan, the various impediments to doing business in the country remain obstacles to increased Japanese investment. [37] In particular, these obstacles revolve around the high costs of conducting business transactions; the expense of financing investments when interest rates are higher than elsewhere in the region; an uncertain legal climate regarding foreign investment; an inadequate physical and institutional infrastructure; and, in many instances, the lack of a viable supply industry. Whilst efforts have been made to speed up the opening of new business ventures, investors often cite complicated bureaucracy and overlapping regulations as major drawbacks to investing in Indonesia when compared to its neighbours. Such red tape feeds the rampant corruption in the archipelago and hampers many aspects of business from investment approvals through to the smooth flow of goods.

Both Sofyan and Bambang Trisulo, chairman of the Association of Indonesian Automotive Manufacturers, have agreed that the capacity-building clauses of the Agreement are vital to Indonesian businesses wanting to access the Japanese market because non-tariff barriers remained the chief obstacle to entry. They have stressed that Indonesia must take advantage of the capacity-building opportunities afforded by Japan’s Manufacturing Industry Development Centre. However, Syamsul Hadi, a lecturer in the Department of International Relations at the University of Indonesia, doubted the capacity-building promises would amount to

anything substantial, given his experience of Japan’s ODA programmes. “I once participated in a program funded by ODA. The program took us on a tour to Japan, visiting temples, leisure places and two factories. One was a razor blade factory and the other was roof tiles. Why would we want to learn that? We can make those things here. Well, at least my knowledge of Japanese temples improved from that programme.” [38] Moreover, he argued that, “It is naive to assume that any influx of Japanese investment that comes in under the EPA will automatically become the fuel for our economic recovery. There is nothing wrong with the FTA concept itself, I just don’t think that Indonesian industries are ready for it.” [39] Bob Widyahartono, a lecturer at the School of Economics at Tarumanagara University, agreed and was also sceptical of Indonesian bureaucrats’ ability to implement the JIEPA. Indonesian Food and Beverage Producers Association chairman Thomas Dharmawan was more specific, claiming that the food industry was unlikely to benefit from the JIEPA because “The issue of food sanitation and health is not included in the EPA. So the agreement will not have a significant effect on our food industry. If they open food factories here, such as what they did by opening meat factories in Australia and several other countries that would be really beneficial for us.” [40]

There seems to be awareness on the Japanese side of the need to sell the JIEPA to the Indonesian public. Amari Akira, Japan’s Minister of Economy, Trade and Industry, and Hayashi Yasuo, Chairman and CEO of the JETRO, have been extolling the virtues of the Agreement, citing the prospect of enhanced strategic business partnerships between Japanese and Indonesian firms. They posit that the JIEPA, “Can lead to a wider range of exported goods to Japan, including more high value-added products.” [41] They also argue that the country’s textile industry will be able to export a greater range of products to Japan, and that Indonesia’s attractiveness as a vehicle



production base will be boosted by reduced tariffs on imported parts and materials from Japan. [42]

On the subject of industrial capacity-building, the Japanese are stressing their role in the improvement of Indonesia's supporting industries, vital in boosting competitiveness as it circumvents the need for factories to import parts and components from overseas. For instance, the JIEPA calls for Japan to dispatch experts in mold and die techniques to transfer knowledge and technology to local staff, in addition to personnel exchanges between Japanese and Indonesian firms. JETRO also promises to hone productivity and quality control in the auto parts industry by offering lectures and guidance from Japanese experts to Indonesian employees. It is hoped that such projects will create jobs and expand SMEs across the archipelago, thus raising the country's profile as an investment destination for other international firms. JETRO is also slated to send specialists to collaborate with local handicraft makers to develop goods for the Japanese market under the 'One Village One Product' banner. Finally, JETRO is planning to install a Business Support Desk in Jakarta to disseminate trade and investment information and offer advice, and will work alongside KADIN to promote the JIEPA throughout the country, particularly to regional SMEs.

After decent export performance in 2007, the forecasts for growth in Indonesia's main export destinations - Japan, United States and the EU - appear bleak for 2008. Indeed, Indonesia's textile exports to the United States and Japan fell during the first quarter of 2008. Exports to Japan, Indonesia's second largest buyer, were 3.5% less than in the first quarter of 2007, although it is hoped that the implementation of the JIEPA will redress this as all such products made using Indonesian or Japanese fabrics now enjoy tariff-free status in both countries. [43]

## Reflections and conclusions

The JIEPA is a more comprehensive and wide-ranging bilateral economic partnership agreement than Japan has signed with Indonesia's ASEAN neighbours, perhaps reflecting the importance of the archipelago as a supplier of resources, a production centre and a large potential market. The problems lie in the implementation of the agreement. For Indonesia, the key factor will be how its domestic firms respond. In tandem with business, the onus is also on both national and regional governments to improve the country's image as an investment destination and not just in resource extraction. In this, the JIEPA can play an important symbolic role in promoting Indonesia as a good place to do business, but the relevant parties must implement it properly. The Agreement could be a stepping stone for Indonesia in that it should boost confidence in Indonesia as an investment destination. For this promise to be realised, and to even retain the current roster of Japanese firms operating in the archipelago, Indonesia needs to rapidly and significantly improve both its physical and institutional infrastructure

The reaction in Indonesia suggests that there could be winners and losers from the Agreement. The Japanese side is strongly selling the concept of capacity-building in key areas such as the auto parts industry. Thailand is the model for Indonesia to imitate in this sector. Despite promises from the Japanese side regarding the development of other value-added industries, it is difficult to envision how such nascent industries will compete with the now cheaper Japanese imports.

In terms of resource extraction, both countries should benefit from the Agreement. The JIEPA might encourage more Japanese investment in the oil and gas sectors, but recent pricing negotiations could offset some of the goodwill generated by the JIEPA. Nevertheless, Japanese

conglomerates are pressing ahead with projects aimed at stimulating Indonesia's oil and gas output. For Indonesia, the extra revenue and domestic supply will be welcomed, whilst Japan's New National Energy Strategy calls for stronger ties with resource-rich countries and targets a greater share of energy imports developed by domestic companies. Such thinking is behind the move towards greater government intervention and resource nationalism prevalent in many regions today. Japanese utilities have been stung out of their complacency with regard to Indonesian LNG supplies amid changing global circumstances and an increasingly seller's market, and will be looking to secure new long-term supply contracts from multiple sources.

However, it remains to be seen if such EPAs can really benefit the developing world in the long run. Ha-Joon Chang has persuasively argued that all major industrialised countries have taken advantage of interventionist economic policies in order to develop, before then preaching the gospel of unregulated international trade to secure market access for their companies overseas. Indeed, Chang contends that free trade has a much worse record in delivering economic development than interventionist policies, citing evidence that GDP increases in developing economies were greater before foreign pressure forced deregulation. Chang views the policies of the WTO, World Bank and the IMF as the biggest barriers to poverty reduction in developing countries, further railing against the failure of trade liberalisation to stimulate growth through privatisation and anti-inflationary policies. [44]

Optimists believe, however, that for Indonesian business to be competitive it must have competition and, since the Asian Financial Crisis of 1997-98, Japan has been increasingly seen as a competitor in a repudiation of the 'Flying Geese' theory. [45] Such thinking posits that Indonesian business can only make strides if benchmarks are set and strategic policies

enacted to reach high standards of production. This perspective stresses the need for Indonesian stakeholders to be proactive in taking advantage of what Japan has to offer in terms of investment value, capacity-building and the transfer of technology and expertise. If implemented properly, this view suggests that the JIEPA could allow the Japanese to exploit potential benefits from Indonesia, whilst Indonesia could tap the Japanese secret of success, fostering a win-win situation for both countries. More specifically, as Japan is renowned chiefly as a process innovator, a major goal will be to replicate Japanese efficiency and quality control in the production cycle. In this sense, optimists look to China as an inspiration. Only time will tell whether the optimists or the pessimists will be proven correct.

David Adam Stott is an associate professor at the University of Kitakyushu, Japan, where he teaches international relations and researches the political economy of conflict in Southeast Asia. See his "[Japan's Fragile Relations with Indonesia and the Spectre of China](#)."

This article was written for Japan Focus and posted on July 13, 2008.

## Notes

- [1] However, it was not the largest recipient of grant aid. Sugeng Bahagijo, 'Japanese ODA in Indonesia - a high price for poverty,' Reality of Aid Reports 2002.
- [2] Hal Hill, 'The Indonesian Economy,' Cambridge University Press, 2000.
- [3] T. Kong and A. Ramayandi, 'Survey of Recent Developments,' Bulletin of Indonesian Economic Studies, Vol. 44, No. 1 (April 2008), pp 7-32.
- [4] Antara, 'Implementation of RI-Japan EPA to begin in November,' August 3, 2007.
- [5] *ibid*
- [6] *ibid*
- [7] Bob Widyahartono, 'IJEPA's targets:

implementation is the key,' Antara, April 18.

[8] *ibid*

[9] *ibid*. Specifically, the surrounds of Jakarta, Bandung, Semarang, Surabaya, Makassar, Medan, Palembang and Medan at first, followed later by Pontianak, Banjarmasin, Balikpapan, Manado, Kupang, Ambon, Sorong, and Biak.

[10] Kyodo, 'Indonesian nurses look forward to work in Japan,' May 11, 2008.

[11] Yomiuri Shimbun, 'Recruiting of Indonesian nurses falls short,' July 3, 2008.

[12] Yomiuri Shimbun, 'Recruiting of Indonesian nurses falls short,' July 3, 2008.

[13] Kyodo, 'Indonesian nurses look forward to work in Japan,' May 11, 2008.

[14] Asanobu Sato and Atsuko Kobayashi, 'Indonesian care workers face many obstacles,' Yomiuri Shimbun, May 22, 2008.

[15] *ibid*

[16] *ibid*

[17] Arudou Debito, "[Japan's Future as an International, Multicultural Society: From Migrants to Immigrants](#)," Japan Focus, October 28, 2007.

[18] Sato and Kobayashi, 2008.

[19] Takeyuki Tsuda, '[Local Citizenship and Foreign Workers in Japan](#),' Japan Focus, May, 26, 2008.

[20] *ibid*

[21] Bill Guerin, 'Indonesia's natural gas dilemma,' Asia Times, July 22, 2003.

[22] Kong and Ramayandi, 2008.

[23] Antara, 'Mitsubishi to build LNG refinery in C Sulawesi,' June 8, 2008.

[24] Jakarta Post, 'Medco aims to halt oil output decline,' May 6, 2008.

[25] Ika Krismantari, 'Japan to buy more LNG from Indonesia,' Jakarta Post, August 24, 2007.

[26] Reuters, 'Japan's Inpex due to unveil plans on Timor Sea gas,' May 14, 2008.

[27] Xinhua, 'Indonesia Says Inpex Proposes \$19.6B LNG Plant,' June 9, 2008.

[28] BPMIGAS, 'Inpex Plans Four-well Masela Program,' Rigzone.com, May 23, 2007.

[29] Xinhua, 2008.

[30] *ibid*

[31] Antara, 'Japanese to spend US\$6 bln on Indonesian oil refinery, LNG projects,' March 28, 2008.

[32] Reuters, 'Japan firms may quit Indonesia over power crisis,' July 5, 2008.

[33] Jakarta Post, 'Bigger Power Crisis Looms,' July 3, 2008.

[34] Philip White, 'Indonesian Anti-Nuclear Activists Visit Japan/Korea,' Citizens' Nuclear Information Center, July 2007

[35] Andi Haswidi, 'Indonesia likely to be the loser in Japan agreement,' Jakarta Post, 18 August, 2007

[36] Antara, 'Japan to cut import duties on 80 pct tariff posts for Indonesia,' June 27, 2008.

[37] Andi Haswidi, 'EPA offers opportunities and challenges,' Jakarta Post, August 20, 2007.

[38] Andi Haswidi, 'Indonesia likely to be the loser in Japan agreement,' Jakarta Post, 18 August, 2007.

[39] *ibid*

[40] Andi Haswidi, 'EPA offers opportunities and challenges,' Jakarta Post, August 20, 2007.

[41] Akira Amari and Yasuo Hayashi, 'The Significance of JIEPA for Indonesia's Development,' Jakarta Post, July 1, 2008.

[42] *ibid*

[43] Jakarta Post, 'RI's textile exports to U.S., Japan drop,' June 4, 2008.

[44] See Ha-Joon Chang, 'Kicking Away the Ladder,' 2002, Anthem Press and the same author's 'Bad Samaritans: Rich Nations, Poor Policies and the Threat to the Developing World,' 2007, Random House

[45] First expounded in the 1930s by Japanese economist Akamatsu Kaname, the 'Flying Geese' pattern of economic development in East Asia was a popular analogy in the 1990s and refers to the fact that Japan tended to produce and export new and often innovative products before its Asian neighbours. As these goods become more widespread and profit margins shrank, lower labor costs prompted a production shift to the 'four tigers' (Hong Kong, Korea, Singapore, and Taiwan), while Japanese production moved to newer technologies. This process then continued shifting from the four

tigers to Malaysia and Thailand, then Indonesia, and finally, China. China's position in this formation has been changing ever since.